PAY IT FORWARD

LESSONS AND RECOMMENDATIONS FOR EUROPE FROM THE UK PAYMENT LANDSCAPE

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fsb
Experts in Business

Acknowledgements

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About FSB

The Federation of Small Businesses (FSB) is the UK's leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that is led by our members, for our members. Our mission is to help smaller businesses achieve their ambitions. As experts in business, we offer our members a wide range of vital business services, including legal advice, financial expertise, access to finance, support, and a powerful voice in government.

FSB is the UK's leading business campaigner, focused on delivering change that supports smaller businesses to grow and succeed. Our lobbying arm starts with the work of our team in Westminster, which focuses on EU, UK, and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

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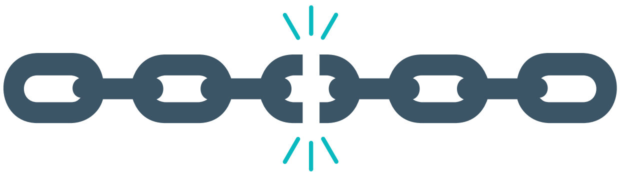
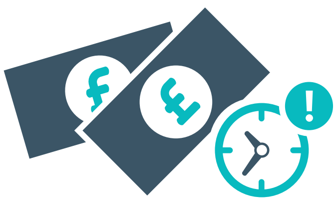
17% of **smaller suppliers** are paid more than **60 days** after providing an invoice

More than a third of smaller suppliers have had their **payment terms increased** over the last 2 years



The most **commonly reported risks** to smaller suppliers are:

- Customers **failing to pay** for services / goods provided **(51%)**
- **Losing** key members of staff **(37%)**
- Suppliers **unable to supply (30%)**
- **IT** problems **(29%)**



Almost **1 in 5 smaller suppliers** are **paid late** more than half the time by the public sector

FOREWORD

The late payment crisis in the UK is severe, leading to the closure of an estimated 50,000 businesses a year in the UK alone and costing the British economy £2.5 billion annually.[1] Only this year, the collapse of the facilities management and construction giant Carillion saw the dangers of poor payment practice writ large. The sorry episode cost jobs and ruined lives.

Small businesses have to run a tight ship with their cash flow, and as they struggle with increasing business costs on one hand and an uncertain economy on the other they should not also have to struggle with the stress, time and money required to chase overdue payments from corporate giants.

Whether through late payments or other damaging payment practices, the pernicious impact of poor payment culture has social, financial, and economic consequences in the UK and across Europe.

Previously, FSB has found that 37% of small firms have run into cash flow difficulties due to late payments, while 30% of small businesses resort to an overdraft and 20% cite a slowdown in profit growth. [2]

About a fifth of small businesses report lower profit growth because of late payments, while 16 per cent have had to delay investments and eight per cent have delayed hiring new staff. There is a clear impact on productivity, growth and economic performance.[3]

Poor payment culture has persisted for too long, both in the UK and across the EU, but in recent years there have been positive developments that have demonstrated that the impact of late payments is now being taken seriously. The EU has led the way in this respect, and FSB strongly supported the adoption of the 2011 Late Payment Directive.

The Directive introduced new requirements that B2B payment terms should never exceed 60 calendar days, unless expressly agreed by both parties and provided that it is not 'grossly unfair' to the creditor. FSB welcomed this development, while overall supporting efforts to move towards a norm of payment within 30 days.

In spite of this, poor payment practice continues to affect many of the 5.7 million small businesses that operate in the UK today, and so FSB welcomed the Commission's 2016 announcement that it would undertake an assessment of the Directive and the European Parliament's decision to report on its implementation.

This report attempts to contribute to this ongoing debate, analysing the impact of poor payment practice on small businesses in the UK and presenting lessons and recommendations that FSB believes could be valuable at the European level.

FSB's analysis draws on survey data gathered for our report 'Chain Reaction', published in July 2018 and focussed on the experience of small businesses in supply chains, and our report 'Time to Act', an in-depth analysis of the reality of payment practices in the UK published in November 2016.

We of course draw our analysis and recommendations from our experience as a national business association, representing over 165,000 small businesses from across the UK. While the late payment picture is different across each EU Member State, we believe the day-to-day realities for small businesses are similar across Europe and there are key lessons to draw from the UK experience.

Finally, while the UK is leaving the EU, the EU represents British small businesses' biggest market and their biggest source of non-domestic customers.[4] We do not expect this reality to change in the foreseeable future.

It is in everyone's interest, therefore, that a culture of prompt payment flourishes across Europe. Whether for services or goods delivered locally or cross-border, we all benefit if a small business can expect their customers to pay on time.

As the Commission and the European Parliament continue their assessment of the Late Payment Directive, and with European elections on the horizon in 2019, FSB believes that the time is now right for further action to ensure that we truly achieve the Directive's aim of 'a decisive shift to a culture of prompt payment.'

Ken Moon,
FSB Foreign Office & EU Chair

1 FSB 'Time to Act: The Economic Impact of Poor Payment Practice', November 2016, p. 7, available at: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-report---late-payments-2016-(final).pdf
2 FSB 'Time to Act: The Economic Impact of Poor Payment Practice', November 2016, p. 6, available at: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-report---late-payments-2016-(final).pdf
3 Ibid
4 FSB, 'Keep Trade Easy: What Small Firms Want From Brexit', March 2017, p. 7, available at: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/keep-trade-easy_-what-small-firms-want-from-brexit-21-march-2017.pdf?sfvrsn=0

INTRODUCTION: THE PAYMENT LANDSCAPE

Since the adoption of the Late Payment Directive in 2011 and its implementation in the UK in 2013, British small businesses have reported only a limited improvement in the payment culture that they encounter in the UK. Whether late payments or supply chain bullying, small businesses still report poor payment practices amongst their customers – including failure to pay – as their top business risk.[5]

Late payments are a consistent problem

FSB's own research sheds some light on why small businesses still perceive poor payment practice to be such a high risk. In research published in November 2016, FSB found that 30 per cent of payments are typically late, broadly unchanged from FSB survey data and 2011 (28%).[6]

In addition, FSB has found that a significant minority of smaller businesses (17%) receive payment more than 60 days after providing an invoice. This data is remarkably similar to the 16 per cent figure obtained by the UK Government from firms that – since 6 April 2017 – have started to publicly report on their payment practices as required under new laws introduced in the UK in 2015.[7]

Some positive signs on payment terms

There are nevertheless some positive signs in certain areas of payment practice, such as payment terms. As covered in the 'Payment Terms' section of this report, the most common terms that small businesses now encounter from the businesses or organisations that they supply to are payment within 8-30 days or payment within 31-60 days.

These payment terms align with the Late Payment Directive's requirement that B2B payment terms should never exceed 60 calendar days, unless expressly agreed by both parties and provided that it is not 'grossly unfair' to the creditor.

However, around one in five small suppliers (17%) still report terms of over 60 days. This figure is consistent whether the small business supplies at the domestic (23%) or European (22%) level, suggesting that issues relating to compliance with the Late Payment Directive extend across the EU.

Worryingly, FSB research has also revealed that, albeit against a long-term improvement, payment terms have recently worsened for smaller suppliers. More than a third (37%) of FSB smaller suppliers say that their payment terms have increased over the last two years, while less than one in twenty (4%) have experienced an improvement.

Supply chain bullying continues to be an issue

The final area of payment culture that has a disproportionately negative impact on small businesses is that of supply chain bullying, as covered in more depth later in this report. Late payments are not the only poor payment practice that negatively impact small businesses, and supply chain bullying is an equally malign element of poor payment culture.

Previous FSB research showed that almost one in five (17%) FSB small businesses said they had experienced supply chain bullying in the previous two years, including retrospective discounting.[8] In our most recent research, FSB found that an extraordinary 12 per cent of small businesses have been asked for a discount in return for prompt payment.

Many smaller suppliers continue to face challenges related to late payments, lengthy payment periods of more than 60 days, and other inequitable contract terms forced upon them by their larger business customers. At a time of rising costs associated with operating a small business, these additional pressures further increase the risk of running a small firm.

5 FSB 'Chain Reaction: Improving the Supply Chain Experience for Smaller Firms', June 2018, p. 8, available at: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/supply-chains-report-final.pdf
6 FSB 'Time to Act: The Economic Impact of Poor Payment Practice', November 2016, p. 6, available at: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-report---late-payments-2016-(final).pdf
7 Regulations made under section 3 of the Small Business, Enterprise and Employment Act 2015 (and, for limited liability partnerships (LLPs), the Limited Liability Partnerships Act 2000), introduced a duty on the UK's largest companies and LLPs to report on a half-yearly basis on their payment practices, policies and performance for financial years beginning on or after 6 April 2017. Companies and LLPs with £36 million annual turnover, £18 million balance sheet total, or 250 employees must comply with the duty to report.
8 FSB, Time to Act: The economic impact of poor payment practice, 2016, available at https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-report---latepayments-2016-(final).pdf

The issue is starting to be taken seriously

In recent years, thanks to campaigning by FSB and the small business community, the UK government has adopted a number of initiatives that aim to tackle late payments and improve the UK payment culture. While these initiatives are by no means perfect, taken together with the implementation of the Late Payment Directive in 2013 – transposed into domestic legislation via the Late Payment of Commercial Debts Regulations 2013 – the UK has made a number of encouraging moves towards fostering a culture of prompt payment.

The most recent initiative to take effect is that of the Small Business Commissioner (SBC). Launched in December 2017, the SBC is a publicly-funded but independent office with the aim of giving small firms help in disputes with larger companies, as well as trying to end the issue of late payment

In addition, last year large companies began to publicly report on their payment practices, policies, and performance under the duty to report requirements of the Small Business, Enterprise and Employment Act 2015. Reported via an online tool provided by the UK government, it is hoped that the data provided – once complete – will help guide small businesses when contracting with new large customers.

Finally, there is the longstanding Prompt Payment Code (PCC). Created in 2008 and overseen by the Prompt Payment Compliance Board, the PCC sets standards for payment practices and best practice for signatory firms, including payment within a maximum of 60 days and a commitment to 'work towards adopting 30 days as the norm'.

While supporting the intentions of the PCC, in recent years FSB has argued that the Code needs to be strengthened with mandatory membership for FTSE350 companies and the ability to remove those signatory companies that do not adhere to its stipulations.

For too long, companies have felt able to sign up to the Code as a demonstration of goodwill, while failing to adhere to its principles. The most recent – and notorious – example of this practice being Carillion, which remained a signatory to the PCC while subjecting its suppliers to payment delays of over 120 days prior to its bankruptcy.

While these three initiatives have demonstrated that the UK government is taking the pernicious effect of late payments on small businesses seriously, there is still far to go. Existing initiatives need strengthening further still – whether it be allowing the Small Business Commissioner greater access to data or creating a more robust Prompt Payment Code – and need to strategically interact and support each other if they are to effectively improve payment culture and practices in the UK.

Alongside recommendations on new initiatives at the European level, this report explores where the EU or its Member States could learn from the UK experience and adopt initiatives that, alongside the terms of the Late Payment Directive, will benefit small businesses across Europe.

RECOMMENDATIONS

Strengthen payment terms further by strictly defining ‘grossly unfair’

The European Commission should:

- **Strengthen small businesses’ legal protection against lengthy payments terms by more precisely defining the term ‘grossly unfair’ as used in the Late Payment Directive.** As FSB’s data attests, too many small businesses are forced to agree to payment terms of over 60 days. The ability for customers and their small suppliers to agree terms ‘provided that [they are] not grossly unfair to the creditor’ is a loophole that can enable the agreement of lengthy payment terms.

Support the aims of the Late Payment Directive through additional initiatives at the European and national level

The European Commission should:

- **Issue a recommendation that all Member States introduce a duty to report on payment practices for large companies *or* introduce such a requirement via any reform to the Late Payment Directive.** In 2015, the UK government introduced a duty to report on payment practices, policies, and performances for large companies via the Small Business, Enterprise and Employment Act 2015.[9] The Act required companies to report on payment practices for financial years beginning on or after 6 April 2017, making this information available publicly via an online tool provided by the government. Due to reporting only commencing last year, data is only partially complete. Nevertheless, this data is vital both in informing small businesses as to the payment practices of potential customers and for the government in assessing the late payment landscape.
- **Enable the Commissioner for the Internal Market, Industry, Entrepreneurship and SMEs to take up the mantle of protecting small businesses by strengthening existing initiatives, such as the SME Envoy Network.** As the chair of the SME Envoy Network, the Commissioner is perfectly positioned to understand the experiences of small businesses across Europe with late payments. The European Commission should empower the SME Envoy Network to provide information, data, and complaints directly to the Commissioner, who in turn should use this data to name and shame large companies or multinationals engaged in poor cross-border payment practices.
- **Design and provide tool kits and advice, specifically for smaller businesses, on relationship management, negotiating, contracting, and invoicing.** In particular, due to the unique supranational position of the European Commission, these tool kits should contain advice for small businesses providing cross-border services or goods to other European customers. Providing small businesses – and especially those engaged in cross-border trade – with the right tools and knowledge can help them to protect themselves from the effects of poor payment culture before problems arises.

Member States, with the encouragement of the EU, should:

- **Appoint a publicly funded, but independent, Small Business Commissioner or ombudsman to look after the needs of small businesses and work to change payment culture for the better.** The Small Business Commissioner (SBC) should empower small businesses in resolving disputes around late and unfair payment issues and provide advice, including on how to take action if a payment is overdue. Small businesses should be able to complain to the SBC about issues they face regarding late payment, contracting, or supply chain bullying, and the SBC should then have the power to investigate and issue recommendations to both parties on how to resolve disputes.
- **If not in place already, encourage the creation and adoption of a Prompt Payment Code for larger businesses above the SME definition threshold.** The Prompt Payment Code should include a robust oversight body, such as the Compliance Board in the UK, a penalties regime, and the ability to remove companies that do not comply with the Code’s terms on payment practices.

9 In addition, LLPs are required to report on their payment practices, policies, and performance via the Limited Liability Partnerships Act 2000.

Introduce sectoral ombudsmen and reform company boards to tackle supply chain bullying

The European Commission should:

- **Ensure the smooth adoption of the Directive on unfair trading practices in the food supply chain.** FSB strongly supports the Commission's efforts to tackle unfair trading practices in the food supply chain, including late payments for perishable goods, via the proposed Directive on UTPs in the food supply chain and its requirement for Member States to designate a public authority to oversee its rules. This reflects the situation in the UK, where the Groceries Code Adjudicator has the power to enforce existing legislation and issue penalties – including fines – for non-compliance with the terms of the Groceries Code.

Member States, with the encouragement of the EU, should:

- **Appoint sector-specific ombudsmen for those sectors that are most at risk of late payments.** In addition to implementing the terms of the proposed Directive on UTPs in the food supply chain, Member States could consider appointing similar ombudsman or regulators for other sectors that are particularly affected by poor payment practices, such as the construction sector. These ombudsmen should be robust, with powers to investigate poor payment practice, enforce existing legislation, and issue penalties for non-compliance. Additionally, these ombudsmen should have open avenues for aggrieved non-domestic companies to appeal to the relevant ombudsmen.
- **Require company boards to appoint a responsible non-executive director with a specific duty to report on behalf of the company's suppliers.** The director should present to the executive board and, subsequently, their findings should be included in the Annual Report. The responsibilities of this non-executive director should extend to the company's entire supply chain, including the investigation of any poor payment practices affecting suppliers and reporting publicly on how the company has tackled the problem. The non-executive director should also encourage greater transparency in payment practices and supplier lists for the benefit of smaller suppliers.

Reform public procurement to protect small suppliers and crack down on late paying public authorities

The European Commission should:

- **Link rules on prompt payment with the public procurement framework**. The UK government has already announced it will consult on disqualifying large companies from central government contracts if they have a history of poor payment. The European Commission should consider doing the same, and explore options for linking rules on prompt payment with the public procurement framework, cross-referencing requirements on payment terms and payment delays and excluding companies that do not comply with the Late Payment Directive from public procurement. Such an initiative would encourage large contractors to adopt a culture of prompt payment and prevent small suppliers from being used a cash flow resource in an industry that often relies on very low margins.
- **Require public authorities to pay interest automatically on any payments made late.** FSB has found that nine out of ten (89%) public sector suppliers have been paid late. This is true both for suppliers to central government (88%), local government (91%) and those supplying to public infrastructure projects (91%). Central government and local authorities should lead the way on paying on time, and the Late Payment Directive should ensure that this happens across the EU. The public sector should have no excuse to pay late.

Member States, with the encouragement of the EU, should:

- **Exclude large suppliers from major central government procurement opportunities if they cannot demonstrate fair and effective payment practices in relation to their subcontractors.** The UK government has stated that it will use its buying power as central government to ensure that big contractors comply with the UK Prompt Payment Code – which aligns with the stipulations of the Late Payment Directive on payment terms – both on government contracts and in their work with others. Member States should consider adopting a similar approach, using data gathered from the duty to report (explored above) to assess large contractors' policies, practices, and performance when awarding procurement contracts.

PAYMENT TERMS

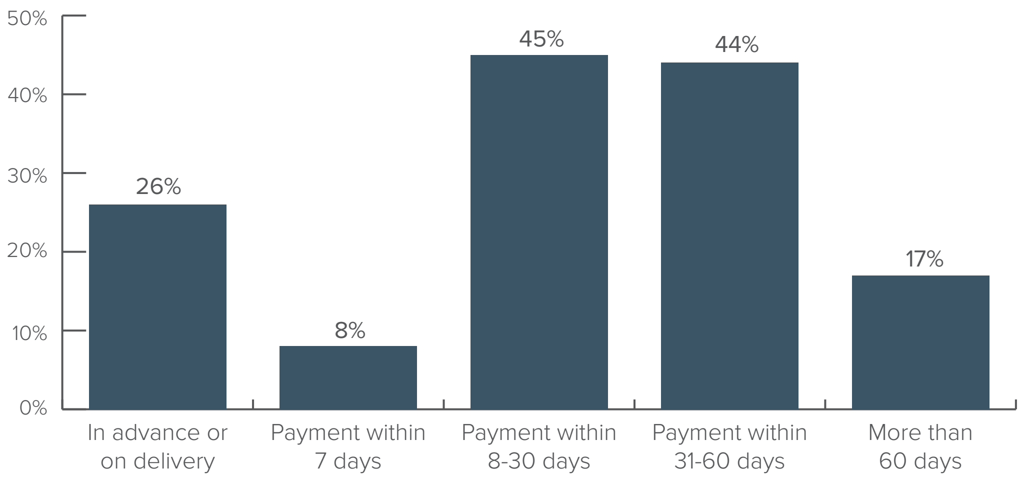
One of the key successes of the Late Payment Directive is formalising the need for a maximum limit on payment terms. For business-to-business transactions the Directive sets a maximum of 60 days for these terms, unless an alternative is expressly agreed by both parties and provided that it is not 'grossly unfair' to the creditor.

FSB's own research has revealed that payment terms of 8-30 and 31-60 days are the most common for small businesses, with 45% and 44% of small businesses reporting them as the payment terms that they commonly encounter.

However, FSB research suggests that the problem of extended payment terms continues. Figure 1 shows that a significant minority of businesses (17%) frequently encounter payment terms longer than 60 days. This data is remarkably similar to the 16 per cent figure obtained by the UK Government from firms have been reporting on their payment practices from 6 April 2017 under duty to report requirements.[10]

As FSB's data attests, too many small businesses are forced to agree to payment terms of over 60 days. The ability for customers and their small suppliers to agree terms 'provided that [they are] not grossly unfair to the creditor' is a loophole that can enable the agreement of lengthy terms. As FSB lays out in its recommendations below, this loophole should be closed through a more precise definition of the term.

Figure 1: Most common payment terms for small businesses
Source: FSB supply chain survey, 2018



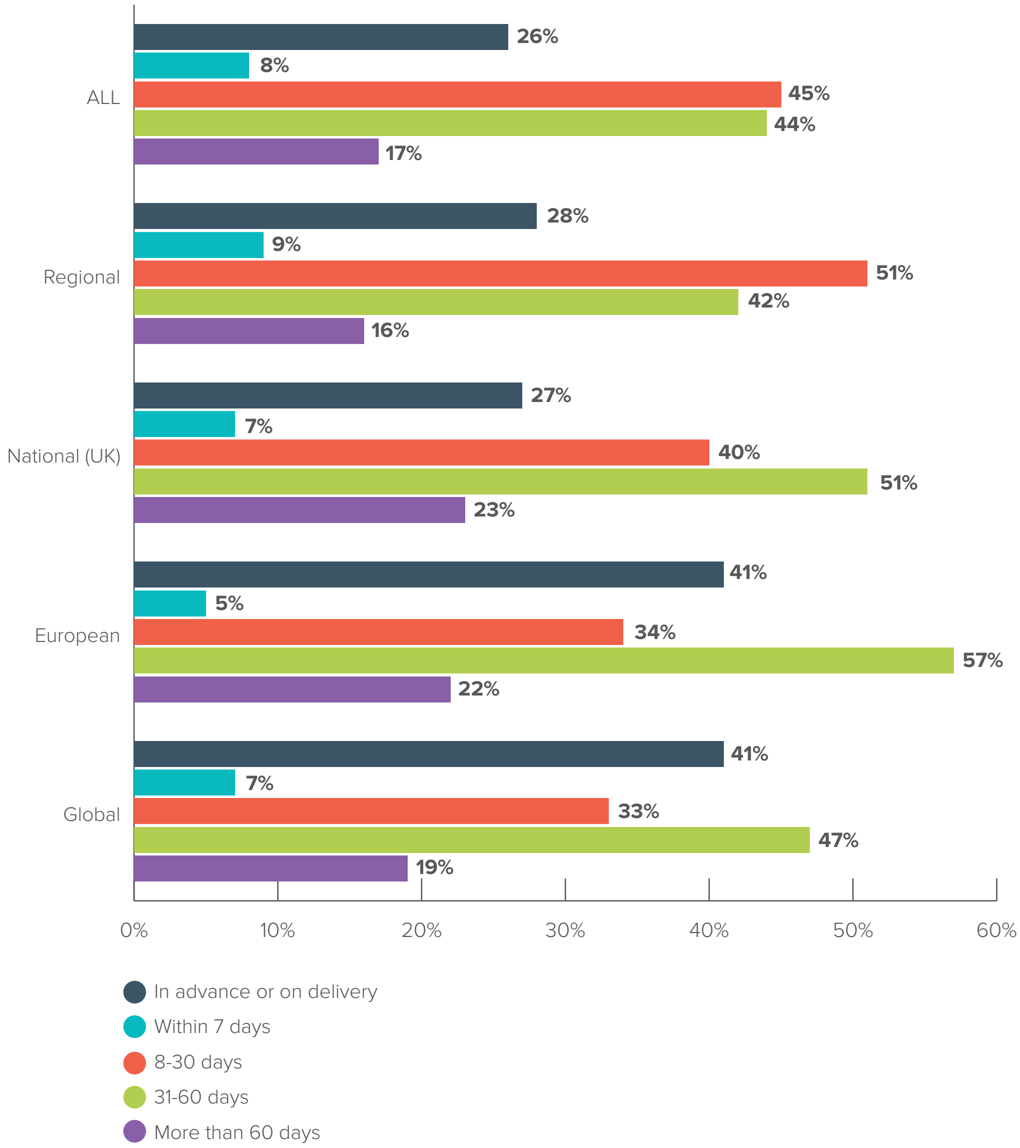
10 As noted above, the duty to report on payment practices introduced via the Small Business, Enterprise and Employment Act 2015 requires companies to report on payment practices for financial years beginning on or after 6 April 2017. Due to reporting only commencing last year, data is only partially complete.

Domestic vs. International Experience

There is clear variation in payment terms depending on geographic market. Figure 2 shows that payment in advance is more often the norm for those supplying to a European or global market (both 41%) compared to those supplying at a regional (28%) and national level (27%). Payment terms of 8-30 and 31-60 days are additionally common across all geographical markets.

It is notable, however, that one in five small businesses trading at both the national and European level report payment terms of more than 60 days as the most common terms with their customers. Whether a small business is trading with a UK-based customer or one based in the rest of the EU, it is clear that they are as likely to encounter payment terms that do not comply with the Late Payment Directive in either market.

Figure 2: Most common payment terms for smaller suppliers (by geographic market)
Source: FSB supply chain survey, 2018

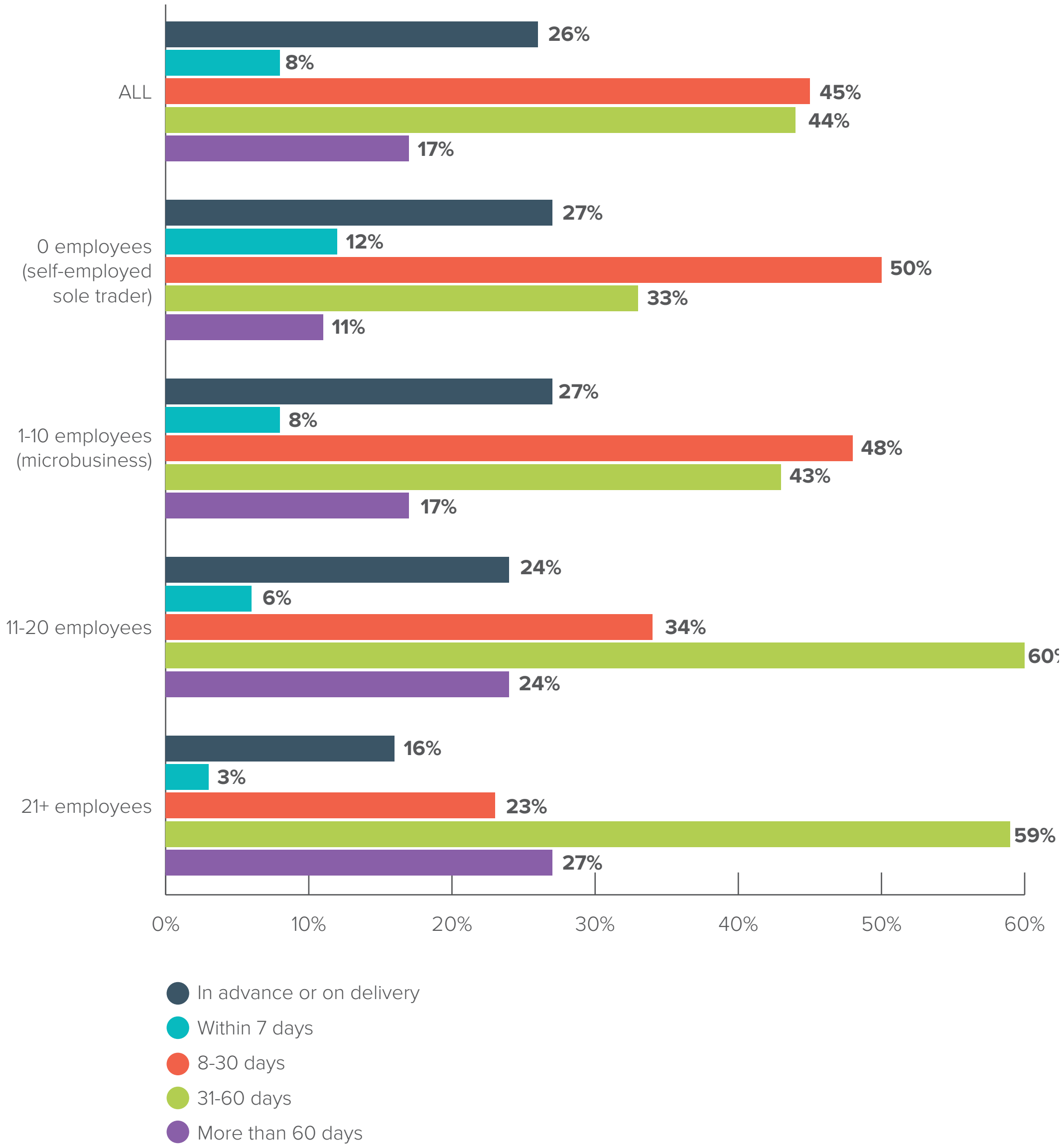


Size of Business

Figure 3 shows that the length of payment terms increase with the size of the supplier business. The largest suppliers tend to have the longest payment terms in their contracts.

Payment within 8 to 30 days was the most commonly reported payment term for half of self-employed sole traders (50%) and microbusinesses (47%). However, payment within 31-60 days was the most commonly reported payment term for businesses with 11-20 employees (60%) and those with 21+ employees (59%).

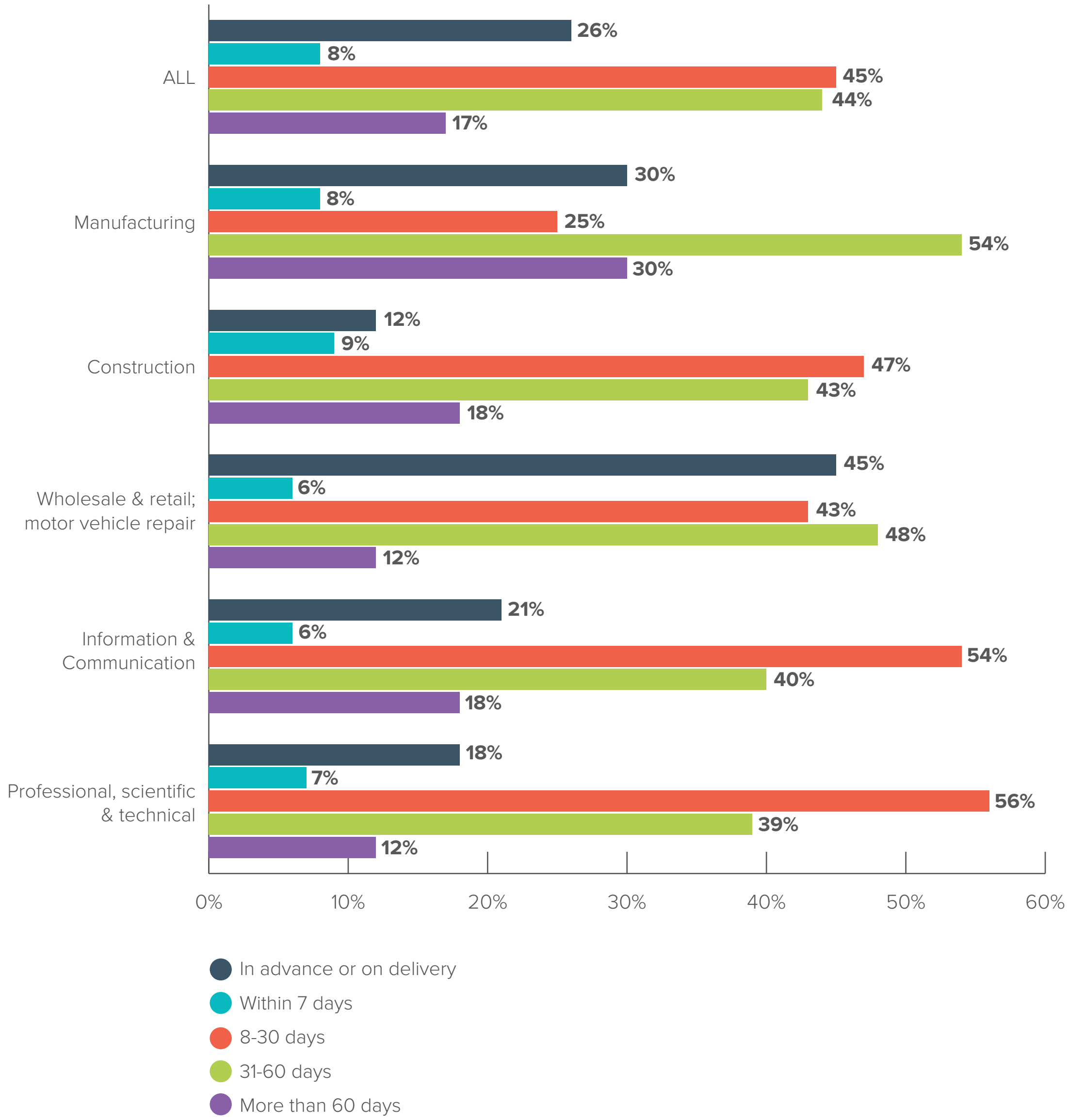
Figure 3: Most common payment terms for smaller suppliers (by supplier size)
Source: FSB supply chain survey, 2018



Sector

Figure 4 shows a sectoral variation in typical payment terms. Payment within 8-30 days was the most common payment term for businesses in professional, scientific, and technical activities sectors (54%) and those in the information and communications sector (54%). However, in the manufacturing sector, payment within 31-60 days was most common (54%). In the construction sector, the most commonly reported terms were either payment within 8-30 days (47%) or within 31-60 days (43%). This of course does not mean that companies in these two sectors are necessarily always paid on time.

Figure 4: Most common payment terms for smaller supplies (by sector)
Source: FSB supply chain survey, 2018



Recommendation

FSB strongly believes that payment within 30 days should be the norm for all companies, whether large or small. Payment terms of over 60 days should only occur in the very rarest of circumstances; for over one in six (17%) of small businesses commonly encounter such payment terms in their B2B dealings is troubling and the impact on small businesses of having to wait for over three months for payment can be severe.

The Late Payment Directive has done a good job in the UK of framing the debate to focus on a maximum of 60 days for B2B payment terms, and there is much evidence in the UK to suggest that it is achieving its aims in this area.

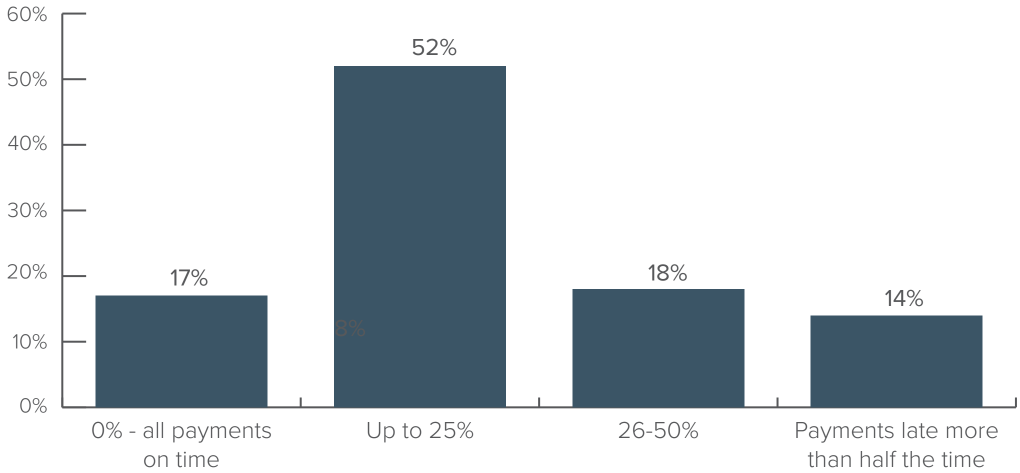
However, as FSB's data demonstrates, too many small businesses currently agree to payment terms of over 60 days. The current loose definition of 'grossly unfair' contained in the Late Payment Directive is a loophole that enables companies to force lengthy payment terms upon their small suppliers. The Commission should strengthen this further by more precisely defining the term 'grossly unfair' as used in the Directive to reduce further the number of small businesses subjected to lengthy payment terms.

LATE PAYMENTS

While there has been progress on payment terms since the adoption of the Late Payment Directive, significant issues remain with customers adhering to these payment terms and paying on time.

Figure 5 shows that most small businesses (83%) have to deal with payments that are made after the agreed date (only 17% say they are always paid on time). Around one in seven (14%) of small suppliers say they are paid late more than half the time by their business or public sector customers.

Figure 5: Proportion of smaller suppliers affected by late payments
Source: FSB supply chain survey, 2018



The real-life effect of late payments on small businesses is severe. Previous research by FSB in 2016 revealed that 60 per cent of late payments were worth more than £1,000, with an average value of £6,142.50. Over a third (37%) reported cash flow difficulties due to late payments and third (35%) also said they spent a substantial amount of time chasing payments. A small but significant proportion reported a delay on investments (16%) and hiring new staff (8%) as a result of late payments.

For small businesses, with limited resources and often narrow margins, late payments can be crippling. The result can lead to small businesspeople having to rely on credit cards or other means of credit to make ends meet, not taking a salary from their business, or reductions in staff.

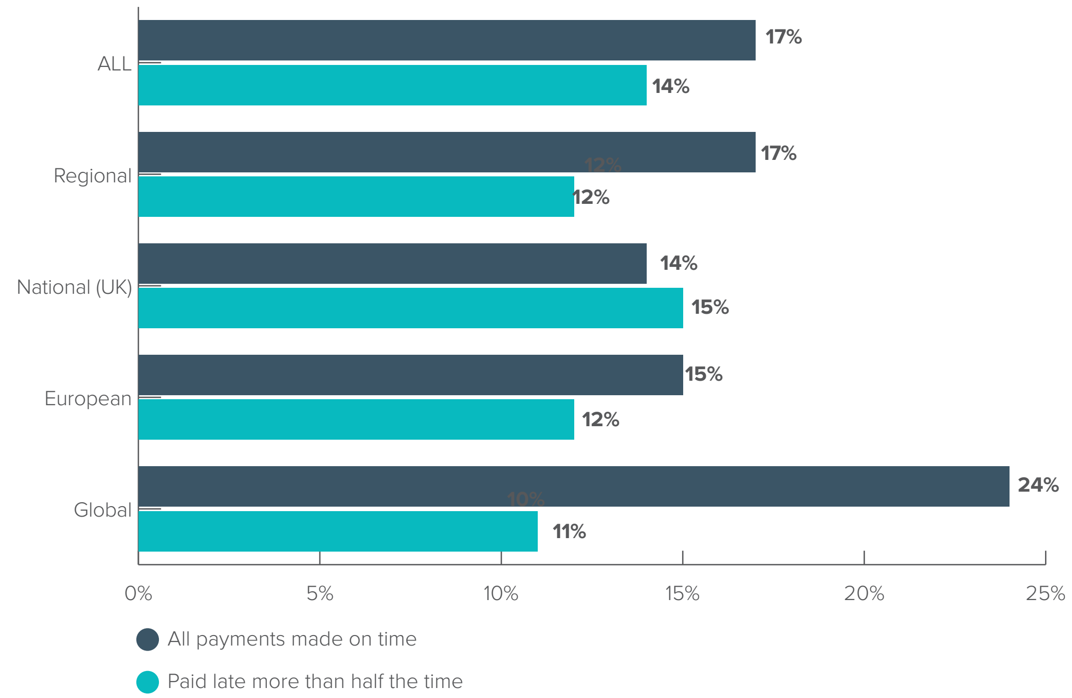
Equally, the economic impact of this disruption to small businesses' cash flow is severe. Late payments lead to the closure of around 50,000 companies in the UK every year. Without late payment issues, business profits would be 2.6 per cent higher. This would translate into a £4.8bn uplift in small business profits.

The economic benefit of ending the late payment crisis, both in terms of jobs created and tax take, is clear. Neither the EU nor its Member States should underestimate the benefits of resolving this crisis.

Geographic Market

FSB members report little variation in late payment practice across different geographic markets. As Figure 6 demonstrates, both small businesses supplying goods or services to domestic customers and those to European customers report similar experiences regarding the number of late payments that they receive.

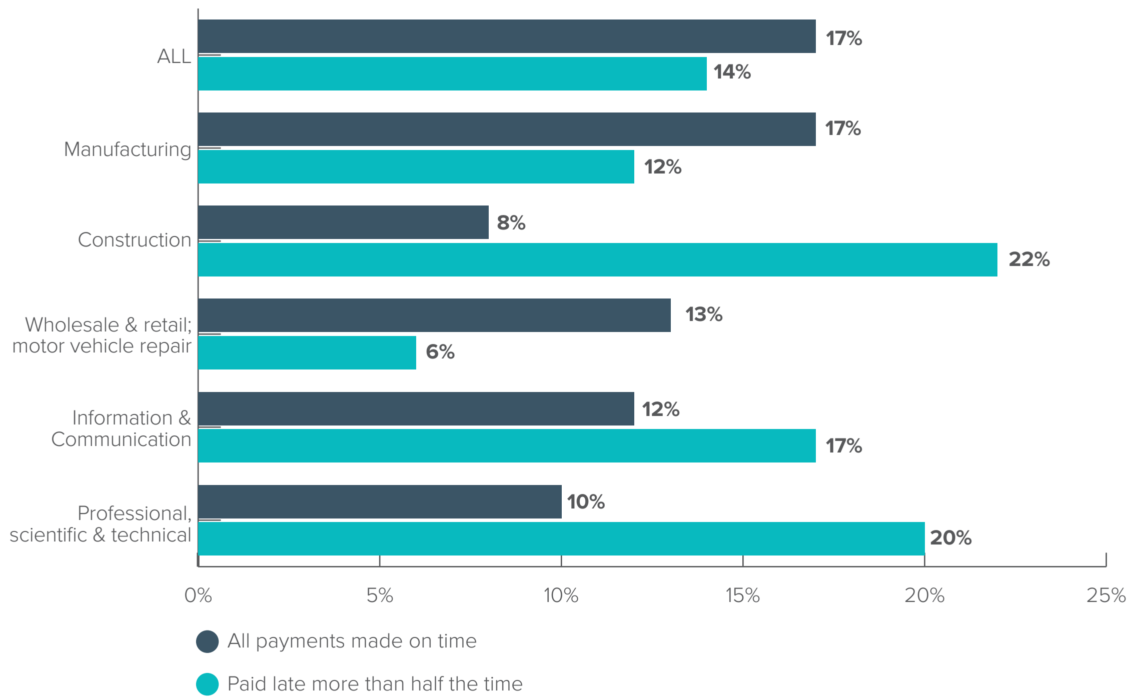
Figure 6: Proportion of smaller suppliers affected by late payments (by geographic area)
Source: FSB supply chain survey, 2018



Sector

Late payment practice varies significantly across sectors. Figure 7 shows that suppliers to the construction sector are the least likely to say they are always paid on time (8% compared to a cross sector average of 17%). Those supplying to the manufacturing sector, on the other hand, are far more likely to say they are always paid on time (17%). Those in the wholesale, retail and motor vehicle repair sectors are the least likely to report being paid late more than half the time (6% compared to the 14% cross-sector average).

Figure 7: Proportion of smaller suppliers affected by late payments (by sector)
Source: FSB supply chain survey, 2018



Recommendation: Increase the available data and improve payment culture

One of the most important elements of tackling poor payment culture is data. In the UK, the amount of data available to regulators and small businesses alike has bloomed since the introduction of duty to report requirements under Section 3 of the Small Business, Enterprise and Employment Act 2015.

The 2015 Act introduced a duty on the UK's largest companies and LLPs to report on a half-yearly basis on their payment practices, policies and performance for financial years beginning on or after 6 April 2017. Companies and LLPs with £36 million annual turnover, £18 million balance sheet total, or 250 employees must comply with the duty to report.

While it is still relatively early in the life of the duty to report, data is beginning to emerge. The hope is that this data will aid other initiatives in combatting late payments, as well as assist small business in determining the payment practices of potential customers. In time, it is hoped that secondary markets may emerge to help businesses comb through this data.

Whether through reform of the Late Payment Directive or through a Recommendation issued to the Member States, the European Commission should consider introducing a similar duty to report for larger businesses across Europe. The data that would emerge would be benefit not only businesses with purely domestic interests, but those looking to engage in cross border trade with concerns about late payment.

A second recent initiative that emerged in the UK in the wake of the Late Payment Directive has been that of the Small Business Commissioner. Created in December 2017, the Small Business Commissioner (SBC) is an independent public body set up by Government under the Enterprise Act 2016 to tackle late payment and unfavourable payment practices in the private sector.

While it is still too early to properly assess the impact of the SBC, its creation was an important signal from the UK government that it took the issue of late payment seriously, and the SBC's name and shame powers – if used – should assist those small businesses that are reluctant to take on late paying larger suppliers.

The European Commission could send a similar signal to the small businesses of Europe by enabling the Commissioner for the Internal Market, Industry, Entrepreneurship and SMEs to take up the mantle of protecting small businesses by strengthening existing initiatives, such as the SME Envoy Network.

As the chair of the SME Envoy Network, the Commissioner is perfectly positioned to understand the experiences of small businesses across Europe with late payments. The European Commission should empower the SME Envoy Network to provide information, data, and complaints directly to the Commissioner, who in turn should use this data to name and shame large companies or multinationals engaged in poor cross-border payment practices.

Similarly, Member States should consider appointing their own publicly funded, but independent, small business commissioners (SBCs) to look after the needs of and speak up for small businesses. These SBCs should have real power to name and shame those businesses that consistently pay late or engage in supply chain bullying, aided by data drawn from initiatives such as the duty to report explored above.

Finally, if not in place already, Member States should encourage their respective business communities to create, adopt, and sign up to prompt payment codes for larger businesses above the SME definition threshold.

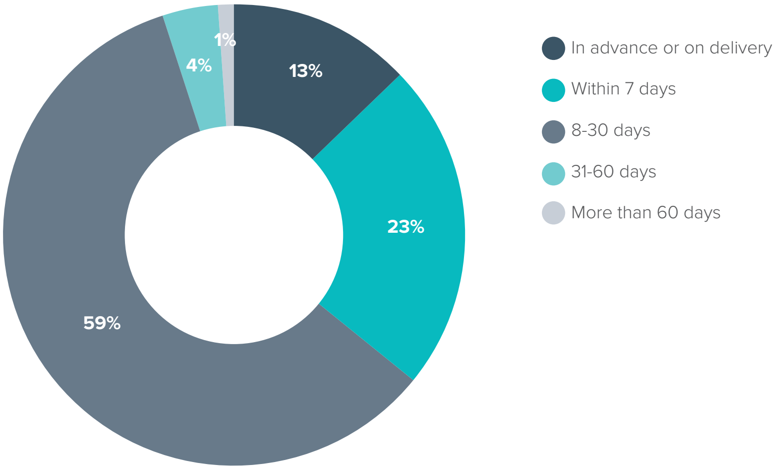
The Prompt Payment Code in the UK has existed for a number of years, but it is not without its faults. It is too simple for larger businesses to sign up to the Prompt Payment Code as a gesture and then not adhere by its terms.

Member States should learn from the experience of smaller businesses in the UK and encourage the development of codes that include an oversight body, such as the Compliance Board in the UK, a penalties regime, mandatory membership for larger firms, and the ability to remove companies that do not comply with the Code's terms on payment practices.

SUPPLY CHAIN BULLYING

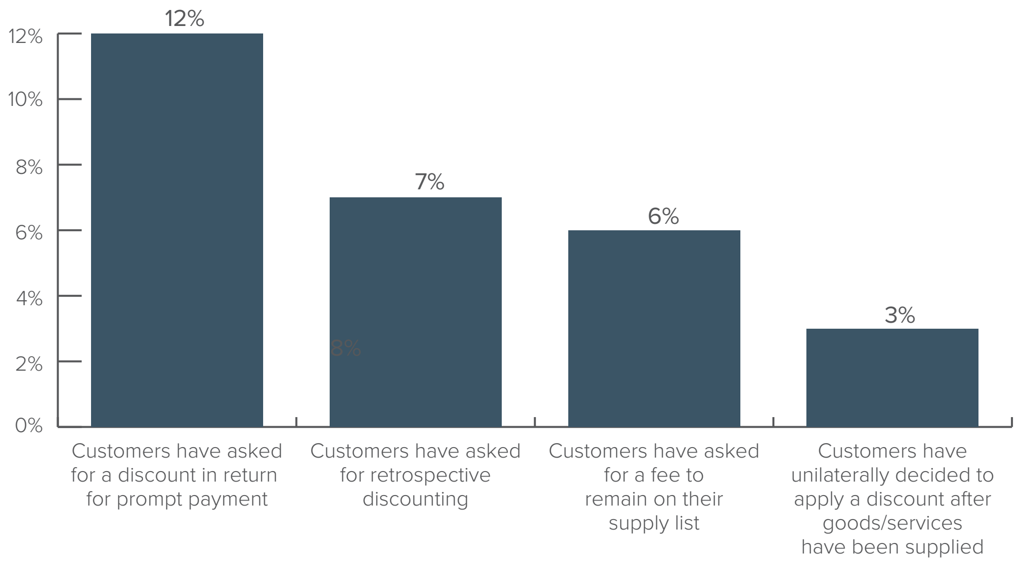
While FSB has witnessed a long-term improvement in the average payment terms offered to small businesses, worryingly many small businesses in the UK have recently reported that their payment terms are worsening. Figure 8 (below) shows that more than a third (37%) of FSB smaller suppliers say payment terms have increased over the last two years, while only four per cent have experienced an improvement. This strongly implies that larger business customers have been leveraging their power to influence payment terms in recent years.

Figure 8: Changes in payment terms for small suppliers
Source: FSB supply chain survey, 2018



As well as a regression in the length of payment terms offered to small businesses, many customers are placing pressure on their suppliers via other means, often after payment terms have been agreed. This pressure can come in the form of measures such as retrospective discounting and fees to remain on supply lists.

Figure 9: Proportion of smaller suppliers facing supply chain bullying
Source: FSB supply chain survey, 2018



Unfortunately, there is a clear power imbalance between many smaller suppliers and their (often larger) customers, which allows some customers to take advantage of using unfair practices. Some are leveraging their power to make unreasonable demands. Almost one in five (18%) of those supplying to multiple large businesses have been asked for a fee to remain on the customer's supplier list, three times the small supplier average (6%).

Furthermore, the situation appears to be worsening. FSB research, conducted in 2014, suggested that almost one in five (17%) small businesses had faced supply chain bullying in the previous two years.11 In FSB's most recent research,

11 FSB, 'Supply chain bullying affects almost one in five small businesses', (11 December 2014) http://www.fsb.org.uk/media-centre/press-releases/supplychainbullying-affects-almost-one-in-five-small-businesses-says-fsb-pr-2014-41

conducted for the 2018 supply chain report, 28% of small businesses reported encountering supply chain bullying of some kind.

The situation appears to be particularly acute for smaller suppliers operating in the construction sector. More than one in five (22%) small businesses in the construction sector report requests for discounts in return for prompt payment, almost double the cross-sector average (12%).

Figure 10 shows that just over a third (39%) of FSB smaller suppliers feel they can influence the terms of their contracts with customers, but a significant proportion (24%) say the opposite. And around a third (32%) feel they can challenge their customers. However, again, a significant proportion (18%) say the opposite.

Figure 10: Proportion of smaller suppliers able to influence / challenge customers
Source: FSB supply chain survey, 2018

Relationship with customers	Yes	No
I can influence the terms of contracts with customers	39%	24%
I feel able to challenge my customers	32%	18%

Perhaps unsurprisingly, smaller businesses that supply to large businesses – particularly those supplying to a single large customer – appear to feel disempowered in terms of their contract negotiations. Almost half (44%) of those supplying to a single large business felt they were unable to challenge their customer, almost double the 24% population average.

Similarly, small suppliers operating in the construction sector feel particularly disempowered. Less than a third (31%) in this sector feel they can influence their contracts with customers, while only one in five (20%) feel able to challenge their customers (compared to 39% and 32% cross sector averages, respectively).

Recommendation: Introduce sector-specific ombudsmen and reform company boards to tackle supply chain bullying

Supply chain bullying is often as much due to corporate culture as it is to power imbalances within the supply chain.

As well as some of the recommendations outlined in the previous section on late payment – such as the Small Business Commissioner – the European Commission should consider reforming the Late Payment Directive or issuing a Recommendation requiring companies to appoint a responsible non-executive director with a specific duty to report on behalf of the company's suppliers.

The non-executive director should present to the executive board on the health of their company's supply chain and, subsequently, their findings should be included in the Annual Report. The responsibilities of this non-executive director would also include the investigation of any poor payment practices affecting supplies, reporting publicly on how the company has tackled the problem. The non-executive director should also look to foster a culture of transparency with regard to the company's payment practices and supplier lists in order to allow small businesses to consider all the facts before agreeing to supply.

Secondly, it is clear from FSB's research that certain sectors are at greater risk of supply chain bullying than other sectors. As it has done in the food supply chain via the draft Directive on Unfair Trading Practices in the Food Supply Chain, the European Commission should consider legislating to protect small businesses in particularly vulnerable sectors, such as the construction sector.

In particular, the draft Directive on UTPs in the Food Supply Chain's proposal that Member States appoint sector-specific ombudsmen for such a high-risk sector is one that should be welcomed. In the UK, the Groceries Code Adjudicator fulfils this function to great effect, but the businesses that fall under its scope are limited. Other Member States should not hesitate to explore similar ombudsmen in other high-risk sectors without prompting by European legislation

Finally, any sector-specific ombudsmen that Member States appoint should come with open avenues for aggrieved non-domestic companies to appeal to them on the same basis as domestic companies. Late payments and supply chain bullying are as much a cross-border issue as a domestic one, and non-domestic companies should have access to the same protections and methods of redress.

PUBLIC SECTOR AND PUBLIC SECTOR CONTRACTS

The collapse of facilities management and construction services firm Carillion in January this year highlighted a number of risks to smaller suppliers. A major contractor to central UK government and local authorities, Carillion's insolvency exposed its 30,000 suppliers and sub-contractors to extreme financial risk.

The collapse additionally highlighted the weaknesses of existing initiatives to encourage prompt payment. A signatory to the Prompt Payment Code since 2013, Carillion were nevertheless notorious for being late payers. As the firm headed towards financial difficulties in 2017, FSB wrote to the firm concerning suppliers waiting 126 days for payment as normal practice. Unfortunately, these warning signs were ignored.

Payment codes such as those that exist in the UK and Sweden are beneficial tools in the policy toolkit and they are an important step in prompting a cultural shift towards prompt payment, and FSB supports their intended purpose. Nevertheless, the Carillion crisis highlighted major shortcomings in the Prompt Payment Code.

This is why FSB has recommended that the Prompt Payment Code reform to include a penalties regime and the ability to remove companies that do not comply with the Code's terms on payment practices. FSB recommends that other Member States promote the adoption of payment codes by their respective business communities, but that they also heed the lessons of the Carillion crisis and adopt codes with appropriate enforcement measures.

Beyond the Prompt Payment Code, the Carillion crisis also highlights the need to open up and diversify the procurement market to ensure that small businesses have equal access and that "too big to fail" contractors do not develop.

Most recently, the UK government consulted on measures to assess contractors' payment practices when awarding procurement contracts. The UK government consulted on two options: the first being for contracting authorities to assess bidders' supply chain management practices, and the second being for contracting authorities to demonstrate Grave Professional Misconduct in payment practice.

FSB supported measures that would allow contracting authorities to consider and assess bidders' supply chain management practices using three key metrics of payment performance, contractual terms, and number of disputed invoices.

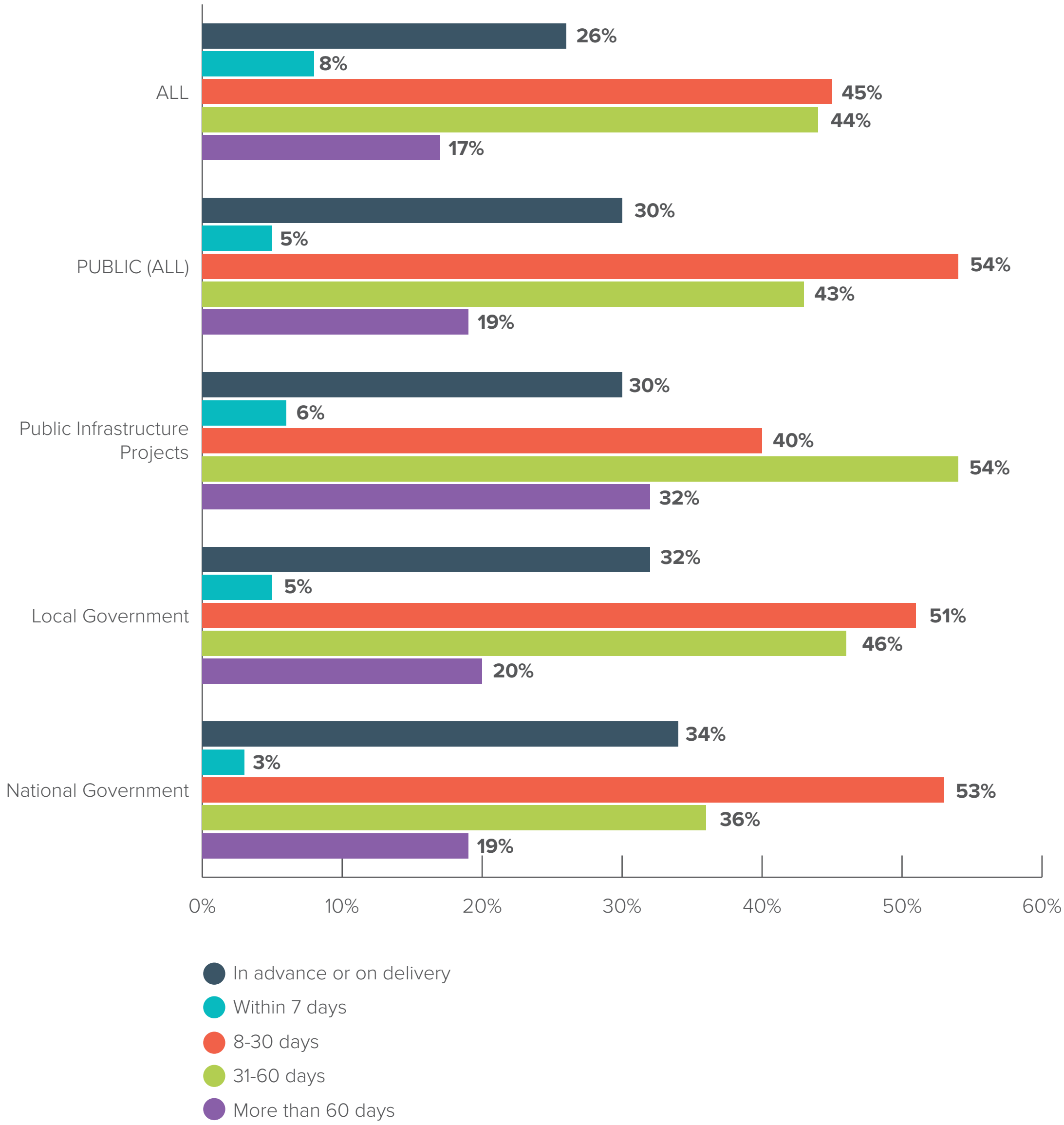
FSB encourages other Member States to consider exploring similar initiatives. At the EU level, FSB would urge the European Commission to consider cross-referencing stipulations on late payment with the public procurement framework in order to protect those smallest suppliers from the dangers of dominant contractors with poor payment practices. In addition, the European Commission should assess whether existing rules on procurement are preventing existing initiatives, such as the Mystery Shopper in the UK, from being fully effective and imposing financial penalties.

Payment practice

Public infrastructure projects are one area where, clearly, there needs to be an improvement in payment terms. Many smaller suppliers are twice as likely to face terms of more than 60 days (32% compared to 17% population average).

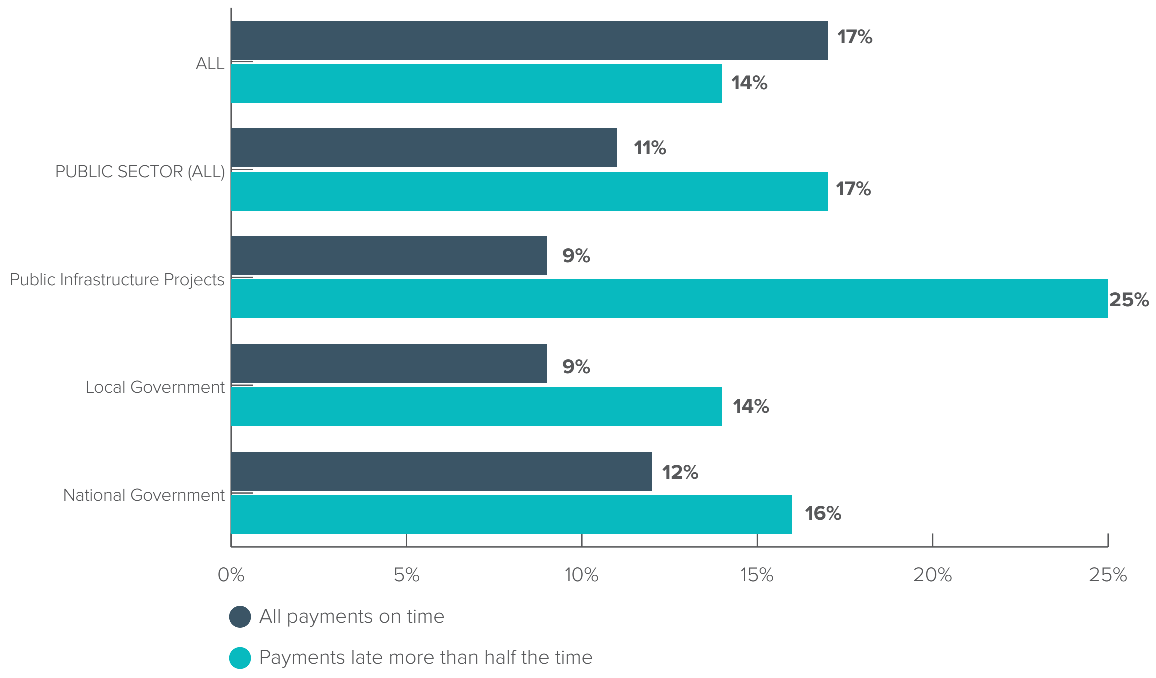
However, more broadly, the UK public sector should be acknowledged for its attempt to drive down payment terms. Figure 11 shows that those supplying to the public sector (including national government, local government and public infrastructure projects) are more likely to agree payment in advance or on delivery (30% compared to 26% population average), or within 8-30 days (54% compared to 45% population average).

Figure 11: Most common payment terms for smaller supplies (by public sector)
Source: FSB supply chain survey, 2018



However, FSB data on late payments suggests that the public sector subsequently struggles to honour these terms (Figure 12). Almost one in five (17%) smaller suppliers to the public sector say they are paid late more than half the time (compared to 14% population average). Nine out of ten (89%) public sector suppliers have experienced late payment, including suppliers to central government (88%), local government (91%) and those supplying to public infrastructure projects (91%).

Figure 12: Proportion of smaller suppliers affected by late payments
Source: FSB supply chain survey, 2018



Recommendation

Small businesses in the UK have been fortunate in recent years to witness an improvement in payment terms that they encounter with central government and local authority customers. Nevertheless, as FSB data and the Carillion crisis demonstrate, there are major shortcomings in the payment performance of both public authorities and major public sector contractors.

The UK government has already announced it will consult on disqualifying large companies from central government contracts if they have a history of poor payment. The European Commission should consider doing the same, and explore options for linking rules on prompt payment with the public procurement framework, cross-referencing requirements on payment terms and payment delays and excluding companies that do not comply with the Late Payment Directive from public procurement.

Consultation at the European level should not discourage Member State governments from moving ahead and acting independently to ensure that their small businesses are not exposed to poor payment practice from major central government contractors.

Member States should consider introducing measures to exclude large suppliers from major central government procurement opportunities if they cannot demonstrate fair and effective payment practices in relation to their subcontractors. Data taken from duty to report requirements, covered earlier this report, can effectively inform such decision-making.

ANNEX 1

Supply chain experiences

Fig A1: Supply chain experience (by size of supplier)
Source: FSB supply chain survey, 2018

<table>
<tr><th></th><th>0 employees (self-employed sole trader)</th><th>1-10 employees (microbusiness)</th><th>11-20 employees</th><th>21+ employees</th></tr>
<tr><td>Payment terms:
In advance or on delivery</td><td colspan="3">24-27%</td><td>16%</td></tr>
<tr><td>Payment terms:
More than 60 days</td><td colspan="2">11 - 17%</td><td colspan="2">24-27%</td></tr>
<tr><td>Late payments:
All payments on time</td><td colspan="2">16-25%</td><td colspan="2">7-9%</td></tr>
<tr><td>Late payments:
Paid late more than half the time</td><td colspan="4">13-18%</td></tr>
</table>

Fig A2: Supply chain experience (by sector of supplier)
Source: FSB supply chain survey, 2018

<table>
<tr><th></th><th>Manufacturing</th><th>Construction</th><th>Wholesale, retail and repair of motor vehicles</th><th>Information and communication</th><th>Professional, scientific and technical activities</th></tr>
<tr><td>Payment terms:
In advance or on delivery</td><td>30%</td><td>12-21%</td><td>45%</td><td colspan="2">12-21%</td></tr>
<tr><td>Payment terms:
More than 60 days</td><td>30%</td><td colspan="4">12-18%</td></tr>
<tr><td>Late payments:
All payments on time</td><td>17%</td><td colspan="4">8-13%</td></tr>
<tr><td>Late payments:
Paid late more than half the time</td><td>6-12%</td><td>17-22%</td><td>6-12%</td><td colspan="2">17-22%</td></tr>
</table>

Fig A3: Supply chain experience (by geographic market of supplier)
Source: FSB supply chain survey, 2018

<table>
<tr><th></th><th>Regional</th><th>National (UK)</th><th>European</th><th>Global</th></tr>
<tr><td>Payment terms:
In advance or on delivery</td><td colspan="3">14-17%</td><td>24%</td></tr>
<tr><td>Payment terms:
More than 60 days</td><td colspan="4">11-15%</td></tr>
<tr><td>Late payments:
All payments on time</td><td colspan="3">14-17%</td><td>23%</td></tr>
<tr><td>Late payments:
Paid late more than half the time</td><td colspan="4">11-15%</td></tr>
</table>

Fig A4: Supply chain experience (by length of time in business of supplier)
Source: FSB supply chain survey, 2018

<table>
<tr><th></th><th>0-4 years (start-up)</th><th>5-9 years</th><th>10-19 years</th><th>20+ years</th></tr>
<tr><td>Payment terms:
In advance or on delivery</td><td>36%</td><td colspan="3">24-27%</td></tr>
<tr><td>Payment terms:
More than 60 days</td><td colspan="2">7-12%</td><td colspan="2">18-20%</td></tr>
<tr><td>Late payments:
All payments on time</td><td>28%</td><td colspan="3">14-16%</td></tr>
<tr><td>Late payments:
Paid late more than half the time</td><td colspan="4">13-17%</td></tr>
</table>

Fig A5: Supply chain experience (by relative customer size of supplier)
Source: FSB supply chain survey, 2018

<table>
<tr><th></th><th>Same size or smaller business</th><th>Single large business</th><th>Multiple large business</th><th>Various size businesses</th></tr>
<tr><td>Payment terms:
In advance or on delivery</td><td>48%</td><td colspan="3">25-26%</td></tr>
<tr><td>Payment terms:
More than 60 days</td><td colspan="2">13-19%</td><td>32%</td><td>13-19%</td></tr>
<tr><td>Late payments:
All payments on time</td><td colspan="2">25-29%</td><td colspan="2">13-14%</td></tr>
<tr><td>Late payments:
Paid late more than half the time</td><td colspan="2">9-16%</td><td>22%</td><td>9-16%</td></tr>
</table>

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