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General Manager
Strategic Policy & Regulation Reform Branch
Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education
GPO Box 9839
Canberra ACT 2601

NSW Business Chamber
incorporates
- Sydney Business Chamber
- Australian Business Limited Apprenticeships
- Australian Business Lawyers and Advisors
- Australian Business Consulting and Solution

Dear Mr Joyce,

AUSTRALIAN PROMPT PAYMENT PROTOCOL – DISCUSSION PAPER

Thank you for the opportunity to comment on the development of the Australian Prompt Payment Protocol (the Protocol).

The NSW Business Chamber (the Chamber) is one of Australia's largest business support groups, with a direct membership of more than 14,000 businesses, providing services to over 30,000 businesses each year. Tracing its heritage back to the Sydney Chamber of Commerce established in 1825, the Chamber works with thousands of businesses ranging in size from owner operators to large corporations, and spanning all industry sectors from product-based manufacturers to service provider enterprises.

The Chamber is a leading business solutions provider and advocacy group with strengths in workplace management, occupational health and safety, industrial relations, human resources, international trade and business performance consulting.

Operating throughout a network of offices in metropolitan and regional NSW, the Chamber represents the needs of business at a local, regional, State and Federal level, advocating on behalf of its members to create a better environment for industry.

NSW Business Chamber Limited
140 Arthur Street
North Sydney NSW 2060

ABN 63 000 014 504

Locked Bag 938
North Sydney NSW 2059

DX 10541 North Sydney

t 13 26 96
f 1300 655 277
e navigation@nswbusinesschamber.com.au

Regional Offices ACT, Mid North Coast, Western Sydney, Northern Rivers, Hunter, Murray/Riverina, Illawarra, Southern Sydney, Northern Sydney, Central Coast

I**mpact of the proposed Protocol**

The Chamber supports the discussion paper's recognition of the challenges facing small business, but it is important to set appropriate expectations about the possible benefits of the proposed Protocol. A useful way to do this is to examine the UK Prompt Payment Code (PPC) on which the proposed Protocol is based.

Take-up: The discussion paper states that more than 60 per cent of the supply chain has signed up to the PPC. While this figure seems significant, it is not clear how it has been measured and should not be taken to mean that the PPC has (or the proposed Protocol will) quickly receive support from large businesses.

The 60 per cent take-up claim comes from independent analysis by UK based business and credit information provider, Experian. The claim seems to have appeared on the PPC website in August 2010,[1] but 94 of the 126 signatories from the FTSE 350 (i.e. the largest UK companies) only signed on after the UK business minister threatened to publicly name and shame non-signatories in November 2012.[2] An August 2013 article suggests the UK Secretary of State for Business is still unhappy with the sign-up rate and threatened to make businesses who fail to sign up pay a levy.[3]

The Government should be wary of adopting similar coercive tactics in relation to the proposed Protocol in Australia. Given compliance monitoring is difficult, it is not clear that a voluntary code will provide the same benefits if many of the sign-ups are effectively forced. Additionally, efforts to force sign-ups could distract attention from other efforts to assist small business.

Effectiveness: The discussion paper states that the PPC has been effective in reducing payment times, with “signatories now paying on average 12 days quicker than in December 2008”. However, this statement comes from an ambiguously worded paragraph in a December 2012 analysis of the PPC by Experian so it is worth clarifying what it means. The full paragraph reads:

> The data indicates that PPC has had a positive effect on payment times. Experian reviewed the difference between the average payment times of signatories and non-signatories to the Code over each of the last four years. It found that on average those who had signed up to the Code paid five days earlier than those who had not. Furthermore, there has been a sizable improvement over the period amongst PPC signatories who now pay 12 days quicker than in December 2008.[4]

Although the wording is ambiguous, looking at the underlying data (set out below in Figure 1) it’s clear that what this means is that in 2012 PPC signatories paid their bills 12 days less late than non-signatories. In December 2008, PPC signatories paid their bills five days less late than non-signatories. This change is due to the fact that PPC signatories reduced their payment time by about 5.5 days whereas non-signatories increased their payment time by 1.5 days.

This change in payment times is good prima facie evidence that the PPC works. Although clearly those who signed the PPC were also better payers in the first place, and may have been more likely to improve their payment performance even if they had not signed it.

[1] http://web.archive.org/web/20100829063939/http://www.promptpaymentcode.org.uk/
[2] https://www.gov.uk/government/news/big-companies-pledge-to-pay-promptly-following-government-drive
[3] www.ft.com/cms/s/0/155e83f6-01c7-11e3-8918-00144feab7de.html
[4] http://press.experian.com/United-Kingdom/Press-Release/prompt-payment-code.aspx?&p=1

Figure 1. Experian analysis of payment times under the UK Prompt Payment Code

Table 1: Days Beyond Terms (DBT) December 2008-December 2012 by size of firm

Employment Band	Dec 2008 - Nov 2009	Dec 2009 - Nov 2010	Dec 2010 - Nov 2011	Dec 2011 - Nov 2012	Difference over period
Small (1-25)	20.05	19.27	21.37	20.64	- 0.59
Medium (26-100)	20.72	19.83	22.01	21.19	- 0.47
Large (101-250)	24.36	23.20	24.15	22.31	1.43
Very Large (251-1000)	30.19	27.93	28.31	25.93	4.26
Giants (1000+)	43.89	39.59	37.55	35.30	8.59

Table 2: Yearly average DBT - PPC signatories vs non signatories

Status	Dec 2008 - Nov 2009	Dec 2009 - Nov 2010	Dec 2010 - Nov 2011	Dec 2011 - Nov 2012
PPC Signatories	18.26	15.33	14.38	12.66
Non Signatories	23.03	22.25	25.60	24.55

Source: Experian

However, another aspect of Experian's analysis raises some concerns about the effectiveness of the PPC for the largest companies (i.e. those with over 1000 employees). Experian states that:

> The only exception [to PPC signatories reducing DBT] is the largest companies who are signed up to the PPC. These actually saw slightly slower payment times compared to non-signatories, though nonetheless improving since December 2008. This could suggest that whilst they are showing willingness to improve and tackle payment times, the size of the business and the sheer volume of invoices and suppliers they deal with may be hindering their progress.

It is not clear whether this means that the PPC signatories amongst the largest companies were worse late payers to start with or improved less than non-signatories. The first scenario would be concerning because it raises questions about the integrity of the PPC brand. The second scenario would be consistent with a situation where the PPC creates pressure for medium sized companies with less market power to improve their payment terms, but had little effect on the largest companies. This points to a risk (albeit probably small) that the proposed Protocol could generate a squeeze in the middle of the supply chain without affecting the behavior of the largest companies.

The July 2013 report of the UK parliamentary inquiry into late payment to small and medium enterprises (SMEs) also expresses skepticism about the PPC's effectiveness.[5]

[5] http://www.debbieabrahams.org.uk/wp-content/uploads/2013/07/FINAL-REPORT-ALL-PARTY-INQUIRY-REPORT-INTO-LATE-PAYMENTS-IN-SMEs1.pdf

Design of the proposed Protocol

The Chamber supports the proposed principles, but has a number of suggestions regarding the design of the Protocol.

Participation: The discussion paper raises two possible criteria for entry into the scheme: two positive referee reports (the requirement under the PPC), or incorporation into the company charter. The Chamber suggests that it would be better to simply require some form of public declaration from signatories.

In considering possible criteria it is important to consider who might wish to become a signatory. The PPC has almost 1,500 signatories. There does not appear to be publicly available data on the size range of signatories, but it is clear that only a small number are large listed companies.

For very large companies, the requirement for suppliers to provide two referee reports seems like a token requirement as it is difficult to imagine that firms with hundreds (if not thousands) of suppliers would be unable to find at least two suppliers who were happy with how they were treated. Indeed, even unhappy suppliers may willingly supply referee reports in an effort to win the favour of a major customer.

Given the likelihood that referee reports would only be a token criterion and the administrative costs associated with processing these reports, it would be better to have no entry requirements at all.

Requiring some form of public declaration (perhaps posted on the Protocol's website) would probably be more effective because any inconsistency with the requirements under the Protocol would then count against the company's reputation for honesty, which is a valuable asset for any business. This declaration could involve a commitment to comply with the Protocol in the future, or it could involve confirmation that the company has been complying with the Protocol for a certain period of time. However, requiring companies to make this commitment in their company charter may be overly burdensome and reduce take-up rates.

Referee reports may be a more effective screening mechanism for smaller businesses with fewer suppliers. However, even then it seems like it would be relatively easy to find two suppliers to provide positive reports. Requiring public statements for smaller businesses would also probably be less useful because of their lower public profile. However, this may be less relevant since the main focus of the Protocol is on the payment behaviour of larger businesses and developing tiered entry requirements based on size would probably overly complicate the process.

Compliance: In general, the Chamber would oppose any option for annual reporting on the basis that it would: significantly increase business compliance costs (particularly for smaller businesses); require substantial administrative resources to process if the number of signatories to the Protocol was similar to the number of signatories to PPC; and have little impact on businesses that deliberately tried to exploit the system.

One possible exception would be if information on late payments could be extracted from existing data held by credit bureaus at little additional cost. If this were possible then companies might be able to set payment term targets and use credit bureau data to report on whether they have been met.

Clearly, ad hoc review on the basis of complaints under the PPC is of limited value because businesses are unwilling to make a complaint that might damage their relationship with a major customer – which is the main reason that they don't enforce payment terms in the first place.

Allowing anonymous complaints may encourage more businesses to come forward, but it would be impossible to assess the validity of an anonymous complaint without giving away the supplier's identity. The incentive for vexatious complaints is not high given that some amount of time and effort would be required to lodge a formal complaint and the damage caused to the company is probably small. However, most companies would be reluctant to accept the reputational risk of being ejected from the Protocol on the basis of anonymous complaints.

Moreover, it is not clear what the consequence of a complaint (anonymous or otherwise) would be. The Experian analysis referenced above shows that there is still a significant degree of late payment among Protocol signatories so it would be inappropriate to eject any firm with a complaint about a late invoice. In the case of non-anonymous complaints it might be possible to analyse the egregiousness of the circumstances in more detail. However, it is not clear that the benefits of performing this analysis would outweigh the costs.

Rather than focusing on the threshold which would determine when businesses are non-compliant with the Protocol, it may be better to develop a system to allow suppliers to provide feedback on their satisfaction with the behaviour of signatories by filling out an anonymous satisfaction survey. This would require various technical obstacles to be overcome, such as ensuring that the general public cannot access the survey and that signatories with only a few suppliers cannot identify those who gave negative ratings. It would also rely on this system being developed relatively cheaply and willingness among most signatories for this information to be publicly displayed. A similar mechanism for providing feedback would be to develop a supplier forum similar to the customer forums that many companies already use.

Other interventions

Australia should be cautious about adopting the more interventionist approaches. As the UK experience has shown, the statutory right to charge interest is of little use if most businesses are not willing to exercise this right. Efforts to intervene by setting or enforcing payment terms through more direct regulatory action could also backfire if large businesses simply pass the additional costs on to their suppliers.

It is important to recognise that, within reasonable bounds, delayed payments can provide benefits to buyers and sellers. Paul and Boden argue that delayed payment (also known as trade finance) can:

- enhance information by allowing buyers to assess products before paying and allowing sellers to signal confidence in their product and assess the financial health of customers through their payment patterns;
- reduce transaction costs by regularising invoices and payment patterns and improving cash flow forecasting;
- allow sellers to adjust prices customers to more easily and subtly adjust prices to different buyers in response to changes in demand; and
- provide a form of access to finance for small business buyers.[6]

There may very well be other steps that could be taken to address problems with prompt payment, but they cannot be identified without further research on the causes and consequences of payment delays.

A key question is the extent to which delayed payment is the result of poor communication and processes, or larger businesses exercising their market power to negotiate favourable contract terms. If the problem is poor communication or processes then it may be possible to produce results that are better for all parties. For example, if cash flow is more important for the supplier than the customer then it may make sense to negotiate better payment terms in exchange for a lower headline price.

It is also useful to distinguish between lengthy payment terms and late payments. Late payments undermine many of the benefits of delayed payments by undermining the regularity of payments and causing unanticipated cash-flow problems. Late payments also create additional enforcement costs and default risks that must be factored into the prices offered to potential buyers. Paul and Boden report 2009 Barclays analysis that found that pursuing overdue bills resulted in “more than four million wasted working hours or 544,640 wasted working days”.[7]

Even if large businesses are in the position to extract lengthier payment terms from smaller businesses there is a question about why they do not simply specify the lengthier terms in the initial agreement. The explanation could simply be shortcomings in communication or payment processes. However, there are reasons why a business may make a deliberate decision to pay late. For example, the cost of pursuing an overdue bill means that a supplier may be willing to accept longer payment terms than they would have agreed to up-front. It may also be that the

[6] Paul, Salima & Boden, Rebecca (2011) ‘Size matters: the late payment problem’, *Journal of Small Business and Enterprise Development,* Vol.18:4, pp. 732-747.
[7] Ibid.

cost of determining and negotiating the terms up-front is too high, making it easier to just work out when it is most convenient to pay at a later date.

Depending on the source of the problem, there may be steps that businesses can take to protect themselves from late payment. For example, small businesses could use credit insurers to address non-payment and pursue issues of non-payment on their behalf. If small businesses think it likely that a bill will be late they can also incorporate discounts for upfront payment into their terms, which is effectively the same as charging interest, but avoids the costs of later negotiations.

Feedback the Chamber has received from business advisers suggests that smaller businesses can do a much better job in identifying, articulating and 'enforcing' their terms of trade including payment. Some these options have been covered in past seminars that the Chamber has provided to its members. It may be possible to more actively use existing small business education activities funded by Federal and State Governments, banks and others to help small suppliers get buyers to pay bills on time (or at least earlier) through clear-cut terms of trade and better collection techniques.

Conclusion

The Chamber is supportive of the proposed Protocol as a first step to addressing problems with delayed and/or late payments. However, the experience in the UK shows that introducing a voluntary code will not be a silver bullet and the existing options for more interventionist approaches also have limited benefits. As such the Chamber emphasizes the importance of further research to better understand the causes of the problem and develop more effective solutions, including exploring the effectiveness of market based solutions such as credit insurance and early payment discounts.

For further information on the views expressed in this submission, please contact Tim Hicks on 02 9548 7259.

Regards,

Paul Orton

Paul Orton
Director, Policy & Advocacy