

**Small Business
Commissioner**
SOUTH AUSTRALIA

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Dear Dr Butlin

Review into Procurement in South Australia

The Office of the Small Business Commissioner (OSBC) is an independent statutory office. The legislation underpinning the OSBC is the *Small Business Commissioner Act 2011* (SBC Act) and a key aim is to resolve disputes or complaints in a timely manner without the need for litigation.

In addition, Section 5(h) of the SBC Act provides me with the ability to present a submission to your Review of Procurement in South Australia.

The management of procurement by the State Government continues to be one of the key issues which is raised with my office by small businesses.

It is disappointing that the Terms of Reference have not included the following capital projects and prescribed agencies¹:

- Adelaide Venue Management Corporation
- Architectural Practice Board of South Australia
- Construction Industry Training Board
- Health Services Charitable Gifts Board
- Legal Profession Conduct Commissioner
- Local Government Finance Authority of South Australia
- Motor Accident Commission
- Return to Work Corporation of South Australia
- South Australian Forestry Corporation
- South Australian Housing Trust
- South Australian Water Corporation
- Superannuation Funds Management Corporation of South Australia, and
- Urban Renewal Authority (now Renewal SA).

Key agencies such as Return to Work Corporation of South Australia, SA Housing Trust, SA Water and the Urban Renewal Authority (RenewalSA) should be subject to this review given the extent of their procurement activities.

The exclusion of capital projects from the review is also an oversight which should be corrected given the impact this sector has on the small business subcontractors and suppliers.



¹ State Procurement Regulations 2005 19/07/2018

Such is the importance of this level and scale of this sector to Government procurement and the broader economy, I would recommend the following section of the *State Procurement Regulations 2005* under the *State Procurement Act 2004* be amended to remove the following definition:

5—Certain prescribed construction projects excluded from definition of procurement operations (section 4 of Act)

(1) For the purposes of the definition of **procurement operations** in section 4 of the Act, a prescribed construction project of a cost exceeding \$150 000 is excluded from the definition.

(2) A **prescribed construction project**—

(a) is a project that primarily involves the procurement of construction work; and

(b) encompasses—

(i) the acquisition and installation of fixtures, plant, equipment, appliances and fittings in conjunction with the construction work; and

(ii) the acquisition of survey, planning, design and other services in conjunction with the construction work; and does not encompass the acquisition of goods and services for the ongoing maintenance of a building or structure.

Nonetheless, I will make commentary relating to all State Government procurement activities as they are relevant to the broader issues of a review of procurement practices.

The reasons are many and varied, and I will go into detail with regard to some specific instances:

The key issues are:

- Payment Terms
- Late and disputed payments
- Transfer of Risk
- Due diligence and Pre-Qualification by Government Agencies
- Financial capacity of small businesses
- Accessing Government Tenders
- Effective Purchasing by bridging the gap between Government and Business
- Aggregating Contracts at the expense of small businesses
- Whole of Government Contracts
- Industry Participation Policy

Payment Terms

The State Government and its respective agencies are required to pay its accounts within 30 days from invoice date under the *Late Payment of Government Debts (Interest) Act 2013* (Interest Act).

In my four years in the role, I have only had a handful of disputes raised by small businesses over late payment issues. Generally, when I have made enquiries the matters have been resolved quickly.

The current State Government successfully amended the Interest Act through Parliament in October 2018 so that agencies which did not pay their accounts within 30 days would be subject to penalty interest payments so long as the invoiced amount was under \$1 million and the interest payment was over \$10.

This is a significant and positive step forward, given \$500 million of accounts were unpaid within the 30 day timeframe over the 12 month period between November 2017 and October 2018². The amended Interest Act came into effect on 1 November 2018 and I will be monitoring outstanding payments and agencies to ensure that the system implemented under the State Government's BASWARE system is working effectively.

² Data from SA Government Shared Services at <http://www.sharedservices.sa.gov.au/ap-govt-payment-performance>

Given the effectiveness of BASWARE, it is my view the State Government should be moving to a payment period under 30 days.

I recommend that the State Government move to a 20 day payment from invoice as a minimum in the first instance. It should be noted that the NSW Government is moving to 20 day payment periods from December 2018 with a 5 day payment period to be implemented by 2019.

However, my broader concern is in the private sector, particularly where they are in receipt of Government grants or are suppliers or contractors.

There is considerable evidence that the private sector is lagging in terms of its payment times.

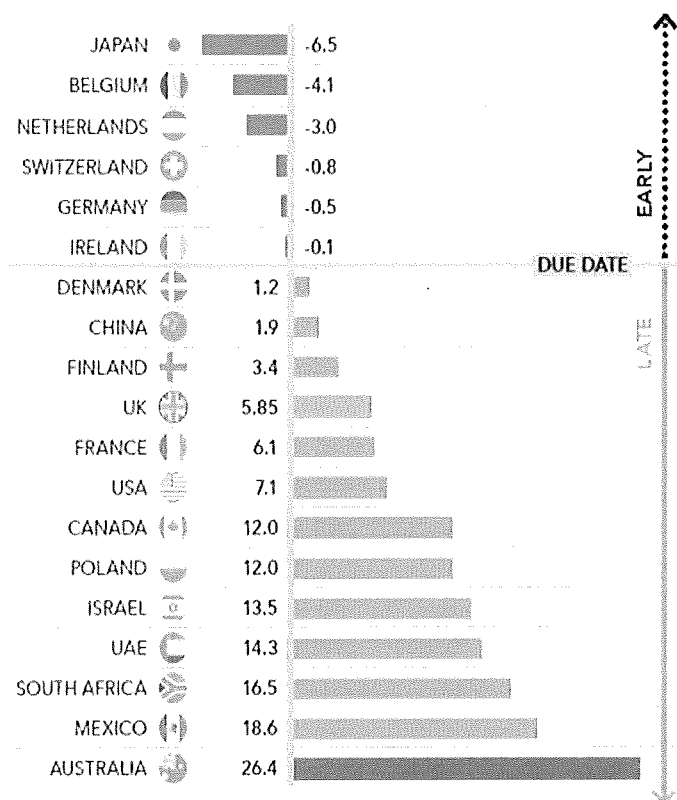


Figure 1 Average Payday 2015
Source: The State of Late Payment 2016 www.marketinvoice.com

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) noted that “Late payments have been a perennial problem for businesses in Australia. Recent research shows Australia lagging internationally, as show in Figure 1 Average Payday 2015.”³

The impact on businesses from late payments should not be underestimated with significant difficulties arising from the lack of or sporadic cash flows.

Many businesses are reluctant to raise concerns about late payments as they fear they will lose future business. This situation is unacceptable.

Businesses have a fundamental right to be paid in a reasonable time when goods and services are supplied.

They should not be banks for big business and themselves then have to seek loans to cover working capital.

³ Payment Times and Practice Inquiry – Final Report Australian Small Business and Family Enterprise Ombudsman Page 4
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I am currently investigating claims that a major business in SA is paying its contractors and suppliers on a 90 day basis and is seeking in tender documents to have payment terms of 120 days a “new standard”. The company concerned has denied its payment processes have changed.

It is interesting to note that the ASBFEO has proposed that the Federal Government “...introduce legislation which sets a maximum payment time for business to business transactions. Certain industries may need terms greater than the maximum which can be agreed providing they are not grossly unfair to one party. Where a longer term is called into dispute it will be considered an unfair contract term.”⁴

It is problematic that only a small number of supplier complaints are made to the Government either through the State Procurement Board or direct to the agency as per the Productivity Commission’s own paper ⁵.

I have been approached by a number of businesses who complain about how they are treated by a Government agency but will not lodge a complaint with either the agency or my office for fear they will no longer gain access to Government work/supplies. The fear of retribution is very real.

The Government has an opportunity to use its buying power to dictate positive payment conditions down the supply chain not only for purchasing but also for organisations which receive Government grants.

I would urge the Productivity Commission to consider the following options and make an appropriate recommendation to the State Government.

The first option is by mandating that payments, as part of a Government to Business contract, cascade to subcontractors and suppliers on standard 30 day terms from date of invoice (as a maximum time frame) unless validly disputed.

This could be achieved by standard contractual terms being inserted into all government contracting arrangements over a certain value. That said, one area which must be addressed would be that “paid when paid” clauses are not valid.

Alternatively, a Fair Payment Code could be developed which could be referenced and enforced through contractual documentation and/or the Industry Participation Policy.

A third option is for this measure to be legislated in the *Late Payments Government Debts (Interest) Act 2013* which could also deal with the “pay when paid” area.

In its simplest form, if businesses want to do work or supply to Government, they will need to pay all their subcontractors and suppliers on a maximum 30 day timeframe (not just those involved in the supply chain for a particular government contract).

Late and disputed payments

The Building and Construction sector unfortunately leads the way in terms of late and disputed payments.

As Small Business Commissioner, I am responsible for the administration of the *Building and Construction Industry Security of Payment Act 2009* (SOPA). I also have access to the *Fair Trading (Building and Construction Industry Dispute Resolution Code) Regulations 2017*.

The SOPA is an important implement in securing payment for subcontractors and suppliers, but in my view, the actual use of the adjudication process is limited.

⁴ Ibid Page 6

⁵ SA Productivity Commissioner Issues Paper: Government Procurement Inquiry Page 20

In order to address that matter, funding has been provided by my office to 6 industry association groups in the 2018/19 financial year to promote the SOPA to their members.

In 2017, a series of changes to the Act was presented to the State Parliament but did not proceed to finalisation prior to the 2018 state election.

Since that time, a national review of security of payment acts by John Murray AM has been released by the Federal Government, and the State Government is now considering its position in relation to the 86 recommendations.

While there is an indication that many of the recommendations will be supported by the State Government, a number are subject to further consideration and/or assessment of resource impacts.

Given the concerns raised by subcontractors regarding intimidation by head contractors and others in seeking to use the Act to be paid, an amendment was proposed by me and accepted by the then Government which made it an offence to seek to stop the security of payment process as follows:

32A—Offence relating to assault etc in relation to progress payments

A person must not directly or indirectly assault, threaten or intimidate, or attempt to assault, threaten or intimidate, a person in relation to an entitlement to, or claim for, a progress payment under this Act.

Maximum penalty:

(a) in the case of an individual—\$50 000 or imprisonment for 2 years or both;

(b) in the case of a body corporate—\$250 000.⁶

It is pleasing to see that this amendment was adopted as a recommendation by the Murray Review and that the Western Australia Government is also considering this amendment as part of its review into the building and construction sector in that state.⁷

Transfer of Risk

While the State Government, through its contractual arrangements, is required to operate at a high standard, there is no standard requirement for agreed terms and conditions between the Government and contracting business to ensure that these terms and conditions travel down through the contract to other providers in a manner which ensures fairness and equity.

My office has recently become aware of two head contractors which have inserted wording in their contracts which, in my view, seeks to subvert the *Building and Construction Industry Security of Payment Act 2009*. Further investigations are underway.

I would encourage the Productivity Commission to recommend that the State Government mandate a requirement that contracts do not contain unfair contract provisions, do not seek to contract out of legislation and that terms and conditions are cascaded down the contractual chain.

I am advised that the Department of Planning Transport and Infrastructure (DPTI) is currently assessing its processes on how contractual terms are cascaded down the contractual chain.

⁶ Building and Construction Industry Security of Payment (Review) Amendment Bill 2017

⁷ Final Report to the Minister for Commerce Security of Payment Reform in the WA Building and Construction Industry – John Fiocco – October 2018 Page 76

Due Diligence and Pre-Qualification by Government Agencies

The State Government has a responsibility, in my view, to ensure that the parties to which it does business with are financially sound.

I have had three instances where the failure of a head contractor contracted to the State Government has severely impacted subcontractors and suppliers down the contractual chain.

In each of the detailed investigations I have conducted (BJ Jarrad Pty Ltd, Elite Australia Pty Ltd and Coombs Barei Constructions Pty Ltd), it is clear that proper and detailed financial due diligence of the failed contractor was not undertaken by the respective agencies.

If the agencies had fulfilled their responsibilities, then harm would not have been caused to these businesses or, at the very least, the harm would have been minimised.

The initial and general response given to those businesses which have lost money by such collapses, has been along the following theme: "There is no contractual relationship between the State Government and your business...and that you (the small businesses affected) should have undertaken your own due diligence."

This type of response does little to appease the subcontractor who contend that they believed they would be paid because it was a State Government project.

This response also seems to ignore the imbalance of power and resources of the State Government compared with a small building subcontractor.

In response to the two reports into Elite Australia Pty Ltd and BJ Jarrad Pty Ltd, the then State Government did not accept my recommendations concerning compensation for failure by the respective agencies to effectively financially oversee its contractors.

It did however approve the Chief Procurement Officer undertaking further development of a framework which assists agencies to manage financial risk and due diligence at the point of contract establishment. It also recommended that the processes be led by the Chief Procurement Officer in consultation with the State Procurement Board, the Department of Treasury and Finance, the Small Business Commissioner and other key agencies with large contract spend in the building and construction industry.

To date no substantive progress on the development or completion of that framework has been reported to me which is disappointing.

I have made a further series of recommendations in a special report into the failure of Adelaide construction company Coombs Barei Constructions Pty Ltd and the engagement of that company by RenewalSA. The State Government is currently considering my report which has not been publicly released.

In summary the recommendations in the report are:

- 1) All State Government agencies must require the completion of a standard form statutory declaration by the Director/s of the Head Contractor just prior to the signing of a contract for building and construction works which declares that the entity is solvent; has no overdue tax debts; has no overdue Return to Work SA payments or superannuation payments; and has no outstanding legal disputes over payments.
- 2) The State Government should implement a whole of government requirement that where agencies utilise prequalification arrangements, approved entities should be reassessed on a

regular basis using up-to-date financial information. Entities which refuse to provide the necessary information should face sanctions.

- 3) A centralized process should be established where agencies can access contractor information.
- 4) Head Contractors must be required to complete statutory declarations detailing that all subcontractors and suppliers have been paid and where not, an explanation of the reasons.
- 5) The State Government should consider developing a "Fairness for Subcontractors, Suppliers and Service Providers" policy that covers State Government expectations of head contractors including assessment requirements, contract and risk management and "step in" arrangements.

Two further recommendations relate to the process of implementation of the above recommendations and also the matter of compensation for the parties affected by the failure of Coombs Barei.

It is recognized that these recommendations may add additional costs to agencies in terms of their management of contracts, however the Productivity Commission may wish to conduct its own analysis on the full economic costs incurred when head contractors fail.

Put simply, repeated market failure in these areas has a wider economic impact.

Financial capacity of small business

A theme which has emerged from my time in the role is the lack of financial capacity and literacy in the small business sector.

The free market nature of the economy should encourage people to seek to establish a business in an area where they have expertise.

The vexed question is should businesses be required to have a technical understanding of key financial responsibilities and challenges which they and their business will face (eg cash flow management and understanding profit and loss).

It is an area in which the Government could take a lead in assisting small businesses with short course training, as part of the overall plan to create a more dynamic, entrepreneurial and profitable business sector.

Accessing Government Tenders

One of the key areas where Government can assist small businesses in accessing procurement opportunities is in the area of training business owners on how to prepare a tender proposal.

The complex requirements under many Government contracts are often difficult, if not impossible, for a time poor small business owner to navigate.

While the Office of the Industry Advocate provides "Tender Ready" workshops to businesses, it is an area which I believe could be further strengthened with the appropriate injection of resources.

In addition to the Tender Ready workshops, I understand the Office of the Industry Advocate is developing online training modules which will allow businesses to develop their skills in quoting and tendering for government at their own pace and with available time.

I fully support this initiative because most small business operators are time poor and this approach will be particularly helpful for regional business operators.

Encouraging more small businesses to compete for Government business can only enhance the procurement process.

For those businesses regularly seeking Government contracts, there is a frustration at being asked for the same general information when tendering or quoting for work every time a tender or quote is released to the market.

Agencies are not in a position to share data in managing contracts or suppliers because there is no aggregation of the marketplace information.

Equally businesses need to engage with each individual Department because there is no single method of identifying them and no platform to engage with Government at this level.

There is no centralised data management. This in itself can create security and confidentiality issues whereby there are many and varied storage locations across Government.

I understand the Industry Advocate is investigating the extent to which non-contract specific tender information can be standardised across SA Government, and the feasibility and options for a standard or common tender pre-registration solution.

Effective Purchasing by bridging the gap between Government and Business

One area which was extremely effective in bringing Government buyers closer to small business and the procurement process was the Office of the Industry Advocate "Meet the Buyer" events.

These free events provided a unique opportunity for local businesses to match their product or service with the decision maker from the procurement section of a wide number of agencies.

The events were extremely well supported by small business but are no longer being held due to resource issues.

The BDO "Growing Change South Australian State Business Survey of 2016" stated:

'70% of South Australian businesses would like to engage with Government at a greater level, however, 66% have not initiated any meaningful form of engagement. We would encourage these businesses to invest in the "Meet the Buyer" and similar events to understand how they can become a provider of services and products to Government'.

It is an area where a relatively small investment can bring a much greater return in terms of having more businesses knowing how to tender and compete for State Government business.

Aggregating Contracts at the expense of small businesses

There is some evidence that agencies have moved to aggregate contracts such that only a larger company has the delivery and financial capacity to perform to contract requirements.

This approach appears to be in response to agency downsizing to meet budget targets whereby the number of skilled contract managers has been reduced.

A move to aggregation severely limits small businesses in competing for contracts and, as a result, some will have no option but to become a subcontractor/supplier to a head contractor which invariably increases risk in terms of the current payment process.

I would recommend that the Productivity Commission seeks further information from key contracting agencies in this regard.

Whole of Government Contracts

There is ongoing evidence of failure of whole of government contracting arrangements. The respective Stationery Contracts are prime examples.

In 2012, the State Government contracted two multi-national companies (Officemax and Staples (now Winc) to supply stationery to the public sector.

The impact of the Across Government Stationery Contract on existing businesses was devastating to the point where the public outcry (and investigation by the Office of the Small Business Commissioner) forced the Government in 2013 to agree to exempt schools from the whole of government contract.

This allowed small businesses such as local newsagents and others who specialised in the school space to at least compete for school purchases.

There is similar but limited evidence in relation to goods and supplies to SA Health and the impact of centralised purchasing has had on regional businesses in particular.

The latest whole of government Stationery Contract known as the Workplace & Related Products Contract (WARP) made some progress in ensuring a wider range of businesses (five) were successful through the tender process.

Concerns, however, remain in relation to the manner in which agencies have sought to try and achieve further savings after the successful tenderers had lodged price information on their products.

I am aware that some stationery suppliers on the panel have had to present to individual agencies as part of a "secondary evaluation" where they have been requested to provide cheaper pricing for products. I have been advised that in one case, an agency specifically asked what rebate would be paid as the agency planned to direct this rebate to a charity.

This process appears to totally undermine the whole of government arrangements.

Further, the implementation of the original five member panel was weighted heavily in favour of the original suppliers (Office Max and Staples (now Winc) which have since merged under private equity owner Platinum), with new entrants having to basically plead with agencies to have their company added to the BASWARE computerised purchasing system.

Put simply, being selected to the new panel did not necessarily mean a change of behaviour at the agency end as evidenced by an email from one of the panel suppliers:

"We have received a request from a (government agency) staff member wanting to source stationery supplies under the Warp contract.

Through this process we have learnt that (government agency) stationery can only be purchased through their internal basware software, for which we are not a listed provider.

To enable us to be included on their basware, authorisation is needed from a manager within this agency.

This authority then allows IT systems officers to integrate us within their basware software which can take a further 4-6 weeks.

As you will agree this is a very long-winded process, and one which favours the incumbent.

As a Warp panellist wouldn't it be prudent that all 5 suppliers are permitted to be available on all agency basware?

This creates an equal environment for government procurement to make better informed decisions around their buying potential.....

Any assistance in relation to the basware issue, would be appreciated.

Regards"

Email to Small Business Commissioner 19th September 2018

I am aware that the Minister for Industry and Skills, Hon David Pisoni MP, has written to his ministerial colleagues in October 2018 requesting they instruct their CEO's to adopt a checklist devised by the Industry Advocate when purchasing stationery and office supplies. The checklist is designed to encourage agencies to recognise suppliers with a higher economic contribution measure and who support local jobs.

What the analysis of the whole of government contracts appears to have failed to take into account is the economic impact on businesses which were excluded from the new arrangements.

Too often do we see Governments announcing dollar savings from so called whole of government contracts. What the financial analysis does not take into account is the impact on small businesses who may have to downsize staff, particularly in the regions.

In the case of the original Stationery Contract , it did not take into account the difficulties many schools faced in having to deal with a centralised ordering system compared with the previous system of direct contact with a local supplier.

Similarly, delivery times and costs increased further frustrating the purchasers.

I would urge the Productivity Commission to undertake a full economic analysis on whole of government contracting arrangements and make appropriate recommendations to require agencies to conduct more rigorous processes around proposed whole of government contracts and ensure that the State is achieving true value for money in a broad economic context, and not just a headline figure which has significant community and political costs.

Industry Participation Policy

I fully support the current Industry Participation Policy (IPP) which has been effective in ensuring agencies rethink their approach to procurement and to ensure that there is a positive outcome for local businesses where appropriate.

There remains considerable work to be done and I support the December 2018 submission put to the Productivity Commission by the Industry Advocate Mr Ian Nightingale.

In particular, further work needs to be undertaken at agency level to improve the understanding of the benefits to the State that arise from the effective implementation of the IPP.

There is a "cultural" piece of work which needs to be done in some agencies that accepts there are economic benefits beyond the lowest price outcome.

Better planning, research and business case development for proposed projects is required.

Decision making once tenders have been accepted should be prompt. One complaint I regularly receive from small businesses is that they went to the time and expense of lodging a tender and had to wait months for an outcome, or in some cases, the project did not proceed.

The Government has a considerable role to support small businesses in building their financial management capacity and assisting them with navigating the complex tender processes of the public sector.

As I have mentioned previously, the ongoing work to assist small businesses tendering for Government work should be considered as essential.

Similarly, the communication to businesses of the Government's broad needs and requirements through the "Meet the Buyer" events conducted by the Industry Advocate should be resourced appropriately.

The work of the Industry Advocate should be supported by robust processes (some of which I have referred to earlier in this submission) within Government agencies in terms of assessment of financial capacity of businesses at initial tender stage but also on an ongoing basis.

I would be happy to discuss any points raised in this submission further should you wish and can be contacted on 08 8303 2026.

Thank you for the opportunity to have input into this important review.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Chapman', with a long horizontal flourish extending to the right.

John Chapman
Small Business Commissioner
23rd December 2018