

9 June 2021

Ms Pothida Youhorn
Acting Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
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Dear Ms Youhorn

QUESTIONS ON NOTICE RELATING TO GREENSILL

Thank you for your letter dated 21 May 2021 regarding Questions on Notice about Supply Chain Finance (SCF). The answers to your questions are in the following pages (formatted as requested).

Introductory comments

Working capital finance and risk management focuses on helping businesses access right-sized and best-priced finance.

For businesses, this means finance solutions to manage the effective interaction and life cycle of converting materials into finished goods and services, stock and inventory management, debtor invoicing and the collection of cash, and then the payment for goods and services through the creditor payment cycle. Depending on the timing of cash collection from customers and subsequent cash payments to suppliers, working capital cash surpluses or deficiencies can arise. SCF can assist in addressing deficiencies.

SCF is particularly important to small and medium-sized enterprises (SMEs). It mobilises working capital and helps smooth liquidity and cashflow management in a business.

SCF is a term describing a set of finance and technology-based solutions that aim to lower borrowing and financing costs and improve business efficiencies for buyers and sellers in a sales transaction. It is a particularly useful finance tool to assist businesses manage their various financial and commercial risks (liabilities), while maximising the use of their assets to minimise their cost of borrowing and other commercial costs.

Contribution of the supply chain finance market to Australia's economy

The SCF market in Australia is not as deep as overseas markets. However, over the past decade, developments have been driven by technology advances and entrants of non-bank lenders.

SCF falls into two key categories – debtor or creditor financing:

- Debtor financing or receivables finance in effect accelerates (or gives certainty of timing) payment of sales invoices to a business – normally at a discount to the value of the invoices. Sales invoices can be factored individually or as an entire sales ledger.
- Creditor financing or reverse receivables finance in effect delays the payment for goods or services for the buyer – the supplier receives the full value of the invoice, while the buyer pays some sort of fee or premium on the funds paid to the supplier.

AFIA makes two observations about the SFC market.

1. The COVID-19 crisis and global recession have impacted global supply chains and only increased the need for businesses to better manage liquidity and strengthen their balance sheets. There are five key areas of emerging working capital opportunities and risks:
 - Days payable outstanding and similar metrics are deteriorating, with businesses looking for more sustainable working capital finance and risk management strategies.
 - Working capital finance and risk management needs to continue to improve, so that businesses can enhance returns, capital utilisation, and other business efficiencies.
 - Receivables, stock, and inventory are assets, with businesses looking to extract value from better utilisation.
 - Cashflow management is even more key, with businesses facing operational challenges and increasing uncertainty with global supply chains.
 - Working capital finance and risk management is improving, but businesses are looking for greater commercial and financial reporting improvements.
2. Like all finance markets, digitisation is increasing access to, and availability of, SCF, for the benefit of businesses across industries. Ultimately, this is good for customers and the economy. There are three key areas of technology-based change:
 - Data and analytics being used to identify tailored solutions – this is particularly key for supply chain finance providers to use data to connect buyer and supplier-focused approaches and apply advanced analytics to identify business efficiencies.
 - Finance being made available earlier in the production cycle – this is particularly key for industries and businesses with seasonal impacts and/or volatile markets, including exports subject to changes in currency and interest rate markets as well as imports facing global supply chain disruptions.
 - Integration of financial and non-financial solutions is driving business efficiencies – supply chain finance providers are working with other fintech and procurement partners to provide integrated solutions via platforms as a 'one-stop-shop' for financing and trade.

Further information about the evolution of the SCF market can be found in reports published by PWC and Oliver Wyman¹.

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) also published a Supply Chain Finance Review in March 2020. In this analysis of the SCF market and related issues, they note that, 'when used to benefit of both the supplier and buyer it can be a real choice for small businesses', being cost effective when compared to other forms of term or revolving credit, improving certainty of payment, and matching assets and liabilities for improved finance and risk management.

Attachment A provides further details on specific questions.

Concluding comments

SCF is, and will continue to be, an important part of the finance market. There is an increasing need for SCF by businesses as they seek to optimise their working capital and accelerate recovery from the global pandemic.

Overall, SCF is valuable for businesses, but there are some important points to note:

- transparency of underlying exposures and assets is important to ensuring counterparty risk assessment, through reporting and processing infrastructure
- controls to ensure diversification, through portfolio management techniques, including automation, need to be robust so as to improve product metrics
- innovation accompanied by due diligence and underwriting standards to ensure understanding of structural risks, through risk profile, product manufacturing, reliance on insurance wrapping, and long-term financing structures is key.

Banks and non-bank lenders will continue to develop their SCF offerings and platforms, ultimately enabling them to meet customer demand as well as direct liquidity into the real economy to where it is most needed, which is the core function of lenders in efficient financial intermediation and capital mobilisation.

Should you wish to discuss our answers further or require additional information, please contact me or Karl Turner, Executive Director, Policy & Risk Management at karl@afia.asn.au or 02 9231 5877.

Yours sincerely

Diane Tate
Chief Executive Officer

¹ <http://www.pwc.com.au/publications/pdf/supply-chain-finance-jul17.pdf> and <http://www.oliverwyman.com/our-expertise/insights/2017/dec/supply-chain-finance--riding-the-waves.html>

ATTACHMENT A: QUESTIONS AND ANSWERS

QON028-01

• How extensively is supply chain financing used?

Debtor and creditor financing, in the form of invoice or receivables financing, factoring and reverse factoring, or stock and crop finance (through the taking of a lien), are widespread and a long-standing financing practices.

We note that banks have historically been the main lenders in working capital or trade finance, including SCF. It has been estimated that pre-GFC banks funded in the region of 90 per cent of SME's capital. However, post-GFC, banks have withdrawn from the SCF market, mostly due to increasing complexity of operations (especially if done manually) and increasing capital requirements as a result of Basel III. Non-bank lenders (especially those with technology-based solutions) have entered the SCF market and are helping address the financing gap for businesses.

We are aware of media coverage related to the use of SCF by some large companies. Furthermore, the ASBFEO's Review centred on concerns that some large companies are using SCF for their benefit and to the detriment of smaller suppliers, exacerbating concerns with payment terms.

QON028-02

• In which sectors of the economy is it used?

SCF is widespread across the economy in Australia and overseas. SCF is used for business-to-business transactions where buyers are given invoice payment terms, including in industries such as consumer goods wholesalers and distributors (retailers), mining and resources, IT and communications service providers, energy service providers, manufacturing, transport and logistics, and professional services. It is important to note that the exact type of financing may differ depending on the industry or business. For example, stock and crop liens are a form of SCF related to agricultural products.

QON028-03

- **What types of invoices are involved (e.g. goods, services, wages)?**

SCF is used for invoices related to the purchase of goods and services. We are not generally aware of its use in relation to wages. However, we note the evolution of other finance tools to assist businesses and/or employees smooth wages. These new finance tools are not referred to as SCF.

QON028-04

- **Is supply chain financing used in public sector payments for wages or other services?**

We are aware of the use of SCF by quasi-public sector entities, such as co-operatives in the agricultural sector (grain, cotton and fruit). As stated above, we note the evolution of other finance tools to assist businesses and/or employees smooth wages. These new finance tools are not referred to as SCF. However, we are aware of public sector entities looking to use these tools to better manage various payments through and across budget cycles.

QON028-05

- **How common is it for supply chain financiers to provide:**
 - o **factoring;**
 - o **reverse factoring; and**
 - o **both factoring and reverse factoring to the same client.**

SCF in the form of factoring and reverse factoring is common. Where a large company enters into a relationship with a supply chain finance provider, it is possible that they would be providing both debtor (factoring) and creditor (reverse factoring) services for the same company, depending on their position in a supply chain.

We note issues related to possible information and power asymmetries that are accelerated by the provision of factoring and reverse factoring to the same client were highlighted in the ASBFEO's Review. Integration of financial and non-financial solutions, coupled with digitisation, is driving new finance tools and portfolio management techniques.

QON028-06

• How common is it for supply chain financiers to finance prospective invoices?

We are not aware of the widespread practice of financing prospective invoices.

Industries and businesses would have accounting policies about revenue recognition in relation to invoices, which may support or impede such prospective invoice financing.

SCF, even in its most common forms, can be an area of significant fraud risk for financiers. In particular, fraud through:

- the raising of invoices for non-existent stock or inventory
- changing of bank account payment details, which means cash is remitted to the fraudster
- multiple financing of the same goods or services
- delivery of fictitious goods and services.

Financing prospective invoices would potentially increase fraud risk. Due diligence and underwriting standards should be conscious of this and other counterparty risks.

As stated above, we note the evolution of financing arrangements and other finance tools to assist businesses. For example, the integration of accounting and financial management via platforms – some of these tools interface with accounting packages and may provide a cash advance or a line of credit based on previous patterns of receivables and/or actual outstanding invoices. The availability of credit for the business to better manage their cashflows is determined as part of usual credit assessment processes. This is unsecured credit and not SCF.

Greensill Capital was focused primarily on creditor finance. Greensill's term funding of receivables, and securitisation of income flows from SCF, in order to fund itself and grow, is rare and not representative of the supply chain finance providers in the Australian market. Furthermore, in this instance, it appears the problem with financing of prospective invoices also related to the timing between the manufacture of goods and the outstanding invoice, and the associated transaction risk.

QON028-07

• What are the advantages, disadvantages and risks of using supply chain financing?

As stated above, SCF gives certainty of timing of cashflows for a business and helps smooth liquidity to help create business efficiencies.

This mobilises capital and liquidity, supporting regular payment further along the supply chain, or for fixed costs, such as utilities, rent and wages. Businesses are happy to pay a 'cost' in the form of a discount on a sales invoice or a premium on a creditor invoice in return for this certainty.

This form of finance is also cost effective when compared with other forms of credit (see table below from ASBFEO Review), noting that the cost and availability of business finance is risk-based.

However, the ASBFEO Review highlights issues that relate to suppliers being forced to use supply chain finance providers that are in a relationship with a larger buyer, rather than one of their own choosing (and when they choose to), which can lead to terms that may not be in their interests or at least not as beneficial as they could be.

Table from ASBFEO Supply Chain Financing Review

Small Business Finance Options	
Finance type	Cost
Overdraft	6.5% - 9%
Business credit card	13% - 14%
Factoring	12% - 30%
Term debt	7% - 36%
Supply Chain Finance	2% - 7%

* Cost is based on \$1 million of finance, unsecured, and expressed as an APR (annual percentage rate). Source: Bank and comparison websites

QON028-08

- **How common is it for supply chain financiers to provide/use structured financing, such as securitisation?**
- o **What leverage levels are reached?**
- o **What additional risks arise?**
- o **How common is it for the trade insurance to be used in relation to supply chain financing?**

AFIA does not have any insight in this area, except to say that this form of securitisation of SCF income flows is rare. We are aware of it being used by Greensill Capital, and understand how it would help support growth and the scaling of their business. We understand that trade insurance was key to Greensill's funding model. The insurance gave certainty to the embedded income flows and made the resulting securities eligible investment assets for institutional investors, including investment banks and superannuation funds.

QON028-09

• For a client, how do the terms and conditions of supply chain financing differ from a business loan?

SCF is a form of secured or partially secured credit. This compares to, at one end of the spectrum, fully secured credit such as a mortgage or asset finance, which would have a fixed term, or unsecured amortising term facilities or revolving credit, such as a credit card or overdraft, which would have no term. The price of these facilities will vary depending on the probability of default and the loss given default of the applicant (see above table for APR comparisons) – that is, risk-based pricing.

QON028-10

• What are the implications of supply chain financing for transparency in financial reporting and accounting and auditing standards?

AFIA is not an expert in this area, but is aware of the following [submission by CPA Australia](#) to the ASBFEO on this issue.