The Senate

Economics Legislation Committee

Late Payment of Commercial Debts (Interest) Bill 2003

October 2003

ISBN 0 642 71314 6

Printed by the Senate Printing Unit, Parliament House, Canberra.

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CHAPTER 1

The Bill

Introduction and Referral

1.1 The Late Payment of Commercial Debts (Interest) Bill 2003 ('the bill') was introduced into the Senate by Senator Stephen Conroy as a Private Senator's Bill on 6 March 2003. On 19 March 2003 the Senate adopted the Selection of Bills Committee[1] recommendation that the bill be referred to the Senate Economics Legislation Committee for consideration and report by 11 August 2003. The Senate later extended the reporting date to 29 October 2003.

1.2 Four submissions were received. A list of the parties who provided submissions is at Appendix 1. One of the submissions, from Kerry Panels Pty Ltd, was accompanied by 843 additional letters of support. In addition, the Committee received correspondence from the Attorney General's Department and the Treasury. The Committee held a public hearing in Canberra on 13 October 2003. A list of witnesses who appeared at these hearings is at Appendix 2.

Provisions of the Bill

1.3 Senator Conroy, introducing the bill, outlined its purpose in the following terms:

> The purpose of the bill is to crack down on late payments by big business and government customers to their small business suppliers.
>
> Many small businesses are finding that their big business and government customers are taking too long to pay their bills.
>
> This creates cash flow problems for small business.
>
> The bill implies a term in qualifying contracts that interest is payable on qualifying debts.

1.4 The objects of the bill are set out in Section 3. The objects are to:

a) improve the payment culture by penalising late payments of commercial debts; and

b) compensate financially vulnerable companies for the impact on their cash flow of receipt of late payments of commercial debts.

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1 Selection of Bills Committee Report No. 3 of 2003

1.5 The bill would apply to contracts for the supply of goods and services where:

- the purchaser is a Commonwealth agency or a large corporation, defined as 'a corporation with a turnover in excess of $20 million per year';
- the supplier is a small business, defined as 'an independently owned and operated entity employing less than 20 people on a full-time employment basis'; and
- both the purchaser and supplier are acting in the course of business.[2]

1.6 The bill prevents a purchaser and supplier from agreeing to a qualifying contract which excludes the right to the statutory interest provided for in the bill.[3] However, a contract may be exempted from coverage under the bill if the contract contains another 'substantial' remedy for late payment.[4] A substantial remedy in this section is one which both compensates the supplier for late payment, and acts as a deterrent to late payment by the purchaser.[5]

1.7 The amount of interest payable under the bill is set by the Minister, who has the option of either setting a rate of interest from time to time, or prescribing a formula for the calculation of interest.[6] Interest accrues from the date the debt falls due, or 30 days after the debt arises (if no date has been set).[7]

Acknowledgement

1.8 The Committee is grateful to, and wishes to thank, the organizations and individuals who assisted with this inquiry.

2 These definitions are in the Late Payment of Commercial Debts (Interest) Bill 2003, s.4

3 Late Payment of Commercial Debts (Interest) Bill 2003 s.10(1)

4 Late Payment of Commercial Debts (Interest) Bill 2003 s.10(2)

5 Late Payment of Commercial Debts (Interest) Bill 2003 s.11(1)(a)

6 Late Payment of Commercial Debts (Interest) Bill 2003 s.9

7 Late Payment of Commercial Debts (Interest) Bill 2003 s.4, ***relevant day***

CHAPTER 2

Issues Arising from the Bill

2.1 The Committee considered a number of issues which arose during its inquiry, and a number of possible solutions to the problem of late payments. This chapter will outline those issues.

The problem of late payments

2.2 This section of this report outlines the extent and implications of the issue of late payments. The Committee observes that late payments are a significant problem for affected businesses, but it is difficult to determine the extent of the problem beyond the automotive repair industry.

Cash flow

2.3 The Committee received substantial evidence that the late payment of commercial debts is a significant issue for small business, especially in the automotive repair industry. In this industry, small businesses such as panel repair shops supply their services to extremely large clients in the form of major insurance companies.

2.4 Small businesses such as these often survive or fail on the basis of their ability to maintain a healthy cash flow:

> I think a lot of small businesses do operate with very low margins and a very tight cash flow. An outstanding debt of $5,000 or $10,000 could send them to the wall. There are a lot of businesses that have turnover of less than $100,000 and it is essentially just their wages that they are working for. A debt of that proportion could certainly damage them. We are not talking about big business or big amounts. It does not take much.[1]

2.5 A small business practitioner, Gerry Raleigh, described his cash flow challenge in the following terms:

> I have got wages to pay every week—and my materials and parts bills. The average make-up of an insurance claim is probably some 60 per cent parts. Then you have materials and labour. The fact that I have got my wages to pay every week puts an even bigger stranglehold on my cash flow. If I do not pay those, I do not have staff.[2]

2.6 Evidence suggested that these cash flow issues have been exacerbated somewhat by the Goods and Services Tax. The GST has increased small business'

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1 *Transcript of Evidence*, Hartcher, p. E20

2 *Transcript of Evidence*, Raleigh, p. E4

awareness of cash flow, but may impose more regular tax payments which in turn become a drain on cash flow.[3]

Unequal bargaining power

2.7 The Committee observed that contracts between motor vehicle repairers and insurance companies already generally include conditions prescribing the date for payment. Mr Raleigh, for instance, stated that his accounts should be paid in thirty days.[4] The Committee inquired as to why these terms could not simply be enforced by the small businesses, obviating the need for the current bill. Two reasons were suggested:

- small business is unable to press their claim for fear that the insurance company will stop contracting them; and
- insurance companies have developed effective ways of delaying and hampering efforts to obtain payment.

2.8 Attempts by small business to enforce claims against big businesses were described by one witness as ‘a bit like insisting on your right of way at an intersection against a big, heavy truck – you just do not do it.’[5] Mr Raleigh, from Kerry Panels, described his concerns as follows:

> If you are a small player working with the insurance companies, you virtually play by their rules. The only way you will get them to [pay penalties for late payment] is to get them to sign a contract—and you will have no hope in hell of getting them to sign any such contract. […] As far as saying to an insurance company ‘You pay within 30 days or I am going to send a late payment fee’ is concerned, they would just laugh at you.[6]

2.9 The Committee acknowledges that there is a substantial imbalance in bargaining power between small businesses and large businesses, and that this may make it difficult for small business to enforce payment terms, for fear of jeopardising future contracts.

2.10 Witnesses also described how small businesses who *do* seek overdue payments from insurance companies find themselves unable to penetrate the larger company’s internal bureaucracy. The VACC described the experience of one of its members:

> When chasing payments from most insurance companies it is usually quite obvious that the staff member you are speaking with has no intention of doing anything to help you and despite the fact that you can name names

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3 See, for example, submission 3, VACC, p. 1.

4 *Transcript of Evidence*, Raleigh, p. E3

5 *Transcript of Evidence*, Hughes, p. E21

6 *Transcript of Evidence*, Raleigh, p. E2

> and times that you have rung previously, they insist that there are no notes on their system and they never received an invoice.[7]

2.11 While the evidence relating to this point was largely anecdotal, the Committee is prepared to accept those anecdotes, as evidence that at least some small businesses have been frustrated in their efforts to obtain payments from larger businesses.

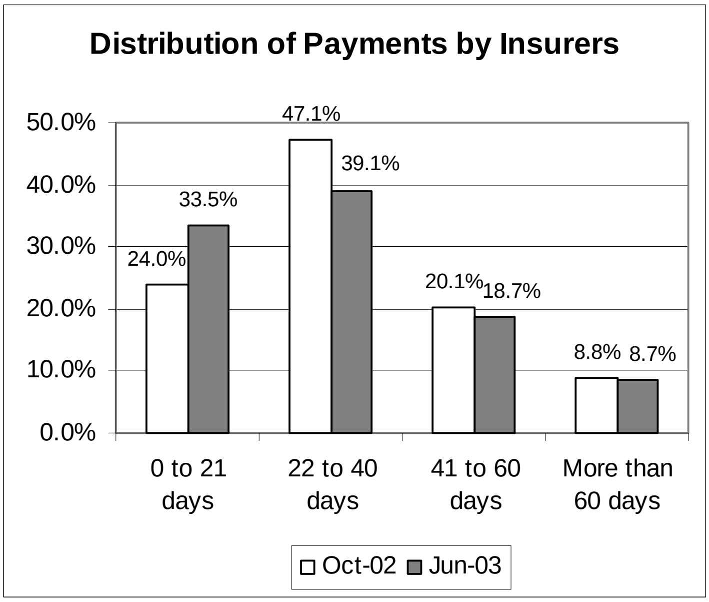
Extent of late payments

2.12 The Committee received a number of indications of the quantum of late payments. The submission from Kerry Panels, for instance, was supported by 843 letters from small business, and the Committee was informed during its hearing that a further 1500 similar letters had been sent to Minister Hockey. While these numbers do not, of themselves, provide conclusive evidence of a widespread problem, the Committee considers that they do provide an indication that late payments are not an isolated or sporadic issue.

2.13 The Body Repair Division of the Victorian Automotive Chamber of Commerce (VACC) has made an effort to collate more reliable data in relation to late payments. It publishes, on a periodic basis, responses to surveys regarding the prompt payment of bills. A number of these reports were provided to the Committee as attachments to the VACC's submission, including the latest report dated June 2003.

2.14 The following graph based on data from the June 2003 survey report shows the distribution of payment periods by insurers to body repairers, and compares the payment periods to those reported in the previous period.[8]

Table 2.1



7 *Transcript of Evidence*, Russell, p. E9

8 Submission 3, VACC, Attachment: *Payments by Insurers – June 2003*, p.10

2.15 This graph indicates that as of the June 2003 survey, 27.4% of respondents indicated that they were paid later than 40 days after the issue of their invoice. However, a number of caveats must be applied to this data. First, while the report considers 30 days to be an appropriate period of time for payments, this 30 day threshold is not reflected in the data above. It is not possible to say what proportion of the payments in the '22 to 40 days' category would have been later than 30 days. Consequently it is not possible to arrive at a firm figure for late payments.

2.16 Second, the Committee has examined the survey form provided to respondents.[9] Question 2 of that questionnaire is the source of the data presented in the above chart. It asks respondents the following question, with respect to each listed insurer: 'For each time range indicated below, what percentages of all payments by this insurer were made within each range?' Respondents are then invited to register a percentage for each period of time, against each insurer they deal with.

2.17 The survey does not obtain information about the actual numbers of claims dealt with in those periods of time, and it is impossible to determine the extent to which the percentages supplied by respondents reflect calculated figures or estimations.

2.18 As a result, the Committee was reluctant to use the VACC surveys as a source of detailed evidence; however despite these caveats, the surveys indicate widespread perceptions of a late payments problem within this industry.

Late payments in other industries

2.19 The evidence received by the Committee related almost exclusively to the automotive repair industry. While it is possible that other small businesses experience problems in relation to late payments, no detailed evidence to this effect was brought before the Committee.

2.20 One witness stated that 'the practice of slow payment is endemic … in the construction industry.'[10] CPA Australia stated that, in response to a survey question, Certified Practising Accountants had indicated 'that an average of 51 per cent of their clients had difficulty getting paid on time by big business.'[11]

2.21 While these statements provide indications of a more widespread problem, they do not provide a basis for the Committee to estimate the real extent of late payment of commercial debts.

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9 Submission 3, VACC, Attachment: *Questionnaire, Payments by Insurers – June 2003.*

10 *Transcript of Evidence*, Hughes, p. E22

11 *Transcript of Evidence*, Hartcher, p. E16

Argument that no problem exists

2.22 The Committee noted that, even within the automotive repair industry, there are arguments that a late payments problem does not exist. While the insurance industry did not provide a submission or evidence to this inquiry, a recent report by the Australian Competition and Consumer Commission took note of some insurance industry views:

> Insurers state that the majority of repairers with whom they do business are on terms of 30 days or less and many repairers incorporated into preferred repairer schemes now receive payments by electronic funds transfer. One insurer stated that approximately 3 per cent of payments to repairers are received later than 30 days.[12]

2.23 This observation contrasts with the views put to the Committee by repairers. The Committee considered that the difference between these views might be explained if a substantial proportion of the late accounts were in fact disputed. However both the ACCC[13] and witnesses before the Committee[14] stated that disputed accounts were uncommon.

2.24 On balance, the Committee considers that there is a late payments problem within the automotive repair industry, particularly in its relationship with insurers. The Committee considers it possible that late payments are a problem in other industries, but insufficient evidence has been presented to allow any examination of those industries.

Avenues to achieve prompt payment

2.25 The Committee's current reference is to examine the Late Payment of Commercial Debts (Interest) Bill 2003. However, it will be useful in the context of this report to consider a number of avenues by which the problem of late payments might be addressed. A number of alternative approaches are outlined below.

Government leading by example

2.26 Legislation is not the only means by which governments can provide leadership. In many cases, governments can provide leadership to private enterprises by exhibiting conduct, or undertaking practices, which are considered desirable.

2.27 The Committee noted the Commonwealth Procurement Guidelines, which state:

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12 ACCC, September 2003, *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector*, p. 13

13 ACCC, September 2003, *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector*, p. 13

14 See *Transcript of Evidence*, Raleigh, p. E3 and Russell, p. E10

> Commonwealth payment policy is to use maximum payment terms ‘not exceeding 30 days' from the date of receipt of specified goods and services and a correctly rendered invoice. The payment policy … is only applicable to departmental payments to small businesses where invoices have a value of up to $5 million.[15]

2.28 In evidence, the Office of Small Business (OSB) advised that in 88 percent of cases, the Commonwealth is paying its bills within the 30 days prescribed by the Commonwealth Procurement Guidelines.[16] OSB also advised that the following Commonwealth agencies include penalty clauses in contracts with their suppliers:

- Agriculture, Fisheries and Forestry Australia;
- Attorney-General’s Department;
- Australian Federal Police;
- Department of Employment and Workplace Relations;
- Department of Finance and Administration;
- Department of Industry, Tourism and Resources; and
- National Archives of Australia.

2.29 The Committee considers that Government could continue to show leadership in this area by expanding the number of agencies which include penalties for late payments in contracts with suppliers, and by continuing to increase the proportion of invoices paid within 30 days.

Improved debt management practices

2.30 Evidence before the Committee suggested that the issue of late payments is exacerbated by small businesses with a poor understanding of debt and creditor management. CPA Australia outlined this problem:

> Cash management is a fundamental part of running a business, and many small businesses are not particularly good at it. Failure to collect debts means that the business has lost not only the value of the sale but also the costs associated with making the sale, such as advertising costs and salespersons’ time and wages […] Good credit management ensures that trade debts are converted into cash flow efficiently, quickly and cheaply, without damaging long-term relationships. Small businesses often lack credit management strategies.[17]

15 Commonwealth Procurement Guidelines, obtained at the Department of Finance website: http://www.finance.gov.au/ctc/publications/purchasing/cpg/commonwealth_procurement_guide.html#IndustrialDevelopment

16 *Transcript of Evidence*, Weston, p. E28

17 *Transcript of Evidence*, Hartcher, p. E16

2.31 CPA Australia's survey of its members found that '62 per cent of small businesses never run credit checks on new customers, and 46 per cent never phone overdue creditors within a week.'[18] They proposed the following solution:

> Our research shows there is a lack of management expertise amongst small business owners and financial management is one of the areas that needs most support and attention. CPA has often advocated the need for a well-targeted business program to assist skills development in this area.[19]

2.32 The Committee agrees that such a program could be a very useful means of reducing the incidence and impact of late payments. Participation in such a program, presented by business operators and for business operators, would be a valuable investment for most small businesses.

GST arrangements

2.33 One of the largest concerns expressed about the cash-flow implications of late payments was that small businesses found it difficult to meet GST obligations which accrue alongside the debt. It appears, on the basis of evidence presented to the Committee, that no small business need be in this situation. The Office of Small Business stated:

> You mentioned that you remit the GST on invoice. That only applies if you are operating on the accruals basis of accounting for GST. If you operate on the cash basis of accounting for GST, you do not have to pay your GST until you actually get the money from the people who owe it to you. Similarly with your suppliers, you get your input tax credits when you make your payment to your supplier. I understand that 86 per cent or so of those registered for GST are reporting on a cash basis and, in the industry, a similar percentage would indicate that they are eligible for cash reporting—those with less than $1 million turnover. It would seem to me that if the avenue for remitting the GST, because they are on an accruals basis of accounting, is causing them an issue, then there may be a case for converting to the cash basis of accounting for GST to avoid that problem.[20]

2.34 Material issued from the Australian Tax Office provides additional guidance. The *Guide to the Goods and Services Tax for Small Business* states:

> When deciding whether to account on a cash or a non-cash basis, you should think carefully about your purchasing and sales patterns, as well as the way you manage your debtors and creditors.
>
> Accounting on a cash basis means you can send the Tax Office the GST for your sales as and when you get paid for them. Similarly you can claim input tax credits for your purchases as and when you pay for them.

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18 *Transcript of Evidence*, Hartcher, p. E16

19 *Transcript of Evidence*, Hartcher, p. E16

20 *Transcript of Evidence*, Weston, p. E28

> You can account on a cash basis if:
>
> - your current or projected annual turnover is $1 million or less,
> - you are currently accounting for income tax on a cash basis,
> - we determine that you can account for GST on a cash basis, or
> - you are a charitable institution, trustee of a charitable fund, gift-deductible entity or government school.[21]

2.35 The Committee therefore urges small businesses, who are experiencing difficulty meeting their GST obligations due to late payment of invoices, to seek advice as to whether cash-based accounting might relieve their circumstances.

Voluntary codes of conduct

2.36 One final way to increase timely payment of invoices might be for parties to negotiate a voluntary code of conduct. These could be sectorally-based: for instance, it may be useful to implement a code relating to the payment of debts by insurance companies to automotive repairers. Such a code, however, relies upon a certain degree of co-operation between the parties. The Committee noted that there is considerable scepticism as to whether such a code could be successfully negotiated in the automotive repair industry.

2.37 The ACCC issues paper indicates that the automotive repair industry has sought the implementation of a voluntary code of conduct.[22] The ACCC has, in the past, hosted a roundtable meeting in order to consider such a code.[23] The view of the insurance industry in response to both the ACCC and the automotive repair industry has been that a voluntary code is unnecessary. While this remains the view of the insurance industry, a voluntary code of conduct seems unlikely to be developed.

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21 Available online at http://www.ato.gov.au/businesses/content.asp?doc=/content/20724.htm

22 ACCC, September 2003, *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector*, p. 22

23 Martin, J, ACCC Commissioner, *Trade Practices Act and the Insurance Industry*, speech to the Insurance Council of Australia, 22 August 2002.

CHAPTER 3

A Legislative Approach?

3.1 The Late Payment of Commercial Debts (Interest) Bill 2003 seeks to provide a legislative solution to the issue of late payments. This chapter will outline some of the difficulties associated with such an approach.

Enforcement of the Bill

3.2 One problem identified during this inquiry and discussed in Chapter 2 was that under current circumstances, even where small businesses have the contractual right to impose penalties for late payment, they may be reluctant to do so for fear of sacrificing future business from that customer. In industries such as the smash repair industry, where a large amount of business comes from a few major companies, the loss of business from one major customer could be enough to force the small business to shut down.

3.3 As a result, for this bill to succeed, it must be clear that the obligations which it imposes can be enforced without detriment to the future business relationship between the businesses.

3.4 The bill does not contain explicit enforcement provisions. However subsection 7(2) of the bill states:

> …
>
> (2) Interest carried under an implied term is treated in the same way as interest carried under an express term.

3.5 In other words, interest which accrues as a result of the bill shall be treated in the same way as interest which accrues as a result of any other provision of the relevant qualifying contract.

3.6 As noted in Chapter 2, however, it is often difficult for small businesses to insist on payment of terms – recall Hughes' evidence that it is 'a bit like insisting on your right of way at an intersection against a big, heavy truck.'[1] If the bill cannot overcome this difficulty, it is likely to be of little practical assistance to small business. This formed the basis of Minister Hockey's criticism of the bill, in a letter tabled before the Committee by Senator Conroy. The Minister stated:

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1 *Transcript of Evidence*, Hughes, p. E21

> While legislation would more clearly establish the right of small businesses to charge interest on late payments, small businesses still may not, in many instances, feel that it is in their best interests to enforce these rights.[2]

3.7 The Committee put this concern to the Victorian Automobile Chamber of Commerce, who responded as follows:

> Our view about the bill which is in question is that it will provide small business with an opportunity to obtain statutory support for their position. The panel beater will be able to quote an act of parliament that would apply a penalty clause and they can quote that clause on their invoices. In our view that would have an impact on slow payment by big business to small business. The reason it will have an impact is because it will be there and it will be quotable. It is not something they have to dream up for themselves. It is not a contractual term that they would have to create. They could include it on their paperwork when they put their invoices in and have the ability to enforce it if they wished.[3]

3.8 While the bill, if enacted, may indeed provide both moral support and a pattern penalty clause, there is nothing in the VACC's evidence to suggest that the bill does anything to make those rights more easily enforced. The Committee concludes that the bill would do little, in practical terms, to aid small business because small business would be extremely reluctant to enforce its terms.

The UK experience

3.9 The provisions of this bill are heavily modeled on the *Late Payment of Commercial Debts (Interest) Act 1998* (UK). This Act came into force at the end of 1998, and its scope has been widened in two stages since. The UK legislation is wider than the current proposal, as it also allows small businesses to charge each another statutory interest and penalties.

3.10 The Committee noted that assessment of the UK scheme appears to justify concerns that this form of legislation is unlikely to be taken up by small business. The International Centre for Credit Management Research surveys businesses in relation to their payment practices. It has stated:

> The latest CMRC survey showed that only 15 per cent of small firms made their customers aware of their right to charge interest if paid late. […] smaller firms showed some reluctance to enforce their rights, for fear of harming business relationships and repeat business opportunities. This may change, as enforcement of interest becomes a business norm.[4]

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2 The Hon. Joe Hockey, MP, letter to Senator Stephen Conroy, 28 July 2003, tabled 13 October 2003.

3 *Transcript of Evidence*, Russell, p. E9

4 http://www.cmrc.co.uk/leaguetables/introduction.htm

3.11 The *User's Guide to late payment legislation* produced by the Better Payment Practice Group (a partnership of business and the UK Department of Trade and Industry) also identifies this problem, and provides the following advice to small business:

> **Don't I risk antagonising my customers if I use the legislation?**
>
> Using the legislation is your statutory right and is not designed to jeopardise existing customer relationships. Rather than seeking to encourage claims for interest and/or debt recovery compensation, the legislation's primary aim is to deter companies from paying their bills late.

3.12 The Committee's view, however, is that the current bill is unlikely to provide a deterrent because, as argued above, its terms may seldom if ever be invoked by affected small businesses.

3.13 The Better Payment Practice Group website[5] does, however, address a number of the solutions discussed in Chapter 2 of this report. It includes advice for small businesses on creditor and debt management, debt collection, and action which can be taken to enforce payment of debts. The site includes pattern letters and clauses which can be used in commercial dealings, and advice on practical matters such as dealing with late payment excuses.

3.14 It also includes a voluntary code, the Better Payment Practice Code. Signatories to the Code can display its logo, and are expected to abide by the four following rules:

- Agree payment terms at the outset of a deal and stick to them;
- Explain your payment procedures to suppliers;
- Pay bills in accordance with any contract agreed with the supplier or as required by law; and
- Tell suppliers without delay when an invoice is contested, and settle disputes quickly.

3.15 Finally, the UK Government, like the Australian Government, has a policy of paying suppliers within 30 days.[6]

3.16 Overall, the Committee's view is that there may be much for Australian small business to learn from the UK. However, the biggest benefits are likely to come from the *non-legislative* solutions provided by the Better Payment Practice Group. The legislation itself has been of uncertain value.

5 http://www.payontime.co.uk

6 UK *Government Accounting Manual*, Ch. 22 ('Procurement') section 6.5 ('Prompt Payment') p.15

Conclusion and Recommendation

3.17 The Committee concludes that late payments to small businesses are a genuine problem which may result in the failure of otherwise competitive businesses. The Committee also supports the fundamental view that once businesses, large or small, incur a commercial debt, they should pay that debt within the agreed time period.

3.18 However the Committee does not consider that the current bill is an effective means to address the issue of late payments. Instead, the Committee has examined some other approaches which could assist small business to obtain prompt payment for their goods and services.

Recommendation

The Committee recommends that the bill not proceed.

SENATOR GEORGE BRANDIS
Chairman

MINORITY REPORT BY THE LABOR MEMBERS

Late Payment of Commercial Debts (Interest) Bill 2003

Introduction

In March this year the Shadow Minister for Small Business, Senator Conroy, introduced the *Late Payment of Commercial Debts (Interest) Bill 2003* ("the bill").

By June the bill had not been brought on for debate in Parliament. Accordingly, Senator Conroy wrote to the Minister for Small Business, Mr Hockey, calling on him to support debating the bill in the August parliamentary session.

In July, Mr Hockey wrote to Senator Conroy saying that Labor's bill did not propose a solution to the problem of late payments and that he would not support bringing the bill forward for debate.

The evidence presented at the inquiry clearly shows that small businesses and industry groups alike believe that Labor's bill offers a solution to the problem of late payments as the bill would empower small businesses to stand up to big business and demand payment.

The Labor members welcome the Committee's acknowledgement that late payments are a genuine problem for small business and may result in the failure of an otherwise competitive business.[1]

However, the Labor members reject the Committee's recommendation that the bill will not be effective in addressing the issue of late payments and suggest that this conclusion is not supported by the evidence presented during the Inquiry.

In light of the fact that late payments is a critical issue for small business, the Labor members recommend that the Minister for Small Business takes the necessary steps to bring Labor's bill on for debate in Parliament at the earliest opportunity.

The Problem

Prior to this Inquiry, the Howard Government had failed to acknowledge that the issue of late payments is a critical issue for small business.

In November last year, Senator Eric Abetz (representing the Minister for Small Business in the Senate) called the issue "esoteric". [2]

[1] Committee Report, Paragraph 3.17, p. 14.

[2] Question Time, Senate, 14 November 2002.

The Department of Industry, Tourism and Resources (Mr Hockey's own department) also failed to see late payments as a problem for small business.

During the Inquiry the Secretary of the Department, Mr Mark Paterson, commented that:[3]

> *"I have already indicated that at this stage we do not believe that adequate evidence has been provided that there is a widespread problem in relation to this."*

Mr Paterson's view was not supported by the empirical evidence presented by both the VACC and CPA Australia.

CPA Australia's *Small Business Survey* in August 2002 found that:[4]

- 40% of small businesses have to wait more than 30 days for payment from large business creditors;
- 33% of business were paid within 30 days;
- 30% of business were paid between 30 and 60 days; and
- 9% of business were paid between 60 and 90 days.

This survey was not industry specific.

CPA Australia also asked CPA's about their own small business clients. The CPA's reported that:[5]

- 51% of the clients had difficulty getting paid on time by big business; and
- 45% said that there was a great deal of adverse impact on their clients by the slow payment by large business.

In relation to insurers, the latest *VACC Annual Survey Report No. 5* dated June 2003 found that:

- 33.5% of payments were made to repairers within 21 days of the invoice being issued;
- 27.4% of payments were made to repairers 41 or more days after the issue of an invoice; and
- almost 10% of payments were made to repairers more than 60 days after the issue of an invoice.

The Labor members view the VACC's Annual Surveys and CPA Australia's studies as evidence that late payments is a widespread problem for small business.

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[3] Hansard, *Economics Legislation Committee: Late Payment of Commercial Debts (Interest) Bill 2003*, 13 October 2003, p. E28.

[4] P. E16

[5] p. E16

In addition to these studies, Mr Raleigh submitted to the Committee 843 letters relating to the issue and a further 1,500 letters have been faxed directly to Mr Hockey's office.

As Senator Conroy observed during the Inquiry, *"That is over 2,000 people in one industry alone saying "help"."*[6]

ACCC Report

In a recent report from the ACCC,[7] one insurer said that only 3% of payments to repairers received payment later than 30 days. Witnesses at the Inquiry were asked for their view on this figure.

Mr Raleigh said he disputed the figure *"most definitely, vehemently."*[8]

Mr Russell said that the figure *"is inconsistent with the surveys that we have been doing for the last three years."*[9]

Factoring

As a result of late payments many small businesses turn to factoring agents to attempt to alleviate the cash flow squeeze.

The VACC's *Survey Report No. 5* notes the proliferation of factoring in the industry.

The Report says:[10]

> *"The rate of factoring in the body repair industry is much too high, and factoring costs eat into the already very small profit margins for repairers, most of whom are small businesses. The proliferation of factoring is indicative of the struggle that repairers face in getting paid on time, and the resultant cash flow crises that can emerge."*

Mr Russell advised the Committee that as many as 40% of members with one particular insurer get factored. He also advised the Committee that the cost was around 3% of the value of the bill which in his words *"you cannot afford to give away these days. It is in the realm of the profit margin."*[11]

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[6] p. E26

[7] ACCC, Issues Paper, *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector*, September 2003.

[8] P. E5

[9] p. E12

[10] VACC, *Payments by Insurers – Survey Report No. 5*, June 2003, p. 18.

[11] p. E13

Mr Raleigh said:[12]

> *"Body shops who find it difficult to pay bills and GST payments because of a dried up cash flow use a factoring company who take on the insurance company bill on their behalf. They pay immediately for a fee of some three percent for the service. If the factoring company is not paid in turn within 30 days maximum, the fee then increases until the bill is paid. So it is an ongoing fee – as the GST late payment is. I believe that the only groups likely to find a negative in the (bill) will be the factoring companies, banks and other lending institutions."*

The Cause of the Problem

The reason why many small businesses are not being paid on time comes back to the issue of the inequality of bargaining power between the parties.

There is an imbalance in the relationship between big business and small business. Because of their nature, small businesses have less bargaining power with big business.

It is not a level playing field.

Accordingly, certain big businesses are exploiting their position and failing to pay small business on time.

In relation to the insurance industry, small businesses are particularly vulnerable.

Mr Russell commented that:[13]

> *"You cannot go to the insurance company and say, 'Give us my money; I'm in a hurry.' It does not work that way. Small businesses are very vulnerable in these circumstances to the market power of the insurers. In Victoria the market share of IAG, which runs RACV, CGU and other brand names is 49% of the market. The market share of AAMI is 23% of the market. These two together are 72%. The next below that falls to away to 9%. Some insurers hold very powerful positions."*

Mr Russell also said:[14]

> *"The VACC obviously fully supports the Late Payment of Commercial Debts (interest) Bill 2003. There is a problem and we can show you the problem. It is out there. Small business is being affected by the failure of insurers to pay.*

[12] p. E2

[13] p. E10

[14] p. E10

They cannot match it with RACV or AAMI. They have not power to battle with them and, for that reason, we think that something must be done."

Mr Raleigh said:[15]

"If you are a small player working with the insurance companies, you virtually play by their rules."

Mr Russell from the VACC said:[16]

"I am not aware of any [small businesses] in the panel repair industry, which we are talking about that the moment, simply because, as we said before, the relationship does not allow it. That is why we are attracted to a legislative provision."

Mr Gardner said:[17]

"The insurer would not accept that term [to pay interest] if you put it up. They would simply tow your car out and take it somewhere else."

The evidence presented to the Committee highlighted the vulnerability of small businesses in the body repairer industry as a result of the inequality of bargaining power.

Legislative Protection

Small businesses need legislative protection to enforce their right to be paid on time.

Evidence presented during the inquiry overwhelming endorsed Labor's proposal to give small business legislative protection to ensure prompt payment.

Mr Russell said:[18]

"Our view about the bill..is that it will provide small business with an opportunity to obtain statutory support for their position. The panel beater will be able to quote an act of parliament that would apply a penalty clause and they can quote that clause on their invoices. In our view that would have an impact on slow payment by big business to small business. The reason it will have an impact is because it will be there and it will be quotable. It is not something they have to dream up for themselves. It is not a contractual term that they would have to create. They could include it on their paperwork when they put their invoices in and have the ability to enforce it if they wished."

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[15] p. E2
[16] p. E14
[17] E14
[18] P. E9

Mr Raleigh said:[19]

> *"I think if it is legislated, it will make it a lot easier for our industry especially, because it is across the board and that is it – you pay."*

Ms Hartcher from CPA Australia said:[20]

> *"There is considerable support amongst our membership for the late payment bill to support small business, as many CPAs see the impact of the problems on small businesses that cannot get paid."*

Mr Hockey has said that small businesses may not enforce the rights conferred by Labor's bill because they feel is may not be in their best interest.

In a letter to Senator Conroy dated 28 July 2003, Mr Hockey said that:

> *"While legislation would more clearly establish the right of small businesses to charge interest on late payments, small businesses still may not, in many instances, feel that it is in their best interests to enforce these rights."*

Witnesses were asked if they agreed with Mr Hockey's view – they did not.

For example, Mr Russell from the VACC said:[21]

> *"No, I do not. Clearly we think that there should be a provision available for small business to use, and that such a provision would given them some power that they currently do not have."*

Self-Regulatory Approach

One of the key issues that the Committee considered was whether alternatives to legislation would solve the late payments issue.

The body of evidence presented to the Committee supported the proposition that small business require legislative support in order to get paid on time.

Accordingly, the Labor members reject the Committee's view that non-legislative alternative approaches will by themselves have any impact on the problem.

Mr Russell said:[22]

[19] p. E6

[20] p. E16

[21] p. E14

[22] p. E9

"VACC and our members have campaigned and petitioned government on this issue. Mr Raleigh referred to petitions that he collected. VACC also collected petitions and those were sent to Minister Hockey last year. VACC has also written to the CEOs of insurance companies requesting improvement in their payment practice. Each time we do a survey we send a copy of the survey results, in full to the insurance companies concerned. To date we have not had very many replies to those letters, and my view is that they do not admit that they have a problem."

Mr Raleigh was asked whether he thought there was another way other than legislation to improve the situation for small business.

His response was:[23]

"I do not believe so. When we first started out with the idea of late payments we noticed a marked improvement in payment terms but they have all started to fall by the wayside again…they have all dropped back again. I believe that will be the case unless it is legislated."

The Office of Small Business takes the approach that further discussions are required.

Ms Weston said that:[24]

"We are interested in continuing our work with the ACCC and the industry to see what can be done. As I recall, the discussion paper that the ACCC issued recommended further discussions with industry. I think there is probably some merit in pursuing that. As I said, we have had dialogue with the VACC, which we will continue."

The Labor members believe that the time has come for action not more discussion in relation to this issue.

The MTAA's submission notes that even the Minister is reluctant to do more than talk about the issue. The MTAA's submission says that they met with Mr Hockey (with the VACC) and that he:[25]

"…indicated that he did not favour any regulation of the matter but undertook to write to the Insurance Council of Australia (ICA) seeking its views and asking that it draw to its members' attention the concerns being registered by small business."

The Committee's Report proposes the following alternative solutions:

[23] p. E4

[24] p. E26

[25] Submission from the Motor Trades Association of Australia, 30 June 2003.

- Government leading by example;
- Improved debt management practices;
- GST arrangements; and
- Voluntary codes of conduct.

Each of these proposals is discussed below.

Government leading by example and debt management practices

The Labor members support the Committee's view that the Government should lead by example and that it's important for small businesses to have appropriate debt management practices.

However, we believe that these solutions should form part of a holistic approach to the problem of late payments. By themselves, these measures are unlikely to have a significant impact where there is inequality of bargaining power between the parties.

GST Arrangements

The introduction of the GST has had a serious impact on the cash flow of many small businesses. Many small businesses including those in the body repair industry use accrual accounting arrangements. This means that the small businesses are required to pay its GST whether or not is has received payment.

If small businesses fail to remit their GST on time, they face penalties. Mr Raleigh's submission notes that when small business is late paying GST they incur a penalty of 11.28%.

Ms Weston from the Office of Small Business suggested that to overcome the problem, small business should convert to a cash basis of accounting.[26]

This is not a viable option according to Mr Gardner from the MTAA who said that:[27]

> *"Body repair, because it is a high cost, low margin business, is one sector that does not get the benefit of the choice of cash account. The GST has crystallised the problem of late payments…."*

In light of Mr Gardner's evidence, the Committee's recommendation that small business should consider converting to a cash basis of accounting, will not assist small businesses in industries like the body repair industry.

Voluntary Codes of Conduct

The COSBOA submission noted that:

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[26] P. E 28-29

[27] p. E8

"….voluntary codes and self-regulation does not work …..a prescribed law that automatically allows a company to charge interest at a prescribed rate that would be legally binding in a court of law may be a solution…."

In relation to whether there would be any change in current practices if the bill is not passed, Mr Gardner from the MTAA said:[28]

"I think that is very dubious. The VACC has a fairly strong naming and shaming process going on now, which is only showing, at the most marginal improvement. I do support that some mandatory arrangement is going to have some effect."

The evidence before the Committee is unambiguous - in spite of the best efforts of those in the body repairer industry, late payments has not been alleviated by raising awareness of the issue or by the Government leading by example.

Legislative action is clearly required.

Small Business Champion

The Committee Report refers to a survey by the CMRC in the UK which noted concerns about the enforcement of a similar Act in the UK.

Although witnesses at the Inquiry said that they would enforce their rights under Labor's bill, the inequality of the relationship between the parties may impact on some small businesses willingness to stand up to big business who do not pay on time.

To overcome any reluctance that small business may have to enforce their rights in Australia, the Labor members suggest that small business needs an "advocate" who can pursue this issue on their behalf.

Ms Judy Hartcher from CPA Australia noted that small business were often unsure of the rights and needed an "advocate" to assist them.

Ms Hartcher said:[29]

"Most importantly, small businesses find it difficult to act alone. In our March 2002 survey, 64% of small businesses agreed with the statement: 'I wish there were someone who could make the government aware of my individual business problems.'

Small businesses are isolated, often unsure of their rights and positions, especially dealing with big business. Ideally, they need an advocate to help

[28] p. E15

[29] P. E17

> *them with their dealings with both big business and government. The legislation would have a better chance of having effective impact if it could be supported by some other initiatives."*

The Labor members recommend that to assist small businesses in enforcing the rights conferred by the bill they need a "small business champion" who is willing to act on their behalf and to whom they can report serial late payers.

However, the scope of the small business champion would broader than simply monitoring the issue of late payments.

Although the Labor members are still considering the exact scope of the small business champion, we believe it should:

- Act as a champion for small business;
- Be independent of Government;
- Provide independent advice to Government on small business concerns;
- Be a centre of advice for small business;
- Monitor the implementation of the statutory interest charge for late payments; and
- Investigate systemic issues of late payment.

The Labor members are of the view that providing small businesses with "small business champion" will encourage small businesses to enforce the statutory rights conferred by the bill and act as an advocate on behalf of small business.

Conclusion

The inquiry into this bill has provided a body of evidence showing the problem faced by small business in relation to late payments by big business.

It's also clear that without legislative protection, small business will continue to face a cash flow squeeze as big businesses exploit their size and continue to ignore payment deadlines.

The Labor members urge the Government to reconsider their opposition to the bill.

With each month that passes without the protection offered by this bill, the greater the cash-flow squeeze being faced by small business.

Senator Ursula Stephens
Deputy Chair

SUPPLEMENTARY REMARKS

Late Payment of Commercial Debts (Interest) Bill 2003

The Australian Democrats agree with the majority Committee conclusion that late payments to small business are a genuine problem which may result in the failure of otherwise competitive business.

There is a clearly a lack of strength within many small businesses that negatively impacts on their dealings with larger corporations. It seems to us that once this is accepted, any measure to empower small business to enforce their debts should be given serious consideration.

If small business currently does not enforce their legal rights for fear of adversely affecting their relationship with larger customers, the statutory imposition of interest is also likely to be ignored.

Whilst the practical influence of this Bill is questionable, we accept that the concept of a ‘small business champion’ could assist small business in enforcing their legislative rights under this Bill.

Accordingly, we strongly urge the Government to allow this Bill to be debated in the Parliament. We will determine our position then based on a further consideration of whether the Bill can, on a practical level, assist significant numbers of small businesses in a meaningful way.

Senator Andrew Murray
Australian Democrats

Appendix 1

Submissions Received

Submission Number	Submittor
1	Kerry Panels Pty Ltd and 843 supporting letters
2	Motor Trades Association of Australia
3	Victorian Automobile Chamber of Commerce (VACC)
4	Council of Small Business Organisations of Australia Ltd (COSBOA)

Appendix 2

Public Hearing and Witnesses

Monday, 13 October 2003 Canberra

BRUGGER, Mr Antony William, General Manager, Office of Small Business, Department of Industry, Tourism and Resources

GARDNER, Mr Geoffrey David, Deputy Executive Director, Motor Trades Association of Australia

HARTCHER, Ms Judith Lorraine, Business Policy Adviser, CPA Australia

HUGHES, Mr Geoffrey Eyre Forrest, Director, Council of Small Business Organisations of Australia Ltd

PATERSON, Mr Mark Ian, Secretary, Department of Industry, Tourism and Resources

RALEIGH, Mr Gerry Michael, Proprietor, Kerry Panels Pty Ltd

RUSSELL, Mr David Victor, Senior Manager, Government and Public Affairs, Victorian Automobile Chamber of Commerce

WESTON, Ms Susan Margaret, General Manager, Office of Small Business, Department of Industry, Tourism and Resources