ECRI BREAKFAST MEETING

FROM WORSE TO WORST?
HOW LATE PAYMENTS SQUEEZE SMEs' LIQUIDITY

Minutes

European Credit Research Institute at the Centre for European Policy Studies
11 May 2010, 08 :30 -10:15, Place du Congrès 1, B-1000 Brussels

Event co-sponsored by intrum justitia

With a one-of-its-kind European payment survey, Intrum Justitia annually engages in the tracking of late payments and payment loss. Every year, the European Payment Index (EPI) offers important data to business leaders and legislators on both national and EU levels. With banks still reluctant to lend, companies are battling for survival by dipping into their own cash reserves – if they have them. And if not, firms save money by laying off staff, slashing wages, staging fire sales of products and paying reduced dividends to shareholders. An enourmous boost to local, regional and national economics would be provided - if everybody just paid on time.

According to the 2010 EPI, a main lesson learnt from the tough market environment is the necessity to achieve better insights into the payment ability of customers through deeper credit checks earlier in the sales process.

Participants of this ECRI Breakfast Meeting were invited to analyze and discuss the latest findings of Intrum Justitia's forthcoming 2010 European Payment Index as well as Rapporteur Barbara Weiler's Draft Report on the April 2009 Commission proposal. On April 28, a strong majority of the IMCO Committee voted for the adoption of the report recasting current legislation on late payments.

Has the payment behaviour worsened in 2010? Should the entitlement to impose compensation payments be turned into an obligation? Should the scope of the Directive be extended to Business-to-Consumer (B2C) relations? Tellingly, 60% of all respondents of the 2010 EPI called for implementing national and pan-European legislation on late payment by consumers, while more than 2.000 companies said that such a move would help their business.

ECRI hosted this Breakfast Meeting a week before the text was initially scheduled to be discussed in the European Parliament's plenary session before being postponed to June/July.

More information can be found at: www.ecri.eu.

Karel Lannoo, CEO of the Centre for European Policy Studies (CEPS) and Director of the European Credit Research Institute (ECRI) opened the event and welcomed all participants to the conference. He underlined the importance of reliable and timely statistics feeding into European policy making and complimented the Swedish credit management service provider Intrum Justitia on the production of its comprehensive European Payment Index (EPI), an annual survey of over 6,000 companies in 25 European countries tracking late payments and payment loss.

In his opening remark, Intrum CEO and President **Lars Wollung** referred to late payments as an "escalating and truly worrying problem in society". Against the background of a record amount of €300 billion annually written-off by companies in Europe – a figure equivalent to Greece's national debt – **Mr Wollung** predicted further "massive write-offs in the future" and warned of a "dangerous polarisation between southern and northern Europe".

The survey reveals diverging payment behaviour in Europe, with payment risk in Nordic countries like Sweden, Finland or Iceland being considerably lower in comparison to nations like Greece, Portugal, Cyprus or Spain. "Credit management has to become a European issue", **Mr Wollung** stated and added that "European businesses strangled by late payments have no breathing space". Especially smaller companies may be forced to put certain projects on ice due to delayed or non-collectable payments by their larger counterparts, which "tend to manage rough situations better".

Presenting the findings of the 2010 European Payment Index, **Madeleine Bosch**, Intrum Justitia's Head of EPI Research, explained that the average written off percentage in Europe increased by roughly one-third over the last three years, amounting to 2.6% in 2010. "This is a devastating picture despite somewhat slower growth in the last year", **Ms Bosch** said. "It may not seem to be a big figure but needs to be compared to turnover and profit numbers", she added, and pointed at extra sales efforts, cutting of wages and laying off of staff as potentially required consequences of bad debt and payment losses.

The study shows that these findings counter positive developments such as the reduction of the average delay in receiving payments beyond the agreed term from 19 to 18 days as well as the drop in the average European payment time from 57 days in 2009 to 55 days in 2010.

"We are dealing with a vicious cycle here: paid late is paying late", **Ms Bosch** explained: in more than 80% of the cases, a debtor's financial difficulties are the reason for late payments. The problem is emphasized by the finding that Europe's firms could save at least €25 billion if they didn't have to go after slow payers. "It is really hard to get paid on time, only 52% of all invoices are settled within the agreed payment term", **Ms Bosch** indicated.

The fear of being paid or not at all also takes on an international dimension as it is hampering cross-border trade within the European Union as well, the study reveals. With data indicating the effectiveness of tougher legislation in Nordic countries (for example supporting the charging of fees and interest on late payments), growth of intra-community trade may be boosted by enforceable EU-level legislation securing payments across borders.

Interestingly enough, however, only 22% of the respondents were familiar with the Late Payment Directive. Intended to cover both the business relation of companies to public authorities as well as business-to-business (B-2-B) relationships, late payments by consumers would not fall under the scope of the new directive. Yet 60% of the respondents support the idea of including so-called B-2-C into pan-European legislation, with 58% stating that this would help improve their business conditions.

Notwithstanding this debate, public authorities remain the worst payers: "33 days is a substantial delay, but we have found an improvement of 4 days compared to 2009", **Ms Bosch** stated.

"Contracting_authorities have been telling me 'of course we pay in time' but this data clearly shows: no, not always", **Barbara Weiler**, MEP and rapporteur of the report on the proposal for the new Late Payment Directive states. Her draft report was adopted by a large majority of the

IMCO committee on 28 April 2010, indicating cross-party support for a recast of the current legislation from the year 2000, which according to **Ms Weiler** "is not working well".

In her intervention, the rapporteur outlined the provisions of the compromise text, which will be discussed in the EP plenary in June or July of 2010. "We want a decision during the Spanish presidency", **Ms Weiler** said.

The agreement struck in the IMCO committee will oblige government bodies to pay their suppliers within 30 days, but grants an exemption from this measure to public healthcare institutions. According to **Ms Weiler**, this should remain the only exemption: "The Council can try, but we will say 'no' – the more exemptions the worse this text will be".

The Committee also proved a somewhat tougher stance on companies as well, tightening the initial Commission proposal of granting complete contractual freedom to companies by fixing a period of 30 days for paying invoices "as a rule" for B-2-B relationships. "This strict agreement is opened", **Ms Weiler's** explained, by granting companies the possibility of contractual agreement on payment terms up to 60 days. The procedure of 'acceptance or verification' of purchased goods and services will be capped at 30 days as well.

Given the reluctance of both the European Commission and the Council to include B-2-C relationships, the IMCO Committee refrained from touching the issue, but "we might do so in two years", **Ms Weiler** said.

The rapporteur also presented the agreement on a €40 fixed fee for recovery costs in case interest for late payment becomes payable. In addition, **Ms Weiler** explained the decision to delete the provision of a lump-sum compensation equal to 5% of the amount due for public institutions. The latter was dropped 'in exchange' for an increase of two percentage points of the statutory interest rate (from 7% to 9%) in order to assure "equal treatment of public and private undertakings".

Responding to comments about the necessity of guaranteeing enforcement of the legislation and the potential reluctance of service providers to take the European Commission to court, **Ms Weiler** confirmed that the Directive encompasses all European Institutions in the future. "Generally, the Directive does not solve every problem, but it does encourage creditors to go to court and to enables them to do so in a less bureaucratic manner". "If Member States take it serious and businesses exercise their rights, then we will see a change in the payment culture in Europe and more fair play", **Ms Weiler** added and voiced her confidence about a quick adoption of the text later this year, given the large majority in the Committee: "The provisions are bound to stay that way."

According to **Mr Wollung**, both the drawing up of better regulation as well as its uncomplicated and efficient enforcement is equally important to create fair market conditions. "We need to lower the barrier to go after late payers. The credit problem is less significant in markets with a fast and effective bailiff system", Intrum Justitia's CEO underlined.

Othmar Karas, MEP and chair of the SME intergroup subsequently scrutinized the adopted report but voiced general support for the piece of legislation. "This is a key directive for SMEs, even if we did not have the current crisis. More payments on time would not only improve the problem of liquidity, but would secure European competitiveness in the long term", he stated. For the provisions to provide legal certainties for SMEs across Europe, Member States should now carefully look into the subject matter and implement it accordingly. But effective advertisement of the existing and upcoming laws is equally important for the companies to know their rights and obligations under the new legislation, he added.

While in favour of the 60 day limit for contractually agreed payment terms in B-2-B relationships, the deletion of the 5% lump-sum and a statutory interest rate of 9%, **Mr Karas** voiced his concerns about the exception granted to hospitals, referring to the SMEs waiting for the settlement of bills by the healthcare sector. "If we find a good formulation for a general exception from the 30 days rule, hospitals could be covered by that", he mentioned and added that "any exception has to bear in mind that longer payment periods can give flexibility – but at the same time we need to be careful that there are no loopholes that make the whole legislation superfluous".

The European Parliament can count on broad backing of the legislative proposal by the European Commission, but needs to be prepared for a "pragmatic but fierce" battle with both counterparties of the institutional triangle on the adoption of the new rules, **Massimo Baldinato**, a member of EU Enterprise and Industry Commissioner Antonion Tajani's cabinet said.

"The Late Payment Directive represents a priority for Commissioner Tajani", **Mr Baldinato** said and added that the Commission would do "whatever we can to have the Directive adopted as soon as possible".

At the same time, the alleviation of problems arising from the late payment of invoices needs to be complemented by improving access to finance for SMEs, **Mr Baldinato** stated. "Access to finance and late payments are two sides of the same coin", he stated and called upon banks to collaborate with SMEs in order to help reduced the pressure on financially constraint companies. According to Intrum Justitia's survey, banks were criticized in a majority of countries as 52% of the respondents lamented the lacking support by financial institutions to help them run their business or help them through a slump.

In addition, the provision of "cheaper and more effective access to justice" should be adequately addressed as well, **Mr Baldinato** concluded.

Luc Hendrickx, Director of Enterprise Policy and External Relations of the European Association of Craft, Small and Medium-sized Enterprises (UEAPME) complimented the IMCO committee on having "done a good job in achieving a compromise between all parties", but did not hide his disappointment. "What's next? Well, we are not going to cry about the in-achievements. It is up to the Council to move ahead, but we will continue lobbying to improve the compromise", he stated.

For **Mr Hendrickx**, in favour of the 30-day limit for payments of bills by governments to companies, the compromise on this topic is a positive and necessary outcome of the debates. "Public authorities should lead by example. SMEs create three-forth of European employment; they should be 'rewarded' by at least being paid in time by public authorities. In addition, this has already been agreed on in the European Recovery Plan", he said.

With reference to diverging opinions within SMEs on the regulation of B-2-B relationships, **Mr Hendrickx** recognized the difficult balancing act between safeguarding contractual freedoms and flexibility on the one side and the protection of smaller companies on the other. "Especially the smallest companies have no flexibility, they have no freedom of contract. Payment terms are imposed on them by larger business partners and accepted by the company for fear of losing a customer. We need this time limit in B-2-B relations in the Directive", he said. As the handling of B-2-B relations constitutes a main point in the discussion among legislators, he urged the Commission to accept the message of the Parliament.

UEAPME is also concerned about the exclusion of business-to-consumer transactions and calls for an extension of the scope of the Directive to all clients of enterprises, regardless of their status. According to the association, late- and non-payments by private customers represent a growing concern for SMEs against which companies will not be protected by the new rules.

He also underlined the importance of awareness and education campaigns in order to inform companies about their legal rights.

Given the existing shortcomings of the proposed text, he urged the European Parliament to foresee a review of the Directive in due time. “This should have been done with the 2000 Late Payment Directive already in 2005, but it never happened”, **Mr Hendrickx** said.

For **John Wilkinson**, CEO of medical technology industry group Eucomed, measures ensuring the elimination of legal loopholes are key “to avoid limiting the obligations for public authorities” and the potential undermining of the enforceability of the Directive. Early repayment should be encouraged by imposing penalties and he added that “it is very surprising that countries like Brazil or Mexico are paying their suppliers quicker than several European countries”.

Eucomed criticizes the exemption from the 30-day limit for public healthcare providers on the grounds that private-public late payments constitute a far greater problem in the healthcare sector than unsettled bills in the B-2-B environment. With employment, R&D efforts, product availability as well as the provision of health services at risk, **Mr Wilkinson** stipulated a stringent payment regime for public authorities. “There should be no different treatment for the healthcare sector”, he stated.

In the ensuing discussion, **Lars Wollung** highlighted the need for granting high levels of contractual freedom and warned of the dangers of limited flexibility. According to Intrum’s CEO, the key problem does not lay within the agreed payment terms for the reason of which the focus should be shifted to “what happens after the due date”. Data show that countries with obligatory debtor fees and interest rates on the face value have a better payment culture than those without these legal provisions, he continued.

This was countered by **Mr Hendrickx** who argued that SMEs in particular are indeed struggling with the imposition of longer payment terms. “The setting of the payment term does constitute a problem for smaller companies, which in addition to selling their products and services are de facto lending money to their larger counterparts”. He called upon policy-makers to “not restart the B-2-B issue” in order to avoid “ending up in 2020 without any legislation”.

DG ENTR’s **Massimo Baldinato** defended the Commission’s hesitant approach to B-2-B regulation by stating that the EU executive is generally not against the inclusion of these transactions but in strong favor of “gaining a better understanding” prior to the drafting of new rules. “We all have one common and justified goal: we want to support SMEs in the EU”, he said, calling upon stakeholders to join forces to reach that objective.