Australian Government
Department of Industry, Science, Energy and Resources

Payment Times Reporting Bills

Submission to the Senate Education and Employment Legislation Committee

Department of Industry, Science, Energy and Resources

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Introduction

The Department of Industry, Science, Energy and Resources (the Department) welcomes the opportunity to provide a submission to the Senate Education and Employment Legislation Committee's (Committee's) inquiry into the Payment Times Reporting Bill 2020 and the Payment Times Reporting (Consequential Amendments) Bill 2020. Together, these Bills implement the Payment Times Reporting Scheme (the Scheme).

This submission responds to the principal issues raised for consideration as part of the Bills' referral to the Committee, namely:

- the use of delegated legislation in the form of Rules to prescribe the details of the Scheme rather than the main legislation;
- technical issues including the treatment of supply chain financing and the appropriateness of the reporting thresholds;
- views that the Scheme will not reduce payment times of large businesses; and
- concerns that submissions made to earlier consultations have not been published.

The submission also addresses issues related to mandating maximum payment times.

The Department looks forward to working with the Committee to ensure that the Payment Times Reporting Bills and Rules are fit for purpose and meet the intended objective of improving payment outcomes for small business.

Payment Times Reporting Scheme

Background to the Scheme

Long (after 30 days) and late payments (after the due date on the invoice) are a significant problem for Australia's 3.5 million small businesses, severely impacting their cash flow. The need to cover the shortfall in their working capital constrains the ability of small businesses to hire, invest and grow, leading to higher bankruptcy and exit rates. It also impacts the mental health of small business owners. These negative impacts flow more broadly across the economy as small business that are paid slowly pay their suppliers more slowly in turn.

A 2019 study by AlphaBeta highlights the importance of addressing the issue of long and late payments from large to small business. [1] Analysis of over 10 million invoices from more than 76,000 small businesses estimated the quantum of long payments from large business is $77 billion per year. More than a third of small business invoices are paid after 30 days, and these invoices take an average of 63 days to be paid. This was estimated to equate to $7 billion in working capital that is transferred from small to large business every year.

According to AlphaBeta's research, normalising a 30 day payment time from large business to small business would have an estimated net benefit to small business of $522 million per year. It would create an estimated net benefit to the Australian economy of $313 million per year.

With the impact of COVID-19, it is even more important that large businesses, as stewards of their supply chains, pay small businesses promptly. Providing more certainty about payment times will support Australian businesses to respond to the economic challenge of COVID-19 and ensure that small businesses remain sustainable over the longer term.

While a number of voluntary measures are in place for large businesses to report their payment times, take-up has been limited and they are more likely to involve good actors. With small businesses lacking the market power to negotiate better payment terms and times, large businesses have little incentive to improve their payment performance. As a result, widespread improvement in payment times is unlikely without government action.

In November 2018, the Prime Minister, the Hon Scott Morrison MP, announced the Government would establish a reporting scheme requiring large businesses with a total annual income of over $100 million to publish information on how they engage with small businesses.[2]

The Scheme is designed to provide greater transparency around payment times. This will allow small business and the public to better identify and engage with companies that pay on time.

Funding of $10 million over four years from 2019-20, $2.6 million in 2023-24 and $2.4 million per year ongoing from 2024-25 was included in the 2019-20 MYEFO to establish the Scheme.

The Scheme's design, as outlined in the Bill and draft Rules, reflects consultation with over 400 stakeholders since early 2019, including small and big businesses, industry groups and government agencies. Consultations included four discussion papers, multiple workshops, a survey

[1] Unpublished research, AlphaBeta, 2019
[2] Prime Minister's media release, Paying small business on time, 21 November 2018

of small business stakeholders, targeted meetings and an Exposure Draft of the legislation and subordinate legislation.

Payment Times Reporting Bills and Scheme

On 13 May 2020 the Payment Times Reporting Bill 2020 and the Payment Times Reporting (Consequential Amendments) Bill 2020 were introduced into Parliament. Together these Bills implement the Payment Times Reporting Scheme (the Scheme).

The main Bill establishes a new requirement for eligible entities to report twice-yearly on their payment terms and practices to their small business suppliers. Large businesses who are constitutionally-covered, carry on an enterprise in Australia, and meet the total annual income threshold of over $100 million per year are required to submit a report each six months of an income year. Government corporate entities who meet the income threshold are also required to report. Businesses and other organisations who do not meet these requirements may choose to voluntarily submit a report. Charitable and not-for-profit entities are exempt from the reporting requirements.

A Payment Times Report will include information on the reporting entities' payment terms and practices, the use of supply chain financing arrangements, and other relevant information. Information from these reports will be published on a central public register, known as the Payment Times Reports Register.

The Bill establishes a Regulator who will administer the Scheme and have the ability to enforce compliance with the reporting requirements. The Regulator is a Senior Executive Service role, appointed by the Secretary of the Department.

Entities who fail to give a report, fail to maintain payment records, or provide false and misleading information in a report may contravene a civil penalty provision. The Regulator will have powers to monitor compliance, investigate suspected non-compliance, impose infringement notices for breaches, and apply to a court for civil penalty orders against entities. Reporting entities may also be directed to undertake independent audits where there is a reasonable suspicion of an entity's wrongdoing in relation to the reporting requirements.

The penalty arrangements in the Bill reflect the serious economic impacts of late payments and the Government's commitment to address this issue through the Scheme. The Regulator will adopt a graduated approach to enforcement ahead of using more coercive tools if reporting entities demonstrate a repeated failure to comply with the Act.

The Bill provides reporting entities with an 18-month penalty free transition period from the implementation date of the Scheme to enable them to transition effectively to the new requirements.

The new reporting requirements will be supported by a Small Business Identification Tool to assist reporting entities in identifying their small business suppliers.

In addition, the Payment Times Reporting (Consequential Amendments) Bill 2020 amends the *Taxation Administration Act 1953* to allow the Taxation Commissioner to disclose certain taxation data on reporting entities to the Regulator for the purpose of administering the Scheme.

Both Bills were introduced into the House of Representatives on 13 May 2020 and were passed on 11 June 2020. The Bills were subsequently referred to the Senate Education and Employment Legislation Committee for inquiry and report by 30 July 2020.

Pending passage of both Bills, the Scheme will commence from 1 January 2021.

Payment Times Reporting Rules

The main Bill provides the Minister with the ability to make Rules, in the form of legislative instruments, which are required or permitted by the Act, or necessary and convenient for carrying out or giving effect to the Act.

An Exposure Draft of the Rules was released for consultation on the Department's website on 13 May 2020 concurrently with the introduction of the Bills into Parliament. A Consultation Paper was also released with the Rules.

The intention of releasing an Exposure Draft of the Rules at the same time as the Bills' introduction, was to provide stakeholders with a holistic view of how the Scheme will operate.

The Exposure Draft of the Rules provides additional detail on the Scheme and interacts with the main Bill by:

- prescribing the use of the Small Business Identification Tool for reporting entities to identify their small business suppliers;
- specifying certain additional matters for inclusion in a Payment Times Report such as the use of supply chain financing arrangements, the method for calculating payment times, the types of expenditure covered by the Scheme, and the proportion of the business' procurement that was from small business suppliers;
- prescribing that in deciding not to publish certain information in a report, the Regulator must consider whether it is information that is irrelevant to the objectives of the Scheme; and
- outlining the content requirements for an application by a business to cease reporting its payment terms and practices as provided in the Bill.

Submissions to the Exposure Draft of the Rules closed on 26 June 2020. The Department is considering these submissions and will take into account stakeholder feedback and the outcomes of this Inquiry process in finalising the Bills and Rules.

Matters raised by the Committee

The Selection of Bills Committee, in referring these Bills for inquiry and report, outlined a number of matters for consideration. These include the use of delegated legislation for detail rather than in main legislation, the treatment of supply chain financing and appropriateness of reporting thresholds, whether this measure will reduce payment times from large businesses, and that submissions to earlier consultations have not been made public.

The use of Minister's Rules and the need for flexibility

The Department recognises that some stakeholders have expressed concern about the extent to which some elements of the Scheme will be prescribed in delegated legislation, in the form of Rules, rather than the main Bill.

Section 58 of the Bill provides the Minister with the ability to make Rules which are required or permitted by the Act. A rule-making power is necessary to allow the legislation to respond flexibly to changing circumstances and to provide substance to the operation of the Act. As legislative instruments, the Rules will be tabled in Parliament, subject to scrutiny and disallowance.

Some stakeholders have raised that certain key concepts of the Scheme are contemplated for the draft Rules. These include defining a 'small business' in Section 5 and 'supply chain finance' in the definitions section of the draft Rules.

It is a common arrangement for schemes that are underpinned by legislation to include administrative and technical detail in delegated legislation. Importantly, the Bill includes the core elements of the Scheme that affect the obligations of reporting entities including the consequences of non-compliance. For example, the Bill sets out the scope of entities that are required to report, the penalty regime, the powers and functions of the Regulator of the Scheme and the compliance and enforcement arrangements.

There are sound policy reasons why it is reasonable and necessary to include certain aspects of the Scheme in the proposed Rules. These are set out briefly below.

Why is 'small business' defined in the Rules?

Section 5 of the Bill defines a 'small business' as an entity prescribed in the Rules. Subsection 58(3) of the Bill specifies that the definition of a small business in the Rules may apply, adopt or incorporate any matter in an instrument or writing from time to time.

It is intended that the Rules will provide that a 'small business' for the purpose of the Scheme is a business that is described as a small business in the Small Business Identification Tool (the Tool), which will be where that entity's annual turnover is less than $10 million.

The issue of how to identify small businesses was canvassed extensively during consultation on the development of the Scheme. Stakeholders overwhelmingly saw the Tool as the best option to identify small businesses for the purposes of the Scheme. This approach reduces the administrative burden on small and large businesses – without such a Tool, large businesses would have to adopt their own method to try and identify whether each of its suppliers was a small business. Inevitably, this would mean small businesses would have to invest significant time and effort to show they were a small business – particularly if they supply to a number of larger businesses who each took a different approach.

The Tool is designed to identify small businesses with an annual turnover of less than $10 million. The data contained in the Tool will be regularly updated, for example, as small businesses are created, close or their turnover increases to more than $10 million.

The Tool will reduce the compliance burden for reporting entities by automating the small business identification process. As part of the Tool, a large business will be able to enter identifying information about their suppliers, with the Tool identifying which of these businesses they need to report payment times for.

As the definition of a small business for the Scheme is intrinsically linked to the Tool, it is appropriate for the technical definition of what is a small business for the purpose of the Scheme be defined in the draft Rules.

Reporting on supply chain financing arrangements

Supply chain finance is a generic term used to describe a range of financing arrangements. Typically these arrangements involve the payment of invoices by an intermediary or third party finance company at a discount to their original value. As outlined in the Australian Small Business and Family Enterprise Ombudsman's (ASBFEO) final report on its review into supply chain finance, many different products with different features are generically referred to as supply chain financing. Common terms include reverse factoring, dynamic discounting and marketplace variations.[3]

Supply chain financing is not explicitly defined in the Act, and is instead provided for in the draft Rules given the difficulties in exhaustively capturing all types of supply chain financing arrangements in the main Bill. This approach is appropriate and necessary given the range and complexity of these products, and the need to provide flexibility for new and emerging products as they arise in the marketplace. Defining the practice in legislation runs the risk of failing to capture new practices, thereby undermining the intent of the reform.

Technical aspects of the Bill

Treatment of supply chain financing

The Department recognises there have been a number of cases where large businesses have extended their payment terms and forced small businesses to use supply chain financing to be paid in a reasonable time. When used to delay payment times, supply chain financing can have a significant adverse impact on small business. As recognised in ASBFEO's review into supply chain finance, where a large business pays their suppliers within a reasonable time, supply chain financing arrangements can be beneficial and offer a real choice to small businesses. For example, these arrangements can provide an alternative to other more expensive financing options such as invoice factoring, bridging loans or using a credit card to cover business expenses.

As a result, the legislation does not prohibit the use of supply chain finance. Instead it seeks to increase transparency by providing small businesses with visibility on when and how a potential large business customer uses forms of supply chain financing. Large businesses will be required to report on whether they have used any small business supply chain finance arrangements during the reporting period. They will also be required to provide details of these arrangements, as well as a statement of the proportion, determined by total number and total value, of small invoices paid during the reporting period under those arrangements.

Approach to reporting payment times

As part of the Scheme, reporting entities are required to report on the proportion of small business invoices paid between certain time periods: less than 21 days, between 21-30 days, between 31-60 days and more than 60 days. The objective of the Scheme is to drive changes to payment behaviour, incentivising large businesses to pay their small business suppliers quickly by publicly reporting on their payment times and practices. This is intended to drive cultural change by creating an environment where paying quickly is the norm and long payment is seen to be unacceptable.

These time periods have been selected to drive this behavioural change. Reporting against these specific metrics signals that these are the targets expected of businesses when paying their small business suppliers. By implication, any payment made outside of 60 days is too long.

[3] Supply Chain Finance Review – Final Report, ASBFEO, March 2020

Greater transparency and improved payment outcomes

The objective of the Scheme is to improve payment outcomes for small businesses by creating greater transparency around the payment practices of large businesses. Small businesses will be able to make more informed decisions about their potential customers. Increased transparency on payment practices and performance is also intended to create pressure for cultural change by incentivising larger businesses to improve their payment performance as this information will be publicly available on the Payment Times Reports Register.

The transparency and integrity of the Scheme is underpinned by the role of the Regulator. The Regulator will have the powers to gather information and publish it on the Register, including the power to 'name and shame' businesses who do not comply with their obligations, and the ability to enforce compliance with the Scheme. Significant penalties can apply for non-compliance, including for a failure to report or report accurately. For example, a business that provides a false or misleading report to the Regulator can be subject to a penalty of up to 0.6 per cent of its total income. These penalty amounts are intended to provide a significant deterrent to any businesses that may attempt to circumvent the Scheme.

In addition, some stakeholders have questioned whether improved transparency of large businesses' payment times and practices is sufficient to improve payment outcomes for small businesses, instead calling for more prescriptive measures such as legislated payment times. Issues relating to mandating payment times are explored further in this submission.

Recent examples in Australia demonstrate the benefits of increased transparency and public scrutiny in changing poor practices of some businesses, while encouraging other businesses to proactively improve their business behaviour. Internationally, the public reporting of payment practices was found to have the potential to attract significant media scrutiny similar to reporting initiatives in areas such as the minimum wage and gender equity.[4]

In Australia, for example, companies such as Telstra, Rio Tinto and Greensill Capital recently changed their business practices following media coverage and public scrutiny of their payment practices including use of supply chain financing.

In early 2020 Telstra was reported to have announced it would reduce its payment terms from 62 to 20 days for 85 per cent of its suppliers. This followed adverse media coverage of Telstra's plans to use a form of supply chain financing for its suppliers and a decision to extend its payment terms from 45 to 62 days.[5]

Similarly, Rio Tinto abandoned its use of supply chain financing in early 2020 following criticism that it was offering its suppliers a reported maximum of 1.5 per cent off an invoice in return for payment

[4] KMPG, Payment policies and performance reporting. Advice to businesses as part of the UK's Late Payment legislation.

[5] www.theaustralian.com.au/business/companies/telstra-chief-andy-penn-in-supplier-pay-backflip/news-story/15c407d21ebad0fa91711466d913b6f2

within a few days. In February 2020, Rio Tinto subsequently reduced its payment terms to 20 days for 90 per cent of its suppliers. [6]

In February 2020 Greensill Capital, a provider of supply chain finance, announced that it would stop providing its supply chain finance services to larger companies that use these arrangements to delay paying their small business suppliers by more than 30 days. This followed public scrutiny.[7]

Other businesses have also proactively improved their payment times to their small business suppliers, recognising the critical role of cash flow in supporting small business. For example, in March 2020 the Woolworths Group announced it would change its payment policy to pay its small business suppliers within 14 days, while BHP reduced its payment terms from 30 days to 7 days for more than 1,100 small Australian businesses.[8]

These examples demonstrate the benefits that increased transparency and public accountability can bring in driving changes to payment behaviour, without the need for more prescriptive requirements.

Mandated payment times

Legislated maximum payment times have been implemented in the European Union (EU) and are being explored in New Zealand. There have also been calls for legislation requiring SMEs to be paid in 30 days. While the policy appears to offer a solution to the problem of late payment times, in practice it has been largely ineffective and can even harm the small businesses it is designed to help.

Analysis of the EU late payment directive concluded "*there was little evidence it had an impact on payment behaviour and the practice of late payment*". [9] Enforcement is rare as it relies on the small business seeking interest on late payments from its large business customer. Given the imbalance in market power between large and small businesses, it is unsurprising that many small businesses are unwilling to exercise their rights. A survey conducted as part of the evaluation of the EU's approach, found that 49 per cent of businesses were reluctant to claim interest as they would prefer to retain good relations, and 26 per cent of businesses did not claim because the cost of claiming the payment was too high relative to the benefit of receiving it.

To allow flexibility for different arrangements across industries and firms, the EU approach allows companies to contract out of mandated payments. With the difference in bargaining power between large and small firms, this has created a significant loophole in the framework. As a result the EU has noted there are often unfairly long payment terms imposed on small suppliers who accept these terms out of fear of losing their business partner.

[6] www.smh.com.au/business/companies/rio-tinto-introduces-20-day-payment-terms-for-suppliers-20200205-p53xzk.html and www.afr.com/companies/mining/rio-tinto-caves-over-reverse-factoring-controversy-20200129-p53vum

[7] www.greensill.com/news/greensill-statement-on-payment-terms-in-australia; www.afr.com/companies/financial-services/greensill-caves-on-small-business-payments-20200207-p53yq1

[8] www.woolworthsgroup.com.au/page/media/Press_Releases/woolworths-group-reduces-payment-terms-to-support-small-businesses/; and www.bhp.com/media-and-insights/news-releases/2020/03/bhp-increases-support-for-local-business-and-contract-labour-hire-during-covid-19-pandemic/

[9] Ex-post Evaluation of the European Late Payment Directive, European Commission, 2015

Mandated payment times of 30 days or longer have been demonstrated to lengthen payment times for some small businesses. As these policies establish a norm for payment length, some businesses who pay more quickly lengthen their payment terms to meet this new standard.

Data from the accounting firm Xero shows that Australian small businesses in sectors ranging from agriculture, fisheries and forestry to accommodation and food services have average payment times which are significantly less than 30 days. [10] In fact, around 23 per cent of small business revenue from large business is paid immediately. A 30 day mandated payment time may result in these businesses waiting longer to get paid, resulting in a negative impact on their cash flow. Mandating 30 day payment times only for small businesses as has been proposed in the Australian context could also result in discrimination against these businesses in procurement decisions. To avoid the risk of regulation and possible penalties, businesses may instead decide to purchase goods and services from medium and large businesses that are not covered by the legislation.

Submissions to earlier consultations

Concerns have been expressed that submissions to previous consultation processes on the Scheme have not yet been made public. The Department is seeking permission from the authors to publish non-confidential submissions to these earlier processes. These will be made available on the Department's website in due course.

[10] Unpublished research, AlphaBeta, 2019