Department for Business Innovation & Skills

BUILDING A RESPONSIBLE PAYMENT CULTURE

A Discussion Paper

7 DECEMBER 2013

Contents

Foreword

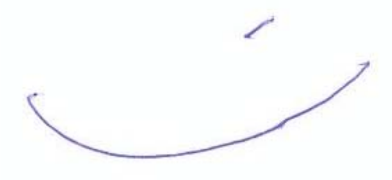
When I speak to small businesses, late payment and long payment terms are almost always amongst their top concerns. The statistics bear this out – 85% of small businesses say they have experienced late payment in the last two years, and SMEs are owed a total of over £30bn in late payments. There is a culture of late payment which is preventing business, small businesses especially, from investing in growth and contributing to economic recovery.

There have been a number of high profile instances where large companies have lengthened payment terms leading to complaints from smaller suppliers – payment terms over 100 days are now far from unusual. Payment goes right to the heart of corporate responsibility, where companies should be mindful of their impact on suppliers and the additional costs this can bring.

The Government has already taken steps to address the issue. We have had legislation entitling suppliers to charge interest of 8% above base rate on late payment since 1998 and, following two additional EU Directives, there is a legal default maximum payment term of 60 days, unless otherwise agreed. But these rights are very rarely exercised in practice because businesses are worried about jeopardising future commercial relationships. So one of the issues this discussion document raises is whether more can be done to encourage businesses to assert their existing rights, and whether there is now a case to strengthen them.

But we appreciate that it is not a subject that can be entirely addressed by means of legislation. This is ultimately a matter of business culture, of the way companies behave towards one another. By pushing companies to sign up to the voluntary Prompt Payment Code, we have aimed for companies to understand the benefit of good supplier relationships built upon prompt payment. Public sector have tried to lead by example and central government departments aim to pay 80% of undisputed invoices in 5 days. But we think more now needs to be done.

We seek views on a range of areas in which non-legislative steps could be taken to alter payment practices, from possible enhancements to the Prompt Payment Code, to bringing more transparency on payment practice into company reporting, to the possible role of sector-based approaches. The document also sets out some further steps we will be taking to drive good payment practice through the public sector. Some of the options explored here are quite radical, and I make no apology for that – the importance of the issue demands it. I encourage all those with an interest in the subject to make use of this opportunity have their say.



Vince Cable, Secretary of State for Business, Innovation and Skills

Executive Summary

We want to make the UK the best place in Europe to start, finance and grow a business. As part of that, we need to tackle the issue of late payment in UK business culture.

Every year, thousands of businesses experience severe administrative and financial burdens, simply because they are not paid on time. Late payment stops these businesses – small businesses in particular - from investing in growth, creating new jobs, and contributing fully to economic prosperity. In the worst cases, late payment can lead to insolvency.

Changing the culture of late payment will benefit the whole economy – helping business to thrive, creating employment, and increasing competitiveness and efficiency through the supply chains.

But addressing late payment also goes to the heart of corporate responsibility. Companies have a responsibility to have regard to both the need to foster their business relationships with suppliers and the impact of their operations on the community.

We appreciate that there is a tension between action on late payment and another vital part of the business environment, namely the principle of freedom of contract. If companies apply a ‘winner takes all’ approach to freedom of contract with more powerful businesses either imposing unfair terms on others, or viewing compliance with their contractual terms and statutory obligations as optional, then the economy as a whole suffers. That is why UK legislation already puts parameters around freedom of contract regarding payment terms, for instance by setting a default payment period of 30 days and providing a statutory right to claim interest in the event of late payment. Striking the right balance between legislating to provide suppliers with basic rights and freedom of contract is clearly crucial.

The Government is acting to set an example. Central Government already pays more than 80% of its invoices within five days and all public sector bodies are required to pay invoices within 30 days. This document outlines further steps we are now taking to ensure that *all* small and medium sized businesses involved in the provision of goods and services to the public sector are paid promptly. For the first time, we will:

- Make sure that small firms are treated fairly by mandating prompt payment terms all the way down public procurement supply chains; and
- Ensure that all public bodies report on their prompt payment performance.

The aim of this consultation is to ask what Government, business and other stakeholders can do to build an environment where businesses treat their suppliers fairly, and accept as a matter of course their obligation to pay what they owe when they owe it, without over-burdensome enforcement.

This paper is composed of two sections. The first describes the impact of late payment in the UK. It also outlines existing rights and schemes designed to help businesses experiencing late payment, including what Government has already done to ensure businesses are paid promptly when they work with the public sector. The second seeks views on:

- Whether more can be done to change business culture through measures to enhance accountability and transparency;
- How to encourage small businesses to make better use of the statutory rights that they already have and whether there is a case to enhance those rights; and
- How we can empower small businesses to help themselves to reduce the risk of late payment.

Timing and responses

1. Government appreciates that action on late payment is a complex issue and requires careful balance. We have therefore deliberately phrased the questions as openly as possible and are keen to hear views from right across the whole business community.

2. Responses to this discussion paper are welcomed for 8 weeks from 7 December 2013 to 31 January 2014.

Devolution

3. The current Late Payment of Commercial Debts (Interest) Act 1998 covers the whole of the United Kingdom. Amendments to it in order to transpose the EU Directive in Scotland have been effected by separate instruments made by the Scottish Ministers.

Process

4. Submissions of evidence should be emailed to latepayment@bis.gsi.gov.uk clearly marked as a response to the *'Late Payment discussion paper'*. If further information or clarification is required, we will make contact as appropriate.

5. When responding, please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents and how the views of members were assembled.

6. In exceptional circumstances we will accept submissions in hard copy. If you need to submit a hard copy, please provide two copies to the Business Finance and Tax Team at the following address:

   Business Finance and Tax
   Spur 1, 3rd floor
   Department for Business, Innovation and Skills
   1 Victoria Street
   London
   SW1H 0ET

   We regret that we are not able to receive faxed documents.

Confidentiality and Data Protection

7. Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA) and the Data Protection Act

1998 (DPA). If you want information that you provide (including personal data), to be treated as confidential please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

8. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

Help With Queries

9. Questions about the policy issues raised in the document can be addressed to:

Scott Macdonald
Business Finance and Tax
Department of Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET
Tel: 020 7215 6504
Email: latepayment@bis.gsi.gov.uk

This mail box will be monitored on a daily basis.

The consultation principles are in Annex C.

Comments or complaints on the conduct of this consultation

10. If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

John Conway
BIS Consultation Co-ordinator
1 Victoria Street
London
SW1H 0ET

Telephone John on 020 7215 6402 or e-mail to: john.conway@bis.gsi.gov.uk

Section 1 - Late Payment in the UK

What is Late Payment?

11. Most companies in the UK supply goods and services on credit, agreeing to defer payment for a period after delivery rather than demanding immediate payment. This system (known as trade credit) is an essential element of business practice in the UK. Around 80% of business to business transactions are undertaken on credit terms of some form, and trade credit constitutes about 37% of total business assets. [1]

12. Late payment occurs when a business has been supplied goods or services on credit, but fails to pay within the agreed term. Legally, if no explicit payment terms have been agreed, payment is assumed to be due after 30 days for the purposes of charging statutory interest.

13. Late payment is not always clear cut. When the good or service being supplied are complex and difficult to value, reaching agreement on what is owed at what time may be difficult. Nevertheless, whether a contract is complex or straightforward, the customer and supplier should share clear expectations, and there should be a transparent, fair process for clarifying issues or disputes.

14. Businesses can also face difficulties if payment terms are very lengthy or if they are changed at short notice. It has always been accepted commercial practice to negotiate robustly over contractual terms. However, the aim of these negotiations should be to reach an agreement which is mutually beneficial. This discussion paper will also consider, therefore, whether more steps are needed to deal with situations where large companies use their dominance and bargaining power to force smaller businesses to accept unfavourable payment terms.

The Scale and Impact of Late Payment in the UK

15. Late payment is not a new issue, but the problem has worsened since the financial crisis and particularly affects small and medium sized firms. Between 2008 and 2012, the overall level of late payments due to these businesses almost doubled from £18.6 billion to £35.3 billion. As of February 2013, the overall level of late payment owed to small and medium sized businesses stood at £30.1 billion – an improvement on 2012, but well above pre-2008 levels. The average amount owed to a small business stood at £31,000[2], and 85% said they had received a late payment[3].

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[1] http://www.accaglobal.co.uk/content/dam/acca/global/PDF-technical/small-business/pol-tp-gp.pdf
[2] http://www.bacs.co.uk/Bacs/DocumentLibrary/PR_Payment_terms_ignored_as_SMEs_wait_eight_weeks_for_money.pdf
[3] http://www.newsroom.barclays.co.uk/Press-releases/SMEs-turn-away-business-to-fight-back-against-late-payments-9c1.aspx

16. Small businesses are highly dependent on cash flow. In extreme cases, a lack of cash flow can result in insolvency, but even when a company remains financially viable, late payment can drain resources, stopping businesses from investing and growing.

17. Recent research shows that:
    - Small businesses on average spend 130 hours each year chasing late payments, which equates to just over three weeks of work, at an average cost of £1,500 per business.[4]
    - 34% of companies report that they have sought external finance to cover gaps in cash flow caused by late payment.[5] The Federation of Small Businesses states that this has led to £180 million in debt interest charges – money that could otherwise be used for investment and growth.[6]
    - In 2011 124,100 businesses were almost put out of business due to their customers paying late. In 2008, 4,000 UK businesses became insolvent as a direct consequence of late payment[7].
    - Good cashflow is vital in enabling businesses to continue to raise finance and invest when required and late payment has a major negative impact on businesses ability to access finance. According to Professor Russel Griggs, the independent external review of the major banks' Appeals Process, in 2012/2013 48% of declined finance applications over £25,000 were rejected on 'affordability' grounds – the ability of an SME to service the debt from its existing cashflow.[8]

18. Late payment has a snowball effect throughout the supply chain. Over 244,000 companies say that they have paid suppliers late as a result of late payment by their customers.[9]

Statutory Remedies for Late Payment

19. Successive governments, as well as the European Union, have recognised the damaging effect that a culture of late payment has on growth by imposing general and sector-specific legislation in order to protect businesses.

General Legislation

20. **The Late Payment of Commercial Debts (Interest) Act 1998** created a statutory framework for tackling late payment. This was amended in August 2002 (when the 2000 EU Late Payment Directive was transposed into UK law) and again in March 2013 (when the 2011 EU Late Payment Directive was transposed into UK law).

21. The legislation's key provisions are:

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[4] http://www.bytestart.co.uk/130-hours-overdue-invoices.html

[5] http://www.atradius.co.uk/creditmanagementknowledge/publications/paymentpracticesbarometersummer2010.html

[6] http://www.fsb.org.uk/policy/rpu/london/assets/late%20payment%20july%202011.pdf

[7] http://www.fsb.org.uk/News.aspx?loc=pressroom&rec=5584

[8] http://www.betterbusinessfinance.co.uk/images/uploads/Annual_Report_Master_2013.pdf

[9] http://www.fpb.org/images/PDFs/FPB_Graydon_research_report.pdf

- Businesses are entitled to charge interest of 8% above Bank of England Base Rate for any late payment;
- Administration costs for chasing late payment can be claimed by business, on a sliding scale depending on the size of the debt;
- Payment contracts must not infringe on a business' right to claim interest and administration costs for late payment;
- Mandatory 30 day payment terms for transactions with public authorities;
- Maximum 60 day payment terms between businesses, unless they agree longer terms and this is not grossly unfair to the supplier.

22. Despite the legislation few companies utilise their rights, particularly against corporate late payers. Just 10% of businesses have considered using late payment legislation[10] despite 22% of businesses having ended a business relationship with a customer because of continued late payment.[11]

Sector-specific Legislation

23. Two pieces of sector-specific legislation also address late payment issues. Part 2 of **The Housing Grants, Construction and Regeneration Act 1996 (the Construction Act)** concerns construction contracts. It:

    - Gives each party to a construction contract the right to refer a dispute to adjudication (a quick, 28 day dispute resolution process);
    - Provides that contractors are entitled to staged payments; and
    - Provides that contracts should have "an adequate mechanism" for determining what should be paid and when.

24. A review in 2004 found that while the Construction Act was generally working well, some improvements could be helpful if the means could be found to deliver them without adverse impacts. Part 8 of the **Local Democracy, Economic Development and Construction Act 2009** made a number of changes to the payment and adjudication provisions of the Construction Act to deliver these improvements. The Construction Leadership Council is now taking further steps to address late payment; this is discussed in the next section of this paper.

25. The **Groceries Code Adjudicator** has been created to ensure that supermarkets treat their direct suppliers lawfully and fairly and to investigate complaints and arbitrate in disputes. The Groceries Code Adjudicator Act (2013) became law in June 2013 and the Adjudicator is Christine Tacon.

26. The role of the Adjudicator is to enforce the Groceries Supply Chain Code of Practice (the Groceries Code). The Groceries Code is intended to remedy adverse effects on competition from supply chain practices which transferred excessive risks and unexpected costs to suppliers, and which restricted or distorted competition in favour of larger grocery retailers. The Groceries Code covers the 10 biggest supermarkets: Aldi Stores Limited, Asda Stores Limited, Co-operative Group Limited, Iceland Foods

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[10] http://www.managementtoday.co.uk/news/1076769/
[11] http://www.newsroom.barclays.co.uk/Press-releases/SMEs-turn-away-business-to-fight-back-against-late-payments-9c1.aspx

Limited, Lidl UK GmbH, Marks & Spencer plc, Wm Morrison Supermarkets plc, J Sainsbury plc, Tesco plc and Waitrose Limited.

27. The Groceries Code requires supermarkets to make sure that all the terms of any agreement with a supplier for the supply of groceries for resale in the UK are recorded in writing, and that supermarkets must pay their suppliers for groceries delivered to the retailer's specification within a reasonable time. If no payment terms are set out in the contract or supply agreement then, in line with UK legislation, a payment will be considered late if it is not made within 30 days of receipt of the invoice.

28. The Adjudicator will be able to launch investigations from late December 2013 when statutory guidance on investigations and enforcement will be published. Investigations could cover matters regarding compliance with the Groceries Code's provisions on prompt payment.

Voluntary Measures to Increase Prompt Payment

29. The Prompt Payment Code (the Code) was set up by the Institute of Credit Management (ICM) in 2008 on behalf of Government in order to promote a culture of prompt payment. Signatories to the Code agree to:

- Pay suppliers on time:
  - Within the terms agreed at the outset of the contract;
  - Without attempting to change payment terms retrospectively; and
  - Without changing practice on length of payment for small companies on unreasonable grounds.

- Give clear guidance to suppliers:
  - Providing suppliers with clear and easily accessible guidance on payment procedures;
  - Ensuring there is a system for dealing with complaints and disputes which is communicated to suppliers; and
  - Advising them promptly if there is any reason why an invoice will not be paid to the agreed terms.

- Encourage good practice:
  - By requesting that lead suppliers encourage adoption of the Code throughout their own supply chains.

30. The Code is voluntary and essentially depends on signatories acting in good faith.

31. As of November 2013, 1,434 organisations had signed up to the Prompt Payment Code, including 70 FTSE 100 companies. This reflects an increase of 23% since the start of 2013, following a campaign by Government and the ICM to drive up the number of signatories.

Prompt Payment in the Public Sector

32. The public sector in the UK spends £230 billion on goods, services and works to deliver public services. It creates liquidity in the economy and is in a powerful position to set an example. It is therefore vital that public bodies apply the highest standards to their payment practices.

33. Amendments to the Late Payment Act created a statutory requirement for public authorities (including local authorities and hospitals) to pay their invoices within a maximum of 30 days. While EU law allows some discretion, the UK has chosen to transpose this legislation so that *all* public authorities have to pay within 30 days, which has gone beyond the EU minimum requirement. Since 2010 Government policy has been that all central Government departments and their agencies should go even further, requiring that they should pay at least 80% of undisputed invoices in 5 days and report on their performance against this target. Central Government departments now also require their prime contractors to pay their suppliers within 30 days.

34. Specific measures have been put in place for Government construction contracts. Construction procurers in central Government departments, their agencies and Non-Departmental Public Bodies are required to ensure that their contracts with suppliers either provide for project bank accounts (PBAs) or include a contractual requirement to pay to Tier 3 of the supply chain within 30 days.

35. PBAs are an innovative payment mechanism. They are a ring-fenced bank account from which payments are made directly and simultaneously by a client to members of its supply chain. PBAs have trust status which secures the funds in them and can only be paid to the beneficiaries – the supply chain members named in the account. Payments out of the PBA are made simultaneously to all parties. The account is held in the names of trustees; likely to be the client and lead contractor but also possibly members of the supply chain. £2 billion of work has now been awarded using this mechanism.

36. This all represents good progress in terms of the public sector leading by example. But we want to go further, which is why we sought views on prompt payment issues in our recent consultation on **Making Public Sector Procurement More Accessible to SMEs**. Following consideration of responses to that consultation, we can now make the following commitments. We will

- Make sure small firms are treated fairly by mandating prompt payment terms throughout public procurement supply chains. This will allow the benefits of prompt public sector payment to be felt by not only prime contractors but also their suppliers as well.
- Ensure that all public bodies report on their prompt payment performance. Bodies will be required to publish their payment performance publicly and online to allow members of the public and suppliers to see that targets are being met.

37. However, we would like to go further and seek views on how the issuance of purchase orders can be improved and what impact this would have on small business cash flow.

Q1. Do you agree that failure to issue purchase orders for public contracts in a timely fashion is a problem and has caused delays in payment? What measures could Government introduce to ensure that this does not happen? How could this be achieved simply and effectively?

38. The procurement reforms being introduced will mean that public bodies are even more likely to pay their suppliers on time. If late payment occurs we want to make sure that suppliers are empowered to complain or charge interest without worrying that this will affect future business relationships.

Q2. Do you think any specific changes or measures could be introduced to make it easier for suppliers to complain or charge interest when they are paid late by public authorities?

Section 2 – Tackling Late Payment

Changing Business Culture

39. Late payment is fundamentally a question of business culture. The fact that average payment terms and actual payment performance vary so much between countries with similar legal frameworks is evidence of this.

40. The table below shows the average of agreed contractual payment terms in days and the average of the number of days that it actually takes for payment to be made.

Country	Average business-to-business payment term in days	Average business-to-business payment duration in days
UK	25	44
Spain	70	97
Italy	65	96
France	40	57
Sweden	28	35
Germany	25	35
Finland	20	27

Source: European Payments Index 2012[12]

41. The fact that countries such as Sweden and Germany perform better is not down to any single legal, economic or administrative factor but because a broader business culture exists that expects prompt payment and enables suppliers to take steps to protect themselves (such as charging interest) without risking their commercial relationships. Conversely, some countries with notionally stronger legal frameworks (like France, where a maximum payment term has been in force for some time) do not perform as strongly.

42. Most companies, particularly those at the top of supply chains, say they value good relationships with their suppliers and seek sustainable supply chains as an important part of their business strategy. Nevertheless, the evidence suggests that large companies are amongst the worst late payment offenders.[13]

43. While some companies may deliberately delay payment in order to improve their financial position, in many cases late payment appears to be a result of administrative issues. There may be a lack of a clear payment policy; staff may not be adequately trained or resourced; or there may not be enough coordination between departments to ensure that invoices are approved quickly.

[12] http://ec.europa.eu/enterprise/policies/single-market-goods/files/late-payment-campaign/presentations/ireland/epi2012_en.pdf

[13] http://www.experian.co.uk/blogs/latest-thinking/2013/02/late-payments-index-the-annual-roundup-of-2012-improvements-led-by-larger-businesses/

44. The next section of this paper therefore identifies and seeks views on a range of options for Government and business for improving the business culture surrounding payment in the UK.

Incentivising Fair, Transparent Payments Practice

45. One way in which businesses can be incentivised to alter their practices is by increasing transparency around areas of performance relevant to corporate reputation or commercial relationships. Government believes that there is merit in considering this approach in relation to payment practices.

46. Greater transparency and awareness around payment policies and practices could help a number of stakeholders:

- For **shareholders and investors**: information on supplier relationships will give them insight into the company's business model and financial structure.
- The **Board and senior management** of corporations should be in a position to understand how they are interacting with their supply chain in practice, not just in principle. This will put them in a better position to drive change and improve their business relationships.
- Existing and prospective **suppliers** would know what to expect from a company they do business with and could help them to negotiate and price contracts on that basis.
- The **public** have an interest in the efficiency of the supply chain; unnecessary costs resulting from late payments are likely to result in higher prices for consumers.

47. In order to encourage greater transparency and raise the profile of payment functions we propose to introduce a new template for voluntary disclosures on supplier payment policies. This template could form part of the framework for narrative reporting, and would provide for disclosures on:

- The proportion of invoices paid within terms;
- The proportion of disputed invoices;
- Supplier payment terms which are over 60 days and the rationale for these;
- Payment policies, including how staff are trained to implement them;
- The process for resolving disputes; and
- How supplier payments are reflected in the company's code of ethics.

48. The Government removed a previous statutory reporting requirement following two consultations with stakeholders. This statutory requirement gave only limited information on payment practice, and produced a 'snap shot' of a company's performance at a single point in the payment cycle. The new proposals would provide for fuller disclosures of policy and performance, giving suppliers, investors and the public the information they need to make sound judgments. We believe companies will be keen to demonstrate continued improvement in their payment processes, contributing to the cultural shift is needed. However, we would also be

interested to hear views on whether a more targeted mandatory requirement (along the lines proposed for the voluntary model) would be more or less effective.

Q3. Do you agree that more disclosure of company performance on supplier payment would be useful? If so, do you agree that a voluntary framework would be an effective, proportionate response, or should a mandatory framework be introduced?

Q4. Do you agree that if a new framework were brought in (whether voluntary or otherwise) it should include the elements described above? Should further elements be included?

Q5. Are there any other measures related to transparency or disclosure that would incentivise companies to ensure that their supplier payments are managed fairly and efficiently?

Strengthening the Prompt Payment Code

49. The Prompt Payment Code was established in December 2008 by the Institute of Credit Management (ICM) at the request of the Government. The Code gives companies the opportunity to commit to good practice in their supplier relationships, improving business cashflow and working capital throughout the supply chain.

50. Almost five years on, we are keen to seek views on how this voluntary Code might be made more useful to signatories and suppliers. A key objective of the Code is to give suppliers confidence that its signatories will follow good practice. However, the Code cannot be successful in changing behaviours unless signatories also feel that it benefits them, perhaps by helping them to attract the best suppliers or by enhancing their overall corporate reputation.

51. There is a lot of publicity surrounding alleged bad practice but little detail of what good practice looks like. One way the Code could better promote best practice may be by highlighting the various ways in which companies manage different stages of the payment cycle in a fair and effective way.

52. The Code could also be strengthened by encouraging challenge. The payment practices of a signatory can currently be challenged by filling in a form on the Prompt Payment Code website. This can include business organisations complaining on behalf of their members as well as suppliers themselves, and can be done on an entirely confidential basis – **the details of the individual or organisation that brought the complaint will only be shared if the complainant agrees**. When a challenge is raised, ICM will contact the signatory for a response to the alleged breach of the Code and, if necessary, begin a process of mediation between the parties. Ultimately, if a signatory is found to be in breach of the Prompt Payment Code and unwilling to rectify their behaviour, they can be removed from the Code.

53. This appears to be an effective, confidential challenge mechanism, and one with real teeth given the reputational risks to signatories. Yet thus far the system has been used relatively infrequently. Since 2008, nine challenges have been raised,

of which four were pursued, in all cases leading to the complainant receiving the payment that had been the subject of the dispute[14]. We will continue to work with ICM to raise awareness of the challenge system, and would welcome proposals of how its use could be further encouraged.

Q6. How can the Prompt Payment Code better raise awareness of good practice? Would case studies of how companies manage different stages of the payment cycle be helpful in demonstrating how the Code principles can be applied in practice?

Q7. Are there any steps that could be taken to encourage more businesses to identify breaches of the Code by signatories?

54. Signing up to the Prompt Payment Code is a powerful way for a business to demonstrate its commitment to prompt payment and good supplier relationships. It commits the signatory to understanding the value that this commitment has. The Code already requires commitment to good practice across a wide range of issues relating to payment practices.

55. However, we would welcome views on whether and how the requirements of the Code might be further strengthened by introducing an **'upper tier'** of the code for signatories willing to voluntarily agree to more stringent requirements. We believe that companies signing up to an 'upper tier' could derive significant reputational and commercial benefit in the long-term. Issues that could be considered in this context would include:

- Publication of payment policies;
- Publication of payment performance;
- Commitment to pay all suppliers within 60 days – i.e. not to seek contractual agreement to go beyond the legal default period; or
- Agreeing to random audits by ICM to check payment performance.

56. These requirements would have a direct impact on suppliers who would be able to charge lower prices knowing that they are trading with a dependable prompt paying customer. Credit could become more readily available as suppliers would feel their money is secure and costs for the customer would potentially be reduced. Investors and shareholders would see that a company is a good payer, with well managed financial accounts.

57. We recognise that some companies will be reluctant to sign up to more stringent requirements, particularly where they feel this creates a competitive disadvantage or additional short-term burdens. We would therefore welcome views on whether it would be appropriate and effective to offer incentives to companies in return for their participation in an 'Upper Tier' of the PPC.

Q8. What further measures would you like to see as either a signatory, or a supplier of a signatory, to give you confidence in the Code as a marker of

[14] Except in one case where the company concerned had been dissolved, and was therefore removed from the Code.

good practice? In particular, would it be useful to ask for publication of the maximum payment terms offered by signatories?

Q9. Should a new 'upper tier' be introduced to the Prompt Payment Code for signatories prepared to agree to more stringent rules?

Q10. Should businesses be offered incentives to sign up to an 'upper tier' if introduced? What would be an appropriate and effective incentive?

Section 3 - Helping Businesses Challenge Late Payment

Fines and Penalties

58. There are already penalties in place for late payment. These are set out in the Late Payment legislation[15] that came into force in March 2013 which allows businesses to charge:

- A statutory interest rate calculated as the Bank of England reference rate plus at least eight percentage points;
- A fixed charge of £40, £70 or £100 depending on the size of the debt; and
- Additional reasonable costs incurred.

59. Although businesses have the right to claim interest and late payment charges very few currently do so, generally because of concern about their commercial relationships. This is a problem; for statutory penalties to be effective, suppliers need to be prepared to use them.

60. One suggestion is that greater penalties or fines could be introduced to incentivise more suppliers to assert their rights and provide a more serious deterrent to late payers. These could take various forms including: setting a higher statutory interest rate; introducing a minimum absolute penalty payment (related to the size of the debt concerned) that can be claimed once the payment becomes late; or providing a sliding scale of penalty payments that increases as the payment becomes more overdue.

61. However, such measures could have unintended or perverse consequences, particularly where late payment is genuinely a result of error or because a company is in temporary financial difficulty. There is also the possibility that increased penalties for late payment could actually encourage companies to shift to longer payment terms.

62. In order to remove the potential conflict between a supplier's pursuit of compensation for late payment and its longer-term commercial interests, one suggestion put forward is the introduction of penalties or 'fines' payable to the Government or a trade body rather than compensation to the creditor. We welcome views on this possibility, but consider that it would raise significant practical issues, not least the question of how any such third party could be made aware of payment becoming late without a complaint from the creditor – and thus indirectly making their identity clear to the debtor. It would also seem more appropriate for any 'compensation' for late payment to flow to the creditor affected.

[15] http://www.legislation.gov.uk/ukpga/1998/20/contents

Q11. What are the barriers to claiming interest on late payment? What could be done to encourage more businesses to claim interest and late payment charges where appropriate and create an environment in which this is considered the norm?

Q12. Do you believe that further penalties payable to creditors would be a useful means of discouraging late payment? If so, how do you think that they could be implemented given suppliers' inevitable concern not to damage future commercial relationships? Do you have views as to how any such additional penalties should be framed or the level at which they should be set?

Q13. Do you see advantages in a third party (which could be Government or another body, such as trade associations) playing a more direct role in the collection of penalties for late payment? If so, how could such a system be implemented effectively given the challenges discussed above?

Length of Payment Terms

63. Another area on which we welcome views is the length of payment terms in themselves, as opposed to payment that occurs beyond an agreed due date. There has, in particular, been regular recent press coverage of cases in which larger businesses are alleged to have lengthened payment terms beyond the statutory default of 60 days at short notice causing detriment to smaller suppliers.

64. Some argue that lengthy payment terms, and in particular changes to longer payment terms with little notice, can be a cause of significant problems. Others maintain, however, that certainty as to when they will get paid is more important to most businesses, irrespective of size, than the length of the payment term itself, as they can plan on the basis of the contract.

65. Businesses are currently able to agree longer payment terms as long as they do so freely and the terms are not 'grossly unfair' to the supplier. As yet, however, suppliers have been unwilling to bring cases to challenge payment terms on this basis, perhaps due to a lack of certainty as to when a court would consider terms to be 'grossly unfair'.

66. Government has been asked to provide greater clarity about what 'grossly unfair' should mean in practice. We welcome views on this matter. We are aware however, of the challenges of designing either law or guidance on such an issue that adequately reflects the varied reality of commercial relationships in different sectors, between different sizes of company and with different standard payment practices.

67. For example, in some industries 90 day payment terms have been the norm for many years and suppliers are used to planning their operations on that basis. In others, the change from a 30 day to a 60 day payment term can cause huge difficulties, because relationships through the supply chain have been predicated on 30 day terms.

68. The most radical step to take in this area would be to create a statutory maximum payment term – perhaps set at the current default of 60 days – or perhaps to establish a framework for the agreement of different maximum payment terms in different sectors. We fully appreciate that this would amount to a significant restriction on freedom of contract over payment terms and that such freedom of contract is something that both supplier and customer can value, as different payment terms can be exchanged for a better price or more custom. But imbalanced negotiations can equally lead to some suppliers feeling they have to offer long credit terms to their customers which they are not able to secure from their own supply chain, leaving them squeezed for cash at both ends. We are seeking views as to whether the difficulties that the issue is raising for smaller businesses could justify such a step.

69. An option to consider short of an absolute maximum payment term is a requirement for greater consultation and transparency when companies wish to agree terms over 60 days. Such a requirement might require companies to consult with their suppliers before implementing terms over 60 days, and to publish the outcome of such a consultation alongside their decision. Following publication, there could then be a requirement for a further period to elapse before the new terms came into force, giving suppliers an opportunity to adjust. This would enhance transparency by requiring companies to explain their decision-making, and improve business culture by mandating the participation of suppliers in payment policy. However, it would represent a restriction on businesses who wished to respond quickly to changes in market conditions.

Q14. Should businesses remain able to agree payment terms that are over 60 days? What impact would a hard limit on payment terms have? How would this affect different sectors?

Q15. Under what circumstances do you think that a payment period should be considered to be 'grossly unfair' to the supplier? How could this be defined more clearly? Would it be possible to agree one set of principles for all transactions or would differentiated approaches be more appropriate, for instance on a sectoral basis?

Q16. If businesses remain able to agree payment terms over 60 days, should they have to consult with suppliers and state publicly that they are doing so, or publish reasons explaining why? Should this apply to all businesses or only large companies? How would this help or hinder your business?

Sector Based Approaches

Addressing Late Payment in the Construction Sector

70. Analysis produced for Construction 2025, the Industrial Strategy for construction, concluded that late payment was a particular obstacle for small businesses in this sector. Contractors are often not paid until some time after the work is done, and it is not unusual for lower tier supply chain members to have to wait up to 100 days to receive payment. This harms cash flow and increases the reliance on borrowing.

71. The Construction Leadership Council is working with the Institute of Credit Management to develop a construction supply chain payment charter. This will set out certain high level principles about fair payment on construction projects. The Leadership Council intends to publish its charter in the New Year and to encourage construction businesses from across the whole supply chain to comply with it.

72. The Construction Supply Chain Payment Charter deals with fair payment at a strategic level. It cannot be a substitute for effective dispute resolution, which is provided by a framework set out in the 2009 Construction Act. The Act was revised in 2009 following extensive consultation with the industry. These changes came into force in 2011 and it is too early to show an impact and so no further review is proposed at this stage. However, given the importance of dispute resolution, it does seem timely to ask whether there is more that might be done to further simplify the current adjudication process.

Q17. Are there simple steps that might be taken to make the construction adjudication process quicker, cheaper or both?

Further Sector Based Approaches

73. As discussed earlier in this document, the complexity and variety of supply chains and sector specific contractual practices can make it difficult to identify a set of criteria around good payment practices that can be applied to all businesses.

74. Sector-based agreements between large primes and tier one suppliers can be an effective means of achieving buy-in to good payment practices. For example, Network Rail has signed a 'Fair Payment Charter' with 30 of its main contractors committing the signatories to prompt, predictable and correct payment.

75. Sector-based approaches to tackling late payment, whether voluntary or statutory, can enable a more targeted identification of good practice. Furthermore, companies operating within a particular sector are more likely to have a sense of existing problems in that sector.

Q18. What role, if any, could industry or sector bodies play in identifying and promulgating good contractual practices within their sectors and adjudicating on disagreements? Do you see particular sectors as priorities for action? How might Government facilitate this?

Credit Information and Credit Management

76. Most business to business transactions involve the provision of goods and services on credit. While financial institutions use complex algorithms and multiple data sources to make credit decisions, small businesses may not have a member of staff with a specific responsibility for credit control.

77. Nevertheless, there is a lot that small businesses can do themselves to avoid or mitigate the problem of late payment. In order to maximise the likelihood of getting paid, it is important that both parties understand the goods or services to be delivered. Both parties should also have clear understanding of the payment terms, the process for resolving disputes, and the process for raising and submitting invoices. All of this should be set down in a written contract. Companies should also take reasonable steps to assess the creditworthiness of their potential customer. This could mean using a credit reference agency, or gathering information by contacting existing or previous suppliers to the company in question.

Q19. Do you think that more information on whether companies have a history of late payment would help suppliers negotiate better terms when doing business?

Q20. What can businesses, data hosting platforms and Government do to facilitate greater transparency?

Use of Technology

78. New technology can help small businesses manage their finances and payments efficiently. Accounting software products for small businesses can help business track their finances. It is now possible for small businesses to take payments on their mobile phones and tablets. They can access direct debit services to enable customers to set up regular payments. They can also use electronic invoicing to make the payments cycle more efficient and speedy and reduce the administrative errors in invoices that often lead to late payment. Electronic invoicing platforms are increasingly offering additional financial services like supply chain finance that can give small businesses more financing options.

Q21. What prevents small businesses from using technology services to help them with financial management and payment? What could be done to encourage greater take up?

Alternative Financing Options

79. When businesses extend credit to their customers, they need to be able to finance the time between expenditure and the receipt of cash. Many businesses finance this period with their cash reserves. However, a growing business may not have enough cash to finance sales growth. Some businesses operate on a seasonal basis where there may be significant gaps between costs and sales receipts. And all businesses need to be able to deal with unexpected fluctuations in cashflow.

80. We know that a lot of small businesses still find it difficult to look beyond the traditional choice of bank credit, whether a term loan or an overdraft, when considering options to help manage cashflow. Furthermore, many look for external finance to support cashflow only when things go wrong – at which point they may have fewer, more expensive options. It would be a significant benefit for many small businesses to understand and have more confidence in using the full range

of options now available for managing cashflow as a normal part of doing business.

81. Some of the most common finance options available to small businesses to manage cashflow beyond loans and overdraft facilities are:

- Factoring and invoice discounting – where a business effectively gets a cash advance against payments due by selling or borrowing against all or part of its debtor book;
- Asset Based lending – where funding is secured against an asset of the business such as property, machinery or stock; and
- Supplier finance (also called supply chain finance or reverse factoring). This is where a customer puts facilities in place that mean that suppliers can claim payment immediately from a third party finance provider. The supplier gets the whole value of the invoice less a discount that is based on the customer's credit rating. The customer then settles with the finance provider when the payment is due.

82. It is very important to stress that such options will not always be appropriate for all businesses, and will of course entail different costs. But we are keen to ensure that small businesses are aware of all the financing options available, and can understand when best to access them, and which may be appropriate to their needs.

83. Government is playing its part in encouraging large companies to offer working capital to their suppliers. In October 2012, the Prime Minister met with the leaders of some of the UK's largest companies to discuss the important role they play in supporting their supply chains. As a result 40 companies agreed to boost this support by actively evaluating the implementation of, or continuing to offer, supply chain finance, opening up an estimated £5 billion additional working capital for SMEs.

84. We are particularly keen to hear whether small businesses are experiencing difficulty in accessing some of these alternative financing options as a result of contractual terms imposed on suppliers by more powerful customers. We have had representations, for instance, that a 'ban on assignment' of obligations relating to a contract can prevent a small business from selling a debt owed by a larger customer onto a factoring service provider, who may be more prepared and equipped to chase up a late payment. If correct, this not only removes a cashflow management option from the supplier but also potentially reduces the incentive on the customer to pay on time.

Q22. Do small businesses have adequate access to the information and support they need to understand the external financing options available to them? What would help raise awareness of these options?

Q23. How could working capital options be made cheaper and more accessible to small businesses?

Q24. Would removing contractual barriers to selling invoices (e.g. as a result of a ban on assignment) be helpful to small businesses by increasing their access to services such as factoring and invoice finance?

Annex A: Building a Responsible Payment Culture response form

The closing date for this consultation is 31/01/2013

Name:
Organisation (if applicable):
Address:

Please return completed forms to:

Business Finance and Tax
Spur 1, 3rd floor
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Telephone: [Your/relevant phone number]
Fax: [Your/relevant fax number]
email: [Your/relevant email address]

Please tick the box that best describes you, your company or organisation.

	Business representative organisation/trade body
	Central government
	Charity or social enterprise
	Individual
	Large business (over 250 staff)
	Legal representative
	Local Government
	Medium business (50 to 250 staff)
	Micro business (up to 9 staff)
	Small business (10 to 49 staff)
	Trade union or staff association
	Other (please describe)

Q1 Do you agree that failure to issue purchase orders for public contracts in a timely fashion is a problem and has caused delays in payment? What measures could Government introduce to ensure that this does not happen? How could this be achieved simply and effectively?

Q2 Do you think any specific change is needed to make suppliers feel better able to complain or charge interest in instances when there paid late on public sector contracts? What measures could Government introduce to encourage this?

Q3 Do you agree that more disclosure of company performance on supplier payment would be useful? If so, do you agree that a voluntary framework would be an effective, proportionate response, or should alternative mandatory options be introduced?

Q4 Do you agree that if a new framework were brought in (whether voluntary or otherwise) it should include the elements described on page 18? Should further elements be included?

Q5 Are there any other measures related to transparency or disclosure that would incentivise companies to ensure that their supplier payments are managed fairly and efficiently?

Q6 How can the Prompt Payment Code better raise awareness of good practice? Would case studies of how companies manage different stages of the payment cycle be helpful in demonstrating how the Code principles can be applied in practice?

Q7 Are there any steps that could be taken to encourage more businesses to identify breaches of the Code by signatories?

Q8 What further measures would you like to see as either a signatory, or a supplier of a signatory, to give you confidence in the Code as a marker of good practice? In particular, would it be useful to ask for publication of the maximum payment terms offered by signatories?

Q9 Should a new ‘upper tier’ be introduced to the Prompt Payment Code for signatories prepared to agree to more stringent rules?

Q10 Should businesses be offered incentives to sign up to an ‘upper tier’ if introduced? What would be an appropriate and effective incentive?

Q11 What are the barriers to claiming interest on late payment? What could be done to encourage more businesses to claim interest and late payment charges where appropriate and create an environment in which this is considered the norm?

Q12 Do you believe that further penalties payable to creditors would be a useful means of discouraging late payment? If so, how do you think that they could be implemented given suppliers’ inevitable concern not to damage future commercial relationships? Do you have views as to how any such additional penalties should be framed or the level at which they should be set?

Q13 Do you see advantages in a third party (which could be Government or another body, such as trade associations) playing a more direct role in the collection of penalties for late payment? If so, how could such a system be implemented effectively given the challenges discussed above?

Q14 Should businesses remain able to agree payment terms that are over 60 days? What impact would a hard limit on payment terms have? How would this affect different sectors?

Q15 Under what circumstances do you think that a payment period should be considered to be ‘grossly unfair’ to the supplier? How could this be defined more clearly? Would it be possible to agree one set of principles for all transactions or would differentiated approaches be more appropriate, for instance on a sectoral basis?

Q16 If businesses remain able to agree payment terms over 60 days, should they have to consult with suppliers and state publicly that they are doing so, or publish reasons explaining why? Should this apply to all businesses or only large companies? How would this help or hinder your business?

Q17 Are there simple steps that might be taken to make the construction adjudication process quicker, cheaper or both?

Q18 What role, if any, could industry or sector bodies play in identifying and promulgating good contractual practices within their sectors and adjudicating on disagreements? Do you see particular sectors as priorities for action? How might Government facilitate this?

Q19 Do you think that more information on whether companies have a history of late payment would help suppliers negotiate better terms when doing business?

Q20 What can businesses, data hosting platforms and Government do to facilitate greater transparency?

Q21 What prevents small businesses from using technology services to help them with financial management and payment? What could be done to encourage greater take up?

Q22 Do small businesses have adequate access to the information and support they need to understand the external financing options available to them? What would help raise awareness of these options?

Q23 How could working capital options be made cheaper and more accessible to small business?

Q24 Would removing contractual barriers to selling invoices (e.g. as a result of a ban on assignment) be helpful to small businesses by increasing their access to services such as factoring and invoice finance?

Do you have any other comments that might aid the consultation process as a whole?

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply ☐

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

☐ Yes ☐ No

Annex B: List of Individuals/Organisations consulted

Federations of Small Business

Forum for Private Business

CBI

British Chambers of Commerce

British Application Software Developers Association (BASDA)

Sage

GXS Ltd

Intuit

Streamline/WolrdPay

Go Cardless

Experian

Dunn & Bradstreet

Equifax

Satago

RBS

Barclays

HSBC

Lloyds

ACCA

Deloitte

Institute of Credit Management

ICAEW

Annex C: Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf

Comments or complaints on the conduct of this consultation

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

John Conway,
BIS Consultation Co-ordinator,
1 Victoria Street,
London
SW1H 0ET

Telephone John on 020 7215 6402
or e-mail to: john.conway@bis.gsi.gov.uk

However if you wish to comment on the specific policy proposals you should contact the policy lead at:

Business Finance and Tax
Spur 1, 3rd floor
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

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