

Earlytrade submission to ASBFEO SCF Review: Marketplace Version III ‘The Earlytrade Marketplace’

Thank you for the opportunity to make a submission to the Australian Small Business and Family Enterprise Ombudsman’s Review of Supply Chain Finance. We would like to outline a ‘Marketplace Version III’ as a separate and alternate version to the two models you put forth in the ASBFEO Supply Chain Finance Review position paper, dated February 2020. We have also answered the question for comment section to the best of our knowledge.

In summary, Earlytrade’s marketplace platform delivers all of the benefits Supply Chain Finance promises with none of the downsides. Some of our Australian customers (including Lion and Beston Global Foods) and small business suppliers (Port Macquarie Work Wear, Aussie Beer Tubes, Pontoon Platform and Boo Studio) have submitted their views and experience of this with the ASBFEO. We are all interested in going on record to discuss the key supplier benefits of the Earlytrade Marketplace. We are also interested in having our Marketplace Version III example featured in the final position paper as an alternative ethical model.

About Earlytrade

Earlytrade is an Australian fintech company that provides a unique ethical alternative to ‘reverse factoring’ or supply chain finance.

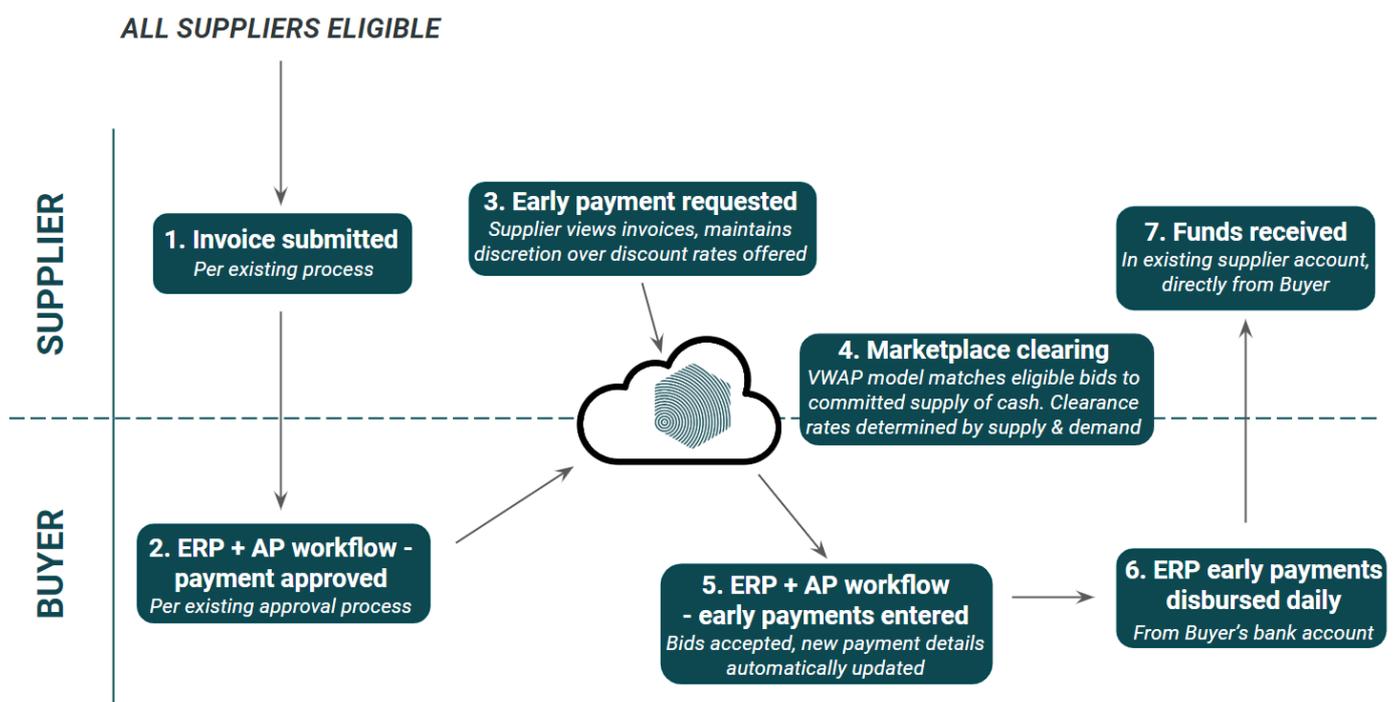
Founded in 2016 by technology entrepreneur, Guy Saxelby and ex-ASX product manager, Piers Symons, Earlytrade owns and operates Australia’s largest early payment marketplace with over 36,000 businesses (mostly small businesses) using the platform to request early payment from their customers.

A key difference between the Earlytrade Marketplace model and other reverse factoring arrangements is that it is entirely supplier-driven. If suppliers require funding before their contractually agreed payment date, they can access an alternative source of liquidity via the marketplace at rates significantly less than bank financing, which in turn creates real value for suppliers.

Earlytrade’s Marketplace matches a committed supply of working capital from customers and the demand for early payment from all their suppliers. Unlike some platforms, Earlytrade does not mine big data or use AI to collect detailed information on the contents of supplier invoices. This is important as it allows Earlytrade’s marketplace to be neutral, with supply and demand driving rates.

Along with its core marketplace platform, Earlytrade has four other products growing in adoption including Earlytrade View, Earlytrade Verify, Earlytrade Grower and Earlytrade Fund. Earlytrade Verify is a product that acts as a compliance mechanism to large corporates payment time performance and can track and report back on adherence to the BCA's Australian Supplier Payment Code. Earlytrade Verify has been developed in advance of Payment Times reporting Framework legislation being enacted by 1 January 2021.

Marketplace Version III - 'The Earlytrade Marketplace'



Establishing the market place: The Buyer selects the early payment platform (such as Earlytrade), which all suppliers are then eligible to use.

Joining the program: Suppliers wishing to access early payments simply register and verify themselves on the platform without needing to endure onerous KYC requirements. Suppliers do not have to register if they do not wish to.

Invoice approval: Invoices approved for payment in the Buyer's ERP system are automatically uploaded to the early payment platform.

Buyer action: The Buyer determines the amount of surplus cash they are able to make available for early payment and the discount rate required for early payments to be accepted

_____ (based on their own marginal cost of funds). A portion of these funds are allocated for early payment to small business only.

Supplier discretion: Suppliers are able to view when their invoices will be paid and decide whether their business would benefit from early payment. If so, the supplier submits a request into the marketplace platform for early payment (prior to the contractually agreed payment term) by nominating a discount they are willing to accept on their invoices. All suppliers with invoices approved for payment are able to specify their individual discount rate. Suppliers always maintain complete discretion over whether they bid for early payment and the discount rates offered.

Marketplace clearing: Using a volume weighted average price (VWAP) bidding model, the marketplace matches eligible bids to the committed supply of working capital. This averages the discount rate across all approved invoices payable to an individual supplier. If the VWAP discount rate exceeds the minimum rate required by The Buyer, and the stated cash limit has not been exceeded, that particular supplier will be granted early payment. The competitiveness of discount rates within the marketplace is entirely determined by supply and demand dynamics, with no use of AI to target specific suppliers.

Small business allocation: To ensure large suppliers do not exhaust the entire supply of working capital, Earlytrade keeps an allocation of cash reserved only for small business suppliers. Small businesses are therefore guaranteed early payment until that allocation has been utilised, after which they can access the broader market. This model guarantees equitable treatment of small businesses as they always compete on a level playing field with other small businesses.

Payment rescheduled: The marketplace platform (Earlytrade) interacts with the Buyer's ERP system to automatically confirm the discount amount and rescheduled payment date for successful suppliers.

Buyer cash utilised: Early payments are made on a daily basis from the Buyer's corporate bank account directly to the suppliers' bank accounts, with no third party financing required. This reduces the KYC and onboarding requirements for small businesses.

Key supplier benefits:

- Supplier driven marketplace
- Suppliers maintain complete discretion as to if and how they interact with the platform, including the discount rates offered
- VWAP bidding model enables early payment for tens-of-thousands more invoices
- Discount rates in the marketplace entirely determined by supply and demand dynamics, with no manipulation by AI
- Small business verification service

- Portion of marketplace funds specifically segmented for small business early payment
- No third party financing required

- No KYC requirements for suppliers to endure

Live Example (Lion Case Study)

Port Macquarie Workwear (PMWW) is a clothing and apparel manufacturer that supplies uniforms and customised workwear to Lion, a leading adult beverages company in Australasia. As a small business, they are often forced to accept extended payment terms from some large commercial customers, meaning their business cash flows can be difficult to manage.

In 2017, recognising these issues faced by their small business suppliers, Lion proudly became one of the first signatories to the Australian Supplier Payments Code, rolling out 30-day payment terms to all suppliers subject to their standard terms and conditions. Lion also gave their suppliers access to early payments via the Earlytrade platform.

For small businesses like PMWW, they are able to log on to the Earlytrade platform to view when all of their approved invoices are due to be paid by Lion. If their business has cash flow requirements before these due dates, PMWW can offer a discount rate that works for their business to access early payment. If PMWW do not require early payment, they will be paid the full invoice amount on the original due date.

The Earlytrade Marketplace calculates the volume weighted average discount offered by PMWW across all of their approved invoices. The marketplace then aggregates bids from all Lion suppliers and compares them to the minimum discount rate required by Lion (based on their marginal cost of funds). If PMWW's bid (discount rate) is greater than the required rate, they will be paid on the following day. The competitiveness of discount rates in the Earlytrade marketplace is entirely driven by the supply of cash from Lion and the demand from suppliers for early payment, so PMWW knows they may be able to access cheaper rates at certain times.

With over 36,000 suppliers actively using the Earlytrade platform to support their cash flow options, the benefits derived by PMWW have been mirrored by thousands of other small businesses throughout Australia. Small businesses are guaranteed to be allocated a portion of all funds made available for early payment in the marketplace.

ASBFEO questions for comment

1. Consistent small business definition

a. For consistency, should there be a single definition of small business for payment terms?

Yes. Based on Earlytrade's experience working with large corporates, a great deal of confusion exists as to what determines a small business within their supply chain. Ambiguity around this definition may allow corporates with poor intentions to take advantage of this confusion and squeeze small businesses even more. Conversely, socially responsible companies who have signed up to codes

such as the BCA Supplier Payment Code have struggled to correctly identify eligible businesses within their supplier networks.

b. If so, what should that definition be? (For example, \$10m turnover?)

The definition must be clear and concise, leaving no room for interpretation. It must also allow for adequate compliance reporting and tracking by external agencies. The current definition of \$10m turnover is well aligned with the small business characteristics we see in the Earlytrade network. In the digitised economy, we consider employee count to be a less accurate proxy for business size. Furthermore, imposing an employee count criteria could effectively penalise resource heavy industries with a large number of employees, yet relatively low turnover.

If the definition does have multiple criteria, it must be expressed that the business will be defined as small if either criteria is met as opposed to both. Keeping the definition simple will remove confusion and, ultimately, drive compliance.

Many of the corporates Earlytrade deals with express concern about how they correctly identify small businesses, regardless of the definition, within their supply chain. In light of this, Earlytrade has spent much of 2019 developing a compliance mechanism to solve this issue. This is now in market with some household Australian corporate names.

2. Enforceable payment times

a. Is there a need for a mandatory Supplier Payment Code?

There is a need for a mandatory Supplier Payment Code for large businesses to pay small businesses promptly. Small businesses are the most vulnerable when it comes to cash flow because banks are unwilling to lend to them. A 30 day term for all payments made to eligible small businesses could provide significant benefits to these businesses and stimulate additional growth in an otherwise slowing economy.

Mandating this is one thing, however the reporting and monitoring of company compliance is critical. Earlytrade can help monitor adherence to any mandatory payment code implemented. The Earlytrade Verify platform allows companies and external agencies to track adherence to payment codes, ensuring that eligible suppliers are indeed paid on favourable terms.

Furthermore, adoption of Earlytrade by large businesses, such as Lion, has demonstrated a significant increase in businesses paid within 30 days. Since working with Earlytrade, Lion has seen a 125% increase in suppliers paid on terms of 30 days and shorter (from 42.06% to 94.63% of total suppliers). It has also seen nearly a 75% increase in all invoices paid on terms of 30 days and shorter (from 51.52% to 89.33% of total invoices).

b. What role does the proposed Commonwealth Government's Payment Times Reporting Framework have in:

i. Assessing payment terms performance when SCF is utilised; and

The PTRF is a vital next step in observing payment practices of large corporations within Australia. However, whilst our understanding is that the framework will require certain reporting standards from large organisations, there will be no disincentive for non-complying entities.

Earlytrade Verify is a product Earlytrade has built to ensure large companies comply with prompt payment terms for their suppliers. Since implementing Earlytrade, Lion have witnessed a 125% increase in the number of suppliers paid within 30 days (from 42.06% to 94.63% of total suppliers).

Developed in 2019, the Earlytrade Verify product provides a structured process to assess and maintain compliance with payment codes, such as PTRF or the BCA Supplier Payment Code. After correctly identifying small, local and indigenous suppliers, Verify can be used to assess payment terms performance by comparing original invoice due dates to early payment due dates and, ultimately, actual payment dates.

Earlytrade welcomes any guidance from the ASBFEO about working with the PTRF team to collaborate on implementing a performance framework that genuinely works and is widely adopted.

ii. Auditing and issuing fines or other sanctions for non-compliance?

Earlytrade believes that auditing and issuing sanctions for non-compliance could be a relevant step forward in driving adherence with standardised payment terms. However, with information in large corporates being quite poor there must be a phased implementation that gives businesses time to get ready. It must be stressed that in order for auditing to be effective, it is important that the Government utilises common technologies to make such tracking available to all.

3. 30 day payment term standard

a. For consistency, should there be an economy wide 30 day payment term mandated?

Whilst this seems like a simple and clean solution, the payment terms ecosystem is much more nuanced and requires deeper consideration. As such, mandating an economy wide 30 day payment term could have the opposite intended effect, particularly on small businesses. For example, there are many industry subcategories that are paid on terms shorter than 30 days. These include primary producers, logistics companies, labour hire businesses and sub-contractors in the construction space. Moving these businesses to 30 day terms could effectively cripple them.

Payment terms between large businesses remain a strategic negotiating tool, and generally do not have too much impact on the broader economy. Mandating a payment term economy-wide could be equivalent to fixing the price of a given good throughout the economy. This could have materially adverse effects on a number of businesses. For instance, Earlytrade is aware of a large logistics firm who currently remain competitive by accepting extended payment terms in exchange for their services. Removing this flexibility could result in other suppliers within their network suffering. As such, we do not consider it necessary to mandate a payment term between large corporates.

However, a 30 day term for all payments made to eligible small businesses could provide significant benefits to these businesses and stimulate additional growth in an otherwise slowing economy. Mandating this is one thing, however the reporting and monitoring of company compliance is critical. The Earlytrade Verify platform allows companies and external agencies to track adherence to payment codes, ensuring that eligible suppliers are indeed paid on favourable terms.

In Earlytrade's experience, a number of large businesses in the Australian economy are focussed on their corporate social responsibility mandate. One such business is Lion who rolled out standard 30 day payment terms across their supply chain, regardless of supplier size. In conjunction with this, they offered suppliers the ability to get paid immediately using Earlytrade Marketplace. This has resulted in

75% of all invoices being paid within 30 days and has seen the average days payable fall to below 25 days.

b. For government contracts, how could 30 day payment terms be made to flow down supply chains to small business suppliers?

An adequate monitoring tool is required to ensure that favourable terms are passed down through the supply chain. Earlytrade Verify is a specialised compliance platform that provides visibility through the supply chain to ensure that eligible businesses are paid on the favourable terms expected. Governments implementing this could mandate that large contractors also utilise the platform to ensure compliance with the specific payment practice in question.

4. SCF as a real choice

a. Should SCF be available to small business to reduce payment times from 30 days to better?

We believe that SCF can be beneficial to suppliers, particularly small businesses, if it is offered in addition to - rather than as an alternative to - fair payment terms. Suppliers, particularly small suppliers, should have total choice and control over whether to opt in to SCF.

b. What forms of SCF are of the greatest benefit to small business?

Supplier-led programs, such as the Marketplace Version III, that give small businesses the flexibility to use the program when they require early payment. These suppliers should be able to request early payment only when their business requires it, in exchange for a discount they determine; they should not have to offer discounts for a fixed period of time. In addition, SCF programs that provide an assurance of liquidity at all times provide the greatest benefit to small businesses.

SCF programs can only truly be beneficial to small businesses if they have a good understanding of the mechanism and implications. Suppliers using Earlytrade Marketplace are given customised, hands-on training via phone and email correspondence to ensure that all aspects of their interactions with the platform are well understood and the potential benefits acknowledged.

Earlytrade has worked with a vast number of small businesses to create value from their customer base. For companies such as Aussie Beer Tubes, Earlytrade Marketplace has removed the uncertainty as to when they get paid. By giving similar businesses visibility into the invoice approval status, they are able to include this information in their planning process. For Port Macquarie Workwear, the value of the Earlytrade Marketplace is the flexibility it offers them. Whenever they require additional liquidity to service their own obligations, the supplier is able to access easy, affordable cash with the peace of mind that they are not locked in for a period of time.

Using the custom built dairy farmer platform, many of Beston Global Foods' suppliers have been able to access early payment for milk that is yet to be delivered. This has allowed them to negotiate favourable prices on feed for their livestock and, ultimately, strategically grow their businesses.

5. Appropriate coverage by accounting standards

a. Should the Australian Accounting Standards Board (AASB) be consulting with its international counterparts to provide clarity as to how to capture and treat SCF in financial reporting?

Yes. Given the globalised nature of the Australian economy, accounting standards should be similar in every country. This would remove even more ambiguity and reduce the propensity of multinationals to manipulate supply chains in certain regions by utilising third-party financiers to fund supplier payments. This would eliminate a major issue for global investors looking to benchmark company performance.

In the event that large corporates are engaging in a customer funded early payment program, the outcome is identical to standard discounting arrangements which have been commonplace in business relationships for many years. By using their own cash to make these payments, it is prudent to consider whether the discounts received should be recognised as a cost reduction in the operating line or, most likely, as a financing income in the form of an alternative cash investment.

b. Should auditors be given formal guidance to ensure consistency in the financial reporting (by note or otherwise) of entities using any form of SCF?

Yes, it's critical that local and overseas investors and credit agencies can take a uniform approach when assessing SCF usage in the working capital cycle.

As above, it is important to differentiate between traditional SCF models and early payment programs funded by the corporate in question. Traditional SCF can cause discrepancies in opinion amongst auditors whereas self-funded early payments are simply a meaningful use of cash for some large corporates.

c. How do small and family business accountants become educated as to what SCF is and what its implications are for reporting?

Large corporates utilising SCF programs should be encouraged to educate their supply chains as to what the accounting implications are. Failing that, the ASBFEO are well placed to provide information following the SCF review. Earlytrade would be happy to work with the ASBFEO to provide educational information to the market.

6. Further questions from competition & regulated financial product perspectives

a. What protections are required for small business that have their business performance data captured and stored by big business that may be shared with third parties?

The integrity of small business data must be maintained at all times.

Many corporates already share detailed supplier information with third parties for the purposes of business process outsourcing, and an early payment/supply chain finance program is another example of this.

What third parties do with that data is very important. In most BPO scenarios, the information is used for the purposes of performing the tasks the third party has been contracted to do. In a similar way, Earlytrade's use of data from our customers, is solely for the purpose of providing our services. There are some circumstances where foreign companies operating SCF programs are moving supplier information overseas, and also in some circumstances using detailed supplier information and AI models to predict optimum discount rates to push onto suppliers.

The Earlytrade platform does not collect detailed or line-level invoice detail from large corporates, meaning corporates cannot manipulate discount rates for specific small businesses. Instead, rates are determined via the Marketplace mechanism regardless of the business name in question.

What those 3rd parties do with that data is crucial, in many circumstances this is shared overseas and into predictive models actively looking for the optimum margin to charge a supplier.

b. Should a small business receive a copy of the contract between the finance provider or platform provider and the other party to the supply chain transaction (buyer)? With the goal of transparency, what data should be shared between the provider and the buyer?

There should be a clear understanding on how the overall relationship works, and what each party's responsibilities are. The Earlytrade Marketplace, for instance, has a set of Platform Participation Rules which our corporate customers agree to, in addition to their suppliers when signing up to Earlytrade. These Participation Rules govern the Marketplace and include penalties for corporates who do not make early payments as agreed.

Small businesses should be made aware of what third party providers will do with their data when they interact with the platform. Data sharing between the SCF provider and corporate buyer should be on an aggregated level, with no reference made to specific supplier behaviours. Looking on an aggregated level can provide useful insights as to which areas of a supply chain are stressed, meaning the corporate can examine their payment practices to these suppliers.

Due consideration should be given to arrangements where the SCF provider is hosting data outside of Australia. There are providers in the market that shift supplier's information into foreign jurisdictions that have either highly invasive data access legislation (such as the Patriot Act), or limited privacy provisions. It should be understood what legal protections suppliers have under Australian and international law in these circumstances.

c. Is there a role that the ACCC needs to play in regards to unconscionable conduct or third line forcing? Are there any other areas that the ACCC should consider?

SCF programs that involve large businesses extending payment terms and effectively forcing suppliers to use the program represent behaviours akin to third line forcing. However, in a supplier driven program, such as Earlytrade, this is less important as suppliers maintain complete discretion over when they interact with the program and the discount rates they are willing to offer.

Earlytrade is also aware of platforms that provide invoicing functionality, which are being pushed on suppliers by their customers, and in many circumstances suppliers are being forced to pay for the right to submit invoices.

d. Should a contract providing SCF in any form be regulated as to how it is implemented/utilised by a big business? Supply Chain Finance Review – Position Paper 10

Resolving the issues around a mandatory payment code and standard accounting treatment will go a long way to resolving the regulatory concerns associated with SCF. In the event that these issues remain unresolved, contractual regulations may have some value.

Earlytrade shares the view of the ASBFEO that SCF and early payment programs are a legitimate and effective tool to appease cash flow concerns for small and family businesses. As mentioned, Earlytrade has worked with many small and family businesses that have used early payments to great effect to reinvest in their business, grow rapidly and manage unforeseen cash flow issues.

Whilst regulatory measures may be of use, it is critical to consider whether any associated increase in costs would be passed on to suppliers seeking early payment. This would inevitably harm these suppliers and may in fact negatively impact the programs offered by socially responsible corporates such as Lion who offer the Earlytrade Marketplace to compliment their standard 30 day payment terms.

e. What mechanisms could protect small business users of SCF from the costs and administrative burden of having to engage with several buyer-led SCF providers?

Having preferred SCF providers who do not require onerous resource requirements from small businesses would alleviate these concerns drastically. Earlytrade does not require suppliers to go through the resource heavy onboarding process that many programs mandate. In addition, Earlytrade maintains the view that any implementation and onboarding costs should be borne by the corporate buyer, with the only impact to suppliers being the invoice discounts they offer in exchange for early payment.

Where suppliers work with multiple Earlytrade customers, they have a single platform to interact with. This means that once they have been onboarded for one customer, they are able to use the Earlytrade platform to manage invoice payments with all of their other buyers who are in the Earlytrade Marketplace.

In addition to preferred providers, the PTRF or other governing body could consider mandating that large businesses must bear all implementation costs of a SCF program in order to comply with the stated policy or framework guidelines.

f. Should the SCF provider report the effective annualised rate of interest charge/discount?

The need for transparency of EARs when offering discounts to corporate customers often depends on the nature of the supplier offering said discount. Many small business users, who are unable to access sufficient capital from traditional financing, are less concerned about the EAR and are more interested in quantifying the dollar impact of an invoice discounting arrangement. Given the lack of alternative funding options, the decision point for these businesses is less about a comparable annual rate and more focussed on the trade off between their profit margin and potential liquidity crunch they are likely to face.

Suppliers who are able to access additional sources of financing often utilise the Earlytrade platform to attain favourable rates compared to alternative options. For these users, who often have a more sophisticated treasury or finance function, it is preferable to view invoice discounts rates on a comparable EAR basis.

As such, it is important that suppliers offering discounts are made aware of what form of discount rates they are offering and are also well educated in the differences between EAR and outright discount rates. However, wider reporting of these rates to external parties does not seem necessary as it represents a critical piece of data integrity. In some instances, it may be beneficial for the ASBFEO to utilise aggregate level data to compare to other financing arrangements that may be on offer to small business users.

g. Should the effective annualised interest rate/discount be reported publicly as a "comparative rate"?

SUBMISSION



— This is not necessary. If small business suppliers are able to access favourable rates of financing, it is their own business decision. Mandating the reporting of this would be akin to banks being forced to publicise actual lending rates to businesses and individuals alike.

h. Is there a role that the Australian Securities and Investments Commission (ASIC) needs to play? i. Is there a role that the Australian Financial Complaints Authority (AFCA) needs to play?

Whichever agency is best positioned to provide a uniform approach to the use of SCF certainly has a role to play. Giving oversight to multiple agencies, however, has the risk of creating mixed messaging and further ambiguity in the market.

For further information, please contact guy@earlytrade.com.

Yours sincerely,

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