Australian Government
Department of Industry, Science, Energy and Resources

Payment Times Reporting Scheme

Regulatory Impact Statement

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Contents

Executive Summary

The Commonwealth Government has prioritised improving payment times from large to small business. This follows evidence that long and late payment times have a significant and negative impact on small businesses, and both governments and large businesses can improve their payment practices towards small businesses.

On 21 November 2018, the Prime Minister announced the policy objective to improve payments times for small businesses. By January 2019, officers from the former Department of Employment, Skills, Small and Family Business and now part of the Department of Industry, Science, Energy and Resources (the Department), working in close consultation with stakeholders, commenced work to design the scheme. The policy design drew from analysis of comparable schemes in Australia and overseas, innovative data analysis on the prevalence of long and late payments to small business, and modelling of the economic impact of long and late payment times.

The stakeholder consultation process was used to better understand issues related to payment times and to test preliminary policy options including a payment times reporting scheme. As part of this process, the Department directly engaged with businesses through expert working groups from industry and government, a discussion paper, multiple workshops and an online forum for small businesses.

Following the initial policy design and stakeholder consultation phase, the Government reaffirmed its support for the policy by making an election commitment to improve payment times for small businesses. The election commitment stated the Government would require large businesses with a turnover of over $100 million to publish their payment information.[1]

The Department has since worked to build a detailed design of the framework, consult further with stakeholders, and develop an implementation and evaluation plan. Later phases of stakeholder consultations involved one on one interviews and meetings, additional workshops, second discussion paper, an expert industry advisory group and a small business survey. Across all consultation phases, a total of more than 400 organisations were consulted, spanning large and small businesses, industry associations, corporate government entities, and policymakers.

Drawing on the findings of this work, the Department has developed draft model legislation to establish the scheme. An Exposure Draft of the Payment Times Reporting Bill was released on 21 February 2020 for public comment. This legislation is proposed for introduction in the 2020 autumn sitting of Parliament.

This Final Assessment Regulation Impact Statement (RIS) presents the next stage in the development of the scheme. It builds upon the findings of these consultations and sets out additional evidence to support government intervention and further policy options that will refine its design of the scheme to better meet policy objectives.

The RIS finds that long payment times from large to small businesses are a significant issue in Australia. In 2017–18, payments from large to small businesses were worth around $281 billion, with around $77 billion of payments paid later than 30 days.[2]

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[1] Coalition Government (2019), Backing Small Business Policy Statement

[2] Small businesses are defined using the ABS definition, i.e. businesses with less than 20 employees. For 2017/18, this accounted for 2,182,065, although only a portion would hold trade credit with large businesses.

As it stands, long payments times have significant and negative impacts to small businesses and the supply chains they operate within.[3] Longer payment times place pressure on small businesses' cashflow, revenue and financing as they extend the period between a small business incurring the costs of producing a good or service and being paid for it. Longer payment times to small businesses produce flow-on effects throughout the economy with smaller firms paid more slowly and therefore paying their own suppliers later.

The cashflow and financing pressures that arise from longer payment times in turn constrain small businesses' ability to hire, invest and grow – and are associated with higher bankruptcy and exit rates. These constraints are more significant to small businesses versus larger businesses, as smaller businesses are more likely to be credit-constrained and pay higher interest rates on financing compared with larger businesses. According to ABS data, these barriers are most impactful for innovative, fast-growing smaller businesses, who are critical to job creation, innovation and economic growth.

This dynamic means that reducing payment times from large to small businesses, which is the equivalent of transferring working capital from large to small businesses, has a net economic benefit. Economics consulting firm AlphaBeta analysed over 10 million invoices from more than 76,000 firms that use Xero accounting software and concluded that if all large businesses in Australia paid small businesses in 30 days, it would be the equivalent of transferring an estimated $7 billion in working capital from large to small businesses. The difference in the cost and ability to access financing between large and small businesses, means that normalising 30 day payment times from large to small businesses produces a net benefit to small businesses of $522 million per year and $4,319 million over 10 years. It creates an estimated overall net benefit to the Australian economy of $313 million a year and $2,591 million over 10 years.

While there is a net economic benefit associated with improving payment times from large to small businesses, this RIS concludes that marked improvement is unlikely without government action. That is because small businesses lack the market power to negotiate better payment terms and times, large businesses have little incentive for improvement, and voluntary efforts to date, whilst effective at the company level, have had limited take-up by Australia's approximately 3,400 largest businesses.[4]

The RIS identifies two policy options to incentivise improved payment times and practices, the cost of introducing a reporting scheme against the status quo and the net benefits of each option. Overall, it concludes that payment times are a significant problem for small businesses, and that a carefully designed reporting scheme which incentivises large businesses to improve payment times to small businesses would have a net benefit for the economy and for small businesses.

Background

In recent years, the Commonwealth Government has prioritised improving payment times from government agencies and large businesses to small businesses.

The prioritisation of this issue followed findings from two inquiries into Payment Times and Practices, prepared by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO), released in April 2017 and April 2019, which found payment times were an issue for small businesses.

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[3] Long payments are defined as payments made 30 days or more after the invoice data

[4] Data provided by the ATO

The need to act has been recognised by large businesses, with the Business Council of Australia (BCA) spearheading the introduction of a voluntary Australian Supplier Payment Code relating to payment times between large and small businesses.

The Commonwealth Government has also introduced a number of measures to improve payment times to small businesses. The Government has shortened its own payment times for small businesses to 20 days and has committed to requiring large businesses seeking government contracts to do the same. The Government is also reporting on its own payment time performance to small businesses. Further, it introduced legislation to support e-invoicing, and to offer five day payment terms for contracts up to $1 million where both the government agency and lead contractor use e-invoicing.

However, while these efforts are welcome, after consideration of ASBFEO's April 2017 report on payment times, the Commonwealth Government determined that more could be done to accelerate improvement in payment times to small businesses.

Accordingly, the Commonwealth Government announced on 21 November 2018 that it would introduce a national large business reporting scheme to encourage fairer, faster payment times and terms for small businesses. Large businesses were defined as those with $100 million or more in annual turnover.

The Department subsequently commenced a stakeholder consultation and policy design process into small business payment times in January 2019 that is ongoing. This work has informed the evidence base presented in this RIS. The objectives of the policy design and consultation process were to better understand issues related to payment times, and to test the design of the payment times reporting scheme.

Stakeholder consultation has been conducted in three phases. It has sought feedback from a broad base of stakeholders, including over 400 large businesses, small businesses, corporate government entities and policymakers. Multiple consultation channels have been used, including expert working groups, public workshops, an online forum, one-on-one meetings, a small business survey and discussion papers.

A subsequent Exposure Draft of the Payment Times Reporting Bill 2020 and an associated consultation paper were released on 21 February 2020. Thirty three submissions were received in response to the draft legislation.

This RIS reports on the findings of that work, as well as independent modelling and policy research that has been commissioned to explore the election commitment and its costs and benefits. It starts by discussing the extent of a payment time problem for Australian small businesses and how payment length impacts small business performance and the broader economy. It then considers whether there is a case for government intervention, two policy options that could be considered to incentivise or mandate improved payment times and the net benefits of each option.

Overall, it concludes that payment times are a significant problem for small businesses, and that a carefully designed reporting scheme to incentivise large businesses to improve payment times to small businesses would have a net benefit for the economy and for small businesses.

Long payment times from large to small businesses are a significant problem for Australian small businesses

Long payment times are a significant and costly issue for Australian small businesses offering trade credit. Trade credit is the practice of paying for goods and services after the date an invoice is issued. It is a common part of business transactions and accounts for a significant portion of trade flows within a modern economy. However, problems arise when trade credit payments extend beyond 30 days, or payments are made late.

Analysis of long payments using anonymised and aggregated Xero Small Business Insights data from the 2017–18 financial year illustrates the extent of the problem. When data from 10 million invoices received or issued by 76,817 firms was analysed, it revealed 36 per cent of trade credit payments to small businesses take longer than thirty days to be paid. When payments are made in over 30 days, they take on average 63 days to be paid. Around 13 per cent of trade credit payments take more than 60 days to be paid.

Australian small and medium businesses receive $281 billion per annum in income from large businesses, of which 77 per cent, or $216 billion, are made on trade credit. Assuming large businesses payment times are the same as the average for all businesses, each year $77 billion in payments to small businesses from large businesses take more than a month to be paid.[5]

Xero data shows that small businesses are also impacted by late payments. These are payments made later than the invoice due date. Fifty-three per cent of trade credit payments are paid late, and when paid late, are on average 23 days overdue. This means payments worth $115 billion a year from large to small businesses are paid late.

A survey conducted by the ASBFEO also found evidence that late payments are hurting small businesses. In a survey of 2,783 businesses[6] from December 2016 – February 2017, all respondents had experienced late payments in the prior financial year. More than half of respondents said that at least 40 per cent of their invoices were paid late. Forty-eight per cent respondents claimed late payments were on average over 30 days late. Further, one in two businesses had $20,000 in late payments owing to them, and 1 in 4 had payments over $50,000 owing to them. Twelve per cent of small businesses spent more than 6 hours chasing late payments a week. The ASBFEO undertook a second online survey of 2,500 small businesses in 2019. Just over half the respondents to the survey reported that 40 per cent or more of their invoices were paid late. Invoices were more likely to be paid late where the supplier had shorter (e.g. 30 day) payment terms, underscoring that shorter payment terms alone are insufficient to drive a change in practice.[7]

This is also emerging evidence of other payment practices that may adversely impact small businesses. ASBFEO has been examining the practice of large businesses offering supply chain financing (SCF) to small business suppliers. This practice most commonly involves a small business being paid earlier than the official payment term of a contract by a third party financier. This is done

[5] Large business payment times are typically longer than the average, reflecting large businesses greater market power. This estimate may also understate the problems as the Xero figures on trade credit include payments from consumers as well as businesses, and consumers are more likely to pay faster than businesses

[6] The ASBFEO survey had 2,783 businesses with 2,597 satisfying the ABS definition of a small business

[7] ASBFEO (2019), Review of Payment, Terms, Times and Practices

in exchange for the small business paying interest on the earlier payment, effectively reducing the amount they are paid. ASBFEO has found that "Many large businesses extend payment terms and times and then offer SCF which has a severe impact on small business where these longer payment terms and times apply and SCF must then be used to bring payment terms back within 30 days".[8]

Long and late payment times negatively impact small business performance

Numerous studies and surveys have found that longer payment times negatively impact small business performance (see Exhibit 1). Impacts include disruption to hiring due to uncertain cashflow, a need to source additional financing, constraints on investment and therefore business growth, and a greater risk of insolvency in the case of already capital constrained firms.

Exhibit 1

Studies also show long or late payment times negatively impact key areas of small business performance at the firm level

Area	Why impacted	ACCA member survey -2015	YouGov & ACI Worldwide (2016, n=100)	Tungsten (2015, n=1000)	Intrium Justitia (2018, n=9600)	BACS (2017)	Basware (2018, n=2036)	ASBFEO (2017, n=2679)	Graydon (2012, n=498)
Financing	Businesses require additional financing to overcome long or late payment times	-	-	-		**25%** Used overdrafts in response	**53%** Needed personal funds	**57%** Needed to borrow or use credit cards	**29%** Increase in bank fees from being overdrawn
Hiring	Disruptions in cashflow can affect decisions to retain or hire people	**54%** more likely to limit employment than a large business	**17%** Negative impact on salaries, recruitment and expense reimbursement	-	**21%** Unable to hire staff	**15%** Affected staffing or bills	**18%** Stopped recruitment **& 13%** let go of staff	**22%** Impacts salary payments	**17%** Delayed hiring staff
Investment/ growth	Disruptions to cashflow can impact investment decisions and subsequent growth	**47%** more likely to limit capital expenditure than a large business	**10%** Affected investment in equipment, research, product development	-	**28%** Hindered growth	-	-	**49%** Stated limits growth of business	**23%** Delayed growth and introduction of services
Insolvency risk	Already capital-constrained SMEs may risk insolvency through poor payments	-	**29%** Said faster payments are crucial to success	**23%** Risked insolvency	**24%** Threat to survival	-	**25%** Financial viability was at risk	**35%** Increased risk of insolvency	**16%** Almost put company out of business

Source: ACCA Global Member survey, ACI & YouGov, Tungsten, Intrium Justita European Payment Report, BACS Q1 Report, Bas & YouGov Effect of Late Payments on Productivity 2018, ASBFEO Payment Times and Practices WP3 2017, Graydon Research on Payment Culture 2012

Analysis of Xero data shows that small firms that are paid later than average have lower revenue growth compared to firms paid faster than average (see Exhibit 2).

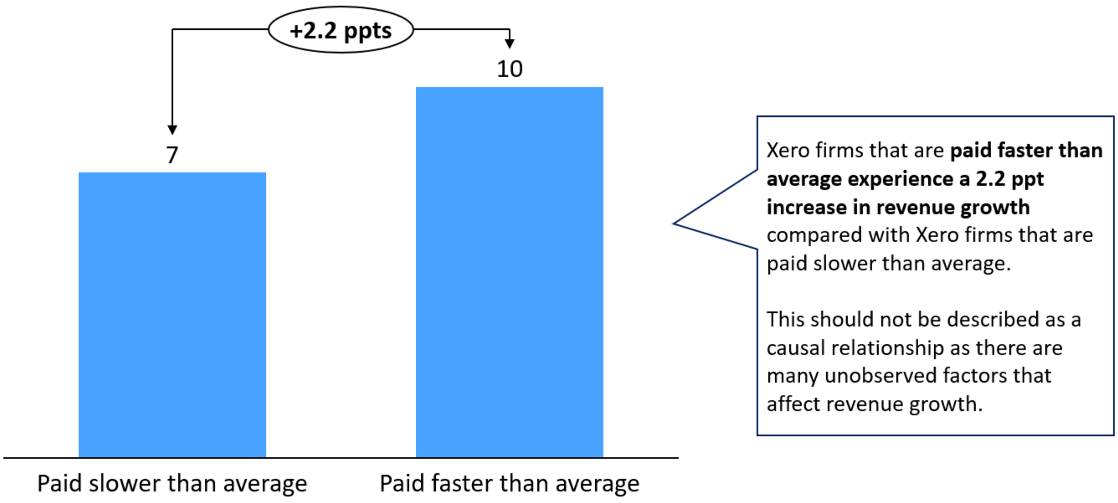
[8] https://www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-SCF-position-paper.pdf

Exhibit 2

Firms that are paid faster than average experience a 2.2 ppt increase in revenue growth compared to firms paid later than average times

Effect of payment time on revenue growth

Average annual revenue growth rate (%)



Results over 128,831 observations for FY15-17.
Source: Xero SBI data, AlphaBeta analysis

Longer payment times also have negative economy-wide impacts

Studies from Australia and overseas have also observed that payment times impact employment, growth, investment and insolvencies at the wider economy level.

A 2018 study[9] from the United States (US) evaluated the impact of the US Government paying small businesses 15 days faster, and the subsequent effect on firm employment. It found that for payments made 15 days faster, 10 per cent went to additional payroll spend, correlating with $6 billion increase after three years from a $64 billion procurement spend on small businesses.

Another study from the US observed the impact of payment times on small business investment and growth.[10] They found a 30-day delay in payments can reduce capital expenditure by 1.2 per cent to 2.1 per cent, which increases if bank credit is tight. A separate study[11] on the high use of trade credit in economies and the effect of passing on financial distress was estimated to lower GDP by at least 0.4 per cent in the US and up to 2.3 per cent in recession years.

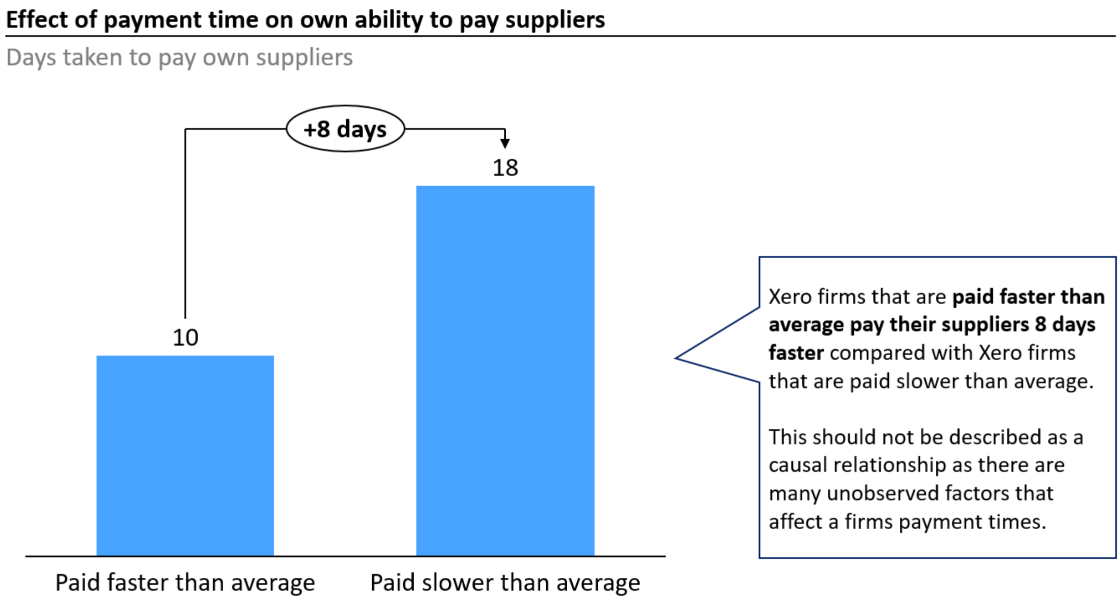
[9] Barrot, J.N. & Nanda, R. (2018) The Employment Effects of Faster Payment: Evidence from the Federal QuickPay Reform, Harvard Business School Entrepreneurial Management Working Paper
[10] Murfin, J. & Njoroge, K. (2015) The Implicit Costs of Trade Credit Borrowing by Large Firms, The Review of Financial Studies, Volume 28, Issue 1
[11] Boissay, F. (2006) Credit Chains and the Progression of Financial Distress, ECB Working Paper No. 573

Studies from the European Union, which has trialled multiple interventions to improve payment times, have observed a relationship between insolvencies and payment times. One study from the EU found that removing late business to business payments would reduce firm exit rates by 2.8 per cent to 3.4 per cent in the worst paying EU member states.[12] A second study in France examining the introduction of 30 day payment terms in the transport industry found that corporate insolvencies decreased by 25 per cent, focused on liquidity-constrained firms and also triggering an increase of entry of small firms.[13]

In Australia, analysis of Xero data shows that small business payment times are transmitted through supply chains, as small businesses pass on to their suppliers the payment times they receive.[14] For example, small businesses paid faster than the average pay their own suppliers eight days faster than small businesses paid more slowly than the average (see Exhibit 3).

Exhibit 3

Firms paid faster than average paid their own suppliers 8 days faster



Results over 241,967 observations for FY15-17.
Source: Xero SBI data, AlphaBeta analysis

[12] Conell, W. (2014) Economic Impact of Late Payments, European Economy – Economic Papers, Directorate General Economic and Financial Affairs, European Commission
[13] Barrott, J.N. (2015) Trade Credit and Industry Dynamics: Evidence from Trucking Firms, The Journal of Finance, Volume 71, Issue 5
[14] Results from 241,967 observations for FY15-FY17 using data from Xero Small Business Insights. Performance of each year of the business was grouped into those above and below the average days taken to receive payments, and compared to the average time taken to pay their accounts payable.

Long payment times have a disproportionate impact on small businesses compared to large businesses

Long payment times place pressure on small businesses' cashflow and financing as businesses need to finance the period between paying for the cost of producing goods and services and being paid for the work.

This is most problematic for small businesses because small businesses are already credit constrained. Credit constraints refer to difficulties in accessing capital, such as having a limited stock of capital to draw from or requiring a high price to access capital. Smaller businesses find it harder to access financing versus larger businesses (see Exhibit 4). Small businesses are more likely to be refused credit and face higher costs to borrow when they do access it. Their more volatile cashflow, lower levels and quality of collateral assets, and more limited information about their business, make it harder to pass credit risk assessments and to secure loans. Their small size and lower bargaining power means they have less ability to negotiate lower fees.

Cashflow pressures on small businesses are likely to be amplified by the twin impacts of the 2019–20 bushfires and spread of the COVID-19 disease. Both events are expected by the Australian Treasury to create economic shocks at the regional and national level, with the impact of COVID-19 alone forecast to take at least half a percentage point from Australia's GDP in the March 2020 quarter.[15]

Exhibit 4

Small businesses face more issues accessing financing versus large businesses

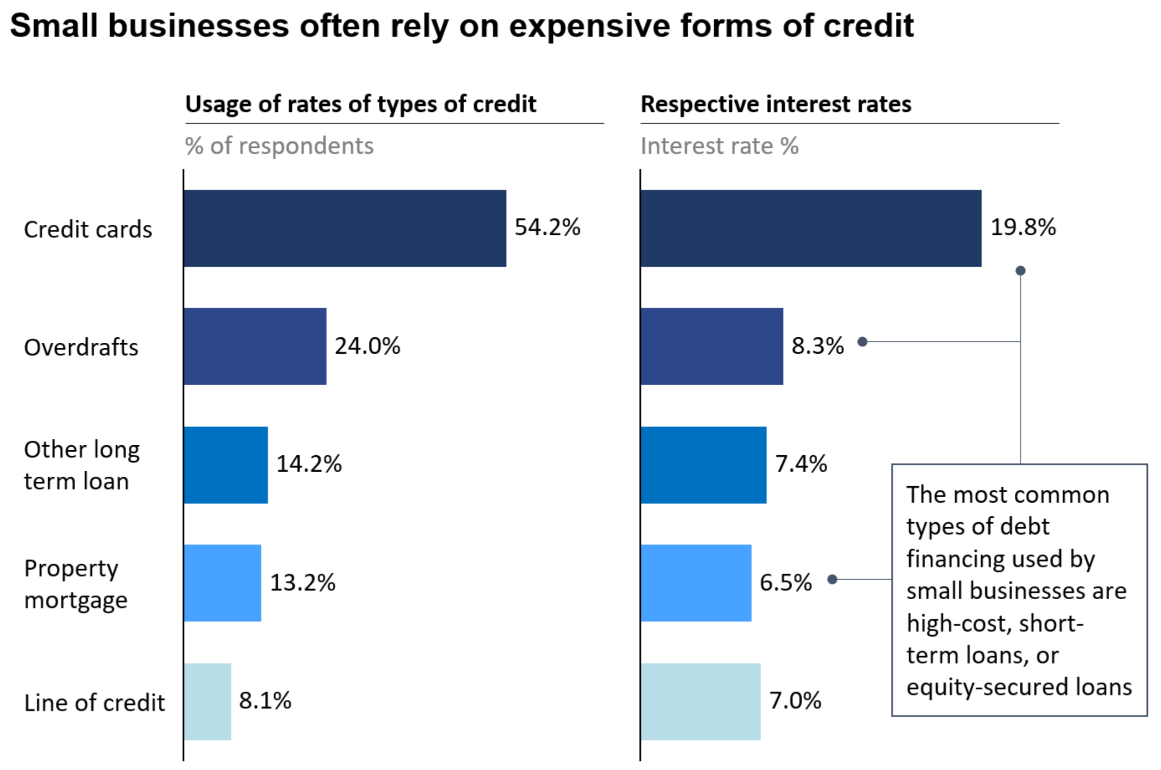
Issue	Small Business	Large Business
Cashflow	▪ More volatile cash flows, meaning debt obligations create more financial stress	▪ Consistent and steady cash flows that allow a choice of optimal capital structure
Collateral	▪ Less quality assets to use as collateral	▪ Many assets to use as collateral
Information	▪ Lack of information, business records and business planning to assess risk	▪ Extensive record of information and accounting for lender confidence
Size	▪ Small quantities of finance mean sources of finance with high transaction costs are unfeasible	▪ Ability to capitalise on economics of scale create access to more diverse options for capital
Bargaining power	▪ Lack of bargaining power to access alternative sources of financing such as trade credit	▪ Higher use of trade credit and other financing due to reputation and bargaining power
Proportion of businesses that sought additional financing for business survival	28%	4.4%

Source: ABS 8167.0 Selected Business Characteristics

15 Dr Steven Kennedy (2020) Opening Statement – March 2020 Estimates

Consequently, small businesses are more likely to rely on non-bank sources of financing, which come at higher costs (see Exhibit 5).

Exhibit 5



Source: Australian Banking Association (ABA) 2016 study, RBA Lending rates

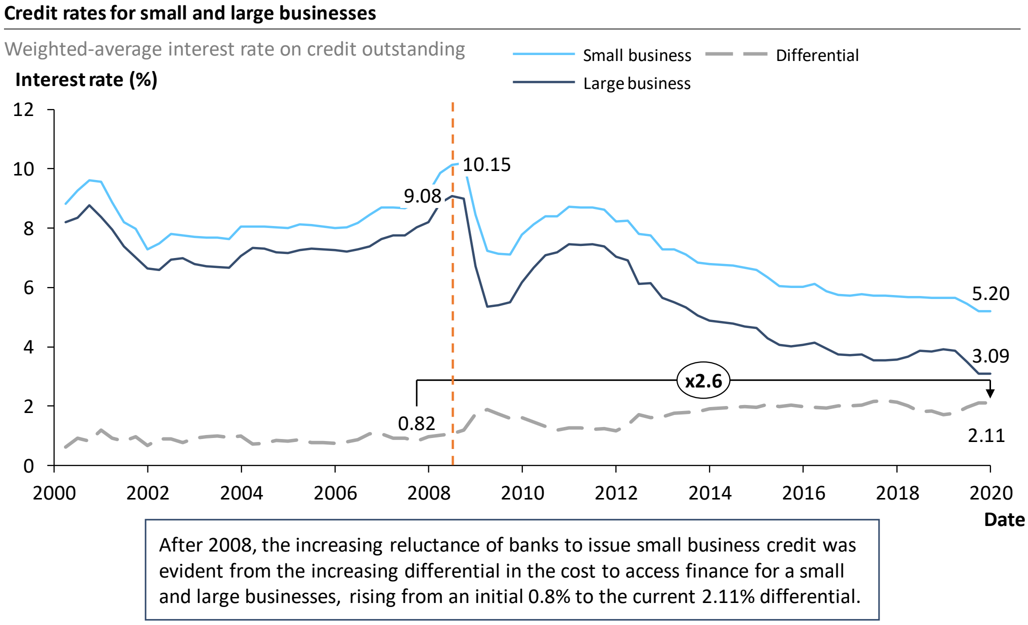
There is an economic imperative for government action to improve payment times for small businesses in the near term

Acting now to trigger payment time improvements for small businesses is important because small businesses have faced a lengthy period of constrained credit and lower investment growth. Australian small businesses have faced increasing difficulty accessing bank financing, and a greater cost to access it, over the past decade. The cost of lending to small businesses has increased relative to large business lending costs (see Exhibit 6), as the differential between the weighted-average interest rate on credit outstanding between small and large business changed from 0.82 to 2.11 from 2008 – 2020.[16] This is partially because access to riskier, unsecured loans (which small businesses are more likely to rely upon) has become more expensive.

[16] RBA Statistical tables – F5 Lending Rates

Exhibit 6

Credit has also been getting more expensive for small businesses relative to large businesses since the GFC



Source: RBA Lending rates

Small businesses have also increasingly had to use real estate, such as their home, as collateral.[17] A reliance on real estate hampers small business financing in multiple ways:

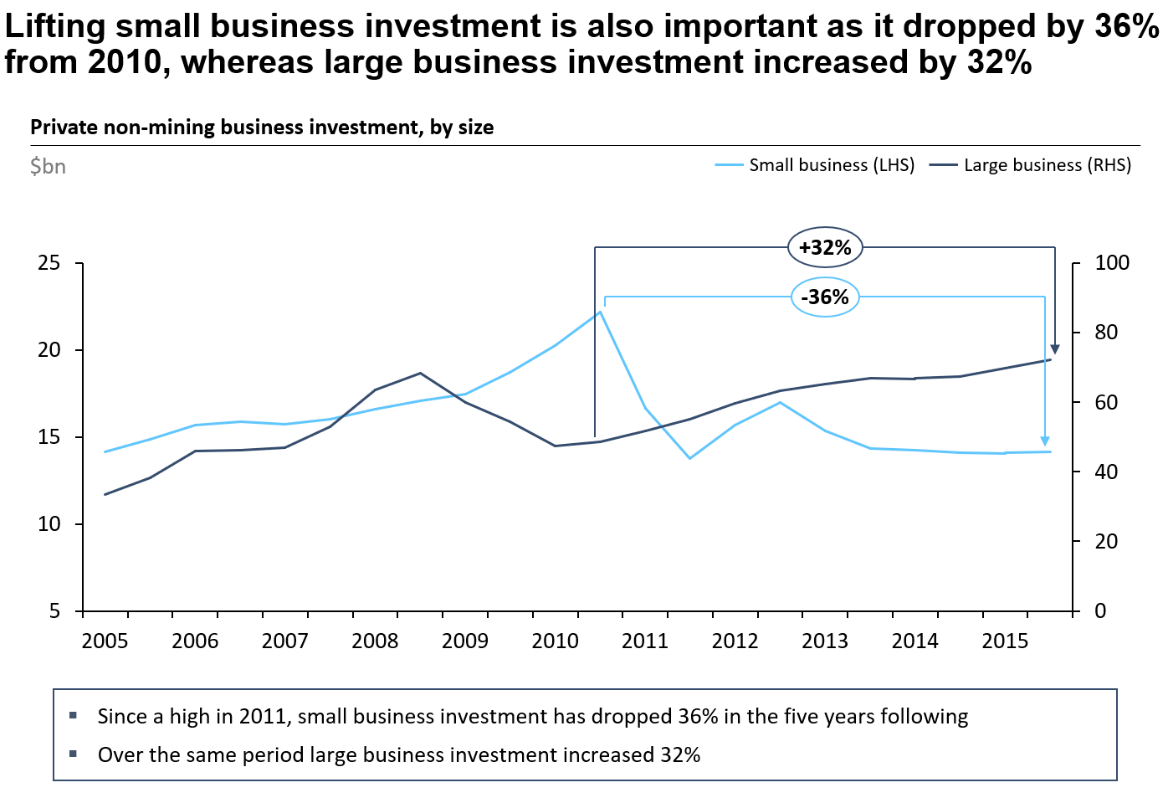
- It increases the risks for small businesses and requires them to mix in their personal assets to improve their financial position;
- It provides a natural limit on lending once a business has pledged all their real estate as collateral, which can impinge growing firms; and
- It is not appropriate for smaller loans for day-to-day activities.

Reliance on real estate for collateral also means small business lending is sensitive to changes in house pricing and ownership rates – which have been variable in recent times.[18] The Council of Financial Regulators have highlighted this as a potential issue in Australia's credit market, noting the risk that the heavy reliance on personal finances and real estate could potentially inhibit small business financing.[19]

Long payment times and lack of access to capital are also associated with lower investment by small businesses. Stimulating small business investment is important because investment by small business has stagnated, particularly by comparison to larger firms (see Exhibit 7). Since 2010, small business investment has dropped by 36 per cent, whilst large business investment has increased by 32 per cent.

[17] Connolly, E. & Bank, J. (2018) Access to Small Business Finance, RBA Bulletin – September 2018 https://www.rba.gov.au/publications/bulletin/2018/sep/access-to-small-business-finance.html
[18] Ownership rates have been down a third over the past 25 years for those aged 25-34, which is the key entrepreneurial period of life (Productivity Commission 2018)
[19] March Quarterly Statement by the Council of Financial Regulators - https://www.cfr.gov.au/news/2019/mr-19-01.html

Exhibit 7



Source: RBA (2017) The Availability of Business Finance, ABS

Innovative small and medium businesses, who are particularly important to job creation and growth, are most affected by longer payment times and constrained access to finance. According to ABS data, innovation active micro and smaller firms are twice as likely to claim payment times as hindering business survival than non-innovation active firms. Small businesses in Australia are also twice as likely as large business to claim access to finance as a barrier to business growth.[20]

Table 1: Proportion of businesses whose reason for seeking finance was to ensure survival of business, by innovation type

Firm size	Innovation-active	Non-innovation active	Total
Micro (0-4 employees)	30.0%	33.6%	31.5%
Small (5-19 employees)	32.1%	25.3%	29.9%
Medium (20-199 employees)	12.3%	8.9%	11.7%
Large (200+ employees)	3.6%	4.9%	3.9%

Source: ABS 8167.0 Characteristics of Australian Businesses, 2017-18 - Finance and business competition

[20] ABS 8167.0 Selected Business Characteristics

Reducing payment times to small businesses would relieve constraints on small businesses' growth

Long payment times from large to small businesses are a significant issue in Australia with an estimated $77 billion of payments paid later than 30 days each year. Reducing payment times would relieve pressure on small businesses' cashflow, revenue and financing. This in turn would give credit-constrained small businesses' greater access to capital, which they could use to pay down debt, or to hire, invest and grow. This is particularly important in the case of innovative, fast-growth smaller businesses who are most impacted by longer payment times and difficulty accessing finance.

Without Government intervention, payment times from large to small businesses are unlikely to materially improve

Government intervention is needed to improve or incentivise shorter payment times for small businesses because of the significant and negative impact long payment times have on small businesses. Marked improvement in payment times without government action is unlikely because small businesses lack the market power to negotiate better payment terms and times, large businesses have little incentive for improvement, and voluntary efforts to date have had limited take-up by large businesses.

Market power asymmetries make it unlikely that payment times will improve without intervention

A key issue in relying on a market driven approach to improving payment times is the fundamental asymmetries in market power between small and large businesses. Small businesses have limited bargaining power relative to larger firms, which means small firms typically accept the terms of large customers, rather than setting them. In an ASBFEO survey of small businesses, 34 per cent of small firm respondents stated they were never able to influence faster payment times set by larger customers. A further 29 per cent reported they could rarely influence them.

A second issue with relying on a market driven approach is that large businesses have a financial disincentive to reduce payment times. When a business customer takes longer to pay a supplier, it improves the working capital position of the business customer at the expense of the supplier. This is because the amount owed to the supplier is held by the customer in its accounts payables thereby increasing the working capital available to a business to use. It is a financially rational strategy for a customer to avoid paying sooner than required. In a situation where there is an asymmetry in the bargaining power of the supplier and customer, as with small and large businesses, there is neither the financial incentive nor financial pressure for the large customer to pay more promptly.

Voluntary efforts have made some progress, but their impact is limited by low take-up

A string of voluntary efforts to improve payments times by large businesses have been trialled for over two years in Australia. These efforts have been genuine, and they have led to some real improvements in payment practices. However, their overall impact has been limited because the vast majority of large businesses have failed to participate in them.

Voluntary and mandatory measures trialled by governments and the private sector to improve payment times include:

- The introduction of the BCA's Australian Supplier Payment Code
- The introduction of a National Payment Times Reporting Register by ASBFEO
- Federal and state government mandating maximum payment times for certain government agencies to small businesses, and mandatory reporting of payment times.

While these measures have improved payment practices and payment transparency, their impact has been limited by the low participation by large businesses due to their voluntary nature, or their policies focus on government agency payment time. This means despite these efforts, average payment times and the frequency of late payments to Australian small businesses have not improved in the last five years. Analysis[21] of Xero data over the past five years indicates that the average payment time in Australia has marginally increased, from 25.1 days in FY2014 to 25.5 days in FY2018.

The BCA's Australian Supplier Payment Code has been in place for almost three years and has attracted over 120 signatories. However, currently there are only around 80 large business signatories out of the 120 signatories, and out of approximately 3,400[22] large firms in Australia.[23]

Evidence from the UK, which has implemented an equivalent code for more than a decade, is that even with more time, the rate of new signatories unlikely to exceed 5 percent per annum, and the majority of large businesses will not sign. The UK's Prompt Payment Code's received its first signatory in 2009. After a decade of government-backed support, only around of 10 per cent of businesses in the recently implemented UK Payment Practices and Performance Reporting scheme identified that they were a code signatory.[24] This is despite greater public scrutiny and members of the UK Government publicly backing the code, previously calling businesses to sign-up or be name-and-shamed as non-signatories.

The ASBFEO National Payment Transparency Register also demonstrates voluntary reporting is likely not a viable to drive widespread improvement in practice. The National Payment Transparency Register was established in December 2017. It encourages businesses to report their payment performance voluntarily and for this information to be published. However, only 29 large firms had signed-up to the ASBFEO register by mid-2019. Firms that have registered were already good performers, with all but four of the signatories paying within 30 days. This highlights a second issue with voluntary measures, which is that they are more likely to be taken up by good actors. This means the firms with the poorest practices do not improve.

Commonwealth and state governments have also mandated better payment times for small businesses by government agencies and started reporting on payment times. These measures have had impact in improving payment times according to government reporting. However, they have had no discernible impact on large business practices as they are not covered by the scheme. Further, large businesses experience no competitive pressure to improve from public sector changes in practices.

[21] Results are the average receivable days on trade credit for 83,380 firms for years FY14-FY18, after removing for extreme values. Data used is from Xero SBI

[22] Based on the total number of businesses identified by the ABS as being required to report under this scheme.

[23] At time of writing, there were 124 signatories in total. ~80 appear on the ATO Corporate Tax transparency report, or were otherwise able to be identified as a large business, which shows approximately the largest 2,200 firms in Australia and is taken as an approximation of the expected group of large businesses

[24] Measured by whether a business indicated they were signatory to a code in their first report to the UK Payment Practices and Performance Reporting requirements

For these reasons, evidence from Australia and overseas shows that without government intervention, there is unlikely to be a significant improvement in the number of large businesses paying small businesses faster and on time.

There are two policy options to reduce the length of payments from large to small businesses

The RIS considers two broad options to address the issue of payment times in Australia. The first is to continue with a business-as-usual approach, and the second is to introduce a payment times reporting scheme for large businesses. The RIS only considers two broad policy options because introducing the payment times reporting scheme was an election commitment of the Government.

The commitment was made following a number of extensive reviews of the issue of payment times to small business in Australia, which canvassed a variety of solutions to improve payment times.

All of these reviews concluded introducing a reporting scheme was the preferred policy response, compared with not acting, or having the government intervene to pass legislation regulating core business decisions, such as payment terms and times without first trialling a less severe option.

The status quo or business as usual (BAU) option relies on voluntary measures that do not require government intervention, such as continuing to rely on the voluntary BCA Supplier Code and other sector specific codes, and the ASBFEO National Payment Transparency Register.

There is no voluntary option beyond the BAU scenario because a number of voluntary options are already in place, including a national voluntary code of practice, sector level codes of practice, and a national voluntary reporting scheme. There are no more additional, meaningful voluntary actions that could be taken to try and improve payment times in Australia. Moreover, evidence from the UK suggests that even over ten years, the rate of take-up of the key voluntary initiative, an industry supplier code, remained stable despite multiple attempts to accelerate it. It did not result in more than 10 per cent of large businesses signing-up to the scheme in a decade.

Each option is assessed based on its ability to address the aim of improving payment times from large to small businesses in Australia. Each policy option is based on the assumptions that the policy will aim to reduce payment times from large to small businesses to a common benchmark of 30 days, measured from the date of the invoice.

Policy option 1: Business-as-usual

In this option, it is assumed that current voluntary measures stay in place, and the Government does not introduce any additional policies to address payment times in Australia. The key voluntary policy in this scenario is the BCA's Australian Supplier Payment Code, which began in 2017 and has since had approximately 80 signatories that are expected to be qualifying entities under this policy.[21]

Other existing government policies such as the ASBFEO National Payment Transparency Register, industry-specific regulations and other industry codes of conduct are assumed to stay in place, but not play a significant role in affecting payment times.

During stakeholder consultations on the issue of payment times, some large businesses stated this is their preferred option. However, many other stakeholders stated that current measures have not materially changed payment times, and other policy options should therefore be considered.

Policy option 2: Mandatory payment times reporting scheme for large businesses using a Small Business Identification Tool, with reporting at the entity level for individual entities and groups

In this option, the government would require qualifying entities (large businesses with more than $100 million annual turnover) to report on their payment performance to small businesses. Small businesses are defined as businesses with a turnover of up to $10 million per annum.

Qualifying reporting entities would report every six months on their payment performance via a central portal administered by the Payment Times Regulator proposed to be an SES officer within the Department), with penalties for entities mis/non-reporting. Examples of fields could include the average time taken to pay small business suppliers and the proportion of invoices paid within 20 days, 30 days and between 31 and 60 days. The government would then publish reported results on a regular basis online. The information would be publicly accessible.

Large businesses advised in the consultation that identifying small business suppliers would create a substantial regulatory burden, because large businesses do not currently collect or record data on the size of suppliers. Therefore, to ease the regulatory burden associated with the scheme, it is assumed the Payment Times Regulator would establish a Small Business Identification Tool (SBI).

The SBI would be a free, online service allowing reporting entities to check if their suppliers were a small business for the purposes of the scheme, and therefore they were required to report on their payment terms and practices to them.

The SBI would allow a large business to upload a file listing the ABNs of the reporting entities' suppliers. It would then match the list to a private data register of all businesses, and return a result for each ABN advising either that the business was required to be reported on (if the business were small), or was not required to be reported on (if the business were large or medium).

The SBI will apply a negative look-up screen against the register, meaning that it will simply determine that a business is large or medium. It will not identify individual small businesses, nor collect, store or use data about them. The reporting entity would use the results to filter their internal data to calculate payment times reporting results for only their small business suppliers.

The obligation to report would apply to incorporated entities with a total annual income of more than $100 million in the most recent income year, and a controlling corporation or member of a controlling corporation's group. All entities within a controlling group would be required to provide an individual report on their payment times performance, irrespective of whether the entity was individually above the $100 million per annum income threshold. The rationale for requiring all entities associated with a corporate group to report individually is that it provides the maximum transparency on a group's practices, and the drivers of payment times results across the group.

Based on taxation data, we assume there are approximately 3,400 individual and group entities that would meet the reporting threshold in their own right because they are above the income threshold, of which approximately 1,400 are individual entities not associated with a group and approximately 2,000 are groups. We also assume there are a further 5,700 entities associated with those groups that would also be obligated to report. This means that under this option, approximately 9,100 entities would be obliged to report (that is, the 3,400 individual entities and groups above the threshold, and a further 5,700 entities associated with a group above the threshold).[25]

Introducing a payment times reporting scheme would create transparency around payment practices of large entities in Australia, recognising both good and bad payers. It would also create an informed view on what payment time norms exist in Australia and encourage improvement amongst reporting entities.

Comparing the net benefits of the two policy options

There are a range of benefits and costs associated with improving payment times under each policy option. This section sets out the calculation of the net benefit for the quantifiable effects for each policy, and discusses qualitative benefits, costs and risks associated with each policy.

The net benefit for each policy in this section is calculated based on two effects that were quantifiable.

The first is the cost and benefit associated with improved payment times in the economy arising from each policy. This is measured by first calculating the benefit that could be obtained if all large firms improved to paying in 30 days to small suppliers, and then multiplying that by portion of the benefit expected to be realised by the policy.

The second cost is the administrative cost associated with the policy itself, such as compliance and actions required by the businesses to achieve the expected improvement. This involves costs such as time spent reporting, time or other costs required to verify suppliers as small businesses, and improvement costs for the large business.

The net benefit of each policy option is estimated as the expected benefit from improved payment times, minus the policy's administrative costs to business.

This is presented as a net present value of the effects over a 10 year period, and also as an equivalent annualised value. In addition to the quantifiable effects associated with a policy, section 6 also considers the additional, unquantifiable benefits and costs associated with each option.

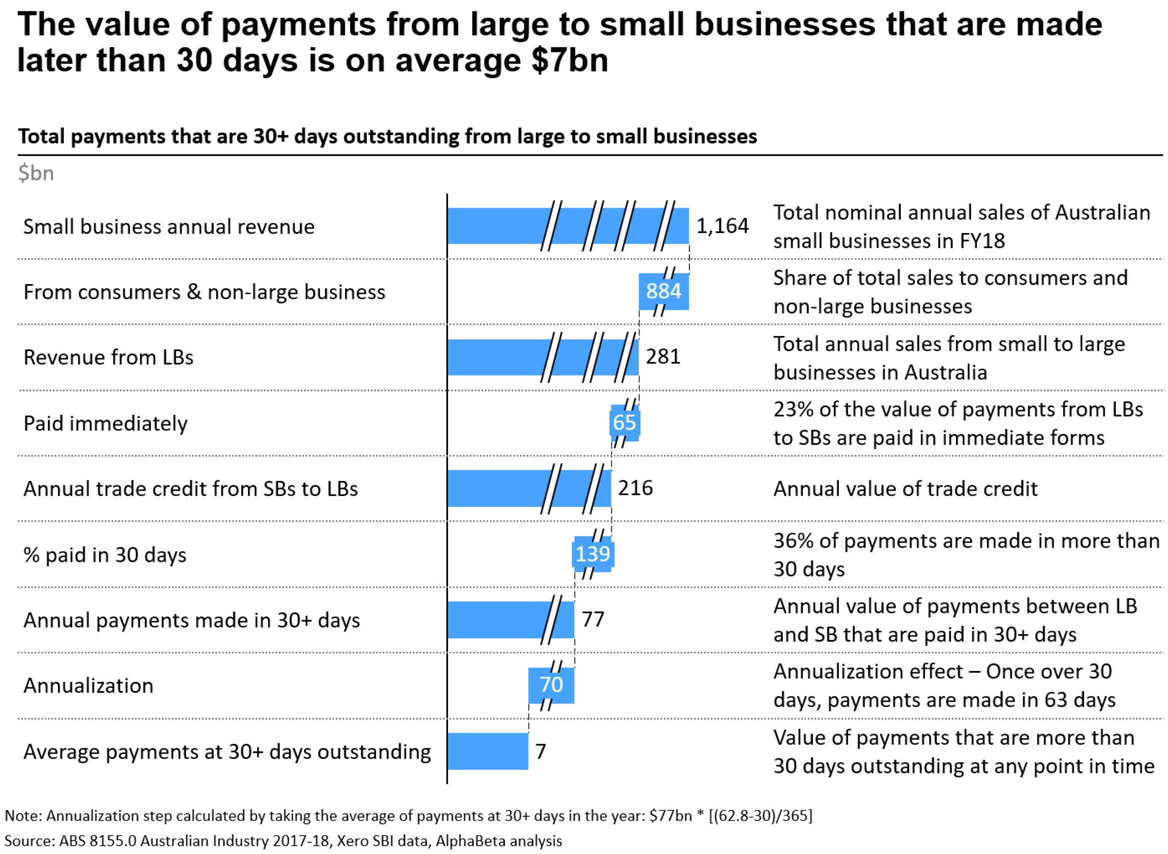
Transferring capital from large to small businesses has a net economic benefit

Government intervention to improve payment times from large to small businesses to 30 days would trigger a net benefit to the Australian economy. Improving payment times to 30 days would result in a transfer of working capital from large to small businesses of approximately $7 billion (see Exhibit 8). This is because when a large business delays a payment to a small business, it increases the receivables of the small business and reduces the payables of the large business. This is equivalent to an increase in the working capital available to the small business and a decrease in the working capital available the large business.

[25] Preliminary investigation estimates from ABS based on 2018-19 BAS reporting. Users comparing data from this release with other ABS data should do so with care, as some other ABS data may exclude non-employing businesses or particular industries or sectors.

If payments from the approximately 3,400 large businesses were made in 30 days, the impact would be equivalent to a transfer in working capital from large to small business of approximately $7 billion (see Exhibit 8). This is the annualised value of payments from large to small businesses made in over 30 days. Small businesses would respond to this by either reducing their net debt and lowering their net financing costs or increasing investment in fixed capital and increasing their output (if they are capital constrained). Large businesses would respond by either increasing their net debt or reducing their investment if they are capital constrained.

Exhibit 8



The net effect is likely to be positive on the economy because the financing costs of small businesses are higher than those of large businesses and the share of small businesses that are capital constrained is higher than large businesses.

This transfer of working capital is likely to lead to a number of other unquantifiable benefits and costs. These are outlined in detail in a later section and include impacts on business hiring, investment, insolvency as well as second order effects such as impacts on the profitability of finance providers.

The first component of the Net Present Value (NPV) for each policy is the benefit from the improvement of payment times to the economy. This is determined to be the effects of a transfer of capital from large to small business that is created as payment times improve (see box below).

Box 1: Calculating the effective transfer of capital from large to small business

The main driver of the net benefit for each policy is the expected effects of a transfer of working capital from large to small businesses that is produced at the point in time where a large business shortens their payment terms.

We can illustrate how this effectively creates a transfer of capital by taking the example of a small business that has a single large business supplier, who pays the small business for a product delivered monthly (i.e. every 30 days) on a trade credit payment term of 60 days. If the large business switches their payment terms from 60 days to 30 days, then at the next pay day, the small business would be expecting two payments coinciding: one payment for a product delivered 60 days prior under the original term, and a second payment for a product delivered 30 days prior under the new payment term.

The cash flows thereafter would be the same as if the large business had not changed their payment terms, i.e. occurring at regular 30 day intervals. Hence, the difference is solely the additional payment made immediately after the change in terms, which is effectively increases the cash flow of the small business and creates an overall working capital transfer from the large business to the small business. This example can be extended and calculated at the economy level. Assuming that any large business that improves their payment terms, prompted by the policy option proposed, does so in the first year the policy is effective, then a figure can be calculated for the expected transfer from large to small businesses for the economy when the policy is introduced. Based on data from the Xero Small Business Insights dataset, for the period 2017-18, 36% of all trade credit payments were made in excess of 30 days, and at an average of 63 days.[26] A reduction of these times to 30 day payment terms would create an approximate 12 day reduction in payment times across the economy, for relevant trade flows between large and small businesses. In Exhibit 8, this was calculated to be an approximate $7 billion effective transfer from large to small businesses.[27]

This one-off improvement to working capital also delivers persistent benefits to small business over time. When a business receives a one-off cash flow benefit of $X at time t=0, that can deliver an ongoing benefit of a*$X*(interest rate) in every subsequent year if a share of the cash flow is used by the business to reduce debt (where cost of debt is materially higher for small rather than larger businesses). Similarly, some portion of the cash flow b*$X can be invested in new capital (if the business is capital constrained) which could earn a return (b*$X*rate of return on invested capital) which would also be ongoing. That is why a one-off cash flow benefit delivers persistent benefits to the small business.

[26] The Xero Small Business Insights data analysed does not distinguish the source of an invoice, so direct payments from large to small businesses cannot be observed, and consumer invoices, which are usually paid more quickly, cannot be separated. The latter fact suggests that the proportion of invoices paid within 30 days is likely over-estimated, and the true figure for B2B invoices is higher, and the figure for large business to small business is expected to be even higher

[27] To check this figure, a similar method was used for the available UK Payment Practices and Performance reporting data. Analysis undertaken in June 2019, using the average time to pay for the 1st report, showed that 61% of businesses paid in excess of 30 days, and these businesses on average made payments in 48 days. An improvement of 61% of payments by 18 days equates to 11 days of improvement, close to the figure estimated from Australia data. The differences in distribution are likely attributable to Xero Small Business Insights data being at the invoice level, while UK data being an average at firm level.

While the transfer itself does not generate a net effect for the economy, as it only moves capital from one group to another, there is expected to be a resultant net benefit based on the asymmetry of credit constraints that face small and large businesses.

As discussed earlier in the RIS, small businesses face higher financing costs, and therefore benefit more from avoided financing costs than the additional financing costs incurred by large businesses. The greater benefit to small businesses minus the lesser cost to large businesses creates an ongoing net benefit for the economy, driven by this differential in the cost of accessing credit.

The modelling underpinning the RIS assumes small businesses have a higher cost of capital cost of around 8%, compared to large businesses cost of around 3 per cent. The average cost of capital for small businesses has been calculated by taking the average interest rate paid by small businesses based on the basket of different financing sources that they access and the typical interest rate for those sources (see Exhibit 5).

The $7 billion transfer is expected to generate:

- A benefit to small businesses of $522 million per year and $4,319 million over 10 years
- A cost to large businesses of $209 million per year and $1,728 million over 10 years
- An overall net benefit of $313 million a year and $2,591 million over 10 years.

This is the benefit that is realised from an improvement to paying in 30 days for all payments from large to small businesses in Australia, equivalent to an improvement of approximately 12 days.

To evaluate the benefit of each policy, it is assumed that the level of the benefit to the economy realised is proportional to the level of improvement achieved by the policy.

As neither policy mandates that large businesses improve their payment times, we assume that that not all businesses do improve and adjust the net benefit down accordingly.

Policies were evaluated based on a business improvement rate between 0 per cent and 100 per cent, which indicates the percentage of the maximum improvement scenario that the policy would achieve. That considered, the percentage of large firms that would be subject to the policy, and the percentage of firms that were likely to improve. For example, an improvement rate of 50 per cent would lead to $157 million in net benefit to the economy per year, and $1,246 million over 10 years. Low and high improvement scenarios were used for each policy given actual improvement rates are hard to estimate with precision.

Additional non-quantified benefits

In practice, the actual benefit to the economy may be higher than the modelled number. This is because when small businesses are paid faster their cashflow position improves and they face less uncertainty in management and planning decisions. As Exhibit 1 summarises, this can trigger a second round of beneficial impacts, such as increased investment and increased hiring by the small business. Improving the cashflow position of a small business also reduces negative events, such as bankruptcies. Small businesses that are paid faster are also likely to pay their own suppliers faster, extending the effect of the improvement through economy.

However, to be conservative, these benefits are described as non-quantifiable benefits rather than quantified in the net benefit modelling. The reason for this is that core operational decisions, such as hiring, investment and the decision to wind-up a company, are influenced by multiple factors. It is not possible to attribute a direct causal relationship between a change in payment times and a specific decision by a firm to change hiring and investment practices.

This is demonstrated by the current economic climate, in which small businesses in multiple sectors have been impacted by a set of disruptive events, such as the impact of the COVID-19 virus and bushfires. In this environment, improving the speed with which small businesses are paid will undoubtedly provide them with cashflow relief and greater certainty in their ability to plan and manage disruptions to the business. However, decisions on hiring and investment are still more likely to be influenced by the impact of larger shocks related to disruptions to consumer demand and to supply chains.

The benefits calculation also excludes the value of benefits to the community from improved payment times to small businesses, and by extension, improved small business performance. Small businesses are a significant employer, with 44 per cent of working Australians employed by a small business.[28] They are also an important provider of goods and services to communities, and a source of social contact and connection. These benefits are not quantified as they difficult to value and model, despite the benefit they provide to communities.

Additional non-quantified costs

There may also be additional non-administrative costs that are not quantified in the modelling. This includes the cost of deterring large businesses from investing. These are not modelled quantitatively because of the numerous factors that affect large businesses' operational decisions but are discussed in the cost section below for each policy option. Evidence from the literature review and consultations with large businesses suggest the impact of these costs on large businesses' financial position and operational decisions was likely to be lower compared with the positive impact on small businesses. This is because large businesses have a much stronger and deeper balance sheet compared to small businesses, and more options for accessing low cost financing. Consequently, the impact of the transfer of working capital is less noticeable versus a small business, and therefore less likely to affect operational decisions such as investment and hiring decisions.

There is a possibility that there would be a minimal cost to financial lending institutions if small businesses were able to access capital at a lower cost, or were less likely to access it because their financial position improved with faster payment times. However, this impact is likely to be limited. This is because small businesses are capital constrained, and often rely on non-conventional sources of capital to fund their business (such as personal savings or borrowings from friends and family). If small businesses financial position improved due to faster payment times, these non-conventional capital sources are likely to cease first, limiting the impact on financial lending institutions. Similarly, while there may be a reduction in small businesses borrowing on credit cards as this is a very expensive form of capital and is not likely to have a material impact on the revenue financial institutions earn from credit card facilities overall.

More broadly, there are a variety of factors that determine demand for lending and the supply of loans. These are likely to be more significant than the impact of payment times on small business demand for these products. To the extent that improving the financial position of small businesses improves the performance of small businesses, it could have a positive impact on demand for lending, as a small business may be more likely to be able to repay a loan, seek a loan or successfully pass a credit approval check.

These costs are discussed further in the risk section of the RIS, and in the following qualitative assessment of each policy.

These costs are more difficult to quantify accurately, especially on a macroeconomic scale, and therefore have been excluded from the NPV calculation in favour of a simpler model.

[28] ABS 8155.0 - Australian Industry, 2017-18.

Calculating the administrative cost

The second component of the NPV is the administrative cost associated with each policy. These are the various processes required under each policy to realise the improvement rates, such as familiarisation with the new policy, collating and undertaking reporting on a regular basis or improvement costs.

For each policy, this was calculated based on which of the specific process costs were incurred in the two policy scenarios, with the net benefit calculation adjusted by the proportion that would improve. For example, if there was an expected 50 per cent improvement rate from a reporting scheme, the administrative cost would reflect the cost of all qualifying entities reporting, and benefit of improvement from half of these large businesses. These costs were estimated following consultation with large businesses and likely reporting entities. Their amount, rationale and calculation are discussed in Appendix A.

Calculating the net benefit

To calculate the net benefit, the administrative cost is subtracted from the benefit associated with the improvement in payment times achieved by the policy to deliver the policy's net present value.

Policy option 1: Business-as-usual

Cost-benefit result

Benefits

The BAU scenario modelled the impact of continuing to rely on the industry-led BCA's Australian Supplier Payment Code, which has been recently introduced and should expect a steady take-up. Of the more than 120 code signatories, 80 would likely be captured under the scheme.

The Prompt Payment Code (PPC) in the United Kingdom (UK) is the most prominent example of an industry payment code. It is administered by the Chartered Institute of Credit Management (CICM) and the Department of Business, Energy and Industrial Strategy (BEIS). Introduced in 2008, 10 per cent of reporting entities under the government's legislated UK Payment Practices and Performance Reporting framework indicated they are a code signatory.

Taking the existing sign-up rate of 80 from the BCA Code's start in May 2017 suggests approximately 30 firms joining per year in Australia. The optimistic view is that this sign-up rate continues, leading to 30 per year and 300 after 10 years – accounting for 9 per cent of potential reporting entities. However, this is likely too optimistic, as evidenced by the UK PPC sign-up rate where take-up was high over the first two years before becoming comparatively much slower in the years following.

Based on these results, a 10 per cent sign-up rate based on the UK experience appears an optimistic estimate, but would be equivalent to around 300 large business signatories in the next 10 years. The lower range estimate is using the UK PPC signatories removing those that were not likely prompted by Government intervention. This is half of the large businesses, giving an estimate of 5 per cent.

Costs

The primary quantifiable effects are businesses incurring administrative costs. Currently under the BCA's Australian Supplier Payment Code, and confirmed through feedback from signatories through consultation, the primary cost is the effort in businesses verifying which of their suppliers qualify as small businesses.

Another issue considered with this policy option is the likely compliance rates, where lower compliance rates would subtract from the likely benefits that that the scheme yields. As reporting for large businesses or BCA signatories is not publicly available, it is difficult to ascertain the existing compliance rate for the BCA signatories.

The experience in the UK has shown compliance rates with a voluntary, self-regulation code can be a material issue. The Prompt Payment Code requires signatories to pay at least 95 per cent of invoices within 60 days, unless in exceptional circumstances. However, as reporting in the UK began in late 2017, the first report of those identifying as signatories to a code showed that less than half of these businesses paid at least 95 per cent of their payments in 60 days.

This does not necessarily imply that these businesses are non-compliant, as businesses could have exceptional trade agreements or are showing improvement towards this requirement. However, since reporting started, the removal of signatories has demonstrated that a compliance rate could be a material issue.

While it is hard to determine, in the modelling we have estimated a range of between 70 per cent and 90 per cent compliance.

Based on these quantifiable effects, we estimate there to be a net economic benefit of between $11 and $28 million per year (averaged over ten years) or put another way, a benefit of between $77 and $198 million (net present value) over ten years.

The sensitivity of the benefit to the improvement rate of large businesses is shown in Table 2 below.

Table 2: Sensitivity of the benefit to the improvement rate of large businesses

Improvement rate of large businesses	1 year benefit ($million)	10 year benefit NPV ($million)
10%	$3	$22
20%	$6	$44
30%	$9	$66
40%	$13	$88
50%	$16	$110
60%	$19	$132
70%	$22	$154
80%	$25	$176
90%	$28	$198
100%	$31	$220

Source: AlphaBeta modelling.
Note this table assumes a 10% compliance rate with the code. In the pessimistic scenario cited in the net benefit finding above, the compliance rate is assumed to be 5% and the improvement rate 70%, hence the quoted figure for 70% improvement rate is slightly higher in the table versus the pessimistic scenario.

Unquantifiable effects

Benefits

Businesses that have joined the BCA's Australian Supplier Payment Code are likely do so because it helps the business's reputation. While we have included the costs of improving for businesses, the gains from an improved reputation are qualitative and difficult to determine. Rationally, as the code is voluntary any business that is joining this code does so believing that it benefits outweigh the costs. Based on this we could assume that the overall benefits to the businesses who join are greater than the costs incurred.

The voluntary payment codes include provisions that are broader than an improvement to payment times, and therefore could lead to other improvements in payment practices. The BCA's Australian Supplier Code promotes principles of transparency, dispute resolution processes, adoption of technological solutions and working with suppliers to reach fair outcomes – none of which are targeted by other policies that are focused on delivering payment time improvement rates.

The BCA's Australian Supplier Payment Code also has the benefit of providing an industry set norm of paying small suppliers within 30 days. This helps set a norm on what payment times in Australia should be. Setting a norm is important to encourage improvement. The benchmark of 30 days was acceptable to most stakeholders consulted in this process.

Costs

A concern with voluntary codes is that only good actors will become signatories. In the modelled scenario, it is assumed that each signatory will improve by the average amount. However, signatories to voluntary codes often present a selection bias, and businesses that are closer to the requirements of the code, or are more open to improving their payment times, are the businesses that are more likely to become signatories. Despite this, it is difficult to determine the extent to which is true with the BCA's Australian Supplier Payment Code.

Regulatory Burden Estimate (RBE)

As the code is voluntary, no regulatory burden is considered.

Policy option 2: Mandatory payment times reporting scheme for large businesses using a Small Business Identification Tool, with mandatory reporting at entity level

Cost-benefit result

Benefits

The primary quantifiable benefit associated with reporting is an improvement in the payment times of large businesses to small businesses. As explained in box 1 above, this results in a net economic benefit due to the difference in the cost to access capital for small businesses.

The modelling assumes a 100 per cent take-up rate of reporting by relevant large businesses as compliance with the reporting is mandatory. It assumes the improvement rate would be higher than a voluntary code scheme, with a range of 30 per cent in a pessimistic scenario, and 60 per cent in an optimistic scenario.

A range is used as there is little evidence to quantify what an improvement rate for large businesses will likely be over time as there are few precedents for this type of intervention. The only comparable policy that has been implemented has been the UK reporting scheme, where only a portion have reported for more than a year and overall trends are still unclear. Recent analysis shows that 45 per cent of UK firms that have reported for more than a year showed improvement, although this is only marginally higher than the proportion that simultaneously worsened. This means the true proportion of firms that improved from the reporting is unknown.

We have taken 60 per cent as an optimistic, upper bound estimate for improvement in Australia given the Australian scheme is focussed on small businesses, unlike the UK scheme which applies to all suppliers. To allow for the fact that overall improvement may be lower than the number of firms that improve as some worsen, a pessimistic scenario is taken as an improvement of 30 per cent over the ten year period.

We estimate the improvement rates in Australia would be higher than those in the UK for a number of reasons. The first is the narrower definition of large businesses in the proposed scheme, which will make it clearer which businesses qualify as reporting entities. This policy is also focused on small business suppliers only, unlike the UK scheme which focuses on all suppliers. A more focused scheme is likely to drive higher improvement by setting a clearer norm, and revealing if firms meet the set standard.

As it costs a large business less to improve times for small businesses only, it is also more likely more large businesses will change. The Australian legislation also proposes the use of penalties for non and mis-reporting, which the UK has not yet introduced in its initial stages. Additionally, the reporting scheme in the UK follows numerous prior government-led payment policies, such as the more prominent, government-backed Prompt Payment Code, the right to claim interest on payment times in excess of 60 days and legislation on the maximum standard contract terms, which may have led some businesses who were willing to improve to do so prior to the commencement of the reporting scheme.

Costs

A regulatory cost is created in requiring businesses to report. This has been estimated based on consultation with large businesses on prospective costs of reporting, and adjusted to allow for all entities in a group to have to prepare a report, even if they did not individually meet the reporting threshold. We assume large businesses incur reporting costs, as reporting is a regulatory requirement. We assume large businesses incur a small verification cost to identify small business suppliers using the Small Business Identification Tool. We do not assess improvement costs as it is a voluntary choice for the business to improve.

The costs cited are an average based on industry consultation and modelling from previous, comparable schemes. In practice, individual costs will vary across businesses depending on factors such as the number of small business suppliers, whether they already report internally on payment times, and the extent of standardisation in payment practices and financial and reporting systems within the group or entity.

Based on these quantifiable effects, we expect there to be a net economic benefit of between $64 and $158 million per year (averaged over 10 years) or put another way, between $447 and $1,107 million (net present value) over 10 years.

The sensitivity of the net benefit to the improvement rate of large businesses is shown in Table 3 below.

Table 3: Sensitivity of the benefit to the improvement rate of large businesses

Improvement rate of large businesses	1 year benefit ($million)	10 year benefit NPV ($million)
10%	$8	$54
20%	$29	$274
30%	$70	$495
40%	$102	$715
50%	$133	$935

60%	$164	$1,155
70%	$196	$1,375
80%	$227	$1,595
90%	$258	$1,815
100%	$290	$2,035

Source: AlphaBeta modelling

Unquantifiable effects

Benefits

The introduction of a reporting scheme will provide a comprehensive measurement of large business payment times in Australia for the first time. This will enable measurement of the extent of the problem and allow evaluation of any other policies used to address payment times. This will also bolster the ability to check the compliance of signatories to the Prompt Payment Code.

As explained in the section on calculating net benefits above, there are likely to be a number of non-quantifiable benefits arising from any consequent improvement in payment times associated with the reporting scheme's introduction.

Costs

It is possible that the scheme will require reporting on supply chain financing practices. Depending on the fields, this may require a large business to request data from a third party supplier. This cost has not been included as it is currently uncertain if third party data requests will be needed, and if they are, what proportion of reporting entities would be impacted.

There is a potential concern that reporting, or any policy option that focuses on small business suppliers significantly, could discourage reporting entities in engaging with small suppliers. While it is feasible that under this policy option that a reporting entity would do this to avoid regulatory burden, no evidence so far has suggested this would happen and is difficult to quantify in its effect. During consultations on options to identify small businesses, including a small business survey, small businesses stated they were generally not concerned about being identified as a small business, as most customers were already aware of their size.

Another issue raised in consultation is the susceptibility of improvement and changes in behaviour to the metrics that are used for reporting. An example brought up from the UK has been the concern that reporting the proportion a business pays on time could lead to businesses extending their initial payment terms, meaning more of their payments would be "on time". Similarly, a reporting measure such as the proportion paid in 30 days could allow businesses that are already paying quickly to increase their payment times to 30 days without any change in the measure.

Regulatory Burden Estimate (annual)

Table 4: Regulatory burden estimate

RBE	Business costs	Community costs	Individual costs	Total costs
	$ 22.5m	$ 0	$ 0	$ 22.5m

The regulatory burden estimate (RBE) is calculated as the average annual equivalent cost over the first 10 years of the policy. For a breakdown of this estimate see Appendix A.

Risks associated with the policy options

There are three broad categories of risk associated with the question of whether to regulate payment time performance and practice:

1. The risk of adverse consequences from inaction on payment times and practices
2. The risk of adverse consequences arising from the implementation of a policy intervention
3. The risk that an intervention is ineffective at driving improvement in payment times and practices

1. The risk of adverse consequences from inaction on payment times and practices

As the RIS outlines, there is significant evidence that payment times from large to small business can be long, and when they are, they have a negative impact on multiple aspects of small business performance. There is also significant evidence from Australia and overseas that large business payment times are unlikely to improve materially or quickly if voluntary action alone is relied upon.

The risk of long payment times materially impacting small businesses is growing due to the declining economic situation in 2020, driven the impact of natural disasters and the COVID-19 pandemic on business operations. This is because reductions in demand for businesses, or disruption to operations, will reduce small business earning capacity and increase financial stress. Small businesses are likely to be more at risk in this situation versus large businesses because their starting financial position is more tenuous. Therefore, this risk is deemed to be moderate to high, particularly given current economic conditions.

2. The risk of adverse consequences arising from the implementation of a policy intervention

A second area of risk is a risk that implementing a policy response to payment times has an unintended adverse consequence. The primary risks raised in this category during stakeholder consultations were the risk of disincentivising large businesses from engaging small business suppliers, and the risk of small business suppliers feeling uncomfortable at being identified as a small business via the Small Business Identification Tool.

Both of these risks were therefore extensively explored during stakeholder consultations on the reporting framework's design. Based on this work, they are considered to be low risk.

Large businesses uniformly said during consultations that the reporting scheme – or a voluntary push to improve payment times - would not disincentivise the use of small business suppliers. This is because decisions on how to procure from suppliers are influenced by many factors, such as the quality, cost, convenience and uniqueness of the goods and services supplied. Large businesses felt that these considerations would substantially outweigh whether a supplier was required to be reported on under the scheme.

In a survey of 300 small businesses as part of the research program underpinning the scheme, 97 per cent of respondents they were unconcerned at being identified as a small supplier. This was typically because their size was already known to customers, and / or because they took pride in being a small business. Only 2 per cent of small businesses surveyed thought that customers were unaware now of their size. Further, 95 per cent of respondents were not opposed to being identified as a small business for the purposes of enabling reporting under the payment times reporting scheme.[29] It is proposed that the Small Business Identification Tool will allow these small business to opt out if they do not wish to be identified as a small business for the purposes of payment times reporting.

3. The risk that an intervention is ineffective at driving improvement in payment times and practices

The final risk is that reporting framework is ineffective at driving improvement in payment times, and therefore the benefits are not realised.

This risk is hard to quantify because of the lack of precedent for an equivalent reporting scheme and therefore evidence on likely improvement rates. For that reason, a pessimistic and optimistic improvement scenario were used in the modelling, with one scenario below the improvement rate observed in the UK for a similar scheme, and one scenario above it.

The design of the Australian framework was informed by the UK experience and may be more effective at incentivising improvement. For example, the Australian framework focuses on the treatment of small businesses, rather than all suppliers, which places greater focus on the specific norm the policy is seeking improvement in, and therefore may result in greater pressure for improvement. It is also less costly for large businesses to improve payment times for small businesses only, and therefore easier to improve. Finally, the Australian framework includes stronger powers to compel, audit and assure reporting compared with the UK scheme, which is likely to the share of participating businesses, and the quality of the data reported.

This risk is therefore assessed as being of low – moderate risk.

Consultations undertaken on this issue

Consultations to date

Following the announcement of the policy objective on 21 November 2018 by the Prime Minister, the Department commenced extensive consultations throughout 2019 and early 2020.

The objective of the initial consultation phase in February 2019 was to better understand issues related to payment times, and to test potential policy options, including a payment times reporting scheme. The consultation period sought feedback from a broad base of stakeholders and identified three key stakeholders most impacted by the potential policy in small business, large business and government entities. In total approximately 80 organisations were consulted, spread across large businesses, small businesses and policymakers.

Following the initial consultation period, a second consultation phase was run from September 2019 – November 2019 which sought feedback on the more detailed design of the scheme. In particular, it considered how the framework should deal with the identification of small businesses in a way that maximised the accuracy of identification and minimised the regulatory burden on businesses. It also examined whether reporting should be at the group or entity level, or if businesses should have the ability to choose their preferred reporting method.

In both consultation phases, multiple channels were used to reach stakeholders. This included expert working groups, workshops, an online forum for small businesses, one-on-one meetings, a small business survey and multiple discussion papers that interested stakeholders could respond

[29] Small Business Survey conducted as part of Payment Times Reporting Framework design, n = 301

to via an online form or written submission. The additional organisations consulted in the second round of engagement brings the total organisations consulted to around 400.

In February 2020, the exposure draft of the legislation was released to provide stakeholders with the opportunity to view the proposed approach and comment on the provisions.

Working groups

In the first round of consultation, two expert working groups were established to advise on the issue, one comprising industry representatives and a second working group with for government representatives. The objective of the working groups was to provide an expert view on both the issue of payment times and the design of a potential reporting scheme. The first working group meetings were held at the start of the consultation, with the intention of defining the key questions and talking points that would be brought forward into the public workshop and the online discussion paper. A second working group was then convened at the conclusion of the public workshops and after early discussion paper submissions to consider the results.

The industry working group included representatives from both large and small businesses and industry organisations. The Government workshop included members from the Australian Taxation Office, the Department of Finance, the Australian Securities and Investment Commission and the Australian Small Business and Family Enterprise Ombudsman.

In the second round of consultation from October – November 2019, an expert working group was also formed.

Public workshops

A series of public workshops were held in February 2019 for participants to understand stakeholder perspectives on payment times and the need for, and nature of, policy interventions. These workshops were held in Canberra (18 February), Perth (19 February), Sydney (20 February), Melbourne (21 February) and online (21 February). Approximately 60 representatives from small business, large business and government entities attended these workshops.

The aim of the public workshops was to engage a range of stakeholders, connect large and small businesses together and discuss the key choices involved in designing policy to address payment. To achieve this, the workshops were structured as a 2 hour event, where the first hour was a presentation of the context of the problem and the policy design option, allowing for questions and discussion, and then followed by an hour where attendees were able to vote on a series of policy design choices and then discuss the results as a group.

A second round of public workshops were conducted in November/December 2019. Workshops were held in Perth (15 November), Sydney (26 November) as well as a targeted workshop organised in conjunction with Chartered Accountants Australian New Zealand (4 December).

These workshops explored in greater detail options to identify small business suppliers, how complex corporate groups and entities should report under the scheme, as well as compliance and enforcement options under consideration.

Discussion papers

A discussion paper, “Payment Times Reporting Framework – Discussion Paper”, was released on 13 February 2019, inviting stakeholders to provide response either to a series of discussion questions or through a formal response. Submissions were received from 22 small business, large business and government stakeholders.

The objective of the discussion paper was to provide a public account for the choices currently present in the policy design, and to invite stakeholders, especially those that were unable to attend the public workshops to vote on the key design choices.

A second discussion paper was released in October 2019, which provided an update on the design of the scheme and sought stakeholder feedback on a further set of detailed design questions.

One-on-one meetings

In addition to the formal consultation channels discussed, there have one-on-one discussions with a range of stakeholders, primarily large businesses and other policymakers. The objective was to provide a chance for stakeholders to further discuss issues with the department independently of the other workshops and provide more in-depth feedback on their experiences with payment times.

Interviews

Interviews with large businesses were used to survey the feasibility and cost of different reporting scheme options. These were used as the basis for the administrative cost estimates present in the regulatory burden measurement and cost benefit analysis. Interviews with other policymakers included those who had worked on payment times as a policy issue both in Australia and in the UK, and also administrators of similar Government regulation schemes.

During the second round of consultation, a further 17 interviews were undertaken with large and small businesses and regulators to better understand their view on the key issues.

Survey

During the second round a consultation, a survey of 300 small businesses was undertaken to establish their attitude to being identified to customers and their preference for the means of identification if it did occur.

Exposure draft of legislation

An exposure draft of the legislation was released for consultation on 21 February 2020. A consultation paper outlining the content of the proposed Minister’s Rules that would be made under the legislation was also released at the same time.

Acceptance of submissions closed in early March 2020. More than 30 submissions were received providing feedback on the exposure draft legislation and Rules.

The preferred option is the introduction of a Payment Times Reporting Scheme

The preferred option to implement is the introduction of a payment times reporting scheme. Improving payment times for small business is an important policy priority, which will deliver a net economic benefit. It is particularly essential as the Australian economy enters an uncertain period with a risk of a downturn, because it will improve the cashflow position of small business and encourage more spending and investment.

The introduction of a payment times reporting scheme is preferred because it will provide greater transparency around payment practices to small businesses. This in turn is likely to encourage more large businesses to pay their small business suppliers faster.

A reporting scheme is preferred to the BAU and voluntary option because in both Australia and overseas, voluntary action has not catalysed a material improvement in payment times to small business.

The reporting scheme will have an effective implementation, compliance and evaluation program

Implementation overview

The implementation of the Payment Times Reporting Scheme requires the following key actions:

- The introduction and passage of enabling legislation
- The establishment of the Payment Times Regulator, including their regulatory and enforcement powers,
- The establishment of the key functions, platforms and supporting materials required to support the scheme. This ranges from the establishment of the reporting and publication platform and a Small Business Identification Tool, to the creation of communication and information materials.
- Ongoing support from a core policy government function.
- The running of an information campaign to alert businesses to the scheme, and their obligations under it

Legislation to enact the scheme has been drafted, with the exposure draft released for public comment in February 2020.

Once the legislation is passed, it will establish the Payment Times Regulator, their powers, and the key functions to support the scheme. The Payment Times Regulator will be responsible for obtaining and publishing information on payment times and practices from reporting entities, that is large businesses and corporate government entities with an annual turnover greater than $100 million. The Regulator will also have responsibility for monitoring and enforcing the provisions of the relevant legislation.

Passage of the legislation will also allow the key functions and platforms supporting the scheme to be established. Planning for this work is already underway to ensure a smooth implementation in time for the commencement of the first reporting round.

Funding for the scheme has been allocated. As part of the 2019-20 MYEFO, the Government provided funding to establish the scheme with $10 million over three years from 2019-20 (including $3.4 million in capital funding), $2.6 million in 2023-24 and $2.4 million per year ongoing from 2024-25.

Enforcement and compliance scheme

The Payment Times Reporting Scheme will be underpinned by a compliance and enforcement regime. The design of this approach balances minimising the cost and regulatory burden of the scheme with ensuring it has good compliance and is able to serve its purpose.

One of the first key steps will be establishing the Payment Times Regulator to ensure large businesses report accurately. It is proposed that the Payment Times Regulator is a Senior Executive Service SES role, appointed by the Secretary of the Department of Industry, Science, Energy and Resources. The Regulator will be impartial and independent. They will have the power to accept and publish reports as well as monitor and enforce compliance with the proposed legislation. This includes the ability to provide written notice to a reporting entity to appoint an auditor, as well as monitoring and investigation powers. The Regulator will also need to engage with a range of stakeholders and promote cultural change within large businesses. The Regulator will be appropriately resourced with additional staff provided to support its functions.

This option is preferred as it will reduce costs compared with establishing a new entity because the Regulator can leverage the existing infrastructure and corporate support functions of the Department. It is preferable to placing the function with an existing regulator, such as the Australian Securities and Investment Commission, as they have a significant work agenda and would have less capacity to focus on addressing the payment time issues.

Locating the Regulator in the Department with policy responsibility for small business could create the perception of bias that the Regulator and its approach to compliance and enforcement favours small businesses. However, this perception of bias could be effectively managed through a number of mechanisms including:

- Creating a specific identity for the Regulator, through separate branding distinct from the Department;
- Establishing distinct reporting and accountability lines between the Regulator and the small business policy function;
- Ensuring internal separation between staff assisting the Regulator and those working on small business policy (for example, through separate record-keeping arrangements).

There are a number of examples where a regulator is successfully co-located with the related policy function. For example, the Gene Technology Regulator is supported by the Department of Health under the *Gene Technology Act 2000*.

Penalties

The Bill establishing the Payment Times Reporting Scheme imports standard penalties from the *Regulatory Powers Act* for a number of offences including failure to report and failure to respond to an audit notice. These penalties can apply daily. In addition, a number of multiple of gain penalties (percentage of company turnover) will be imposed for false and misleading information, failure to keep records and assist the auditor. This approach is necessary to maintain a deterrent effect given the size of the companies involved.

The Bill also allows the Regulator to publish information about a reporting entity that has failed to comply with the Act. This will provide transparency to small businesses using the register, allowing them to determine the companies they will engage with.

As enforcement activities are not covered by Regulatory Impact Statements, costs associated with these penalties and publishing non-compliance have not been included in the RIS.

The Bill requires reporting entities to maintain records for seven years. This is required to enable compliance activities to be undertaken. This is similar to the Australian Securities and Investment Commission (ASIC) requirement for companies to keep records for seven years or Tax requirement to keep records for five years including the below:

- Receipts and other evidence of all sales and purchases you made for your business
- Tax invoices, wage and salary records
- All documents about GST
- Records of the purchase, sale and other costs of any business assets, such as land, buildings or office equipment
- All records relating to tax returns, activity statements, fringe benefits tax (FBT) returns, and contributions to employee super.

As reporting entities are already required to keep similar records, this has not been included in the regulatory burden estimate.

Auditing and investigation powers

It is proposed that the Regulator has the power to request an audit of reporting on the basis of a reasonable suspicion of misbehaviour. The Regulator will either accept the large business choice of auditor or will choose its own. The large business will be required to pay for the cost of the audit. This cost is not included in the Regulatory Burden Estimate as it is considered to be an enforcement cost.

A number of standard powers have also been imported from *Regulatory Powers Act* covering monitoring and investigation. These powers are required to identify the accuracy of reports.

This approach is necessary because of experiences with the UK scheme whereby the accuracy of reports were unable to be examined and verified. Audits will only be undertaken as a last resort where other information raises issues about the accuracy of the data provided by a large business and they are unwilling to change their approach.

Power to identify reporting entities

A consequential amendment to relevant taxation legislation will give the Regulator the power to use tax data to access information on reporting entities for the purpose of the scheme. This information will be used to identify entities who should be reporting. The information will be subject to the normal safeguards established by comparable schemes that have been given access to tax data for similar purposes.

Taking a graduated approach to compliance and enforcement

To minimise the regulatory burden associated with the scheme, there will be a transition period of 18 months where compliance and enforcement actions will not apply. The purpose of this grace period is to allow reporting entities the opportunity to establish their internal reporting function and build the capability to report efficiently and accurately, without the risk of inadvertently triggering a penalty or enforcement action.

Following this 18-month period, a graduated approach will be taken to compliance and enforcement. This will start with education and awareness raising, followed by working with companies, and then application of penalties as a last resort.

The Bill for the scheme provides that certain decisions made by the Regulator are reviewable. These include: a decision not to determine that an entity has ceased to be a reporting entity, a decision to not allow further time to give a payment report; and a decision to publish the identity of an entity with details of non-compliance.

The scheme will seek to establish a constructive relationship between the Regulator and reporting entities. A reporting entity will have the obligation to provide a report within 3 months of the end of a reporting period. However, the Bill allows a reporting entity to seek an extension of time to report by applying in writing to the Regulator. A reporting entity will also have the right to request that the Regulator registers a revised version of a payment times report.

Evaluation of the scheme

The Payment Times Reporting Scheme will be reviewed after three years. The review will consider the efficiency, effectiveness and appropriateness of the scheme, and opportunities to improve it.

In considering the efficiency and appropriateness of the scheme, the review will assess the regulatory burden imposed on large businesses and government, whether this is proportionate, and if there are opportunities to further reduce it.

In considering the effectiveness of the scheme, the review will evaluate trends in payment times and practices for reporting entities covered by the scheme, and whether there is evidence that the scheme has incentivised improvement. It will also consider whether the measures in the scheme could be improved, or require additional efforts to support them.

Appendix A – Administrative cost estimations

In addition to the benefits and costs associated with a change in payment times in the economy, there is also the expected cost on qualifying entities in complying with the proposed policies, which is encapsulated by the Regulatory Burden Estimate (RBE) used in this statement.

To determine the RBE of each policy, the likely requirements imposed on each qualifying entity in the proposed policy scenarios was considered and broken down into distinct processes. These processes were then the subject of consultation with large businesses that would likely qualify with reporting, to arrive at a range of potential costs each would impose on a business. In addition, these costs were compared to similar regulatory impact statements where comparable.[30]

Costs have been quoted as either a dollar figure or in terms of working days and the corresponding employee level, depending on what is more applicable. Costs have also been categorised as either an initial, one-off 'transition cost' that are costs imposed within the first year of complying with the policy option, or an 'ongoing cost' that is expected to continue annually.

The RBE is then taken as the total, non-discounted cost over the first 10 years and then divided for an annual estimate for each policy option.

As the first policy option considered is a voluntary, business-as-usual scenario, the RBE is assumed to be zero. The remaining option is explained below.

Policy option 2 – Requiring entity-level reporting

This option requires all entities that meet the qualifying threshold to produce a report for that entity. Where the qualifying entity is a group, the requirement to produce an entity report also applies to all related entities, irrespective of whether they are above the threshold individually. A provisional estimate for the number of entities that would be required to report under this scenario is 9,100.[31] Hence, the estimated cost for this policy option is taken as the average cost of reporting for each entity, multiplied by the estimated 9,100. For some activities, such as submission and CEO verification, qualifying entities will have the option to perform them at the group or entity level. We assume that reporting entities will take the most efficient option, and report as they do for tax purposes. Therefore, for these activities we assume 3,400 firms perform them.

Table 5: Estimated costs for qualifying entities to report

	Estimated range of costs	Average cost
Transition costs	\$13.9m - \$40.5m	\$27.2m
Ongoing costs	\$14.9m - \$24.6m	\$19.7m
RBE cost		\$22.5m

This policy option has been broken down into its expected required processes, and each were then consulted on and a range was estimated for its cost. Practice will vary across different business sizes

[30] Primarily, the UK Payments Practices and Performance Reporting Scheme conducted an impact assessment using a survey of businesses. Their results have been used as a reference point for some estimates presented here where directly comparable, and referred to as the UK Scheme

[31] Preliminary investigation estimates from ABS based on 2018-19 BAS reporting. Users comparing data from this release with other ABS data should do so with care, as some other ABS data may exclude non-employing businesses or particular industries or sectors.

and structures, but again the estimation below reflects the expected average cost for entity-level reporting. Reporting at entity level is assumed to involve processes of:

- **Familiarisation** – Time taken for a business to familiarise and understand the requirements of the policy. Estimations based on feedback suggested this would likely take one employee between one day and one week to complete. This is comparable with UK estimations, which was approximately $1,000 to complete[32]. An estimation of between 2 and 3 days was used[33]
- **IT costs** – Refers to any changes required to the business's IT system. Through consultation, businesses expressed that reporting requirements that were limited to the proposed fields could be reported from one set of existing accounts, and hence completed with minor or no additional IT changes. This is again comparable with feedback received in the UK estimations. An estimate of between $0 and $1,000 was used.
- **Verification** – Refers to the process of identifying which invoices are related to small businesses, which is done using the proposed Small Business Identification Tool. As this is a novel process that is being proposed as part of this policy option, the estimate remains general. However, it is expected to be simple in its use, and in consultation businesses have expressed a likely ease of using the proposed design. An estimate of half a day for to learn how the tool works, and another half a day per year of reporting ongoing was used.
- **Preparing the report** – Refers to the process of preparing the report once qualifying entities are familiar with the reporting requirements, made any requisite IT changes and verified which invoices are to be reported on. This involves collating data and summarising it into the required reporting fields. It is expected that within the first year of reporting, this will require managers to organise and coordinate reporting within the entity. After this initial setup, it is assumed an employee will be able to carry out the process of preparing the report, given that the report is a basic summary of invoicing data and not requiring any qualitative assessment. An estimate of between 2 days and 4 days was used for a manager in initial transition costs, and an ongoing cost of between 2 days and 3 days is assumed for an employee to produce the report at an ongoing basis[34]
- **Verifying the report** – Refers to ensuring the report is correct and entering data in the online form and submitting the report into the online portal. An estimate of between half a day and 1 day was used for a manager to verify the reporting, assuming that it is performed twice in the year. We assume that this is done at the entity level.
- **Approving the report** – Refers to the requirement that each report has to be approved at the CEO level. The modelling assumes half-yearly reporting, and therefore that this activity is performed twice in a 12 month period. An estimate of between 1 – 2 hours was used, inclusive of two approvals.[35] We assume this is done at the group level.
- **Submitting the report –** refers to the time required to complete and submit an online form to upload the reporting. We assume this is done at the group level twice a year, and that it requires between 2 – 3 hours.

[32] Results from the UK Impact Assessment are originally in £ and are quoted here in approximate AUD figures
[33] The wage of an employee is estimated to be $100,000, and the wage of a senior employee to be $200,000 per year. This is then divided into a per-working day figure
[34] This is treated as an average figure.
[35] The daily salary at this level is estimated to be $2,400