PAYMENT DEFERRED

The importance of prompt payments to SMEs & some solutions to current problems

Acronyms and Abbreviations

ASBFEO – Australian Small Business and Family Enterprise Ombudsman

BACS - Bank Account Clearing System

CFO - Chief Financial Officer

CIDB – Construction Industry Development Board

CPA – Consumer Protection Act

CPO – Chief Procurement Officer

CSD – Central Supplier Database

DA – Democratic Alliance

DPME – Department of Performance Monitoring and Evaluation

DPSA- Departments of Public Service and Administration

DSBD – Department of Small Business Development

DTI – Department of Trade and Industry

EBIT – Earnings Before Interest and Tax

GDP - Gross Domestic Product

KPI - Key Performance Indicator

NDP – National Development Plan

NSBC – National Small Business Chamb

NT – National Treasury

PRCA - Public Relations Communication Association

PTME - Property Management and Trading Entity

SA – South Africa

SARS – South African Revenue Service

US SBA – United States: Small Business Administration

SBREFA – Small Business Regulatory Enforcement Fairness Act

SCF – Supply Chain Finance

SMEs - Small and Medium Enterprises

SOE – State Owned Enterprise

UK - United Kingdom

Contents

1. Introduction

It is estimated that small and medium-sized enterprises generate up to half of the gross domestic product (GDP) and nearly 60% of employment in SA. 90% of all new jobs will be created by SMEs by 2030, according to the National Development Plan (NDP). Thus with 9.3 million people unemployed, supporting these SMEs is critical.

In February 2016 government pledged to partner with private business in setting up a fund to provide capital to this sector. Big business raised to R1,4 billion to establish the SA SME Fund which is barely operational and failed to attract equivalent government funding. Instead, February's 2018 Budget announced a R2,1 billion start-up fund but with little detail on its mandate or strategy.

The initial start-up funding required by SMEs was below R100,000 for more than half (62%) of businesses surveyed in a 2015 report in SA, with only 4% raising more than R1,000,000[1]. However, investment funding is only one side of the coin, the other important component is **cash flow.** When business owners refer to "access to finance" as a critical constraint to growth, they are more often than not referring to working capital not investment capital.

The purpose of this document is to describe the importance of prompt customer payment to SMEs' working capital requirements, with the issue being late payments that directly affects their cash flow. The document attempts to find solutions to resolve the issue of late payment in both the public and private sectors. The issue of late payments requires a two-pronged approach, firstly to stop late payments from occurring in the first place and secondly to seek fair resolution to disputes related to late payments through the creation of a Small Business Ombudsman.

2. Cash Flow

"It's the new normal: big companies are paying their bills late, later, and latest. When economic hard times hit in 2007 through 2008, CFOs and finance departments felt the pressure to improve their organisations' working capital positions. The longer companies could hold on to cash, the more liquid they were, and the safer they felt. Paying bills quickly meant dipping into cash reserves, possibly taking

[1] https://businesstech.co.za/news/business/123929/9-things-you-need-to-know-about-small-businesses-in-south-africa/

away money from new-product development, mergers and acquisitions, marketing, or anything else that might drive top-line revenue"[2]. It was either that or be forced to rely for growth on expensive external financing. Extending payables is a "best practice", and a good way to grow a cash stockpile with little pushbacks from small businesses.

Cash flow makes or breaks a small business. If one does not have the cash to pay expenses and salaries, then one's business can't survive. Simply put: no cash equals no business. This is a reality even if a small business has all the customers it wants and talented employees who do their jobs well.[3]

A small business, low on cash will make late payments to vendors and employees and often miss tax payment deadlines, so incurring costly penalties. It can't pay what it doesn't have[4]. Unfortunately, this leads to more problems that eventually reach a point when there's no saving the business.

Prompt payments by departments and businesses will relieve the mounting pressure that Small and Medium Enterprises (SMEs) are currently under, and will alleviate the rate of SME closures in South Africa. The total number of liquidations increased by 15.4% (23 more cases) in September 2016 compared with September 2015 according to a Stats SA report released in October 2016. Liquidations increased by 4.3% in the third quarter of 2016 compared with the third quarter of 2015. However, most business failures are not recorded as liquidations, so the rate of business failure is much higher in reality. In 2008 there were a reported 707 000 registered businesses, which dropped to 670 000 in 2015 (Stats SA). Small businesses, far from being the source of new jobs expected in the NDP, have been bleeding jobs.

President Ramaphosa highlighted the issue of late payments during his reply to the debate on the 2018 State of the Nation Address, pointing out that government should remove barriers to entry to small businesses. He stated that: *"It is clear that the failure of some government departments to pay suppliers within 30 days has a devastating impact on small and medium-sized businesses. This is something that I want to see addressed as I visit government departments, because the culture of late payment has gone on for far too long and has caused far too much damage, particularly to emerging black businesses*".

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[2] http://ww2.cfo.com/credit-capital/2013/01/when-your-big-customer-wants-to-pay-late/
[3] http://capitalsolutionsbancorp.com/how-late-payment-of-invoices-are-a-danger-to-your-business/
[4] http://smallbusiness.chron.com/delayed-billing-affecting-cashconversion-cycle-39094.html

This follows on the former President Jacob Zuma's commitment to ensuring that government departments pay SMEs within 30 days[5], made during his 2016 State of the Nation Address. This commitment should be embraced by the business sector. Many small businesses are afraid to negotiate favourable payment terms upfront, for fear of losing a potentially large customer, such as a government department. Many large organisations know this and put pressure on suppliers to accept their often-lengthy payment terms.

SMEs cannot cope with longer payment times and the possibility of non-payment can have a devastating impact on any business, large or small. What's most worrying is that this late payment culture has a ripple effect on the whole supply chain, with businesses in every link admitting to paying their suppliers late because of the liquidity problems caused by outstanding payments higher up the chain[6].

Late payments are a serious problem for many SMEs as large enterprises push suppliers, not realising that by undermining one firm by failing to pay on time, they could be destabilising the entire supply chain. During public hearings conducted by the Public Service Commission during 2012/3[7], the following reasons were given by departments for late payments:

- that service providers did not adhere to the requirements of proper invoicing;
- service providers often did not have official purchase orders when they submitted invoices;
- quality assurance of goods and/or services that took place after capturing invoices delayed payment;
- accrual of unpaid invoices from one financial year to the next caused cash flow shortfalls;
- departments did not monitor their payment processes effectively;
- capacity related constraints hampered departments' ability to pay service providers on time;
- fraud and corruption resulted in late and/or non-payment to service providers with some service providers receiving preferential treatment.

In SA, a government colloquium in 2014 passed several resolutions calling, inter alia, for the introduction of payment guarantees, penalties for late payment, and the creation of a special tribunal

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[5] http://www.businesspartners.co.za/media-room/posts/sme-industry-welcomes-late-payment-clamp-down-1007/
[6] http://www.debtadvocate.co.uk/the-effect-of-late-payment-on-business/
[7] https://pmg.org.za/committee-meeting/21313/

or ombudsman to intervene on behalf of small businesses. Few or none of these resolutions have been enacted.

It is clear that while the government has identified late payments as a barrier to small business, the problem has persisted and has got worse.

3. To the figures

The 2016 National Small Business Survey reported that 76% of small businesses that had been in operation for less than five years identified a lack of funding and poor cash flow as the major impediments to growth.

In a 2016 survey of 400 small business owners across 22 sectors in South Africa, a big chunk of responding owners (38%) said that they were hit with unexpected cash flow issues stemming from late-paying suppliers.

The State of South African Small Business report in 2017[8], confirms that Cash flow is the second biggest challenge small businesses face and 35% of respondents said that cash flow issues "keeps them up at night". A recent Sage study "Late Payment: The Domino Effect"[9] found *"more than 8% of payments due to the country's Small & Medium Businesses are never made or made so late that businesses are forced to write them off as bad debt."*. The report continues by highlighting that *"52% of South African Small & Medium Businesses experience direct negative impacts from late payments"*. As a consequence of late payments, 34% of SME's say they pay suppliers late, causing a domino effect impacting other smaller businesses creating a vicious circle of late payments. 28% say they delay investments in their businesses which impacts on the future growth of SMEs.

Following up on late payments is also a major constraint for small business with SMEs spending an average of 20-man days a year doing this and incurred more than R48,000 in costs chasing overdue debtors.[10] Additionally, SME's point out that the main barrier to chase late payments in South Africa

[8] https://www.xero.com/content/dam/xero/pdf/xero-south-africa-state-of-small-business-2017.pdf

[9] http://www.sage.com/za/newsroom/sage-south-africa/2017/12/01/late-payments-the-knock-on-effects-on-sa-small-businesses

[10] Survey undertaken by Plum Consulting for Sage (The domino effect: the impact of late payments – Dec 2017) which analysed responses from over 3,000 business builders to look at the effects of late payments on Small & Medium Businesses. It highlights significant implications for our entrepreneurs and their ability to operate, plan and grow.

(40% of respondents) is the "protection of client relationships", which again demonstrates the disadvantage SMEs have in receiving payment due to them.

In 2015, an SME Insights Report[11] which interviewed 1300 SMEs in South Africa made some startling discoveries. On the average, the number of days it takes to collect money from sectors are:

1. 86 days for provincial government
2. 82 days for national government
3. 81 days for municipal government
4. 70 days for parastatals
5. 42 days for large private sector
6. 35 days for small and medium private sector

This shows that the government remains one of the leading culprits of late payments[12]. Based on DA Parliamentary Questions posed to National Departments as of January 2018, government owes a total of over R7.7 Billion with over 106 000 invoices in total. Of particular concern is that over 12 160 invoices to the value of R2.2 Billion are older than 120 Days.

These numbers are even more shocking when comparing them to last year March 2017, when national departments had over 17 000 invoices that were paid after 30 days to the value of R1.3 Billion Rand. At provincial level, 15 754 invoices were paid after 30 days totalling R1.1 Billion[13]. Minister in the Presidency, Jeff Radebe reported that government departments had over 23,000 unpaid invoices worth R2.2 billion. The number of invoices paid late by national departments also rose from over 13,400 in September 2015 to nearly 14,900 in September last year[14]. Clearly, the problem is persisting and worryingly getting even worse.

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[11] http://www.saica.co.za/portals/0/documents/saica_sme.pdf

[12] For the purposes of this discussion paper the definition of late payments is that, suppliers should be paid within thirty days from the receipt of an invoice. Treasury Regulation 8.2.3 provides that "Unless determined otherwise in a contract or other agreement, all payments due to creditors must be settled within 30 days from receipt of an invoice or, in the case of civil claims, from the date of settlement or court judgement"

[13] http://www.polity.org.za/article/gcis-government-making-strides-in-the-payment-of-suppliers-within-30-days-2017-08-14

[14] Executive Statement by Minister Jeff Radebe on Payment of Service Providers by Government within 30 days- National Assembly, 17 November 2016 available online: www.dpme.gov.za/news/Pages/Executive-statement-by-Minister-Jeff-Radebe-on-payment-of-service-providers-by-government-within-30-days-.aspx

It is important to note that although the problem is widespread in national government, certain departments transgress more than others in regard to late payments. In an analysis conducted by National Treasury in September 2017[15], the four worst performing departments with invoices older than 30 days and not paid, made up over 96% of the total invoices and 82.7% of the total amount outstanding. The same pattern emerges regarding non-payment of invoices by provinces where the top three culprits (Gauteng, Eastern Cape and Northern Cape) make up 85% of invoices and 77% of the total amount outstanding. Western Cape only had 68 invoices not paid or less than 0.1% of the total 56,897 nationally.

The discrepancies between Departments and Provinces can point to better accounting and payment practices for some departments and provinces but also point to a lack of consistency and standardisation across departments. At the local government level more, research needs to be conducted into supplier payments but, Midvaal Local Municipality stands out as an exemplary payer with a policy of settling invoices within 15 days.

These numbers are exceptionally large and give credence to the contention that SMEs are struggling with cash flow but unable to change the terms or rules of engagement as they have little bargaining power.

4. Solutions from the Public Sector

4.1 SME's late payment hotline & DPME 'Special Unit'

In 2009 the Department of Trade and Industry under the stewardship of the Small Enterprise Development Agency (SEDA) established the SMME Payment Assistance Hotline. By 2012, the Hotline had received 7 109 queries related to late payments made by state departments and entities, of these 5 155 queries were resolved resulting in R300 million paid to SME's[16].

Common challenges identified by SMEs regarding the Hotline include:

- SMEs are not informed of the correct payment process requirements such as registering on the Central Supplier Database;

[15] National Treasury (2017). Payments within 30 days – National and Provincial Departments. Presentation made by Sandiso Thutshini (Director, National Treasury)
[16] http://www.seda.org.za/Happening/LatestNews/PressReleases/Pages/R300millionpaidtoSMMEs.aspx

- Verbal appointments to render services with no paper trail;
- Government departments requesting additional services without issuing variation orders;
- Not provided with order numbers to render services in emergency situations; and
- Invoices that are lost or misplaced.

Common challenges faced by the public sector:

- The quality of work/goods that SMEs render or the standard of work that was agreed upon not delivered by SMEs including unfinished work;
- SMEs continue to render services even though the contract has lapsed; and
- Tax clearance issues of SMEs and SMEs do not inform the departments when company and banking details change.

The Hotline has subsequently been moved to the Presidency and their Presidential Hotline including a dedicated email address to lodge queries. It is however unclear what the performance has been since 2012 and whether the elimination of the dedicated line has had a negative impact on the reporting and resolution of the late payments.

Recognising the problem of late payments, in 2016, Minister in the Presidency, Jeff Radebe, committed to taking a tougher stance on government departments that were failing to pay their suppliers on time. Officials who failed to pay suppliers within the 30-day period were to be charged with misconduct[17].

The Public Financial Management Act (as amended) ('PFMA'), and the Municipal Finance Management Act (MFMA), requires Accounting Officers to settle all contractual obligations and invoices, including intergovernmental claims, within the prescribed and agreed period. In 2005, National Treasury (NT) published regulations in terms of the PFMA, on payment invoices and stipulated that the agreed upon period is 30-days from receipt of a legitimate and/or undisputed invoice.

In August 2015, during a joint meeting between the Departments of Public Service and Administration (DPSA) and Performance Monitoring and Evaluation (DPME) Portfolio Committees, the DPME said that

[17] Executive Statement by Minister Jeff Radebe on Payment of Service Providers by Government within 30 days-National Assembly, 17 November 2016 available online: www.dpme.gov.za/news/Pages/Executive-statement-by-Minister-Jeff-Radebe-on-payment-of-service-providers-by-government-within-30-days-.aspx

Cabinet had approved the establishment of a special unit in the DPME to investigate cases of late or non-payment within 30 days. The unit would work with NT and the DPSA but would be administered by the DPME. It would report on a quarterly basis to Cabinet on departments' compliance with the 30-day period and would make recommendations regarding possible disciplinary action, where needed. Its mandate would include investigating late payment or failure to pay invoices, identifying the causes of this, and facilitating and instituting misconduct proceedings to ensure there are consequences. It would also support or intervene where there is continuous noncompliance.

In November 2016, Minister Jeff Radebe gave an update on the work that had been done by the DPME Unit. Since its inception, the unit conducted oversight visits to various national and provincial departments whose performance was unsatisfactory. These included the national departments of Defence, Home Affairs and Water & Sanitation, Public Works/PMTE as well as Gauteng, Northern Cape, KwaZulu-Natal and North West provinces. The aim of these visits was to identify the main causes of non-payment of invoices, identify blockages and assist departments in putting improvement measures. The Minister also added that best practices were discussed and assurances from Chief Financial Officers regarding improved compliance with invoice payments were obtained.

Regarding the Unit's engagements with service providers, aggrieved suppliers or service providers were able to lodge complaints with the Unit, and investigations would be conducted to ensure the legitimacy of the unsettled invoices, and payment would be facilitated.

By the end of 2016, a total of 144 cases had been lodged and 57 of those had been finalised. Eight (8) cases were disputed, while 4 were unable to be investigated due to lack of supporting documents. About 75 cases were in the process of being investigated.

The Minister also stated that a total amount of R207 million had been recovered by the Unit and paid to various service providers.

4.2 National Treasury– Central Supplier Database (CSD)

Treasury established the Office of the Chief Procurement Officer (CPO) on 1 September 2015 to simplify the process of doing business with government by enabling an electronic registration and verification processes of all businesses supplying services to the government. By July 2016, the CSP had surpassed 150 000 registrations.

Further collaboration between the DPME and NT resulted in the establishment of a walk-in centre housed at the offices of the NT in Tshwane. The walk-in centre would deal with suppliers' queries, and these would be shared between the DPME and NT.

Notwithstanding these initiatives, they still have a limited scope in that they apply to relationships between government departments and suppliers; but not between private sector entities. Indeed, in the process of attending to the queries on payment of suppliers, the DPME Unit had uncovered numerous cases where government institutions had duly paid the invoices but the main contractor had refused to pay the sub-contractor money due to them. Certainly, this is an example that highlights the need to establish better mechanisms within the private sector that can address the issues related to late supplier payments.

One suggestion to consider is to link government's central supplier database to department procurement and payments systems as well as to SARS. Automating the linking of approval of work done for government departments to their supplier payments system and SARS would enable the smooth processing of invoices and lead to penalties for late payment of tax due by suppliers being passed on to late paying departments.

4.3 Prompt Payments Regulations

A Construction Industry Development Board (CIDB) study found that 43 % of payments made to contractors in the construction industry were made after 30 days of invoicing. In May 2015 the Department of Public Works published a set of Prompt Payment Regulations [18] to ensure prompt payment in both private and public sector contractual agreements in the construction industry, excluding home building contracts. The regulations have two main goals: to ensure prompt payment and to create a platform for effective dispute resolution.

Section 26D of the regulations stipulates that payment of invoices "may not be made 30 days after the date on which the contractor, service provider or supplier has submitted an invoice or tax invoice to the client or employment in relation to construction work, goods or services completed or delivered in accordance with that contract". Importantly 26D(2), states that if payments are not made within 30 days, "a client must in addition to the amount that had become due and payable, pay interest to the contractor, service provider or supplier". This provision clearly places penalties on late payers which can significantly increase compliance. Finally, 26D(3) states that interest paid in terms of (2) needs to be disclosed in the financial statements of the client or employer concerned, which again can ensure

[18] Amendment of the Construction Industry Development Regulations (Construction Industry Development Board Act 30 of 2000) published for public comment in the Government Gazette, 29 May 2015.

compliance as these payments can be seen as fruitless and wasteful expenditure. This essentially can name and shame transgressors as part of financial reporting.

The regulations advocate for “progress payments” where the person or company that has carried out construction work are entitled to payments for work completed while the project is underway. This regulation can significantly improve cash flow for contractors who often don’t have enough cash on hand to complete entire projects and require continuous cash flow (through monthly invoicing).

The regulations stipulate that the clients or employers need to give effective notice of the intention to withhold payment from the supplier while the supplier has a right to suspend performance for non-payment. In both cases, disputes can be referred to adjudication at any time by either party (through CIDB Board approved adjudicator nominating bodies) where adjudication procedures are designed to resolve disputes between parties. The adjudicator’s decision must be handed down within 28 days of the dispute being referred, or a maximum period of 42 days if both parties agree. Additionally, parties are required to give effect to the adjudicator's decision within 10 days.

Some[19] have critiqued the overall scope and effectiveness of the proposed regulations including risks posed by, for example, suspension of work. The constitutionality of the regulations was questioned by the Department, which[20] stated that *“the prompt payment regulations were not aligned to section 33 of the CIDB Act. The regulation was unconstitutional. This was being dealt with.”* This means that the regulations will not be implemented and will likely to re-published once amended.

Although these developments are concerning the regulations are the first attempt by the government to deal with prompt payments. The regulations, once checked and adapted for constitutional compliance, should be expanded outside the construction industry to include all contractual agreements between public and private clients and suppliers, service providers and contractors.

4.4 Key Performance Indicators

In the SME Insights Report, the research indicated that there are numerous actions that government could consider motivating SMEs to grow and develop: the government sector needs to speed up

[19] Rudolph, Wright & Abraham (2016). *Cash flow is king.* Construction Law. Available online: http://www.withoutprejudice.co.za/free/article/4885/view
[20] Statements made by Ms Mandisa Fatyela-Lindie, Executive Manager: DPW at a Portfolio Committee for Public Works, 08 November 2016, https://pmg.org.za/committee-meeting/23607/

payment in order to reduce cash flow pressure for SMEs and allow working capital to finance growth. According to SMEs, the main reasons for SME business failures are overwhelmingly cash-flow related.

Establishing a Key Performance Indicator (KPI) for all financial officers in government around ensuring payment to suppliers within 30 days is vital. There could even be a case made to reduce this to 21 days. The 9 extra days an SME can hold on to cash allows it, in turn, to manage cash flow better and pay its own suppliers on time.

If the government wishes to maximise the power of their procurement engine for transformation and job creation they should do more to make their business more attractive to SMEs by improving payment terms and simplifying the tender process. Only a small band of SMEs generate more than 50% of their turnover from business with government and run successful businesses. Long payment terms are a concern for many of these SMEs. It stands to reason that SMEs will prefer doing business with sectors that pay them on a timely basis.

In this regard, other SMEs are their best payers, and big business and government are, on average, challenges for SMEs with respect to payment terms. In the report, 85% of SMEs say the current payment system is unsatisfactory. When asked what remedies they think might help, SMEs have a preference for an ombudsman for overdue accounts (86.4%), a Chapter 7 auditor general or a public protector-style solution which monitors/investigates government performance (85.3%), terms on order payment by Treasury on due date (76.5%) or government accounting officers are measured on payment terms of SMEs (70.3%). Only 9% of the sample was happy with the way things currently are. SMEs must be paid faster.

5. Solutions from the Private Sector

5.1 Prompt Payment Code

Voluntary commitments such as the Prompt Payment Code[21] which the National Small Business Chamber (NSBC) has championed strive to improve payments to SME suppliers within 30 days. It should be noted that the Prompt Payment Code is a commitment, not a legally enforceable obligation. It focusses rather on the reputational gains corporate or government bodies can obtain from good business practices. Additionally, the commitment is a *"statement about your business ethics and*

[21] https://www.promptpaymentcode.co.za/faq.html

you're allowing your suppliers to measure your actions against your words". Beyond requiring prompt payment, the code also requires signatories to provide clear guidelines to suppliers regarding invoicing and payments.

A similar code has also been adopted by the Charted Institute of Credit Management on behalf of the Department Business, Energy & Industrial Strategy in Britain[22]. The main tenets of the Code are that signatories pay suppliers on time, give clear guidance to suppliers and encourage good practice by requesting that their entire supply chain adopts the Code. The Prompt Payment Code includes a Code Compliance Board that has the responsibility to enforce the Code. The Board investigates transgressions made by signatories of the Code and can provide information to help further breaks or even expel the company from the Code. The impact of the expulsion of the code is dependent on the nearly universal adoption of the Code by key players and public awareness of the Code. Simply put expulsion from the Code should have reputational damage to transgressors thus ensuring compliance and the protection of SMEs.

The Bell Pottinger (PR firm) saga illustrated the power of expulsion from a respected voluntary body, the PRCA (Public Relations Communication Association)[23]. The expulsion was based on the breaches by the company of the Codes of Conduct and Professional Charter. This together with the public sentiment around the Company led to it being put into administration and serves as a clear warning to other companies to act within the Code and Charter. One key aspect is the large number of signatories to the Association which gives it more authority and legitimacy to regulate behaviour in the industry.

An equivalent option to increase the signatories to the Prompt Payment Code in the private sector is that the public sector could require companies to include a certificate of "good standing" with the Code as part of tender processes. This could require that the Code be managed through a newly created Statutory Body or managed through a government department/unit such as the DPME 'Special Unit' (by expanding their mandate).

The DA would champion, within the framework of the Prompt Payment Code, the inclusion of payment history and age analysis in the BEE scorecard. Points would be allocated in the Supplier

[22] http://www.promptpaymentcode.org.uk/
[23]http://www.fin24.com/Companies/Advertising/breaking-bell-pottinger-expelled-from-pr-body-for-gupta-work-20170904

Development section of the scorecard for prompt payment, and points deducted for poor payment practices. This would incentivise prompt payments and reward companies for good practice. It would also be highly visible to suppliers and potential suppliers, who might think twice about doing business with serial abusers.

5.2 Business assistance services

A key issue for SMEs specifically small and newly created enterprises, is their ability to professionally administer their business activities. Small firms often lack enough internal administrative capacity including the production of appropriate invoices as well as the management and delivery of said invoices to clients. As previously indicated by government departments, late payments occur due to incorrect invoices or invoices that are not submitted on time.

There are various private sector firms that focus on business support services, such as recurring billing systems that can handle payment collection and invoicing. Additionally, credit checks on potential clients with (private firms) could limit SMEs' risks for late payments[24].

5.3 Other instruments for improving working capital

To improve the cash flow of small businesses several other instruments and services are available from the private sector. These include credit guarantees (supplier buys insurance to cover losses from unpaid invoices due to client default), sale of invoices to factoring houses or banks (supplier sells its invoices to the factor who pays a portion of these invoices upfront, the factor takes responsibility for collecting on the invoices), invoice discounting (supplier gets paid a portion of the invoices upfront but maintains responsibility for collecting on the invoices), sale of credit card receivables (similar to invoice discounting but used on credit card transactions.) All of these services incur a fee which is calculated on the creditworthiness of the supplier or the risk incurred in collecting on the invoice/credit card receivables.

The downside of these instruments is that many SMEs have dubious creditworthiness and so do not qualify or pay high rates of interest/ fees to take advantage of the services.

[24] Eg. "Billdozer" – recurring billing specialists. http://www.billdozer.com/

5.4 Supply Chain Finance

Supply chain finance, also known as reverse factoring, is a set of solutions that optimizes cash flow by allowing businesses to lengthen their payment terms to their suppliers while providing the option for their large and SME suppliers to get paid early. This results in a win-win situation for the buyer and supplier. The buyer optimizes working capital, and the supplier generates additional operating cash flow, thus minimizing risk across the supply chain[25].

Simply put, supply chain finance allows a supplier to secure its money earlier by piggybacking on the creditworthiness of a buyer. Practically, supply chain finance ensures the SME gets its cash within a few days. See below an illustration of the SCF:

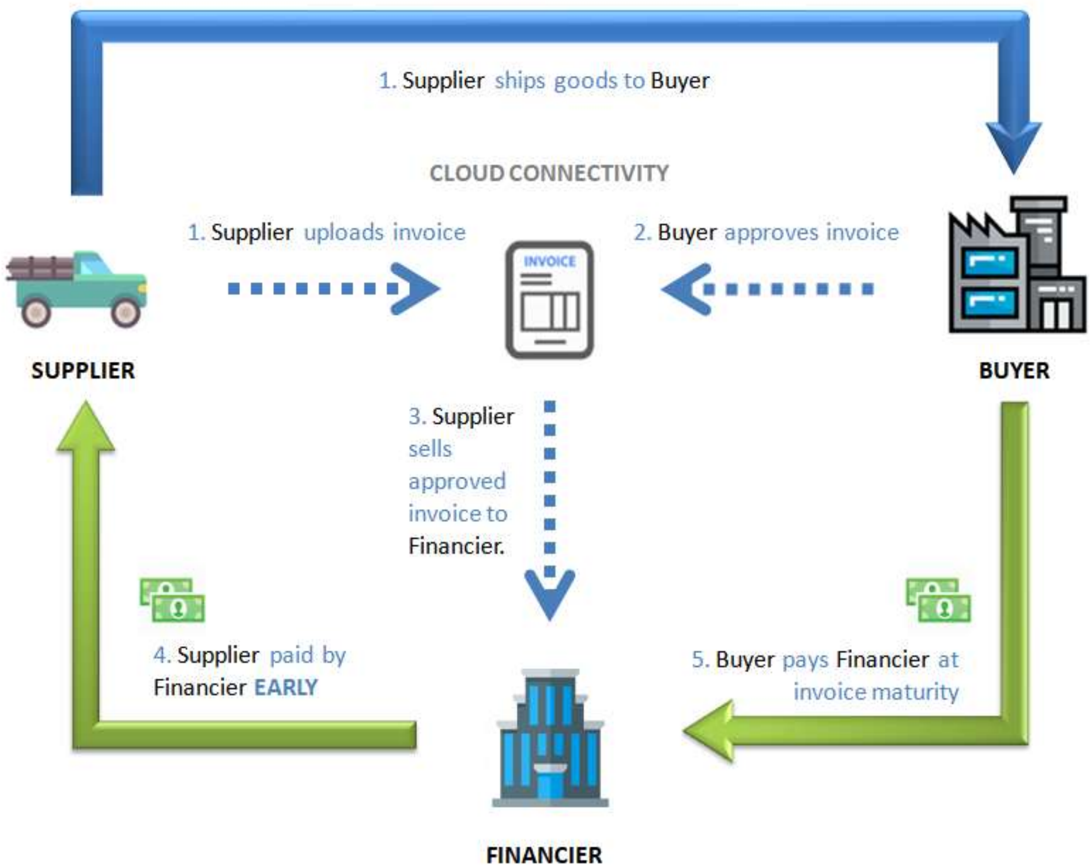

Figure 1: Supply Chain Finance (Illustration by Michael Melvill as sourced out of a draft paper, Innovative SME Funding Solutions to Ignite Growth in SA, 2018)

[25] https://primerevenue.com/what-is-supply-chain-finance/

1. The SME (Supplier) ships goods to the Government entity/Corporate (Buyer)
1. The SME (Supplier) uploads its invoice for goods and services
2. The SOE/Corporate (Buyer) approves the invoice.

Approval means recourse on the invoice is assumed by the (investment grade) buyer. Financiers, therefore, carry less risk and can charge lower interest rates.

3. The SME (Supplier) sells the invoice to the Financier

Sale of an invoice ensures the Buyer's liability is recorded as Accounts Payable. (IFRS. GAAP)

4. The SME (Supplier) may elect to be paid early by the Financier for a small fee.

5. The SOE/Corporate (Buyer) pays the Financier's invoice at maturity

Whilst every step is necessary for SCF to work, in practical terms, from an SME Suppliers perspective there are only two steps: Upload invoice & Elect early payment. The principal benefit of SCF for financiers is that they only have to deal with a small number of creditworthy buyers rather than a large number of suppliers and/or invoices.

SCF is in its infancy in South Africa, with PicknPay and Santam being two early adopters in the retail and financial services sectors. It does have much promise, however, to unlock billions of Rands in working capital that would have a significant positive multiplier effect on the broader economy.

6. Small Business Ombudsman

An Ombudsman is an independent, impartial entity endowed with the authority and responsibility to receive, investigate or informally address complaints and when appropriate, make findings and recommendations and publish reports.

The origin of the word is found in an Old Norse word 'umbodhsmadhr' meaning 'representative of the people' and this provides the conceptual foundation of its functions.

Many other names are used to represent the ombudsman office such as the office of Public Protector.

The literature identifies three categories of Ombudsman, defined according to the mode of their appointment and the scope of their mandate. The three types are: classical/legislative (appointed by the legislature either at national or sub-national level), executive (appointed by the executive), and organisational (appointed by an organisation). A key distinguishing factor between the classical/legislative and executive Ombudsmen is that the former is *"located outside the structure of the agency it oversees, and receives complaints from external users of the service provided by the agency"* (Fowlie 2008, p 19-20)[26].

Conventionally, the Office of the Ombudsman is viewed as an important instrument of democracy insofar as it is established to protect the people against violations of human rights, the abuse of power by public institutions, error, negligence, unfair decisions and maladministration. They perform several functions related to this mandate including receiving and responding to public complaints against public or private entities, conducting investigations, making binding recommendations; and sometimes also serve as an effective and cost-free conflict resolution mechanism.

To be properly suited to discharge these functions, however, the office of the Ombudsman must have a number of features. These are identified by Gregory (2000, p 100)[27] as: visibility and accessibility, credibility, which encapsulates impartiality, independence, adequate judicial remit, adequate investigative powers, appropriate standards of appraisal of administrative practices, and action on investigated matters; effectiveness in terms of adequate remedial action, securing compliance with recommendations, and speedily handling of cases; accountability; personal qualities of office holders; appropriate political and governmental environment. Maine adds that the Ombudsman complements the judiciary in dispensing administrative justice and acts as a custodian of citizens' rights. In a way, therefore, the Ombudsman is "*another lawful and constitutional device for the improvement of … citizen's rights"* (Maine 2004, p 61)[28].

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[26] Fowlie, F. 2008. 'A Blue Print for the Evaluation of an Ombudsman's Office: A Case Study of the ICAAN Office of the Ombudsman'. Unpublished PhD Thesis, La Trobe University, Australia.
[27] Gregory, R. 2000. 'The United Kingdom Parliamentary Ombudsman'. In V Ayeni (ed). The Ombudsman and Good Governance in the Kingdom of Lesotho. London: Commonwealth Secretariat.
[28] Maine, A L. 2004. 'The Role of the Ombudsman in Deepening the Tenets of Democracy'. Paper presented at the 2nd National Workshop for Members of Parliament of Lesotho. National Convention Centre, Maseru, 5 May. Also see Motlamelle Anthony Kapa, "Promoting the Effectiveness of Democracy Protection Institutions in Southern Africa The Office of the Ombudsman in Lesotho", EISA, 2009

6.1 International

6.1.1 United States: US Small Business Administration (SBA) – Office of the National Ombudsman

The U.S. Small Business Administration (SBA) was created in 1953 as an independent agency of the federal government to aid, counsel, assist and protect the interests of small business concerns, to preserve free competitive enterprise and to maintain and strengthen the overall economy. The SBA helps Americans start, build and grow businesses. Through an extensive network of field offices and partnerships with public and private organizations, SBA delivers its services to people throughout the United States, Puerto Rico, the U. S. Virgin Islands and Guam.

The SBA equivalent in South Africa would be the Department of Small Business Development (DSBD). However, the functions of the SBA go beyond the present mandate of the DSBD in that the SBA's mandate also traverses the regulatory environment. For example, the Small Business Act, from which the SBA was established, entitles small businesses to a "fair proportion" of government contracts and sales of surplus property, whilst the Small Business Investment Act provides investment vehicles for small business investments. The SBA also has regulations on loans to small businesses.

In South Africa, these functions, specifically those related to government procurement policy, usually fall within the purview of the Department of Trade and Industry (DTI) and its Sector Codes. Still, the DSBD does also have financing institutions such as SEFA.

In terms of a dedicated small business ombudsman, the US SBA does house a National Office of the Ombudsman. The Office of the National Ombudsman states that it "assists small businesses facing unfair or excessive federal regulatory compliance or enforcement issues such as repetitive audits or investigations, excessive fines, and retaliation".

It is an "impartial liaison", that directs reported regulatory fairness issues to be reviewed by the relevant agency. It is spread across all government agencies and aims to reduce regulatory burdens, and resolving regulatory and other disputes involving small businesses and government agencies.

The Office of the National Ombudsman was established by the US Congress in 1996 as part of the Small Business Regulatory Enforcement Fairness Act (SBREFA)[29]. The Act aimed to provide a channel through which businesses, small government entities, and small non-profit organizations that experienced unfair regulatory enforcement actions by federal agencies would be able to seek remedy.

It is important to note however, that the Ombud process does not suspend, cancel, modify, or replace any legal or administrative process or other mandates for formal review that an agency may require, and that the National Ombudsman does not have authority to make a ruling or decision on a case, or impose any punitive or corrective measures on a federal agency.

Notwithstanding its progressive mandate, one can see the limitations with the US SBA and its Ombudsman: firstly, there is a narrow focus on regulating relationships between small businesses and the government, whereas there is little mention of disputes arising between small businesses and large firms in the private sector. Secondly, the Ombudsman has very limited enforcement capacity and relies on other government (federal) agencies to review and make binding decisions.

6.1.2 Australia: Australian Small Business and Family Enterprise Ombudsman (ASBFEO)

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO)[30] was launched as recently as March 2016. It has two primary functions that define its activities: to assist and to advocate for small businesses and family enterprises.

The Ombudsman is appointed by the 'Governor-General', but the appointment is ratified by the Minister. In essence, the Ombudsman in this sense is ostensibly of the executive and legislative type as the executive is directly involved in the appointment, and due to the fact that the Ombudsman reports directly to and can receive instructions from the Minister.

The ASBFEO derives its mandate from the Australian Small Business and Family Enterprise Ombudsman Act 2015[31].

However, the powers of the ASBFEO are ambiguously defined by the Act. For instance, while on the one hand, the ASBFEO can impose fines or 'penalty points', and even imprisonment sentences under

[29] https://www.sba.gov/ombudsman/legislation
[30] http://www.asbfeo.gov.au/about
[31] https://www.legislation.gov.au/Details/C2015A00123

conditions an inquiry or hearing, on the other hand, the Act does not state whether or not a recommendation or decision of the ASBFEO is legally binding or enforceable outside of inquiries or hearings. The key assistance function of the ASBFEO relates to dispute resolution processes as contained under 'Division 3' of the Act. Yet even within this context, the Act does not provide that the resolutions or recommendations emanating from the dispute resolution processes are binding whatsoever. The ASBFEO is allowed to recommend that aggrieved parties seek alternative resolution processes – not however, in courts.

It seems that much of the power(s) vested in the ASBFEO comes from the Minister, and depends on the context within which the ASBFEO is involved in, such as an inquiry or hearing. Yet at the same time, it is interesting to note that an important function concerning dispute resolution enjoys limited enforcement capacity.

6.2 South Africa

The concept of the Ombudsman in South Africa has taken on varying dimensions. In terms of legislation the Ombudsman Act, 1979 (Act 118 of 1979) was repealed in 1994 when the Public Protector Act was enacted, which established the Office of the Public Protector. Various other pieces of legislation, at both national and sub-national levels, have been promulgated to establish different types of ombud offices. Acts such as the Financial Services Ombud Schemes Act and the Consumer Protection Act (CPA Act) are aimed at protecting, regulating, and mediating relations between consumers and service and goods providers.

At the same time, Chapter 9 institutions have derived their mandate from the Constitution and these, to varying extents have functions that can broadly be characterised within the conceptual ambit of an ombudsman.

South Africa does not have an executive ombudsman body of the 'classical type' as the executive. However, in addition to the Chapter 9 Institutions, South Africa does enjoy a strong culture of organizational type ombudsmen. Though, these tend to be voluntary bodies with little to no statutory mandate or legally binding enforcement mechanisms as is the case with organisational ombuds like the Press Ombud or Ombudsman for Banking Services (OBS). Still, no legislative or organisational ombudsman that is specifically devoted to small businesses (and/or family enterprises) exists in South Africa.

Although there are organs within the state that deal with disputes arising between the government and small businesses, these organs do not deal with disputes that exist between businesses. Certainly, this is true of other countries such as the U.S and Australia.

South Africa's Public Protector Office remains one of the few Ombud offices in the world that can make legally binding decisions on anyone or entity, including the President, and enjoys a wide scope to investigate and make recommendations across a spectrum of issues. Certainly, this enforcement capacity makes the Public Protector an effective ombudsman.

When deliberating on the establishment of a Small Business Ombudsman, policymakers would need to think about a number factors including, but not limited to:

- Scope: The size and nature of businesses that can approach the Ombudsman (as well as government agencies)
- Functions: Assistance, advocacy, dispute resolution processes, investigative hearings or inquiries
- Powers: legally binding decisions; voluntary association
- Administration: Which entity would administer the office?
- Type: Executive, legislative or organisational

The establishment of a dedicated small business ombudsman could play a key role in providing dispute resolution channels to small businesses; advocating for small businesses in policymaking structures; providing information and other forms of assistance. What will be important for such an institution is its enforcement capacity, the scope of its mandate and primary functions.

7. Conclusion

SMEs are the future job generators for the 9.2 million unemployed people in South Africa. The DA firmly believes that every effort must be made to ensure that SMEs are given the backing and financial support they require in order to thrive and prosper. One of the key ingredients in this support package is having SMEs paid swiftly and timeously. Without cash flow, SMEs will struggle and eventually collapse. This document highlights the steps that need to be taken to improve supplier payments for SMEs and ease the cash flow concerns from both a private and public-sector perspective. To effectively solve the issue of late payment a combination of solutions include national monitoring units, centralised procurement, prompt payment regulations and codes, and the creation of an ombudsman.

Specifically, the establishment of a dedicated small business ombudsman could play a key role in providing dispute resolution channels to small businesses; advocating for small businesses in policymaking structures; providing information and other forms of assistance. What will be important for such an institution is its enforcement capacity, the scope of its mandate and primary functions. With these proposals, SMEs will have a fighting chance of competing in a very restrictive and low-growth environment.

The DA will continue to explore all the various solutions possible in order to promote an environment where small businesses can thrive.