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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

23 July 2021

Dear Committee Members,

Subject: Supply Chain Finance Public Hearing, 28 July 2021

I have held senior positions in the supply chain finance sector for the last 7 years, supporting and providing solutions to tier 1 corporates and their suppliers. Prior to this, I was appointed by Grant Thornton UK to deliver 'Growth*Accelerator*' a £200 million programme to provide growth support for 20,000 of England's most ambitious small businesses. A Conservative and Liberal Democrat Coalition Government programme, my role was to qualify and quantify alternative finance solutions and business strategy that support and encourages small business growth.

Prior to moving to Australia, I led the UK division of a supply chain finance provider, where I worked alongside Lord Digby Jones who served as Director General of the Confederation of British Industry and an ambassador for small businesses. Financed by the British Government via the British Business Bank and RSA, we provided supply chain finance solutions for corporate businesses and their suppliers. Businesses using our solutions included The Ford Motor Company, Airbus, Ralph Lauren and Pfizer. Our advocates included the late Sir Ron Halstead CBE, former Deputy Chairman of British Steel and President of the Engineering Industries Association, who saw our supply chain finance solution as the answer for small businesses to tackle late payments.

In 2017, with my team at Fifo Capital (Fifo), we launched an Australian-based supply chain finance product, built from the ground up, and driven through ethics and fairness for suppliers.

There is clearly a need for wider understanding of supply chain finance in Australia. To do this we must first decouple it from the Greensill saga and unpack each independently. The finance product was not the problem, Greensill was.

Greensill used a perfectly good metric called the 'Cash Conversion Cycle' and 'doubts in financial reporting methods' to twist Supply Chain Finance

The Cash Conversion Cycle (CCC) is a general metric to measure management's ability to convert cash on hand into more cash on hand through purchasing, production and sales. It measures the time taken to produce goods and get paid less the credit period from suppliers. The longer the credit period from suppliers, the shorter CCC a business has. A shorter CCC means less working capital; less working capital means you have freed up cash previously tied up in the business and, for a large enterprise, this could be tens of millions of dollars, an attractive proposition to a CFO who faces many stakeholders and shareholders.

Reports of bigger businesses in Australia, that have been associated with Greensill, outline they have extended their supplier terms from 30 to 90 or even 120 days which is a result of working with Greensill. In other words, buyers forcing suppliers to give longer terms and by doing so, these buyers shorten their CCC and free up cash in the business whilst placing the strain on the smaller supplier – the common denominator here is Greensill.

Other businesses who morally and responsibly choose not to force their suppliers from 30 to 90 day terms, can ethically use supply chain finance to pay those supplier 100% of the invoice value on the original invoice due date, whilst at the same time, these businesses pay the finance company at a later date of their choosing for a small fee.

The cost of finance is often a fraction of the freed-up cash, in this scenario there is no pressure on suppliers, but rather the buyer is paying the cost of finance to extend terms to the finance company.

The doubts around financial reporting of supply chain finance have allowed businesses that used the services of Greensill to decide for themselves how they saw fit to report their use of supply chain finance. Greensill and their clients concluded that, because Greensill bought the supplier invoice, they then became the supplier, and ultimately the buyer then owed payment to Greensill. In this instance, the amounts owed remain in the accounts payable section of the balance sheet and, for all intents and purposes, would be read by an investor as only amounts owed to suppliers.

These balance sheets, whether Greensill funding was used to pay the supplier on terms or used as a sweetener for those suppliers now on longer terms, do not show the use of supply chain finance by the business and in the case of one client that has drawn large media attention, this practice enabled them to not disclose the fact they were using Greensill's funding and as such this meant other financiers and investors where not clear on the true financial exposures of that business, this lack of insight meant these lenders would lend more, fuelling what looked like a rapidly growing business, underpinned by less debt than the true story.

Greensill's use of Credit Insurance
Greensill positioned credit insurance as underpinning their bonds to investors, such that in the event of a collapse of a client, the investor's funds were safe. This was an exaggerated claim. Credit insurers such as Bond and Credit Co provide insurance for certain 'trigger events', they are not a total disaster policy. A responsible lender, like Fifo, knows they have a responsibility to their investors to ensure they protect their investments, and not claim credit insurance as some sort of 'magic solution'.

Prospective Receivables
Brought to the media attention is the claims that Greensill funded prospective receivables. To set the record straight, that was Invoice Finance, not supply chain finance. If Greensill did provide prospective Invoice Finance, then effectively they were funding 'non-existent' invoices. Complex modelling and even justifiable hypothesis could convince us that, on the surface, it is plausible that a prospective receivable would become a real receivable. However, that is all it is, just a calculated guess. Ultimately this sort of lending is a highly volatile and risky business loan, underpinned by the Director's guarantee.

Greensill 'flew too close to the sun'; they never saw, the more clients they added to their own balance sheet, the higher the risk they were putting on themselves and their investors. Their lack of rigger in their own processes and responsibility, together with poor security and relentless desire for growth, with little or no regard for consequences, has led to their collapse.

Financial reporting of the use of Supply Chain Finance

The question around how supply chain finance should be reported was a result of Carillion, the UKs second biggest construction company that collapsed in January 2018. Greensill was involved in funding Carillion. The question arose because investors and credit rating agency, Moody's Investor Service, did not see the collapse coming.

Carillion opted to report supply chain finance as part of their accounts payable. The financier would buy supplier/subcontractor invoices, and in effect became the supplier. For a small portion of Carillion's overall payables this would not have had very much impact but, because of the aggressive nature of Carillion, this meant the financier was buying large amounts of supplier invoices for Carillion to pay later. It was because the financier's debt remained as a trade payable that Moody and investors did not see it.

Yet was it so hard not to see? I have included an article I wrote on the subject which gives better insights to what happened.

It was not supply chain finance ance that caused the collapse of Carillion. As part of Moody's rating of Carillion and investor's evaluation of same, they would have seen the 'account payable days' had pushed out significantly, a sign the business was paying later and that their payables ledger was showing considerably more debt past 90 days, both good indicators something of significance had changed compared to previous annual statements.

Ultimately, when a financier purchases a supplier's invoice as part of a supply chain finance programme, it should be either reported under liabilities as a short-term debt by the buyer or, the buyer should disclose that supply chain finance is being used and what identify what portion of the trade creditors are financed.

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Understanding Supply Chain Finance as a financial solution for all businesses

Supply chain finance is good for businesses of all sizes. It enables both suppliers and buyers to trade on the terms they need to operate. At Fifo, we say it is 'Business on Better Terms'.

Non-recourse for the supplier

First and foremost, the payment is non-recourse to the supplier. This means it is the only finance product that is on equal terms to actually receiving cash payment from the buyer. Every other form of finance is debt or equity based. This incredibly important point has been lost in all the noise around Greensill. When a supplier can use finance to have their invoices paid and do so without giving security or equity in their business, without the risk of that finance being debt and, without the need to pay the money back to the financier if the buyer ceases to trade, then this is no different to receiving the actual payment from the buyer. Compare this to debt products where the supplier is still accountable to the financer if the buyer ceases to trade.

Supply chain finance was used to help many businesses, small and large through the GFC to accelerate cash flow and improve working capital. It can do the same here in the Covid-19 pandemic. Look no further than what is currently happening in the hospitality sector; each time we lockdown, hospitality businesses have mounting supplier bills which are compounded, and those suppliers need cash. Introduce supply chain finance and the suppliers are paid 100% of their invoice on time, or a little less if they want earlier payment, and the hospitality business has better terms to the financier. Financial pressure removed for both businesses.

A good case study of non-recourse in action is actually Carillion. There was nearly £100 million of supplier payments funded through their supply chain finance programme at the time of their collapse. As those suppliers were paid non-recourse, the financier had no right to claim the money back and therefore those suppliers benefited from not missing out. Unfortunately for those suppliers not on the Carillion supply chain finance programme they would have become unsecured creditors, many of which never saw payment. Worse still, if they had factored those invoices or had loans in their businesses, they would still be liable for that debt.

Allows a business to responsibly adjust their Cash Conversion Cycle

Businesses can implement the positive impacts of shorter CCC through the use of supply chain finance but, in doing so, cover the cost of the finance for the extended period from the original invoice due date to the revised later due date. This places no strain on the supplier.

Freedom of participation

Suppliers are free to join the programme and free to select which invoices they would like paid early.

No security over the supplier's business

Under a true supply chain finance programme there should be no security interest registered by the financer over the supplier's business on the Personal Property Security Register. The only time this might differ is where an invoice is abnormal, or there is an abnormality in the supplier/buyer relationship.

Non-related Entities

There can be no invoices funded between related entities, this is especially important where credit insurance is used.

Fair Payment Terms

The friction and pressures of trading are significantly reduced, if not completely removed, when suppliers and buyers control the timing of payments, that is, when they are paid and when they pay, respectively.

Many business owners I speak to cite their frustrations around the drive for businesses to pay in 30 days. The expectation that all businesses can even consider paying within 30 days is heavily flawed. For instance, where a business needs to purchase raw material components from overseas, then these slow tradelines affect how fast that company can turn raw materials and components into widgets and get paid. Equally, latest statistics show, if exporting to any of the major European countries, exporters can expect payment terms of 52 to 92 days from those overseas customers, so how are they expected to meet 30-day payment terms locally without making themselves internationally uncompetitive along the way.

Freedom to agree fair payment terms should be between supplier and buyer, and for many reasons it should be left to the two parties to negotiate. However, this freedom does not extend to buyers changing terms simply because they can. A buyer has a responsibility to its supply chain. Manufacturing no longer stops at the factory gates, it is a complicated multi-entity, multi-tier collaboration between businesses.

Agreement between the buyer and the supplier of the payment date (due date) is the central point to a fair supply chain finance programme. For instance, this date might be 30 days from invoice date and is the date the supplier will ultimately be paid 100% of the invoice value. For any day the supplier wants to be paid early, they offer a discount and for any day later the buyer wishes to pay, the buyer pays a finance fee in addition to the invoice amount.

Conclusion

Supply chain finance is the only financial solution that empowers both buyer and supplier to control their respective payables and receivables– it is a win/win. It removes debt from supply chains and reduces debt for SMEs. It enables buyers and suppliers to control when they get paid, and ultimately enables them to better control their cashflow without using debt finance where they would need to give security over their homes and their businesses.

It is therefore good to see the UK Parliamentary inquiry into Greensill conclude that their collapse in March this year does not justify regulatory reform to the wider supply chain finance market, a conclusion I encourage and hope you equally arrive at for Australia.

Yours sincerely,

[redacted]

Wayne Morris
Chief Executive Officer

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Carillion Article

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 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.

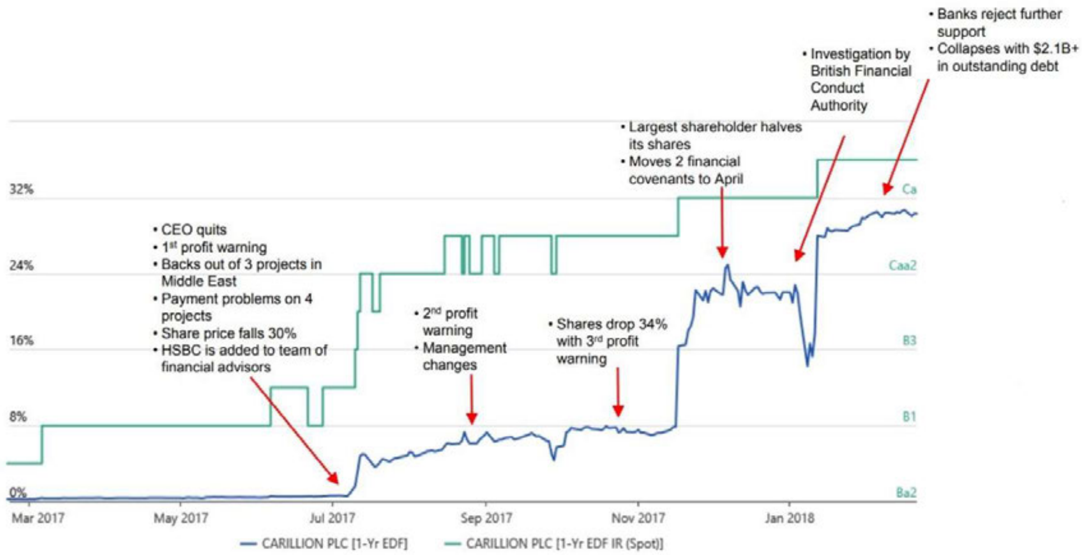
Here's the key bit – which Moody now recognise – accounting for reverse factoring liabilities was included in trade creditors not net debt. It was signed off by the internal auditor Deloitte who were paid millions of pounds, some research reports as much as £10 million, to report on risk management and 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 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 realtively 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. It was reported that £91 million had been paid out 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.

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…?