

“6. SCF is using AI to target small business

The data collected by SCF providers is extremely detailed and provides insight into individual small business profit margins and cash flow fluctuations. We are aware that some SCF providers are using artificial intelligence (AI) and algorithms to target small businesses by dynamically setting SCF fees to extract the greatest possible return from small businesses, including those that are already in distress.”

This is not how Taulia works.

No data sources are used by Taulia that pull in financials for small businesses.

The discount associated with an early payment is "dynamic" in the sense that it's based on a daily rate. As the due date approaches, the discount to get paid early approaches zero. For example, if you want an early payment to get paid 5 days before the due date, the discount is less than it would be if you wanted payment 10 days before the due date. The daily rate itself does not adjust dynamically. When it comes to rates, we regularly hear from our supplier users that they value predictability, and this is what we offer.

A key reason for offering early payment is to help strengthen your supply chain. Businesses we work with are offering early payment to help those in distress that work with them.

While this section of the position paper does not accurately describe how Taulia uses AI, we do use AI for our SCF programs. The way it's used is very different with the intent of optimizing program adoption. For example, we use AI to predict the approval time of invoices. An early payment is only available after an invoice is approved. If a 30 day invoice isn't approved until day 28 lets say, there's essentially no opportunity for early payment. We use AI to identify situations like this so we know not to contact the supplier. There's essentially no value for them so it would be a waste of their time to consider being paid early.

Discounts for early payment have been an historic feature of trade negotiations, but the new platforms offering SCF, often backed by powerful artificial intelligence, have brought an insidious new front to the war small businesses are waging to get paid within a reasonable time frame.

The utilisation of artificial intelligence in forms of SCF also removes the human element of business interaction and allows further squeezing of any discounts agreed to for prompt payment. The impacts of this sort of behaviour have already been examined through the Banking Royal Commission in Financial Misconduct. As small businesses already operate from a weakened position with their large business counterparts, the adoption of these technologies in unscrupulous ways has the capacity to flip the entire business operating system on its head. This is being facilitated by external online platforms to strip value from other people's businesses and concentrate information in the hands of those with the greatest bargaining power.

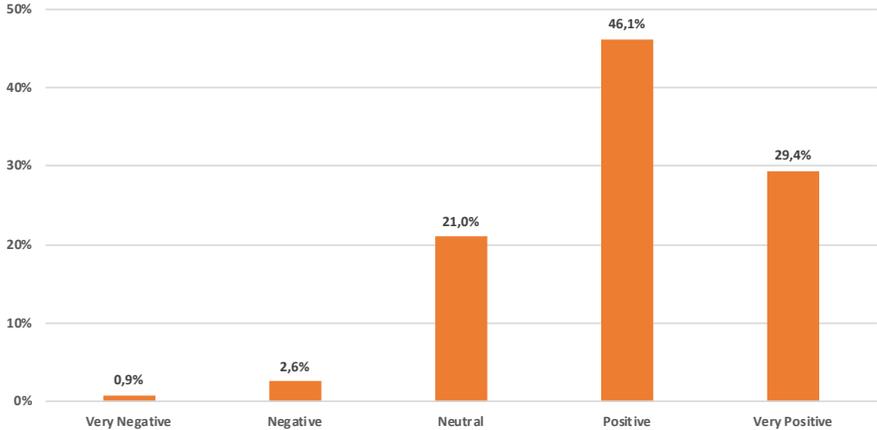
Early payment is optional for suppliers. When it is offered, it is creating an option for businesses which they didn't previously have. It can't possibly "strip value" from suppliers as they simply won't use it if they don't obtain value.

Page 9

SCF as a real choice

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

The feedback we see from businesses regarding early payment is very favorable. Our annual Supplier Survey shines a light on the views of nearly 20,000 of our suppliers; ranging from small businesses to international enterprises (see latest results below). Taulia is providing an option for suppliers that was not previously available and the vast majority view it positively.



In addition to the overall data, we hear directly from suppliers regularly about how helpful it has been to their business. Below is a link to a video testimonial from a company that would have gone out of business if it were not for early payment through Taulia. I've included a few other quotes below that from our most recent survey.

Video Testimonial: <https://twitter.com/taulia/status/1108380538497306624>

Supplier Quotes:



## Page 12

### Example

Bob is a carpenter who sub-contracts to ABC Construction. This is the biggest contract that he has ever had. Bob signed up to 30 day payment terms for the work he completes for ABC. After being on these terms for 6 months, ABC advised Bob that they were changing all payment terms to 65 days. ABC tells Bob that it offers a reverse factoring scheme, which means that Bob can still get paid in 30 days, provided he agrees to take a discount from anywhere between 2% and 8% on his invoices depending on how soon he wishes to be paid on each invoice. This impacts Bob's ability to pay his own suppliers, properly assess the cost of jobs, and manage his cash flow projections. Unfortunately for Bob, as he needs to make payroll, he has no choice but to accept a discount on his invoices.

This is an example of extending payment terms more than it is about reverse factoring. Extending terms happens frequently even without any early payment programs like reverse factoring. Early payment programs are provided to help businesses with optional financing.

The rates here are not accurate. I believe it is just a mistake in the writing of it. The 2% to 8% is not the discount on the invoice. I think it should be APR. The APR (Annual Percentage Rate) is the discount applied for financing over 365 days. To go from 65 days to 30 days and be charged an 8% discount is an 83% APR! 2% to 8% is more common as an APR which would translate to 0.2% - 0.8% of the invoice value.

In terms of other choices this supplier would have, the most comparable alternative is factoring. With factoring, rates are in the 12 – 18% range or higher and there a number of companies who offer this solution and can be found online. In addition to the cost however, factoring can be quite cumbersome to setup and restrictive for the business long term as they need to pledge receivables. When compared to factoring, supply chain finance/reverse factoring is very appealing.

## Page 13

### Example

Sophie contracts to a large tech company, Whizz Bang, which has made great fanfare spruiking their movement to 30 day payment terms for their small business suppliers. Sophie contacts Whizz Bang to move onto the 30 day terms within their system. However, Whizz Bang defines a small business as having fewer than 20 employees. As Sophie has 21 employees, she doesn't fit this category and goes onto the standard terms which have recently been extended from 45 days to 62 days from the end of the month. As Sophie's business has a turnover of about \$2 million per year, she still considers herself a small business. However, in acknowledging the impact of extending payment terms, Whizz Bang offers Sophie access to earlier payment at a discount through a third party supply chain financier.

Sophie would prefer not to take a cut on her invoices to get paid, and tries to wait it out, but there are a couple of months where she needs to get paid in 30 days to manage cash flow. Sophie notices that after taking a discount to get paid, the following month her 'discount offer' is higher on about the 30th day of the month, leading her to believe that Whizz Bang know she will be looking to get paid close to that date. Sophie contacts her procurement manager and is assured that Whizz Bang don't target offers at specific times, but she remains unsure about how transparent they are being.

This is an example of a company finding a loophole in the definition of small businesses more so than it is about dynamic discounting.

In dynamic discounting, there is no third-party financier. The buyer company is making the payment directly to the supplier.

Taulia does not have variable pricing to a supplier based on time of month or any other similar characteristic. Suppliers are placed into a single daily rate that is consistent. The only fluctuation that can occur is when the pricing is tied to a benchmark rate such as BBSW.

## Page 14

### Example

Gabe owns a business that contracts with XYZ which is a large agricultural firm. XYZ regularly publicises its work in supporting the local communities that they operate in, and claims to support small business by being a signatory to the Supplier Payment Code. Under the Code, XYZ chooses to define small business as having less than 20 employees and sets out a range of postcodes where this arrangement applies.

Gabe has chosen to work with XYZ as he believes it will look after him, given he is a small, local supplier. Gabe's friend who lives in the next postcode also supplies to XYZ and Gabe knows that his friend gets good payment times as part of their 'local supplier' commitment. Gabe, who has 12 staff,

has worked hard to employ as many local people as possible, knowing that XYZ is also a big supporter of the local community.

One day, Gabe is contacted by his procurement manager at XYZ to be told that it is implementing a dynamic discounting policy for its suppliers who fall outside their 'small business' definition, and at the same time they are extending those business' terms from 30 to 90 days. XYZ explains to Gabe that although it uses a definition of fewer than 20 employees to define small business, those businesses also need to be within a set range of postcodes and he is based outside that range. Gabe is moved by XYZ to the longer payment terms with dynamic discounting.

Gabe contacts XYZ and asks why the discounts that he needs to accept to be paid within 30 days are constantly varying. He notes that whenever he really needs to bring payments forward to within 30 days that the discounts on his invoices seem even greater than they normally are. He is told that the discounts vary because they are set against a variety of indicators and that the algorithm takes his own circumstances into account. This impacts Gabe's ability to minimise project overruns and therefore accurately predict timeframes to quote projects.

Gabe is left with a choice: To try to manage the longer payment terms, to take a constantly varying discount on invoices and have his profit squeezed even further, or to move premises to within the postcodes set by XYZ.

Similar to above, this is more about a buyer finding a loophole in the definition of a Small Business than an example of dynamic discounting. Taulia does not use algorithms to determine discounts like this.

Page 18

Taulia, a SCF platform provider, states that the use of machine learning and AI big business has the capacity to "identify the most suitable payment terms for individual suppliers ... buyers can take advantage of prediction and network insights to find the APR that best balances supplier adoption levels against their required rate of return."

Additionally, in the same article it was stated that: "vendors with strong networks may also be able to draw upon insights from those networks about how suppliers react to offers at varying payment terms, sizes, rates and tenors."

It is unreasonable for large businesses to use complicated and expensive AI systems to manipulate small businesses into reducing their margins. When small business data is aggregated from the top down it creates value and control for big business and the platform and financial providers. In contrast, where small businesses retain bottom up control of their data they can determine when and how that data is used. When big business utilise third party platforms, small business data privacy needs to be ensured.

Here is the full quote from this article:

*Vendors with strong networks may also be able to draw upon insights from those networks about how suppliers react to offers at varying payment terms, sizes, rates and*

*tenors. Based on this information, vendors can identify the most suitable payment terms for individual suppliers and determine the level of flexibility that buyers may need in managing those terms. This exercise should be conducted in lock-step with AI to determine the most appropriate APR to offer suppliers. For example, a buyer offering a self-funded dynamic discounting programme could find that there is a 20% likelihood that a specific supplier will opt to accelerate payments at 8% APR. At 6% APR, the probability might go up to 25%, but the net yield would be lower. Conversely, at 10% there might be only a 1% chance that the supplier will accept the offer.*

There is no manipulation of small businesses here. Early payment programs are optional. Suppliers will only use them if its beneficial to them. This comment is explaining the need to find a win-win for buyers and suppliers. In the example from the quote, if the pricing is too high (10% APR) it will not be accepted and neither the buyer or supplier receives benefit. The use of AI is being suggested to improve this rate setting determination ultimately ensuring a win-win for all parties involved.

Page 21

One version of this is associated with a product a number of SCF providers offer called dynamic discounting. With this product, the big business buyer itself provides the funding for early payment but at a discount, supposedly based on the buyer's own credit rating. However, Taulia claims on its website that buyers who use Taulia's dynamic discounting scheme can "earn a risk-free high return ... by investing [their] cash to capture discounts, [they] can earn risk-free returns that are much higher than traditional investments. Our customers achieve double-digit returns and there is no risk as [they're] committed to pay at invoice maturity anyway." It would seem logical that if the buyer is earning returns that are much higher than traditional investments then some of this efficiency should be reflected in lower supplier's costs.

Early payment is optional for suppliers. They would only accept it if it was better than their other alternatives. It therefore does lower the supplier's costs if they are using it. Furthermore, it doesn't come with all the other challenges that you see with traditional lending such as the requirement for collateral (like using your home) or lengthy paperwork.

Also, it should be noted that there is spread between the interest rate a company can receive on its cash (i.e. traditional investments) and the interest rate they can borrow at. This creates further opportunity to generate value for both buyers and suppliers since self-funded early payments do not have a middleman (i.e. a bank).

Email from Ben

With regards to algorithms, in a general sense we'd like to know what is the capability of algorithms that are used within the context of supply chain finance platforms.

More specifically we are looking to understand how they are used to determine pricing.

Subsequently, we would like to know how this plays out in terms of categorisation of pricing and if this is disclosed through to the supplier as well as how supplier behaviour is tracked to inform decision making and how this information is shared with buyers.

Above there were a few examples specifically mentioning algorithms. As stated with those specific examples Taulia does not vary pricing to suppliers based on time of the month, past behavior or financial position. Suppliers receive a consistent fixed daily rate or a rate pegged to BBSW. This rate offered is fully disclosed to the supplier prior to them accepting an early payment on their invoice.

In terms of information shared with the buyer, it differs between 3<sup>rd</sup> party financed supply chain finance and buyer financed dynamic discounting. In supply chain finance, the buyer has no visibility into pricing. On dynamic discounting, since they are paying the invoice early from their system and with their own cash, they can calculate the pricing.