Title: Impact Assessment: Directive of the European Parliament and the Council on Combating Late Payment **IA No:** BIS0364 **Lead department or agency:** Department for Business, Innovation and Skills **Other departments or agencies:** Cabinet Office; Scottish Government; Welsh Government; Northern Ireland Executive and Government of Gibraltar	# Impact Assessment (IA) **Date:** 12/06/2012 **Stage:** Consultation **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries:** Andy Harrison andy.harrison@bis.gsi.gov.uk 0207 215 6032

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£50.8m	£50.8m	- £5.9m	No	NA

What is the problem under consideration? Why is government intervention necessary?

Since 2009 we've seen a downward trend in late payment duration. Though still problematic as it impacts on cash flow which is seen as an obstacle to business success and trade as the perception is that exporting entails a higher risk of late payment, insolvencies, debt write-offs etc. HMG must bring its law into line with EU law. Intervention is necessary to ensure compliance with the changed Directive. It is also necessary due to: a) asymmetric information, in that creditor businesses may face difficulties understanding how to claim for compensation due to late payment, b) market power, in that debtors may take advantage of creditors due to market power they have and negative externalities that the debtor imposes on the creditor.

What are the policy objectives and the intended effects?

Government is committed to combating late payment. Its overall objective is to improve the cash flow of businesses. Specifically the Government aims to:
1) Confront debtors with measures that successfully discourage them from paying late;
2) Provide creditors with measures that enable them to fully and effectively exercise their rights when paid late; and
3) Create a level playing field across Member States.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The following options have been considered:
Option 1: Do nothing. Current late payment legislation would not change.
Option 2: Implement the revised Directive. The main changes include: a) requiring public authorities to have a maximum 30 day payment term; and b) replacing the current 3 tiered compensation structure depending on the value of the debt with a flat rate of compensation.

Option 2 is the the preferred option as it is considered to best meet the policy objectives. The recast Directive will help improve cash flow across business by introducing a simple compensation structure for suppliers suffering late payment. It is also a helpful step in establishing a level playing field across Member States and a simplification of current UK legislation.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 03/2018

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: ______________________ Date: ______________

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	**High:** 101.6	**Best Estimate:** 50.8

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0	N/A	0	**0**
High	0		0	**0**
	0		0	**0**

Description and scale of key monetised costs by 'main affected groups'

Other key non-monetised costs by 'main affected groups'

The revised Directive will result in a one-off administrative cost to business in having to familiarise themselves with the revised legislation. However, the revised Directive involves only minor changes and therefore this familiarisation cost is likely to be small. The revised Directive changes the amount of compensation the creditor business has to pay the debtor if they pay late. However, this compensation is a transfer from the debtor to the creditor and therefore has zero net cost.

	Total Transition (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0	N/A	0	**0**
High	0		11.8	**101.6**
	0		5.9	**50.8**

Description and scale of key monetised benefits by 'main affected groups'

If the revised Directive results in public sector authorities meeting the 30 calendar day payment period in commerical transactions, this would generate a benefit to creditor businesses of £11.8m from reducing the administrative cost of chasing late payment. If the Directive failed to change the behaviour of public sector authorities, the benefit would be £0. Our best estimate lies between these 2 points (£5.9m), but we are seeking to refine this estimate through the consultation.

Other key non-monetised benefits by 'main affected groups'

Businesses perceive selling abroad as entailing a higher risk of late payment and the revised Directive by helping to create a level-playing field across Member States, may reduce the disincentives to engage in cross-border trade between businesses that currently exists. If successful in combating late payment the revised Directive may also reduce the value of written-off debt, administrative costs of chasing late payment from other businesses, number of insolvencies and increase confidence.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

It is estimated that around 107,000 SME employers could benefit from the imposition of a 30 calendar day deadline on public setor payment. Given around 2.2% of businesses paid late chase late payment and the estimated cost of chasing late payment is £5000, this generates a potential benefit of £11.8m. The best estimate is taken as the mid-point of the estimated benefit as the impact of the revised Directive on the behaviour of public authorities is uncertain.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: 0	**Benefits:** £5.9m	**Net:** £5.9m	No	NA

Evidence Base (for summary sheets)

Following agreement by all EU Member States, this Impact Assessment has been revised taking into account the changes made to the recast European Directive 2011/7/EU on combating late payment in commercial transactions. The costs and benefits and elements of the package may be revised following the completion of the consultation process and will be reflected in the Final Impact Assessment.

Introduction

History of the Late Payments Directive

The UK first introduced legislation on late payment in 1998, which aimed to ensure that small businesses did not suffer financially from late payment. The legislation allowed small businesses the right to charge statutory interest on overdue payments from large businesses.

This legislation was enhanced in 2000, to enable small businesses to claim from each other, and again in 2002, to bring the UK into line with the new EU Directive (2000/35/EC).

In 2000, the European Commission adopted a Directive (2000/35/EC) to combat late payment in **commercial transactions**. According to the Directive, a late payment interest levy may be charged when payment is not made within the contractual or legal deadline. The Directive provides for a statutory rate of interest, but allows the parties to agree otherwise. It becomes payable from the day following the date or the end of the period for payment fixed in the contract, or 30 days following the date of receipt by the debtor of the invoice or an equivalent request for payment if the payment period is not fixed.

In 2009, a report by the European Commission found that there were €1.9 trillion (£1.6 trillion) worth of late payments in the European economy, €1.1 trillion of which is owed to SMEs[1]. In many Member States it was suggested that public authorities had longer payment terms than commercial ones (in the UK the model public sector contract provides a 30 day payment period to suppliers but Government has set central Departments much more stretching targets – to pay 80% of invoices within 5 days).

The revised Directive recognises current UK legislation and practice as an exemplar and essentially mirrors existing UK legislation and practice. The main legislative difference is that the revised Directive requires public authorities to have a maximum 30 day payment term (with the exception of the healthcare sector). This legislative change effectively mirrors current practice across the UK public sector. The revised Directive also establishes a single rate of compensation (compared to the three rates depending on the size of the debt available in UK legislation).

The European Commission believes that, once introduced by all EU member states, the new rules could mean an extra £150 billion being made available to businesses across Europe, helping to relieve cash flow problems.

Problem under consideration

Since the recession, there has been a downward trend in the average number of days beyond contract terms for which invoices were paid late. Latest data from pH group for Q1 2012 shows

[1] Recruiter 2012

that the number of days invoices were paid beyond contract terms was 16.2 days[2] for the UK, contrasting with the peak of 20.5 days at the beginning of 2009. Despite this improvement, late payment continues to be a problem for business and has detrimental consequences:

- ***Cash flow:*** Late payment represents a significant cost to creditor enterprises. In general, late payment strains cash flow, adds financial costs, reduces potential for investment opportunities and fuels uncertainty for many creditor businesses and in particular, small businesses, especially in times of limited and expensive access to finance. The result is that their competitiveness and solvency are often compromised. Data from Bacs[3] (May 2012) claim that unpaid bills to small businesses are now at their highest level - £35.3 billion - in almost five years, with combined debts up by almost £2 billion compared to the first half of 2011. Bacs report that 41 percent of small businesses say that big business are still, in the main, the worst offenders (compared to private companies, individuals, other small businesses and Government departments), insisting on payment terms of as much as 120 days, with many suppliers waiting up to five months to be paid. In February 2012, the SME Business Barometer[4] suggests that 51% of SME employers consider cash flow difficulties as an obstacle to their business success, with 10% considering it their main obstacle to success. Of these 51% of SMEs that consider cash flow an obstacle, 62% reported that cash flow difficulties were due to late payment from other businesses.

- ***Trade:*** Late payments have a negative impact on non domestic trade generally. There is significant variation in payment practice across Member States, which is confusing to suppliers and is likely to inhibit trade. Further, most businesses perceive selling goods and services to businesses and authorities in other countries as entailing a higher risk of late payment. In the Commission's final Impact Assessment it reported that domestic late payment ran to six days whereas non domestic late payment ran to eleven days[5]. This heightened risk of late payment discourages enterprises from selling products and services in other countries, since it increases uncertainty and the cost of doing business. International Trade News[6] reports that in comparison to the rest of the continent, small and medium-sized businesses dealing with companies in Spain or Italy can expect to wait the longest for payment as Spanish businesses tend to pay invoices after 75 days, followed by Italy where it takes an average of 67 days. In contrast, Germany or Sweden, usually settle invoices after 24 and 30 days respectively. Late payment is clearly not just a UK phenomenon and in fact, if anything, many countries' payment habits are even worse than the UK's. If UK businesses are regularly dealing with overseas companies they will almost certainly encounter late payment which could have a negative, ripple effect on financial commitments in the UK.

- ***Public procurement:*** Although the payment delay is longer for business to business transactions, long payment periods in public procurement contracts and late payment by public authorities also discourages businesses to participate in public procurement opportunities. This discouragement reduces the competitive intensity in public procurement which can limit the downward pressure on prices tendered for contracts. According to the February 2012 SME Business Barometer, 8% of SME employers who have worked for the public sector in the last 6 months said that they tend to be paid within 10 working days of the receipt of the invoice, 6% said 11 to 15 days, 1% said 16 to 20 days, 43% said 21 to 30 days and 38% said longer than 30 days.

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2 PH Group data is calculated using information on the suppliers invoice and we know this often fails to reflect suppliers terms .e.g. suppliers typically quote 30 day payment when we know most of UK business suppliers terms are 30 days net monthly.

3 http://www.techradar.com/news/world-of-tech/roundup/small-businesses-waiting-on-35bn-in-late-payment-1081311

4 SME Business Barometer, February 2012.

5 European Commission Final Impact Assessment 2009

6 http://www.internationaltrade.co.uk/articles.php?CID=1&SCID=13&AID=459

- ***Confidence:*** The culture of late payment creates uncertainty in the supply chain and a lack of confidence across the economy.

- ***Insolvencies:*** There is some indication that late payment causes insolvencies. In 2008, 4,000 companies who went insolvent cited late payment as the main cause and in 2009 it was estimated that UK business would pay £180 million in interest payment on overdue payments. Further, Research on Payment Culture[7] in 2012, indicated that as a result of late payment 124,100 SME employers were almost put out of business. Although we can not infer causality, there does appear to be some correlation between the number of insolvencies and the duration of late payments. Both days beyond term and insolvencies peaked at the beginning of 2009, both then declined in the latter half of 2009 and have been broadly stable since.

IA Q1: Do you have any further evidence about problems created by late payments, particularly where this potentially impacts on business survival/insolvency?

In general, late payment strains cash flow, adds financial and administrative costs, reduces the potential for investment opportunities and fuels uncertainty for many creditor businesses and in particular SMEs[8], especially in an economic downturn with limited and expensive access to finance. The result is often that their competitiveness and solvency, and eventually their viability are compromised[9].

The European Commission[10] estimated that the value of turnover paid late accounts for around €1,864 billion across the EU:

Value of annual turnover in the EU (€bn) paid late	**€bn**
Large company turnover paid late	724
SME turnover paid late	1,141
TOTAL	**1,864**

Written-off debt represents a significant cost to business and the UK economy more generally. Intrum Justitia's 2011 European Payment Index (EPI 2011)[11], an annual survey of almost 6,000 businesses across Europe found:

- Written-off debt across Europe has risen by €12 billion over the past 12 months. In 2010, 2.7% of all transactions across Europe were written off, compared to 2.6% in 2009.
- Other countries showing a negative development, with written-off debt increasing by over 10%, are the UK, Ireland, Denmark, Austria, Portugal, Hungary and Sweden.
- In the UK 55% of companies see late payments as a threat to survival and 65% see it as prohibiting growth.

IA Q2: Do you have any further evidence about the incidence or magnitude of write-offs associated with late payment debts?

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7 Research on Payment Culture, by Forum of Private Business and Graydon credit risk intelligence, April 2012.

8 OECD SME, 2002. In Successes and Challenges for SMEs, 2003, the SME Union observes that payment delays caused by big companies are twice as frequent as those caused by SMEs. A survey in the UK (Mamut survey, published November 2006) showed that 56% of the SMEs with less than 20 employees have debtors who are late payers versus only 29% of those with 20-50 employees. See also Bulletin de la Banque de France, n. 168, décembre 2007, p. 82-84.

9 Pike R., Cheng N.S., Cravens K. and Lamminmaki D.: "Trade Credit Terms: Asymmetric Information and Price Discrimination Evidence From Three Continents", Journal of Business Finance & Accounting, 32(5) & (6), June/July 2005, p. 1201.

10 This turnover could be linked to any delay, i.e. from one days delay to 60 days delay or more. This figure has been calculated by combining the average percentage of turnover paid late with data on average company turnover by size from Eurostat. Since this figure is based on people responding to the RPA questionnaire, it may overestimate the turnover paid late reflecting respondents' bias towards the subject.

11 http://www.intrum.com/ie/Press-and-publications/Pressreleases/Publication-Container/Intergrated-services-e-commerce/

Rationale for intervention

Government must bring its legislation into line with European Union law. Intervention is necessary to ensure compliance with the changed Directive.

A number of market failures arise in relation to late payment:

Asymmetric information for creditor firms

- Creditor businesses may face difficulties in claiming interest on late payment due to complexities in understanding how to claim, what interest rate they are able to charge and furthermore, many businesses are also unaware of the right to charge interest.

Abuse of market power

- There may be some cases where the debtor wields considerable market power compared to the creditor, which the debtor then takes advantage of. Businesses value their commercial reputation and their relationships with their clients and therefore fear that chasing payment would damage their reputation with the client. Smaller businesses in particular often rely on a fewer number of clients, and are unwilling to use Late Payment Legislation to chase payment in the worry that they risk losing the client. This creates a situation in which debtors are not held to account for paying late as well as gaining an unfair economic benefit of an interest-free loan.

Negative externalities

- Often, debtors are unconcerned about the wider costs imposed on the creditor through late payment. Evidence suggests that smaller firms typically spend the longest chasing late payments; around 1.65 hours per day according to the Barclays Local Business Annual Late Payments Report[12]. Legal proceedings and the pace of proceedings are seen as a prohibitive cost in relation to the amount of interest that would be claimed.

Evidence from stakeholders suggests that there is a culture of late payment, which is seen by the debtor as a means of managing cash flow with no negative impacts upon the creditor. However, not only does late and delayed payment cause the death of valid businesses but it also undermines confidence, and therefore innovation, in the supply chain.

As part of a late payment campaign, leading industry trade bodies recently wrote an open letter to the Business Minister, Mark Prisk, calling for a number of measures to tackle the late payment problem. This included clamping down on large companies taking ‘prompt payment discounts' and imposing retrospective changes to payment terms and conditions that are not contractually agreed. It also included a request to review the Late Payment of Commercial Debts (Interest) Act 1998, so that more affected suppliers are encouraged to charge interest on late payments.

Policy objective

Government is committed to combating late payment. Its overall objective is to improve the cash flow of businesses, which is of particular importance in times of economic downturn.

Specifically the Government aims to:

1) Confront debtors with measures that successfully discourage them from paying late;

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[12] http://www.newsroom.barclays.com/content/Detail.aspx?ReleaseID=1721&NewsAreaID=2

2) Provide creditors with measures that enable them to fully and effectively exercise their rights when paid late; and
3) Create a level playing field across Member States.

Legislation is not intended to be the option of first resort when payment is late. It acts as a deterrent to late payment and a driver for payment on time by establishing a clear expectation in law that payment will be made according to agreed terms that creditors will not be penalised financially when paid late and debtors will not benefit. The legislation can be clearly referenced in all contracts and invoicing, alongside setting out the costs of not paying on time and is therefore an important tool for suppliers to use as part of their wider strategy for ensuring they get paid on time.

Legislation cannot be the sole remedy for late payment as the evidence suggests[13] that suppliers are often poor at agreeing payment terms with suppliers, poor at invoicing accurately (or to the terms of their customer) and regularly fail to undertake credit checks. The UK has embarked upon a programme to support suppliers to better manage their customer relationships and over 300,000 copies of guides to managing cash flow have been downloaded by business. The revised Directive highlights measures taken in the UK to support and encourage prompt payment, including establishing the public sector as an exemplar and promoting best practice (through measures such as the Prompt Payment Code).

The legislation is aimed at creating an environment where paying on time is the norm and late payment is seen to be unacceptable across the business community. The Directive should prohibit abuse of freedom of contract to the disadvantage of the creditor. Where a term in a contract or a practice relating to the date or period for payment, the rate of interest for late payment or the compensation for recovery costs is not justified on the grounds of the terms granted to the debtor, or it mainly serves the purpose of procuring the debtor additional liquidity at the expense of the creditor, it may be regarded as constituting such an abuse. For that purpose, any contract term or practice grossly deviating from good commercial practice, contrary to good faith and fair dealing, should be regarded as unfair to the creditor.

[13] Research on Payment Culture, by Forum of Private Business and Graydon credit risk intelligence, April 2012.

Table 1: Key differences between the current and proposed Directive

	RECAST DIRECTIVE: **Directive 2011/7/EU on combating late payment in commercial transactions**	**CURRENT LEGISLATION: The Late Payment of Commercial Debts (Interest) Act 1998 as amended and supplemented by the Late Payment of Commercial Debts Regulations 2002**
Business to business payment terms	Member States shall ensure that the period for payment fixed in the contract does 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 if not grossly unfair to the creditor.	There is no defined payment period and parties are free to agree payment terms. However, if there is no agreed payment period the Act sets a default of 30 days (except where there is a long-standing relationship with terms considered to be standard practice).
Public sector payment terms	Member States shall ensure that in commercial transactions where the debtor is a public authority the payment period does not exceed 30 calendar days following receipt by the debtor of the invoice	There is no discrete reference to public sector terms. However, the Cabinet Office model contract references a 30 day payment term.
Public sector healthcare payment terms	Member states may extend time limits to a maximum of 60 days for public entities providing healthcare (extensions of this nature must be reported to the Commission)	n/a
Statutory interest rate	Simple interest is calculated as equal to the sum of the Bank of England reference rate plus at least eight percentage points	Interest is calculated as the equal of the Bank of England base rate plus 8 per cent.
Compensation for recovery costs	The creditor is entitled to obtain from the debtor, as a minimum, a fixed sum of € 40, as compensation for recovery costs, plus additional costs incurred.	A fixed charge of £40, £70 or £100 depending on the size of the debt (under £1,000, under £10,000, and higher).
Application	Member States shall decide whether to exclude contracts concluded before 16 March 2013.	n/a
Verification periods	Member States should ensure that the maximum duration of a procedure of acceptance or verification does not exceed, as a general rule, 30 calendar days. Nevertheless, it should be possible for a verification procedure to exceed 30 days where agreed and not grossly unfair to the creditor.	n/a

Description of options considered (including do nothing)

Option 1: Do nothing

Directive 2000/35/EC was adopted in order to combat late payment in commercial transactions. According to the Directive, a late payment interest levy may be charged when payment is not made within the contractual or legal deadline. The directive provides for a statutory rate but allows the parties to agree otherwise. It becomes payable from the day following the date or the end of the period for payment fixed in the contract, or 30 days following the date of receipt by the debtor of the invoice or an equivalent request for payment if the payment period is not fixed. Current late payment[1] legislation specifies that the creditor is entitled to obtain from the debtor a fixed charge of £40, £70 or £100 depending on the size of the debt (under £1,000, under £10,000, and higher respectively). For debts over £10,000 a flat rate of £100 must be paid to the creditor.

Option 2: Implement the Directive

This new Directive 2011/7/EU on combating late payment in commercial transactions legislation repeals and modernises old rules. Table 1 above summarises the key differences between the current Directive and proposed Directive.

Main Provisions

Ensures that if the date or period for payment is not fixed in the contract, the creditor is entitled to interest for late payment upon the expiry of any of the following time-limits:

- 30 calendar days following the date of receipt by the debtor of the invoice or an equivalent request for payment ;
- if the date of the receipt of the invoice or the equivalent request for payment is uncertain, 30 calendar days after the date of receipt of the goods or services.

In addition, countries shall ensure that:

- the maximum duration of the procedure of acceptance or verification does not exceed 30 calendar days from the date of receipt of the goods or services, unless otherwise expressly agreed in the contract and provided it is not grossly unfair to the creditor;
- the period for payment fixed in the contract does not exceed 60 calendar days, unless otherwise expressly agreed in the contract and provided it is not grossly unfair to the creditor.

Compensation

When interest for late payment does become payable in commercial transactions, the creditor is entitled to obtain a minimum fixed amount of EUR 40. This fixed sum is payable without the necessity of a reminder and as compensation for the creditor's own recovery costs. In addition the creditor will be entitled to obtain reasonable compensation from the debtor for any recovery costs exceeding that fixed sum and incurred due to the debtor's late payment. This could include expenses incurred, inter alia, in instructing a lawyer or employing a debt collection agency.

Public Authorities

In commercial transactions where the debtor is a public authority and a certain time period has expired, the creditor is entitled to charge interest, without the necessity of a reminder, where the following conditions are satisfied:

[1] Definition: Payments that miss their due dates according to an agreed contract.

- the period for payment does not exceed any of the following time-limits: i) 30 calendar days following the date of receipt by the debtor of the invoice or an equivalent request for payment; ii) if the date of receipt of the invoice or the equivalent request for payment is uncertain, 30 calendar days after the date of the receipt of the goods or services;
- the date of receipt of the invoice is not subject to a contractual agreement between debtor and creditor.

The new Directive proposes that member states may extend the time-limits up to a maximum of 60 calendar days for:
- any public authority which carries out economic activities of an industrial or commercial nature by offering goods or services on the market and which is subject as a public undertaking to the transparency requirements laid down in Commission Directive 2006/111/EC;
- public entities providing healthcare which are duly recognised for that purpose.

Evidence suggests that the best way of securing timely payment is to agree terms in advance of the transaction and to invoice timely and accurately - effort therefore needs to be focussed upon managing customer relationships and managing cash flow. Although prompt payment continues to be a problem in the UK we are also recognised as an exemplar across Member States, including for the measures introduced by Government's to drive a culture of paying according to agreed terms, with examples such as the Prompt Payment Code[2], improved guidance for suppliers and speedy public sector payment.

Monetised and non-monetised costs and benefits of each option

Option 1: Do nothing

Data from the February 2012 SME Business Barometer suggests that 51% of SME employers consider cash flow difficulties as an obstacle to their business success and of these 62% say it is due to late payment from other businesses. This equates to around 32% (i.e. 0.51 x 0.62 = 32%) of SME employers. Evidence suggests, however, that only a small proportion of businesses actually chase late payment using legislation. According to the Confederation of British Industry[3] only 7% of SME employers have used existing UK legislation to chase late payment. Given this we can assume that approximately 2.2% (0.32 x 0.07 = 2.2%) of SME employers are paid late and then go on to chase payments. If the same proportions are assumed for large businesses, this means approximately 26,500 employing businesses (2.2% of the total stock of 1.2 million employers[4]) chase late payments using the legislation.

Barclays data[5] suggests that about 17% of money paid late is on sums over £5000 (data is not available for sums over £10,000). Therefore it is estimated that approximately 4,500 businesses (i.e. 17% of those 26,500 employing businesses who are paid late and chase payments), could potentially receive the £100 compensation, the benefit of which equals £450,000. The remaining 22,000 businesses that are paid late and chase late payment are assumed to be able to potentially receive the £40 compensation, the benefit of which equals £880,000. The total benefit to businesses who could potentially receive compensation is therefore estimated to be approximately £1.3 million (i.e. 4,500 x £100 + 22,000 x 40). This is also the cost to businesses that pay late. However, the cost could be spread amongst a smaller number of firms if one firm owed several suppliers. The net benefit is therefore zero as the cost

[2] http://www.promptpaymentcode.org.uk/

[3] Initial Impact Assessment – gathering evidence for negotiating positions www.bis.gov.uk/files/file53264.doc

[4] BIS Business Population Estimates, 2011

[5] http://www.newsroom.barclays.com/content/Detail.aspx?ReleaseID=1721&NewsAreaID=2

represents a transfer from the debtor business to the business receiving the compensation (the creditor business).

It is recognised, however, that although very few businesses use the legislation that is in place to chase late payment for fear of damaging business relations, there are more businesses that chase payments without using the legislation.

IA Q3: Do you have any further evidence about the incidence of firms chasing late payments outside of existing legislation?

In 2009, evidence suggests that businesses have been forced to write off £526 million in bad debt over a 12 month period and are struggling as suppliers and customers to pay on time, according to Barclays Local Business Annual Late Payments Report [2009].

A survey by the Federation of Small Business in May 2011[6] asked its members about the value of debt written-off over the past 12 months. The results are shown in the table below. From this, the aggregate debt written-off has been estimated based on applying the percentage of FSB members who had reported to have written-off debt to the total number of employing businesses (1.2 million SME Employers) and multiplying this by the mid-point of the value of invoices range.

Value of invoices	% of members that had written-off this debt	Aggregate debt written-off
£1 - £4,999	47	£1.4 billion
£5,000 - £9,999	9	£0.8 billion
£10,000 - £34,999	8	£2.2 billion
£35,000 or more	2	£0.8 billion
		Total: 5.2 billion

There are other costs to creditors that are not replicated for debtors, including:

- **Administrative costs of chasing payments:** According to the Barclays Local Business Annual Late Payments Report smaller firms typically spend the longest chasing late payments; around 1.65 hours per day. According to the ASHE[7] finance officers are paid a median hourly wage of £12.28. This equates to a cost per small firm of just over £5000 per year, assuming 250 working days per year (i.e. £5000 = 1.65 x £12.28 x 250). Given 970,000 small businesses[8] (with 1 to 9 employees) and assuming that 2.2% of these employers are paid late and go on to chase late payment (as above), this equates to a cost of £107 million per year (i.e. £5000 x 2.2% x 970,000).
- **Opportunity costs of funds that are paid late:** According to the Barclays Local Business Annual Late Payments Report [2009], on a typical day, small businesses are £32,838 out of pocket as a result of suppliers or customers failing to pay the standard 30-day invoicing period. This could potentially be saved or invested and therefore there is a foregone interest loss. Assuming small businesses are £32,838 out of pocket per day, this totals approximately £12 million per year (£32,838 x 365 days) which could potentially be invested earning an annual return of 0.5% (base rate). This equates to £60,000 per year of foregone interest (0.5% x £12 million). However, this is a transfer from the creditor to the debtor and therefore the net cost is zero.

IA Q4: Do the assumptions underpinning the above estimates of costs and benefits seem sensible? Do you have any evidence that could help to refine these estimates?

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

7 http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-256648

8 BIS: Business population estimates for the UK and the regions

Option 2: Implement the Directive (preferred option)
A key feature of the revised Directive is the creation of a level playing field for UK suppliers operating across Member States, essentially extending the protections enjoyed by those supplying in the UK consistently across all Member States. This could potentially alleviate some of the adverse consequences late payment has on trade among Member States, by reducing the risk of late payment by overseas debtors.

The revised Directive establishes in legislation current UK best practice for payment by public authorities. There is no discrete reference to public sector terms in current UK legislation. This may result in an increasing number of public sector authorities meeting the 30 calendar day payment period in commercial transactions. According to the February 2012 SME Business Barometer, of the 24% of SME employers who had worked with the public sector in the last 6 months, 38% said that they tend to be paid more than 30 days after the receipt of an invoice. Therefore it is estimated that approximately 9% (38% of 24%) of SME employers, equating to around 107,000 SME employers (given 1.2 million SME employers), will benefit from the imposition of a 30 calendar day deadline on public sector payment. These businesses will therefore benefit from a reduction in the administrative costs of chasing late payment.

As above, estimating the cost of chasing late payment as approximately £5000 per small business, and that 2.2% of businesses paid late go on to chase late payment, this generates a benefit of £11.8 million. However, it is possible that the new Directive fails to change the behaviour of public sector authorities and they continue to pay later than 30 days and so this benefit is not realised and the benefit is zero. It is difficult to estimate the level of compliance but given current Cabinet Office best practice guidance is for payment by public authorities to be made within 30 calendar days and this is often not met as outlined above, there is reason to believe compliance may not be 100%. Therefore, we estimate that the likely outcome lies between these two extremes, giving **a benefit of £5.9m per year**. Given the lack of available information on the value of the debt owed by public sector authorities, the benefit of a reduction in the value of written-off debt has not been quantified.

The revised Directive may also result in a reduction in the administrative costs involved in chasing late payment. We do not have comparable information relating to the number of businesses that are paid later than 60 calendar days. Therefore, in the absence of better information and for illustrative purposes, if it is assumed that the revised Directive reduces the administrative cost (as calculated under option 1) of £107 million on small firms by 1% to 3%, this would result in a benefit of £1.1 million to £3.2 million respectively. However, there is likely to be a one-off administrative cost to business of familiarising themselves with the legislation.

IA Q6: Do you agree with the assumptions in the above calculations? Do you have any further evidence that could help to refine the estimates about the potential reduction in administrative costs associated with chasing late payments?

The revised Directive provides for an automatic compensation of €40 (approximately £35), whereas current UK law provides for a three tiered payment depending on contract value. It is unclear whether this will act to reduce late payment, given that the current compensation sums are larger. However, it is a simplification of the current three-tiered system which may encourage businesses to make more use of the legislation. As with Option 1, the cost to the debtor of paying this compensation is equal to the benefit to the creditor or receiving it, and therefore the net benefit equals zero.

The revised Directive also provides a set period payment term of 60 days, should payment terms not be agreed up front. As is clear from the revised Directive, businesses are generally free to fix in their contract, the date or the period for payment. It is therefore only in the absence of a relevant contractual clause that the statutory period of 60 days prescribed by the directive must apply. In other words, only where businesses are silent on the matter does the situation fall within the scope of the directive. As mentioned above, this pan Europe simplification coupled with the Commission's planned awareness raising campaign, will encourage businesses to agree payment terms up front, thereby negating the need to make use of the legislation.

If the Directive is successful in reducing late payment then this should have positive consequences, including a reduction in the value of written-off debt, reduced insolvencies and increased confidence. Quantification of these benefits is difficult, given a lack of evidence on the potential impacts of the revised Directive. However, for illustrative purposes – if it is assumed that the revised Directive results in a 1% reduction in the value of written-off debt (£5.2 billion, calculated above), this would result in a benefit to creditor businesses of £50 million. If the Directive reduced the value of written-off debt by 3%, a benefit to creditor businesses of £150 million would result.

IA Q5: Do you agree with the assumptions in the above calculations? Do you have any further evidence that could help to refine the estimates about the potential reduction in write-offs?

If nothing is done, the roots of late payments in commercial transactions and corresponding passive attitudes will persist and may get worse if economic conditions deteriorate. Evidence from a range of sources has suggested that one of the key issues emerging from small business finances are signs of cash flow difficulties. Late payment by firms, both from their customers and to their suppliers, clearly affects the cash flow position of a business and there is some suggestion of a relationship between late payment and the rate of insolvency in the economy[9].

North/South divide[10]

Evidence shows that member states in the south of Europe can have very long payment delays for commercial and public sector transactions. Greece is the worst offender when it comes to late payments. But it's not alone. Spain, Portugal, Italy, Cyprus and others are also chronically slow payers, routinely breaking the terms of contracts entered into by healthcare companies.

By contrast, the diligent northern nations tend to pay more or less on time.

Risks and assumptions

In the absence of better evidence it is assumed that the Directive will reduce administrative costs by 1% to 3%. It is possible that this is an overestimate and that actually the current administrative burden may not change. Alternatively it may be an underestimate and further administrative cost savings by the creditor business may result.

In addition, in the absence of better information it is assumed that the value of written-off debt may fall by 1% to 3% as a result of the revised legislation. However, it is possible that this is an overestimate and therefore the saving quantified may be an over-estimate.

The risks associated with the revised legislation are minimal given that there are few changes and the legislation is based on current UK legislation.

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[9] See page 7

[10] Euractiv 2011 - http://www.euractiv.com/euro-finance/greece-defaulting-cash-owed-companies-analysis-505906

Wider impacts

We will be seeking the views of business at consultation stage however we envisage a:

- positive impact on increasing investment
- positive impact on reducing insolvency
- positive impact on increased business confidence and certainty

Specific Impact Tests

Small Firms Impact Test

In 2009, a report by the European Commission found that there were €1.9 trillion (£1.6 trillion) worth of late payments in the European economy, €1.1 trillion of which is owed to SMEs[11].

It should be noted that late payment issues are not confined to a specific business sector or type of business. However, the European Commission's Impact Assessment reports that *"SME's are particularly vulnerable to late payments; SMEs are more exposed to variations in cash flow, the financial costs of late payment for SMEs are particularly high, with cash flow needs having to be met by short-term bank loans or overdrafts. Micro and small companies' lower turnover and limited access to finance often result in more expensive credit[12]".*

Much of the above analysis on the costs and benefits of the options relates to SME's. However, we estimate that the administrative costs of chasing late payment is likely to be even higher for smaller businesses, as it will be the business owner that is chasing, with a higher associated wage rate for their time.

We will be seeking a micro business waiver since the measure needs to apply to all businesses that provide goods and services to other businesses and the public sector so that they are covered under the directive. It is essential that micro businesses receive the same protection as other businesses; therefore we do not believe it is possible to exempt micro businesses from this regulation. But as the cost of this regulation is zero providing they pay on time, it will not represent any additional burden on micro businesses.

Competition Test

Would the regulatory proposal:-

- Directly limit the number or range of suppliers? No impact
- Indirectly limit the number or range of suppliers? No impact
- Limit the ability of suppliers to compete? No impact
- Reduce suppliers' incentives to compete vigorously? No impact

Human Rights Impact Test

- Will the policy/decision engage anyone's Convention rights? No impact
- Will the Policy/decision result in the restriction of a right? No impact
- Is the right an absolute right? No impact
- Is the right an limited right? No impact
- Will the right be limited only to the extent set out in the relevant article of the ECHR? No impact

[11] Recruiter 2012
[12] European Commission Final IA 2009

Sustainable Development Impact Test

- Will the project/policy lead to changes in emissions/absorption of greenhouse gases? No impact
- Will the project or policy option be vulnerable to the predicted effects of climate change? No impact
- Will the project/policy lead to a change in the financial costs or the environmental and health impacts of waste management? No impact
- Will the project/policy impact significantly on air quality? No impact
- Will the project/policy involve change to the appearance of the landscape or townscape? No impact
- Will the project/policy change either in the UK or internationally 1) the degree of water pollution, 2) levels of abstraction of water or 3) exposure to flood risk? No impact
- Will the project/policy change the balance of the habitat, will it disturb or enhance habitat or wildlife? No impact
- Will the project/policy affect the number of people exposed to noise or the levels to which they're exposed? No impact

Social Impacts

- Will the policy/project impact on social inclusion, community life or equality? No impact
- Will the policy/project impact on health/wellbeing, education or social protection? No impact
- Will the policy/project have an impact on personal data, privacy, or family life No impact
- Will the policy/project have an impact on participation, the justice system, media, or on ethics? No impact
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Economic impacts

- Will the project/policy have economic impacts? No impact

Summary and preferred option with description of implementation plan

Option 2 - implementing the recast Directive – is the preferred option as it is considered to best meet the policy objectives. The recast Directive will work towards improving cash flow across business by introducing a simple compensation structure for suppliers suffering late payment. The intent is that the simple compensation structure will act as a deterrent to late payment by ensuring that delaying payment carries a financial penalty (rather than an interest free benefit). Government considers the recast Directive a helpful step in establishing a level playing field across Member States (the protections enjoyed by suppliers operating in the UK will be extended to their operations across Member States) and a simplification of current UK legislation. Government plans to consult business and their representatives on implementation with the aim of copying out the directive.

The UK will be required to transpose (implement) the new Directive (2011/7/EU) by 16 March 2013. There has been some interest in early transposition (implementation) of the Directive and our position has always been clear: our first step will be to consult with those affected. We will listen to what UK business says and follow the guidance laid out in the Coalition Government's guide to transposition and the Scottish Government's guidance. Whilst we have already consulted on the draft Directive, we are committed to listening to business.

One in One out

As this change of legislation is European in origin it falls out of scope of one-in one out.

Annex 1: Summary of responses to previous consultation

Government consulted the leading business representative organisations (the CBI, IoD, FPB, FSB, BCC, PCG and EEF) in 2009 as part of its evidence gathering process to aid negotiations.

In their response to the consultation the consensus was that late payment is a real inhibitor of business success and growth; that suppliers will claim there is an aversion to using existing legislation for fear of losing customers and that the UK already has an established strategy for tackling late payment which is more comprehensive than the Commission's proposals – that will have only a very limited impact if SMEs fail to utilise legislation.

Others welcomed the European Commission's efforts to update current rules on late payment and felt that the EU proposals would be a powerful adjunct to current UK legislation, as it will create further debate on the subject, commenting that a culture that says it is acceptable to pay a supplier outside of agreed credit terms, or to change those credit terms mid-contract, has to be wrong.

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