

Review of the Australian Supplier Payment Code

January 2019

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FOREWORD BY THE INDEPENDENT REVIEWER

The Australian Supplier Payment Code has made an important contribution to improved payment times and practices over the past 18 months. I was pleased to lead this review and thank my fellow panel members for their contributions.

This review of the performance of the Code finds that it is fundamentally well-designed and fit-for-purpose. Individual signatories report that it has led to changed practices and faster payment times to small businesses.

The review team focussed on three key issues: the barriers to increased adoption of the Code, the challenges of identifying a small business and the adequacy of reporting and oversight. A number of improvements to the Code and its management are recommended in response to issues raised in consultations.

The review makes a clear finding that using financing to set longer contractual payment terms and then pay small businesses within 30 days at a discount is not acceptable under the Code. It also recommends that, where payment terms beyond 30 days are mutually agreed with a small business, they must satisfy a new good faith and fair dealings test.

Identification of small business suppliers can present a challenge for signatories. The Government should establish a credible and up-to-date small business register that signatories can quickly and efficiently use to validate a suppliers' small business status.

Voluntary culture change within organisations is the best way to deliver improvements in payment times and is preferable to a mandatory code or costly regulation. Adoption of the Code has been solid but needs to increase. Business and government entities with large numbers of small business suppliers should adopt the Code and give it their support, otherwise the prospect of regulation will increase. There are no compelling reasons for major entities not to adopt the Code.

Graeme Samuel AC

FOREWORD BY THE PRESIDENT OF THE BUSINESS COUNCIL

The BCA launched the Australian Supplier Payment Code in May 2017 with support from Council of Small Business Australia (COSBOA) and the Victorian Government. The Code is a voluntary, industry-led approach to reduce payment times to small business and to lift payment practices generally.

Healthy cashflow is important to all businesses, but especially so to small business. The Business Council believes that cultural change is needed to recognise the importance of fast and on-time payment to small business suppliers, and that the voluntary code is the best way to achieve this.

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.

I would like to thank the independent reviewer, Graeme Samuel AC, and the members of the review panel for contributing their considerable time and expert advice. We welcome the review's recommendations.

Thank you to the organisations that have signed the Code for your leadership on this important initiative. All companies and governments are encouraged to sign up to the Code.

The Business Council looks forward to continuing to promote the Code and improve payment times and practices for small business suppliers. Trade between big and small business is valued around \$500 billion a year and is crucial to the Australian economy.

Grant King

President

Business Council of Australia

ABOUT THIS REVIEW

The Australian Supplier Payment Code was launched by the Business Council of Australia in May 2017, with support from the State Government of Victoria and the Council of Small Business Australia (COSBOA). It currently has 101 signatories with collective annual revenue of over \$550 billion.

Any entity operating in Australia can sign the code. The Code's success will be determined by the extent to which it is adopted beyond the Business Council's membership, especially by businesses and government agencies that have high counts of small business suppliers.

Signatories' commitments include paying small business suppliers within 30 days, paying suppliers on time, and working with small business suppliers to adopt electronic trading. The Code addresses the problem of long payment terms and late payments to small businesses, which cause undue financial stress and are detrimental to the wider economy.

One year after its launch, this review of the performance of the Code considers its effect on payment times for small business suppliers and the lessons from signatories about the implementation and administration of the Code. It identifies a number of actions to encourage wider adoption of the Code.

The review commenced on 6 September 2018. The Independent Reviewer is Professor Graeme Samuel AC, who previously served as the chairman of the Australian Competition and Consumer Commission from 1 July 2003 to 31 July 2011.

A consultative panel was established with the following members:

- Kate Carnell AO, Australian Small Business and Family Enterprise Ombudsman
- Judy O'Connell, Victorian Small Business Commissioner
- Peter Strong, Chief Executive, Council of Small Business Australia (COSBOA)
- Dirk Fourie, Principal, Procurement, Rio Tinto Australia

The findings and recommendations in this report take into account the expert advice provided by the consultative panel but should not be interpreted as a reflection of the views of the individual members.

Extensive consultations with signatory and non-signatory companies were conducted throughout the review.

SUMMARY

Payment practices and times have improved but there is still a lot more to do

The Code is working to speed up payment times, improve small business cashflow and support a more efficient and productive economy. Many of Australia's largest businesses, some with supply chains made up of thousands of small business suppliers, have signed the Code.

By signing the code, signatories report that their payment times to small business suppliers have reduced and they are working more closely with small business suppliers to improve payment practices.

Faster payment

Examples of faster payment cited by signatories to the Code:

- One submitter advised that prior to the Code, they had a standard set of terms where they paid all suppliers within 45 days, so the shift to 30 days for all suppliers has reduced the payment cycle across the board by at least 15 days.
- One submitter reported payment times moving from 60 days to 30 days
- One submitter reported that since implementation of the Code, net payment days have reduced by 7 days from the 'invoice date'.
- One submitter advised that the number of their suppliers identified as small businesses and on payment terms of 30 days or better had increased from around 700 suppliers to over 3700 suppliers as a result of signing the Code.

Changed practices

Examples of changed practices cited by signatories to the Code:

- One submitter advised that since signing the Code they now hold regular meetings with suppliers to discuss overdue invoices, work with specific suppliers to amalgamate and reduce unnecessary invoices into a single national purchase order and have an internal process in place to efficiently escalate complaints regarding unpaid or overdue invoices.
- Another submitter has implemented a supplier financing platform that enables their suppliers to gain "real-time" visibility of invoice in the payment timeline and the ability to gain early release of invoices should accelerated payment be required.
- One submitter advised that they are working intensively with their suppliers to make electronic invoicing the standard - a process that has required a significant investment of time and resources.
- One submitter provides their suppliers with clear guidance about their payment procedures, making available video tutorials and quick reference guides explaining how to use their e-Procurement system.

Some signatories noted in submissions that they already paid suppliers within 30 days before signing the Code.

Despite the improvement, there is still work to do:

- Long payment terms and late payments persist for many small businesses, as demonstrated by the strong survey response to the Australian Small Business and Family Enterprise Ombudsman's recent payment times inquiry.
- More widespread adoption of the Code is needed. All large business and government entities in Australia are encouraged to sign the Code, particularly those with high counts of small business suppliers in their supply chains.

Assessment of the Code

Overall, the review finds the Code is well-designed for the task of improving payment times to small business and is relatively easy for signatories to adopt. The review focussed on three key areas:

1. Barriers and challenges to increasing adoption of the Code
2. Identification of small businesses
3. Reporting and oversight arrangements

Most signatories to the Code were comfortable with the existing requirements and saw no need for major change. However, some major entities yet to sign the Code cited concerns in these areas during the review:

- compliance risk and the potential impact on reputation
- the challenges and costs of identifying a small business supplier
- uncertainty about how exemptions work
- time needed to change to complex internal payments systems and processes.

The review makes a series of recommendations to clarify the operation of the Code in these areas and remove any remaining barriers to its adoption. Some of the key recommendations are for:

- the application of the 'mutually agreed terms' exemption for payment beyond 30 days to be subject to a 'good faith and fair dealings provision'
- compliance with the Code to be on a 'best endeavours' basis
- the establishment of a small business register
- encouraging signatories to adopt the 'turnover' definition of a small business and phasing out the 'headcount' definition
- a clearer process for addressing cases of egregious breaches of the Code

More widespread adoption is required

With these changes there should be no compelling reasons for large corporate and government entities not to sign the Code.

Some of Australia's largest businesses have signed the Code, as well as the State Government of Victoria and a significant number of local councils and small to medium sized businesses (see www.supplierpaymentcode.org.au/view_the_signatories).

More widespread adoption of the Code is needed, primarily by large and medium-sized businesses and governments with large numbers of small business suppliers and payment times beyond 30 days.

There is the prospect of payments regulation unless there is further improvement in payment times to small business. The Australian government recently announced payment times reporting for large businesses and a requirement for prime suppliers to adopt 20-day payment terms as a condition of government contracts.

The voluntary approach outlined in the Code is the preferred way to improve payment outcomes – where 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, regulation 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.

Getting the voluntary approach right will support a more productive economy and should be supported as the primary mechanism for improving payment times.

DETAILED DISCUSSION OF ISSUES AND ACTIONS

Issue 1. Increase the number of code signatories

Many of Australia's largest companies have signed the Code and take-up continues to grow. In addition to some of Australia's largest companies, the Victorian government and a number of small-to-medium sized businesses and local councils have signed on to the Code.

Generally, submitters to the review consider the Code is well designed and does not require major change. Some specific concerns raised by non-signatories are set out below. The review recommends changes to provide more clarity about the operation of the Code in some of these areas and remove any remaining barriers to sign up.

There is a need to substantially increase the number of signatories over the next twelve months, particularly large organisations paying small businesses on extended terms. Those organisations should be the focus of targeted efforts to increase adoption of the Code.

Prime Minister Scott Morrison has urged greater adoption of the Code: "I want to see all the big businesses sign up to the Business Council's payment code. That's at 30 days and I think they should match us at 20 days as well." (28 November)

Failure to achieve more widespread adoption of the code will heighten the prospect of regulation. The Australian government recently announced that large companies will have to report on their payment times annually and will have to pay small businesses within 20 days as a condition of any government contracts. Additional regulatory measures cannot be ruled out.

The Code will be more successful if large and small businesses adopt e-invoicing and other electronic trading tools that will reduce errors and facilitate faster processing of payments. This will help companies meet their commitments under the Code.

Reasons cited for not signing the Code

A number of reasons were given for non-signatories not yet adopting the Code:

- little or no awareness of the Code in some organisations
- internal bureaucratic processes or personnel changes that delay the signing of the Code
- companies are not prepared to sign until all necessary systems changes are in place to be compliant from day one - changes to payment systems and processes can require a significant time and cost
- some companies want greater assurance that compliance with the Code is low cost and not onerous
- similarly, concern about the prospect of a legalistic approach to enforcement of the Code and the risk of penalties or reputational impacts for any non-compliance
- medium sized businesses may not be signing because these companies are owned by a private individual or family and not willing to accept the private costs associated with reduced working capital

Improving invoicing and payment practices

In some cases, supplier invoicing practices can be the reason for payment times being delayed. This was also a key finding of the review of payment times and practices by the Australian Small Business and Family Enterprise Ombudsman in 2017, which found that “incorrect invoices are the biggest cause of late payments”. The reasons include paper-based invoicing, errors in invoices, wrongly addressed invoices, etc

Some of the examples raised during the review include:

- suppliers of bags of ice to retail stores who leave a paper copy of the invoice on the premises. The paper invoice tends to get lost or misplaced in the store, or the payment details are incorrect and difficult to read.
- suppliers back-date invoices, meaning they are often overdue by the time they are received or shortly thereafter
- the service and/or goods are not fully or adequately delivered despite the invoice being issued by the supplier
- invoices are issued to a specific individual, rather than to the section of the organisation that deals with accounts
- invoices provided by suppliers list the wrong entity within the corporate group, which adds to internal delays in processing the invoice.

Greater use of e-invoicing is regarded as an effective solution to these problems and is promoted under the Code.

Need for greater clarification about the operation of the Code

Overall, the general view from signatories is the Code is a practical document and does not require fundamental change. However a number of non-signatories sought clarification on how the Code operates in some key areas.

Regarding the ‘pay on time’ commitment, submitters sought clarity on:

- whether the requirement applies to small business or to all businesses. In response, while it is essential to pay small businesses on time, it is also a requirement that Code signatories will apply the ‘pay on time’ principle to all suppliers. Paying on time is not only good practice, there are wider benefits for the economy from correct and timely payments.
- whether the requirement is subject to receipt of a correct invoice and correct product, so that signatories are not held responsible for errors by other parties. It will be clarified in the Code that receipt of a correct invoice and correct product is a pre-condition for the pay on time requirement (as it already is for the 30-day payment requirement).

The rules for allowing the ‘mutually agreed terms’ exemption to 30-day payment terms need to be clearer and strengthened. It is acknowledged there are occasional circumstances where longer payment terms may be in both parties’ interests, however the concern is around situations where those longer terms are not being negotiated and agreed on an equal footing. To address this, the review proposes that a good faith and fair dealings test apply whenever the mutually agreed terms exemption is applied.

Submitters sought clarification on whether supply chain finance is permissible under the Code. As a rule, the Code does not allow payment terms to be set at longer than 30 days (other than mutually agreed terms) and financing to be applied to reduce actual payment times to below 30 days. The Code does not inhibit the use of financing to reduce actual payment times when payment *terms* are less than 30 days.

The retail sector raised the question of applying longer payment terms for products with low stock-turn (eg, where stock is on display for several months before sale and it is considered reasonable for both parties to share the working capital cost). The review panel took the view that large businesses should generally pay small suppliers within 30 days but that the mutually agreed terms exemption was available in the occasional instance where both parties agree to the longer terms.

A concern was raised that strict application of the 30-day terms in all circumstances could be detrimental to small business suppliers if they lose business to a larger supplier offering longer payment terms (an 'unintended consequence'). The review panel considered that the risk of this occurring was low but should be monitored.

Some non-signatories have sought flexibility for existing payment cycles that are slightly beyond 30 days (eg 35 days) due to current practice or directions from global head office.

Actions

Raise awareness and promote take-up of the Code

Action 1

Business Council to develop a plan to raise awareness of the Code and increase take-up by businesses and governments.

- promote the Code website at www.supplierpaymentcode.org.au:
- generate more favourable publicity for signatory companies, which the Business Council is currently doing through social media
- Major non-signatories will receive correspondence from the Business Council inviting them to sign and an offer of a follow-up meeting to respond to queries.
 - In order to have the biggest impact, the plan will target businesses and governments with large numbers of small business suppliers and with payment times of greater than 30 days.
 - engagement will be targeted to the appropriate personnel within an organisation.

Action 2

Business Council to provide a dedicated resource to deal with enquiries and to process new Code applications.

Action 3

Develop and distribute digital stamps that Code signatories can use to promote their compliance with the Code.

Update the text in the Code and the guidance materials

Action 4

Business Council to make the following changes to the text of the Code and guidance materials:

- Clarify the 'pay on time' commitment:
 - applies to all suppliers
 - is dependent upon 'receipt of a correct invoice or receipt of a correct product from the supplier' (as applies for the 30-day payment requirement)
- Add a 'good faith and fair dealings' provision to the Code that must apply whenever a signatory uses the 'mutually agreed terms' or 'standard industry practice' exemptions to pay small business beyond 30 days
 - A 'good faith and fair dealings' provision would apply so that suppliers "are afforded both fairness of process (good faith) and fairness in outcomes (fair dealings)".
 - The 'good faith and fair dealings' provision will mirror the same provision proposed by the independent review of the Food and Grocery Code of Conduct (FGCC). (The Model Fair Dealings Principles that are proposed to apply under the FGCC are attached to this report.)
 - Add a clear statement that the maximum 30-day payment terms to small business applies in all other instances.
- Add a comment in the Code's guidance notes that payment *terms* to small businesses must be 30 days or below (except where 'mutually agreed terms' or a 'standard industry practice' apply), and that supply chain financing cannot be used to get around this requirement by setting terms above 30 days and then paying in less than 30 days (ie by paying a lesser sum, discounted at the signatory's cost of funds).

- Add text to the Code and the guidance materials to encourage signatories to pay in as short a time as possible (or to match the Federal Government’s 20-day payment terms).
- Replace all references to ‘signatory companies’ with, simply, ‘signatories’, to recognise that government entities and other business entities are also encouraged to sign the Code
- Re-draft commitment number 6 to make it clearer:
 - change from “Report on company policies and practices in place to comply with the Code” to “Publish the policies and practices that give effect to the signatory’s commitments under the Code on the signatory’s website.”

Action 5

Provide a full set of guidance materials that are easily accessible on the Supplier Payment Code website (based on the existing full set of FAQs).

Promote e-invoicing to raise efficiency and reduce errors

Action 6

Business Council to work with government and industry (including via the Digital Business Council (DBC)) to encourage more suppliers to use electronic trading platforms that comply with the standard developed by the DBC.

Action 7

Business Council to produce best practice guidance to assist signatories to implement the fourth commitment to “work with supplier businesses, where practicable, to apply technologies and practices that will speed up invoice lodgement, reconciliation, approval and payment processes”

Issue 2: Definition of a small business

Many submitters advised that it can be challenging to identify and verify the small business status of a supplier. Manual intervention is often required that is costly (for both parties) and prone to error. This is a barrier to efficiency and to the take-up of the Code.

An independently verified register of small businesses, with businesses identifiable by their ABN, would make identification of eligible small businesses much easier and faster.

Issues raised in the review

Small business register

The challenge of verifying the small business status of a supplier was raised in almost all submissions and consultations, and it was universally stated that a small business register would make the Code much easier to implement.

Options considered were:

- create a register of small businesses (turnover <\$10 million), with easily referenced ABNs, and which is updated in real time
- if this is too difficult given there are close to 2 million small businesses, create a register of large businesses (turnover >\$10m), with small businesses identified by exception.

The review strongly recommends the government explore the feasibility of establishing a small business register as a priority.

The review panel discussed other possible solutions to this problem, such as signatories setting standard payment terms for all contracts at 30 days or less and then negotiating longer terms with their 'non-small business' suppliers. However, this would require substantial change to existing contracts and policies and would be unlikely to be acceptable to many current (and prospective) signatories. It would impose substantial costs and restrictions on businesses.

Headcount definition

The review panel recommended that the headcount definition of a small business be removed from the options for new signatories. Headcount can be an imprecise indicator and difficult to determine when there are part-time employees and contractors.

The review panel recommended the turnover definition be the sole criteria for defining a small business. The maximum annual expenditure criteria will continue to be allowed.

If the headcount definition is removed, then signatories who are currently using the headcount definition should be given a specified period of time to move to adopt the turnover definition (or to the maximum annual expenditure criteria).

Actions

Small business register

Action 8

Establish a register of small businesses to assist with supplier identification and verification

- If a small business register is not feasible, establish a large business register and identify small businesses by exception.
- the register must be able to identify and exclude small businesses that are part of a larger group of companies (and therefore do not qualify for 30-day payment terms).

Headcount definition

Action 9

Phase out the use of the headcount definition of small business (fewer than 20 employees) by:

- disallowing its use for new signatories and grandfathering its use by existing signatories.

Issue 3. Reporting and oversight

Signatories are responsible for self-enforcement and are required to publish, on their website, the policies and practices they have in place to fulfil their commitments under the Code. Signatories are not required to report on their actual payment performance but are free to report on payment performance if they choose to do so.

It is important for the integrity of the Code that it is achieving its objectives and that signatories are meeting their commitments.

Reporting and oversight

Most Code signatories do not support stronger reporting or oversight given the voluntary nature of the Code and the importance of limiting unnecessary compliance costs.

It is clear from submissions and consultations that signatories to the Code sign up in good faith, take the commitments seriously and take the necessary steps to comply with the Code and avoid the potential consequences for reputation from breaches.

However, other stakeholders remain concerned about compliance monitoring, and small businesses remain concerned that they cannot always raise complaints with signatories for

fear of losing future business. There were mixed views on the review panel about whether payment performance reporting should be required under the Code.

The review concludes that reporting of payment performance is not currently necessary and reputation risk is a sufficient incentive for ensuring Code compliance. Reporting would add a compliance burden, particularly for smaller entities who have signed the Code, and would also duplicate the Australian government's new payment times reporting regime for large businesses.

Some companies raised concerns about a legalistic approach to enforcement and the prospect of being 'named and shamed' if they cannot achieve 100 per cent compliance with the Code, especially for reasons that are not intentional or beyond their control, for example, if an invoice gets lost in the system. This concern about a legalistic interpretation of compliance was a barrier to some companies signing the Code. To address this concern the review has recommended that a 'best endeavours' obligation be applied to the Code.

Clarifying the process for Code breaches

Submitters and the review panel sought greater clarity around the processes to deal with ongoing breaches of the Code by a signatory. 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 and Small Business Commissioners) 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.

There will be a greater role for the Australian Small Business and Family Enterprise Ombudsman and state Small Business Commissioners to hear and address complaints if they can't be addressed under the signatories' own complaints and dispute resolution processes (which are required to be in place under the fifth commitment of the Code).

Other mechanisms to strengthen compliance and assurance considered were:

- Displaying the signatory's date of signing the Code, so that the implementation period can be checked
- Greater use of publicity – both in a positive way to promote Code signatories or alternatively by third parties to highlight poor compliance. (Publicity may also be used by third parties to highlight companies with long payment times who haven't signed the Code.)
- Reduce the allowable 18-month implementation period to 6 months to speed up improved payments outcomes (with exemptions only if a signatory can prove it is necessary).

Economy-wide payments data

The absence of an economy-wide data series on payment times to small business made it difficult to assess the wider impact of the Code on payment time performance. A credible data series would be useful for tracking sectoral and economy-wide payment trends and for identifying areas where payment performance needs to improve.

Actions

Compliance

Action 10

Amend the text of the Code and the guidance materials to introduce a 'best endeavours' standard for compliance, while reinforcing that a very high standard of performance is expected.

Action 11

Reduce the maximum implementation period to 6 months, with longer timeframes permitted only where the signatory can demonstrate exceptional circumstances due to the complexity and size of their supply chain or payment systems.

Action 12

Business Council to make clear on the Supplier Payment Code website that small businesses can contact small business commissioners and the ombudsman directly with any complaints about the payment performance of a Code signatory.

Action 13

Add each signatory's month and year of signing to the Supplier Payment Code website

Action 14

Business Council to establish connections with Small Business Commissioners and the Small Business and Family Enterprise Ombudsmen to receive any regular reports of non-compliance by a signatory, so that further direct action can be taken.

Action 15

Update the process for dealing with regular and material non-compliance, should it occur. The Business Council will approach any company who is regularly in breach of the Code, whether deliberately or through negligence:

- the Business Council will alert the signatory to the allegations of non-compliance and ask them to change their practices – it is critical for the integrity of the Code that all signatories are delivering on their commitments
- If non-compliance continues, the signatory's name and logo can be removed from the published list of signatories as a last resort
- the Business Council will not publicly 'name and shame' a signatory.

Action 16

Government to develop a regular statistical series of payment times data across the economy, including payment times to small businesses. This could be developed in consultation with business information and accounting software providers.

BUSINESS COUNCIL OF AUSTRALIA

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