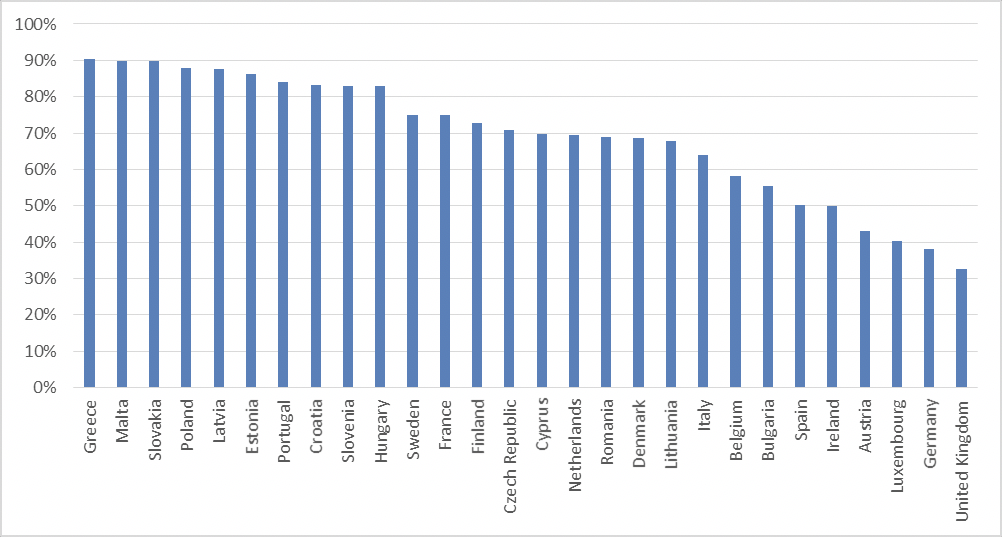
# Assignment – Late Payments

# Problem definition

Ex-Post Evaluation of Late Payment Directive ENTR/172/PP/2012/FC – LOT 4

More than three out of four (78%) companies in Europe have experienced late payments in the last three years. The figure below shows that in most countries more than half of survey respondents had experienced late payments over this period.

Figure 1. Share of survey respondents that experienced late payments in the last three years (%)

Source: European Business survey

Working capital management is a crucial factor in individual firm performance. The use of trade credit (when a product or service is delivered today but paid for at a later stage) is widespread in Europe. As Paul and Boden find in their 2011 article on late payments in the UK, “*trade credit is a prominent part of the UK trading environment, where at least 80 per cent of business-to-business transactions are on credit*”. Furthermore, many Small and medium-sized enterprises (SMEs) are not able to pay their suppliers before they are paid by their customers, owing to liquidity constraints, and might thus end up paying late themselves. All these inconveniences lead to a chain reaction which by now is established as common practice and in some countries part of the business culture.

Given the importance of accounts receivable/payable for firm performance and the extensive use of trade credit, it is clear that late payment is a significant determinant of enterprise survival. Indeed, Wilson (2008) reports that working capital management and late payment problems are a primary cause of small business failure. This is because late payments negatively affect cash flow and add financial costs and uncertainty for creditors. The financial crisis has further constrained cash flow and thereby amplified the importance of prompt payment for a speedy economic recovery.

Moreover, SMEs are likely to be disproportionately affected by late payments because they may not have easy access to finance to cover any temporary shortfalls. Furthermore, such finance – where it is available - may be more expensive than for larger companies, and SMEs do not always have appropriate credit management systems for preventing or managing late payments.

It is thus not surprising that, at EU level, the proportion of firms identifying late payment as a barrier increases with the decreasing size of the firm. 47% of micro firms identified late payment as a barrier, while this is limited to 35% in case of bigger firms. In addition, issues related to late payments extend beyond the impact on directly affected companies to public services, employment, and the internal market.

Late payment imposed on businesses by public authorities can discourage participation in public procurement contracts, which in turn prevents public authorities from getting the best value for taxpayers’ money. From a social point of view, late payment increases uncertainty for many creditors and may impact employment strategies. For example, in Germany, 35% of companies indicated that late payment had a strong impact on the need to lay people off (similarly in the UK (30%), in Spain (28%) and in France (25%)). On average 40% of European business managers said late payment contributed to them not hiring, while one out of four European companies said the consequences of late payment included job cuts. The figure below shows the share of managers across the EU who believe that late payment has an impact on redundancies. An Intrum Justitia report found that 36% of businesses believed that their existence was being threatened by late payment. Indeed, insolvencies are estimated to lead to the loss of 450,000 jobs each year in the EU and outstanding debts of EUR 23.6 billion.

Late payment creates additional or administrative costs as companies invest resources into chasing late payers or they pay interest on the credit contracted to continue business operations. Once they experience a late payment, small businesses are reluctant to make use of the instruments they have at disposal to access their money due to fear of harming the relations with the distributors. Besides the fear factor, it is very costly to hire a lawyer or a debt agency to chase the debt, and the few companies who actually engage in such activities experience both worsened relationship and a gap in the budget. Also going to court is time consuming and the outcome is often unpredictable. In the current state of play, the legislation does not favor the small debtors in enforcing their rights as creditors. Alongside the monetary costs of enforcing their rights, the overall burden should be considered. Resolving the issue through courts is very time consuming. Whereas in large firms there are departments dedicated to dealing with legal issues, small companies need to delegate employees that would otherwise work on other issues, postponing thus their own task and curtailing the company’s productivity. A report from the World Bank estimated that cases are solved through legal proceedings last an average of 512 compared to 7-30 days for cases resolves through alternative dispute resolution.[[1]](#footnote-1)

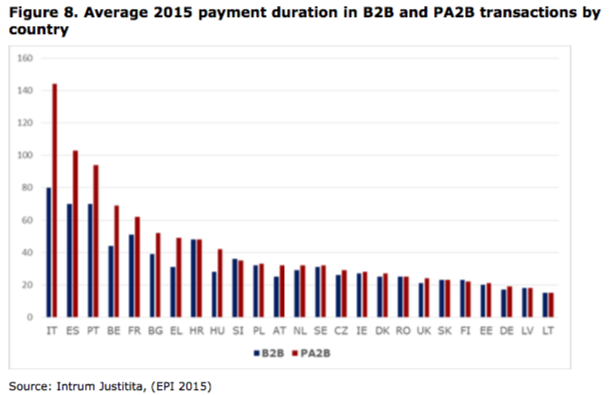
In the UK, a report by the Federation for Small Businesses (FSB) indicated that the cost of chasing late payment amounts to 2,100 EUR per year per SME, for an aggregate cost of about 11 billion EUR (8 billion GBP). In Spain, late payment cost 930 million EUR to SMEs in the second quarter of 2017, although an 11% improvement could be noted compared to the previous quarter due to the reduction of average payment duration.

Late payments may also have a negative impact on the functioning of the internal market and cross-border trade. Many businesses consider cross-border trade with businesses or public authorities from other Member States riskier in terms of the frequency of late payments and the uncertainty on how to deal with late payers. As a consequence, companies may refrain from cross-border trade to the detriment of the functioning of the internal market.

Focusing on the issue of bad debt only, Intrum Justitia reported that in 2014 total bad debt losses for European businesses had risen from 3.0 to 3.1% of revenues, roughly corresponding to a cost of 8 million jobs.

In the current state of play, the Member States have in force regulatory provisions more favorable to the creditor than those required to comply with the minima set in the Directive. Moreover, a limited number of countries have adopted stricter provisions with regards to payment terms – the longer the payment term is, the more likely that a court will consider it to be grossly unfair. A number of Member States have introduced a higher interest rate than that required by the Directive. Furthermore, several countries introduced prompt payment policies by public authorities, a measure considered among the most effective. Other measures taken are regulation obliging the use of electronic invoices, imposing administrative penalties and government addresses of VAT payments.

The figure below shows differences in average payment duration across Member States for both PA2B (between public authorities and economic operators) and B2B (between

economic operators) transactions in 2015. Italy, Spain and Portugal have the longest overall payment duration, while the Baltic countries and Germany are at the other end of the spectrum.

Identify all relevant elements of the problem. In groups list the identified elements on the flip-chart and try to identify a potential problem. By following the steps below build a problem tree mentioning both causes and effects.

Step 1: Reflect on what the problem is and why it is problematic

Step 1: Assess the magnitude and the dimension of the problem

Step 2: Assess the causes and their relative importance

Step 3: Identify who the relevant stakeholders are

Step 4: Describe how the problem would evolve without any new action (= baseline)

# Setting objectives

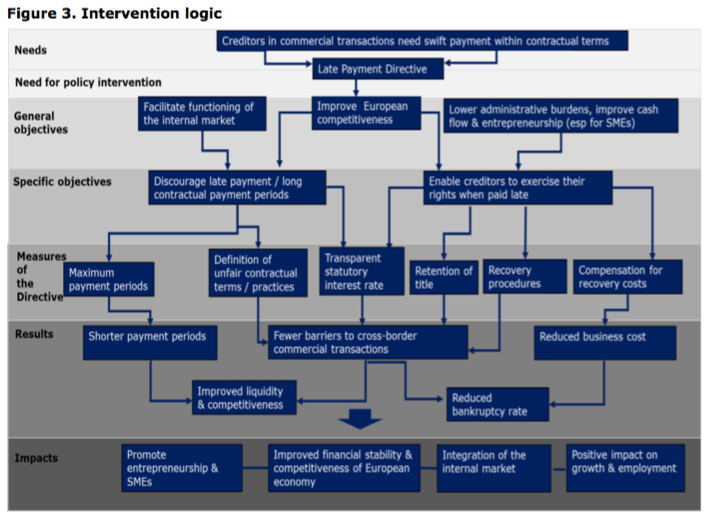
**Ex-post evaluation of Late Payment Directive ENTR/172/PP/2012/FC – LOT 4**

The general objectives of the Directive are to contribute to the development and improvement of the Single Market, and to improve European competitiveness. The Directive also aims to eliminate barriers to cross-border commercial transactions.

By introducing contractual payment terms, the Directive aims to discourage long payment periods and late payment but also to enable creditors to exercise their rights when they are paid too late. To achieve these objectives, the Late Payment Directive (LPD) sets out a range of measures including harmonized rules for payment periods, increased transparency on interest to be paid by late payers and compensation rights for companies that are paid too late.

These measures, in turn, should improve the cash flow of European enterprises, remove barriers to cross-border commercial transactions in the EU, reduce cost to businesses (and SMEs in particular), and thus reduce bankruptcy rates.

Finally, these results – if achieved – should have the following impacts, reflecting the general objectives stated at the outset: a positive impact on growth and employment, the integration of the single market and an improved financial stability and competitiveness of the EU economy.



Read the objectives at the IA report and discuss:

* whether the objectives are clear and understandable
* whether the objectives are linked to the problem described
* whether both general and specific objectives are laid out
* what could have been done better?

# Finding policy options

**Ex-post evaluation of Late Payment Directive ENTR/172/PP/2012/FC – LOT 4**

It should be noted that, for some important aspects of the three problem causes, the EU does not necessarily have the power to act. Certain problems related to the structure of national or regional markets should be dealt with by Member States while, as regards the business cycle, most of the economic policy levers are in the hands of the Member States so that no overall solution for all problem causes can be found at EU level. Consequently, this impact assessment will concentrate primarily on the problem causes on which the EU has the right to act.

Take a look at the incomplete IA Report from the previous exercises.

Do a brainstorming with your group on possible policy-options:

* + What are possible basic approaches towards problem-solution?
  + What alternative policy-options of the EU would you propose and why?
  + How should the relevant policy-instruments look like?

In doing so, follow the next steps:

1. Identify a **baseline** from which the impacts of the policy options will be assessed;
2. Start by compiling a **wide range** of alternative policy options;
3. Identify the **most viable** options;
4. **Double check** the suitability of the retained policy options; and
5. **Describe in reasonable detail** the key aspects of the retained policy options to allow an in-depth analysis of the associated impacts.

# ASSESSING IMPACTS

**Ex-post evaluation of Late Payment Directive ENTR/172/PP/2012/FC – LOT**

For one of the policy-options developed under exercise 3:

* Who would be the main affected stakeholders?
* How would the main impacts of this policy- option look like?
* Do a qualitative mind-mapping of possible impacts in the env./soc./eco. dimension. Consider positive/negative and direct/indirect impacts. Are there any interdependencies between impacts of different dimensions?
* What would be the main challenges regarding quantification and monetization of the identified impacts – how and where could relevant data be collected ?

1. Doing business 2016 Poland. A World Bank Group Flagship Report [↑](#footnote-ref-1)