

# **Late Payment of Commercial Debt**

**Research Paper 97/25**

**12 February 1997**



On 24 January 1997, the *Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997* were laid before Parliament and are to be debated by the House of Commons on Thursday 13 February 1997. These draft regulations amend the *Companies Act 1985* and will require each public company, and each large private company within a group headed by a public company, to state its payment practice in its directors' report indicating how long, on average, it has taken the company to pay its bills.

This paper sets out briefly the background to the issue of late payment and the measures introduced since 1993 to combat the problem. It provides a summary of the divisions within the business community over the need (or otherwise) for a statutory right to interest. It also aims to provide a comparison between the payment performance of businesses in the UK with that of other members of the European Community.

**Lorraine Conway**  
**Business & Transport Section**

**House of Commons Library**

---

Library Research Papers are compiled for the benefit of Members of Parliament and their personal staff. Authors are available to discuss the contents of these papers with Members and their staff but cannot advise members of the general public.

## Summary

Late payment of commercial debt is a subject which has provoked a good deal of press comment and parliamentary interest in recent years. In particular, the debate has focused on the complex arguments for and against introducing into UK law a statutory right to interest on overdue bills. To some extent, support for new legislation was at its strongest two years ago when companies feeling the effects of recession needed to maximise their cashflow. At present, the business community remains divided on whether there should be a statutory right to interest.

On the 13 June 1996, Mr Michael Heseltine, the Deputy Prime Minister, in launching the third Competitiveness White Paper, announced that the Government had rejected proposals for a statutory right to interest payments.<sup>1</sup> The decision followed a five-month review launched in January 1996 by Small Business Minister, Richard Page. The review sought comments from business representatives and was informed by the so-called "Your Business Matters conferences", and by commercial and academic research.

The Government claimed that eight of the nine organisations representing small firms which responded to the review rejected the proposal of a statutory right to interest on late payment. They feared it would be used against, rather than by small firms, lead to longer credit periods and legitimise the practice of late payment.<sup>2</sup> In the Government's view, new research indicates that better credit management by small firms can have the most significant effect on the incidence and impact of late payment. It also favours giving publicity to companies' payment policies and is introducing Regulations accordingly, including the *Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997* to be debated on Thursday 13 February 1997.

This paper sets out the background to the issue of late payment together with the measures introduced since 1993 to combat it and provides a summary of the divisions within the business community over whether there is a need for a statutory right to interest on overdue trade bills. It also provides a comparison between the payment performance of businesses in the UK with that of other Members of the European Union.

---

<sup>1</sup> *Competitiveness: Creating the Enterprise Centre of Europe*, Cm 3300, June 1996

<sup>2</sup> *Ibid*

## **Abbreviations**

SMEs	Small and medium sized enterprises
FPB	The Forum of Private Business
CBI	The Confederation of British Industry
FSB	The Federation of Small Businesses
ABFD	The Association of British Factors and Discounters
IoD	The Institute of Directors
TECs	Training and Enterprise Councils
BCC	The British Chambers of Commerce

## **CONTENTS**

	<b>Page</b>
<b>I Introduction</b>	<b>7</b>
<b>II Background to the late payment issue</b>	<b>9</b>
<b>III The current position</b>	<b>12</b>
<b>IV European comparisons</b>	<b>20</b>
<b>V A European Commission recommendation</b>	<b>24</b>
<b>VI Division within the business community</b>	<b>28</b>
<b>VII Further reading</b>	<b>33</b>
<b>Appendix 1 The Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997</b>	<b>34</b>



## I Introduction

Late payment of commercial debt is a continuing problem for businesses in the United Kingdom. In 1995, the Forum of Private Business (an organisation which represents the interests of small businesses) estimated that 43.6% of small businesses surveyed were still concerned with late payment, and 19.5% considered it to be a major priority for action by the Government.<sup>3</sup> The results of a survey by the CBI (the Confederation of British Industry) and Coopers & Lybrand (the accountancy firm) released on 13 May 1996, showed that, in spite of improved credit control procedures, late payment represented a problem for 45% of small and medium sized enterprises (SMEs).<sup>4</sup>

New surveys of average payment periods are regularly published by various organisations. Although data collection methods vary across surveys, with the result that the surveys do not always identify the same trends, the general picture is that slow payment and bad debts have a major impact on UK business.

For example, ICC (the company and industry data specialist) estimated that in 1995 a quarter of limited companies (more than 300,000 businesses) were loss-making, of which two-thirds were high risk debtors, potentially unable to fulfil credit commitments to customers. As a result many companies incurred bad debts by supplying goods and services to customers who were unable to pay.<sup>5</sup>

A survey conducted by Dun & Bradstreet (the business information group) in February 1996, found that UK businesses on average take 72 days to pay debts, against terms granted of 30 days.<sup>6</sup>

The results of a survey by Bradford University of 655 manufacturing companies in March 1996, revealed that on average less than 50% of invoices were paid on time.<sup>7</sup> It also found that the typical firm quoting 30 days' credit is more than likely to be paid 60 days or later after the delivery of the goods. Nearly 40% of the 655 businesses surveyed reported that their operations had been severely affected by late payments during the recession.

The results of the CBI and Coopers & Lybrand survey showed that for SMEs, the average number of days taken for debts to be paid had increased marginally from 52.8 days in 1994 to 53.2 in 1996.<sup>8</sup> However, fewer businesses said they saw late payment as a threat to their

---

<sup>3</sup> "The 40th Quarterly Survey of Small Firms", an oral survey by the Forum of Private Business, Quarter 4 1995, published January 1996

<sup>4</sup> Confederation of British Industry news release, *Small and Medium Enterprises Tackle Late Payment Problem Says CBI/Coopers & Lybrand Survey*, 13 May 1996

<sup>5</sup> "One group in four makes a loss", *Financial Times*, 4 December 1995

<sup>6</sup> "Coping with late payers", *Financial Times*, 5 March 1996

<sup>7</sup> "Debtors may get better deal", *Financial Times*, 5 March 1996

<sup>8</sup> Confederation of British Industry news release, *Small and Medium Enterprises Tackle Late Payment Problem Says CBI/Coopers & Lybrand Survey*, 13 May 1996

## Research Paper 97/25

existence. The survey also showed that SMEs had continued to improve their credit control procedures.

A survey by the Federation of Small Businesses [the "FSB"] also concluded that the situation was getting less severe by the end of 1996. The FSB found that small firms were now waiting on average 65 days for their money (compared with typical contractual terms of 30 days), a marked improvement against the 74 days average calculated by the FSB a couple of years ago.<sup>9</sup> In particular, large corporations were now less likely to take extended credit from suppliers.<sup>10</sup>

However, a survey released on 29 July 1996 by Intrum Justitia (a debt collection company) revealed a different trend. This survey concluded that late payment problems have become worse over the past year. Some 31 % of companies reported a deterioration in the payment of their invoices compared to 20 % who reported an improvement.<sup>11</sup>

Statistical differences aside, few would disagree that late payment of commercial debt has become one of the most contentious of issues for SMEs. Business groups are divided, however, over how to handle the problem. Broadly, views have polarised between two schools of thought: those for and those against the introduction of a statutory right to interest on outstanding debts. At present, the possibility of receiving interest on trade debt only exists in the UK where provision is specifically made in the contract, or where the creditor has resorted to litigation.

---

<sup>9</sup> "Late payment hits business", *Independent on Sunday*, 27 October 1996

<sup>10</sup> Ibid

<sup>11</sup> "40 % of delays are intentional", *Financial Times*, 30 July 1996

## II Background to the late payment issue

In the November 1993 Budget Statement, the Chancellor of the Exchequer, Mr Kenneth Clarke, voiced the Government's concern about the damage caused to small businesses by late payment:<sup>12</sup>

"Late payments wreak havoc with cash flow, and for many small firms they can make the difference between survival and failure. The habit of late payment is corroding our business culture. I am quite sure that it needs to be dealt with.

There are many options for tackling that problem, and my Right Hon. Friend the President of the Board of Trade and I will be looking at two in particular: first, a new British standard for payment performance; and secondly - more significantly - legislation to provide for interest on late payments. Late payment was a serious problem for small businesses throughout the last recession. I believe that the time has now come to take that issue head on."

In conjunction with this statement the DTI published on 30 November 1993, a consultation paper on late payment of commercial debt. This consultation paper examined the causes of late payment and sought views on possible solutions including legislation for a statutory right to interest and a British Standard for prompt payment.<sup>13</sup>

Lord Strathclyde, Minister for Small Firms, said on 30 November 1993 when announcing the consultation paper:<sup>14</sup>

"I have today therefore issued a public consultation document to seek views on possible courses of action, including legislation to introduce a statutory right of interest. There is increasing support for such a measure, but there are also concerns over the implications of statutory interest. We will want to pay close regard to the overall impact such measures might have on the solvency of small and medium sized companies."

Responses to this consultation document were required by 31 March 1994. The object of the consultation period was to try to reach a decision as to whether the government should

---

<sup>12</sup> Budget Statement, HC Deb. 30.11.93 c.936

<sup>13</sup> Department of Trade and Industry press notice, *Government Announces Consultation on Late Payment of Commercial Debt*, 30 November 1993

<sup>14</sup> Ibid

continue to use education and persuasion to encourage prompt payment of bills or to use legislation. Lord Strathclyde said:<sup>15</sup>

"Arguments also exist in favour of a voluntary approach, possibly through a British Standard on Prompt Payment, which could measure payment systems and performance. Government will look positively at these concepts should the results of the consultation process confirm that they would be effective. A further option for consideration is that Government maintains its existing strategy of education, persuasion and leading by example.

However, the causes of late payment are many and require responses on a number of fronts. The consultation process therefore welcomes other proposals from respondents. I would also welcome views on what more can be done to educate business in better credit management and debt collection methods."

The results of the consultation exercise were incorporated into a Government White Paper, *Competitiveness: Helping Business to Win*.<sup>16</sup> The consultations had revealed a 'narrow margin' in favour of a statutory right to interest on late payment, but there was concern about the negative impact this might have on small businesses. Since there was no clear mandate for legislation, the Government decided not to introduce a statutory right to interest. Instead, it announced in the White Paper several initiatives to encourage prompt payment by Government and the private sector. The new measures included:

- Government Departments and their agencies to comply with the CBI's Prompt Payers Code, to state whether they have done so, to publish their payment policies in their annual reports and to publicise their arrangements for handling complaints of late payment. [The CBI Prompt Payers Code sets out a code of practice to assist firms to fulfil their obligations to honour contract payment terms].
- Streamlining of court procedures for debt recovery and a review of the limit for the informal small claims procedure.
- Implementation of proposals to require public companies to state their payment policies in their directors' reports: the aim being to provide suppliers with information about how they can expect to be treated by their major customers.
- Development of proposals for a British Standard for prompt payment.

---

<sup>15</sup> Ibid

<sup>16</sup> *Competitiveness: Helping Business to Win*, Cm 2563, May 1994

- Work with trade associations, business links and others to improve credit management and debt collection skills in small firms.

The Government also agreed to keep the situation under review for the next two years. If a significant improvement did not occur, then legislation might again be considered.

Lord Strathclyde, then Small Firms Minister, said:<sup>17</sup>

"On balance, the Government has decided not to introduce legislation at this stage. The main need is to bring about a change in business culture - and hence shorter payment times. We are not convinced that legislation would have this result. We will, however, continue to keep the position under review."

On the 18 November 1994, the DTI published a guide to help small businesses combat late payment entitled *Make the Cash Flow*.<sup>18</sup> This guide offers advice to small businesses on how to pursue payment of debts effectively and also how to reduce the risk of bad debts and late payment.

Shortly afterwards, on 28 February 1995, the DTI announced that it was consulting on how public companies should state in their annual reports their policies towards paying their suppliers. The consultation period ended on 11 May 1995 and the *Companies Act 1985 (Miscellaneous Accounting Amendments) Regulations 1996* were made on 1 February 1996. These Regulations require companies to state their **payment policy** in their annual reports. The Government was of the view that disclosure by large companies of their payment policies would heighten awareness of the need to speed payment.

In the 1995 Competitiveness White Paper, *Competitiveness Forging Ahead*,<sup>19</sup> the Government announced its intention to invite the representatives of small businesses to arrange a series of regional conferences to discuss the problems faced by small firms and to contribute to the formulation of policies to help small businesses. This exercise was to be conducted under the title "Your Business Matters". The Government also reaffirmed its intention to review the case for a statutory right to interest in 1996.

A call for a statutory right to interest was also the subject of a Private Member's Bill sponsored by Jon Owen Jones MP which had its First Reading in the Commons on 13 December 1995 but went no further.<sup>20</sup>

---

<sup>17</sup> Department of Trade and Industry press notice, *Government Acts On Late Payment*, 24 May 1994

<sup>18</sup> Department of Trade and Industry press notice, *Make The Cash Flow - A Guide to Combat Late Payment*, 18 November 1994

<sup>19</sup> *"Competitiveness Forging Ahead"*, CMND 2867, May 1995

<sup>20</sup> Interest on Debts, Bill 28, 13 December 1995

### III The Current position

The first six months of 1996 saw the late payment debate gain even greater momentum.

On 11 January 1996, in a written answer to a question by Dr Martin Clark MP on the Government's plans to review the case for a statutory right to interest, Mr Richard Page, Minister for Small Business, announced that the Government had agreed to look again at the arguments for statutory interest. He said:<sup>21</sup>

"There have been some signs of improving payment times in the UK, but late payment continues to be of concern to a number of small firms. Therefore, even though the package of measures now largely in place has not been so for long enough to have had an impact on late payment, I have decided to look again at the arguments for and against statutory interest. The review will be in the context of my wider consideration of how the problem of late payment can best be addressed. I have today invited relevant submissions from representative bodies who responded to the public consultation in November 1993. The submission will be considered alongside research and survey evidence. The outcome of the review will be published in the summer."

This new review was to fulfil the Government's commitment to look again at a statutory right to interest two years after the 1994 White Paper.<sup>22</sup>

On 1 February 1996, the Government had also launched a new credit management guide aimed at assisting trade associations and other business support organisations (BSOs) to help the firms they represent. Launching the new guide, the Small Business Minister, Richard Page, explained that around 40 % of small firms do not have any standard terms of trade, many small businesses fail to carry out credit checking before credit is offered or have no planned collection process. Commenting on the new guide, entitled *Late Payment - Help for Small Business: a best practice guide for trade associations and business support organisations*, Mr Page said:<sup>23</sup>

"Based on DTI-funded projects with the Federation of Master Builders, METCOM and Walsall Chamber of Commerce the guide is designed to encourage and assist other organisations to help their small firms members. It looks at late payment problems and solutions. Getting the basics -like credit checks- right. And it suggests a number of projects that could be run by trade associations or BSOs to help members. Projects like training, shared credit check services, telephone hot-lines, codes of practice or standard form contract documents."

---

<sup>21</sup> HC Deb. 11 January 1996 c.293W

<sup>22</sup> *Competitiveness: Helping Business to win*, Cm 2563, May 1994

<sup>23</sup> Department of Trade and Industry press notice, *Richard Page Launches New Credit Management Guide*, 1 February 1996

The "Your Business Matters" conferences were launched by the Prime Minister on 26 September 1995, with the final conference taking place on 11 March 1996. Directors and proprietors of small businesses were invited to discuss best practice, to identify barriers to growth and to highlight those areas where Government action could help.<sup>24</sup> A research project, which was led by the Forum of Private Business, was also carried out in conjunction with the conferences. The findings of the 11 regional conferences<sup>25</sup> and the survey were presented in a report.<sup>26</sup>

This report states that late payment and bad debts were all highlighted at the regional conferences as particular problems for SMEs. The survey revealed that SMEs rank late payment as one of their top three financial concerns.

According to the report, although there were strong arguments in favour of introducing a statutory right to interest, the weight of opinion was that this was not the best solution. Overall, a legally enforceable right to interest was seen as an additional burden which would be difficult to pursue in practice and which would be damaging to established customer relations. It was also suggested that a statutory right to interest would encourage firms to use late payment as a legitimate line of credit.

A popular proposal was that large firms should have to disclose in their annual reports the average length of time that they actually take to pay their debts. Delegates also proposed that companies with the worst payment records should lose any quality accreditation or awards (such as ISO9000) that they might have been given.

Central and local government were also highlighted as being amongst the worst payers of commercial debt. It was suggested that both government departments and local authorities should be required to publish their payment performance records.

---

<sup>24</sup> Note. The conferences were organised by a steering committee representing the IoD, the Federation of Small Businesses, the Forum of private Business, the TEC National Council, the Association of British Chambers of Commerce and the CBI. A series of one day conferences were held across the country between October 1995 and February 1996. In total, 11 regional conferences were held and some 1,500 delegates, more than half of them small business people, attended the conferences.

<sup>25</sup> Note. These conferences were attended by over 800 small business owners, in addition to representatives from the banks and from the business support agencies

<sup>26</sup> Institute of Directors, *Your Business Matters: Report from the Regional Conferences*, URN 96/765 (June 1996); and  
Institute of Directors, *Your Business Matters: Executive Summary - Key Problems and Policy Solutions*, 1996

Speaking at the final national conference on 11 March 1996, the Prime Minister acknowledged the findings of the regional conferences and outlined a number of new measures to help combat late payment. He said: <sup>27</sup>

"Let me turn to the problem of late payment of bills. In our consultation the conferences were generally - not universally - against introducing a statutory right to interest. The DTI are examining all these responses. The problem is that many of the possible solutions cause as many difficulties as they solve. We have to make sure that what we do makes things better not worse.

There are no easy answers to late payment. But that does not mean that there is nothing we can do. There is.

I was very struck by the quotation in your conference report, quoting a businessman who said that 'Rather than legislate, we should manage by embarrassment'.

There is a lot to be said for that; peer pressure does work. So I believe we should take steps to generate embarrassment amongst those who wilfully and continually pay late.

We intend to start by consulting again on whether companies should be required to publish their payment performance, as well as their policies. Personally, I think they should.

The last time we looked at this issue, many businesses were in favour, but without agreement on how to achieve it. It may be difficult to design a perfect measure of payment performance. But the results of your conferences suggest that mandatory disclosure is something we should look at again, so we will. If consultation supports the idea we will implement it.

But whether or not business collectively wants to go ahead with this requirement for itself, I am sure we should apply it to the public sector. It is simply not acceptable that the Government should be a late payment culprit.

We have done a lot to improve our payment performance. For example by the end of this month all Departments should have signed up to the CBI Prompt Payment Code. But I believe we can do better.

So I intend to instruct all Departments to pay promptly and, to ensure they do, we will publish each year a league table of all Government Departments' payment performance - not their aspirations, but the record of what they actually achieve, measured on a consistent and rigorous basis, and combine this with tough targets to ratchet up the weaker performers.

I would like to do the same for local authorities, all too many of whom emerge from the conference reports as bad performers too. I have asked David Curry, as Local Government Minister, to pursue this urgently with local authorities and the Audit Commission. I hope they will agree to have league tables published on their performance. If not, we'll consider requiring them to.

Late payment is a big issue for the construction industry. The construction contracts legislation, going through Parliament now, will tackle their problems head-on by banning the unacceptable practice of 'pay when paid' contracts."

---

<sup>27</sup>

Prime Minister's Speech to 'Your Business Matters' National Conference, QEII Centre, 11 March 1996

## Research Paper 97/25

On 20 March 1996, the President of the Board of Trade, Mr Ian Lang, welcomed the Prime Minister's instruction to every Government Department to sign up to the CBI's Prompt Payers Code by the end of March 1996. Mr Lang said:<sup>28</sup>

"The Prime Minister has today instructed every Government Department that they must sign up to the CBI's prompt payment code by the end of this month.

He has also asked all Government departments to develop rigorous and consistent methods of monitoring their payment performance by the end of April and to start collecting that data - for use in the Government 'league tables' - by the end of June."

On the same day (20 March 1996), in a speech to the Industry Forum's "Small Firms Conference", the Rt. Hon Tony Blair announced Labour Party policy on the subject of late payment and made a commitment to introduce a statutory right to interest on late payments by companies above a certain size threshold:<sup>29</sup>

"In our judgement late payment will only be effectively tackled through range of measures, these should include:

- a requirement on large companies to publish their payment practices

-the government and public agencies ensuring they pay their bills within thirty days

We are confident these measures will bring a change in attitudes and will help expose the chronic late payers. But we also believe that in themselves they will not be sufficient to root out late payment. Paying your bills late brings a financial gain to the defaulter. We need to create a situation in which late payment is not worth it.

A statutory right to interest on late payment is precisely that: an entitlement. It is up to the creditor as to whether to use it. It simplifies the complexity of the common law rules of contract on interest.

It is worth noting that every other member of the European Union, with the exception of Eire, has a general right embodied in legislation to interest in the event of late payment on commercial debt embodied. Sweden twenty years ago put on to the statute book a right to interest. The result has not been a flurry of court proceedings, but the development of a commercial culture in which bills are paid promptly.

---

<sup>28</sup> Department of Trade and Industry press notice, *Ian Lang Announces Late Payment Consultation Timescale*, 20 March 1996

<sup>29</sup> Speech by Tony Blair MP, Leader of the Labour Party, to the Industry Forum's Small Firms Conference, at Gibson Hall, Bishopsgate, London, 20 March 1996

The percentage of companies paying late in the UK is the highest in Europe. Our proposal is that the statutory right to interest on late payment should only apply to payment by companies above a certain threshold. We will consult on the best method of implementing this proposal, so that small firms gain the maximum advantage and we avoid the common fear that small companies will simply end up pursuing other small businesses."

In response, on 13 June 1996, Michael Heseltine confirmed the Government's decision not to introduce legislation to provide for interest on overdue commercial invoices.<sup>30</sup> This decision followed a five-month review by the Small Business Minister, Richard Page, which began in January 1996.

Commenting on the results of the review, Mr Page said:<sup>31</sup>

"More than 100 representative organisations, banks and businesses responded to the DTI review. The responses, particularly from bodies which directly represent small firms - like the Federation of Small Businesses, the IoD and the Association of British Chambers of Commerce - show a clear rebuttal of the call for a statutory right to interest on late payment. Even organisations in favour of legislation have reservations about its effectiveness.

And new research indicates that better credit management by small firms can have a significant effect on the incidence and impact of late payment.

The study by Professor Nick Wilson of the University of Bradford found that less than a fifth of smaller firms had a credit policy, two fifths didn't agree terms in writing before a sale and 84 per cent paid their suppliers late. The relatively small proportion who spend time on 'front-end' credit management (ie. negotiating and agreeing terms, checking credit worthiness and monitoring and using credit limits) saw a significantly higher proportion of their bills paid on time, had fewer bad debts and saw late payment as less of a problem.

Good credit management is therefore a critical tool in addressing the problem of late payment.

So I have today written to every Business Link asking them to step up their efforts in helping small firms improve their credit management skills. Similarly, Small Firms Ministers in Scotland, Wales and Northern Ireland are contacting equivalent organisations

We are looking again at whether companies ought to be required to publish their payment performance. The consultation will ask whether public limited companies and their large subsidiaries should be required to disclose how long, on average, it takes to pay their bills. We are aiming to issue the consultative document at the end of June and regulations - if appropriate - would be introduced in the Autumn. We have supported the development of the British Standard on Prompt Payment, are streamlining court procedures for debt recovery and are examining enforcement procedures. And Government is determined to set a good example by ensuring that its bills -and those of its Agencies - are paid on time.

---

<sup>30</sup> Department of Trade and Industry press notice, *Government rejects statutory interest on late payment*, 13 June 1996

<sup>31</sup> Department of Trade and Industry press notice, *Government rejects statutory interest on late payment*, 13 June 1996

## Research Paper 97/25

We don't underestimate the drain that unpaid invoices have on small firms' resources. But what is the value of new rules and regulations that would bring cost and red tape but very few benefits? Firms already have existing civil or contractual rights to claim interest - but very few choose to include it in contracts and even fewer enforce it. A statutory right to interest is an additional burden that would be difficult to pursue in practice and could easily backfire on the small firms sector."

On the same day, Mr Page also answered a written Parliamentary Question about the statutory right to interest review in which he said:<sup>32</sup>

"It is right that the Government listens to and acts upon the views of the business community and it is clear that there has been a significant shift in opinion, particularly by the small firms representative organisations, against legislation. Eight of the nine main small firms organisations have stated that they are against legislation because of the detrimental impact they fear it would have on small businesses. Even a number of organisations who responded to the review in favour of legislation had serious reservations about its effectiveness. Additionally the regional "Your Business Matters" conferences concluded against legislation."

Also on 13 June 1996, the Government announced greater prompt payment requirements on Government Departments, including more demanding targets and the publication of a league table of performance figures. Government Departments will aim to pay 100 per cent of undisputed bills on time.<sup>33</sup> The first league table was published by the Economic Secretary to the Treasury on 17 December 1996.

On the 27 June 1996, the Government published a further consultation document entitled *Tackling Late Payment: Stating Payment Practice In the Directors' Report*.<sup>34</sup> The document detailed a proposal to require the reporting of **payment practice** in addition to **payment policy**. The closing date for comments was 27 September 1996. According to the DTI, the overall response to the consultation was in favour of introducing a new disclosure requirement.<sup>35</sup>

Draft regulations, entitled the *Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997*, were laid before Parliament by the Small Business Minister Richard Page on 24 January 1997<sup>36</sup> and are to be debated by the House of Commons on 13 February 1997. The draft regulations amend section 234 of the *Companies Act 1985* and Part VI of Schedule 7 to the Act. They will require each public company, and each large private company within a group headed by a public company, to state its payment practice in its

---

<sup>32</sup> HC Deb. 13 June 1996 c.268W

<sup>33</sup> Ibid

<sup>34</sup> DTI consultative document, *Tackling Late Payment: Stating Payment Practice In The Directors' Report*, URN 96/842, June 1996

<sup>35</sup> Department of Trade and Industry press notice, *More Government Moves To Tackle Late Payment*, 24 January 1997

<sup>36</sup> HC Deb. 24 January 1997 c.760W

directors' report. This statement should give a figure indicating how long, on average, it has taken the company to pay its bills. This figure, which is expressed in days, is the ratio of trade creditors at the end of the financial year to purchases from suppliers during the year. The statement will be required for directors' reports for years ending after 24 March 1997. It is hoped that this annual disclosure of performance figures will help small firms monitor year-on-year the payment records of the larger companies with whom they may be considering doing business.

In September of last year, the new British Standard on Payment Performance, BS 7890, a voluntary but enforceable code for prompt payment, was launched. It requires companies to handle transactions transparently, fairly and promptly while providing clear documentation and settling disputes quickly. Government departments were required to sign up to the new British Standard - as they had been earlier in the year to the CBI's "Prompt Payers' Code". The latter, which represents the only centrally held register of businesses with a public commitment to good payment practice, will continue to exist alongside the British Standard.

Launching the new British Standard, the Small Business Minister, Richard Page, said:<sup>37</sup>

"The Government recognises that late payment is a serious problem for small businesses and is committed to tackling it. So, with the aim of helping to promote a "prompt payment culture" we have supported the development of the British Standard on Prompt Payment. The Standard will set out procedures - for both small firms themselves and the firms they supply -that will help to make sure that more invoices are settled on time. And the Standard has teeth -Trading Standards Officers will be able to investigate complaints of non-compliance by those claiming to abide by the Standard.

Government is also determined to set a good example by ensuring that its Bills - and those of its Agencies - are paid promptly. The Prime Minister has already tasked all Government departments with the job of paying all their undisputed invoices on time. And as Mrs Knight has announced today the DTI - and the Treasury - will be the first two Government departments to adopt BS7890."

On 29 November 1996, Small Business Minister Richard Page also welcomed an Audit Commission announcement that it will require local authorities to publish their bill payment record as a performance indicator for the next financial year. The announcement was made at the same time as the Audit Commission published payment performance figures for local authorities. Mr Page said:<sup>38</sup>

"It is important that the public sector leads by example and the publication of local authority payment performance figures is welcome. There is already a requirement for Government

---

<sup>37</sup> Department of Trade and Industry press notice, *"Richard Page welcomes new prompt payment standard - DTI and Treasury become first to sign up to BS7890"*, 10 September 1996

<sup>38</sup> Department of Trade and Industry press notice, *"Page Welcomes Local Authority New Payment Performance Commitment"*, 29 November 1996

## Research Paper 97/25

Departments and their Agencies to monitor their payment performance and this information is published in their annual reports.

In March of this year the Prime Minister announced the introduction of more consistent monitoring and rigorous targets for Government Departments and publication of their performance in an annual league table. The Economic Secretary to the Treasury will be publishing soon the first league table based on the revised monitoring arrangements.

But this is just one of a number of measures the Government is taking to encourage a prompt payment culture. Credit control and related professional guidance for small firms through Business Links, initiatives like the 'Making the Cash Flow' information pack; the new British Standard on prompt payment and legislation requiring larger firms to publish their payment performance should all help to reduce the impact that late payment has on our vital small businesses."

## IV European comparisons

Every member of the European Union, with the exception of the UK and Ireland, has a general right to interest embodied in legislation in the event of late payment of commercial debt.

In most Member States (Belgium, Denmark, Germany, Spain, France, Italy, Luxembourg and Portugal), contractors and suppliers are entitled to interest payments where the prescribed payment term is not observed. Belgium, France and Italy are the countries where this right is established most firmly, in that interest becomes payable there automatically and without any need for a formal demand for payment to be served. Under French law, the authorising officer is required to make out automatically a payment order for such interest at the same time as the principal amount of the claim. In other Member States (for example Germany, Spain and Luxembourg), entitlement to interest payments is conditional on fulfilment of certain procedural obligations.

As for the applicable interest rate, several Member States (Belgium, Denmark, Germany and Portugal) use their central bank's discount rate, plus one or two percent in most cases. France and Luxembourg use an interest rate laid down by ministerial decree and Spain a rate set each year in the finance law.

In the UK and Ireland, there is no general entitlement to interest in the event of late payment of a commercial debt. In both countries, however, a right to interest on overdue bills may be granted by the court to which the case is referred (assuming interest payments are not expressly provided for in the contract or general sales conditions).

However, according to the DTI, there is little evidence from elsewhere in Europe to confirm whether statutory interest has been effective as a response to late payment.<sup>39</sup> Although statutory interest exists, for example, in France, Italy and Spain, they continue to experience payment delays and their average payment periods are significantly longer than those in the UK.<sup>40</sup>

An extract from the Grant Thornton and BSL European Business Survey for 1996 is reproduced below.<sup>41</sup> This is the only survey of its type to be undertaken among small to medium sized enterprises on a European-wide basis, and shows European average payment periods in days.

---

<sup>39</sup> Department of Trade and Industry press notice, *Government Acts On Late Payment*, 24 May 1994

<sup>40</sup> Ibid

<sup>41</sup> "Grant Thornton Good Payment Practice - A Question of Culture?", Grant Thornton European Business Survey, 1996

	1993	1994	1995	1996
<b>AUSTRIA</b>	-	44	43	43
<b>BELGIUM</b>	45	57	59	52
<b>DENMARK</b>	39	36	33	35
<b>FRANCE</b>	67	70	64	64
<b>GERMANY</b>	34	43	42	38
<b>GREECE</b>	69	73	74	77
<b>IRELAND</b>	56	56	59	59
<b>ITALY</b>	90	90	90	84
<b>LUXEMBOURG</b>	58	66	58	56
<b>MALTA</b>	-	64	64	76
<b>NETHERLANDS</b>	48	47	49	46
<b>PORTUGAL</b>	76	63	49	61
<b>SPAIN</b>	74	80	73	73
<b>SWEDEN</b>	-	38	37	37
<b>UK</b>	52	49	48	50
<b>SWITZERLAND</b>	-	-	53	50
<b>FINLAND</b>	-	-	23	24

As can be seen, Scandinavian countries, (namely Denmark, Sweden and Finland) are consistently the best performers of all. The average payment period in the UK has increased from 48 days in 1995 to 50 days in 1996 and the longer term trend (1992-6) shows payment periods remaining relatively stable around the 50 day mark.

At first glance, therefore, UK companies appear to be among the more prompt payers. The average payment period in the UK is 50 days, better than the 73 days for Spain, and 84 days for Italy. The problem, however, is that when UK companies do pay late, they are often very late. In the UK, the most common terms of trade are for payment to be due within 30 days. Since 1993 there has been a steady decline in the number of UK SMEs being paid within 30 days. This trend has continued, and in 1996 only 12% of SMEs were paid within this period.

Despite this, only 5% of SMEs in the UK believe that payment periods are getting 'a lot worse' compared to an EU average of 10%. This compares favourably with the UK peak in 1993 when 20% of UK SMEs believed payment times were getting 'a lot worse'.

Finally, the 1996 Grant Thornton survey also shows that 76% of SMEs in the UK wrote off 0 to 1% of their annual turnover as bad debts. Only 3% of SMEs in the UK wrote off more than 3% of their annual turnover.

In addition to these figures, Dunn & Bradstreet [D&B] has also compiled a survey of payment performances in Europe based on more than 10 million European business payment experiences during the third quarter of 1995.<sup>42</sup> D&B's figures refer to the percentage of companies paying 15 or more days after the due date in the EU's four major countries. According to this survey, the most prompt payers were German businesses where only 19.4% of payments were 15 or more days late. D&B's figures are as follows:

Country	% of payments 15 days + overdue
Germany	19.4%
Italy	37.8%
European Union average	38.4%
France	40.4%
UK	42.1%

Those in favour of a statutory right to interest on overdue trade bills argue that British businesses are at a clear disadvantage to their main European competitors. Sweden is often cited as a good role model for the UK.<sup>43</sup> It is argued that changes made by Sweden since the early 1970's have had a major impact on overdue payments. The principal changes it introduced are set out below:

(a) In 1974 a *Debt Recovery Act* was implemented. It regulates ethics in debt collecting work, whether it is undertaken by the creditor himself, by a debt collecting agency or by other proxy.

(b) Legislation enacted in 1975 provides that companies paying late must add interest of 8 per cent above central bank rate to bills.

(c) In 1981 legislation was enacted giving the creditor a right to 'debt recovery compensation'. This compensation is quite separate from an award for court costs.

---

<sup>42</sup> Dunn & Bradstreet press release, *Italian Businesses are now better payers than British*, 16 February 1996

<sup>43</sup> "Bad debts at office spoil exporters' day", *Financial Times*, 28 January 1997

However, the Institute of Credit Management (ICM) claims that it is misleading to make direct comparisons between European performance figures without taking into account other significant factors. In Sweden there has been a statutory right to interest for late payment of commercial debt for almost 20 years, but it is rarely used because a culture of prompt payment has evolved. Similarly, in Germany, a system of cash discounts of 2% to 3% for settlement in 10 days is the culture and failure to offer such discounts is almost unheard of. It follows that businesses have traditionally paid promptly to take advantage of discounts. A further example of an entirely different business culture cited by the ICM is Spain. In Spain monthly invoices are commonly covered by Bills of Exchange, whereby - to put it very briefly - the right to claim payment of a future debt is sold in advance.<sup>44</sup> In France businesses appear to pay their bills on time but it must be borne in mind that the standard terms of payment are 90 days.<sup>45</sup>

A European survey by the Association of British Factors and Discounters (ABFD), released in February 1996, also appears to show little correlation between tough penalty regimes and prompt payments. Of the five countries with the worst payments records, three (Italy, Spain and Cyprus) provided a statutory right to interest. The survey also found that countries in Northern Europe paid more quickly than those in the South. According to the ABFD, this suggests that different payment practices in Europe are based on different business cultures rather than on legal penalties.<sup>46</sup>

---

<sup>44</sup> Institute of Credit Management, *Response of the Institute of Credit Management to the DTI Consultative Document*, April 1994.

<sup>45</sup> "How Late It Was - Or Was It?", *Accountancy*, September 1996

<sup>46</sup> "Doubt on late payment penalties", *Financial Times*, 6 February 1996

## V A European Commission recommendation

The European Commission has also expressed its concern at the apparent decline in business ethics in Europe. In particular, the Commission has sought to highlight the heavy administrative and financial burdens placed on SMEs as a result of commercial debt.

In 1994, a survey by Grant Thornton found that over 25% of businesses in the European Union have to wait more than 90 days to be paid, and 8% face delays of more than 120 days.<sup>47</sup> This has created a domino effect whereby businesses pass on their cash flow problems by delaying payment to their suppliers. A study by Intrum Justitia in 1994, showed that across Europe, more than one-third (36%) of delays in domestic payments are intentional, rising to 43% for cross-border payments. In the UK the figures are 53% and 60.6% respectively.<sup>48</sup>

The background to the European Commission's involvement in the late payment issue is summarised below.

Since 1993 the Commission has consulted on the payment practices in the various Member States. This consultation has been based, in particular, on a working paper which provides an economic analysis of the impact of payment periods, sets out the legal framework in the Member States and explores the various options for initiatives at European Union level.<sup>49</sup> More than 130 written opinions were received from national and European professional organisations and from some Member States. The Commission also organised a public hearing on payment periods in Brussels on 7 and 8 July 1993, at which some 30 organisations outlined their positions.

The European Parliament commented on the working paper in its resolution of 21 April 1993 on *sub-contracting and public procurement contracts*.<sup>50</sup> The Economic and Social committee also delivered an opinion on 30 June 1993.<sup>51</sup>

A European Commission initiative was announced in the *White Paper on Growth, Competitiveness and Employment*.<sup>52</sup> This White Paper emphasized that both the Member States and the Community are responsible for creating an environment conducive to the creation and development of SMEs. Payment periods constitute one of the priority areas in which the White Paper recommends improvements.

---

<sup>47</sup> "Days of reckoning", *Accountancy Age*, 16 March 1995

<sup>48</sup> Ibid

<sup>49</sup> SEC(92) 2214 final, 28 November 1992

<sup>50</sup> Resolution A3 - 0123/93, PV 07 II, 21 April 1993

<sup>51</sup> OJ No. C249, 13 September 1993

<sup>52</sup> The European Commission, *White Paper on Growth, Competitiveness and Employment*, p.14

The *integrated programme in favour of small and medium-sized enterprises [SMEs] and the craft sector*,<sup>53</sup> which the European Commission adopted on 25 May 1994, attaches particular importance to the EU's efforts to improve the legal environment of business. A recommendation on payment periods was announced in this connection. This was followed, on 24 October 1994, by the European Parliament in its Resolution on the "Integrated Programme" emphasizing that the Commission should forward proposals to deal with the problem of late payment of commercial debt.<sup>54</sup>

On 12 May 1995, the European Commission adopted a *Recommendation on payment periods on commercial transactions*.<sup>55</sup> The European Commission has justified this recommendation by arguing that:<sup>56</sup>

"The lack of convergence in the Member States' legal, regulatory and administrative provisions as regards payment periods is an obstacle to the proper functioning of the internal market. As a result, measures need to be taken to facilitate cross-border trade by establishing common minimum guarantees for all operators in the Community, thereby helping to make the most of the potential benefits of the single market."

The main aim of this recommendation is two-fold:

- first, to combat late payment by providing for a legal framework which will serve as a sufficient deterrent to bad payers and hence ensure that contractual payment periods are adhered to.
- Secondly, to ensure that reasonable payment periods are maintained in transactions where the contracting parties are not on equal footing, in particular public procurement contracts).

The recommendation sets out principles and methods for improving payment periods and calls on Member States to take the most appropriate measures in accordance with their own legal systems. As far as the legal framework governing payment periods is concerned, the Commission specifically points out 3 areas for improvement. These are:

(i) greater transparency of contractual relations;

---

<sup>53</sup> COM (94) 207 final of 3 June 1994

<sup>54</sup> Resolution A4-0022/94, PV 28 II, 24 October 1994

<sup>55</sup> "Commission Recommendation of 12 May 1995 on payment periods in commercial transactions", (95/198/EC), *Official Journal of the European Communities* No L 127/19, 10 June 1995

<sup>56</sup> "Communication on the Commission recommendation of 12 May 1995 on payment periods in commercial transactions" (95/C 144/03), *Official Journal of the European Communities* No. C 144, 10 June 1995, p.5

(ii) a better balance in contractual relations; and

(iii) a stronger means of dissuading bad payers.

For the UK, the recommendation's most controversial proposal is that creditors should have an automatic right to interest on arrears as soon as the contractual or statutory period has been exceeded. Interest for late payment should be set at a level which is sufficiently dissuasive for bad payers. The recommendation suggests that it should be at least equal to the commercial rate for overdrafts. Alternatively, it could be set at the discount rate plus a certain percentage to reflect the prevailing market rates (as is the case in Denmark and Sweden). The recommendation also proposes that compensation should be payable from debtors to creditors for legal and administrative costs incurred in chasing debts. Member States should also introduce simpler, faster and cheaper legal procedures for collecting debts.

The recommendation states that in order to evaluate what progress has been made, Member States should forward a report to the Commission on action taken in respect of the various elements of this recommendation before 31 December 1997. On the basis of this evaluation, the Commission has said that it may decide to propose further measures which may, of course, mean a draft directive.

Finally, on 4 July 1996 the European Parliament passed a resolution calling on the Commission to implement a directive which would, amongst other proposals, introduce a statutory right to interest throughout the EU.<sup>57</sup>

It should be stressed that the Commission's recommendation of 12 May 1995 does **not** have the force of law. It is up to each individual Member State to decide whether or not to implement all or any of the measures proposed in the recommendation.

It is probable that the UK Government's position concerning the measures proposed in the Commission's recommendation, will be that **subsidiarity** should continue to apply. In other words, the problem of late payment should be addressed within the legal framework of each individual Member State. The Government may also take the view that since the recommendation was only adopted in May 1995, the European Commission must ensure that it allows sufficient time to gain the benefit of a full evaluation of the effect of its proposals in each Member State before considering a draft directive .

The DTI confirmed that the Government will report back to the European Commission on what action it has taken to combat late payment by December 1997. It is likely that it will

---

<sup>57</sup> "European Parliament resolution on Commission recommendation on payment periods in commercial transactions", 4 July 1996

## Research Paper 97/25

state that the UK government has already implemented a number of practical measures that go beyond the requirements of the Commission's recommendation, including :

- Streamlining and simplifying court procedures for debt recovery in the UK.
- Introducing a payment performance requirement for the public sector, including central and local government.
- The implementation of proposals requiring all public limited companies to quote their payment policy in their annual report.
- Further consultation on whether public limited companies should state their actual payment practices in their annual report.

For the time being, however, the UK Government has decided not to introduce a statutory right to interest on overdue commercial invoices.<sup>58</sup> Instead, it is committed to taking steps to change the payment culture of firms in the UK.

---

<sup>58</sup> Department of Trade and Industry press notice, *Government rejects statutory interest on late payment*, 13 June 1996

## VI Division within the business community

The business community remains divided on whether there should be a statutory right to interest on commercial debt. Briefly, supporters of legislation argue that:

- it could signify disapproval of the current slow payment practice and encourage a change in business culture resulting in improved payment performance;
- it could provide businesses with an additional mechanism for obtaining compensation for payment delay;
- it would harmonise UK legislation more closely with that elsewhere in Europe; and
- UK businesses rely too heavily on short-term finance, as a consequence late payment produces a disproportionately greater strain on the SME sector. A statutory right to interest on late trade payments should be part of a company's normal credit management process.

The Forum of Private Business (the FPB) remains a strong supporter of a legislative option. It has argued that voluntary codes of practice have failed to make any significant impact on the UK's late payment record<sup>59</sup> and while there is no effective legal sanction against late payers, there will always be those who will take credit from their suppliers.<sup>60</sup> In 1994, the FPB even drafted its own "Interest on Debts Bill".<sup>61</sup> It envisaged the Bank of England setting an interest rate at a level sufficient to compel all companies to pay on time. If incurred, the interest would be paid separately into an account which the creditor could collect over a period of perhaps several years. This would allow companies with trading difficulties to pay any interest at a more convenient time. In tandem with this, a late payer's annual accounts would include liability for interest on late payments. According to the FPB, this would serve to encourage companies to reduce the amount of interest, which would be offset against their turnover.

In 1994, the Institute of Directors (IoD) also submitted to the DTI a detailed suggestion of how a statutory right to interest could work. It was proposed that the right to interest should apply to all commercial contracts in the private and public sector and that interest should be set at a level that made it uneconomical for companies to delay payment. The interest should be set nationally, possibly linked to bank base rates, rather than left to the discretion of the courts. Contracts between companies should specify the date at which interest payments

---

<sup>59</sup> "Decision on debts gets split reaction", *Financial Times*, 25 May 1994

<sup>60</sup> "Debtors may get better deal", *Financial Times*, 5 March 1996

<sup>61</sup> See Appendix A to the executive summary of the "Response of the Forum of Private Business (FPB) to the DTI Consultative Document on Late Payment of Commercial Debt", 31 March 1994

would begin but if no payment date is set it could be defined by previous practice in the trading relationship or in the industry concerned. According to the IoD proposals, there should not be a maximum period of credit and the IoD also opposes the idea that business parties could contract out of statutory provisions of interest, since interest becomes due when the contract has already been broken by late payment.<sup>62</sup>

Dunn & Bradstreet has also called for legislation to enforce a statutory right of interest to make interest on late payments automatic. It dismisses the plan for the establishment of a British Standard on late payment as "yet another useless exhortation to make British companies pay on time which is doomed to failure".<sup>63</sup>

Lord Alexander, Chairman of NatWest Group, has also stated his support for legislation because:<sup>64</sup>

"it sets a benchmark against which late payment practices can be established. Legislation gives customers greater transparency, an option of redress and removes the short term financial advantage of late payment. Introducing legislation for a statutory right to interest will help bring about a badly needed change in business culture. I believe there will be an enormous benefit in terms of greater certainty of cash flow. Certainty of payment is more valuable than what may equate to a false promise from debtors."

However, those opposed to legislation suggest that:

- provision already exists under UK law to charge interest on late payment if the contract so specifies, and in practice, few companies make use of this;
- the right would still need to be exercised through the courts but small businesses could be reluctant to take action against customers for fear of losing that custom;
- the legal cost of enforcing the statutory right might exceed the value of the interest payable;
- large companies might simply demand extended credit periods or the signing of exclusion clauses;
- formalised credit management is a time consuming and administrative burden;
- it would be better to develop a climate of prompt payment rather than to legitimise the practice of late payment by legislating for it.

---

<sup>62</sup> "Interest on all bills, says IoD", *Times*, 29 March 1994

<sup>63</sup> Dunn & Bradstreet International press release, *Italian Businesses Are Now Better Payers Than British*, 16 February 1996

<sup>64</sup> "Why we need legislation on late payment", *NatWest in business*, summer 1996

The Federation of Small Businesses, the CBI, the Institute of Chartered Accountants, the Institute of Credit Management and the Association of British Factors & Discounters (ABFD) are among those organisations which have expressed reservations about the value of a statutory right to interest. They have argued, variously, that:

- if the level of interest were low (say 8 per cent) it would still represent a cheaper line of credit than bank overdrafts;
- small businesses are poor payers themselves, many small companies rely on trade debt as part of their cash-flow management;
- statutory interest would not help where late payment was due to a shortage of funds (ie. if a debtor could not pay the capital sum, neither could it pay interest).<sup>65</sup>

In a memorandum to the DTI published on 31 March 1994, the Institute of Chartered Accountants in England and Wales stated that:<sup>66</sup>

"the prospect of receiving payment plus interest at a future date is unlikely to be as attractive as being paid on time. The amount of the interest would be insignificant in comparison with the sum owed and the extra burden of interest on a late payer would be comparatively light unless the applicable rate were fixed at a penal level. In any case the burden of interest is likely to weigh more heavily on a small business than on a large one."

In the view of the Institute "fostering a business climate in which payment on time is the norm is we think, more likely to achieve change than are changes in the legal framework. But we would support a requirement on large companies to state publicly their payment policy."<sup>67</sup>

According to the Institute of Credit Management (the professional credit management organisation), the solution to late payment lies not in legislation but in the Government providing education in credit management techniques regionally, perhaps through the Training and Enterprise Councils (TECs).<sup>68</sup>

---

<sup>65</sup> See, for example, "CBI recommends debt ombudsman", *Financial Times*, 6 April 1994 & "Statutory right to interest could harm small firms", *Times*, 12 April 1994

<sup>66</sup> Institute of Chartered Accountants news release, *Legislation On Late Payment Of Commercial Debt Unlikely To Be Effective, Say Chartered Accountants*, 31 March 1994

<sup>67</sup> "Memorandum on Late Payment Of Commercial Debt", submitted in March 1994 to the Department of Trade and Industry on behalf of the Council of the Institute of Chartered Accountants in England and Wales in response to the Department's consultative document of November 1993

<sup>68</sup> *Response of the Institute of Credit Management To The DTI consultative Document Late Payment of Commercial Debt*, Parts 1 & 2, April 1994.

Similarly, the Chairman of ABFD, Mr Ben Allen, has said:<sup>69</sup>

"The evidence from countries in the European Union that have a statutory right to interest demonstrates the ineffectiveness of the measure. British companies record shorter payment times than many of their competitors in Europe. We believe that improving legal procedures for the recovery of debt would be the most effective step that the Government could now take to tackle the late payment problem and would help to redress the present imbalance which we believe exists in favour of debtors."

Although initially in favour of a statutory right to interest, the British Chambers of Commerce (the "BCC") have now abandoned their support of legislation in favour of bringing about a change in business payment culture. A survey of 567 small companies conducted by the BCC and sponsors, and released on 29 July 1996, revealed that if a statutory right to interest were ever introduced, only two out of five small firms (41%) would enforce it against all their debtors. Of the majority (59%) that would not, most cite one of two reasons: fear of losing some customers and the belief that some customers simply would not pay it.<sup>70</sup> The BCC reached the conclusion that poor credit management was the biggest problem facing small firms in the collection of debts and called on a national initiative to promote the message that 'good financial practice makes good business sense'. It welcomed the recent increase in the Small Claims Court thresholds and the focus in recent months on improving small firms' access to justice, but feels more needs to be done.<sup>71</sup>

Grant Thornton, financial and business advisers, have also expressed serious doubts about the effectiveness of statutory interest for SMEs. Grant Thornton argues that in practice, legislation may prompt larger organisations to force their suppliers to extend a greater period of credit, for example from 30 days to 90 days, thus ensuring that payment deadlines are met. Alternatively they may simply query the invoice, creating a 'justified' delay in payment. Grant Thornton suggests that the solution is for smaller businesses to create better credit management systems. This begins with the setting of credit terms and is continued with an effective debt collection procedure.<sup>72</sup>

According to the CBI, a set of positive solutions is needed "which aims to change business culture so that it pays to pay promptly. Our CBI Prompt Payers Code, which now has over 1,000 signatories, and the British Standard for Payment Performance,...are important first steps in achieving this change which we believe can't be achieved through a statutory right to interest on late payment of debts".<sup>73</sup>

Those who argue for a more educational approach to late payment, appear to suggest that the core of the problem is a culture in the UK which runs through the business community and

---

<sup>69</sup> Ibid

<sup>70</sup> British Chambers of Commerce news release, *Poor Credit Management Holding Small Firms Back*, 29 July 1996

<sup>71</sup> Ibid

<sup>72</sup> "Good Payment Practice - A question of culture?", *Grant Thornton*, 1996

<sup>73</sup> Confederation of British Industry and Coopers & Lybrand news release, *Small And Medium Enterprises Tackle Late Payment Problem Says CBI/Coopers & Lybrand Survey*, 13 May 1996

which views paying trade bills late as a useful business tool to manage working capital. They argue that Government support can assist in raising awareness of this issue, but it is up to businesses themselves to change this culture. However, according to the Bank of England, no empirical evidence exists that formal training in financial and other management helps a business to succeed, although it is recognised that these skills are important tools in running a business.<sup>74</sup>

As a final comment, it is, perhaps, worth pointing out that the late payment debate has become slightly obscured by the complex arguments for and against a statutory right to interest. Although conflict may exist on the subject of legislation, it is also true that the public and private sectors are working closely together and with the Government through consultations on standards, disclosing payment practices and the launching of new initiatives to address the issue of late payment.

It is yet too early to predict what impact the current programme of measures to address this issue will have on the culture of payment in the UK. Such changes inevitably involve long lead times.

---

<sup>74</sup> Bank of England, *Finance For small Firms: A Fourth Report*, January 1997

## VII Further reading

1. *Competitiveness: Helping Business to Win*, Cm 2563, May 1994.
2. *Competitiveness: Forging Ahead*, Cm 2867, May 1995.
3. *Competitiveness: Creating the Enterprise Centre of Europe*, Cm 3300, June 1996.
4. Institute of Directors, *Your Business Matters: Report from the Regional Conferences*, URN 96/765, June 1996.
5. Institute of Directors, *Your Business Matters: Executive Summary - Key Problems and Policy Solutions*, 1996.
6. Grant Thornton European Business survey, *Grant Thornton Good Payment Practice - A Question of Culture?* 1996.
7. *Commission Recommendation of 12 May 1995 on Payment Periods in Commercial Transactions*, (95/198/EC), Official Journal of the European Communities No.L 127/19, 10 June 1995.
8. *Communication on the Commission Recommendation of 12 May 1995 on Payment Periods in Commercial Transactions*, (95/C 144/03), Official Journal of the European Communities No. C144, 10 June 1995.

## Appendix 1

*Draft Regulations laid before Parliament under section 257(2) of the Companies Act 1985 for approval by resolution of each House of Parliament*

---

DRAFT STATUTORY INSTRUMENTS

---

1997 No.

COMPANIES

The Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997

*Made - - - 1997*

*Coming into force 1997*

The Secretary of State, in exercise of the powers conferred on him by section 257 of the Companies Act 1985<sup>a</sup>, hereby makes the following Regulations of which a draft has been laid before Parliament in accordance with section 257(2) of that Act and approved by a resolution of each House of Parliament:

### **Citation, commencement and interpretation**

1.— (1) These Regulations may be cited as the Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997.

(2) These Regulations shall come into force on the day after the day on which it is made.

(3) In these Regulations "the 1985 Act" means the Companies Act 1985.

---

<sup>a</sup> (a) 1985 c. 6; section 257 was substituted by section 20 of the Companies Act 1989 (c. 40)

### Inclusion of payment practice in report

2.— (1) Insubsection (4) of section 234 of the 1985 Act<sup>b</sup> (duty to prepare directors' report) in the entry relating to Part VI of Schedule 7 (company's policy on the payment of creditors), after the word "policy" insert the words "and practice"

(2) For Part VI of Schedule 7 to the 1985 Act substitute the following Part—

#### "PART VI

#### POLICY AND PRACTICE ON PAYMENT OF CREDITORS

12.— (1) This Part of this Schedule applies to the directors' report for a financial year if—

- (a) the company was at any time within the year a public company, or
- (b) the company did not qualify as small or medium-sized in relation to the year by virtue of section 247 and was at any time within the year a member of a group of which the parent company was a public company.

(2) The report shall state, with respect to the next following financial year—

- (a) whether in respect of some or all of its suppliers it is the company's policy to follow any code or standard on payment practice and, if so, the name of the code or standard and the place where information about, and copies of, the code or standard can be obtained,
- (b) whether in respect of some or all of its suppliers it is the company's policy—
  - (i) to settle the terms of payment with those suppliers when agreeing the terms of each transaction,
  - (ii) to ensure that those suppliers are made aware of the terms of payment, and
  - (iii) to abide by the terms of payment,
- (c) where the company's policy is not as mentioned in paragraph (a) or (b) in respect of some or all of its suppliers, what its policy is with respect to the payment of those suppliers;

and if the company's policy is different for different suppliers or classes of suppliers, the report shall identify the suppliers to which the different policies apply.

---

<sup>b</sup> (b) Section 234 was amended by regulation 5 of S.I. 1996/189

In this sub-paragraph references to the company's suppliers are references to persons who are or may become its suppliers.

(3) The report shall also state the number of days which bears to the number of days in the financial year the same proportion as X bears to Y where-

X = the aggregate of the amounts which were owed to trade creditors at the end of the year; and

Y = the aggregate of the amounts in which the company was invoiced by suppliers during the year.

(4) For the purposes of sub-paragraphs (2) and (3) a person is a supplier of the company at any time if-

- (a) at that time, he is owed an amount in respect of goods or services supplied, and
- (b) that amount would be included under the heading corresponding to item E.4 (trade creditors) in Format 1 if-
  - (i) the company's accounts fell to be prepared as at that time,
  - (ii) those accounts were prepared in accordance with Schedule 4, and
  - (iii) that Format were adopted.

(5) For the purpose of sub-paragraph (3), the aggregate of the amounts which at the end of the financial year were owed to trade creditors shall be taken to be-

- (a) where in the company's accounts Format 1 of the balance sheet formats set out in Part I of Schedule 4 is adopted, the amount shown under the heading corresponding to item E.4 (trade creditors) in that Format,
- (b) where Format 2 is adopted, the amount which, under the heading corresponding to item C.4 (trade creditors) in that Format, is shown as falling due within one year, and
- (c) where the company's accounts are prepared in accordance with Schedule 9 or 9A, the amount which would be shown under the heading corresponding to item E.4 (trade creditors) in Format 1 if the company's accounts were prepared in accordance with Schedule 4 and that Format were adopted."

**Transitional provision**

3. A company may, with respect to a financial year ending on or before 24th March 1997, prepare and deliver to the registrar of companies such annual accounts and annual report as it would have been required to prepare and deliver had these Regulations not been made.

1997

Parliamentary Under-Secretary of State  
for Small Business, Industry and Energy,  
Department of Trade and Industry