Late payment:
Where does the solution lie?

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Hilton-Baird Collection Services

Introduction

The ongoing challenges surrounding the late payment culture which prevails in the UK currently remain a source of much debate and frustration, and understandably so. From the lengthy discussions in the highest echelons of government, as ministers seek to find an elusive all-encompassing solution to the problem, to the number of column inches that have been dedicated to raising its profile, it represents an issue that has consumed an almost incomprehensible amount of time.

But nowhere has its impact been felt more keenly than amongst British businesses who, according to Bacs Payment Schemes, were owed a collective £30 billion in overdue payments at the end of 2012. The result is that they are invariably having to invest time and resource – which could instead be spent securing growth opportunities – into chasing their customers for payment. It is this startling figure which has been cited time and again in recent months to highlight just how endemic the problem has become.

Although many schools of thought exist as to where the blame lies, with the government and the UK's largest businesses often finding themselves in the firing line, there are significantly fewer voices proposing viable remedies that will cure the problem of late payment once and for all.

With the help of leading debt collection agency Hilton-Baird Collection Services' most recent Late Payment Survey, which questioned business owners and finance directors on a range of issues in January 2013, this white paper explores how businesses can best safeguard their cash flows from the effects of late payment and what can be done to resolve it.

Gloomy context

The survey, which is now in its third year, found that British businesses were being made to wait an average of 21 days beyond agreed credit terms to be paid for their work in 2012. This equates to more than four working weeks and is a full four days longer than they were waiting just 12 months earlier.

The impact this is inevitably having on their day-to-day operations is considerable. The natural result is that 73 per cent of respondents, which comprised a whole mix of business owners from sole practitioners to multi-million pound corporate entities, said they had to devote more time and resource to chasing customers as a direct consequence of late payment. This figure looks problematic enough given how much attention is therefore diverted away from chasing new sales and collecting newer debts, but it is compounded even further by the other measures many have had to take.

More than one in four, for instance, had to compensate for this cash flow gap by securing additional borrowing (29 per cent), which typically comes at an added and unbudgeted cost to the business. Almost one in five also felt they had no option but to delay payment to the increasingly unsympathetic HM Revenue & Customs (18 per cent) to preserve their cash flow for longer. But perhaps of most concern was that 48 per cent elected to hold onto the money they owed their own customers for longer. More often than not, this represents the simplest way for businesses to maintain a healthy cash flow in the event of late payment, particularly as many have found accessing new credit from their bank so challenging of late, but it is arguably the biggest reason behind the sheer profundity of the problem.

Other factors

All of this of course stems from the turbulent economic climate. Although the double-dip recession has now been erased from history, it doesn't obscure what has been an extremely challenging period for businesses. Confidence amongst both companies and consumers has sunk to all-time lows while unemployment has soared, leading to many being unsure when and how to spend their money. Even when cash flow isn't a major problem and businesses have decent cash reserves, the uncertain economic forecasts both in the short and long term are typically deterring them from making bold investment decisions.

What this has meant is that, when orders do come into businesses who are struggling, there is a greater temptation to chase turnover ahead of making the right business calls. A credit report might suggest a prospective customer isn't the promptest payer and is in financial difficulty, but can the business really turn down a large and potentially lucrative order? Unfortunately, the reality is that a defaulting customer can provide far more complications than they're worth.

Meanwhile, where in times gone by businesses have been able to secure additional credit from their bank to help sustain their cash flow, many have found traditional funding harder to obtain as the banks have tightened their belts. The introduction of several government lending schemes and initiatives have so far failed to have the desired effect, thus reducing the options businesses have had to preserve their cash flows.

Despite this combination, in many quarters the blame game surrounding late payment has so often led to the country's largest businesses being criticised for their payment practices. While national newspapers have launched campaigns, the business minister, Michael Fallon, threatened to name and shame the members of the FTSE 350 who refused to sign up to the Prompt Payment Code, which is a voluntary commitment to pay suppliers on time and administered by the Institute of Credit Management. However the research from Hilton-Baird Collection Services suggested that multi-million pound corporate firms are by no means the sole root of the problem. Only 19 per cent of respondents said that corporate and listed companies were the tardiest payers in 2012, a figure which is down 4 per cent from 12 months before. Instead, 44 per cent labelled privately owned, limited companies the slowest at paying their invoices, with 9 per cent suggesting that the public sector was worst.

What this proves is that late payment is largely engrained into the fabric of the British economy. Businesses large and small are at risk whenever they offer credit terms unless they are actively implementing an effective credit management strategy.

Firmer approach

Getting this aspect of the business right has therefore assumed a greater purpose in recent times – not only to reduce the likelihood of late payment from occurring in the first place, but also to ensure the most productive and cost-efficient measures are taken once an invoice does exceed the agreed terms.

The overall consensus is that businesses are understandably adopting a firmer stance as the word 'tolerance' has vacated the majority's vocabularies. For instance, the survey found that the suspensions of work and services (54 per cent) and customer credit facilities (45 per cent) were not just widespread in 2012, but more so than they were in 2011. The proportion of businesses choosing to write to debtors and involve their solicitors also increased annually, to 47 per cent, with 31 per cent now opting to use the Small Claims Court and County Court Judgements.

While these represent strategies for 'after the event', there don't appear to be enough businesses attempting to seize the initiative early on by gaining a full picture of their customer's financial wellbeing before agreeing to their order. This carries a bigger importance nowadays, particularly given the threat of so-called 'zombie businesses'. These are described as businesses with low or no profitability that are teetering on the verge of insolvency, but just about able to continue trading from month to month. Typically they can just about afford the interest payments on their loans – benefiting from the record low interest rates – without paying any of them off. The perils of trading with such businesses, of which insolvency body R3 estimates there to be 108,000 in the UK, is that they are prone to paying bills late and could enter insolvency proceedings at any moment.

In 2012, only 48 per cent of businesses credit checked new customers, although this figure is up by 1 per cent year on year. Of even more concern is that only 29 per cent regularly credit checked their existing customers in 2012 despite the propensity for a business's financial circumstances to change overnight in the current economic climate.

Further still, very few businesses have a set strategy when it comes to offering credit, the credit control process itself and the steps that should be followed in the event an invoice exceeds terms. Just 16 per cent of those surveyed said they had a written credit policy in place, despite the benefits it brings in ensuring a structured and tested process is followed at all times.

Similarly, only 25 per cent opt to charge statutory interest on late payments. Not only can this help with the cost of chasing an overdue invoice, including the additional time and resource that must be invested and also the potential cost of outsourcing its recovery to debt collection specialists, it can also act as a useful deterrent. When the remaining three quarters were asked specifically why they chose not to include it as part of their credit management arsenal, 63 per cent believed their customers would just ignore it, while 51 per cent were concerned about the potential risk of losing customers.

This could also be the reason why so few elect to call upon the expertise of specialist debt collection agencies. Just 14 per cent of businesses chose to outsource all or part of their credit control process in 2012, despite 60 per cent of those that do citing the facilitation of the collection of aged debt as the primary advantage, and 30 per cent benefiting from the reduction in in-house overheads.

The future

All of this information indicates that businesses could and probably should be doing more to help themselves. Each of these strategies, when used effectively and as part of a holistic approach to credit management, carry different advantages and can dramatically improve the likelihood of timely payments. However, these measures alone will not put an end to late payment.

Many expect direction and sanctions to come from the very top, but intervention has largely proven unproductive thus far. The Late Payment of Commercial Debts (Interest) Act, although commendable and popular amongst one quarter of businesses in the UK, clearly isn't having the desired impact as the majority see it as too difficult to enforce and worry about the risk of losing customers. Although in March 2013 the EU Late Payments Directive was introduced to British law to reaffirm these statutory rights and encourage payment within 60 days in business-to-business transactions, only time will tell how fruitful this will be. Meanwhile, Michael Fallon's threats to the country's largest businesses haven't worked, with even those members of the FTSE 350 who did subsequently sign up to the Prompt Payment Code still in control of whether they pay on time or not. It is a voluntary code rather than a legally binding document.

This only serves to illustrate the barriers the government has in place. While it can introduce new schemes and measures to encourage timely payment, it must ultimately rely on businesses to commit to them and clean up their payment practices.

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