

The background of the page is a black and white photograph of a complex, geometric architectural structure. It features a network of intersecting lines and cables, forming a series of interconnected triangles and polygons. The structure appears to be a large, open-air or semi-enclosed space, possibly a stadium or a modern building's interior. The lines are thin and dark, contrasting against a lighter, overcast sky. The overall impression is one of precision and modern design.

# Ending late payment

PART 2: WHAT WORKS?

## About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 170,000 members and 436,000 students in 180 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of 91 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development.



This is the second of a series of three reports on the problem of late payment and how businesses and governments can work together to alleviate it.

It brings together evidence from a wealth of ACCA-commissioned publications and other research as well as 36 case studies involving ACCA members around the world to help define good practice in both business and policy.



### ABOUT THE AUTHOR

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## Introduction

In 2014, ACCA conducted a review of the widespread problem of late payment: a life-threatening challenge for many businesses globally. This review brought together recent ACCA research with the experience of ACCA members and other finance professionals to examine potential solutions.

The outcomes of this review have been presented in three reports.

*Ending Late Payment, Part 1: Taking Stock* combines an extensive literature review with quantitative data from ACCA's member surveys to suggest a correct definition of late payment, trace its precise origins and document its impact on the global economy.

*Ending Late Payment, Part 2: What Works?* brings together a wealth of ACCA-commissioned publications and other research as well as 36 case studies involving ACCA members around the world to help define good practice in business and policy.

*Ending Late Payment, Part 3: Reflections on the Evidence* summarises ACCA's findings and issues a call to action for governments, financial services firms, large corporates and small businesses.

Late payment is a fact of life for the majority of the world's formal businesses. It helps some survive against the odds, but it also threatens the survival of others. It is at once a sign of distress from the weakest businesses and a privilege exercised by the most powerful. From a macroeconomic perspective, it is both inefficient and potentially destabilising.

Professional accountants around the world lead the fight for prompt payment, ensuring that businesses are protected from customer defaults and can cope with interrupted cash flows. Their first-hand accounts can offer both business and policy audiences valuable insights, and none more valuable than those of ACCA's globe-spanning membership. From sectors and regions where late payment is endemic to the few places where businesses and governments have managed to turn the tide, the ACCA membership has, collectively, seen it all.

This report aim is to help pinpoint good practices in business and policy that can aid in the fight against late payment. It brings together a wealth of ACCA-commissioned publications and other research for this purpose; but at its heart is a selection of case studies involving ACCA members around the world.

In December 2014, ACCA invited around 300 members to share their experiences of dealing with threats from, and to, the rest of the supply chain. As the member sample was drawn from the ACCA-IMA Global Economic Conditions Survey (GECS; waves Q4 2011 to Q3 2014), it was possible for questions to be tailored to three distinct audiences. The exercise distinguished between businesses struggling with late payment despite the viability of their customers, businesses at risk of customer defaults (and late payments), and healthy businesses that nonetheless had suppliers or customers at risk. After selecting for relevance, this exercise yielded 36 usable responses – and the key themes emerging from these are discussed and placed in their proper context in this section.

## 1. What influences payment terms?

Most members who offered their views for this study generally approached the question of late payment as a function of the position of customer and supplier in industry structures and pay hierarchies. A strong distinction was made repeatedly between paymasters, who can usually control the timing of their own payments, and contractors, who have much less discretion and tend to pass on late payment down the supply chain. Since major supply chains can be many levels deep, most businesses will not tend to be paymasters, or indeed have customers who are. Some businesses nevertheless made a point of finding a niche as high in the hierarchy as possible in order to ensure more predictable cash flows. Others accepted their lot and focused on avoiding defaults and financing their working capital.

Paymasters do not necessarily pay promptly, of course; in fact, they can be some of the worst offenders. They can, however, usually be assumed to present a small or negligible credit risk, making alternative financing (such as invoice discounting) possible. Related to such payment hierarchies was the matter of customers' government ties or public sector status – in most emerging markets, members spoke in no uncertain terms of the political as well as economic power of major buyers, with the extractive industries being singled out repeatedly. Government itself is a paymaster, and in many countries it is the most notorious late payer of all.

Related to such hierarchies was the strong influence of industry norms – long-established patterns of payment terms (and breaches thereof) tied to cycles of demand and commissioning in each industry. Members mentioned industry norms regularly as a starting point for all credit negotiations, and

ACCA's research elsewhere (eg Paul and Boden 2012) confirms that they are a key determinant of the relative power of suppliers.

Some industries, especially those with long supply chains, provided an opportunity for reciprocal relationships, whereby the suppliers to one business were also its customers further down the line, or where a key customer would call on trusted suppliers and subcontractors for support when bidding for new business. Reciprocity gives suppliers a number of tools in the fight against late payment – for instance, more than one respondent mentioned that by doing their best to match payment terms on orders outstanding on both sides, they could ensure that the cost of extending credit terms more or less netted off, and keep overall leverage low. Others said that their companies tolerated late payment in exchange for access to future tenders as subcontractors – effectively taking a quasi-equity stake in their customers.

*'By the very nature of our business we have to have a degree of flexibility in our payment terms. The majority of our customer base is made up of multinational oil majors – they cannot be pressured into paying, and often have 'in-built' processes that are fundamentally to delay their acceptance of an invoice. It is... a kind of incestuous market where many customers are also suppliers – and vice versa. Because of this there is probability of potential set-off which minimises debt exposure.'*

CFO, OFFSHORE SUPPLY VESSELS OPERATOR, CONGO

In a further generalisation of the reciprocity principle, many members were keen to explain that capacity-related norms in their industries created opportunities for collections.

Customers keen to manage their capacity ahead of peak times (eg a major holiday or industry event, or a major tendering round) were always more likely to offer prompt payment or settle overdue payments in order to keep suppliers 'on side'.

*'We have had key suppliers failing to supply us with materials and goods for lack of prompt payment; in such cases we usually prioritise their payments and clear any outstanding old accounts to enable them resume doing business with us. During the festive season, we usually buy in bulk to enable us to continue operating until the mid-January, when many businesses resume from their breaks.'*

ACCOUNTANT, FACILITIES SERVICES COMPANY, KENYA

A hierarchy of customers and corresponding credit terms is commonly maintained by businesses, with new customers offered goods and services on a cash basis only (for as long as six months in some cases), then allocated a credit limit subject to performance, which could quickly revert to zero, sending them back to a cash-basis arrangement. In emerging markets, bank guarantees are commonly required and the pool of eligible banks might even be restricted to a few major institutions. In industries where suppliers can look forward to ongoing project-based business, key suppliers may demand rolling cash advances, calculated as a given percentage of open purchase orders.

Members responding from a buyer's perspective noted that there were also hierarchies of suppliers, based on monopoly power and their ability to disrupt the purchaser's output. Not surprisingly, powerful suppliers tended to demand better credit terms or even

upfront payment, and were rarely paid late. Exceptionally, suppliers of goods with substantial transport costs could also expect the same treatment. It is likely that monopoly power can explain much of the mid-market's success in ensuring prompt payment – as discussed in Part 1 of the Ending Late Payment series.

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'There are certain products of ours whose features are much better than the competitors', for which we will ask for 100% settlement before goods are shipped. In other words, we do this when no real substitute products exist. Having said this, most of our products have competition. So, we do what most competitors do: we have an internal credit control department, which is independent from the business / operation team. They are authorised to go after the customer when needed. Apart from this, we have worked with the banks to factor receivables at a preferential rate. We include such cost into our margins model before we sell or commit to our customer about the price.'

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CFO, INDUSTRIAL AUTOMATION COMPANY, CHINA

Overall, respondents stressed the importance of relationships in gauging the financial strength of both customers and suppliers, and noted that long-standing relationships, aided by industry expertise, can often be much more informative than formal controls – though ideally the two should complement each other.

These views are in agreement with past ACCA research. Using a quantitative approach, ACCA and CBI (2010) found that, of all the formal and informal methods used by SMEs in dealing with late payments, only relationship management had a significant impact on the quality of SMEs' receivables. The importance of relationships in providing information critical to credit decisions as well as a lever by which to achieve prompt payment is confirmed by Paul and Boden (2012) for the UK and by Collis et al. (2013) across different countries.

Relationships contribute greatly to credit control, but members also noted that supplier relationships can suffer from discontinuity due to staff turnover, succession or change of management, a merger or acquisition, or some other rare and disruptive event on either side of the transaction. In such cases, important knowledge and ownership of suppliers relationships are often lost and it is possible for credit controls and indeed the quality of receivables to deteriorate as a result.

Finally, members did not always see a clear distinction between late payment due to administrative failures and tactical late payment (ACCA 2015). In fact, some explained that customers have 'built in' processes to delay acceptance of an invoice, whether through overzealous queries and disputes or through purposefully convoluted and opaque accounts-payable procedures.

## 2. Dealing with customers in trouble

Members were clear that late payment is often a signal of genuine and/or permanent credit risk and distinguishing this from tactical and administrative late payment was a very high priority in their credit practices. Such a distinction must be made early because internal policies and external enforcement options differ enormously under the two different scenarios.

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*'To use a German expression, you cannot delve into the pockets of a naked man.'*

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HEAD OF ACCOUNTING AND FINANCE,  
FACILITIES SERVICES COMPANY, GERMANY

Members reported that direct contact, including on-site visits or access to on-site staff can help businesses make a quick judgement and ensure that they are well prepared; a failing customer will generally find it hard to disguise its condition. Other red flags mentioned included reduced orders, surprise requests for discounts, and changes of company names or premises.

Most members argued that credit risks are potentially reversible if addressed early, and most (though not all) focused on preserving or cementing valued commercial relationships. Research evidence confirms the value of this approach. Even during the worst of the Global Financial Crisis of 2008–9, Finley (2009) shows that businesses displaying tell-tale signs of distress had at least a full financial quarter before they experienced a crisis. With genuine but reversible credit risks, treatment of

customers in trouble was dependent on the attitude and transparency of the customer, and could often include cheaper and more substantial forbearance than could be achieved through late payment: extending terms by three months was common.

The most common approach to forbearance was to prioritise protecting the supplier's own cash flow from further disruption, by agreeing on the orderly receipt of future payments, sometimes even at a small discount. A payment plan could then be agreed for the outstanding debt, with customers generally unable to access the supplier's full range of services (eg warranties) during this period.

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*'When a customer has been identified as having trouble our first step is to protect ourselves. We look at what is outstanding but also what contracts may still be open and running. As long as our customers are honest with us in relation to their situation we try to work with them to correct the situation.'*

*There is no point in behaving aggressively where the company may just be having a short-term difficulty which, although problematic, can be solved with cooperation. The experience of credit control staff with individual customers is crucial because over time they develop a gut feeling, if you will, as to when something is not in order.'*

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HEAD OF ACCOUNTING AND FINANCE,  
FACILITIES SERVICES COMPANY, GERMANY

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*'We ring-fence the old debt and come up with a plan that sees all current invoices being paid regularly while arrears are paid systematically until they are cleared. This has helped customers to keep afloat during times of financial difficulty and allowed customers to revise their business models.'*

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FINANCIAL CONTROLLER, AUTOMOTIVE  
INDUSTRY, ZIMBABWE

Members' experiences of such payment plans were generally positive and they emerged as a useful tool. Nonetheless, as the viability of customers became more doubtful, it was clear that most members quickly ceased to expect significant recoveries through conventional means: only a going concern can secure that. Crucially, forbearance needs to be a tailored plan, not a blanket policy: ACCA and CBI (2010) show that simply making allowances for difficult economic times tends to reduce the quality of UK SMEs' receivables, all other things being equal.

### 3. Policies and structures

Input from ACCA members suggests that much of the challenge in credit control comes from the misalignment of incentives within the business. The incentives of sales teams are usually tied to contracts won, profit margins and sales figures, while those of finance or credit control functions (where these exist) are tied to recoveries and cash flows. As a rule, it is tempting for businesses to empower revenue generators at the expense of those in charge of credit control, but most businesses tried to establish a balance. In their research for ACCA, Paul and Boden (2012) show that this tension is everywhere – from large corporates to husband-and-wife management teams splitting the sales and collection roles between them. Their research also found that successful small businesses had managed to turn credit management into an enabler, not a gatekeeper, by allowing the business to reward prompt payers and choose appropriate terms of credit for others.

In their own evidence, ACCA members recommended that the business should emphasise communication between Sales, Finance (or AR/Credit Control) and Operations, ensuring that all three are clear about their responsibilities, which should in all three cases include collections. For example, one member explained that in their company collections were discussed in client meetings, with finance or credit colleagues present. Another explained that it was crucial that both sales and credit control understood the internal processes of clients, and had opportunities to develop relationships with them. Monthly credit control meetings focusing on key debtors, with all three functions involved, were cited as a useful means of coordination.

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'The predicament the organisation is experiencing today is due to lack of communication between the finance team (in particular the Accounts Receivable team) and the operations team. The area of responsibility is vague and the operation team assumes 'collections; is exclusively a finance team's function. ...Despite regular discussions, business area teams tend to give more leniency to the customers with the overriding objectives of securing jobs, and hence revenues. Business area teams tend not to discuss collection or debts when meeting their customers. The situation is exacerbated, in my opinion, as the primary KPIs for the business area teams exclusively focused on revenue and gross margins, and to a lesser degree EBITDA [earnings before interest, taxation, depreciation and amortisation]. Their bonuses are exclusively dependent on these KPIs.'

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DIVISIONAL FINANCE DIRECTOR, OIL AND GAS SECTOR, MALAYSIA

One final area where collaboration was seen as particularly important was dealing with disputed invoices. Collections were optimised when the efforts of finance (including short-term extensions of credit terms) could be combined with on-site visits, offers of technical assistance and/or replacements.

In turn, members were at their most content when key performance indicators (KPIs) for sales were tied to cash flows – commission clawbacks were occasionally used as a means of enforcing this. Most significantly, members with good quality receivables stressed the importance of maintaining

an independent credit control function with resources proportionate to the funds at stake.

Shared incentives and cross-functional collaboration are important means of aligning behaviour, but even more important is the role of credit policies. Members believed that appropriate policies were crucial and they should be reviewed regularly in light of results, and should require authorisation at appropriate levels within the organisation. A comprehensive credit policy should cover a broad range of topics, from how to determine correct credit limits for customers to how the business should manage collections, conduct debt provisioning and decide on debt write-offs, as well the correct level of authorisation required for agreeing extraordinary terms with a customer. Paul and Boden's findings (2012) confirm the importance of credit policies, and explain that these do not need to be overly complex to be effective – in fact the opposite is usually true. Policies need to be communicated across Sales, Operations and Finance, and indeed to the customers themselves. Finally, when policies are out of date or prove unrealistic, it is better to modify them decisively than let them become disused, as that will encourage staff to make ad hoc decisions.



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'In the last six to seven years when financial problems became acute for many companies we empowered the credit control department by transferring personnel with specific skills from other departments of the [finance function]. Also, we improved our internal procedures by establishing credit control meetings every month to which participants are the sales director, the credit control manager and, as a minimum, two executive members from the board of directors.... We tried to help customers facing financial difficulties by changing their credit terms. The most common way was by agreeing with them to pay cash for new deliveries and for the old balance to be repaid in one or two years. Of course changing credit terms also resulted in a change in pricing.'

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CHIEF ACCOUNTING OFFICER, FOOD PROCESSING COMPANY, GREECE

A number of members also said that their companies carried out comprehensive due diligence on customers before raising or removing their credit limits. While 'due diligence' is a very broad term, the most commonly cited elements involved commissioning background checks on directors, buying annual credit reports from third parties and using databases of media mentions and court decisions. Many suppliers implicitly or explicitly blacklist late-paying customers, and well-connected businesspeople will routinely have informal access to this information as well. Due diligence might be moderately expensive, but it was seen as a good investment when preparing to deal with large companies or government buyers – since the supplier would have little leverage on

its customers and it would be difficult for the firm to extricate itself from these relationships.

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'In my sector, most coal mines are controlled by state-owned companies, and thus hold big bargaining power when deciding the business contracts; any post-contract receivable control policies would be useless. So it is only prudent for us to carry out investigations into these clients beforehand. Normally we ask questions of these companies' current suppliers, such as whether there are any late payments outstanding, and the frequency with which these occur. As for other, smaller clients, we insist on a payment in advance policy because the geographic locations of coal mines in our country are scattered and it would be financially impossible to take any useful follow-up actions when late payments happens.'

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FINANCE DIRECTOR, COAL MINE INSTRUMENTS COMPANY, CHINA

Finally, prompt payment discounts were contentious when demanded unilaterally and with little notice, creating what Paul and Boden (2012) call 'effective late payment', but generally speaking they were often seen by members as a useful tool for suppliers. If planned carefully, they need not represent a discount at all from the supplier's point of view, but rather a cross-subsidy from late payers to prompt payers that effectively corrects for differences in the cost of working capital.

## 4. Dealing with uncertainty

Cash flow management and forecasting are essential disciplines for businesses, for the purposes of both financial management and raising finance. Yet late payments can complicate forecasts by introducing an element of uncertainty over which management has little control.

Making informed cash projections usually starts with ageing debtors' reports; these can break down each customer's outstanding balance into groups of invoices according to the amount of time elapsed since the customer was invoiced, allowing management to rank customers according to risk and in each case apply different assumptions about the likelihood of prompt payment and recoveries. Ageing reports are usually communicated to sales and operations teams, and are also used to distinguish between the merely late and the doubtful; here the assumptions used may vary dramatically. Businesses applying a conservative definition will flag up payments overdue by as little as 30 days as doubtful, but in countries where late payment is endemic, 180 or even 360 days would be used as the cut-off point.

Occasionally, some suppliers would use ageing debtors' reports not in order to forecast inflows but to engage in duration-matching – essentially ensuring that accounts payable were delayed enough to offset the impact of late payment. This common practice can be helpful to individual businesses, but it is likely that it also helps exacerbate the systemic effects of late payment.

A reasonably resourced finance or credit-management team will generally prepare a receivables analysis and an analysis of customers' payment histories on a regular basis, though typically high-value customers will receive the most regular treatment – for instance,

one member explained that their company prepared monthly reports on all customers but weekly ones on major customers.

Such analyses can then inform bad debt provisions and cash flow estimates, the frequency and depth of which varies according to resources and need. Cash flow forecasts themselves are typically weekly, are updated on a regular basis, and can look one or two years ahead, hence bad and late debt forecasts are applied against these. Estimates of overdue payments are prepared less frequently, typically on a monthly basis and as part of the management accounting process, and forecasters use these to adjust future cash inflows downwards, in order to allow for bad debt. In members' evidence, this 'haircut' would be determined based on individual customers' histories, the credit manager's experience of past defaults, feedback from colleagues involved in collections, but most of all from information gleaned through direct and regular contact.

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*'By definition, theoretical collection plans will not work in South Asian countries...Very few companies are paymasters and the majority of SMEs' funding is from the lead and lag of payments. Therefore projections are prepared based on historical records and on industry knowledge such as the seasons of the industry. For example, in the media industry credit periods extend up to 90 or 120 days, but during seasons such as the New Year in April and Christmas in December, customers may pay in advance in full for reservation of your slots. Bill discounting only started in Sri Lanka a few years back, but it is with recourse and there is no absolute assurance of recovery.'*

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HEAD OF GROUP FINANCE, MEDIA COMPANY, SRI LANKA

Since late payment is ultimately at the customer's discretion, it is important not to overstate how predictable it is. 'Rules of thumb' are used widely. One respondent, for instance, explained that their forecasts always began by assuming that 20% of receivables would be paid late. Another assumed that 3% of receivables would eventually have to be written off – both not too far off from the regional averages reviewed by Atradius (2014). Whatever the rule of thumb used, the estimate can subsequently be revised on the basis of actual information; the benefit of this treatment is that it creates a useful conservative bias and places the onus on finance to confirm that payments are indeed likely to be received. External information can also be used to inform rules of thumb. One member explained that the trend in non-performing loans (NPL) in the financial sector was used along with the firm's actual rates of late payment in the previous year in order to develop assumptions about overdue payments.

Where resources were scarce or customers were atypical, purely ad hoc provisions based on direct, informal knowledge, were not unheard-of either; these need not be inferior to any other method, but do require regular monitoring and updating. To ensure adequate feedback, and regardless of how late payments and bad debt were forecast, businesses checked the robustness of credit policies by defining a level of 'tolerable' variance from cash projections, which would trigger a review of policies.

## 5. Core business practices and late payment

Most members believed that all-important business relationships should not be left to chance, but, rather, treated as major operational priority. Members spoke of involving multiple directors to maximise the social collateral behind the relationship, and ensuring monthly meetings, not including social occasions, to cement the personal touch as well as gather up-to-date information on customers. This is a labour-intensive and time-consuming approach, which at least one member admitted was hard to justify when working with smaller customers – hence their preference for larger businesses.

Credit terms are, in the end, contract terms and thus contract design is a first line of defence against late payment. At the most basic level, members stressed the need for clarity of wording, eg the terms of credit themselves or the precise dates from which credit terms apply. Members recommended adding clauses entitling the supplier to invoice for penalty fees or statutory interest automatically in the event of late payment, and language ensuring that the supplier can hold lien on goods sold and retain ownership of them until they are paid in full; this should give the supplier the legal right to reclaim unsold stock in the event of late payment. As a rule, suppliers should also reserve the right to withhold delivery of new orders or warranty on old orders until they have been paid in full. Especially in the case of international transactions, the actual modes of payment should be specified in writing, favouring methods such as letters of credit and bank guarantees, as opposed to bank acceptance drafts, which one member explained incur higher costs when discounting or holding to maturity.

Despite all these options, late payment was still a fact of life for many businesses. One way to deal with it was by managing exposure to individual clients and sectors. This could involve diversifying the firm's income across customers and product lines, or choosing to do business only with major paymasters or with large, stable companies.

Efficient administration is an important tool in the cause of avoiding late payment. Members insisted on the value of not only understanding the customer's systems, invoicing in the correct format, and knowing the individuals in charge of payments, but also invoicing and communicating demands early, accurately and at predictable intervals – starting ahead of the date when payment was due and increasing in frequency. Many members argued that 'staying on top' of projects and customers in this way increased their chances of prompt payment, and some reviewed their billing processes annually to ensure that appropriate pressure was being applied.

One respondent noted that accounting software allowed scheduling and automation of many invoicing- and collections-related tasks, removing any excuses for poor management – an attitude that the accountancy profession should arguably champion. Using collections agencies was also seen as a convenient way of professionalising collections, although Paul and Boden (2012) warn that businesses should be careful to maintain ownership to the actual commercial relationships at all times.

Finally, the use of supplier relationship management (SRM) systems was cited both by suppliers and customers as an

important tool in preventing late payment and alerting customers to suppliers potentially put at risk by their credit policies. Supplier relationship management (SRM) systems, especially when they involve electronic invoicing facilities, can provide greater visibility of the status of invoices and remove at least some of the incidence of administrative errors that slow down payments. Academic research also points to the potential for supply chain coordination to limit defaults and late payment. Simulations by Xu et al. (2010), for instance, show that information sharing and vendor-managed inventory systems can reduce systemic risk in the supply chain, but require some element of cross-subsidy since market participants will not always have a direct incentive to invest in them.

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*'Normally, the main focus in our contracts is the payment terms and credit period, which in most cases is 45 to 60 days. However, to avoid any cash flow issues we always opt for the one-month advance equivalent to PO value for any particular month. This not only gives me strong foundations to start any project but increases my confidence in the customer as well. Our customers have also introduced an online SRM payment system, which generates timely POs and E-Invoices to facilitate payments on time. In dire situations, I can go to the board and request a shareholders' loan.'*

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GENERAL MANAGER FINANCE CNL,  
TELECOMS COMPANY, PAKISTAN

## 6. Doing right by suppliers

Although late payment makes headlines, many buyers positively strive to pay promptly, using it to secure preferential access to good suppliers and keep their supply chains healthy and competitive.

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‘We aim to pay suppliers and subcontractors promptly at all times as we feel it gives us a competitive edge when competing for supplier/subcontractor resource over larger competitors who can offer larger contracts but are known to pay late. We’re generally a cash-rich business and continuity and reliability of supply is far more important to us than holding onto cash. This enables suppliers in financial difficulty to tender for work with us safe in the knowledge that they can rely on payment.’

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GROUP FINANCE MANAGER, RESIDENTIAL PROPERTY DEVELOPER, UK

Just as suppliers claimed that they would be able to tell when customers had difficulties, most respondents stressed that they would be able to understand when their suppliers are in trouble, using regular contact opportunities to raise red flags. Not all agreed, however, and research confirms that this is not always the case. Finley (2008), for instance, warns that major buyers will tend to concern themselves most about their largest suppliers, particularly their total spend, those with the most volatile prices, those causing the most problems, or simply those that the individual procurement professionals understand best.

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‘If a key supplier were facing difficulties we would know by word of mouth or by the supplier being unable to meet its obligations and wanting to be paid before the due dates or demanding cash payments...also if the company starts changing their names and business premises without a good reason we will be concerned with that and investigate. We [...] always try not to rely too much on one key supplier so that our operations are not affected by them failing to supply us. We are always looking out to get alternative supplier who can supply us with materials and goods of the same quality and more importantly at lower prices.’

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ACCOUNTANT, FACILITIES SERVICES COMPANY, KENYA

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‘We would not normally know if a supplier was having financial difficulties unless they advised us of the same. However, we always have different suppliers from different countries to ensure that we do not face any difficulties in case we have problems with any one supplier. We have at least 3–4 suppliers for the same item to ensure trouble-free operations. We haven’t had any such problems with a supplier but we have had one of our customers going out of business because he was not paid by the main contractors. We ended up losing money as a consequence. Normally, we provide for such eventualities as a general policy.’

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GROUP FINANCIAL ADVISER, DIVERSIFIED GROUP, SAUDI ARABIA

Members were quick to identify risks associated with supplier failures, which involved delays and cost increases as well as compromises in quality, and one could even point to the fallout from a supplier failure caused by late payment further up the supply chain.

Nonetheless, while most suppliers prioritise protecting themselves from defaults, most customers prioritise continuity of supply. The result is that businesses, especially larger or better-resourced ones, will have multiple suppliers that they evaluate and keep on stand-by; this way of protecting supply has the unfortunate side effect of further reducing the bargaining power of suppliers, potentially feeding the dynamics of late payment.

## 7. Cash pools, directors and alternative finance

According to the ACCA members interviewed for this review, larger suppliers with group structures and well-resourced finance functions have a key advantage over SMEs in preparing for and dealing with late payments, as their treasury management teams (or regional sub-teams, in very large firms) are tasked with preparing strategies for covering defaults and other short-term working capital requirements. Most importantly, different parts of the business can tap into a shared cash pool, or at least borrow from it at a cost. This support is not given lightly – one member explained that only wholly-owned subsidiaries could tap into the group's cash – but as long as the group's income is sufficiently diversified, such a strategy offers a great deal of protection. Because of this facility, some of the larger businesses responding to ACCA's call for evidence reported that their finance functions do not treat late payments as a cash flow issue at all, but rather one related to profit and loss.

In smaller businesses, this is not an option; finance providers must provide the same safety net, with less certainty and at a higher price. When in plentiful supply, financing and insurance options can provide this safety net, swapping the cost of late payment for the more predictable costs of financing working capital. Many members giving evidence reported having short-term borrowing facilities on standby and reviewing them regularly to ensure that they would be well able to accommodate a substantial late payment or default. Other members explained that directors' loans offered a similar safety net – but the onus would then be on directors to diversify their own income and the pressure on the finance function to anticipate late payment and bad debts would be greater.

## 8. Neutralising late payment

In the short term, late payment is a fact of life for many individual businesses with limited bargaining power and resources. For many of these, especially when their customers are not default risks, it makes sense to swap the risks associated with late payment for higher operating costs or a higher cost of capital: making late payment a cost of doing business. As a rule, this is possible by improving the transparency of receivables, raising finance against them, insuring them, or some combination of these three. About 8% of ACCA's global membership is involved in securing finance for businesses in this way – about a quarter of all members involved in raising finance at all (ACCA 2014b).

The global trade credit insurance market generated about \$10.6bn in premiums in 2013 (Swiss Re 2014), with emerging Asian markets driving all the industry's rise in penetration (premiums to GDP) over the 10 years to 2013 and most of its growth – at an extremely high annual growth rate of 38%, compared with 7.6% globally. This market is notoriously concentrated, with three private insurers (the firms Euler Hermes, Atradius and Coface) accounting for 56% of all premiums globally in 2013. A fourth, the Chinese-government-owned Sinosure, accounted for another 22% through its near monopoly of the Chinese market.

Overall, the insurance industry dampened the impact of the 2008–9 financial crisis only marginally. Faced with a doubling in the value of claims year-on-year in 2008, insurers reduced cover drastically or withdrew it altogether. Trade credit limits fell by 18%, against a 23% drop in actual trade, while state-owned credit insurers' share

of short-term credit limits jumped from 15% pre-crisis to 28% in 2010 (Swiss Re 2014). Since then, however, the industry has rebounded and become more flexible, more often offering non-cancellable credit limits or insurance of individual buyers (or groups of such, as opposed to a firm's entire order book). New major sources of information on trade credit risk, such as the ICC Trade Register (ICC 2014), are likely to spur further growth and innovation and help new providers enter the market.

Meanwhile, with volumes of over €2.2trillion in 2013 and growth of around 13% a year between 2009 and 2013, the global factoring market is both mature and fast-growing (ICC 2014a). Growth is being driven primarily by cross-border financing, which has, since 2009, grown twice as fast as domestic factoring, and by the growing entry of commercial banks into the sector. Unlike credit insurers, factors saw a once-in-a-lifetime opportunity in the recovery from the financial crisis of 2008–9, with global volumes growing by 57% between 2009 and 2011 as bank lending retreated and banks shifted to invoice discounting and factoring. Europe dominates the global factoring market with 60% of advances, with Asia a distant second at 27%.

Yet factoring and invoice discounting in particular can carry a stigma in many industries as the mark of a failing business, while many buyers, including in the public sector, strongly object to having their invoices used in this manner – and many around the world place bans on assignment of their invoices. Appropriately, the UK government was consulting, as of late 2014, on making such bans null and void

in private sector business-to-business contracts in the UK (BIS 2014b), having only removed such requirements from its own contracts in 2008.

Supply chain finance is a much younger industry, and is growing much faster, particularly in Europe and the largest emerging markets (Demica 2012). The ACCA Global Forum for SMEs (2014) predicted growth of at least 20%–30% a year for the industry in its recent review of financial innovation, while research commissioned by ACCA (Camerinelli 2014) found a potential \$255bn to \$280bn saving available through reverse factoring. While buyers would stand to benefit most, capturing about 35% to 50% of these savings, another 25% to 45% could accrue to suppliers as the difference between discounts offered and financing costs avoided. Significant examples of supply chain finance initiatives highlighted by the Global Forum for SMEs (2014) included Mexico's Cadenas Productivas, backed by the state development bank Nafin, or the Global Trade Suppliers Finance (GTSF) programme supported by the International Finance Corporation (IFC). A key uncertainty holding back the growth of the industry is the accounting treatment of receivables under supply chain finance – particularly whether they should be treated as the buyer's debt to the financial institution involved (Sodhi and Dalla 2012).

Anecdotally, it appears that the growth of both factoring/invoice discounting and reverse factoring has been driven substantially by the pressure on banks from rising capital requirements, and the pressure on supply chains from a lack of financing for smaller suppliers. Sensing a rare growth opportunity, many banks may have entered the

market without necessarily having the expertise necessary for this (Quinn 2009).

That said, when implemented correctly, such options provide more than a safety net to suppliers. Among the ACCA members who provided case study material, users of trade credit insurance and factoring often saw as much value in the additional expert credit management resource included in these services as in the insurance or financing themselves. Raising finance through insured receivables can yield even greater results, at a price. Despite high levels of user satisfaction, access to such services could be limited in developing countries, and might require collateral or other concessions, or otherwise be prohibitively expensive.

One key technology that could act as an important enabler of supply chain finance is also growing fast, keeping pace with the growth of supply chain finance itself. E-invoicing globally is growing at around 20% a year, and as of 2013 it accounted for over 8% of all business-to-business and business-to-government invoicing worldwide – about \$170bn (Koch 2014).

By making the status and progress of invoices transparent to suppliers, finance providers and buyers at once, e-invoicing can remove a great deal of the uncertainty and administrative errors surrounding payments, thus helping avoid some kinds of late payment and improving suppliers' access to finance. In Europe, prompt payment ranks highly (third of nine) among industry motivations for

embracing this technology (ACCA 2012) and unsurprisingly, many of the countries leading the fight against late payment, such as Denmark and Finland, are also frontrunners in the adoption of e-invoicing. Furthermore, ACCA's research among UK SMEs (ACCA 2014a) suggests that small suppliers using e-invoicing have a much better chance of securing alternative finance (usually invoice discounting) when offered adverse terms on overdraft facilities by their banks.

## 9. Legislating against late payment

States around the world try to regulate trade credit – both in the fundamental sense of enforcing contracts through the judicial system and in the sense of imposing maximum credit terms, especially in contracts between government and businesses, or giving suppliers the right to claim compensation from late-paying customers.

The 2011 EU Late Payment Directive, which was transposed into national law in the EU member states between 2012 and 2013, is perhaps the most widely applied regulation of this kind, but many countries have similar legislation in place. Very often, late payment laws apply specifically to government agencies or to particular sectors involving complex supply chains – specifically construction – with a view to protecting subcontractors as well as prime contractors. Late payment laws specific to such sectors are actually more common than blanket late payment legislation, and can be found, eg in the US, Australia, New Zealand, Ireland and Malaysia. As of early 2015, efforts were also underway to pass similar prompt payment legislation across Canada, starting with Ontario.

As a rule, late payment regulations can give suppliers and sub-contractors a range of tools against late payment. These may include:

- a cap on the credit terms that can be agreed explicitly or implicitly in a contract, or on the terms that can be agreed without further justification
- a right to statutory interest on overdue payments, charged at a penalty rate
- a right to compensation for costs incurred in chasing and collecting late payments
- access to dispute-resolution mechanisms
- an obligation on prime government contractors to respect agreed credit terms regardless of the timing of payments by the buyer
- an obligation on prime government contractors to pass on the terms of credit agreed with end-buyers and/or to notify the buyer of any prompt payment discounts received
- a right for government subcontractors not paid on time to appeal to the end-buyer for payment, which may then be deducted from any payments due to the prime contractor
- a right to withhold further services until payment is received
- the voiding of bans on assignment in contracts.

Evidence of success achieved through such regulation, however, is still sparse. Reviews of the EU Late Payment Directive of 2000 (Hoche 2006) and the UK Late Payment of Commercial Debts Act of 1998 (Wilson 2008) found very small increases in prompt payment following the introduction of regulation, despite a period of brisk economic growth and unprecedented access to finance. Hoche (2006) suggested that a change in attitudes might be the most significant impact, with fewer businesses agreeing that late payment is ‘part of our [country’s] culture’.

ACCA’s own figures from the Global Economic Conditions Survey (GECS) allow for a more nuanced analysis of the impact of the 2011 Directive. Although its implementation was followed by a reduction in the incidence of late payment to SMEs throughout Europe, this has almost always been the result of improvements in access to finance and the reduction in the rate of corporate insolvencies (Figures 9.1 and 9.2). Nor does the new Directive seem to have brought payment trends for SMEs closer in line to those for large corporates – if anything the GECS data suggest the two have diverged (Figure 9.3).



Figure 9.1: Percentage of SMEs in Western Europe reporting cash flow challenges

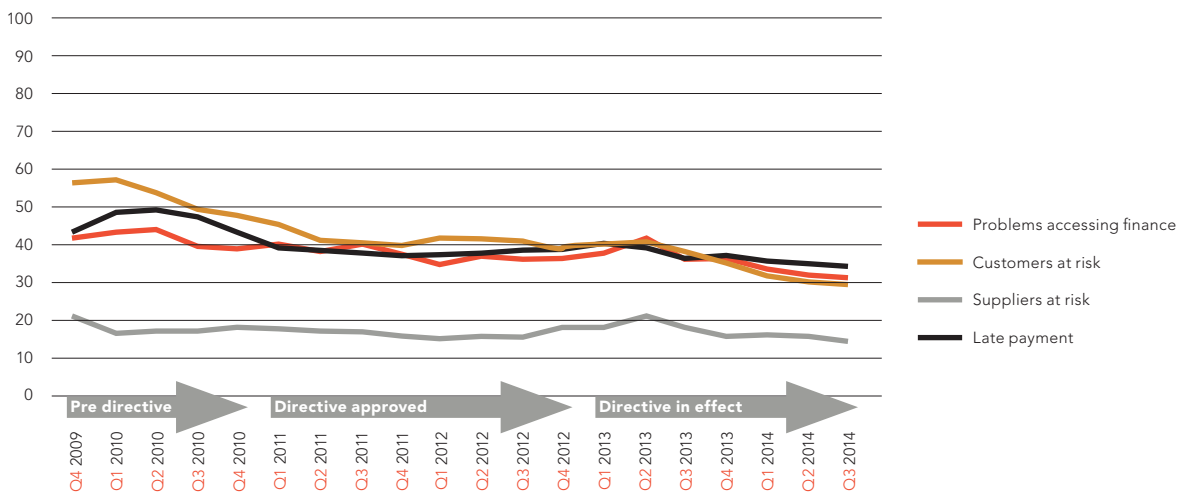


Figure 9.2: Percentage of SMEs in Central and Eastern Europe reporting cash flow challenges

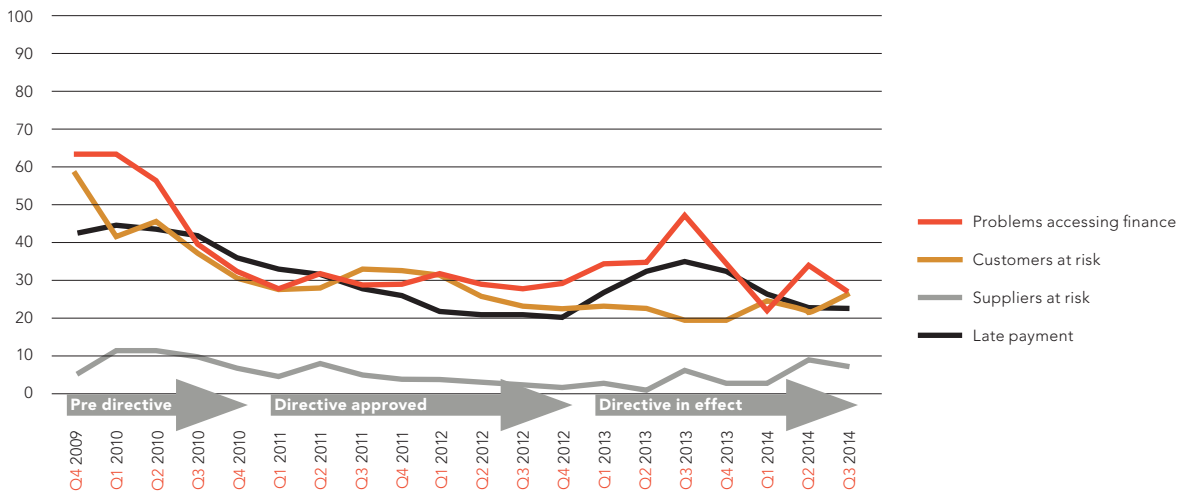
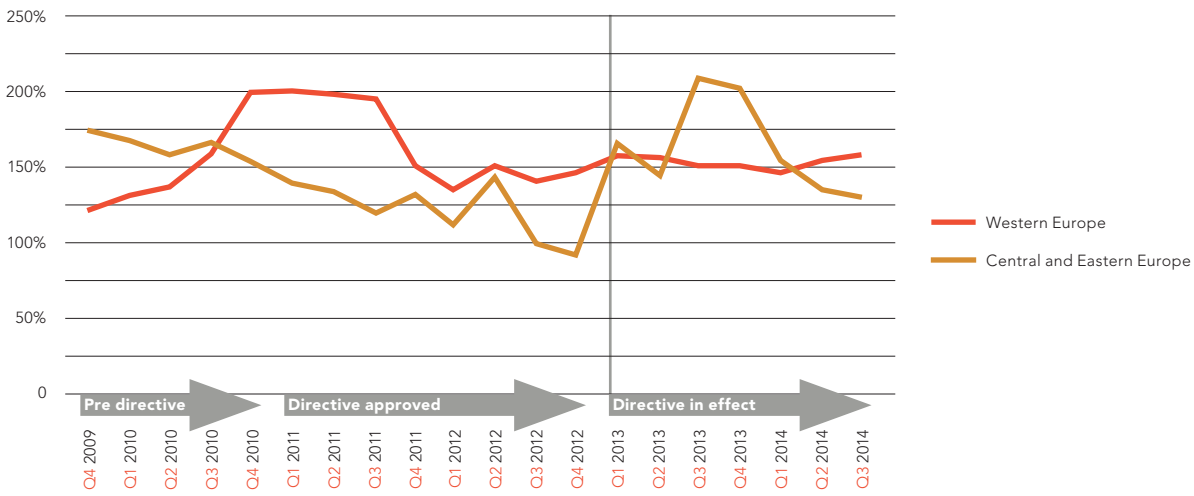


Figure 9.3: How much more likely than large corporates are SMEs to report late payment, post-Directive?



Self-regulation is also used in many countries to complement firms' rights under the law. ACCA has long supported, for instance, the UK Prompt Payment Code, administered by the Chartered Institute of Credit Management (CICM) since 2008. The UK code has provided inspiration for prompt or responsible payment codes in South Africa (since 2013), and in Ireland and Italy (since 2014), but with some variation signatories to all four tend to commit to:

- paying within agreed terms
- refraining from retrospective changes to terms

- avoiding changing terms on unreasonable grounds
- providing clear and accessible guidance on payment procedures
- providing and communicating a dispute-resolution system
- giving prompt notice of problems likely to delay payment of an invoice
- cascading good practice throughout the supply chain.

It is not clear how much influence such codes have on behaviour. In the UK, stakeholders have generally supported

the code but warned that a lack of enforcement and accountability of signatories as well as a lack of transparency on outcomes can severely weaken its application (BIS 2014a). The lack of proposed limits to credit terms will also tend to revive controversy about such Codes (ACCA 2014). The South African Prompt Payment Code specifies a limit for credit terms (30 days) and even one for dispute resolution, whereas the UK government was consulting on including a similar cap in the UK Prompt Payment Code as of late 2014.

On one level, ACCA, supports codes regardless of their immediate impact on payment terms, on the basis that what constitutes good practice must be made explicit to suppliers and buyers alike. Awareness of such codes can build a shared understanding about what regulatory tools can then also be created, and may provide a valuable signalling device for good buyers. ACCA also believes that codes can be strengthened further; for example, stakeholders' input to BIS (2014a) suggests that a range of measures could complement or enhance a prompt payment code:

- a confidential 'whistle-blowing' process
- a record of successful challenges of payment terms
- a register of payments complaints
- an audit scheme for code signatories
- appointment of named 'owners' of the code within signatories
- transparency requirements, including the publication of standard contracts.

### **A QUALITATIVE STANDARD FOR LATE PAYMENT: 'GROSSLY UNFAIR TERMS'**

Since what represents 'acceptable terms of credit' is a complex matter, regulators have occasionally sought to appeal to a qualitative standard for unacceptably long terms. The EU Late Payment Directive of 2011 requires that terms should not exceed 60 days unless explicitly agreed between the two parties and provided the terms are not 'grossly unfair' to the suppliers.

Under the Directive, 'grossly unfair' terms can be struck out of a contract by a court, but the onus remains on the supplier, or a representative business body, to make a legal challenge to such terms. For the time being, this option provides little protection to suppliers – there was, as of 2014, almost no legal precedent in Europe to help suppliers establish whether they had a case, and the costs involved in such legal action were certain to be substantial (BIS 2014a).

The Directive does not explicitly define 'grossly unfair' terms, except in the case of contracts requiring suppliers to waive their rights to compensation under the Directive, which guarantees that such terms will qualify as 'grossly unfair'. The term 'grossly unfair' hinges on the civil law concept of 'good faith', which does not directly translate outside civil law

systems but is generally understood to indicate the opposite of opportunistic behaviour (Mackaay 2011). The Directive stresses that all circumstances of the contract must be considered in determining whether terms are grossly unfair, and merely outlines some factors that should be considered. These include, in particular:

- (a) whether the terms represent a gross deviation from good commercial practice and are contrary to good faith and fair dealing,
- (b) the nature of the goods or services in question, and
- (c) whether the purchaser has any objective reason to deviate from the 60-day limit for payment terms. (European Commission 2011)

The UK government consulted recently (BIS 2014a) on stakeholders' understanding of 'grossly unfair' terms, and almost a quarter of responses indicated that a single, economy-wide definition would be impossible. ACCA's response noted that other contract terms, such as where buyers reserve the right to amend terms unilaterally at short notice, or make payment contingent on factors unobservable to or outside the control of the supplier, might also constitute 'grossly unfair' terms.

## 10. The limits of the law

As a rule, the ACCA members who contributed to this study opined that invoking legislation was not a very promising approach for businesses struggling against late payment. Although threats of litigation, involving both overdue payments and legal costs, were sometimes used as a behavioural nudge, overall, legal action itself was very rare and almost always reserved as a last resort when the relationship with a customer had broken down irreversibly or when the customer was failing.

Clearly, it is difficult to place the onus of triggering a legal challenge on the supplier; members generally argued that customer relationships would be damaged by such actions, which would cost them more money in lost business than they could possibly recoup through prompt payment. The law might offer even fewer options in emerging market settings where debtors are politically influential or government owned – adding political and social implications to the already daunting commercial ones; one member remarked that only a ‘truly desperate’ firm would take this course.

When it comes to failing customers, members and their companies insisted that they always reserved the right to use all legal means available to them, but noted numerous shortcomings that made the process unappealing. The most common complaint was that the process takes too long to secure any meaningful recoveries and can be excessively complex and expensive for all parties. Administrator and legal fees in particular, could cancel out many of the recoveries in a liquidation. In the best of cases, a first hearing in court might take a month; in the worst, two to three years; either way, the full cash flow

implications of late payment would be experienced by the supplier.

These claims are borne out by the World Bank’s Doing Business publications (World Bank 2014), which review, among other things, the ease of enforcing contracts and resolving insolvent businesses around the world. As Table 10.1 illustrates, suppliers in key South Asian emerging markets, such as India, Pakistan, Bangladesh or Sri Lanka, have to wait around or over 1,000 days in order to enforce contracts – and only in a few countries can businesses enforce contracts in less than a year; resolving insolvencies takes even longer. Among major ACCA markets, Singapore stands out for the speed of contract enforcement, and Asia-Pacific generally performs well – perhaps explaining some of the region’s success in avoiding late payment (ACCA 2015).

Once again, in discussing the options provided by regulations and the law, members drew a clear distinction between late payment by failing customers, and tactical or administrative late payment. Because the law is easiest to invoke in the event that a customer fails, it is particularly unfortunate that legal systems throughout the world provide suppliers with limited protection from creditor dilution – essentially, secured and preferential creditors (including employees) have a legal advantage, whereas a wide range of unsecured creditors, including trade creditors, have to make do with whatever assets are left.

Another, more easily-overlooked shortcoming of the legal approach is caused by the fact that businesses can disguise removable assets – through transfers to business directors and their

families or other businesses within a group. One ACCA member remarked that small debtors may be even harder to pursue through the courts than large corporates as it is easier for them to conceal business assets. Movable asset registries provide one answer to this problem, and have been found to improve access to both formal and informal credit significantly (Love et al. 2013).

Strict enforcement does not always make a difference either, if there is no focus on tactical late payment and tactical default. For instance, while one ACCA member in Malawi regretted the fact that issuing cheques that subsequently ‘bounced’ was not criminalised in Malawi, in Sudan defaulting on cheques is a criminal offence and can lead to a prison term. Another member noted that this has resulted in incarcerations but without proportionate recoveries.

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*‘In our country legislation has made defaulting on cheques when they come due a criminal offence and the debtor can be brought to jail till he settles his outstanding debts, but I don’t think this is making any difference to the process of late payment. We end up watching many traders being sent to jail without any money being repaid.’*

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CHIEF INTERNAL AUDITOR, SUGAR COMPANY, SUDAN

Of course, the fact that businesses might despair of the legal system is no argument for governments to abandon the idea of redress altogether – it is, rather, a call for reform. ‘Justice delayed is justice denied’, and ACCA members pointed out that such delays can positively encourage late payment. Moreover, governments certainly have

been known to make a difference; there is evidence from ACCA members that different legal structures have different implications for the feasibility of claiming late payments. For instance, one member noted how the merger of their country's Arbitrary and Civil-Criminal courts had increased the court backlog and exacerbated the problem. A member in another country noted that the introduction of small claims courts promised some relief from late payment. Arbitration can also often provide a solution; one member, in particular, noted that even with adequate legal protection in place, most cases are settled out of court to avoid mutual embarrassment.

These findings suggest that, regardless of the intentions of lawmakers, regulatory safeguards against late payment are more likely to be used as behavioural nudges or as means of boosting collections against insolvent parties. This needs to be carefully factored into the design of regulation, with more attention dedicated to supporting suppliers in relationships that they wish to maintain.

That said, respondents also provided examples of circumstances under which court decisions can, in themselves, make a difference:

- if they can act quickly to ring-fence the bank balances of the customers on behalf of creditors, before the troubled customers' suppliers withdraw and the business begins to fail, creating a widening cash flow interruption
- if cases taken to court have an immediate impact on customers' credit scores; the downside, of course, is that this creates a disincentive for businesses to report late payments at all, unless reporting can somehow be automated
- if the courts can approve the use of bailiffs in order to facilitate recoveries; whenever the topic was discussed, members reported significant success and suggested that seeking to use bailiffs was a time-honoured company policy.

Concessions to the first of these rules can be seen in the use of freezing injunctions or the European Account Preservation Order in the EU, which allow the freezing of debtors' accounts under certain conditions, including the posting of collateral by creditors. Such measures have, however, been criticised for jeopardising the continuity of businesses in financial difficulty, and essentially allowing the courts to decide on the viability of a business (R3 2014). A better balance is struck in the US, where any outstanding invoices issued by limited liability companies in the 20 days before a business enters into bankruptcy are treated as administrative expenses of the procedure itself in order to ensure that bad debts do not escalate (ACCA 2013).

Table 10.1: The institutional context of late payment

Country	Getting credit			Enforcing claims			Resolving insolvency		
	Depth of credit information index (0–8)	Credit registry coverage (% of population)	Credit bureau coverage (% of population)	Time to enforce (days)	Cost (% of claim)	Number of procedures	Time to resolve (years)	Recovery rate (cents on the dollar)	Creditor participation index (scored 0–4)
Bangladesh	0	0.9	0	1442	66.8	41	4	25.8	1
Brazil	7	52.5	63.6	731	16.5	43.6	4	25.8	3
Cambodia	5	0	29.3	483	103.4	44	6	8.2	3
China – Shanghai	6	33.2	0	406	15.1	37	1.7	36	1
China – Beijing	6	33.2	0	510	17.5	37	1.7	36	1
China – Hong Kong SAR	7	0	96.1	360	21.2	26	0.8	87.2	3
Cyprus	4	0	6.8	735	16.4	43	1.5	70.5	2
Czech Republic	7	6.4	76.6	611	33	27	2.1	65.6	2
Ethiopia	0	0.2	0	530	15.2	38	1.8	38.3	1
Ghana	6	0	14.1	710	23	38	1.9	24.3	0
India	7	0	22.4	1420	39.6	46	4.3	25.7	1
Indonesia	6	46.4	0	471	115.7	40	1.9	31.7	1
Jamaica	6	0	10.1	655	45.6	35	1.1	64.2	2
Kazakhstan	7	0	51.7	370	22	36	1.5	43.3	2
Kenya	0	0	4.9	465	47.2	44	4.5	27.1	2
Malaysia	7	56.2	78.6	425	37.3	29	1	81.3	3
Mauritius	7	71.9	0	519	25	34	1.7	67.4	2
Myanmar	0	0	0	1160	51.5	45	5	14.7	1
Nigeria	6	0.1	5.8	509.8	57.7	40.2	2	27.9	2
Oman	6	20.6	0	598	13.5	51	4	37.7	1
Pakistan	3	7.3	4.5	993.1	23	46	2.7	39.4	3
Qatar	5	23.3	0	570	21.6	43	2.8	56	1
Romania	7	12.3	46.6	512	28.9	34	3.3	30.7	2
Russian Federation	7	0	64.6	267	14.9	35	2	43	2
Singapore	7	0	50.8	150	25.8	21	0.8	89.7	2
South Africa	7	0	55.4	600	33.2	29	2	35.7	3
Sri Lanka	6	0	44.5	1318	22.8	40	1.7	42.4	2
Thailand	6	0	52.7	440	15	36	2.7	42.3	3
Trinidad and Tobago	6	0	67.4	1340	33.5	42	2.5	27.1	3
Uganda	0	0	4.9	490	31.3	38	2.2	37.9	1
Ukraine	7	0	48	378	46.3	30	2.9	8.6	1
United Arab Emirates	7	6.8	28.3	524	19.5	49	3.2	28.6	3
Vietnam	6	41.8	1.4	400	29	36	5	18.6	1
Zambia	7	0	7.3	611	38.7	35	2.4	39.3	3
Zimbabwe	3	0	5.8	410	83.1	38	3.3	13.8	2

Source: World Bank (2014).

## 11. What role is there for corporate reporting?

Like all financial intermediation, trade credit uses a great deal of both soft and hard information. In their international review published by ACCA, Collis et al. (2013) show that small suppliers see customers' financial reports as being of limited use in preventing late payment and/or defaults. Instead, information derived from financial statements only becomes an important part of credit decisions when medium-sized and larger entities contract with each other and with small entities, and even then such information is used indirectly, as incorporated in credit agency or credit insurer scores. These typically calculate accounting ratios and factor them into proprietary scoring models to arrive at credit scores and recommended credit limits. Studies on private company samples such as Ma and Martin (2012) demonstrate that access to better-quality financial information on customers tends to improve the cash balances of suppliers, and ACCA and CBI (2010) also demonstrate that using credit reference checks and other quantitative metrics increased SMEs' confidence in their credit policies, thus releasing cash for other uses.

While financial data can usefully inform trade credit decisions, users are not uncritical of the published figures. In Collis et al. (2013) report that respondents in different countries have claimed that inventory figures could be manipulated, and are not generally reliable. Figures for cash, investment and distributions (by way of dividends or owners' pay) were of more interest, as were turnover and turnover growth. As ACCA and CBI (2010) demonstrate, timing should also be a concern for users of financial information: in the period covered by that research, the age of nearly all information used in credit decisions, typically ranging from 21 to 37 weeks among UK SMEs, was about twice that of the information the

businesses thought appropriate for their own management purposes.

Overall, Collis et al. (2013) suggest that there are three alternative 'credit technologies' underlying credit decisions among the countries studied:

- Model 1: in environments with a low level of formal financial or credit information and low levels of interpersonal trust, sales are heavily cash-based or rely on deposits, pre-payments and bank guarantees.
- Model 2: in environments with a low level of formal financial or credit information but reasonable levels of interpersonal trust, credit is provided disproportionately to trusted counterparties or those with a good reputation.
- Model 3: in environments with a high level of formal financial or credit information, businesses rely on natural credit reference monopolies and highly standardised credit checks to help screen potential customers.
- Model 3a: public credit registers obtain information from mandatory submissions of financial statements, and the quality of information can vary depending on reporting requirements – in the case of small companies it can be very poor while for unincorporated firms it is usually non-existent. Some countries (eg Finland) have markedly more relaxed traditions on corporate disclosure, which greatly enhances the potential of this model.
- Model 3b: private credit-reference bureaux obtain information from scarce public data and through voluntary submissions, at what appears to be a greater overall cost

to all the parties concerned. Coverage of the business population and individual organisations can, however, be more complete.

One particularly interesting question in light of the findings of Collis et al. (2013) is to what extent the institutional context of credit information, creditor protection, enforcement of contracts and insolvency can encourage or discourage the use of trade credit. Using data on 195 country-years from the World Bank Enterprise Surveys (2004–14)<sup>1</sup> and from World Bank (2014), it is possible to attempt a very limited answer. A simple stepwise linear regression analysis suggests that only credit bureau coverage is a significant predictor of the extent to which manufacturing SMEs use trade credit to finance working capital ( $p=0.000$ ). When it comes to financing investment through trade credit, however, credit bureau coverage remains significant ( $p=0.000$ ), but credit registry coverage ( $p=0.008$ ) and the time taken to resolve insolvency ( $p=0.008$ ) also emerge as significant predictors. These early findings would suggest that model 3b, as described above, is consistent with SMEs' relative reliance on trade credit to finance working capital, while model 3a, complemented by efficient insolvency processes, may be more consistent with SMEs' relative reliance on trade credit to finance investment.

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1. The datapoints used in this analysis refer to observations for an individual country in a given year. Multiple instances were included in the analysis for countries surveyed in more than one year; data on use of trade credit were taken from the World Bank Enterprise Surveys, while institutional variables (eg on credit information or insolvency procedures) were taken from the *Doing Business* (World Bank 2014) dataset.

## A ROLE FOR NARRATIVE REPORTING

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If the value of financial information to suppliers is limited on its own, then ACCA would argue that narrative reporting can complement it in useful ways and should be made mandatory for limited liability companies. This is not a major departure from the duties of companies and their directors. Already, legislation around the world acknowledges that these parties should have 'due regard' to the need to foster sustainable relationships with their suppliers (ACCA 2013). At the time of writing, the UK government was consulting on a new system of reporting on companies' prompt payment records, to replace the narrative reporting requirements in place up until 2013 (BIS 2014a). In so doing, it acknowledged that past efforts to reduce late payment through mandatory disclosure requirements had failed, and it is relatively easy to understand why (ACCA 2013; BIS 2014a).

First, companies are able to manipulate reporting periods and conventions in order to present more favourable aggregate payment totals. Crucially, they can aggregate operationally critical 'core' purchases (see Chapter 1), which are typically paid for promptly, with 'non-core' purchases, which can be significantly delayed. Furthermore, reporting on payment times cannot, unless at great expense, distinguish appropriately between delays that are dispute-driven and otherwise, overdue and non-overdue, administrative and tactical.

Many assumptions about the benefits of prompt payment reporting are far from proven. Late-paying companies might not think twice about discouraging potential suppliers, either because they already have multiple suppliers on standby, or because it would be those suppliers with the weakest financials that would opt out first. Perhaps most importantly, however, investors and creditors may not penalise aggressive management of accounts payable. They might even reward it, as long as it appears to predict higher earnings in the short-term. Enqvist et al. (2014) find evidence of this correlation in the US and Greece, for instance, but not in Finland, a noted leader in the fight against late payment. Ukaegbu (2014) finds the same effect at play throughout key African economies. It is possible that countries making progress against late payment have found ways of breaking the link between profitability and aggressive accounts payable management.

A different approach to disclosure can, however, be more successful. Disclosures in strategic reports should aim to explain how the company is complying with its legal obligation to 'have regard to' the need to foster the company's business relationship with suppliers and customers, and therefore payment policies and practices, where material or outside the norm, should be disclosed. In the long term, ACCA would like to see reporting on this matter become aligned to the International Integrated Reporting Framework (IIRC 2014), and in particular to the notion of 'relationship capital', as applied to supplier-buyer relationships (IIRC 2013).

For more immediate purposes, however, there are three mechanisms that policymakers could consider:

- Payment times reporting could be used as a liquidity/stress-testing mechanism. The aim would be to demonstrate the extent to which the business typically relies on suppliers with long credit terms in order to finance its short-term liabilities, or how it would be affected if suppliers had to cut credit limits or tighten terms.
- Payment times reporting could be used as an estimate of the total value of credit the suppliers extend to the company. This would simulate the cost to the company of maintaining a conventional credit facility equivalent to the suppliers' credit over a financial year.
- A review of supply chain health could be conducted. Consolidation among a company's suppliers tends to reduce the buyer's bargaining power and may interrupt supplies. Hence any late payers that risk consolidation as suppliers abandon them, merge or go out of business would be penalised by investors. This proposal is very sensitive to reporting conventions, however – a company with a very complex supply chain and a large number of suppliers could easily disguise consolidation.



## 12. Conclusions and recommendations

This study set out to understand how trade credit and late payment work in practice, how businesses try to protect themselves from late payers, and what prospects there are for policy to improve the plight of businesses – especially SMEs. Its findings challenge some widely held beliefs on late payment but uphold others.

The findings of this international study suggest that late payment is not really the product of flawed business or national cultures as is often implied. Industry structures, norms and hierarchies, relative market power, business cycles, financial infrastructure and legal systems are much stronger influences. It is not surprising that smaller businesses suffer the most from late payment, but there is also no straightforward link between business size and late payment.

At the intersection of all the factors feeding into late payment, the potential influence of governments can be substantial, as long as their efforts are realistic and broad-based. It is particularly important that governments and stakeholders coordinate their efforts against late payment at a sector level, rather than over-relying on individual major companies willing to act as prompt payment champions.

Suppliers themselves are not as helpless against late payment as some might think. ACCA members explain, however, that it takes a highly focused approach to give real protection to a small business. This involves investing in customer relationships as well as in an independent, well-resourced credit control function (either within the finance function or as a stand-alone unit) that works closely with the finance, operations and sales functions, as well as the customers themselves.

Objectives and behaviours need to be aligned across all these parties, with credit policies providing a particularly useful coordination tool.

Suppliers can protect themselves through careful due diligence and in-depth receivables analyses building on ageing debtors reports. They can make more realistic provisions for bad debt, informed by first-hand information gathering, and incorporate these into regular cash projections. There is also a lot that they can do to improve the administration of receivables, from better understanding of customers' systems and the use of automation to bringing in outside expertise on credit control and collections.

For suppliers, the fight against late payments continues with contract design: businesses should ensure that their terms of credit are clear and explicit and that contracts give them appropriate rights over goods that remain unpaid for, as well as the right to withhold services or delivery as appropriate. Even the methods of payment can make a significant difference and must be specified in advance. Finally, despite receiving very unfavourable press coverage, prompt payment discounts can be an acceptable means of aligning prices with the cost of servicing individual customers – as long as they are not imposed unilaterally and at short notice.

Financing and liquidity insurance is a major element of the fight against late payment, and small suppliers in particular need to replicate to the extent possible the protection provided by the internal cash pools of diversified business groups. Exploring and securing alternative sources of finance (including factoring and trade credit insurance) is important, but ultimately

directors must be alive to the implications of providing credit to major suppliers and be willing to take on some risk through equity injections.

Finally, suppliers need to be able to distinguish quickly between late payment and genuine credit risk. There is often no substitute for first-hand inspection and probing. When customers are struggling but ultimately viable, forbearance can work. Businesses should seek to shield themselves from further cash disruption and reduce services to struggling customers but should also use payment plans to maximise recoveries and help customers surmount their problems.

Buyers, and their boards in particular, have an obligation to have 'due regard' to the need to foster sustainable relationships with their suppliers. In the interest of their own sustainability, rather than just good corporate citizenship, they should take stock of the risks and costs to which late payment exposes them – including continuity costs, loss of access to the best suppliers, and the risk of consolidating a supply chain in the long run. They need to monitor the financial health of their supply chains and in so doing extend their focus beyond their largest or most volatile suppliers.

Buyers stand to gain from prompt payment because most of the adjustments they need to make are about systems, not policies – key priorities are improving the efficiency and continuity of accounts-payable management, embracing supplier relationship management systems and e-invoicing. All these interventions are profitable for buyers and suppliers alike: indeed in countries such as Finland, where late payment is in retreat, the link between profitability and late payment

appears to have been successfully broken – without weakening the business case for late payment, change will be difficult.

Finally, major buyers should sign up to sector-wide prompt payment commitments or prompt payment codes where available, and boards, as opposed to government liaisons and CSR departments, should take high-level ownership of their commitments and report on the treatment of suppliers as an indication of the company's continued viability. Self-regulation is far from perfect but it can help establish expected standards of behaviour, create new industry norms, and prompt innovation among signatories.

Finally, buyers in genuine difficulty need to be open with suppliers and seek credit in a more appropriate manner. ACCA's research shows that a request for additional credit is approximately as likely to be successful as an intentional attempt at late payment – and that suppliers can be very reasonable when dealing with honest partners.

Governments, as some of the biggest buyers of goods and services, need to lead by example in the fight against late payment. With access to the capital markets, most of them have no excuse for borrowing in this way from business. It is therefore encouraging that many governments have adopted rules that commit them to prompt payment or that attempt to cascade good practices down the supply chain. All governments should follow suit, and should use their clout as major buyers to effect non-regulatory change as well.

Two good examples of this effect can be seen when, in their own supply chains, governments embrace

e-invoicing and factoring or supply chain finance (eg by removing bans on assignment clauses from their standard terms). The benefits, through easier financing and added certainty, do not accrue simply to government suppliers – by growing the market for such services and demonstrating their effectiveness, these benefits will cascade down to the private sector as well.

Governments can do more. They should consider how their tendering processes can create 'capacity events' in their supply chains: essentially forcing prime contractors to pay more promptly in order to secure capacity at more regular intervals. There is a balance to be struck between the efficiency of large, long-term contracts and the additional bargaining power shorter-term or more modular contracts can offer sub-contractors, but governments have scarcely begun to explore this.

On the other hand, governments' efforts to regulate trade credit between private enterprises and penalise late payment are well intentioned and provide some useful tools to suppliers, but they have not made a big difference to the incidence of late payment itself. Policymakers need to re-examine whether they are in fact regulating only for a small minority of cases – failed supplier relationships and insolvent customers – and whether putting the onus on suppliers to take cases to court is an adequate approach.

This is not to say that regulating for these specific cases is not important. There is good evidence that making the enforcement of contracts faster, by making the courts more efficient and providing alternative dispute resolution mechanisms, can stimulate the flow of credit and boost investment.

Enforcement can only work optimally if the courts can distinguish fairly quickly between businesses that are solvent and those that are not, and between businesses that are viable and those that are 'lost causes', and take quick action to ring-fence assets for creditors. Alternatively, US-style protections against dilution of 'latecomer' creditors can help.

In addition to their responsibilities for the legal infrastructure, governments have an obligation to help build the financial infrastructure that will mitigate late payment and boost trade credit. This can involve support for movable asset registries and credit bureaux, or the sharing of credit information, and extend to support for alternative finance sources and trade credit insurance – a market which governments, led by China, have entered very dynamically since the financial crisis. Governments can also boost the supply of information through mandatory payment terms reporting for companies, and consider how it can best provide investors with actionable information.

These proposals will not, in themselves, end late payment. Fluctuations in a firm's access to finance or the viability of different sectors, as well as the changing fortunes of individual firms, will continue to give rise to late payment even if good practices become more widespread. Nonetheless, good practices can start to erode the business case for late payment and create the conditions, such as greater access to alternative finance, that will reduce the impact of the remaining instances of late payment.

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# ENDING LATE PAYMENT

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In 2014, ACCA conducted a review of the widespread problem of late payment, a life-threatening challenge for many businesses globally. This review brought together recent ACCA research with the experience of ACCA members and other finance professionals to examine potential solutions.

The outcomes of this review have been presented in three reports.

- ***Ending Late Payment, Part 1: Taking Stock*** combines an extensive literature review with quantitative data from ACCA's member surveys to correctly define late payment, trace its precise origins and document its impact on the global economy.
- ***Ending Late Payment, Part 2: What Works?*** brings together a wealth of ACCA-commissioned publications and other secondary research as well as 36 case studies involving ACCA members around the world to help define good practice in business and policy.
- ***Ending Late Payment, Part 3: Reflections on the Evidence*** summarises ACCA's findings and issues a call to action for governments, financial services firms, large corporates and small businesses.



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The three reports are available from

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ACCA's 2014 review of the state of business finance is an ambitious global investigation into the challenges faced by businesses when trying to raise finance and the ways in which finance professionals in industry, practice and financial services help them along the way.

The outcomes of this review have been presented in three reports.

- ***The State of Business Finance, Part 1: Facts and Figures***, presents an analysis of two sets of quantitative data taken from the ACCA-IMA Global Economic Conditions Survey.
- ***The State of Business Finance, Part 2: Case Studies***, brings together twelve in-depth studies of business financing seen through the eyes of ACCA members around the world.
- ***The State of Business Finance, Part 3: Reflections on the Evidence***, summarises ACCA's findings and issues a call to action for governments, the financial services industry and, most of all, finance professionals around the world.



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