



TIME TO ACT

THE ECONOMIC IMPACT OF POOR PAYMENT PRACTICE

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Experts in Business

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WHO WE ARE

FSB (Federation of Small Businesses) is the UK's leading business organisation. We are non-party political and exist to protect and promote the interests of the self-employed and all those who start up and run their own businesses. Small and medium-sized businesses make up 99.3 per cent of all businesses in the UK, they account for 47 per cent of private sector turnover and employ 60 per cent of the private sector workforce.

¹ Any policy recommendations proposed in this report are exclusively the work of FSB.

POOR PAYMENT PRACTICE

THE ECONOMIC IMPACT ON SMALL SUPPLIERS



A third of payments to small businesses are late

Impact of late payments on a small business

37% have run into cash flow difficulties

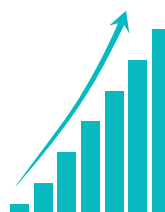


30% have been forced to use an overdraft

20% cite a slowdown in profit growth



Impact of paying small businesses on time*



£2.5 billion annual boost for the UK economy

50,000 more businesses kept



(*based on 2014 figures if there had been no late payments)

Average value of each late payment owed to small businesses



61%

of small businesses are paid late by big businesses



79% of small businesses don't charge interest for overdue invoices

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FOREWORD

Small businesses have grown increasingly frustrated at the slow progress that has been made in addressing the scourge of poor payment practice. This is not just a commercial problem – it is also ethically wrong. When large businesses pay late, it can put small firms out of business. It's as simple as that. It also creates a negative payment culture, one which runs through supply chains and throughout suppliers.

Legislation states the period for payment in a business-to-business (B2B) contract should never exceed 60 calendar days, unless expressly agreed by both parties and provided that it is not grossly unfair to the creditor.² In spite of this, poor payment practice now affects many of the 5.5 million small businesses that exist in the UK today.

Part of the reason why is because the payment terms of some large businesses have grown from 30 days to well over 100 days in some cases, with instances of supply chain bullying rife. This reflects a wider cultural trend, where payment terms are used to improve cash flow and the margins of larger businesses, at the expense of small suppliers. This harms small firms' cash flow, seriously hampering their ability to invest, grow and in some cases, threatening their existence.

Both for small businesses and the UK economy, this is unacceptable and needs to stop. At the moment, poor payment practice is not taken seriously enough in the boardrooms of larger companies, particularly with regard to corporate governance strategies. The Government has recently signalled its intention to introduce new reforms on corporate governance, targeted at the behaviour and conduct of large businesses. Given the impact of poor payment practices by large companies on smaller ones, it is essential late payment becomes a central focus of this important government agenda.

FSB has led the debate on poor payment practice in the UK. Most recently, our work has sought to raise the profile of individual practices that lead to supply chain bullying, as well as an analysis of the impact of unfair contract terms, generally imposed by larger companies, is having on small firms.

This report examines and quantifies the significant economic impact of poor payment practice. In addition, it considers the policy interventions required to address a problem that is presenting a growing cost to the economy. Given current low levels of business confidence and high uncertainty, this cost is only likely to increase if nothing is done to address it.

Our research has found that, worryingly, the level of late payment in the UK is broadly unchanged from five years ago. However, we also reveal that ending late payment could significantly reduce business failures, contributing to a positive impact to the UK economy. We believe the time is now right for action to be taken, to drastically improve the UK's payment culture and address some of the unacceptable practices carried out by larger companies.



Martin McTague
FSB Policy Director

² Department for Business, Innovation and Skills, 'Directive 2011/7/EU on Combating Late Payment in Commercial Transactions - A Users Guide to the recast Late Payment Directive', (October 2014), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/360834/bis-14-1116-a-users-guide-to-the-recast-late-payment-directive.pdf

EXECUTIVE SUMMARY

The size of the problem

About a third of payments to small businesses in the UK are late (paid outside agreed contract terms). FSB's survey of about 1,000 small businesses highlights the scale of the problem of late payment.³ On average, 30 per cent of payments are typically late, broadly unchanged from FSB survey data from 2011 (28%) – **suggesting the pervasiveness of late payments has not changed significantly in recent years.** Only 12 per cent of small businesses in FSB's latest survey said that customers always pay on time.⁴ About one in 10 small businesses say that 80% or more of payments are typically late.

The average payment delay is over a month long. The majority of late payments (84%) are more than two weeks late, with an average payment delay of about six weeks.

The average value of each late payment is not trivial, with small businesses saying that 60 per cent of late payments are greater than £1,000 in value, with an average value of £6,142.

Large private businesses are the most likely to pay small businesses late. Over three fifths (61%) of small businesses said payment from large private firms tended to be late.

Instances of supply chain bullying are rife across the UK's payment culture. In a survey of 2,500 FSB members in December 2014, almost one in five (17%) said they had faced supply chain bullying in one form or another in the previous two years.⁵ The results indicated a serious deterioration of payment practices across a number of sectors.

KEY FINDINGS

- 30 per cent of payments to UK small businesses are late.
- Average value of each late payment is £6,142.
- 37 per cent of small businesses say late payment causes cash flow problems.
- Ending late payments would have saved 50,000 UK businesses from failing in 2014.
- This would also increase the gross value added (a measure of economic output) to over £1 billion.

The business impact

Poor payment practice is having a wide range of economic effects on small businesses in the UK. Some 37 per cent of small businesses surveyed in this research said they had run into cash flow difficulties as a result of late payments.

Chasing late payments creates significant administrative burdens for small businesses. Thirty-five per cent said they spent on average 1.2 whole days per month chasing late payments.

Late payment contributes to reduced business performance. About a fifth of small businesses report lower profit growth as a result of late payments, while 16 per cent have had to delay investments and eight per cent have delayed hiring new staff – suggesting a clear impact on productivity, growth and economic performance.

³ FSB, 'Late Payment Survey', (August 2016).

⁴ FSB, 'Late Payment Survey', (July 2011), <http://www.fsb.org.uk/LegacySitePath/policy/rpu/london/assets/late%20payment%20july%202011.pdf>

⁵ FSB, 'Supply chain bullying affects almost one in five small businesses', (11 December 2014), <http://www.fsb.org.uk/media-centre/press-releases/supply-chain-bullying-affects-almost-one-in-five-small-businesses-says-fsb-pr-2014-41>

The economic impact

Ending late payments could significantly reduce business failures in the UK. We estimate that, if the UK had a similar payment delay ratio to Germany, then there would be about 25,000 fewer business deaths per year, contributing to an uplift in gross value added (GVA, a measure of economic output) of over £1 billion. A situation without any payment delays would have kept over 50,000 companies in business in 2014, generating a £2.5 billion uplift in GVA to the UK economy.

In addition, small businesses could see a significant increase in their profits. We estimate that, if small businesses did not face late payments this year, profit growth in 2016 would be 2.6 percentage points higher. This would translate into a £4.8 billion uplift in small business profits, reflecting higher levels of turnover and reduced costs, such as overdraft or loan charges.

Despite these costs to business performance and the fact that businesses have been able to charge interest on late payment since 1998, **very few small businesses charge interest on overdue invoices.** About 80 per cent do not charge interest on overdue invoices, suggesting both a lack of awareness and a fear of undermining existing commercial relationships has considerably limited uptake of this option.

The policy response

Poor payment practice should be at the heart of the Government's corporate governance agenda. The Government has signalled that it may look to make reforms on boardroom governance and rebuild trust in larger businesses. For too long the UK's payment culture and supply chain bullying have been ignored in the corporate governance debate. The Government should, therefore, make this a key area of focus in any proposed reforms. This should take place alongside tackling wider supply chain bullying, including the imposition of unfair contract terms on smaller businesses.

Existing legislation has been ineffective in addressing late payment culture. Only 20 per cent of companies say they have seen a positive effect from the EU Late Payment Directive.⁶ Exercise of the rights conferred by the Directive is not widespread due to fear of damaging good business relationships, which leaves small businesses unwilling to penalise large companies for late payment. In the UK, FSB research in 2015 found that only one in five (21%) FSB members were confident the Prompt Payment Code (PPC) would be enough to address the UK's poor payment culture.⁷

Ultimately, the research provides compelling evidence that changing the overall payment culture in the UK – and particularly tackling instances of supply chain bullying – should be key priorities. There is a strong case for measures that specifically target the conduct, practice and behaviour of larger companies, where problems of late payment are most severe. The PPC needs to be strengthened, while the new Small Business Commissioner (SBC) should have the resources and influence to positively create change across the UK's payment culture.

⁶ Intrum Justitia, 'European Payment Report 2016', (May 2016), p.3.

⁷ FSB, 'Small firms have little confidence in the Prompt Payment Code, says FSB', (March 2015), <http://www.fsb.org.uk/media-centre/press-releases/small-firms-have-little-confidence-in-the-prompt-payment-code-says-fsb-pr-2015-11>

FSB POLICY RECOMMENDATIONS

- 1. Make it mandatory for all FTSE 350 businesses to sign up to the Prompt Payment Code and introduce a penalties regime for repeat offenders of poor payment practices.** As previous attempts to persuade FTSE 350 companies to sign up to the Code have been insufficient, now is the appropriate time to mandate their participation with the Code. This should encourage more large businesses to actively review their treatment of suppliers and make payment practices central to their corporate governance strategies.

A new penalties regime led by the Code's Compliance Board should also be introduced. This regime should be based on a "three strikes and you're out" rule, which specifically targets repeat offenders of late payment. The Code should work with the Small Business Commissioner (SBC), when in place, to define what activity a strike would entail. Additionally, those signatories who commit the most egregious examples of supply chain bullying should be immediately struck off from the Code. For those signatories that wish to re-join the Code, they should be required to demonstrate that tangible steps have been taken to improve payment practices, with a final decision taken by the Code's Compliance Board.

- 2. Regulations should give the SBC a specific remit to directly address supply chain bullying.**

The SBC, when considering the conduct, behaviour and practice of larger companies, should have specific regard for instances of supply chain bullying. Regulations covering the scope of SBC's remit should be reviewed on an annual basis to prevent it becoming too prescriptive.

- 3. Supplier interests should be represented at executive board level as part of the Government's ambition to strengthen the stakeholder voice on executive boards.** Larger companies should be required to report annually to their shareholders on their payment practices. This could be achieved by including in their Annual Report the payment information they will have to publish from April 2017 as part of the Government's new Duty to Report regulations. These companies should also be required to appoint a (non-executive) Director on their board, with a specific statutory duty to report on behalf of the company's supplier, presenting their findings to their executive board and subsequently including them in the Annual Report.

- 4. The SBC's "name and shame" powers should be used effectively.** The SBC's ability to "name" companies should be used in a way that exerts the maximum influence and impact across the business community. This power should focus on the most serious instances of supply chain bullying. The SBC must also play a leading role in promoting good payment practice across the business community. Equally, the SBC must also use its powers to "name and praise" good practice and highlight positive examples where appropriate.

- 5. A timetable around the appointment process for the SBC should be published immediately.**

Although proposals for the SBC were first announced in July 2015, no appointment has yet been made, despite one being expected in summer 2016. The Government should now publish a deadline for when the SBC will be appointed, in order to provide greater confidence amongst the business community that such an initiative will positively create culture change across the UK.

- 6. Launch a marketing and communications strategy for the SBC.** The Government should raise awareness of the SBC amongst the small business community as soon as the Commissioner is appointed. This should also be linked to raising awareness of existing initiatives, such as the challenge function of the PPC, which remains an under-utilised remedy with huge potential to help support culture change. It should look to involve Local Authorities, Local Enterprise Partnerships, Growth Hubs and representative bodies, to ensure the role of the SBC is understood by small businesses before it goes live.
- 7. Payment information through the Duty to Report must be made accessible for small firms.** The Government should look to launch digital resources alongside the launch of the Duty to Report which specifically allow small businesses to compare the payment practices of large companies as well as making the data shareable.
- 8. Launch a joint industry-government taskforce on the future role of technology in addressing late payment.** New technology has the potential to empower small firms by providing more ways of chasing late payment. A joint industry-government taskforce should examine how new technology and data sharing (including the new Duty to Report) can be used to improve the UK's payment culture.

INTRODUCTION

This report outlines the serious and pervasive problem of poor payment practice, specifically B2B late payment. It considers both the impact this has on small businesses themselves as well as the broader UK economy. It also seeks to underline how addressing poor payment practice is not just vital for individual businesses, but also in supporting the broader growth prospects and productivity ambitions of the UK economy.

Late payment is the most frequent type of dispute experienced by small businesses. Seventy-two per cent of respondents to an FSB survey had a dispute about late payment or non-payment.⁸ The category of payment-related disputes includes both late payment (42%) and non-payment (30 per cent) of debts. The latter is likely to have been written off by many small businesses.

Whilst poor payment practice is regularly acknowledged as a serious problem across the policymaking and business communities, its relationship with the overall economic climate is rarely explored in any detail. FSB believes it is important to understand the impact late payment has on small business productivity, particularly during a period of significant economic uncertainty. Indeed, relevant action in 2017 will be crucial towards maximising the role of small businesses in supporting economic growth and job creation across the UK.

Beyond the impacts of paying small suppliers last, the report details evidence of supply chain bullying, which remains a growing issue amongst small businesses. Poor contractual practices, such as unfair payment terms and breaches of contract, reduce the economic and financial resilience of small businesses. It often harms small firms' cash flow and, in some cases, threatens their existence. The strong bargaining position of large purchasers often leaves small businesses feeling forced to accept unfair payment terms despite the problems they cause, highlighting the need for steps to be taken to address these imbalances in bargaining power and protect smaller firms.

As part of this, the Government's new corporate governance agenda should focus on the responsibilities which larger companies have to treat their smaller suppliers fairly and pay on time. At its essence, corporate governance is about how the board of directors set the values of the company. To date, payment and supply chain practice has not been taken seriously enough at the board level of larger businesses. This needs to change immediately.

This report examines how policymakers can reduce the prevalence of late payments, examining some of the policies in place across the globe. We also consider the rise of new technology that could potentially play a more central role in addressing the problem of late payment.

⁸ FSB, Forthcoming Research, Respondents were asked to list the types of dispute they had experienced over the years 2010 to 2015. Respondents could report more than one.

SETTING THE SCENE: TRENDS IN LATE PAYMENTS IN THE UK AND ELSEWHERE

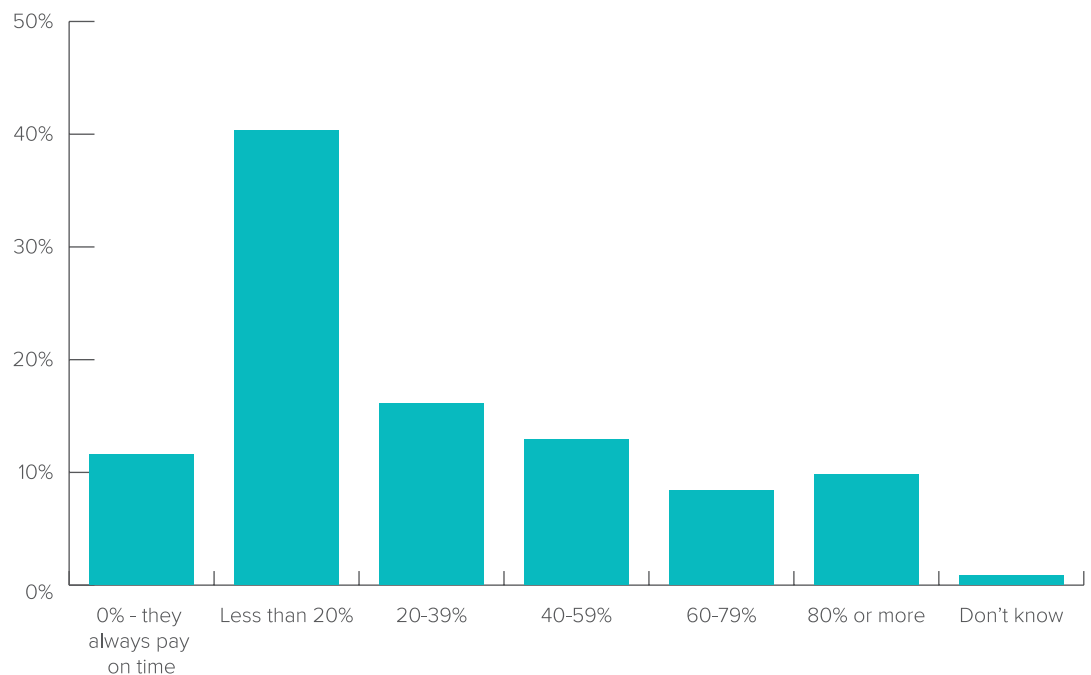
Our survey of small businesses conducted as part of this research highlights the significant scale of the problem of late payments for small businesses based in the UK. On average, 30 per cent of payments from customers of small businesses are typically late,⁹ broadly unchanged from FSB survey data from 2011 (28%) – suggesting the pervasiveness of late payments has not changed significantly in recent years.¹⁰ Only 12 per cent of small businesses surveyed by the FSB said that customers typically always pay on time. About one in 10 small businesses said that 80 per cent or more of payments from customers are typically late.¹¹

KEY FINDINGS

- Only a 2 per cent improvement in late payments for FSB members during the last 5 years.
- One in 10 small businesses say 80 per cent of payments are typically late.
- Average delay in payment is six weeks.
- 61 per cent of larger businesses and 37 per cent of smaller firms run into cashflow difficulties from late payments.

Figure One: What percentage of payments from your clients/customers are typically late?

Source: FSB late payment survey 2016



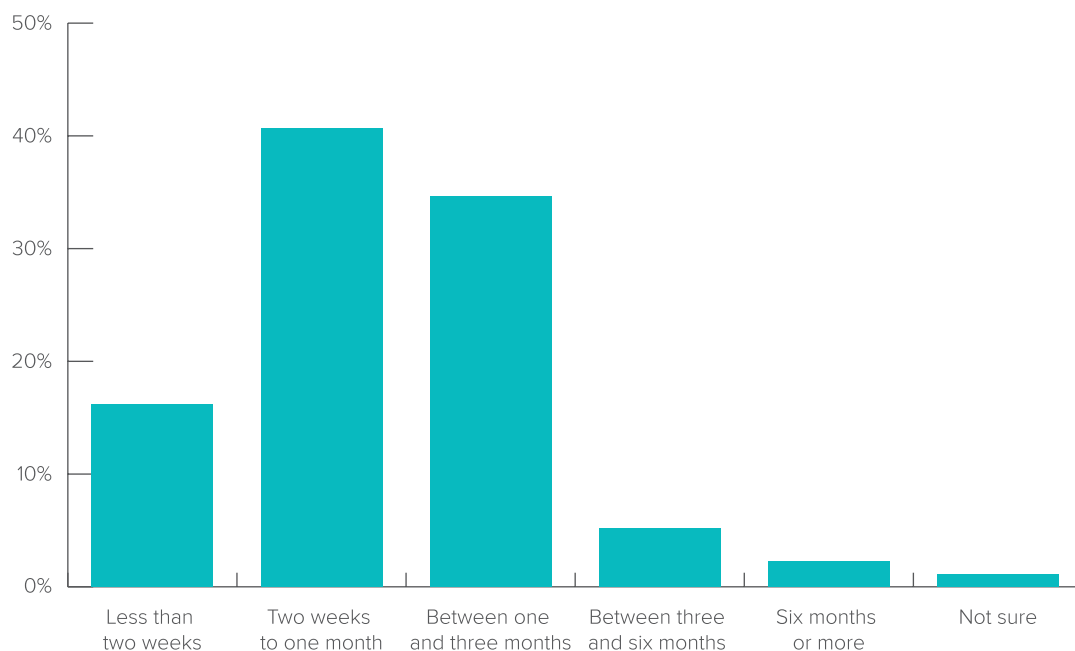
Furthermore, the majority of late payments (84%) are more than two weeks late (i.e. after the agreed contract terms), with an average payment delay of about six weeks.

⁹ FSB, 'Late Payment Survey', (August 2016).

¹⁰ FSB, 'Late Payment Survey', (July 2011) <http://www.fsb.org.uk/LegacySitePath/policy/rpu/london/assets/late%20payment%20july%202011.pdf>

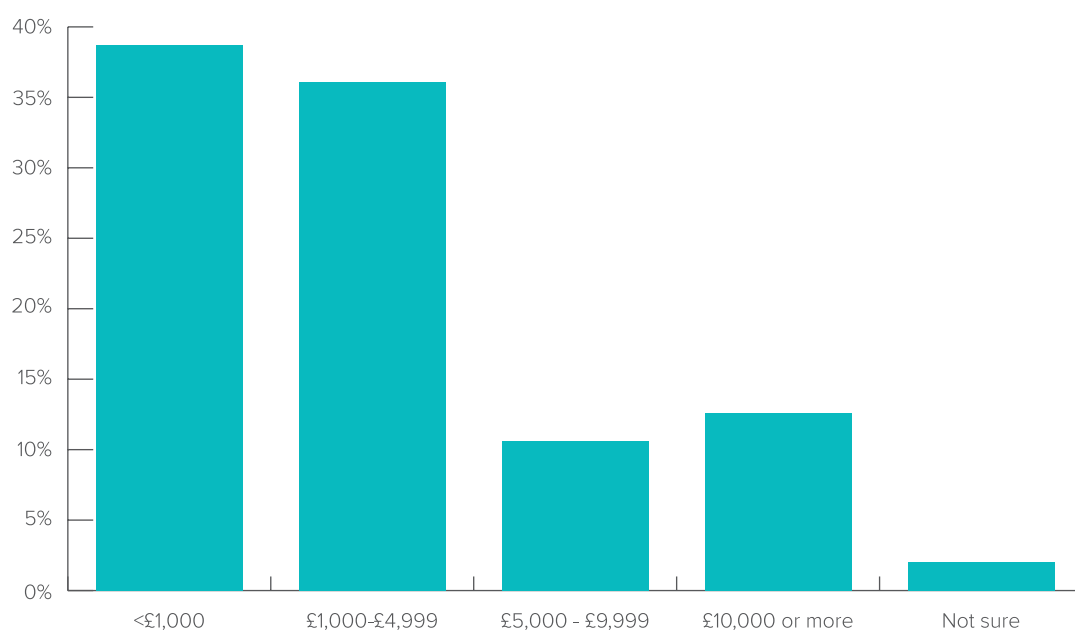
¹¹ FSB, 'Late Payment Survey', (August 2016).

Figure Two: Thinking about late payments to your business, what is the average delay in payment?
Source: FSB late payment survey 2016



The average value of each late payment below is not trivial, with small businesses saying that 60 per cent of late payments are greater than £1,000 in value, with an average value of £6,142 across all of our survey respondents.¹² Four small businesses even had over £100,000 owed to them on average per late payment.

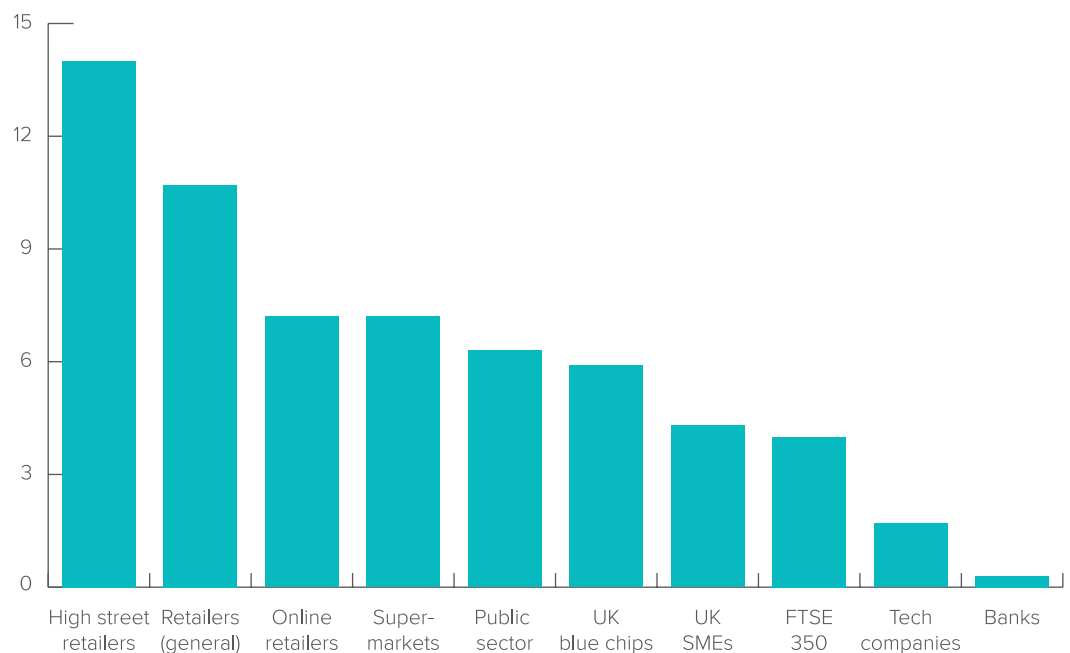
Figure Three: What would you say is the average value of each of these late payments?
Source: FSB late payment survey 2016



¹² This figure was calculated by taking the average value of each respondent to FSB's August 2016 survey.

Within the UK, there are significant variations in payment trends across industry sectors, with purchasers in some industries significantly more likely to have a high average payment delay - something that is likely to also be observed in other countries. MarketInvoice undertook an analysis of 30,000 invoices, mainly examining payment records in 2015, which shows high street retailers having a much higher average payment delay than other sectors, such as banks and online retailers.¹³

Figure Four: Who pays UK businesses when? Average payment delay (in days) by sector
Source: MarketInvoice, January 2016



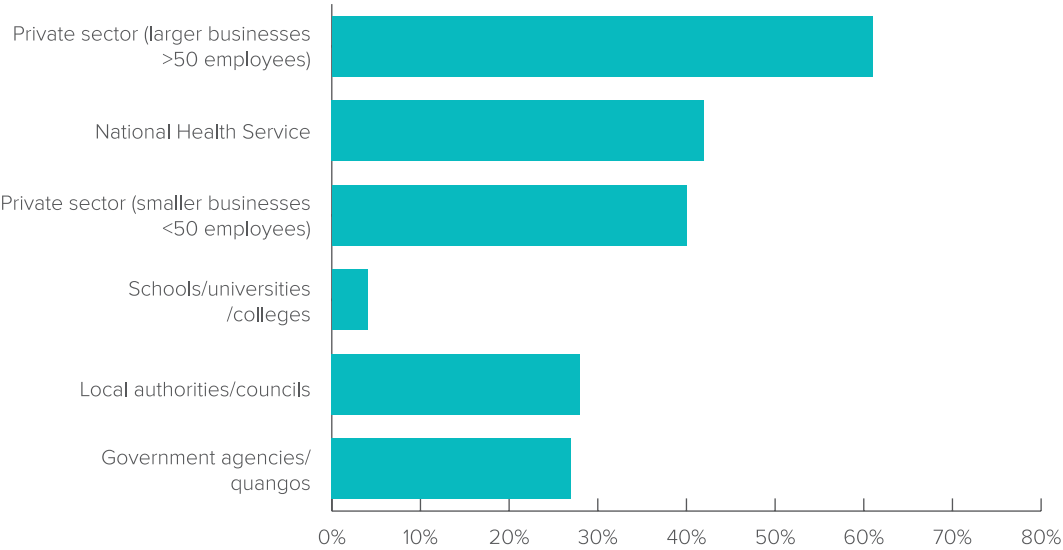
The survey commissioned as part of this research also sheds some light on this matter, with large businesses the most likely to pay late according to survey respondents. Over three fifths (61%) of small businesses said payment from large private firms tended to be late. This compares with less than 30 per cent for local authorities and government agencies.

KEY FINDINGS

- 61 per cent of late payments are from large private firms.
- FSB estimates 2.8 million small firms have suffered financially due to supplier contract terms.
- As a result small businesses face costs of at least £3.8 billion.

¹³ MarketInvoice, 'The State of Late Payment', (January 2016), p.14 http://info.marketinvoice.com/hubfs/The_State_of_Late_Payment_MarketInvoice_2016.pdf

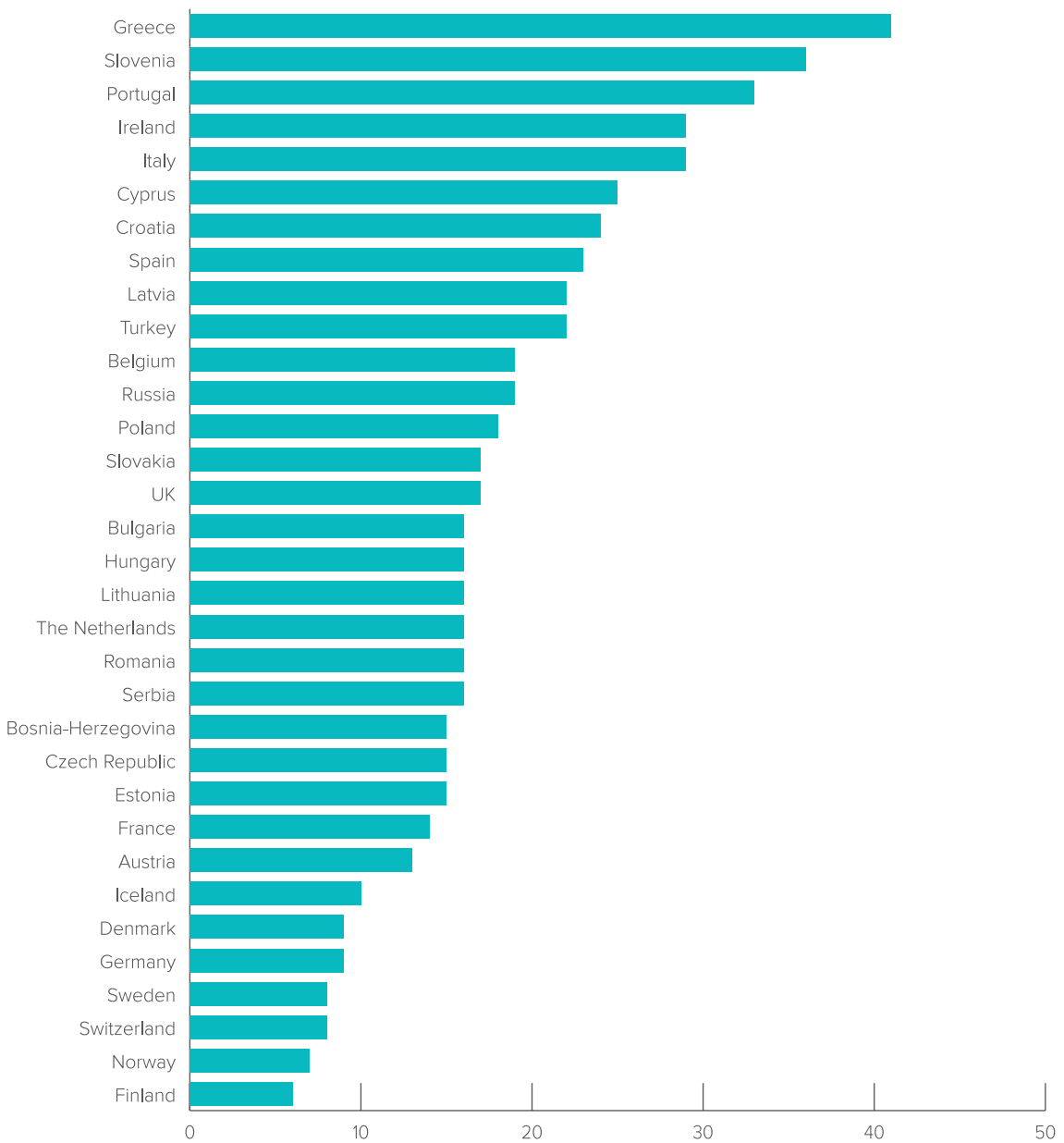
Figure Five: Types of organisations most likely to make late payments
Source: FSB late payment survey 2016



HOW DOES THE UK COMPARE TO OTHER COUNTRIES?

The European Payment Report from Credit Management Services group Intrum Justitia, contains detailed survey insights across a range of countries. As figure six below illustrates, there are wide variations in average B2B delays. Notably, the UK has longer average B2B delays than a significant number of European countries. The UK lags behind Germany, Switzerland and the Nordic countries. Compared with Germany, UK average B2B payment delays were eight days longer in 2014.

Figure Six: Average payment delay in days, 2014
Source: Intrum Justitia, Late Payment Report, 2015

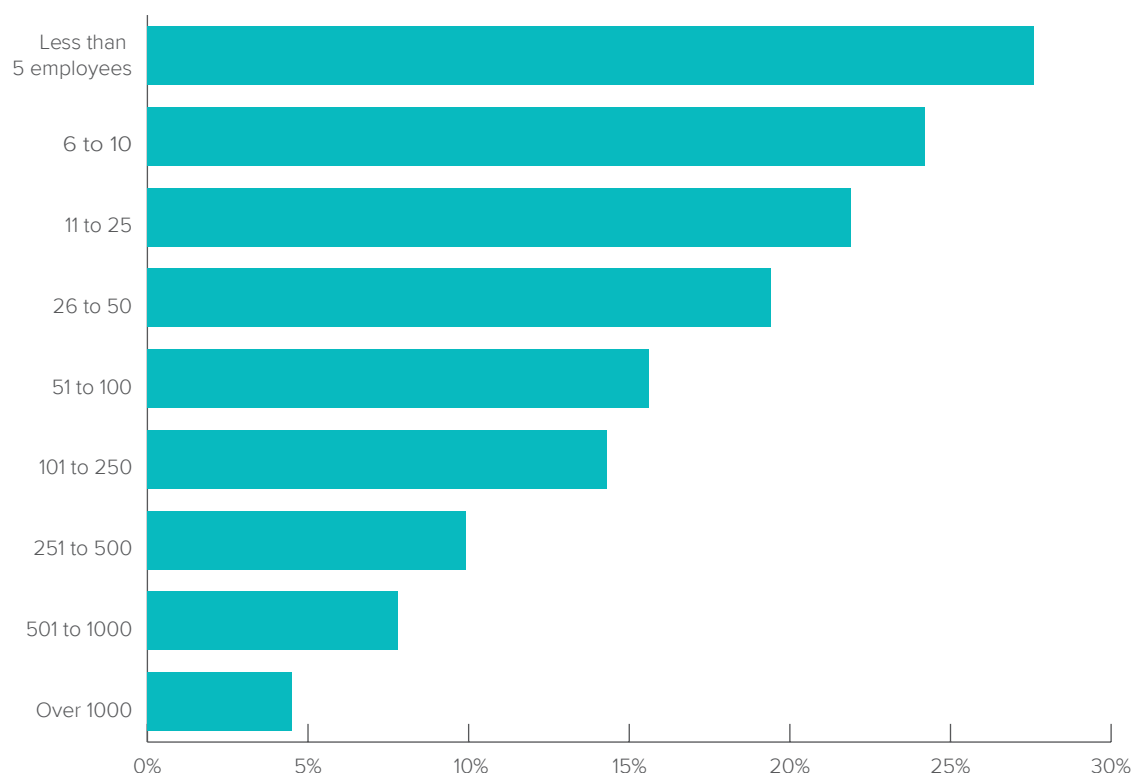


TRENDS IN SUPPLY CHAIN BULLYING

Having established the size and nature of the problem of late payment, we now turn to the abuse of supply chains, particularly that of larger companies towards smaller ones. Supply chain bullying has become increasingly prominent in the UK. The Dun & Bradstreet data below highlights prompt payment by employee size and how larger companies pay "in a much slower manner than their smaller counterparts". This indicates why the focus on poor payment practice is necessarily on B2B supply chains.¹⁴

Figure Seven: Prompt payment by employee size for March 2016

Source: Dun & Bradstreet, May 2016



Equally, data from the Association of Chartered Certified Accountants indicate that businesses with fewer than 50 employees are 50 per cent more likely than larger firms to experience poor supply chain practice.¹⁵ The reliance of trade credit for many small businesses means that the importance of retaining sufficient working capital to manage short-term obligations is becoming ever more challenging.

This resulting strain on supply chains is further complicated by the prevalence of poor contractual practices, such as unfair payment terms and breaches of contract. Such activity reduces the economic and financial resilience of small businesses and, in turn, diminishes their productivity and growth prospects. Small businesses often have less ability to contract and transact with customers and suppliers on the most advantageous terms because of a lack of equality in bargaining power.

FSB has undertaken recent research about small businesses' experiences of contract terms with suppliers of goods and services to their business¹⁶ (rather than small businesses acting as suppliers themselves). Although focused on the purchase of goods or services, it suggested that there is a significant problem in the power imbalances between small and larger businesses when agreeing contract terms.

¹⁴ Dun & Bradstreet, 'UK Quarterly Industry Report – Quarter 1', (May 2016), p.4.

¹⁵ ACCA, 'Ending late payment – Part 3: Reflections on the Evidence', (May 2015), p.7.

¹⁶ FSB, 'Unfair contract terms costing small firms billions', (22nd August 2016), <http://www.fsb.org.uk/media-centre/press-releases/unfair-contract-terms-costing-small-firms-billions>

The survey showed that over half (52%) of small businesses have suffered detriment as a result of supplier contract terms over the last three years.¹⁷ FSB estimates that 2.8 million small firms are likely to have experienced negative financial consequences due to supplier contract terms. As a result, small businesses faced additional costs of at least around £3.8 billion.¹⁸ This equates to nearly £1.3 billion a year, on average.

Although the table below again deals with contracts between small businesses and their suppliers, it still highlights how an imbalance in the relationship between small and large businesses may impact upon how contract terms are agreed.¹⁹

Figure Eight: The way in which the contract term that most negatively impacted the business was resolved

Source: FSB terms of contracts survey 2016

Resolution	% reporting this was the way it was resolved
The supplier/ provider was too big and powerful to challenge	30
Was resolved informally, but unsatisfactorily	18
Good grounds to challenge the provider/ supplier, but not enough time, money and resource to be able to do so	17
Didn't know how best to challenge the provider/ supplier, so the issue remained unresolved	17
Was satisfactorily resolved informally with the other party	11
Supplier/ provider was too important to the business to challenge	10
Informal advice enabled successful challenge before the problem escalated	3
External advice from expert advisors, such as accountant or lawyers, enabled satisfactory resolution before the issue escalated	3
Resolved using Alternative Dispute Resolution	2
Went to court	0.2

The data above suggest that differences in size and therefore, resources between contracting businesses is a significant issue alongside knowledge gaps. Thirty per cent of small businesses said that a failure to challenge contract terms was at least in part due to the asymmetry in market power between parties. A further 34 per cent would have liked to have challenged the other party, but did not have the knowledge or resources to do so.

¹⁷ FSB, 'FSB Response - Protections For Micro-Businesses In Non-Regulated Markets', (June 2016), p.7.

¹⁸ The figure of £3.8 billion was identified by using the estimate of the number of small and medium-sized businesses across the economy which are likely to have suffered negatively due to supplier contract terms and then multiplying that figure by each of the different percentages reported by respondents regarding the quantity of detriment of the instance of supplier contract terms that had the most negative impact on their business. This established an estimate of the number of small and medium-sized businesses that suffered detriment in each cost range presented in the survey. These numbers were then multiplied by the mid-point value in the different cost ranges to establish an estimate of the total quantum to small and medium-sized businesses in each cost range. Finally, these amounts were summed to give an estimate of the total detriment across the three years for the worst instances of detrimental supplier contract terms across the UK's small and medium-sized business community.

¹⁹ FSB, 'FSB Business Contract Terms Survey', (June 2016).

Small businesses suffer from a lack of bargaining power partly because they do not have the resources (time, knowledge, labour or capital) to dedicate to dealing with a dispute. Typically, in a small business, all resources are focused on sustaining and growing the business and in particular, maintaining cash flow. Spare resource is targeted at meeting key legal requirements, such as paying tax or regulatory compliance. Regulatory compliance alone costs a small business at least £6,000 a year.²⁰ Small firms are, therefore, often relatively unsophisticated when dealing with contractual issues and no better able to protect themselves than individual consumers.²¹

Relationship imbalances (including with larger businesses) in themselves do not cause supply chain bullying but they may be an important contributing factor. This results in vulnerabilities that are typically exposed in contractual relationships and commercial disputes around late payment.

In December 2014, FSB surveyed over 2,500 members on late payment and found that approximately one in five (17%) had faced supply chain bullying in one form or another over the past two years.²² The results indicated a serious deterioration of payment culture (and practices) beyond simply extended payment terms. As part of this survey, businesses were asked to give examples of the most common poor payment practices they had to deal with, including pay to stay. FSB used these examples to create a list of the five payment practices most resented by small firms, in use across the UK economy today:

1. Flat fees – “pay to stay”: also known as “supplier assessment charges” or “supplier investment payments”. These are flat charges which companies levy on suppliers, either as a requirement to be on a supplier list, or packaged as an investment into hypothetical future business opportunities. It is often indicated that non-payment will result in de-listing.
2. Excessively long payment terms – “pay you later”: many companies insist on payment terms of 90, or even 120 days. In effect, this becomes an interest free loan from firms in the supply chain to large companies with excessive payment terms.
3. Exceeding payment agreements – “late payment”: as well as insisting on long payment terms, many companies are routinely exceeding agreed terms, or changing terms retrospectively to allow them to miss agreed payment dates. Also thought to be common is the practice of extending payment dates if money is owed on, or close to, the end of a financial reporting date in order to smooth a big company’s balance sheet.
4. Discounts for prompt payment: prompt payment discounts are arbitrary discounts big firms give themselves for paying early, or even just on time. For example, a firm that has agreed to pay 120 days following receipt of an invoice may also apply an automatic discount of three per cent, if they pay on or before the 120th day.
5. Retrospective discounting: some firms seek to apply retrospective discounts to outstanding money owed to a supplier. This involves the company effectively changing the terms of the contract signed with the supplier after a contract has been agreed. Methods used to extract these vary, but include threats of de-listing, withholding payment, and previously unagreed discounts applied to specific volumes of business.

20 FSB surveyed 1,685 smaller business owners online between 17t-28t February 2016. Sixty-nine per cent of respondents were in the category of 0-4 employees; 16 per cent had 5-9 employees; 9 per cent had 10-19 employees; and 5 per cent had 20 or more employees. The calculations were based made assuming a typical 227 working days per year and a 40-hour working week. This figure was calculated by multiplying the 840 hours annual hourly burden by the £7.20 National Living Wage. It suggests an annual burden equivalent to £6,048.

21 Fletcher, A., Karatzas, A. and Kreutzmann-Gallasch, A., ESRC Centre for Competition Policy & FSB, ‘Small Businesses as Consumers: are they sufficiently well protected?’, (January 2014), p.7.

22 FSB, ‘Supply chain bullying affects almost one in five small businesses says FSB’, (22 July 2015), <http://www.fsb.org.uk/media-centre/press-releases/supply-chain-bullying-affects-almost-one-in-five-small-businesses-says-fsb-pr-2014-41>

Corporate governance

One key debate which must be used to more effectively tackle supply chain bullying is corporate governance. The Companies Act 2006²³ states that a company has an overarching duty to take account of a range of stakeholders in making decisions in promoting its success:

- “(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to.*
- (a) the likely consequences of any decision in the long-term.*
 - (b) the interests of the company’s employees.*
 - (c) the need to foster the company’s business relationships with suppliers, customers and others.*
 - (d) the impact of the company’s operations on the community and the environment.*
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct.*
 - (f) the need to act fairly as between members of the company.”²⁴*

It is clear from our evidence that many large companies are failing to meet these responsibilities to their suppliers.

The Financial Reporting Council, which is responsible for promoting high quality corporate governance, noted in a July 2016 report that “a challenge for companies is how to ensure that supplier culture and behaviour meet the standards that apply within their own group.”²⁵ However, it also noted that “this can be difficult” because suppliers, “may have their own set of values and working methods and they may be supplying a number of different companies, each with its own set of requirements”.²⁶ This can be addressed by larger companies formalising their engagement with smaller suppliers and thereby proactively addressing any issues with poor payment practices.

Meanwhile, an important power at the SBC’s disposal will be its ability to name and shame large companies responsible for poor payment practice. This will provide the SBC with the potential to generate positive influence and awareness of supply chain bullying across the business community. Raising awareness of the prevalence of supply chain bullying and the consequences for small businesses is important. Publicly highlighting bad practice can result in behavioural change from companies, as there has been in recent years following revelations and media coverage of tax evasion and aggressive avoidance by businesses in recent years. Equally, the SBC must also use its powers to “name and praise” good practice and highlight positive examples where appropriate.

²³ Companies Act 2006, <http://www.legislation.gov.uk/ukpga/2006/46/contents>

²⁴ Companies Act 2006, Section 172, <http://www.legislation.gov.uk/ukpga/2006/46/contents>

²⁵ Financial Reporting Council, ‘Corporate Culture and the Role of Boards - Report of Observations’, (July 2016) p.30.

²⁶ Ibid.

WHAT IS THE ECONOMIC IMPACT OF POOR PAYMENT PRACTICES?

There are many reasons to expect why late payments have a negative impact on the real economy. Firstly, restricted cash flow limits the ability of businesses to expand and invest. Furthermore, it increases the chance of financially vulnerable firms failing. Poor payment practices may also increase risk aversion among businesses, leading to higher rates of precautionary saving and lower rates of investment, which diminishes their own productivity and that of the UK economy more generally.

The European Commission's report, *The Economic Impact of Late Payments*, addresses the economic effect of late payments by approximating the possible financial cost for firms and by estimating the empirical link between late payments and the exit rate of firms.²⁷ The research considers B2B transactions and focuses on four EU countries – Italy, Spain, Portugal and Greece – where late payments are a particularly big problem. However, the econometric analysis in the research uses a broader set of EU member states and thus, the results can be extended to other countries.

The research confirms that higher levels of late payment lead to a greater exit or death rate for firms within countries, by exacerbating the burden of already financially-constrained firms, which can ultimately, push them out of business. The increase in business failure rates has a subsequent impact on GDP within a country.

The estimated impacts are significant. The European Commission's research considered the extent to which company exit rates change as payment delay ratios change. Payment delay ratios are expressed as the absolute duration of delay, in days, with regards to the agreed payment terms. This therefore reflects the different contractual terms observed across countries. For B2B transactions, the research estimates that a one point reduction in the payment delay ratio, will reduce exit rates by between 2.8 and 3.4 percentage points.

Research by the International Monetary Fund (IMF)²⁸ also identifies a link between late payment and economic performance in the private sector. The research shows that payment delays appear to reduce profits, increase the likelihood of formal insolvencies and reduce economic growth. The report states that the size of the impacts is hard to pin down as they vary across econometric model specifications. However, the results on the size of the impact are statistically significant in most specifications. A one-standard deviation increase in delayed payments is estimated to reduce profit growth by between 1.5 to 3.4 percentage points.

²⁷ Connell, W., European Commission, 'Economic Impact of Late Payment', (September 2014).

²⁸ IMF, 'Governments' Payment Discipline: The Macroeconomic Impact of Public Payment Delays and Arrears', (March 2015).

NEW ESTIMATES OF THE IMPACTS ON THE UK ECONOMY

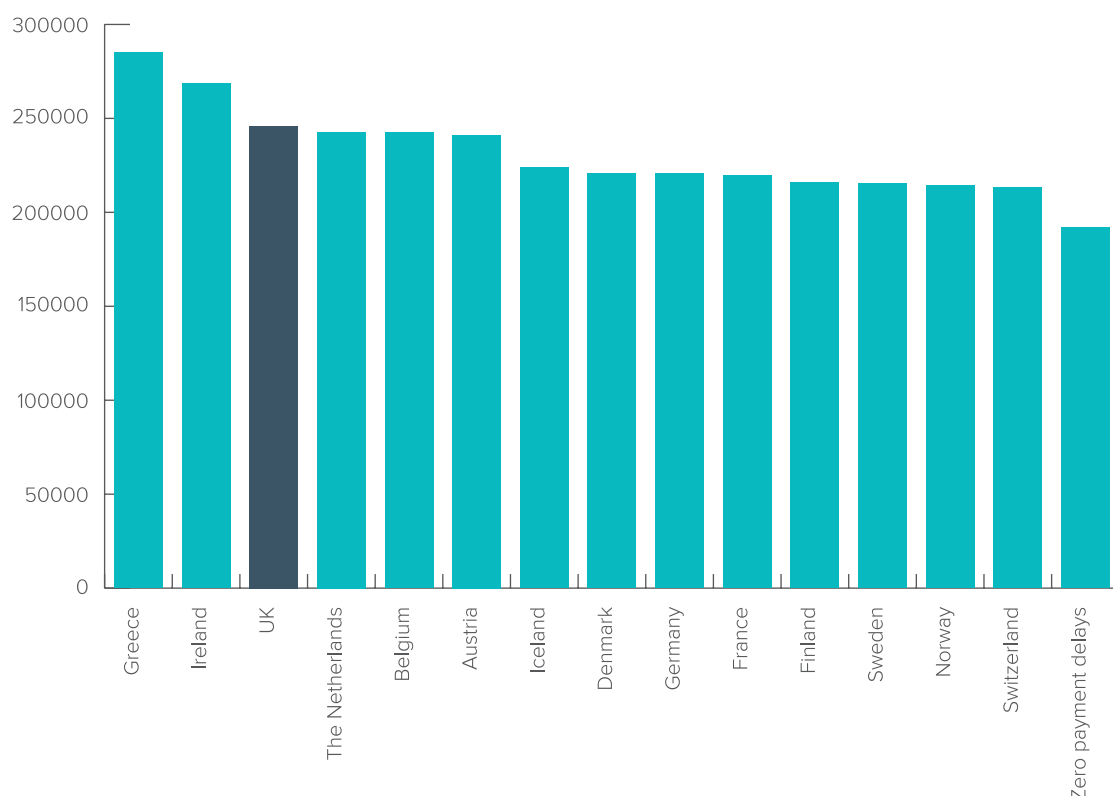
Based on the relationship between payment delay ratios and business failure rates estimated in the European Commission study, we have considered the potential economic benefits to the UK from having lower typical payment delays. In particular for the purpose of benchmarking, we have considered the extent to which business failure rates would be lower, in the event of payment delay ratios matching those seen in other countries.

We estimate that if the UK had the same payment delay ratio as Germany, the business death rate would fall by about one percentage point. Office for National Statistics (ONS) data estimates the death rate stood at 9.6 per cent in 2014, amounting to 246,000 businesses.²⁹ A one percentage point decline in the death rate would imply about 25,000 fewer business deaths in that year – a significant 10 per cent reduction in the number of businesses failing. If the UK had the same payment delay ratio as Switzerland, the European country with the lowest payment delay ratio, according to Intrum Justitia, then the number of business failures would have been 33,000 lower – a reduction of 13 per cent. A situation with zero payment delays in the UK is estimated to lead to a 22 per cent reduction in the number of business deaths, which, in 2014, would have equated to over 50,000 companies staying in business.³⁰

On the other hand, a deterioration in the UK's payment culture would lead to more business failures. We estimate that in 2014, there would have been close to 40,000 more business failures if the UK had the same payment delay ratio as Greece – an increase of 16 per cent.

Figure Nine: Number of UK business deaths, compared to hypothetical scenarios with payment delay rates, seen in other countries

Source: Office for National Statistics, 2014

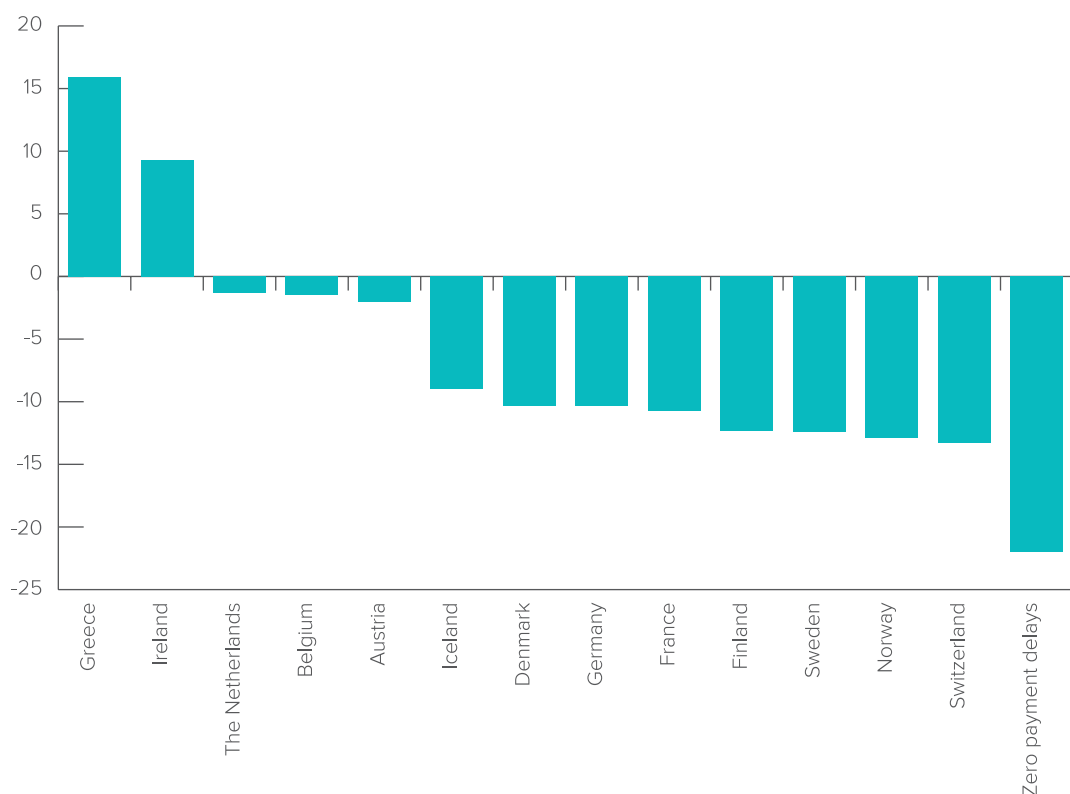


²⁹ Office for National Statistics, 'Business Demography: 2014', (24 November 2015) <http://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/bulletins/businessdemography/previousReleases>

³⁰ To construct these estimates, we first used previously cited Intrum Justitia data on payment terms and delays to estimate the payment delay ratio in each market and how the UK compares with other countries. Given the relationships between payment delay ratios and business deaths identified in the previously cited European Commission research, we were then able to estimate the change in business failures in the UK arising from higher or lower payment delay ratios.

Figure Ten: Estimated per cent change in number of UK business deaths from the UK having the same payment delay ratio as other countries

Source: Office for National Statistics, 2014



The findings of the analysis above align with past research that has been undertaken. Research by R3, the Association of British Recovery Professionals, found that late payments cause 20 per cent of insolvencies in the UK, which is broadly what our analysis above, based on the European Commission research, suggests.³¹ If the UK's payment delay ratio fell to zero, the relationship identified in the European Commission research, suggests there would be a 22 per cent decline in business deaths.

The impact of business failures on economic output (as measured by gross value added, "GVA") is somewhat difficult to quantify as we do not have data on the financial situation and size of the businesses that failed due to late payment problems. However, the order of magnitude is likely to be significant. Based on a median registered business turnover of about £150,000, according to the Department for Business, Energy and Industrial Strategy's business population estimates, we have considered the overall economic impact in terms of GVA lost.³²

Our calculations suggest the reduction in business failures from the UK having a German rate of payment delay, could have led to a direct GVA uplift of approximately £1.2 billion in 2014. The order of magnitude of the gains is thus significant, even without considering other effects, such as higher rates of investment and expansion by businesses. If the UK had the same payment delay ratio as Switzerland, then the gains rise to £1.5 billion while a situation with zero payment delays leads to a £2.5 billion GVA uplift.

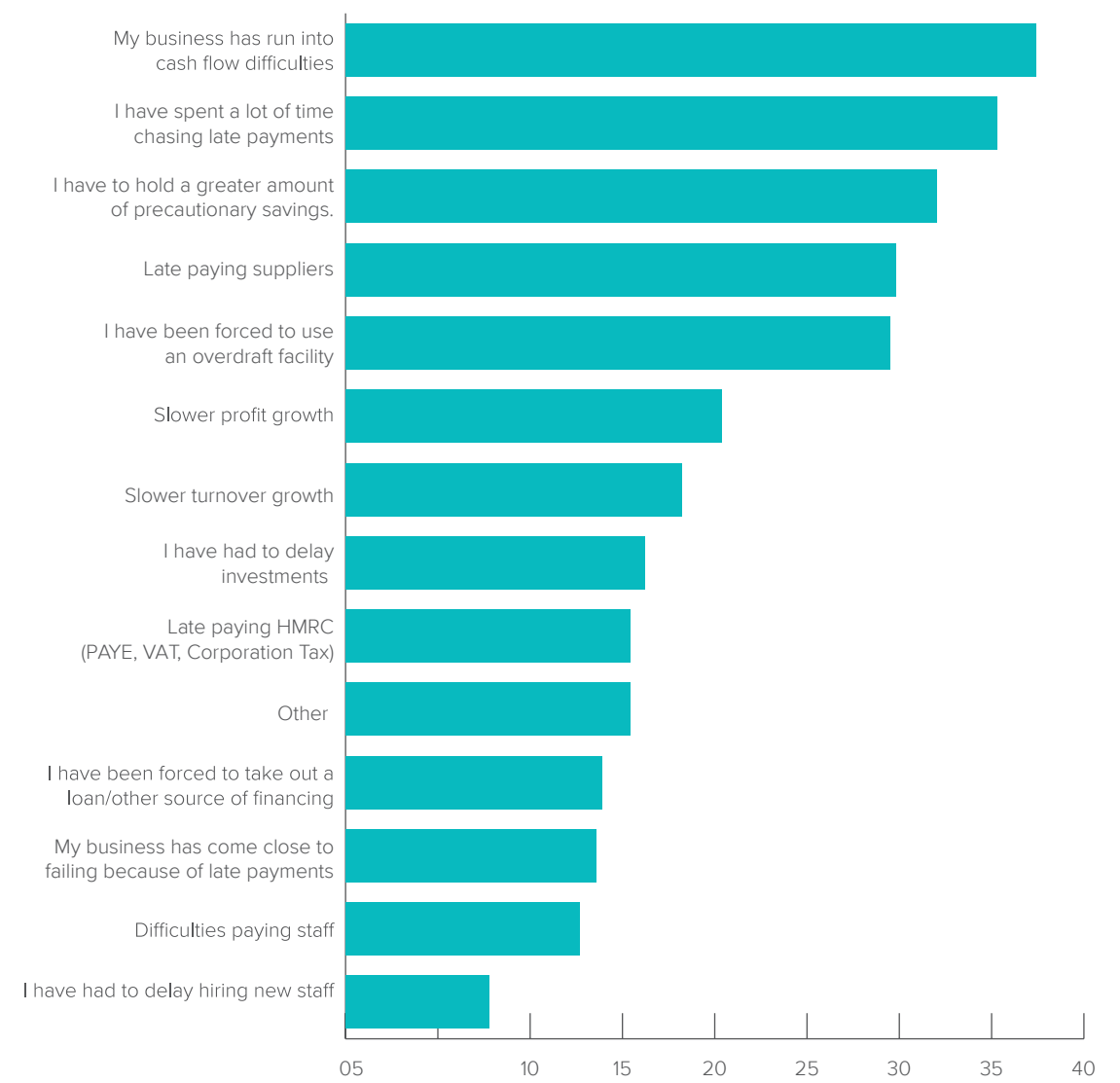
³¹ R3, 'Late Payment causes 20 per cent of insolvencies', (11 April 2014) <https://www.r3.org.uk/index.cfm?page=1114&element=19763>

³² We also use data in the ONS Annual Business Survey on the turnover-to-GVA ratio. Across all non-financial businesses, GVA was 30.5 per cent of turnover in 2014.

THE IMPACT OF LATE PAYMENT ON SMALL BUSINESSES

In FSB’s research, small businesses were asked to state the impact of late payments on their business and the survey results show a wide range of economic impacts (as figure eleven illustrates). Some 37 per cent of small businesses said they had run into cash flow difficulties as a result of late payments, while 35 per cent said they spent a lot of time chasing late payments.³³ Close to a third (32%) of small businesses stated they have had to hold a greater level of precautionary savings, suggesting that lower levels of late payment could unlock these savings and generate more investment in the economy.³⁴

Figure Eleven: What has been the impact of late payments on your business?
Source: FSB late payment survey 2016



33 FSB, 'Late Payment Survey', (August 2016).
34 Ibid.

In addition to these costs, there are costs associated with reduced business performance. Thirty-seven per cent have faced difficulties with cash flow. About a fifth of small businesses reported lower profit growth as a result of late payments, while 16 per cent have had to delay investments and eight per cent have delayed hiring new staff – suggesting a clear impact on productivity growth and economic performance.

KEY FINDINGS

Late payment results in:

- A fifth of small businesses experiencing lower profit growth.
- 16 per cent have delayed business investment.
- Eight per cent of small firms have delayed hiring new staff.
- Three in 10 small firms paying their own suppliers late.

Our research also suggests that late payment to small businesses creates further instances of late payment. Three in ten small businesses said that late payment made them late in paying their own suppliers, thereby creating a vicious circle.

Some of these costs can be quantified. Our survey revealed that businesses devote, on average, 1.2 whole days per month to chasing late payments. Based on data on the average hourly wage paid to financial administration staff from the ONS Annual Survey of Hours and Earnings, we estimate that the per year time cost of chasing late payments is about £1,524 per annum per small business. Across all small businesses the aggregate time cost stands at about £8 billion.

In addition, the impact on profit growth can be estimated by combining the results of our survey with the findings in the IMF paper referenced earlier, on the impact of late payments on profit growth. We estimate that, if small businesses did not face late payments this year, profit growth in 2016 would be 2.6 percentage points higher. This would translate into a £4.8 billion uplift in small business profits, reflecting higher levels of turnover and reduced costs, including overdraft and loan charges.³⁵

³⁵ Note that this is lower than the £8 billion time saving estimate from having no late payments, reflecting the fact that staff currently devoting time to chasing late payments are unlikely to be removed from the payroll. Instead, their time might be devoted to other, more productive, activities.

UK POLICY AND INDUSTRY INTERVENTIONS AROUND LATE PAYMENT

The below provides a brief summary of relevant interventions – both from government and industry – that have been taken forward to address the problem of late payment.

Statutory right to interest

In 1994, the Department for Trade and Industry consulted on a range of options regarding addressing late payment, including legislation for a statutory right to interest and a British Standard for prompt payment.³⁶ However, it was not until 1998 that legislation for a statutory right to interest actually came into force through the Late Payment of Commercial Debts (Interest) Act.³⁷

The legislation eventually enabled all businesses and the public sector “to claim interest from all businesses and the public sector on debts incurred under contracts agreed after that date.”³⁸ The Act created a default payment period of 30 days (unless an alternative payment term was contractually agreed between debtor and supplier) after which interest would apply. The interest rate was calculated by adding the “statutory” rate of eight per cent to the current Bank of England Base Rate. The measure was not a compulsory one, with the decision up to the supplier as to whether to claim for interest following a late payment.

This was followed in June 2000, by an EU Late Payments Directive on combating late payment in commercial transactions (2000/35/EC), which required EU Member States to introduce a statutory right to claim interest and effectively expanded the scope of the existing UK legislation.³⁹ It was modernised in February 2011 through a new Directive (2011/7/EU) of the same name. This was to be integrated into law by March 2013 across all EU countries.

The Directive applied the statutory right to claim interest to all commercial transactions and public authorities, set at eight per cent plus the local currency Base Rate (as with the original UK legislation). In addition, it entitled the creditor to increased fixed compensation for recovery costs (first introduced in the 2000 Directive) of £40, £70 or £100, “depending on the size of the debt (under £1,000, under £10,000, and higher) plus additional reasonable costs incurred”.⁴⁰

At present, despite the costs to business performance identified in the previous chapter, take up of this measure has been very low. About 80 per cent of small businesses do not charge interest on overdue invoices.

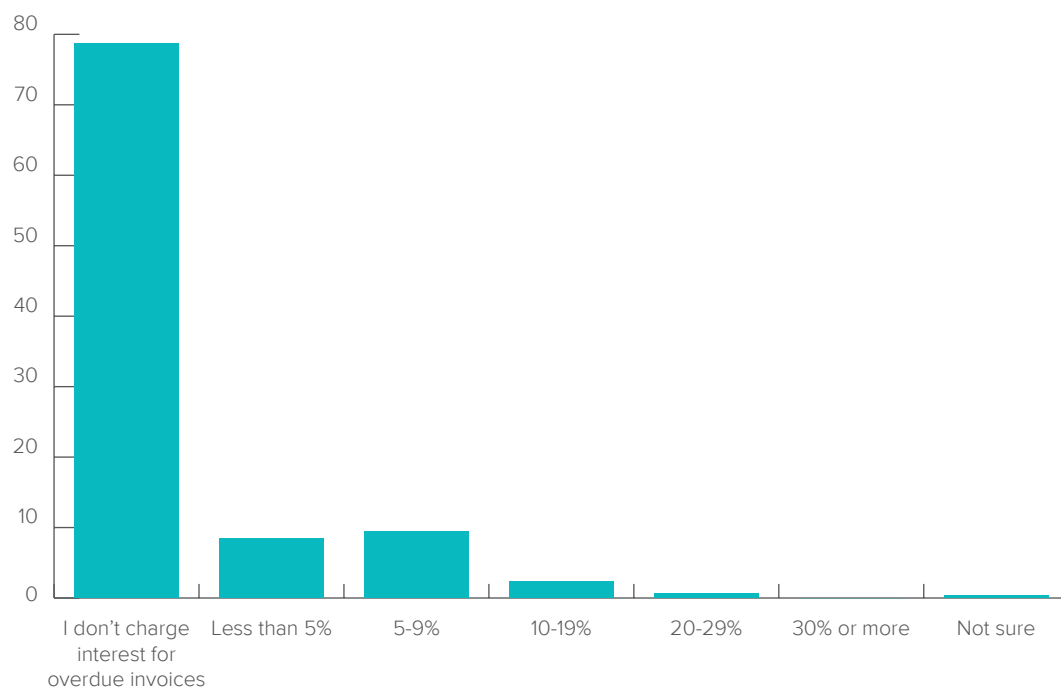
³⁶ Edmonds, T., ‘Late Payment of Debts – House of Commons Library Briefing Paper’, (20 July 2015), p.5.

³⁷ The legislation was updated in 2002.

³⁸ Edmonds, T., ‘Late Payment of Debts – House of Commons Library Briefing Paper’, (20 July 2015), p.9.

³⁹ European Commission, ‘Opinion of the Commission pursuant to Article 251(2) (c) of the EC Treaty, on the European Parliament’s amendments to the Council’s common position regarding the proposal for a Directive of the European Parliament and of the Council on combating late payment in commercial transactions’, (3 August 2000), <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex:52000PC0133>

⁴⁰ Department for Business, Innovation and Skills, ‘A Users Guide to the recast Late Payment Directive’, (October 2014), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/360834/bis-14-1116-a-users-guide-to-the-recast-late-payment-directive.pdf

Figure Twelve: What annual rate of statutory interest do you charge on overdue invoices?**Source:** FSB late payment survey 2016

Prompt Payment Code

In 1996, the Conservative Government moved to require all Whitehall departments and agencies to sign up to the Confederation of British Industry's PPC.⁴¹ This voluntary, business-led initiative, required signatories to adhere to a series of initiatives that promoted positive payment and supply chain practice. In addition, signatories provided regular information on their own policies, including payment terms.

In 2008, a new PPC was established by the Chartered Institute of Credit Management on behalf of the Government. The Code covers prompt payment, as well as wider payment procedures, including promoting and sharing best practice. A new Code Compliance Board was also created, partly to investigate challenges made towards signatories by suppliers and to take appropriate action if there is evidence of non-compliance.

As of 3rd October 2016, the PPC currently had 1,857 signatories across the business community of which 137 are FTSE 350 companies.⁴² However, concerns have been raised as to whether the Code has led to better payment practice. There have been claims that some companies, prior to signing up, "increased their payment terms in some cases without negotiation or notice, and by up to 3 times previous contract terms (e.g., 25 to 75 days)".⁴³ In October 2012, the former Minister of State for Skills and Enterprise, the Rt Hon Matthew Hancock MP, wrote to all those FTSE 350 companies not already signed up to the PPC, encouraging them to do so. As of January 2013, approximately 54 had signed up.⁴⁴

Following a Number 10 Summit convened by FSB in February 2015, Mr Hancock confirmed new changes to the PPC. Importantly, the Code set a 30-day payment term target for all signatories to work towards, with a maximum limit of 60 days.

⁴¹ Edmonds, T., 'Late Payment of Debts – House of Commons Library Briefing Paper', (20 July 2015) p.6.

⁴² Prompt Payment Code. http://ppc.promptpaymentcode.org.uk/ppc/signatory_paged.a4d

⁴³ Abrahams, D., 'The report from the all-party inquiry into late payments to small and medium-sized enterprises', (July 2013), p.7.

⁴⁴ Kamel, A., 'FTSE 100 firms sign up to Prompt Payment Code', (2 March 2013) <http://www.telegraph.co.uk/finance/businessclub/9904803/FTSE-100-firms-sign-up-to-Prompt-Payment-Code.html>

The EU Late Payments Directive

With the aim of protecting European businesses, in particular small businesses, against late payment and to improve their competitiveness, Directive 2011/7/EU on combating late payment in commercial transactions was adopted on 16 February 2011. It has gradually been integrated into the laws of EU member states. The main provisions of the directive are:

- Public authorities have to pay for the goods and services that they procure within 30 days or, in very exceptional circumstances, within 60 days.
- Enterprises have to pay their invoices within 60 days, unless they expressly agree otherwise and provided it is not "grossly unfair".
- Automatic entitlement to interest for late payment and €40 minimum as compensation for recovery costs.
- Statutory interest of at least eight per cent above the European Central Bank's base rate.
- EU countries may continue maintaining or bringing into force laws and regulations which are more favourable to the creditor than the provisions of the Directive.

Despite the objectives of the Directive, evidence suggests that it does not go far enough in ending the problem of late payments. Only 20 per cent of companies say that they have seen a positive effect from the Directive.⁴⁵

Furthermore, a European Commission impact assessment has also found a mixed impact from the legislation and notes that a wide range of other factors, such as national business culture, economic conditions and power imbalances, are key determinants of payment culture:

"There is little evidence that the Directive has had an impact on payment behaviour and the practice of late payment to date. Furthermore, exercise of the rights conferred by the Directive is not widespread due to fear of damaging good business relationships. Rather than legislation, business culture, economic conditions and power imbalances in the market are the driving factors of payment behaviour".⁴⁶

Ultimately, this suggests that fully addressing the problem will require a broader range of policy measures.

Reporting & Payment Terms

The Directive is explicit in its requirements to EU member states on B2B payment terms. The period for B2B payment fixed in the contract should not exceed 60 calendar days, unless otherwise expressly agreed in the contract and provided it is not grossly unfair to the creditor. It should, therefore, remain possible for parties to agree on payment periods longer than 60 calendar days, provided such extension is not grossly unfair to the creditor.

However, ambiguity still persists on the Directive's reference to a 60-day maximum for B2B payment terms, "provided it is not grossly unfair to the creditor". EU member states have interpreted "grossly unfair" differently in their implementation of the Directive. Following concerns raised from a number of representative bodies, the former Coalition Government acknowledged there was "support for further definition of the term". It added, "further work is required to investigate how successful such a change would be".⁴⁷

⁴⁵ Intrum Justitia, 'European Payment Report 2016', (May 2016), p.3.

⁴⁶ European Commission, 'Ex-post evaluation of Late Payment Directive', (2014), p.6.

⁴⁷ Department for Business, Innovation and Skills, 'Late Payment: Challenging 'Grossly Unfair' Terms', (October 2015), p.5.

Groceries Code Adjudicator

The UK Groceries Code Adjudicators Act 2013 was passed in order to ensure supermarkets act fairly towards their suppliers and address adverse effects on competition around supply chain practices, particularly with regards to anti-competitive behaviour conducted on behalf of larger grocery retailers.⁴⁸ The resulting Groceries Code Adjudicator (GCA) has powers to investigate complaints, conduct arbitration in disputes and to enforce the Groceries Supply Code of Practice (the Groceries Code), which covers the UK's 10 largest supermarkets. As with the new SBC, the GCA also has name and shame powers.

In January 2016, the GCA found Tesco to be in serious breach of the Groceries Supply Code of Practice. It found Tesco had made unilateral deductions from suppliers, taken an unacceptable length of time to pay suppliers and in some cases, intentionally delayed payments.⁴⁹ Tesco subsequently apologised and changed its payment terms to suppliers,⁵⁰ highlighting the importance of name and shame powers.

Duty to Report

The Small Business Act 2015 requires “certain companies to publish information about their payment practices”. It also introduces a Duty to Report payment information for the UK's largest companies.⁵¹ Such companies will be required to submit the following metrics:

- standard payment terms, including any changes to these in the last reporting period.
- average time taken to pay.
- proportion of invoices paid beyond agreed terms.
- proportion of invoices paid in 30 days or less; paid between 31 to 60 days; and paid beyond 60 days.
- amount of late payment interest owed and paid.
- whether financial incentives were required to join or remain on supplier lists.
- dispute resolution processes.
- the availability of: e-invoicing, supply chain finance, preferred supplier lists.
- membership of a Payment Code.⁵²

This information will be submitted to a digital register, published on a six-monthly basis and made publicly available by the Government. A phased implementation is expected to be launched from April 2017.

Small Business Commissioner

The Enterprise Act 2016 contained measures to establish an SBC to enable small businesses to resolve disputes and avoid future issues through the provision of general advice and information, related to dispute resolution and contract principles. The Government has detailed the SBC's responsibilities as follows:

1. Provide general advice and information related to supply relationships and focus on dispute resolution and contract principles.

⁴⁸ Groceries Code Adjudicator Act 2013, <https://www.gov.uk/government/organisations/groceries-code-adjudicator>

⁴⁹ Groceries Code Adjudicator, 'Groceries Code Adjudicator Investigation into Tesco plc', (26 January 2016).

⁵⁰ FSB, 'Report finds Tesco deliberately delayed payments to suppliers', (26 January 2016) <http://www.fsb.org.uk/media-centre/latest-news/2016/01/26/report-finds-tesco-deliberately-delayed-payments-to-suppliers>

⁵¹ Enterprise Act 2016, <http://www.legislation.gov.uk/ukpga/2016/12/contents>

⁵² Department for Business, Energy and Industrial Strategy and The Rt Hon Matt Hancock MP, 'Prompt payment: implementing the duty on large companies to report on payment practices and policies – Written Ministerial Statement', (20 March 2015) <https://www.gov.uk/government/speeches/prompt-payment-implementing-the-duty-on-large-companies-to-report-on-payment-practices-and-policies>

2. Signposting to appropriate services, e.g. sector ombudsmen, regulators, existing independent advice services, approved alternative dispute resolution (ADR) providers, FSB member services, Chartered Institute of Credit Management or the SBC's own complaints handling function.
3. Consider complaints by small business suppliers about payment matters arising with larger businesses which they supply.⁵³

The SBC should have a key role in developing a culture of good commercial contracting and business practice aimed at reducing the incidence of disputes. Additionally, the SBC should also have role in enabling early informal resolution.

There are a number of other areas below where the SBC could add further specific benefits:

- supporting businesses to resolve emerging disputes by upskilling business owners and managers in relationship management, negotiation and conciliation skills.
- raising awareness of Alternative Dispute Resolution (ADR) amongst the small business community by offering both basic general advice on the differences between types of ADR and more tailored advice and guidance on what might be most appropriate given the particularities of a specific dispute.
- become the hub for signposting to different individual providers of commercial ADR services, such as the Ministry of Justice's (MoJ) 'Find a Civil Mediation' provider online directory service.

Australia and the role of Small Business Commissioners

The concept of the SBC was originally based on a model that has existed in the Australian state of Victoria since 2003. However, the associated SBC Act states the purpose of the Victoria model is "to enhance a competitive and fair operating environment for small businesses".⁵⁴ As such, broad powers and functions were established and there was no specific focus on late payment, unlike with the UK proposals. Similar SBC models now exist in every state across Australia, as well as at federal level.

The 2014-15 Annual Report for the Victoria SBC highlighted an 81.7 per cent success rate of settling cases at mediation.⁵⁵ The customer satisfaction rate with the service stood at 94.7 per cent.⁵⁶ This suggests the use of name and shame powers on behalf of Australia's SBC model, has also been effective in encouraging dispute resolution on late payment.

Furthermore, SBCs have been granted additional powers in recent years, which enable them to more thoroughly discourage late payments and unresponsiveness by larger companies in resolving disputes. The number of businesses refusing to respond to calls for mediation and dispute resolution fell following amendments to the Small Business Commissioner Act in May 2014, which helped improve cooperation. SBCs can now issue a certificate to say that a party has engaged with mediators, or refused to do so. If a party is judged to have unreasonably refused, they will be named in the SBCs' annual reports to Parliament. In Victoria, the proportion of applications where the respondent party has refused to engage with the Victoria SBC fell from 14.9 per cent in 2013-14 to 5.2 per cent in 2014-15, suggesting that the threat of reputational damage can be a powerful way of encouraging large businesses to resolve payment disputes.

In contrast, the UK Government is in the process of establishing a single SBC to represent its entire 5.5 million-strong small business community. According to the UK Government's impact assessment, the SBC is expecting to handle only "500 complaints a year".⁵⁷ Meanwhile, the SBC's website "is expected to handle "enquires on 390,000 disputes from 70,000 businesses".⁵⁸ The Government has also concluded that "there is little evidence that intervention is required in the market" for the SBC to offer mediation itself. Instead, it will "signpost to existing dispute resolution providers, rather than offer services in-house".⁵⁹

⁵³ Department for Business, Innovation and Skills, 'Enterprise Bill – A Small Business Commissioner', (26 July 2015).

⁵⁴ Parliament of Victoria, 'Small Business Commissioner Act 2003', (2003), p.3.

⁵⁵ Victorian SBC, 'Annual Report 2014-15', (September 2015), <http://www.vsbcc.vic.gov.au/wp-content/uploads/2015/10/vsbcc-Annual-Report-2014-15.pdf>

⁵⁶ Ibid.

⁵⁷ Department for Business, Innovation and Skills, 'Small Business Commissioner Impact Assessment', (11 September 2015), p.2.

⁵⁸ Ibid.

⁵⁹ Ibid.

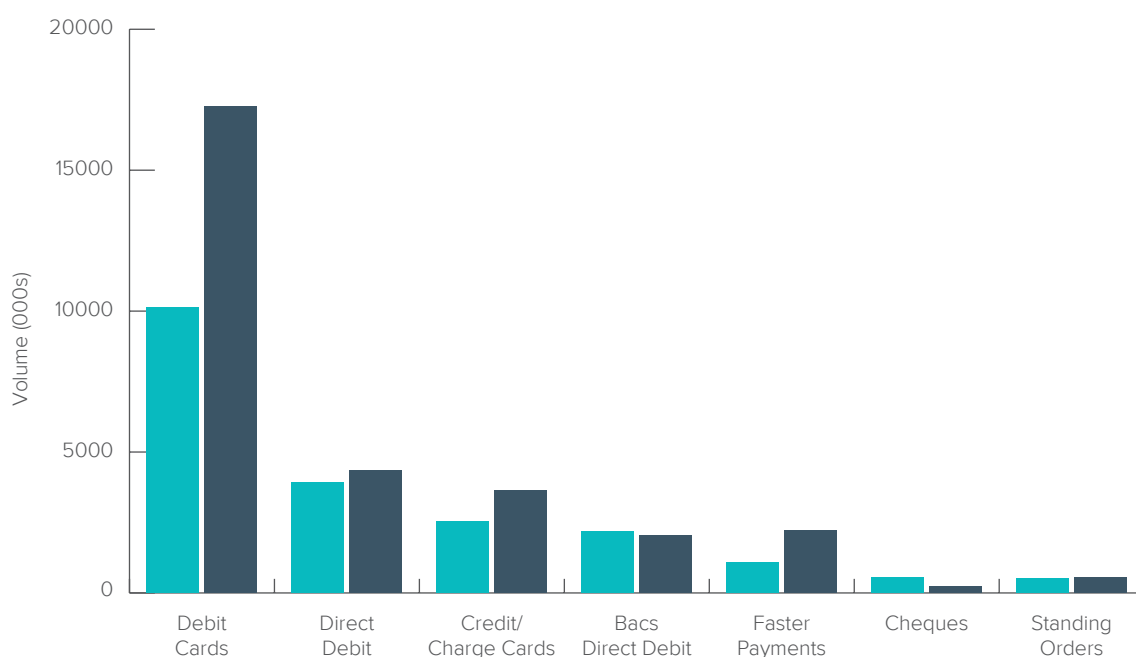
Existing UK and EU policy interventions have been insufficient in tackling poor payment practices, as well as the overall payment culture. This is partly due to the failure of existing initiatives to work towards developing a cohesive framework in addressing these issues. For example, whilst the right to charge statutory interest is welcome, such initiatives have done little in and of themselves to address broader issues around late payment. Therefore, a greater focus on initiatives which address payment culture will be important in the future.

THE POTENTIAL IMPACT OF TECHNOLOGY ON LATE PAYMENT

Payments systems are the centre point of how businesses and consumers make and receive payments as well as purchasing the goods and services they require to operate. It is also the infrastructure between banks, building societies and other financial institutions where accounts are held, that facilitate monetary transactions between one another. The role of technology has not been largely considered in the policy debate around late payment.

The importance of payments technology is of further significance given the fact that cash payments are in relative decline. Figures from Payments UK indicate that such cash has now fallen to under just half of all payments made in the economy, with the UK one of the highest non-cash users in Europe.⁶⁰ Whilst cash remains important, the opportunities for small firms to take advantage of new payment methods is considerable.

Figure Thirteen: Payment methods: now and in the future
Source: Payments UK, 2016



Many small businesses will continue to use physical currency and cheques to both run their business and interact with services such as banking. A good number of small businesses, particularly in rural areas, also face difficulties in using new payments technology and online banking services due to poor access to reliable broadband.⁶¹

The EU's Second Payments Services Directive (PSD2) is currently being transposed into UK law. Proponents of the legislation note it could make access to digital payment services easier, thereby allowing businesses which have previously relied on cash to recognise the benefits. PSD2 seeks to promote digital payment services by boosting competition and encouraging choice. It will enable Account Information Service Providers (AISPs) to sit between, for example, a bank and a business, and collate information from a number of sources into a single point, such as different bank accounts held by the business. This will potentially allow businesses flexibility and control over managing their payments.

⁶⁰ Payments UK, '2015 UK Payment Statistics', (June 2015).

⁶¹ FSB, 'Reassured, Optimised, Transformed: driving digital demand among small businesses', (September 2015), p.26 [http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-telecoms-report---september-2015\(2\).pdf?sfvrsn=0](http://www.fsb.org.uk/docs/default-source/Publications/reports/fsb-telecoms-report---september-2015(2).pdf?sfvrsn=0)

Below are some examples of where technology could potentially play a more prominent role in addressing the problem of late payment in the future.

Request to Pay

One example of technology PSD2 is indirectly helping to facilitate is Request to Pay. Not a product in itself, but a feature likely to be integrated into future accountancy and payment mechanisms, Request to Pay will allow businesses and consumers more control over how to create and send payment requests. It could also enable recipients of such requests to decide how to respond to a payment. Such technology holds the potential to reshape existing relationships between business debtors and suppliers. As PaymentsUK explains, on receiving a Request to Pay, a payer could “opt to respond either by making an immediate payment or by scheduling one or more payments to be made at a later date”.⁶² One of the challenges of rolling out Request to Pay will be ensuring small businesses have access to the Internet and understand how the service works.

Faster Payments

The Faster Payments Service, launched in May 2008, is a UK real time payment system that enables individuals, businesses and the Government to make payments up to the value of £250,000.⁶³ It can be used for making immediate or one-off payments, as well as arranging forward-dated payments.

Payments made via this system have obvious benefits for micro and small businesses as a future de facto method of payment, as payments can be received – and, crucially, credited to a bank account – far quicker than they would be through other means. This has obvious benefits towards providing greater certainty of cash flow. In contrast, credit card payments are immediate for the payer, but not for the payee – it can take up to three days to receive the funds in a bank account; cheques take up to five days to clear once deposited; and Direct Credit payments take three days to clear in an account once the payment is initiated.

Cheque Imaging

Many small businesses are still paid by cheque, despite many being negatively impacted by the long clearing cycle, thereby creating challenges around their liquidity. Approximately 640 million cheques are still written in the UK every year.⁶⁴ Recent changes to UK legislation have allowed banks to move away from paper-based clearing systems for cheques to images of cheques, typically taken on a smartphone, allowing digital processing to take place. This will reduce the time taken to clear funds, allowing for businesses to receive payment far quicker, thereby potentially helping to maintain a more stable cash flow.

Current B2B supply chains where payment is made with cheques can take up to six working days to clear. Cheque imaging will allow the clearing process to move to the next working day. It works by the business taking a photo of their cheque via a secure mobile banking app or, alternatively, using scanning equipment provided by their bank.⁶⁵

62 PaymentsUK, ‘A vision for World Class Payments in the UK’, (March 2016).

63 In 2005, the contract to build and operate the real-time central infrastructure on behalf of the Faster Payments Scheme Limited was awarded to Vocalink.

64 Treasury Select Committee, Payments Council, ‘The future of cheques’, (May 2011).

65 Steele, D., ‘Age-friendly banking’, (30 April 2016), <https://ageukblog.org.uk/2016/05/04/branch-closures-present-banks-with-age-friendly-design-challenge/>

Asset-Based Finance

This is used to describe both invoice finance and a range of asset-based lending services. Invoice finance, which is specifically available to B2B transactions, includes factoring and invoice discounting, which enables businesses to access finance against outstanding debts and, thereby, support cash flow.

With supply chain finance, the value of invoices is funded following approval from the customer. Supply chain finance has been traditionally accessed through some larger businesses organisations, but the market is now growing through the emergence of a number of alternative providers. Many of these alternative providers offer online platforms that give small businesses greater flexibility and control over when they receive payment, in order that they may manage their working capital requirements.

In Tim Breedon's 2012 government-commissioned report, *Boosting Finance Options for Business*, a key recommendation was to encourage greater standardisation and certainty in order to make invoices "more easily assignable and hence tradeable, an important aspect of a more developed invoice discounting market".⁶⁶ The report stated this could help small businesses move away from a reliance on overdraft facilities for maintaining working capital towards asset-based and supply chain finance.

Electronic Invoicing

E-invoicing potentially offers shorter payment delays, reduced printing costs and fewer errors. Some have argued that the "implementation of electronic invoicing systems by many large buyers" has contributed to improved payment practices in the UK economy.⁶⁷ The possibilities it provides towards greater automation are particularly significant, with integrated processing allowing e-invoices to be generated directly to trading parties. Proponents also point to a reduced risk of fraud, given companies must first undergo a series of background checks by software providers before being accepted on to e-invoicing systems.

Typically, e-invoice providers allow suppliers to upload e-invoices to platforms, advance money to them and take a small commission. In 2015, Mexico made it a requirement that invoices over a certain amount "must be filed digitally in a pre-specified format" in order to improve payment practice, increase the collection of indirect tax and clamp down on fraud.⁶⁸ It has been reported that Argentina and Brazil are considering taking similar action.⁶⁹ Similarly, Sweden, which has some of the most highly rated payment practices in the world, also introduced regulations in 2008 which require the management of invoices electronically by all public authorities and, in 2013, for companies of more than 50 employees.

The examples above highlight potential opportunities for policy interventions and technology to overlap when addressing the problems of late payment. As businesses within supply chains incorporate more technology into how they manage their financial and tax affairs, the opportunities for improvements to be made in the UK's payment culture are likely to increase.

⁶⁶ Breedon, T., 'Boosting finance options for business', (March 2012), p.27.

⁶⁷ Ibid.

⁶⁸ Tungsten Corporation PLC, 'Tungsten Network launches new Mexico solution', (5 May 2015), <https://www.tungsten-network.com/press-releases/2015-tungsten-network-launches-new-mexico-solution/?id=2591>

⁶⁹ Bounds, A., 'Mediation and technology focus on scourge of late payments', (8 June 2015), <https://www.ft.com/content/7651b58a-f95e-11e4-ae65-00144feab7de>

CONCLUSION

Payment terms in the UK are typically imposed upon small businesses rather than negotiated. Larger businesses often still use their bargaining power to continue providing unfavourable payment terms in the face of legislation. This has created a culture wherein both late payment and supply chain bullying are having a severe negative impact on small businesses. This is why FSB believes it is vital that late payment is placed at the heart of the Government's corporate governance agenda.

We have detailed these impacts in this report and demonstrated a clear correlation between a poor payment culture and business failure rates, business productivity and in turn, economic growth. Our own estimates for the UK economy suggest that if payment delay ratios declined to match those seen in Germany, then the number of business failures would be about 25,000 per year lower. This translates into an estimated boost in economic output of over £1 billion. A situation with zero payment delays would have kept over 50,000 companies in business in 2014, generating a £2.5 billion uplift in GVA for the UK economy.

We also estimate that, if small businesses did not face late payments this year, profit growth in 2016 would be 2.6 percentage points higher. This would translate into a £4.8 billion uplift in small business profits, reflecting higher levels of turnover and reduced costs, such as overdraft or loan charges. There is a clear imperative for late payment and supply chain bullying to be tackled in order for small businesses, and the UK economy at large, to experience the significant economic benefits of doing so.

In contrast, a deteriorating payment culture in the UK could have a significant negative economic impact, particularly with current levels of business confidence in negative territory for the first time since 2012.⁷⁰ We estimate that, if the UK had the same payment delay ratio as Ireland and Greece in 2014, there would have been 23,000 and 39,000 more business failures, respectively.

Therefore FSB argues that more needs to be done to produce culture change across the UK's larger businesses. Addressing supply chain bullying must also be a direct area of focus for larger companies. CEOs and board members need to place this issue at the heart of their own corporate governance strategies. Meanwhile, government interventions should ensure that, for those larger businesses which continue to exploit and take advantage of smaller suppliers, the appropriate action is taken.

In particular, there should be a mandatory sign-up to the PPC for all FTSE 350 businesses alongside an SBC being able to efficiently tackle poor payment practice. Evidence from Australia suggests that the threat of naming and shaming large businesses that refuse to cooperate in resolving disputes, can lead to tangible results with regards to culture change. This should also be replicated with the UK's SBC, which has a key role to play in highlighting areas of excellence and good practice which can lead towards broader culture change.

The SBC should also do more to address the relationship imbalances between small and large businesses that often contribute to supply chain bullying. Our research has demonstrated that power imbalances are an important contributing factor towards supply chain bullying. Generating greater awareness of the SBC as a resource small businesses can use to resolve late payment disputes - before it is launched - will also be crucial.

Finally, the role of technology clearly needs to be better addressed by both government and industry in terms of tackling late payment. A huge amount of innovation has taken place in recent years, with more set to occur following the implementation of PSD2. This trend, alongside recent policy interventions requiring the publication of more data on larger businesses' payment practices, provides the potential to empower small businesses through better control over their finances and accessing information on suppliers as well as more effectively nudging those companies who pay late. Policymakers need to capitalise on this progress and further identify opportunities to utilise technology for the betterment of the UK's payment culture.

70 FSB, 'Q3 Voice of Small Business Index', September 2016, p.3, <http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-sbi-q3-2016-v06.pdf?sfvrsn=0>

POLICY RECOMMENDATIONS

The evidence in this report strongly demonstrates how a poor payment culture is negatively impacting upon economic growth across the UK, specifically in terms of business failure rates. Our recommendations are therefore based on the premise of seeking to empower small firms, raising awareness of the seriousness of the issue and encouraging interventions that actively address deterring such activity. We have also looked to support the Government's corporate governance agenda by making relevant proposals which best serve the interests of small businesses.

1. Make it mandatory for all FTSE 350 businesses to sign up to the Prompt Payment Code (PPC) and introduce a penalties regime for repeat offenders of poor payment practices

The PPC has the potential to positively address the UK's payment culture, but needs to be significantly strengthened in order to do so. As previous attempts to persuade FTSE 350 companies to sign up to the Code have been insufficient, now is the appropriate time to mandate their participation with the Code. This should encourage more large businesses to actively review their treatment of suppliers and make payment practices central to their corporate governance strategies.

Currently, if a failure to adhere to the current principles of the Code is identified, instant removal can follow. However, this is rare. A new penalties regime led by the SBC's Compliance Board should therefore be introduced. This regime should be based around a "three strikes and you're out" rule, which specifically targets repeat offenders of late payment. Those signatories who commit the most egregious examples of supply chain bullying (listed in this report) should be immediately struck off from the Code. Through the Code's existing challenge function, the new Duty to Report regulations and the launch of the SBC, greater information sharing should help to provide the evidence base required to support the operation of this regime. For those signatories wishing to re-join the code, should be required to demonstrate that tangible steps have been taken to improve payment practices, with a final decision taken by the Code's Compliance Board (in consultation with the SBC once it is in place).

2. Regulations should give the Small Business Commissioner (SBC) specific remit to directly address supply chain bullying

The SBC, when considering the conduct, behaviour and practice of relevant parties, should have specific regard for instances of supply chain bullying. These should be reviewed on an annual basis so that the SBC's scope can adapt as the UK's payment culture changes and does not become too prescriptive.

As highlighted in this report, FSB has accumulated considerable evidence of the sorts of activities that small firms face regarding poor supply chain practice. It is clear that an imbalance of power often exists between small and large businesses with regards to late payment disputes. The SBC must address poor payment culture by taking strong action in this area. It should directly challenge retrospective unilateral changes to payment terms, banning supplier lists and limiting the length of time after receipt of invoice wherein a purchaser can challenge invoices issued from a supplier. This would send a strong message to larger businesses that using small businesses as a mechanism to control cash flow is completely unacceptable.

3. Supplier interests should be represented at executive board level as part the Government's ambition to strengthen the stakeholder voice on executive boards

Larger companies should be required to report annually to their shareholders on their payment practices. This could be achieved by including the payment information they will shortly have to publish as part of the Government's new Duty to Report regulations in their Annual Report.

These companies should also be required to appoint a (non-executive) Director on their board, with a specific statutory duty to report on behalf of the company suppliers, presenting their findings to their executive board and subsequently including them in the Annual Report. These responsibilities would also include investigating any issues of poor payment practice affecting suppliers and what has subsequently been done to address them. Such reforms would ensure that tackling late payment and supply chain bullying was at the heart of the Government's new corporate governance agenda.

4. The SBC's "name and shame" powers should be used effectively

The SBC's ability to "name" companies should be used in a way that exerts the maximum influence and impact across the business community. This power should not be used in every instance of late payment, but rather look to focus on the most egregious instances. It should also be used to specifically target examples of supply chain bullying. However, in using these powers, the SBC should also look to protect the anonymity of the supplier where this has been requested. The SBC must also play a leading role in promoting good payment practice across the business community.

5. A timetable around the appointment process for the SBC should be published immediately

Although the SBC was announced in July 2015, no appointment has yet been made, despite one previously being expected in summer 2016. The Government should immediately publish a timetable as to when the SBC will be appointed in order to provide greater confidence amongst the business community that such an initiative will positively promote culture change across the UK. Any further delays at this stage would be unacceptable. FSB should also be involved in the recruitment process for the SBC, to make sure that the criteria for selection matches the needs of the UK small business community.

6. Launch a communications and marketing strategy for the SBC

The SBC will play an integral role in addressing the cultural challenges that surround late payment in the UK. In order to do this, a significant amount of resource needs to be invested as early as possible to raise awareness around the body. This should also be linked to raising awareness of existing initiatives, such as the challenge function of the PPC, which remains an under-utilised remedy with huge potential to help support culture change. The Government should begin to raise the profile of the SBC and look to involve Local Authorities, Local Enterprise Partnerships, Growth Hubs and representative bodies.

There should also be an examination of the key points where small firms are likely to interact with government services on a regular basis, such as through business support schemes and HMRC. This can be used to more effectively signpost people towards the SBC.

7. Payment information through the Duty to Report must be made accessible for small firms

The Duty to Report will require large companies to publish a broad range of metrics on their payment practices. This legislation holds the potential to positively create culture change. However, simply publishing this data is not enough. The Government should look to launch digital resources alongside the launch of the Duty to Report. These should specifically allow small businesses to easily compare the payment practices of large companies as well as making the data shareable. This work should involve developing a user-friendly website that is widely marketed across the business community.

The Government should examine how this data could also be shared with external organisations. For example, there may be scope for this data to be integrated into existing accountancy software packages which small businesses typically use. Data exchange between the Duty to Report and the PPC could be shared to further improve transparency on payment practices. Finally, price comparison and other benchmarking websites could use this data to develop best practice and online guidance over who pays promptly and who does not.

8. Launch a joint industry-government taskforce on the future role of technology in addressing late payment

New technology has the potential to empower small firms by providing more ways of chasing late payment. Current initiatives are already improving the e-invoicing capabilities of small firms as well as how automatic invoice reminders are being used to chase late payment. In addition, with the Duty to Report regulations requiring larger companies to submit more data on payment practices, a joint industry-government taskforce should examine how technology and increased data sharing could be used to improve the UK's payment culture.

RESEARCH METHODOLOGY

In the research, we quantified the size of the problem of late payments in the UK and how this compares with a range of other economies. In addition, we examined and quantified the economic impact of late payments to small businesses and considered the potential boosts to the UK economy that could be realised from clamping down on late payments. CEBR supported our analysis of this data.

An online survey was commissioned as part of this research, providing new and timely quantifications of the economic impacts of late payments. Members were invited to participate in the research via email and social media channels. Nine-hundred and fifty FSB members (and small businesses) responded to the survey, which was carried out by Verve. The survey was undertaken between 1 and 19 August 2016.

The survey began by asking respondents about their payment terms, both with regards to the typically agreed time period and the form in which these were received. We then moved on to specific questions around respondents' experience of late payment, including the key impacts on the business. The survey concluded by asking respondents with which types of businesses, according to size, they most frequently experienced late payment.

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