Use of e-invoicing by UK SMEs

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This report reviews the extent and the drivers of e-invoicing adoption among UK SMEs. Its concludes that UK SMEs have the potential to send hundreds of billions of pounds' worth of e-invoices, which could improve their access to some forms of external finance. Nonetheless, adoption generally depends on the initiative of customers rather than SMEs themselves.

This report was commissioned by the UK Department for Business for the UK National E-invoicing Forum. It was prepared by ACCA using evidence from the BDRC Continental SME Finance Monitor.

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1. The e-invoicing agenda

E-invoices are invoices that are issued and received in an electronic format that ensures tax and general regulatory compliance; they are transmitted, processed and archived fully electronically from end to end throughout their life cycle (ACCA 2012).

In all but a few countries around the world, only a minority of invoices are processed fully electronically. Nevertheless, the potential benefits from wholesale adoption of e-invoicing are very substantial. Only the most obvious of these relate to the removal of administrative, paper, printing and postage costs. In fact, most of the economic gains from e-invoicing do not arise from these savings, but rather from the full process automation and integration from order to payment between trading parties (EC 2010a).

Bearing this in mind, in December 2010 the European Commission published a Communication entitled *Reaping the Benefits of Electronic Invoicing for Europe* (EC 2010a), setting out its vision for making e-invoicing the dominant form of invoicing in Europe by 2020. In order to coordinate policy and commercial initiatives to promote the adoption of e-invoicing in Europe, the Communication proposed the creation of a European Multi-Stakeholder Forum (EMSF) on e-invoicing, as well as the creation of corresponding national multi-stakeholder forums in the member states. Its recommendations were accompanied by a Commission Decision (EC 2010b) specifying the terms of reference for the EMSF.

The UK e-invoicing Advocacy Group (UKeAG) was founded in 2010 and in 2011 the Department for Business, Innovation and Skills (BIS) endorsed it as the UK's national forum. Accordingly, the UKeAG has since been renamed as the UK National E-invoicing Forum. The activities of both the EMSF and the national forums are organised to perform the following four strands of work:

1. monitoring e-invoicing adoption in member states and at EU level
2. exchanging experiences and good practices
3. proposing appropriate solutions for remaining cross-border barriers
4. moving towards a single e-invoice standard data model.

In February 2012, as part of its Finance Fitness campaign, BIS explicitly endorsed e-invoicing as part of the solution to the problem of late payments of commercial debts. Finally, in September 2012 the Department held a workshop, chaired by the UK Business Minister, Michael Fallon, exploring the potential for technology and service providers to help combat late payment. One of the questions posed at this workshop was what constraints were keeping the UK's small businesses from adopting e-invoicing. The present report attempts to provide part of the answer to this question, by examining a new source of information on e-invoicing adoption: the SME Finance Monitor (BDRC 2012).

2. About the SME Finance Monitor

The SME Finance Monitor (BDRC 2012) is the definitive account of how UK small and medium-sized enterprises (SMEs) gain access to finance. Carried out by independent consultants BDRC Continental on behalf of the British Bankers Association (BBA) Business Finance Taskforce, it is based on a quarterly telephone survey of 5,000 SMEs. The Monitor questionnaire contains questions on the demand for and use of finance by SMEs, their financial and organisational capabilities, and the challenges they face in doing business, as well as their plans for the future.

At the request of ACCA and the Forum of Private Business, BDRC agreed to introduce a new question on the sending of electronic invoices by SMEs into the Q2 2012 edition of the SME Finance Monitor, thus creating the largest and most detailed dataset ever on SME's use of e-invoicing in the UK and some of its determinants. This report discusses the insights emerging from the data.

2.1 METHODOLOGY

The phrasing of the SME Finance Monitor question on e-invoicing represents a compromise. The intention was to remain as faithful as possible to the definition used by Eurostat in producing survey data on the uptake of e-invoicing. Eurostat's 'ICT Usage and e-commerce in Enterprise' study[1] collects these in the context of the 2011–15 benchmarking framework for the Digital Agenda Scoreboard, Europe's strategy for achieving a flourishing digital economy by 2020.

In practice, the need to conserve space in what is already a very lengthy survey meant that precisely replicating the Eurostat questions was impossible. In the end, respondents were asked:

> [does your business] *submit invoices to customers electronically over the internet in a format that can be processed automatically and transferred directly from your application into the recipient's own system. The transmission protocol might be XML, EDI, PDF or other similar formats.*

As we shall see, this has resulted in a 'noisier' version of the Eurostat question, which does, nonetheless, capture similar information.

1. Metadata and questionnaires for the study are available from Eurostat at http://epp.eurostat.ec.europa.eu/cache/ITY_SDDS/en/isoc_bde15d_esms.htm and http://circa.europa.eu/Public/irc/dsis/emisannexes/library?l=/data_-_database/theme_3_-_popul/isoc/householdsindiv&vm=detailed&sb=Title

2.2 A FIRST LOOK AT THE FINDINGS

Owners and managers in about 29% of UK SMEs[2] claimed to be sending e-invoices under the definition used by the Finance Monitor in Q2 2012 (See Table 2.1). Weighting these results by turnover suggests that these SMEs account for roughly 35.5% of UK SME turnover, or £543bn.[3]

Since Eurostat has not yet provided data on the use of e-invoicing in 2012, it is only possible to compare these findings with the most recent available Eurostat figures (2011), which suggest that 52% of UK SMEs with more than 10 employees sent some kind of invoices electronically in 2011, although only 6% sent electronic invoices suitable for automatic processing. It is fair to assume that, as there have been no substantial policy changes, e-invoicing will have become marginally more widespread in the UK between 2011 and 2012, so comparisons are broadly valid.

This comparison suggests that the definition of e-invoicing used in the SME Finance Monitor includes a good deal of invoicing that Eurostat's methodology would not recognise as 'true' e-invoicing. In particular, including PDF as a sample e-invoice format may have inflated the number of e-invoicing users. In order to reconcile the two, there is an attempt later on in this report to construct a proxy for 'true' e-invoicing, on the basis of SME finance monitor data. First, it is necessary to understand what the headline figures reveal.

2.3 WHAT KINDS OF BUSINESSES SEND E-INVOICES?

A selection of the SME Finance Monitor's broad set of variables were considered as possible proxies of a business' tendency to use e-invoicing. The link with e-invoicing is unlikely to be causal in most cases, so it is important to remember that these are not, strictly speaking, *drivers* of e-invoicing but rather, *indicators* of possible e-invoicing activity.

2. For the total SME sector, Eurostat typically reports adoption figures among businesses with 10 to 249 employees; the equivalent figure based on the BDRC (2012) sample would be 37%.

3. These estimates are based on the midpoints of 12 turnover size-bands, as no numerical data are available from BDRC on SME turnover. As such they will over-estimate adoption by smaller businesses and under-estimate adoption by larger ones. On balance, this means the estimate is conservative.

Table 2.1: Use of e-invoices by small and medium-sized UK firms: a comparison

	Employment size band			
Indicator	*0*	*1 to 9*	*10 to 49*	*50 to 249*
Eurostat 2011: Businesses sending electronic invoices suitable for automatic processing	:	:	4	14
Eurostat 2011: Businesses sending electronic invoices **not** suitable for automatic processing	:	:	48	62
Eurostat 2011: Any invoices sent electronically	:	:	49	65
BDRC 2012: Any invoices sent electronically	28	29	36	40

The following variables were considered:

- business size (turnover, employment, credit balance)
- internationalisation (importer and exporter status plus a general 'internationalisation' variable derived from factor analysis)
- formalisation (legal form, business planning, formal HR policies, regular management reporting and financially trained staff plus general 'formalisation' variable derived from factor analysis)
- innovation (online trading, new products and services or business improvement over the last three years, plus general 'innovation' variable derived from factor analysis)
- sector (including for/non-profit/franchise status)
- business track record (age of business, start-up status and owner/manager's experience, high growth, risk rating)
- owner/manager's demographic characteristics (gender, age, qualifications, ethnic group)
- region in which the business is based
- financing (including individual types of finance, general 'banking', 'supply chain finance' and 'informal finance' variables derived from a factor analysis).

By applying CHAID analysis[4] to the headline figures on e-invoicing, it is possible to establish which of the above are good indicators of possible use of e-invoicing as measured by BDRC (2012), and even to rank them by order of significance. The model used highlighted a set of six variables as indicators of e-invoicing activity, and ranked them as follows.

Quality control and customer integration

E-invoicing is more likely wherever businesses are used to sharing significant information with their customers and especially among businesses embedded in large supply chains. Businesses working to a formal quality standard or practising Total Quality Management are thus almost twice as likely as their peers to issue invoices electronically (47% compared with 25%). This multiple rises from 1.9x to 2.7x after controlling for other variables (see Chapter 3).

International supply chains

Exporter SMEs are more likely to issue invoices electronically than businesses with no international activity (43% compared with 27.5%) and those businesses that both import and export are even more likely to do so (48.5% compared 27.5%). Both these effects are neutralised, however, if the business practices quality control or TQM. This suggests that both quality control and internationalisation are acting as proxies for a) having powerful customers and b) being embedded in international supply chains.

4. CHAID (Chi-squared Automatic Interaction Detection) analysis is a method of exploring the interactions between variables. It uses a range of explanatory variables in order to break down a complex phenomenon (in this case, e-invoicing adoption) into a series of simpler ones. It does so by selecting the business characteristic most likely to divide the sample into groups with significantly different levels of adoption, and then repeating this process for each of the subgroups identified until the resulting groups contain fewer than 100 observations or cannot be broken into groups containing at least 50 observations each.

E-commerce

Doing business online makes invoicing online more intuitive and possibly easier. Businesses trading online are more likely to issue invoices electronically than those without a website (35% v. 22%). This multiple remains constant at 1.6x even after controlling for all other variables.

Formal policies

Businesses that are experienced at formulating and maintaining formal policies are more likely to adopt e-invoicing, reflecting the behavioural nature of adoption among SMEs. Here the main proxy has been having a formal HR policy, although use of company credit cards also acted as a proxy in similar ways.5 Businesses with formal written HR policies were more likely to issue invoices electronically than those without (41% compared with 26%) and so were businesses using credit cards (35% compared with 27%).

B2B sales

As a rule, both the phrasing of the question on e-invoicing and the nature of e-invoicing itself mean that sectors in which most sales are business to business (b2b) are likely to exhibit higher rates of e-invoicing adoption. In predominantly business-to-consumer (b2c) sectors such as hospitality, health and social work as well as retail, between 15% and 16% of SMEs reported sending e-invoices, while in sectors with a higher share of b2b sales such as manufacturing, construction, transport and communication reported, uptake was typically twice as high: between 27% and 31%. As one might expect based on this trend, 'business services and real estate' stand out as the sectors with the highest incidence of electronic invoicing (42%) – and it is very likely that it is business services, rather than real estate, that predominantly account for this finding. After controlling for other factors, the multiples for construction, transport and business services were significant, with multiples of x1.8, x2.2 and x2.6 against unclassified businesses respectively.

Legal status

Companies are more likely to issue invoices electronically than unincorporated businesses (37% compared with 14%–26%). This result obtains only among businesses practising quality control and trading online, suggesting it might be a proxy for some business characteristic other than legal status – one possibility is that it signals compliance capabilities as distinct from quality control.

Figures A1 and A2 in the appendix demonstrate the full interactions between variables in this model.

5. To ensure that credit card use is not acting as a proxy for businesses in financial difficulty, the use of e-invoicing among SMEs that do not usually pay off their credit card balances in full at the end of each month (17%) was compared with that by SMEs that sometimes (36%) or always (39%) do. The results imply that it is the policy, rather than the credit, element of credit card use that is most associated with use of e-invoicing.

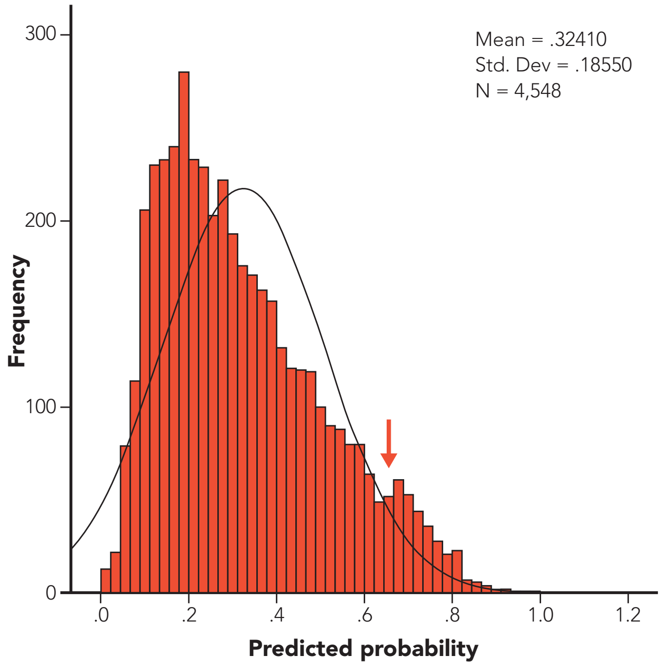
3. Isolating 'true' e-invoicing

The CHAID analysis findings are consistent with what is known anecdotally about e-invoicing adoption but the CHAID figures are much higher than the Eurostat figures, suggesting that the headline measure of 'e-invoicing' used in the SME Finance Monitor is appropriate but very 'noisy'. In order to remove some of the noise, ie where businesses send electronic invoices that are not suitable for automatic processing, a statistical model of e-invoicing adoption was developed, using as predictors the same broad set of variables as in the CHAID analysis. Using binomial regression analysis, it was possible to estimate a probability of e-invoicing adoption for each business in the sample.

For a business to qualify as a likely adopter of 'true' e-invoicing, two conditions must be met. First, the predicted probability of e-invoicing adoption according to the binominal model has to be 65% or higher (see Figure 3.1).[6] Second, the respondent must not have *explicitly* said that their business was not using e-invoicing.

This method of selection classified roughly 10% of all headline adopters, or 2.8% of the total population of UK SMEs, as likely adopters of 'true' e-invoicing, although this percentage was significantly larger among higher size-bands – for instance, one sixth of medium-sized businesses in the UK were classified as 'true adopters.' These businesses are responsible for about 8.1% of UK SME turnover, suggesting that roughly £124bn-worth of invoices annually are sent by businesses capable of processing them entirely electronically. Half of this volume of invoices (51%) appears to be sent by enterprises turning over less than £1m per year.

Figure 3.1: Estimated probabilities of e-invoicing adoption: distribution and cut-off point



This model has several desirable properties: it produces headline figures comparable with Eurostat's, and replicates the significant difference in adoption rates between medium and small businesses as well as between 'true' e-invoicing and other electronic invoicing (see Table 3.2).

Table 3.2: Electronic invoicing by small and medium-sized UK firms: a second comparison

	Employment size band			
Indicator	*0*	*1 to 9*	*10 to 49*	*50 to 249*
Eurostat 2011: Any invoices sent electronically	:	:	49	65
BDRC 2012: Any invoices sent electronically	28	29	36	40
Eurostat 2011: Businesses sending electronic invoices suitable for automatic processing	:	:	4	14
BDRC 2012: 'True' e-invoicing estimate from model	2	4.5	7	17

6. This percentage was chosen as the benchmark because there is a clear break in the distribution of probabilities at this point: the presence of a second local mode, or 'peak' in the distribution, suggests a different phenomenon is at play past this point than is true across the sample. As Figure 3.1 demonstrates, most businesses are clustered around relatively low probabilities.

4. Profiling e-invoicing adopters

Tables 4.1 and 4.2 present a profile of e-invoicing adopters under the two different definitions discussed here. Unfortunately, owing to the tight criteria used to isolate true adopters, this is a sample of just 263 businesses; many differences that appear to be significant are in fact not. Because of this limitation it has also been difficult to analyse in detail the effect of e-invoicing on access to finance – the sample of 'true' adopters made only 37 overdraft and 18 loan applications between them in the year leading up to Q2 2012.

Overall, however, it is possible to say that adopters tend to be larger, more formal businesses than non-adopters, and in particular are more likely to employ people and have more than £250k of turnover. They are also more likely to be limited liability companies and to be internationally active. They are more dynamic businesses than the broader population, even after accounting for size and other variables, making them more likely to grow or become smaller, although this dynamism has a strong positive bias.[7]

Users of e-invoicing are generally more likely to need external finance for working capital and are less likely to fall into what BDRC (2012) calls the 'disengaged' category of businesses that have not applied and are unwilling to apply for external finance. Because of their greater working capital needs they are also more likely to face self-reported cash flow issues, particularly using unauthorised overdrafts or requiring cash injections from their owners. Despite this, on average their credit risk ratings are very similar to those of the general population, suggesting that e-invoicing may be helping suppliers manage what might otherwise have been an unviable position in the credit cycle. As might be expected, 'true' adopters are more likely, all things being equal, to use invoice finance.

7. In statistical terms, 'true' e-invoicing is more strongly associated with plans for moderate or rapid growth than with businesses becoming smaller, and is not associated with businesses closing in a statistically significant way.

Table 4.1: Descriptive statistics about adopters (Q2 2012)

		All SMEs	Headline	Model
Employment	0	74%	73%	54%
	1 to 9	22%	23%	35%
	10 to 49	3%	4%	8%
	50 to 249	1%	1%	4%
Turnover	Less than £25,000	39%	34%	29%
	£25,000 – £49,999	19%	20%	8%
	£50,000 – £74,999	10%	12%	13%
	£75,000 – £99,999	5%	6%	4%
	£100,000 – £249,999	8%	7%	4%
	£250,000 – £499,999	4%	5%	8%
	£500,000 – £999,999	3%	4%	13%
	£1m – £1.9m	2%	2%	8%
	£2m – 4.9m	1%	2%	4%
	£5m – £9.9m	0%	0%	*
	£10m – £14.9m	0%	*	*
	£15m – 24.9m	0%	0%	*
Legal status	Sole proprietorship (single owner)	68%	61%	42%
	Partnership	5%	3%	
	Limited liability partnership	2%	1%	4%
	Limited liability company (private limited company, public	26%	35%	54%
Sector	Agriculture, hunting and forestry, fishing	4%	3%	4%
	Manufacturing	7%	6%	12%
	Construction	22%	24%	24%
	Wholesale/retail	12%	7%	4%
	Hotels and restaurants	3%	2%	*
	Transport, storage and communication	7%	7%	8%
	Real estate, renting and business activities	26%	38%	44%
	Health and social work	6%	3%	*
	Community, social and personal service activities	12%	9%	4%
Regions	England North	20%	14%	16%
	England Midlands	23%	26%	20%
	England South	43%	49%	52%
	Scotland	7%	4%	*
	Wales	4%	5%	12%
	Northern Ireland	3%	2%	*
Age of business	Less than 12 months	8%	7%	12%
	Over 1 but under 2 years	12%	11%	8%
	2 – 5 years	25%	27%	20%
	6 – 9 years	17%	18%	20%
	10 – 15 years	13%	15%	16%
	More than 15 years	24%	21%	24%
Dynamic indicators	Start-up	20%	18%	20%
	Fast growth	10%	11%	19%
Risk ratings	1 Minimal	5%	6%	12%
	2 Low	10%	9%	8%
	3 Average	28%	28%	23%
	4 Above average	43%	43%	46%
	5 Not known	14%	14%	12%

Note: 'Headline' adopters are respondents who claimed to be sending electronic invoices in the original survey. 'Model' adopters are respondents classified as using 'true' e-invoicing based on the model described in Chapter 3. * percentage is zero or cannot be disclosed.

Table 4.2: Behaviours and organisation of e-invoicing adopters (Q2 2012)

		All SMEs	Headline	Model
Growth objectives over the next year	Grow substantially	6%	6%	20%
	Grow moderately	41%	39%	44%
	Stay the same size	44%	46%	28%
	Become smaller	4%	4%	4%
	Sell/pass on /close the business	5%	5%	4%
Types of finance currently used	Overdraft	22%	22%	31%
	Loan	11%	11%	16%
	Grants	2%	2%	4%
	Loans or equity from friends/family	5%	6%	12%
	Loans or equity from directors	6%	7%	12%
	Loans from other third parties	1%	2%	4%
	Leasing or hire purchase	7%	9%	16%
	Invoice finance	2%	4%	12%
	Credit cards	19%	23%	44%
	Import/export finance	0%	1%	8%
	None	57%	51%	36%
	Disengaged (doesn't want finance)	30%	34%	15%
Financial needs in last quarter	Applied for new loan	3%	3%	4%
	Reviewed loan or mortgage	2%	2%	*
	Chosen to pay off loan or mortgage	1%	1%	*
	Applied for new overdraft facility	4%	5%	12%
	Reviewed overdraft facility	4%	5%	4%
	Cancelled or reduced overdraft facilities	1%	1%	*
	None of these	88%	86%	77%
Formalisation and international activity	Formal written business plan	34%	38%	64%
	Financially trained person in charge of finances	24%	27%	32%
	Exports	8%	12%	27%
	Exports accounting for more than 50% of turnover	2%	3%	8%
	Imports	6%	8%	23%
	Regular management reports	41%	51%	84%
	New products or services	18%	25%	48%
	Significant improvements to the business	38%	49%	77%
	Performance related pay	10%	13%	32%
	Online trading	53%	65%	96%
	Written HR policy	16%	22%	62%
	Total Quality Management or quality standards	18%	30%	88%
Cash flow problems	Missed loan repayments	2%	2%	8%
	Unauthorised overdrafts	7%	7%	16%
	Bounced cheques	6%	6%	8%
	County Court judgments	1%	1%	*
	Used HRMC's Time to Pay service	4%	5%	12%
	Problems getting trade credit	3%	4%	12%
	None	84%	83%	69%
Cash injection from owners in the last 12 months	Voluntary	16%	16%	16%
	Involuntary	25%	25%	36%
Total		100%	100%	100%

Note: 'Headline' adopters are respondents who claimed to be sending electronic invoices in the original survey. 'Model' adopters are respondents classified as using 'true' e-invoicing based on the model described in Chapter 3. * percentage is zero or cannot be disclosed.

5. Conclusions and recommendations

Although it is impossible to estimate, on the basis of the SME Finance Monitor data, the volume and value of e-invoices sent by UK SMEs, it is clear that even under the most narrow definition of e-invoicing adoption its users (just over 2% of the SME population) account for at least 8% of all SME turnover, around £124bn a year. A much greater percentage of SMEs send invoices that may not be fully electronic but are substantially so – most will be PDFs. This wider group has a collective turnover of £543bn, although it is not known how much of this is handled electronically.

It comes as no surprise that the primary driver of e-invoicing is the presence of dominant buyers, often multinationals, who are able to dictate policies to their suppliers. This implies, however, that the ability to embed e-invoicing into the business could determine SMEs' access to international supply chains – further strengthening the case for wholesale adoption in the UK.

In light of the importance of major customers to the e-invoicing agenda, it is perhaps not always appropriate to ask what the obstacles are for small suppliers, but rather why more major buyers are not giving their suppliers this option.

On the supplier's side, behavioural barriers to e-invoicing adoption are clearly discernible in the above findings. The relatively few SMEs that are good at developing and adopting internal policies, from quality management to human resource management or even the use of credit cards, are more likely to also adopt e-invoicing; so are businesses that are used to trading online. These behavioural limitations should not be seen as given; in fact they should suggest ways in which business support can be used to encourage professionalisation and, through this, e-invoicing adoption.

E-invoicing adopters are very dynamic businesses with substantial liquidity needs. Indeed, the above findings suggest that e-invoicing is used by businesses that would otherwise face both poor credit terms from their customers and poor payment terms imposed by their suppliers, and still do in some cases. Overall, however, the fact that their credit risk ratings are not significantly different from those of the general business population suggests that e-invoicing reduces the default risk among businesses that would otherwise appear very risky on paper. Since few SMEs will have simultaneously moved to e-invoicing with all their customers, research could (and does) send mixed messages about the effect of e-invoicing on SMEs' creditworthiness.

To answer this question conclusively would require substantially more data on SME finance applications than are available in the Q2 2012 edition of the SME Finance Monitor. That said, the e-invoicing question will be used in future editions, helping build a more robust dataset that will enable such analyses.

On a more positive note, e-invoicing adopters' higher level of engagement with external finance means that banks and other finance providers could have a substantial incentive to offer e-invoicing services if this could lead to cross-selling of other products. Unsurprisingly, SMEs that send e-invoices are much more likely to be able to access invoice discounting.

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Appendix

Figure A1: CHAID analysis results – SMEs practising quality control only

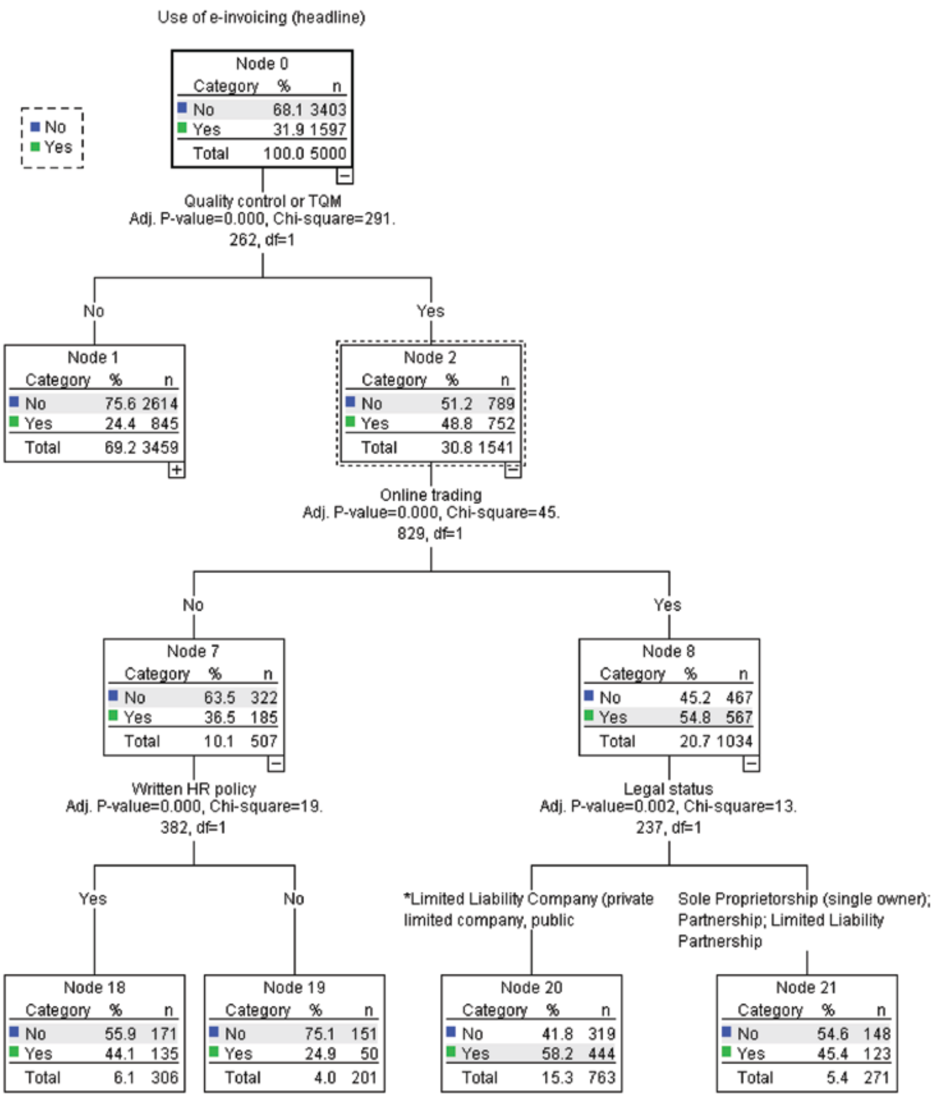
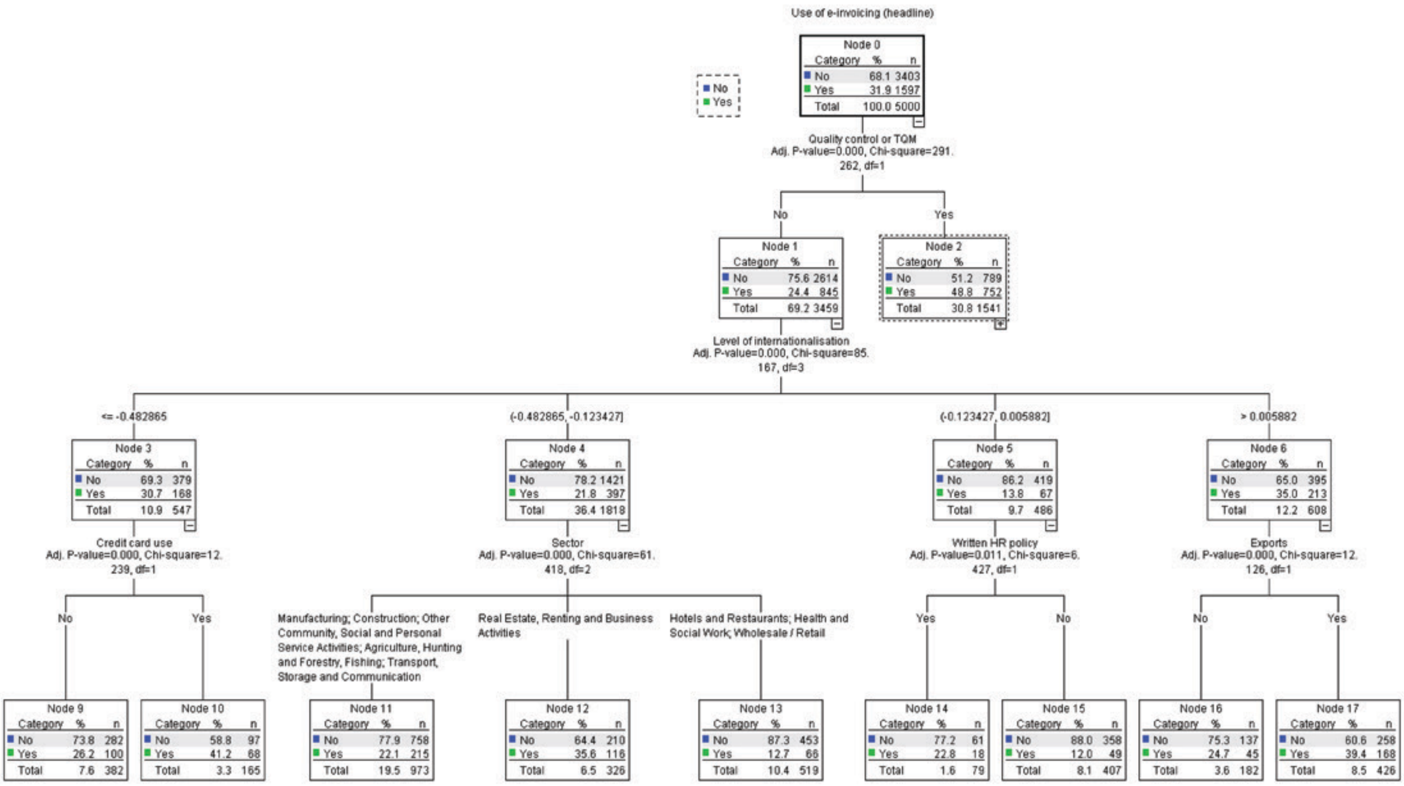


Figure A2: CHAID analysis results – SMEs not practising quality control



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