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A Hoard of Unpaid Invoices: Dissecting Economies & Private Market Forces To Solve B2B Late Payments

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<u>A Hoard of Unpaid Invoices: *Dissecting Economies & Private Market Forces To Solve B2B Late Payments*</u>

by

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ABSTRACT

The average small-to-medium-size business in the United States keeps just enough of a cash buffer to last 27 days worth of normal operational costs, but in 2016 81% of all B2B invoices were delayed at least 30 days or more past the due date of payment.

Furthermore, in 2016, the average SMB held roughly $84,000 in unpaid accounts receivables, with that number also varying across industries. As an example, the average IT SMB held roughly $163k in unpaid accounts receivables, while the average transportation company held roughly $102k in the same. Yet we wonder why 50% of all SMBs close shop in under 5 years of their existence.

Late business-to-business (B2B) payments are symbolic of rampant trade credit. The conditions surrounding the need, use, exploitation, and the legal protections to curb trade credit vary significantly across nations and business cultures. However, while cultural practices do have a way of impacting commerce, the various instances of late payments across the world have several other universal factors in common as well.

In this paper, we take a look at some global economies and the particularities of practices influencing late payments within their borders. We then dissect their public policies in an effort to gauge the pressure points which they hope to address - as well as any noticeable impact such policies may have had on future payment practices. We then juxtapose our lessons from public policy against the impact of private market solutions and technologies aimed at resolving late payments, and use those contrasting images to better understand the various factors that may have been left unanswered in public policy.

Finally, I use my experience dissecting and studying the impact of public legislation to craft and put forth policy proposals of my own - aimed at resolving the most common imbalances and exploits observed during the course of my study.

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1. INTRODUCTION

A] What Is Late Payment: Defining The Problem

As a business process, late payment is not a rarity or odd occurrence, but rather a by-product of one of the most important financial instruments in the world – trade credit. The Association of Chartered Certified Accountants (ACCA) estimates that almost half of all business-to-business (B2B) transactions in the world are supported on the back of trade credit.

By and large, "late payment" is an umbrella term which is used to encompass several different types of buyer-seller behavior, but in general it is used to refer to a situation where a buyer with a healthy cash-flow fails to pay an invoice for goods or services rendered on the agreed upon due date as per their set terms with the seller.

The ACCA[1] denotes that at least 30% of all sales based on trade credit are paid outside the agreed terms, if not more, and that roughly 21% of B2B invoices in developed and emerging markets are paid more than 60 days after the invoice date. Furthermore, roughly 3% of all trade credit sales result in bad debts.

As often happens with umbrella terms, late payments are not one-size-fits-all situations which are the result of flawed business partnerships or cultures, but rather are often the logical end-product of industry structures and norms, standard business cycles, imbalance in market hierarchies, financial infrastructures in business environments, and the relative strength and weaknesses of judicial systems, among various other factors.

Short of non-payment, late payment is essentially a play on credit financing. According to the ACCA, the appeal for buyers to indulge in the practice of late payment is often related to the fact that it is essentially more easily availed than a loan for working capital – with a more flexible structure as well. Moreover, a significant portion of all B2B firms operate on the premise of payment cycles – wherein all debts to sellers are cleared at

[1] Manos Schizas, *Ending Late Payment Part 3: Reflections on the Evidence* (Association of Chartered Certified

specific time intervals, regardless of payment terms agreed upon in contracts.

This allows many firms to accrue interest on their working capital as well, while it's parked in their accounts, in addition to income generated through clients of their own. Since trade credit relies particularly on goods or services having already been rendered, the power dynamic is heavily skewed in favor of the buyer.

The seller would go out of their way in most cases to first ensure that they receive the money owed at all as a greater priority, and that they receive it within a reasonable time-frame so as to not overly burden their own working capital as a secondary priority. Furthermore, for most sellers or suppliers, putting up with late paying clients holds the promise of repeat business from the client, and sellers who play along with extended credit terms are often a prime choice for most buyers.

These advantages make the premise of late payment marginally attractive to both buyers and sellers, and make it significantly harder for public policy as well as free market solutions to significantly curb late payment culture in business. Consequently, businesses often wake up to the real-world effects of late payment only when their cash flow has already been stretched dangerously thin.

Regardless of possible advantages to their pick of clients which protracted credit terms and habitually late paying buyers may offer to sellers, it increases operating costs by forcing businesses to take working capital loans as a stopgap measure, limits growth and expansion, and the domino effect severely damages the economy at large.

The ACCA has divided the various circumstances and scenarios which result in late payment into 13 distinct reasons[2]:

1. Industry-standard credit terms which are long by the standards of other industries;
2. Routine administrative delay or dispute of invoice;
3. Low-probability provision for bad debt;
4. Routine de-prioritization of suppliers or sellers;
5. Extended terms or prompt payment discounts demanded by a dominant buyer;

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2 Schizas, *Ending Late Payment Part 3*, 5.

6. Non-routine administrative delay or dispute (with potential for legal recourse);
7. Short-term major invoice dispute;
8. High-probability provision for bad debt;
9. Tactical invoice disputes (with potential for legal recourse) by dominant buyer;
10. Medium-term protracted major invoice dispute;
11. Late payment with supplier dilution;
12. Extended credit terms with potential supplier dilution (including provisions for bad debt and potential for legal recourse);
13. Buyer default in bad faith.

Factors Determining Late Payments

As we discussed in the previous section, late payment is a natural by-product of trade credit. This also means that the fundamental forces affecting late payment are not random in their occurrence, but rather arise from the interaction between the following five facets of a working business environment:

[1] The working capital needs and requirements of businesses, which themselves are dependent on new orders as well as an increase in price of inputs such as labor and raw materials for production;

[2] Ease of access to short-term credit from intermediaries, such as banks and other formal lending sources;

[3] Prevalent interest rates in the market, as well as other sources and causes of business indebtedness;

[4] Ease of access to liquidity for the end buyers at the top of supply chains;

[5] The valuation of a business, driven by retained earnings or losses, bad debt, and equity injections.

The ACCA determines that these facets of a business' interaction with its environment drive late payment at different stages. Since the valuation of a business affects capitalization, the occurrences of late payment to the sellers and suppliers of a business will correspond with access to credit as well as the state of liquidity of global markets, and will vary greatly with working capital needs.

Therefore, for example, buyers are far more likely to risk bad debts during a recession, while sellers and suppliers are more likely to risk over-trading and over-inflating their working capital needs during a recovery period in the economy.

Since late payment is a problematic off-shoot of a viable business process, rather than a random happenstance, an enhanced understanding of the factors and reasons influencing greater or lesser instances of late payments will help us empirically judge the efficacy of existing policies and open market solutions. It will also help us frame better policy recommendations of our own by aiding in the compilation of factors which must be addressed in any practical framework, further on in this paper.

Impact of Late Payment

The basic impact of late payment on businesses can be summed up in the following points:

[1] It raises costs associated with the financing of working capital;
[2] It depletes cash reserves in businesses, while often losing them the interest which could have been accrued on the same in the meantime;
[3] It escalates administrative costs associated with collections and recoveries;
[4] It drains labor productivity, and causes businesses to require passing up further profitable work;
[5] It creates substantial distractions from everyday work for both owner-managers as well as the business staff;
[6] Despite healthy client registers, it creates losses for businesses which would otherwise seem profitable on paper;
[7] It often places the burden of financing the entire supply chain above on the smallest sellers and suppliers which are usually placed quite low in the pecking order;
[8] It creates unemployment and bankruptcy;
[9] By killing otherwise profitable business ideas, late payment stifles competition and hampers business progress in markets with unsustainable late payment problems;
[10] Since companies seem to increasingly accept the presence of late payment as a given, the fallbacks required for small businesses to survive late paying clients increase the barriers to entry for businesses in industries with the worst payment practices.

When compounded with each other, the last two points of impact listed above create insulated markets, with smaller companies facing greater struggles to enter such markets from the outside, while the smaller companies inside struggle to survive. This gives rise to environments which are ripe for monopolistic acquisition of market share by the largest companies around.

Since these largest companies are typically grabbing more market share and expanding their reach within the business environment through the trade credit offered to them by their smallest suppliers to begin with, who could very well go bankrupt owing to the late payments, it also creates an economy supported entirely through unpaid credit and the death of small businesses, thus weakening the backbone of the economy and setting it up for a vulnerable future.

B] Why Is This A Problem Worth Solving?

In the previous segments, we took a brief look at the nature of late payment as an extension of trade credit, as well as a cursory glance at its general impact on small businesses in the world. The primary question before we delve into closer examination of this phenomenon, however, is – why is B2B late payment a problem worth solving?

Moving beyond the generic assumption that it's an anomaly in the way the system is *supposed* to work, late payment is entrenched enough in several commercial markets around the world to be considered a normative aspect of the business culture.

In fact, looking up and down the hierarchy of businesses from newly-established enterprises to well-respected commercial giants, most ventures account for late paying clients right from the beginning, and seem to have little drive towards finding resolutions for the phenomenon of late payment itself beyond increasing their access to supplier financing options or charging interest on overdue accounts receivables.

After a time, the entrenchment of late payment seems so complete that smaller businesses who once suffered through long periods of waiting for their clients to clear their overdue accounts now put their own suppliers through the same pains once they themselves have grown larger, because they consider that to be the normal way business transactions are conducted.

While this may be anecdotal, I personally faced this lack of awareness and drive in combating B2B late payments during my professional experiences in India. While meeting with a business acquaintance who has enjoyed a long and successful career as a resourceful financial executive in mid-sized Indian companies, I was taken aback when this well-informed professional considered a 120 to 150-day payment period as perfectly within the normal range for outstanding accounts receivables. My ensuing explanation that the average payment period for Indian companies, as reported by respectable resources, was 60 days was treated as an interesting factoid rather than a possible venue worth exploring to increase the bottom-line profitability of the executive's firm.

This lack of drive towards finding more solutions to the root problem of late payment itself, rather than managing its symptoms, is clearly visible in other business trends too. Today, there are more banking, non-banking, and private third-party services and solutions opening every day which offer a myriad of supplier financing options. In comparison, enterprises and products which specifically target the reduction of Days Sales Outstanding (DSOs) and eradication of late payment along the supply chain through various accounts management technological solutions are few and far between.

Why? The answer is simple – it is easier to build a stable business by managing supplier financing options and earning percentages on transactions between buyers and suppliers than by creating a monthly subscription product which helps businesses recover their own money faster from the accounts of their clients.

Even if we look at public trade (domestic) policies which regulate trade credit and the phenomenon of late payment, several policy revisions skip the question of managing late payments altogether. One notable example of this is the recent attempt to revise the MSMED Act in India during 2015-16. The MSMED Act is responsible for regulating late B2B payments from larger enterprises to smaller-and-medium-sized-businesses (SMBs), and between SMBs themselves, and also specifies important legal compensation such as interest earned on overdue accounts receivables.

In the last attempt to revise the MSMED Act through a commission set up to make it more meaningful as a law in keeping with the needs of current businesses, the panel forewent the segments dealing with late payments and associated penalties and legal recourse for compensation in favor of putting forth recommendations concerning supplier financing and access to credit for SMBs.

Even if we put aside such examples, treating them as the exception rather than the rule – the most notable pieces of legislation concerning B2B late payment among smaller businesses in the world, the 2011 EU Directive for one, are still largely ineffective in making a dent in this problem. As we'll see in later segments in this paper, that arises from policy being treated as a sort of backstop used to put a cap on just how extreme the law allows the phenomenon of late payment to become, rather than a practical tool usable by businesses to swiftly deal with defaulting or late-paying clients.

The fact that most legislative systems in the world suffer from great backlogs of cases as well as rampant lethargy is no secret. In fact, annual reports like *Doing Business* do a great job at keeping a track of how well or otherwise the courts in every country support the business enterprises of that economy in enforcing legal contracts. Regardless, ongoing policy discussions seem to treat those judicial delays and inability to dispense rapid judgment as a natural limitation of policy-making as well, instead restricting themselves to capping contractual payment terms and re-assessing late payment interest rates.

However, as you'll learn in later segments, such measures even in strongly pro-SMB policies are quite meaningless in the long run. Without any way to enforce these laws rapidly, most SMBs never even consider taking legal remedial action against their clients, for fear of losing their current as well as future clientele in a process which would take years and large chunks of their overdue accounts receivables to resolve anyway. By the time compensation is at hand, most SMBs would be already staring bankruptcy in the face.

Thus we return to the crux of this segment. If businesses in general prefer gaining more access to credit than to resolve the underlying issues responsible for most of their overdue accounts receivables; If investors see supplier financing as a better bankable option than exploring ways in which their financed firms can minimize their overdue accounts receivables; If government policies as well treat late payment as a foregone conclusion to a large extent and instead focus on increasing access to credit for smaller businesses – why should B2B late payment be treated as a crucial problem worth solving?

The answer comes to us in the form of groundbreaking new research performed by the MIT Sloan School of Management and The Harvard Business School[3]. The study conducted in conjunction between these two schools tracked the effects of "QuickPay" policies enforced in G2B payments from 2011 to 2014 in the United States.

Federal government procurement accounts for 4% of GDP in the US and represents

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[3] Jean-Noel Barrot & Ramana Nanda, *Can Paying Firms Quicker Affect Aggregate Employment?* (National Bureau of Economic Research, 2016), 2. Last Accessed 31/08/2017. http://www.nber.org/papers/w22420.pdf. DOI: 10.3386/w22420

roughly $100 billion in goods and services purchased from SMBs spanning across every industry and geographic location in the nation. Pre-2011, government contracts typically required one-to-two-month payment terms after the approval of an invoice. Taking into account the time taken to typically approve invoices in government departments as well as any delays caused by invoicing disputes or rejected invoices because they wouldn't match a required format, this could mean that businesses would be getting paid anywhere between 40 to 90 days after the provision of contracted goods or services.

This was addressed in September 2011, when new "QuickPay" rules pushed for acceleration of payments to a subset of small business contractors by shrinking the payment period by 15 days, thus accelerating roughly $64 billion in annual contract value.

As studied by MIT and HBS, every accelerated dollar of payment led to a $.10 increase in the payroll value of the SMB suppliers[4], with two-thirds of the increase coming from new hires and the rest for increased earnings per worker. The direct effect of this policy was to increase annual payroll by over $6 billion, and to create 75,000 jobs in the three years following the reform. This is the first time a definitive answer has been found to the question – what difference would it make if a business were paid just 15 days earlier?

At a macro-level, resolving B2B late payments help provide more jobs by supporting the growth of SMBs, which are universally known as the backbone of any economy. Faster B2B payments reduce volatility in the survival of sound companies with quality products, thus bolstering the health of the supply chain as a whole – since one company affected by late payments usually passes the same problem down the chain to their own suppliers as well.

In an ideal world, resolution of the phenomenon of late payment would also improve business standards as a whole by relegating the impact of defaulting and late-paying clients on the soundness of a good business with innovative products to that of an aberrant scenario rather than the current everyday struggle to maintain cash flow. This would enable the world of business to move to a more meritocratic stage, where businesses with better products but lesser money in the bank to be able to absorb losses and the everyday costs of late payments would be able to succeed more often as well.

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[4] Barrot & Nanda (NBER, 2016), 20

At a micro-level, the most glaring effect of reducing late payments would be to increase the average lifespan of 50% of small businesses well beyond their current 5 years. Should this problem still be left alone, while we continue to treat its never-ending symptoms?

2. METHODS

A] Limitations of the Paper

Given the sheer scope of paths to explore in the study of a topic as vast as late payments among businesses, we must first outline the limitations set upon the discussions of this paper. Since the purpose of this research is to better understand the various factors within an economy that may either help or hinder businesses in their aim to fairly receive compensation for their goods and services, all statistics, discussions, conclusions, and policy analyses in this paper are exclusively rooted in the domestic side of commerce, even when we do escalate conversations from individual cases to a global scale.

By and large, trade can be cleanly divided into foreign and domestic, and among these the numbers pertaining to foreign clients receive just as much attention to publication as the domestic clients when it comes to their treatment from primary research enterprises. However, the area of late payments as it pertains today to foreign commerce also intersects heavily through other realms of regulation such as cross-border movement of finances and international taxation treaties among other things.

Given the importance of historic international relations, ongoing political developments, and the reliance of foreign late payments on the resolution of several international regulatory complexities slowing down banking processes as well, the qualitative nature of the kind of data and discourse required for foreign late-paying clients would veer us drastically away from the study of the various factors influencing the same from within an economy.

Keeping in mind the physical limits of a paper at this academic level as well, the lack of space within which to be able to discuss both foreign and domestic sides and the resultant inability to be able to do justice to them both within this work firmly cinched my decision in this case to respect this limitation, and concentrate this research on the public and private aspects of problem-identifying and problem-solving in late business-to-business (B2B) payments for the domestic side of commerce in various eminent global markets.

Lastly, while this paper does examine some financial tools in the way of invoice financing platforms and services, it does not include within it any specific or detailed discourse on working capital loans or access to other banking- or NBFC-provided financial instruments for SMBs.

The major reason for this exclusion of the subject of 'access to credit' is that it is extensively covered in most other contemporary works and resolutions aimed at reducing the impact of late payments on small businesses. In fact, anecdotal and statistical evidence seems to bear out the fact that most current instances of communication between governance and commerce to resolve late B2B payments seem to instead disproportionately divert efforts towards increasing access to lines of credit for the affected smaller businesses.

With access to credit for SMBs being a symptomatic issue related to late payments, rather than a root cause of or contributory factor to it, I felt justified in excluding it from the discourse of this paper.

B] Sources & Methods

The purpose of this paper was to trawl data relevant to the discussion of late payments between B2B clients and their SMB suppliers, and present conclusions from within contemporaneous writing spanning chronologically between 2008 & 2017.

In order to be able to delve past the blanket acceptance of late payments as a 'given' in businesses which many global payment cultures seem to have inculcated within them, these contemporary publications and articles helped us ascertain those hard variables affecting overdue accounts receivables which were instead associated with policies and behaviors propagated by the participants of any individual economy being studied.

While we're going through the relevance of sources and methods used herein, it also becomes necessary to address for a moment my choice of countries which were to become the specific case studies for this discussion.

Among the five, United States and India were both natural venues for me to explore since I have prior operational experience in the United States due to my own entrepreneurial history, and am currently based out of India. Since any policy recommendations I put forth would apply to the payment culture of these two countries more specifically than it would for other nations, it was natural that these two countries be profiled within this paper.

Since the economic rivalry of US and China brings forth many merits of better understanding the commercial culture in China today, and China and India having some similarities in that they are both among the dominant markets of the world with both enjoying the highest concentrations of human resources available in developed economies, China found a ready place for profiling within this paper. It also provides a counterbalance to both the commercial culture in the United States as well as India, in that it is an extremely large marketplace with much more than the average amount of government regulatory presence bearing down upon it.

In discussing Japan and the United Kingdom, I had two starting purposes. I wanted to showcase prominent economies which have an active role on the global stage, but which have either culturally or politically unique perspectives which have led to unorthodox treatments of the late payment issue among their businesses.

Since the EU can not be afford to be ignored in any paper discussing global efforts and impact to curb runaway late payment cultures, recent events unfolding in the United Kingdom since the 2015 made for these islands to be the perfect focal point around which to discuss both the efforts of the EU, and the impact of those efforts in an individual member nation. Even though the UK has since opted to leave the European Union, it makes the journey started by the EU directives and culminating in the UK's unique "Duty to Report" stand on payment practices for larger enterprises no less relevant as a study.

In juxtaposition to UK's new approach to resolving late payments, Japan provides a view into an amazing counter-culture which established its own attitude and response towards late payments among businesses as far back as the late 1880s. The case study of Japan doesn't just provide us with the amazing example of a policy which still functions largely as effectively now in modern times as it did in the era it was framed, a rather unique proposition considering the redundancy of many public policies caused by the advent of technology, but it also serves to show the strength of policy when it accounts for the culture and idiosyncrasies within which it needs to function - as opposed to creating ideologically sound policies in a vacuum, which then usually fail in matter of practical application precisely because they were crafted to work without accounting for the particularities of the people governed under it. The efficacy of Japan's particular cultural attitude towards resolving late payment can not be questioned either, with roughly 63% of Japanese businesses being paid late as opposed to the average 90% across the Asia Pacific region.

While this paper includes no first-hand data which was created and delivered by my own hands, all statistical data and analyses mentioned in this paper has been derived from two kinds of sources:

1. Primary Sources

These are research papers or results of investigative studies which have either been released by governments, or by credible international for-profit and non-profit research enterprises which dedicate their resources to publishing greater insights from the worlds of business and financing. In essence, in this paper, I have attempted to draw data from high-level sources in order to have a more informed discussion of the 'bird's eye view' of finance as it pertains to late payment, and its impact.

2. Secondary Sources

For this paper, having a bird's eye view alone isn't sufficient in order for us to truly understand the far-reaching compound effects of late payments. As pertaining to the purposes of this discussion, I have also drawn on numerous secondary sources in order to inform us of more localized impact and assessments of policy effectiveness from the business communities which are affected by them the most.

To this end, I have drawn on the works of industry experts, relevant governing politicians from the associated fields, articles from journalists and analysts from credible publications sharing their insights from the perspective of their knowledge of the associated fields and its relevant pressure points, etc. The reason why I treat these as secondary sources are because these individuals, organizations, and institutions rarely offer fresh data of their own in such works, but more often provide deeper insight and allow us to better appreciate the long-term meaning and consequences of the statistical pictures being painted through the same primary sources and information.

3. LITERATURE REVIEW - I

Public Policy Solutions

Governance is a constant experiment in informed trial-and-error. This means that public policies become the clearest way to measure the efficacy of structured solutions over a broad sample of commercial entities in the field of late payment, and well as the difference between their projected and real impact on the problem.

Furthermore, it would be a fallacy to presume that any impact on the late payment problem in a business environment is solely due to changes in public policy. In fact, any significant change whatsoever in the treatment of late payment by the businesses in a particular market can be attributed to a mixture of changes in public policy, innovative private solutions, and an increase in awareness of rights and protections which leads to an evolution in the way the problem of late payment is treated by the business community.

This leaves us in a predicament, insofar as extracting empirical data relating to the impact of public policy is concerned. In the absence of minutely specific quantitative data from a broad sample taken before and after a specific change is enacted, the only other way these measures can be studied is by comparing the public policies in different countries and discussing those factors which are held responsible by credible publications for the nation's payment practices, and whether the policies in place at the time are considered ideal or harmful for business in general.

Therefore, in order to carry out this activity, we shall compare the markets of Japan, India, China, United States, and the United Kingdom.

A] Japan

State of Payment Practices

While 91% of businesses in the Asia Pacific region offer trade credit, only 79% of Japanese commercial enterprises[5] provide lines of credit to their customers at any given point in time. As noted by Atradius in their annual Payment Practice Barometer, Japanese businesses are far more likely to demand upfront payments, or request payment in cash on provision of goods or services, or trade in cash equivalents or terms other than trade credit.

Overall, roughly 60.4% of the total B2B sales value in the country is provided to clients on trade credit, as compared to the average of 50.6% of B2B sales value in the Asia Pacific region. Since this value is significantly higher than the regional average, it can be inferred that although fewer businesses in Japan offer trade credit to customers, the value of sales on trade credit in Japan is still far higher than the regional credit sales.

As of 2015, Japanese businesses give their clients an average of 47 days from the date of invoicing to clear their credit purchases. This payment term is significantly higher than the 33 days on average given by other businesses to their clients in the Asia Pacific region.

It is interesting to note that, unlike the average of 90.2% of businesses which faced late payment at the Asia Pacific level, only 63.2% of Japanese businesses were paid late by their clients.

This predisposition to pay invoices early is documented across multiple sources. In 2016, UK firm Market Invoice released the report of their five year long analysis of payment practices from across the globe. Spanning over 30,000 invoices from across 80 different countries, Market Invoice used the data at hand to draw a comparative baseline snapshot of the average treatment of billing around the globe. As per their baseline, if Israeli businesses

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[5] *"Payment Practices Barometer Japan 2015,"* Atradius Group. Last Accessed 31/08/2017. https://atradiusdutchstatebusiness.nl/publikaties/payment-practices-barometer-japan-2015.html

pay their clients late by an average of 13.5 days and US businesses are paid late by 7.1 days, Japanese businesses are paid 6.5 days early by their customers and buyers[6].

Furthermore, only 24.8% of the total value of B2B sales remained unpaid on their due dates, which was markedly below the average of 44.8% B2B invoices paid late at the Asia Pacific level. As compared to roughly 10% of B2B invoices which remained unpaid past 90 days or more in the Asia Pacific region, only 5% of B2B invoices in Japan were still pending at this stage.

It must be noted, however, that the average DSO of Japanese businesses rests at 40 days[7], which is higher than the 35 day average for Asia Pacific – and is technically the longest Days Sales Outstanding in the region. Yet, it is also understood that this figure is higher due to the longer payment terms which are offered to clients by the Japanese businesses themselves, and thus is a measure of their regular contractual terms rather than the efficacy of their collection processes or treatment of late payment as a business culture.

Another effect of their longer payment terms is that the period which invoices may be left overdue for Japanese businesses averages around 13 days past the agreed upon date of payment. This figure is far lower than the regional average of 25 days overdue for Asia Pacific businesses. However, while these longer payment periods proffered by companies to their clients provides better payment metrics, it also increases the administrative cost of business operations.

As compared to other businesses in Asia Pacific which usually denote liquidity issues and intentional late payments as means of financing operations through trade credit as the two largest reasons for late payment by clients, the two most common instances of late payment in Japan are due to dispute over services and goods, and the complexity of payment procedures. Only 20% of Japanese businesses report insolvency or intentional late payments as reasons for overdue Accounts Receivables.

Most strikingly, the amount of unrecoverable trade credit in Japan averages just 1% of

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[6] *"The State of Late Payment 2016,"* MarketInvoice.com, 15. Last Accessed 31/08/2017. http://info.marketinvoice.com/hubfs/The_State_of_Late_Payment_MarketInvoice_2016.pdf

[7] *"Payment Practices Barometer Japan 2015".*

the total value of B2B sales on credit. This is literally half the amount of unrecoverable credit faced by businesses in the Asia Pacific region. Amidst this 1% of unrecoverable credit, 63.7% of Japanese businesses state the reason as the customer's bankruptcy as compared to 54.4% of Asian Pacific businesses. Furthermore, only 20% of businesses report these unrecoverables as a result of failure of the collection process, as compared to 38.6% of businesses in Asia Pacific.

B2B Debt Collection in Japan

As stated by Euler Hermes' collection profile on Japan, the payment culture in the country is quite stringent and largely experiences on-time or early payments despite longer DSOs.

In terms of transparency of data, financial information is regarded to be largely available with ease in Japan, with various third-party providers offering their services to compile financial data and several companies disclosing their financials on a quarterly basis[8].

In matters of late payment, charging 6% interest on the principal amount from periods past the due date is allowed since the debtor is deemed as responsible for having failed their contractual obligations. If payment is still pending after one year, then the late payment interest may even be included into the principal amount provided that a notice to pay has been sent to the debtor.

The law even allows suppliers to demand compensation for damages arising as result of late payment, as long as the contract includes provisions defining the compensations and their form of payment.

On the matter of debt collection itself, Japan has a Civil Law system in which courts are unbound by precedents, but do tend to consider major decisions upheld by the Supreme Court as guidelines. Summary courts act as the first judicial arena of appeal on cases regarding breach of contract, but any claims above JPY 1.4 million are automatically brought before the higher District Courts.

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[8] *"Euler Hermes Collections: Collection Profile Japan,"* Euler Hermes, 3. Last Accessed 31/08/2017. http://www.eulerhermes.com/mediacenter/Lists/mediacenter-documents/Japan-Collection-profile.pdf

While these domestic courts are often fairly efficient in meting out timely rulings, the tribunals held to investigate and judge on validity of evidence are often time-consuming and expensive.

In-Court Contract Enforcement In Japan

In order to study the efficiency of the Japanese court system, the *Doing Business* report conducted its own experiment on how long it would take to enforce a contractual payment for goods or services rendered between two companies.

Standardizing the experiment across various nations required that the *Doing Business* group lay down quantifiable rules to maximize the accuracy of resultant data. They did so by establishing the following steps in the process, in order to produce a faithful recreation of an in-court legal process for recovery of payment:

[1] The dispute relates to a lawful transaction of goods or services in exchange for compensation between two businesses (Seller and Buyer), both of whom are to be located in the economy's largest business city.
[2] The buyer orders custom goods, and fails to pay.
[3] The fiscal value of the dispute is either 200% of the income per capita, or the equivalent of USD 5,000 in local currency, whichever is greater.
[4] The seller requests a pretrial writ of attachment to secure the property at the beginning of the case.
[5] The dispute on the quality of goods requires an expert opinion.
[6] The judge decides in favor of the seller, without appeal.
[7] The seller enforces the judgment through a public sale of the buyer's movable assets.

In order to get a contractual payment enforced through court in Japan, it takes an average of 360 days and roughly 23.40% of the total claim value[9].

In this regard, Japan ranks at 51 out of a total of 189 economies. The *Doing Business*

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[9] *"Doing Business Economy Profile 2016: Japan."* World Bank Group, 92. (World Bank, Washington DC, 2015) https://www.openknowledge.worldbank.org/handle/10986/23284 Last Accessed 31/08/2017.

report also marks it at 65.26 as a distance to the frontier (DTF) score. To clarify this further, the DTF score stands for the proximity or distance an economy is on a scale of 0 to 100 from the frontier – or the country which performs the best in this particular regard.

In comparison, Korea – which stands at Rank 2 in enforcing business contracts, and has a DTF score of 84.84 – requires an average of 230 days to resolve the same claim.

However, the Japanese business environment contains protections outside of the legal system as well. Foremost among them, experts such as Euler Hermes attribute the lack of significant late payment to cultural particularities.

These cultural particularities lead to unique incarnations of late payment protection. A particular example from the Japanese system is that debtors who have failed to pay on time twice over six months may be banned from the banking system.

Out-of-Court Factors Enforcing B2B Contracts in Japan

One of the largest out-of-court practices which drive timely B2B payments in Japan stem from the nature of the country's business payment practices.

According to a business guide released by Sumitomo Mitsui Banking Corporation, Japan's second largest banking entity, a majority of business-to-business transactions in the nation are carried out through Corporate Checks ("Kogitte") and Promissory Notes ("Tegata"; similar to IOUs, but legally defined under Japanese law)[10].

Typically, promissory notes are held to lie midway on the spectrum between the informal nature of an IOU and the absolute nature of a loan contract with regard to legal enforceability.

To be specific, promissory notes contain a written promise by one party to pay another party a definite sum of money either on demand or at a specified future date. It also contains all the terms relating to the indebtedness by the issuer or maker to the note's payee, such as amount, interest rate, maturity date, date and place of issuance, and issuer's signature.

[10] *"Characteristic of Japanese Banking Practices"* Sumitomo Mitsui Banking Corporation. Last Accessed 31/08/2017. http://www.smbc.co.jp/global/supporting/about_gcbd/information.html

Being the country's most popular form of business transactions, these two financial instruments are heavily policed by the Japanese clearing house system. As such, the structure of these instruments is strictly outlined in the Japanese Commercial Code.

Their popularity also exempts them from the Japanese Anti-Monopoly Law, in order to maintain the guarantee of clearance under any circumstances. This is particularly vital since promissory notes are transferable negotiable instruments.

The Japanese clearing system is most notably characterized by a mandatory bank transaction suspension rule, under which banks must suspend transactions for a certain duration with obligatory payers whose bills or checks are dishonored. The bank transaction suspension rule was already in existence as early as 1887 with the aim of maintaining orderly credit conditions of bills and checks.

Under the current system in place, all financial institutions participating in a particular clearing house shall halt their Current (checking) account and lending transactions for two years with a person or business whose bills and checks to vendors or suppliers have been dishonored twice during a six-month period[11].

Since over 74% of Japan's check and promissory note transactions are carried out by the Tokyo Clearing House, which functions with the participation of over 323 financial institutions, defaulting on notes in this context might well mean a ban from the Japanese Banking system altogether.

However, while this enforces a system of absolute justice in the case of repeat defaulters, it still wouldn't help the vendors in reclaiming owed compensation for goods or services rendered. In such a case, since promissory notes are typically post-dated for payment after 90 to 120 days, they are supported by Japan's vast and broadly developed discount notes market.

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[11] *"Payment Systems In Japan,"* Japanese Bankers Association, 6. (Japanese Bankers Association, 2012). Last Accessed 31/08/2017. https://www.zenginkyo.or.jp/fileadmin/res/en/banks/payment-systems/paymentsystems.pdf

Under said system, vendors can either go and transact with banks to take over the promissory note at a discounted rates or go to several private financial institutions who would provide them with immediate capital. Once the bank has control of a promissory note, and if it is aware of the possibility of an upcoming default, it may halt the processing of the promissory note and instead offer it back for repurchase to the issuing business or debtor company.

This system of out-of-court checks and balances through the financial network itself ensures that Japan's businesses have a strong incentive to conclude any transactional debts on time. It also provides creditor businesses with the assurance of several options of being able to swiftly recoup a majority share of their compensation for a healthy cash flow, in exchange for comparatively small discount rates.

This goes a long way to explain why even when Japan's businesses offer longer payment terms on average, they still manage to settle B2B debts 6 days faster than the rest of the world's baseline payment practices.

B] United Kingdom

State of Payment Practices

The United Kingdom has long since faced an entrenched environment of late business-to-business payments. In fact, according to BACS Payment Schemes Clearing House, small to medium-sized businesses in UK were owed £46.1 billion (roughly $58 billion) in late payments in 2014 alone[12].

This debt burden steadily grew from £18 billion in 2008, and exceeded the previous peak of £37 billion in 2012.

In the United Kingdom, 48.2%[13] of the total value of B2B sales is usually transacted on trade credit terms. Among British businesses, 90% of B2B SMBs were paid late on invoices by their customers in 2015. Resultantly, roughly 44.6% of the total value of B2B receivables remained unpaid past their due date. This signifies a 3% increase in late payments from 2014 to 2015.

B2B trade credit terms offered by British businesses average 25 days from the invoice date, which appears to be 2 days shorter than credit terms offered to clients in 2014. Yet, businesses could close on overdue accounts receivables only 52 days after invoicing.

On average, businesses in the UK face Days Sales Outstanding of 53 days in 2015, which also indicates a rise of over 8 days from their DSO in 2014. Not only does this denote a worsening trend of late B2B payments in UK, 1 in 4 British businesses also expect their DSO to further deteriorate over the next 12 months.

As compared to other countries in Western Europe, where nearly 58% of businesses cite liquidity issues faced by clients as reason for late payment, only 49.4% of British

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[12] *"UK Businesses Forced To Make Late Payments,"* PYMNTS.com. Last Accessed 31/08/2017. http://www.pymnts.com/news/2014/uk-businesses-forced-to-make-late-payments/

[13] *"Payment Practices Barometer UK 2016,"* Atradius Group. Last Accessed 31/08/2017. https://group.atradius.com/publications/payment-practices-barometer-uk-2016.html

businesses held that to be the case in their experience. However, this also reflects a rise from the 43.6% of British businesses which asserted the same in 2014.

Furthermore, less British businesses (26.8%) maintained that the late payment of invoices was an intentional move by clients in order to alternatively finance themselves than did in 2014 (35.6%). The figure from 2015 is also more in line with the experience of businesses in Western Europe where 28.2% of B2B SMBs hold alternative financing moves by clients to be the main reason behind their overdue accounts receivables.

In the end, 1.4% of overdue B2B Accounts receivables were reported as uncollectable by British businesses, which is in keeping with the 1.3% average for Western Europe. While 26.8% of businesses in UK reported the receivables as uncollectable due to their inability to locate the client, 31.1% asserted that the reason for their failure to recover was mainly due to the high costs of pursuing trade debtors.

Moreover, despite the fact that small businesses are protected under the Late Payments of Commercial Debts Act 1998, there are widespread reports of practices labeled by the UK Federation of Small Businesses as "supply chain bullying"[14].

Typically, the law of United Kingdom provided for an average payment term of 30 days, with provisions that if an agreed-upon contractual term is to exceed 60 days at the most – it could only be legally viable if terms were enforced which would assure fairness for both parties involved.

Yet, larger conglomerates such as AB InBev, Heinz, and others were widely reported to have payment terms of 97 to 120 days for their suppliers. In particular, Premier Foods also threatened its supply chain with dissolution of contracts unless they made cash payments, later backing down in the face of a political storm to accept "more conventional type of discount negotiation."

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[14] *"One in five firms face supply chain bullying says FSB,"* BBC.com, 2014. Last Accessed 31/08/2017. http://www.bbc.com/news/business-30427503

Late Payment Legislation in the United Kingdom

The Late Payment of Commercial Debts (Interest) Act 1998

The United Kingdom was one of the first member countries of the European Union to enact legislation pushing businesses and commercial entities towards prompt payment practices.

The Late Payment of Commercial Debts (Interest) Act was passed in 1998[15], and was originally framed to provide small to medium-sized businesses (SMBs), with 50 or fewer employees, with the framework to charge interest on late payments to larger businesses and public sector organizations of any size.

The Act extended to the territories of England, Scotland, and Northern Ireland. It was eventually amended in 2002 to allow SMBs to charge interest on late payments by other small businesses as well.

As per the letter of the Act, unless its enforcement was specifically ousted by contractual terms between businesses, a supplier would have a statutory right to claim 8.5% interest for the late payment of commercial debts. The accrual of this interest would generally start from the day after the agreed date for payment of the debt.

Where no date was contractually agreed upon, the statutory interest would start from the date 30 days after the supplier delivered its goods or services, or the buyer received the invoice, whichever was later.

The Act further allowed suppliers to claim fixed compensation as costs associated with recovering the debt, which were tiered based on the size of the debt. For a debt of less

[15] "Late Payment of Commercial Debts (Interest) Act 1998" Last Accessed 31/08/2017. https://www.insolvencydirect.bis.gov.uk/technicalmanual/ch25-36/Chapter31/part1/31-1part7.htm

than £1000, suppliers could claim a sum of £40. The compensation for debts between £1000 and £9,999 was £70, while debts of £10,000 or more enabled the vendor to claim a sum of £100.

Notably, the Act placed no limitations on the time period which could be contractually enforced by buyers on suppliers. Hence, if a buyer forced Net 90 terms on its vendor, and paid within those 90 days, it would technically not be indulging in late payment practices.

European Directive 2011/7/EU

On the heels of the financial crisis of 2007-08, business in the European Union was plagued by late payment practices.

As per the European Commission, "Each year across Europe, thousands of small and medium-sized enterprises (SMEs) go bankrupt waiting for their invoices to be paid. Jobs are lost and entrepreneurship is stifled. Late payment causes administrative and financial burdens… For Europe's valued SMEs, any disruption to cash flow can mean the difference between solvency and bankruptcy."[16]

Thus, on July 1st 2009, the European Parliament consulted the European Economic and Social Committee on actionable reform which could further the protection of small businesses from late payments.

The end result of the Parliament and EESC's deliberations was the Directive 2011/7/EU, which made substantive chances and amendments to the previous Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions.

This directive established the following benchmarks for the legal frameworks of EU's member nations:

- Public bodies have to pay for goods and services received from suppliers within 30 days or, in very exceptional circumstances, within 60 days.

[16] *"Late Payment Directive"* European Commission. Last Accessed 31/08/2017. http://ec.europa.eu/growth/smes/support/late-payment_en

- Enterprises have to pay their invoices within 60 days, unless expressly agreed upon contractually through terms which are not “grossly unfair” to suppliers.
- An automatic statutory entitlement to interest for late payment, as well as a minimum €40 compensation for recovery costs.
- A statutory interest of at least 8% above the European Central Bank’s reference base rate.

By doing so, the EU directive specified the maximum contractual payment terms acceptable by law between a buyer and supplier, and well as the automatic provision of compensation. It was formally adopted on 16 February 2011, and EU countries were given till 16 March 2013 at the latest to integrate the directive into national law.

EU countries were also given the freedom to maintain or continue bringing into force any laws and regulations which are even more favorable to the supplier, placing this directive as the minimum benchmark to be met by member nations.

The Late Payment of Commercial Debts Regulations 2013

These regulations finally came to force on 16 March 2013, and amended the previously existent Late Payments of Commercial Debts (Interest) Act 1998[17].

The immediate effect of these regulations was to address the shortcoming of the previous Act. Mainly, since the previous Act never outlined stipulations regarding the maximum payment terms acceptable by law, the enforcement in UK of the EU directive ensured better legislative support for suppliers.

The biggest legal advantage lay in the fact that if larger buyers were to continue their standing practice of long contractual payment terms above 60 days, they would have to include provision of a “substantial contractual remedy” in order to ensure that the agreement is not “grossly unfair” to their suppliers.

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[17] *“Late Payment of Commercial Debts”*, Osborne Clarke, 1. (Osborne Clarke, 2013) Last Accessed 31/08/2017. http://www.osborneclarke.com/media/filer_public/19/8e/198e3129-4118-45fa-9801-eb34d34204e2/late-payments-of-commercial-debts.pdf

Determination of whether the contractual payment terms is "grossly unfair" to suppliers would be carried on a case-to-case basis, and would factor in all relevant circumstances including:

- Whether the long payment period is a gross deviation from good commercial practice and contrary to good faith and fair dealing; and
- Whether the buyer has an objective reason for requiring the extended payment terms.

While suppliers had automatic claim to the compensation based on the debt amount, they could also claim as compensation any "reasonable" costs of recovering the debt, which exceeded the fixed sum. However, the provision of 8% above the base rate meant that the statutory interest payable remained steady at 8.5%.

Impact of Directive 2011/7/EU on late payment practices in the United Kingdom

As we can gauge from the profile of payment practices in United Kingdom mentioned above in this paper, the directive has had little practical effect on curbing late payments despite the increased legislative support for suppliers.

An ex-post evaluation carried out on behalf of the European Commission by Valdani Vicari Associati, Technopolis Group, and Ernst & Young bore the same results. They found that exercise of the rights conferred by the Directive was not widespread because suppliers feared damaging good business relationships.

They also found that almost 66% of companies are well aware of the general rules regulating late payments as of 2011 within EU member countries, and 86% of companies knew about their right to compensation and interest. Yet, 60% of companies indicated that they would never exercise their rights to claim interest or compensation as safeguarded under public policy[18].

The European Commission had initially submitted in its impact assessment accompanying the directive an estimation of a total of EUR 1,864 billion in company

[18] Hausemer et al. *"Ex-Post Evaluation of Late Payment Directive",* 8. (European Commission, 2015). Last Accessed 31/08/2017. https://publications.europa.eu/en/publication-detail/-/publication/400ecc74-9a54-11e5-b3b7-01aa75ed71a1# DOI: 10.2873/016503

turnover which are paid late each year. Assuming that these companies then fill their working capital gap by using overdraft facilities offered by financial institutions, the potential benefit to European companies from savings relating to administrative and financial overheads alone is estimated at EUR 158 million per day[19] of reduction in late payment.

However, in the 2 years between the implementation of the EU directive and the ex-post evaluation report, there is little evidence that the directive has had an impact on payment behavior and the practice of late payment.

At the same time, in countries which face a shorter average payment duration, companies have been more likely to use the directive and exercise their rights as compared to other economies. This may be because faster average payment experiences in general make late-paying companies the outliers in the economic environment, rather than the norm, thus releasing suppliers from worries relating to lack of future work owing to damaged working relationships.

If suppliers know well that the next client they do business with is more than likely to pay them quickly, they have less apprehension regarding the state of the survivability of their business. This greater balance in the working dynamic of a supplier and buyer enables them to pursue their legal rights with less worry about negative fallout.

Thus, in this sense, the directive seems to be an effective instrument for companies in countries where the problem of late payment is less severe.

Moreover, despite the lack of tangible change in late payment practices, no member nation has requested for the directive to be repealed because it serves greater value in other forms. Most importantly, it has created a benchmark and so brought greater uniformity to the payment terms across the EU markets.

It has also kept the problem of late payment high on the political agenda, ensuring that an active discourse on tackling late payments is upheld. This allows for legislative

[19] *"Evaluation of the Late Payment Directive/ REFIT Evaluation,"* European Commission, section 6.1.7. 26 August 2016. Last Accessed on 31/08/2017. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016SC0278

experiments to continue with great momentum, ensuring that even if a solution is not apparent today, it is still being researched.

It also provides an anchor point for the introduction of effective accompanying measures at a cross-national level. Since there are no regulatory or administrative costs associated with this directive, beyond a one-off requirement for businesses to familiarize themselves with the legislation, it also does not increase the burden on the small business.

However, the report accedes that, given the multi-faceted nature of late payment as a problem, "there can be no one-size-fits-all legislative solution and the Late Payment Directive can only be one measure among many in the fight against late payment." Moreover, targeting solutions which address business culture and norms, external economic conditions, free market forces, and power imbalances are more likely to yield successful change than legislation.

UK's Report on Payment Practices and Performance

While the EU-driven legislation granted more policy support to suppliers than ever before, it was also a resounding failure as an actionable protection against late payment.

In 2008, it was estimated that over 4000 SMEs[20] went out of business in the United Kingdom due to their customers failing to pay on time. Despite the remnants of the financial crisis having entirely abated by 2014, and the directive granting increased powers to suppliers, payment practices were scarcely better.

Even though larger clients were increasingly scrutinized in the media for their supply chain payment practices, they shifted their methods from outright late payment to demanding unreasonably long payment terms or even switching payment terms to lengthier periods at the last moment. Given that these clients held the leverage in the relationship dynamic, they continued to dictate payment terms and contractual negotiations.

[20] *"Late Payment"* Federation of Small Businesses, page 4. July 2011. Last Accessed on 31/08/2017. http://www.fsb.org.uk/LegacySitePath/policy/rpu/london/assets/late%20payment%20july%202011.pdf

A government report from November 2014 also outlined that only 10% of businesses in UK had considered using late payment legislation, despite 22% of businesses having reported ending a business relationship[21] with customers because of continued late payment. As such, while the legislative fight against late payment was escalating on paper, practices remained virtually identical on the ground.

This continued till early 2015 when the UK government, understanding the increasing value placed on corporate social responsibility and boardroom reputation in business, announced new legislation mandating all large firms (businesses with more than 250 employees) to publish payment practices every 6 months. This was carried out through the passing of the Small Business, Enterprise, and Employment Act.

A discussion paper led in 2013 by the UK government, called "Building a Responsible Payment Culture", showed that over 73% of businesses had called for greater transparency in payment practices. By 2015, seeing the visible lack of change in late payment problems, the UK government announced this new measure as a way to protect future supplier-buyer business interactions by providing the supply chain with detailed information regarding potential new clients.

On the occasion, UK's Business Minister Matthew Hancock declared that "We are determined to make Britain a place where late payment is unacceptable and 30-day terms are the norm… We've acted to ensure all public payments do that, right down the supply chain, and are bringing in new strict transparency rules… These new rules will make poor payment performance a boardroom reputational issue for companies and help change the culture once and for all."

Among the reporting requirement, this new "Duty To Report" legislation now mandates large companies to publish the following information[22]:

- Standard contractual payment terms and maximum contractual payment periods;
- Whether suppliers are consulted or notified about changes in payment terms;
- Proportion of invoices paid beyond agreed terms (by percentage);

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[21] *"Daily Hansard - Debate"* Parliament.uk, column 225. 18 November 2014. Last Accessed on 31/08/2017. https://publications.parliament.uk/pa/cm201415/cmhansrd/cm141118/debtext/141118-0003.htm

[22] *"Hancock: Large Firms must publish payment practices"* Gov.uk. 20 March 2015. Last Accessed on 31/08/2017. https://www.gov.uk/government/news/hancock-large-firms-must-publish-payment-practices

- Average time taken to pay invoice from the date of issue (by number of days);
- Proportion of invoices paid within 30 days, between 30-60 days, and beyond 60 days (by percentage);
- Amount of interest paid in reporting period (by number);
- Amount of interest liable to pay (by number);
- Process for dispute resolution for overdue invoices;
- Whether the company offers e-invoicing, supply chain finance, or holds preferred supplier lists;
- Whether the company demands payment or incentives for businesses to join or remain on a supplier list; and
- Whether the company is a member of any specific Payment Code.

Planned to be put into force from April 2016 onward, this new legislation requires that all large firms publish the information in the prescribed format to a central digital portal, access to the information from which shall be made publicly available by the government. Since the first reports from this measure are yet to be released by the UK government, an ex-post impact assessment on the measure is as yet pending.

<u>United Kingdom Prompt Payment Code</u>

The Prompt Payment Code (PPC) was initiated by the Institute of Credit Management (ICM) in 2008 on behalf of the UK government as a voluntary measure to promote a culture of prompt payment. The PPC's signatories, though not mandated to sign up to the code, voluntarily make a public commitment to pay on time and pay fairly. This creates a way for businesses which deal in fair payment practices to distinguish themselves from their competition to potential partners in the supply chain.

Since the UK government pushes for the PPC to represent a gold standard of payment practices in the business environment, it allows for the creation of a business-side push towards greater resolution of late payment problems, rather than having legislation force change in the free market.

Signatories to the PPC are asked to[23]:

- Provide 5 references from the supply chain to validate membership;
- Pay invoices within a maximum of 60 days, and seek to pay within 30 days as the norm;
- Avoid practices which are grossly unfair and adversely affect suppliers; and
- Report annually on payment practices and performance (for SMBs), and half-yearly (for large signatories).

While the initial lack of government oversight created an atmosphere where companies could fraudulently sign up to the PPC in order to receive its mark on their business, while still refusing to follow fair payment practices, this state of affairs changed in March 2015 with the establishment of a rigorous Compliance Board to enforce the code.

Furthermore, the Compliance Board also consisted of members from the business community who heard cases against defaulting PPC signatories as well, thus allowing for less bureaucratic and faster resolutions of allegation against enterprises. Any offending signatory is now promptly excluded from the PPC, and loses all competitive benefits bestowed upon it through the code.

As of 2017, 32 of the biggest suppliers to the government have signed on to the PPC and committed to clear 95% of their invoices within 60 days, and to work towards adopting 30 days as the norm. Together, the signatories of the code as of Q3 2017 collectively account for around 40% of government procurement spend[24].

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[23] The Rt. Hon. Matthew Hancock MP, *"Changes to the Prompt Payment Code"*. Chartered Institute of Credit Management, 24 March 2015. Last Accessed on 31/08/2017. http://www.cicm.com/wp-content/uploads/2015/03/Joint-Minister-and-CICM-letter-to-signatories-24.03.15.pdf

[24] *"Businesses get on board with Prompt Payment Code,"* Gov.uk. 5 July 2017. Last Accessed on 31/08/2017. https://www.gov.uk/government/news/businesses-get-on-board-with-prompt-payment-code

C] India

State of Payment Practices

The instance of late payment is deeply entrenched as a cultural business practice among Indian enterprises.

India has seen a strange bucking of payment trends in recent years. While average number of days taken to clear overdue accounts receivables has reduced steadily in the last three years, between 2012 to 2015, the overall prevalence of late payments in the business environment has sharply increased.

To clarify, the average Days Sales Outstanding (DSO) of businesses in India at the end of 2014 had been 65 days[25], which had been tremendously higher than the regional average of Asia Pacific at 34 days. This DSO fell to 35 days by the end of 2015[26], which was in line with the Asia Pacific average DSO for businesses.

However, on the other hand, the instances and value of late payments in Indian businesses rose sharply in the same time-span.

By October 2015, 98% of Indian businesses reported granting trade credit to their customers over the past year, while 97% experienced late payments by clients in the same time frame. These values are significantly higher than the equivalent figures for the Asia Pacific, which stand at 91% and 90.2% respectively.

Furthermore, an average of 53.5% of the total value of domestic B2B invoices remained outstanding after the due date, which was notably higher than the 44.8% average for the Asia Pacific region. This 2015 figure was also the highest recorded percentage of late

[25] *"Payment Practices Barometer India",* Atradius Group. 1 November 2014. Last Accessed on 31/08/2017. https://group.atradius.com/publications/payment-practices-barometer-india-2014.html

[26] *"Payment Practices Barometer India 2015"*, Atradius Group. 21 October 2015. Last Accessed on 31/08/2017. https://group.atradius.com/publications/payment-practices-barometer-india-2015.html

payment value of overdue B2B invoices from among all the countries surveyed by Atradius in 2015.

It was also appreciably higher than the 40.4% average overdue B2B invoice value experienced in India by the end of 2014. This denotes a 13.1% increase in instances of late payment of B2B invoices by value in a single year.

Considering that only 33% of the total value of domestic B2B receivables were overdue in India in 2013, it also signifies a roughly 20% rise in instances of late payments by value in the span of 2 years.

The contractual payment terms in India average 29 days, which is the third shortest payment term in the Asia Pacific, and below the 33-day average payment term for the region. However, businesses clear overdue invoices roughly 34 days after the due date. Hence, B2B companies get paid approximately 63 days after invoicing, on average.

By the end of 2015, 14% of the total unpaid B2B accounts receivables were found to be still unpaid after 90 days or more past the due date, which was higher than the 10% average for the Asia Pacific region.

It was also significantly higher than the same statistic at the end of 2014, which denoted that only 6.1% of receivables were still pending at the end of 90 days. This shows a 2.3x rise in the number of accounts receivables going unpaid in India past 90 days in the span of a single year.

Roughly 50% of Indian businesses in 2015 stated that the late payment experienced by them was due to liquidity issues faced by clients[27]. 38.8% of Indian businesses also stated that the late payment was an intentional move by clients as an alternative method of financing their own operations through trade credit.

Among the key factors for late payments was one significant change. As compared to figures from recent years, one reason seen to be on the rise as attested by 28% of Indian

[27] *"Payment Practices Barometer India 2015"*, Atradius Group.

businesses was the inefficiency of the banking system contributing to the payment delays.

Although complexities relating to the Indian banking system had been often attributed to payment delays from foreign clients, 2015 was the first year where their contribution to domestic late payments was noted with any significance in the domestic B2B market.

2.2% of the average total value of B2B receivables in India was unrecoverable in 2015. This figure is lower than its equivalent value of 2.9% average in 2014. It is also a staggering improvement over the same figure from 2013, when roughly 7.7% of the total value of domestic B2B receivables had been written off as unrecoverable by Indian businesses.

It must be noted that the greater instance in 2015 of invoices remaining unpaid past 90 days signifies an important trend – even though more B2B invoices are remaining overdue past the period of 90 days from the due date, there are still fewer instances of unrecoverable receivables overall.

Though small at first glance, this demonstrates a significant improvement in collection methods and practices in the country. However, this analysis can only be corroborated if there is further evidence of a similar trend in future reports. If not, it merely signifies a rise in preference for 90-120 day payment term agreements between a larger number of companies and their supply chain in 2015 than existed in 2014.

This possible extrapolation would also be in keeping with the known practices of large businesses across the world, who are increasingly attempting to persuade or leverage longer payment terms with suppliers. Evidence of such payment behavior by large firms was clearly seen in the United Kingdom profile above.

Concerning the unrecoverable accounts in India in 2015, 50% of suppliers stated that the receivables went uncollected due to the customers' bankruptcy. 38.6% of suppliers also stated that they faced unrecoverable receivables because of the failure of collection attempts, while 35% of suppliers stated that the receivables had been written off because the debt was too old.

Late Payment Legislation in India

The Interest On Delayed Payments To Small Scale And Ancillary Industrial Undertakings Act, 1993

In response to long-standing demands of small enterprises for protection from the abusive payment practices of larger clients, the Delayed Payments Act came into force on 23 September, 1992[28]. It extended to the whole of India, except the State of Jammu and Kashmir.

The Delayed Payments Act provided some crucial basic legal cover to:

1. Ancillary industrial undertakings or small scale industrial undertakings holding permanent registration certificate issued by the Directorate of Industries of a State or Union territory;
2. National Small Industries Corporations; &
3. Small Industries Development Corporations registered under the Companies Act, 1956.

As per this Act, any buyer was liable to pay "compound interest (with monthly interests)" at such rate which was 5% points above the floor rate for comparable lending, if the due payment was not made on or before the date agreed upon between the buyer and supplier in writing.

The floor rate referred to in the clause represented the minimum rate stipulated for loans by the Reserve Bank of India. However, since these lending rates were tiered depending on the size of the loan, it meant that the amount of the overdue payment would determine the calculation of interest on the original amount.

If there was no formalized agreement, the due date of payment would be the "appointed day" as it was recognized in the Act.

For clarification, the "appointed day" refers to the day following immediately after the

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[28] *"The Interest On Delayed Payments To Small Scale And Ancillaryindustrial Undertakings Act, 1993"* IndianKanoon.org. Last Accessed on 31/08/2017. https://indiankanoon.org/doc/1005016/

expiry of 30 days from the "day of acceptance or the day of deemed acceptance" of any goods or services by a buyer from a supplier.

For the purposes of these clauses,
"*The day of acceptance*" means:

1. The day of the actual delivery of goods or the rendering of services; or
2. Where any objection is made in writing by the buyer regarding acceptance of goods or services within 30 days from the day of the delivery of goods or the rendering of services, the day on which such objection is removed by the supplier;

"*The day of deemed acceptance*" means, where no objection is made in writing by the buyer within 30 days from the day of the delivery of goods or the rendering of services, the day of the actual delivery of goods or the rendering of services.

In addition to formalizing the liability of buyers towards their suppliers, the Act also clarified that any waiver of interest, compound interest, or liability for late payments agreed upon in writing between a buyer and supplier would not be held legally binding.

In addition, not only did the Act forbid buyers from writing off late payment interests as deductible expenses for the purposes of computation of taxation, but no buyer could appeal a ruling of late payment liability unless 75% of the decreed amount was first deposited with the relevant court of law.

Lastly, the Act also mandated that any buyer with outstanding debts to suppliers would specify said amount along with any applicable interest in their annual statement of accounts as unpaid dues.

Amendment to the Delayed Payments Act, 1993 (1998)

While the Delayed Payments Act of 1993 provided a starting framework for late payment protection of small businesses in India, it still had several glaring shortcomings.

In the absence of transparency or immediate accountability, since the business relationship in any supply chain was skewed in favor of buyers, there was seen a proliferation of contracts where suppliers were forced to accept impractically long payment terms from larger buyers.

Furthermore, the tiered interest rate meant that any compensatory payment to be made by buyers on clusters of smaller individual monetary sums on invoices, if it would come, would be a mere slap on the wrist in comparison to the many advantages of cash hoarding through late payments. As such, this still wasn't an effective remedy for smaller enterprises which were more likely to have several outbound invoices of relatively smaller sums than fewer payments due for large gross amounts.

These were some among many insights which the Indian government gleaned from their first attempt at providing late payment protections to small enterprises. This lack of effective implementation eventually led to the Amendment to the Delayed Payments Act, which came into force on 10 August, 1998.

As per this amendment, any buyer was liable to pay "compound interest (with monthly interests)" at "one and half time of Prime Lending Rate charged by the State Bank of India," if the due payment was not made on or before the date agreed upon between the buyer and supplier in writing.

On 1 March 1999, this Prime Lending Rate was 12%, thus ensuring that defaulting buyers would be facing 18% interest on late payments right from the start, irrespective of the invoice amount.

However, there were two other changes made to the Delayed Payments Act which could arguably be noted as much greater long-term protections[29]. Firstly, the amendment enforced that no contractual agreement between buyers and suppliers could exceed a payment delay of 120 days from the day of acceptance or the day of deemed acceptance.

Secondly, these small scale and ancillary industries could now approach the Industry Facilitation Council (IFC) for settlement of their disputes with buyers with regard to late

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[29] *"Amendment to the Interest on Delayed Payments to the Small Scale and Ancillary Industrial Undertakings Act, 1993".* Last Accessed on 31/08/2017. http://diodisha.nic.in/Doc/AMENDMENT-TO-DELAYED-PAYMENTS-TO-SSI-ACTS.pdf

payments.

State Governments were empowered with the constitution of such councils which, if they could not achieve reconciliation between buyer and supplier, could formally act as Arbitrators for settling disputes following the provisions of the Arbitration and Conciliation Act, 1996.

As recorded from the resources of the Directorate of Industries (DoI) under the State Government of Odisha, their Industry Facilitation Council was comprised of representatives from banks, chambers of commerce, small scale industry associations, and ranking officials from the DoI itself, with jurisdiction over the entire state.

Understandably, this provided small industries with more actionable measures as a significantly quicker remedy, without having to step into the logjam of the Indian court system. Instead, in cases where payment had been pending for 120 days or more, suppliers provided the IFCs with

- Copies of the purchase order or contract;
- Relevant receipts;
- Details of pending bills;
- Material accounts of raw materials if any;
- Details of partial payments if any;
- Acceptance of works executed where applicable; and
- Any copies of orders from buyers extending the payment dates to suppliers.

As such, the Amendment provided a notable improvement over the original Act.

The Micro, Small And Medium Enterprises Development Act, 2006

At the beginning of the 21st century, the Indian government realized the vastly diverse commercial group which was being left undefined and unsupported among smaller to medium sized enterprises (SMEs) or smaller to medium sized businesses (SMBs). In fact, prior to the MSMED Act of 2006, the medium industry or enterprise had not even been defined in any law.

While the Delayed Payments Act of 1993 had provided a basic cover to manufacturing industries, the absence of a comprehensive legal definition and framework left a sizable portion of the Indian business environment with no actionable late payment protections or support.

Furthermore, there was little to no basic protection for the large emergent services sector which had grown to assist the small scale industries, thus requiring the passing of laws which would encompass both industrial units and related service entities.

These circumstances changed with the merging of the Ministry of Agro and Rural Industries and Ministry of Small Scale Industries into the current Ministry of Micro, Small and Medium Enterprises (MSMEs). This move to a single over-riding administrative body was considered crucial to the enhancement of the competitiveness and survivability of the MSME sector.

The next step then came with the passing of the Micro, Small and Medium Enterprises Development (MSMED) Act into law on 18 July 2006[30]. This Act did not only cover the National Small Industries Corporations and Small Industries Development Corporations previously covered under the Delayed Payments Act, but also "any company, co-operative society, trust or a body, by whatever name called, registered or constituted under any law for the time being in force and engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprises."

It further defined micro, small, and medium enterprises whether in manufacturing or service industries, and created provisions for any commercial enterprise to fall into those brackets –whether registered under any law or not – to benefit from the MSMED Act as long as it was registered under the Ministry of MSMEs.

Once this Act came into force, the period of the "appointed day" in late payment clauses was cut in half from its previous 30 days. Now, the "appointed day" was considered the day following immediately after the expiry of a period of 15 days from the day of

[30] *"The Micro, Small and Medium Enterprises Development Act, 2006",* The Gazette of India. 16 June 2006. Last Accessed on 31/08/2017. https://ic.gujarat.gov.in/documents/pagecontent/MSMED2006.pdf

acceptance or the day of deemed acceptance of goods or services by a buyer from a supplier.

Moreover, the legally allowed period for a buyer to provide an objection in writing was reduced from 30 days to 15 days as well.

This meant that both “the day of acceptance” and “the day of deemed acceptance” were now held to be within 15 days of the delivery of goods and services in the absence of a formalized agreement or contract, as long as all objections regarding the nature and quality of goods or services had been resolved between buyer and seller.

Most notably, the MSMED Act reduced the maximum cap on payment delay between the agreed upon due date and date of delivery of goods and services in a contract between a buyer and a supplier from the previous 120 days to 45 days.

In case of non-payments from a buyer to a supplier, the buyer would be held liable for “compound interest with monthly rests” from the date immediately following the day payment was due at “three times of the bank rate notified by the Reserve Bank.” On 21 July 2006, the bank rate put forth by the RBI had been 6%, thus ensuring an 18% interest on late payments from buyers right from the onset.

For faster out-of-court legal remedies, the MSMED Act followed in the footsteps of the IFCs, and included provisions for the constitution and management of Micro and Small Enterprises Facilitations Councils (MSEFCs).

These MSEFCs could as well act as conciliators and arbitrators in case of dispute, as provided under the Arbitration and Conciliation Act of 1996. Additionally, the Act also provided for the MSEFCs to either conduct such proceedings themselves or refer the case to any other institution or centre providing alternate dispute resolution services for conciliation.

In case of appeals made by buyers contesting awards and decrees for late payments granted to suppliers in a court of law, the MSMED Act retained the provision for 75% of the claim to first be deposited with the relevant court.

However, it made a significant addition by granting the court the ability to directly give that 75% to the supplier if it seemed that the appeal application was to be disposed, depending on the reasonable straightforwardness of the case, and imbued with any conditions the court would deem appropriate. This was expected to be a strong protection against buyers employing the judiciary as part of their delaying tactics.

D] China

State of Payment Practices

"*62% of the businesses… reported that domestic B2B customers have slowed invoice payment due to liquidity problems over the past year.*"[31]

With that opening statement, the 2015 Atradius Payment Practices Barometer paints a blue picture for the world's second largest economy.

41.8% of the total value of domestic B2B sales in China is provided on credit. Despite the advanced placement of the Chinese economy in terms of size and growth, Chinese businesses prefer payments in cash or cash equivalents.

As per the report, 93.6% of businesses in China reported facing late payment problems from their B2B clients during 2015. Since yet another study – by credit insurance group, Coface, in this instance – reported that 8 in every 10 Chinese businesses experienced overdue payments in 2015, it can be reasonably asserted that B2B payment practices in China are suffering.

On average, Chinese businesses are given a term of 37 days from the date of invoicing to clear overdue accounts receivables. This is held to be the third longest average payment term in the Asia Pacific region, and has increased by an average of over 14 days from 2012 to 2015.

Furthermore, domestic B2B clients typically settle their dues within 22 days after the due date. This means that suppliers in China are paid within 60 days after invoicing.

43.1% of the total value of domestic B2B sales is reported to be overdue. Between 2013 to 2015, it has been noted that the value of domestic B2B invoices paid late has

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[31] *"Payment Practices Barometer China 2015,"* Atradius Group. 21 October 2015. Last Accessed on 31/08/2017. https://atradiusdutchstatebusiness.nl/publikaties/payment-practices-barometer-china-2015.html

increased by roughly 10%. Moreover, taking into consideration that only 41.8% of domestic B2B sales are on credit, Atradius found that late payment by B2B customers occurs more frequently on invoices for small amounts than in most of the other countries in Asia Pacific.

In the case of very long outstanding receivables, 7.5% of the total value of domestic B2B sales remained unpaid after 90 days or more in 2015. For this reason, cost containment due to the burden of carrying trade debts has been regarded by 28.6% of Chinese businesses as one of the biggest challenges to profitability in 2015. In addition, 25% of businesses assert that maintaining adequate cash flow is also at the top of the list of challenges.

Among the key payment delay factors, 62% of Chinese businesses indicated that late payment by clients was mainly due to liquidity constraints. As compared to the 46.3% of businesses in the Asia Pacific whose clients pay late due to liquidity issues, this figure is markedly higher. 27.3% of businesses were also paid late due to the formal insolvency of the buyer.

In comparison to the country's payment practices in 2014, even though Chinese businesses have lower DSOs (down from 52 days to 39 days), and the percentage of businesses paid late due to liquidity problems faced by clients has dropped from 67.12% to 62%, the percentage of accounts receivables overdue has increased from 34.3% to 43.1%. More importantly, the percentage of total value of domestic B2B invoices still pending past 90 days has increased from 3.9% to 7.5%.

In 2015, 1.8% of the total value of B2B receivables were eventually written off as unrecoverable, which was lower than the 2.5% uncollectable B2B accounts receivables in 2014. Among them, 52% of Chinese businesses reported not being paid due to bankruptcy and formal insolvency of the buyer. Another 40% reported their receivables as uncollectable due to failure of their collection attempts. 37% among them all also noted that the receivables had been written off as the costs to pursue the debtors were too high.

According to the *Doing Business 2016*[32] report for China, enforcing a commercial

[32] *"Economy Profile 2016: China"*, page 109, as part of Doing Business 2016: Measuring Regulatory Quality and Efficiency. World Bank Group: Washington DC, 2016. Last Accessed on 31/08/2017. DOI: 10.1596/978-1-4648-0667-4

contract through the courts takes roughly 452 days and costs 16.2% of the claim amount. While the environment hosts lawyers who agree to take cases on a 'no win, no fees' basis, they are still reputed to take a significant chunk of the claim amount after the fact.

Keeping that in mind, as well as noting the considerable time investment, it may be understandable why SMBs are unequipped to take larger clients to the courts for reasonable resolution of overdue accounts receivables.

To emphasize that point, even a summary guide[33] for B2B enterprises on getting paid in China released by the China-Britain Business Council lists that most Chinese companies expect to have a decent profit margin included in the first 90% of payment owed to them, and view the final 10% as 'great if you can get it' rather than a guaranteed payment.

Furthermore, in order to smoothen business relationships to get foreign B2B enterprises operating in China, they even go on to note that – *"*Usually, when dealing with Chinese businesses, there will be as many as 5-6 signatures before a payment finally gets paid off. An effective way to do so for some has been to use the key holiday periods to offer simple gifts related to the industry you are in.*"*

However, the same guide also advises businesses to "*find a way to inflict pain,"* noting that Chinese companies often find a way to build in some form of 'kill switch' to their goods or services in case they need to make a point about payment.

Along with the efforts of Chinese authorities to transition their economy from an export-driven model to a consumption-driven one, increasing regulatory requirements, stock market volatility, and a significant rise in non-performing corporate loans, the notable entrenchment of late B2B payments along the supply chain are also being held responsible for the slowing down of Chinese economic growth.

However, since an economic slowdown invariably brings along with it a greater need for trade credit, cash hoarding, and short-term credit instruments, it is estimated that the

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[33] *"A Guide to Getting Paid in China",* China-Britain Business Council. Last Accessed on 31/08/2017. http://www.cbbc.org/cbbc/media/cbbc_media/KnowledgeLibrary/Reports/A-Guide-to-Getting-Paid-in-China.pdf?ext=.pdf

current environment will lead to further decline in B2B payment practices in the near future in China.

This slowdown, in conjunction with the current prevailing B2B late payment practices, will inexorably push Chinese businesses into a cycle where clients are unable to pay their supply chain, or meet sufficient targets to repay corporate loans while maintaining adequate free cash reserves, which will in turn play its part in further slowing economic growth.

To that end, 43% of businesses in China do not expect the B2B payment practices in their country to improve over the coming 12 months. Moreover, 20% of businesses also expect the payment practices to degrade further.

Late Payment Legislation in China

No Legislative Policy Framework for Corporate Late Payment in China

As the title of the segment suggests, the People's Republic of China has no codified laws regulating the phenomenon of trade credit or corporate late payment.

Under Chinese law, B2B late payments are treated as another form of private loan financing. However, in this case, the loan is considered to be provided involuntarily, since a defaulting buyer in such a situation is automatically forcing the supplier to support a loan of the amount of the overdue accounts receivables. To clarify, the amount pending for goods or services rendered is automatically considered as a loan from the seller to the buyer by a Chinese court of law.

Moreover, Chinese legislation has no codified cap on maximum late payment interest which can be charged to the buyer by the seller in case of default. However, to that end, the Supreme People's Court of China (SPC) has placed two tiers of caps on any interest on financial transactions which occur within the boundaries of the nation.

The 2015 SPC Rules on Loans[34] apply to any transactional interaction, whether real estate, share transfer, agreements on purchase or service, etc. They place a 24% per annum and another 36% per annum cap on any enforceable 'general interest' to be paid on late payment by the buyer to the supplier. The legal precedent regarding these caps applies specifically to cases where late payment interest rates have been negotiated and included in an enforceable contract between buyers and sellers.

Between the two caps, the difference lies in the legal rights of the paying party or the buyer to recover the relevant portion of late payment interest, but bears no change on the supplier's rights to recover payment pending on overdue accounts receivables.

Under the 24% cap, the portion of late payment interest not exceeding that rate is enforceable by the receiving party through legal action in a court of law.

For the portion exceeding 24% per annum late payment interest rate but less than 36% per annum, the supplier cannot enforce payment through court action, and the buyer cannot engage in court action to recover such portion if it has already been paid to the supplier.

To clarify, if the supplier can leverage their working relationship and provision of goods or services to force payment of late payment interest ranging between 24% to 36% per annum, the buyer cannot initiate litigation to recover such payment through a court of law. However, the supplier cannot enforce such interest rates even if specified on a legal contractual agreement through a court of law.

Similarly, under the 2015 SPC Rules on Loans, the portion of late payment interest exceeding 36% per annum cannot be enforced by a supplier through litigation in a court of law. However, a buyer who has paid a portion of late payment interest in excess of 36% per annum can initiate legal action against the supplier in a court of law to recover such amounts.

In cases where corporate contracts remain silent on matters relating to late payment or associated interests, suppliers will forego any 'general interest' and the SPC will award late

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[34] Baker McKenzie, *"Under the latest PRC rules, how much late payment interest or liquidated damages can be charged under a real estate agreement or share transfer agreement?"* September 18 2015. Last Accessed on 31/08/2017. https://www.lexology.com/library/detail.aspx?g=e252df8b-52b1-41dd-a17a-1485243bb34b

payment interest at just 1.3x to 1.5x of the applicable benchmark loan interest rate set by the People's Bank of China (PBOC). As of July 2016, the PBOC rate is 4.350%, which means any late payment interest awarded would vary between 5.65% and 6.52% per annum.

However, there remains a lack of clarity on this point as well. Strictly speaking, the caps set under the 2015 SPC Rules on Loans apply specifically to loan interests and not non-loan transactions such as late payment on goods or services. Prior to these caps, the SPC had set the legal cap on loan interest at 4x the benchmark loan interest rate of the PBOC. Although the Supreme People's Court never issued any interpretations to formally extend this rule to non-loan agreements, in practice the SPC and some lower courts had applied '4xPBOC' by analogy to non-loan agreements.

Late payment interest is the most typical form of liquidated damages pre-agreed between buyers and sellers. The overriding legal policy remains that the court does not support claims for liquidated damages which significantly exceeds the actual loss of the supplier.

Ultimately, in practice, if suppliers demand liquidated damages exceeding 1.3x of their actual loss, then the portion in excess will not be enforced by the court. Yet again, more often than not, the court tends to simply apply the specific rules and caps relating to loan interests by analogy to non-loan agreements such as late payments if the agreement is silent on late payment interest, rather than try to ascertain the amount of 'actual loan' and then apply the general rule of 'no more than 1.3x of actual loss'.

As well, if the agreement between buyer and supplier provides for late payment interest as well as additional liquidated damages, the court will allow both claims but subject the amount to be paid to a total cap of 24% per annum.

In case of continued default on pending payment by the buyer, even after receiving judgment on the matter from a court of law, the court will impose an additional daily 'penalty interest' of 0.0175% on the overdue principal stated in the court ruling from the date of non-compliance with the judgment. The late payment interest already awarded under the court judgment will continue to accrue on the overdue principal amount from the due date under the agreement till the date of payment.

In the end, as can be surmised from the legislative profile above, late payment legislation in China sorely lacks any centralized codification. Thus, it seems that suppliers depend on the judgment of court for a meaningful resolution, and that the efficacy of litigation can only be gauged on a case-to-case basis.

However, this does point to two over-riding aspects of Chinese law with regards to late payment recovery. Firstly, contracts are far more vital between buyers and suppliers in China, since the interest and costs recovered by the supplier with and without a legal contract vary noticeably. However, even if certain provisions of a contract are unenforceable in a court of law, such an event will not invalidate the entire contract as is seen in many other countries. Instead, the court will simply reinterpret the provision in a manner that is legal and move on with the case.

Secondly, the legal precedents set in place by the Supreme People's Court of China seem more concerned with protecting the buyers from having to pay exorbitant amounts of interest in the case of late payment, than protecting the suppliers from being paid late in the first place. This characteristic, where legislation seems openly more concerned with protecting the rights of buyers than of suppliers, has as yet not been seen in any of the other countries or economic zones that have been profiled in this paper up to this point.

Payment Instruments: Fapiao, Contracts & Invoices in Chinese B2B Industry

Fapiao & Late Payments

As will be clear from evidence in several segments of this paper, invoices play a large part in the phenomenon of B2B late payments. As such, China's unique practice in terms of invoicing is one which has bearing on both the impact of late payment among Chinese suppliers, as well as possible policy recommendations to correct late payments in other markets.

In China, the most common instrument of invoicing used is called a "Fapiao". However, the word "Invoice" is a misnomer when representing the Chinese Fapiao. The closest translation of this document is “Proof of payment”. As such, it is not meant to be a document which is supplied from the seller to the buyer before the payment for goods and services rendered is completed.

The Fapiao[35] is a receipt which is printed through a specific printing machine that is connected to the Chinese Tax Bureau. Theoretically, once the goods or services have been provided from seller to buyer, the accounts receivables concerning said transaction are cleared. After the payment is done, the seller enter the transaction amount into the Fapiao machine, which then prints a confirmation receipt that is to be given to the buyer. This fapiao is then used by the seller to pay the corresponding revenue tax to the Tax Bureau at the end of each month.

Thus, a Fapiao is first and foremost a taxation instrument, since Chinese tax authorities control the declaration of taxation at the point of transaction. However, in practice, this is the closest equivalent to the concept of an invoice or bill which is delivered after the provision of goods or services.

In China, larger buyers often refuse to process payments to suppliers until the fapiao has been printed and delivered, or at least a photocopy of it. When questioned upon the need for such a practice, larger buyers often respond with – “How do we know that a Fapiao will be issued once payment has been sent?”

However, since the non-declaration of a transaction in China is considered a criminal offense, it seems that the push to issue a Fapiao before payment has been made is more of an effort on the buyer’s part to retain greater power in the dynamic of their transactional relationship than any true misgivings over non-receipt of a Fapiao from a seller after the payment. This is clear from the way a Fapiao is issued in the B2C industry, whether a customer completes a transaction on an eCommerce website or a McDonalds – the Fapiao is printed and provided the instant the transactional sum is paid.

Instead, since buyers aim to retain this upper hand in the transactional relationship – and yet pay their suppliers anywhere between 30 to 120 days from the date of issue of the

[35] *“China’s ‘Fapiao’ Invoice System Explained”,* China Briefing. May 22 2017. Last Accessed on 31/08/2017. http://www.china-briefing.com/news/2017/05/22/understanding-chinas-fapiao-invoice-system.html

Fapiao – the suppliers not only have to bear the burden of overdue accounts receivables, but are also still forced by law to pay the required revenue tax on the transaction at the end of that month.

Contracts & Invoicing

However, despite the wide-spread use of Fapiao in the Chinese B2B industry, they are still not considered a replacement for an invoice. This is one particular practice which is alien to most other commercial markets, and often an obstacle to business when foreign companies first deal with Chinese enterprises.

While Chinese B2B enterprises do not send invoices, they do so because every B2B transaction in China is typically covered under its own individual contract. Instead of an itemized bill after the provision of goods or services, Chinese buyers and sellers negotiate and sign itemized contracts containing details of the same. If the order changes at any point in time, the original contract is either amended or a fresh contract is drawn up.

Since this leaves a crucial gap between the period of negotiation and the end of delivery of goods or services, corporate lawyers and legal experts often recommend smaller suppliers to leave out any vague language from their contracts with buyers which may be used later to further postpone payments. As such, many B2B SMBs eschew language such as "payment upon satisfactory delivery" from contracts drawn with their buyers, since it may be exploited by buyers to find fault in well-performed services or quality goods for the sole purpose of postponing their date of payment even before sellers have sufficient cause to undertake legal action.

However, as we've noted in the previous segments, Chinese law has no codified regulations on B2B transactions. Even though *Doing Business* may note the average time taken to fight a breach of contract in a Chinese court as roughly 452 days at 16.2% of the claim amount, it may well happen that sellers either may not have the resources to take a buyer to court, or may not receive any late payment interest at all if their contracts are found wanting in any way, or if the interpretation of the closest existing equivalent law by the sitting judge on their case does not end in the supplier's favor.

These factors, as well as the state of payment in Chinese B2B industries profiled in the segments above, go a long way towards explaining the lower trend of business on credit in China as well as the SMB preference to complete transactions through cash or cash-equivalents.

E] United States of America

State of Payment Practices

According to Atradius' report on the payment practices towards suppliers in USA during 2016, the United States seems to be suffering from an upward pressure in insolvencies. The vital point to note in this regard is that the US has no legislative framework under which the state of payment practices between companies is regulated. The onus of bearing out a fair judgment in credit disputes between organizations lies on the wording in their contract, the breach in which is then gauged accordingly by a court of law.

Considering the fact that judicial systems are increasingly under strain by a global rise in late payment between buyers and suppliers, let's take a quick look at where this currently leaves the state of payment practices in the USA.

Surveys in the US show that 92% of suppliers were paid late between 2015-2016. 44.8% of the total domestic B2B sales value was transacted on credit, down from nearly 51% in 2015. Among these, 46% of those domestic B2B invoices remained pending past the due date in 2016[36], which remains reasonably stable since 2015 (46.4%).

There have been no significant changes in payment terms extended by suppliers, with buyers getting 20 days to clear their overdue accounts in 2016 versus the 22 days they granted in 2015. As compared to the other economies in the Americas, this reduction of payment term speaks to the US suppliers' strong focus on protecting their businesses from the negative impacts of late payments by clients on their cash flow and profits.

Logically, in the credit-flush economy of United States, this speaks of a business approach wherein suppliers would rather know sooner than later if they are to face late payments anyway, and thus give themselves more time to better prepare alternative sources of funding to maintain a healthy cash flow.

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[36] *"Payment Practice Barometer - The Americas 2016".* Atradius Group. 28 September 2016. Last Accessed on 31/08/2017. https://group.atradius.com/publications/payment-practices-barometer-americas-2016.html

On average, clients in US settled their past due invoices around 34 days late in 2016, putting the average payment period for overdue invoices at roughly 55 days from the date of invoicing.

In 2015, about 15% of the total value of domestic B2B sales remained pending 90 days past the due date. Owing to a lack of corresponding information in 2016, it is largely unclear whether this trend has changed in any significant way.

On average, 1.4% of collectables remained unrecoverable in 2016, as compared to the 1.8% of unrecoverable accounts faced by US suppliers in 2015.

29.8% of suppliers in US stated the reason for late payments in 2016 to be the liquidity issues of the client, down from 44.8% in 2015. Additionally, 32% of suppliers in 2016 held the late payments as a deliberate move by buyers to finance their business, while 27% of delays in clearing overdue accounts was attributed to the formal insolvency of the customer. Studies also note that domestic late payments in the US B2B sectors occur as often due to ineffective invoicing and disputed invoices as they do due to the client's formal insolvency.

State of Payment Legislation

State of Small Businesses in United States

Let's start with hard numbers. In September 2016, JP Morgan Chase released a study of cash flows, balances, and buffer days in the typical small business in US, compiled from 470 million transactions conducted by 597,000 small businesses. Their analysis returned a stark conclusion.

Roughly 50% of all small businesses in the United States hold a cash buffer only large enough to support 27 days of their typical outflows[37]. Let's keep in mind, as we learned in the

[37] *"Cash is King: Flows, Balances, and Buffer Days",* JP Morgan Chase & Co, Page 6. September 2016. Last Accessed on 31/08/2017. https://www.jpmorganchase.com/content/dam/jpmorganchase/en/legacy/corporate/institute/document/jpmc-

last section, that the average payment period for overdue invoices – 46% of all domestic B2B invoices – stands at roughly 55 days from the date of invoicing.

This hasn't been just an off year either. A report released by the Georgia Tech Financial Analysis Lab in 2014 stated that corporate payables to small business suppliers had steadily increased between 2009 and 2014 from 35 days to 46 days[38]. Clearly, despite the comparatively stable 55 days in 2015 and 2016, the overdue payables clearance periods have seen a steady rise in the last decade.

Additionally, an American Express Open Report published in July 2016 stated that 49% of small business owners were concerned about the cash flow issues at their company, and 27% experienced a cash flow crunch in their most recent quarter.

So, what legislative framework exists to protect these small businesses in the face of chronic overdue accounts receivables and crippling cash flow crunches?

Legislative Framework For B2B Payments To Small Businesses

None. As of the end of 2016, there still exists no comprehensive and cohesive federal legislation which regulates the payment practices in the B2B industry between suppliers and buyers.

The only aspect of business payments which are regulated in US legislation deal instead with the responsibilities and penalties of payment on G2B contracts, from federal agencies to their sub-contractors.

Regular B2B payment practices, covering transactions between suppliers and buyers, are instead regulated solely by the language of the contracts drawn up between the transacting parties. However, as per Doing Business 2016, the average small business in US spends roughly 420 days at a cost of 30.5% of the claim amount to litigate a breach of contract in a court of law.

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institute-small-business-report.pdf

[38] David M. Katz. *"Company Payables Jump to 46 Days,"* CFO.com. 21 July 2014. Last Accessed on 31/08/2017. http://ww2.cfo.com/supply-chain/2014/07/company-payables-jump-46-days/

Considering that it's an average though, that number may vary wildly depending on where one transacts business in the United States. Small businesses in Los Angeles, for example, spend roughly 495 days at a cost of 42% of the claim amount in order to recover their overdue accounts receivables in case of breach of a contract.

Even putting aside the time taken to resolve a case in a court of law, suppliers often get counter-sued by their clients when they do dare to initiate litigation. One notable example of this is the 2015 case of Imperial Bag & Paper co. (supplier) v A&P[39], which owns retail chain subsidiaries such as SuperFresh and Food Emporium. When the overdue accounts receivables owed to Imperial Co. – a family owned company – crossed $3.7 million dollars, they demanded A&P to clear their accounts and refused to offer any more credit. Upon receiving the request of payment and notification of non-extension of credit, A&P stopped all communication with the supplier, forcing the former to go to court.

Once the lawsuit against them was filed, A&P publicly denounced Imperial's claims and vowed to counter-sue for breach of contract, stating that by ceasing lines of credit Imperial co. had "attempted to unilaterally change the terms of its contract."

Due to such complications in the legal environment of US, and from the fear of losing future clientele if they develop a reputation as a litigious supplier, most small businesses refuse to enforce their contracts in a court of law. Even if they leave aside considerations of time that would be needed to resolve such a case, the average of 30% of the claim amount still makes going to court a significantly more expensive option than other alternative means of resolution such as Invoice financing or Dynamic Discounting.

President Barrack Obama's Executive Orders: QuickPay & SupplierPay

The QuickPay Initiative

Recognizing this dearth of protection and the stagnation it causes in the growth of small US businesses, President Barrack Obama signed an executive order in 2011 to put into

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[39] *"A&P's Late-Pay Feud With Supplier Heads To Court."* PYMNTS. 26 June 2015. Last Accessed on 31/08/2017. http://www.pymnts.com/news/b2b-payments/2015/aps-late-pay-feud-with-supplier-heads-to-court/

effect a new initiative – QuickPay. This move was also prompted by the fact that though the US economy began recovering from the last Great Recession in June 2009, growth was sluggish and bank lending following the financial crisis was entirely insufficient to meet the demands of industry, particularly for small businesses. Alternative channels of financing were egregiously expensive, with interest rates typically upwards of 25% even when such small firms could gain access to credit.

In essence, QuickPay reduced the government's payment time from 30 days after receiving an invoice to 15 days. Since there already existed legislation regulating payment periods and penalties for G2B transactions, the infrastructure required to enforce violations against this initiative was already in place. If an agency did not pay a vendor the amount due by the required payment date, it would be obligated to pay the vendor a late-payment interest penalty.

In a statement, Karen Mills, then administrator of the Small Business Administration had lauded the policy: "QuickPay is a smart and powerful boost that effectively delivers billions more dollars into the hands of small contractors so that they can do what they do best — create jobs."[40]

As a clarification towards the source of the purported billions of dollars in savings, Joe Jordan – SBA Associate Administrator – had qualified that those savings represented the interest saved on the cost of financing the goods and services produced for the government.

Continuing on the clarification, he had stated that many businesses, perhaps most, do not finance their production or inventory out of their revenue but rather through trade credit and borrowing through loans. Even if these businesses were not to do so, utilizing their cash reserves in order to further their business operations would carry with it an opportunity cost. "By cutting the receivables time in half, you're reducing the negative float — it's the financing cost of the good or service they just sold to the government," Mr. Jordan said.

Moreover, QuickPay specifically reduced this payment period just for officially

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[40] Ross Mandelbaum. *"Will Obama 'QuickPay' Policy Mean Billions to Small Businesses?"* The New York Times. 15 September 2011. Last Accessed on 31/08/2017. https://boss.blogs.nytimes.com/2011/09/15/will-obama-quickpay-policy-mean-billions-to-small-businesses/?mcubz=1

designated “small business” government sub-contractors, and not large corporations which transacted with federal agencies as well. Since small business G2B contracts totaled roughly $98 billion in 2010, halving the payment period for these small enterprises was expected to boost survivability and growth by a significant margin.

Furthermore, it was expected that these smaller businesses getting paid faster would also result in their own sub-contractors getting paid on time as well, thus resulting in a trickle benefit down the supply chain though this was not yet specifically implemented or enforced through the initiative.

Even though this factor was not specifically discussed in QuickPay literature, it also should not be ignored that this policy came with yet another side-effect in favor of small businesses. By reducing the financing costs of providing goods or services to the government for small businesses, this initiative would help such SMBs to increase their profit margin in each endeavor thus enabling them a better competitive foothold in their individual industries against larger conglomerates which operated as government contractors as well.

As for the tangible outcome of this program, it was analyzed in a study released by Harvard Business School in conjunction with MIT Sloan. This report, as we’ve discussed in a previous section, outlined that for every accelerated dollar even simply made available to small businesses 15 days sooner, payroll increased by 10 cents on each of those dollars, with two-thirds of the effect coming in from an increase in new hires and the rest through an increase in earnings. Essentially, having less funds locked in overdue accounts receivables would enable a firm to:

[a] Secure more human and other resources;

[b] Recruit from better talent pools;

[c] Increase the efficiency and return on every dollar spent on their infrastructure through better hires;

[d] Expand their production and other operational capabilities to grow.

To explain the surprising depth of impact from such a seemingly small shift in payment periods, the study exposited on the multiplier effect of working capital. As per their example, a small business firm with $1 million of sales[41] being paid 30 days after delivering its goods or services always has at least $80,000 of cash 'tied up' in receivables at any point of time. Even a seemingly small shift in the payment terms from 30 days to 15 days would in that case permanently release $40,000 of cash for the firm on an ongoing basis. In extreme scenarios, where a firm is able to support growth exclusively through internal cash flow rather than credit instruments, this would allow the firm to double in size to $2 million twice as fast.

To remain objective, it has to be noted that vocal critics of this program often voiced concerns over its true impact on the survivability of small businesses since the initiative only regulated the number of days it would take for an agency to clear their outstanding payables towards their contractors *after* an invoice was accepted, which in itself could add weeks or months to the payment cycle. However, given that the HBS report showed that even just a reduction of those 15 days could permanently add 10 cents to a small firm's payroll for every accelerated dollar – it increased survivability and growth prospects for SMBs nonetheless, and so was a step in the right direction even if there were many opportunities for improvements within it.

Finally in 2013, the QuickPay program was officially amended to incentivize these primary small business contractors to adhere to the 15-day payment standard in their own payment practices.

The SupplierPay Initiative

As we've discussed before, a statement released by Charles Mulford, director of the Georgia Tech Financial Analysis Lab, said that corporate payables had increased on average from 35 days in March 2009 to 46 days in July 2014.

Moreover, ever since the last Great Recession, bank funding to small businesses had hit an all-time low, and still hadn't recovered significantly 6 years later. For most banks, lending to small businesses was a costly and risky endeavor which required them to drive up

[41] Barrot & Nanda (NBER, 2016), Page 8.

interest rates charged by banks to insure their investment. As of 2013[42], the effective interest cost for investment grade corporation bonds ranged from 1.6 percent to 2.4 percent, while it was 6.1 percent for non-investment grade corporations, and 10.3 percent and above for small businesses – and this was when they considered a small business firm as eligible for a loan, irrespective of the creditworthiness of the business itself.

According to Federal Deposit Insurance Lending Corporation[43], as of June 2012 lending to small firms was down about 20 percent since 2008, while lending to larger firms was up 4 percent since its low in 2011.

Regional survey data from the Federal Reserve Bank of New York showed that 37 percent of all small businesses had applied for credit in the fall of 2013, while another 18% of businesses that wanted to apply had specifically been discouraged from doing so by the banking institutions. Of those that applied, over 40% either received no capital at all or received less that the amount they had requested.

The problem with this scenario was that SMBs accounted for almost half of all private sector workers in 2011, according to census data. However, only 1% of businesses with less than $25 million in revenue were able to access debt and equity markets in comparison to over 90% of businesses with over $1 billion in revenue.

Although the reticence of lending institutions towards extending lines of credit without safeguarding their interests was understandable in the aftermath of the last Great Recession – it must be admitted that, from a logical perspective, this situation could spell nothing but disaster for the survivability of small businesses in general considering that they were often the ones bearing the burden of cost associated with trade credit extended to and late payments from those large revenue businesses anyway. So, not only were they not getting paid on time, but they had little recourse but to opt for expensive, profit-breaking, informal lines of financing in the desperate need to keep their firms from going bankrupt.

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[42] Dr. Susan Helper. *"Reducing Supplier Working Capital Costs: How Buyers Benefit"*. US Department of Commerce. 17 November 2014. Last Accessed on 31/08/2017. http://www.esa.doc.gov/sites/default/files/supplierpayslidepresentationv8.pdf

[43] Dr. Susan Helper, Jessica R. Nicholson, and Ryan Noonan. *"The Economic Benefits of Reducing Supplier Working Capital Costs."* US Department of Commerce. Last Accessed on 31/08/2017. https://www.sba.gov/sites/default/files/aboutsbaarticle/The_Economic_Benefits_of_Reducing_Supplier_Working_Capital_Costs.pdf

As we've seen time and again, this situation would lead to:
[a] A slowdown in the immediate overall growth of the economy:

Since smaller businesses form the supply chain which enables the large buyers at the top to even produce and sell their products in the first place, and their stagnation and bankruptcy en masse would adversely affect not only the stakeholders within the firm, but any client firm whom they served as well. Although the impact of a small supplier's bankruptcy in the supply chain could be reduced by replacing one with another, there were various associated supplier turnover costs as well in setting up the infrastructure for yet another supply chain with a new seller, which would inherently reduce the profitability of the large companies too.

[b] A drastic slowdown in the long-term economic growth of the country:

Any economy depends on a collection of newer and more valuable enterprises rising up through the supply chain, and replacing older high-value corporations as their products go obsolete or they die a slow and natural death. Even if the attrition rate of higher net businesses at the top is reduced through government support, tax incentives, etc. the economy still depends on SMBs eventually growing into larger businesses, thus creating even more jobs, and giving rise to opportunities for higher-value domestic and global products either by themselves or in conjunction with other large businesses.

If a series of circumstances, as was seen here in US between the lack of lines of credit and excessively delayed payments by clients, was to make surviving the first five years of an SMB even harder than it normally is in this hyper-competitive stratum – the opportunities for such businesses to grow and give back to the economy in the form of more jobs and greater tax revenue would not only keep decreasing, but it would expose 50% of the private sector workers in the country to an increasingly volatile environment where job security itself was suspect from one financial year to another.

[c] Every aspect of development and standard of living, from government projects to daily consumer goods, would keep becoming drastically more expensive than even a steady inflation rate in a developed first-world nation could explain:

Free market forces in any economy influence the checks and balances provided by constant development in thoughts, philosophies, technologies, and practices which affect businesses of all ranges, in order to keep the price of any product from swelling beyond the reach of significant portions of its target demographic in a populace. However, that actually also requires that any small business idea which has the potential to positively disrupt the current practices of its field be able to turn into an operational and survivable business venture in order to make any impact in the open market, and reduce costs or help keep them in check.

Moreover, when suppliers for any non-disruptive product or service lasted long enough in their sectors, and grew sufficiently to be able to figure out cheaper ways of providing the same service – they played a big part in keeping in check or making cheaper the final price of the end product for which they were part of the supply chain.

A short anecdotal example here would be that of Tasty Catering[44], an SMB in Illinois, recognized by Forbes as one of the Top 10 Best Small Companies in America. Founded in 1989, Tasty Catering made its name in the mid-2000s for a simple yet revolutionary change in its business practices. The CEO of the firm, Tom Walter, had created a council some time previously within his firm so every member of staff from cooks and accountants, to office staff and drivers would have a representative on it who could directly engage with the leadership.

When an employee noticed that fuel prices were cheapest on Tuesdays, and most expensive on Thursdays and Fridays, it was brought to the notice of the firm's leadership which immediately changed the way the SMB purchased fuel for its fleet of delivery vehicles – leading to an annual saving of $35,000. This measure alone resulted in a profit margin which was nearly double the industry's national average. The capital was then invested in engaging employees from local communities, which has kept the firm's turnover rate below

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[44] The Hitachi Foundation. *"From Command-And-Control To Employee Engagement: How Tasty Catering Communicates Its Values"* Forbes. 25 February 2016. Last Accessed on 31/08/2017. https://www.forbes.com/sites/thehitachifoundation/2016/02/25/how-tasty-catering-communicates-its-values/#3982544435a9

2% as opposed to the industry norm of roughly 50%. Since then, their employees have launched twelve other ventures with support from the company, thus creating their own "fleet" of small businesses that Tasty Catering brought to bear in order to improve the state of employment and growth in their local community.

Even if such developments didn't lead to a price drop for the end-consumer, it would still negate potential increases in price due to inflation, thus keeping costs of living or that of running different commercial ventures within reasonably equivalent means as before. Furthermore, even when not reducing the price of the end-product, such tweaks and reductions in cost price versus selling price of any product in the supply chain would increase the profitability of both the suppliers as well as their buyers, thus providing both with excess capital to be re-invested into the business in the form of expansion of operations, greater payroll, etc. which would mean more jobs for the economy as well as a greater purchasing power for larger sections of its populace than before.

After the initial successes of QuickPay, the Obama administration turned to the private sector in hopes of improving the state of the SMB sectors in US. In 2014, they launched a private sector initiative called SupplierPay, which was loosely modeled on the practices of QuickPay.

As per the SupplierPay initiative, companies would join the government in a pledge to pay their small suppliers faster, or failing that – help their suppliers gain access to financing solutions with would ease their working capital burdens at a lower cost till the buyers were able to clear their outstanding payables.

In alignment with the regulations put forth under the QuickPay initiative, the SupplierPay program upheld its participant corporations to a pledge to pay their suppliers within 15 days of the invoice being accepted.

Problems Within The SupplierPay Initiative

The practice to push for longer payment terms among suppliers by significantly larger clients is partly attributed to InBev[45]. In 2008, the MNC beer giant InBev acquired Anheuser-Busch, one of America's largest brewers, to form the world's largest beer company. InBev itself was an affiliate of 3G Capital, a global conglomerate which owns food and beverage brands such as Heinz and Kraft Foods.

After the merger, 3G Capital began requesting its suppliers to agree to 120 day payment terms, as opposed to the standard 30 days, utilizing its enormous monopoly in many of the F&B markets as well as the suppliers' dependence on their current standing business engagements with its affiliates, to get their compliance.

This arrangement was a major shift in the status quo of supply chain practices, and other big companies rapidly followed suit to give themselves some financial breathing room in the aftermath of the 2008 crisis.

It was in response to such practices, by then overwhelmingly present in American supply chains, that the Obama administration launched SupplierPay in 2011.

Soon after the launch of SupplierPay, industry professionals were quick to accurately point out that the initiative had glaring problems, even if it were built on the back of a reasonably successful policy such as QuickPay.

[a] No Means of Enforcement: Unlike the QuickPay initiative, which was built on top of existing legislative infrastructure that regulated the liabilities of Federal agencies when it came to settling accounts payables with their contractors, the SupplierPay initiative had no such basis in law. It was a pledge where only the clients themselves could choose to hold themselves accountable, without any rapid enforceable legal protection for their suppliers if the clients lapsed in upholding their pledges.

Unlike this particular path to reforming buyer-supplier payment relationships in B2B SMBs in US, other American countries intent on bringing about wide-ranging improvement in trade credit-related scenarios had done so through legislative regulation of associated

[45] Stephanie Strom. *"Big Companies Pay Later, Squeezing Their Suppliers."* The New York Times. 6 April 2015. Last Accessed on 31/08/2017. https://www.nytimes.com/2015/04/07/business/big-companies-pay-later-squeezing-their-suppliers.html

practices. For example, Brazil set up the "Nota Fiscal Eletrônica" or NF-e, which made e-invoicing mandatory for nearly all enterprises.

Under this system, the handover of goods and services from supplier to buyer is illegal without being accompanied by an authorized digital document bearing confirmation by the tax authorities of the details of the transaction. This system reduced invoice processing times, improved SMB survivability, and lowered exploitation of smaller suppliers by larger clients, though of course there will always remain exceptions who find loopholes to exploit in any reform.

This is a perfect example of how a nation's government tangibly improved the state of their country's B2B SMBs by regulating associated practices with measurable impact, rather than simply drafting idealistic policies which would ultimately have "no teeth", as stated by David Gustin[46] - a prominent expert on Trade Financing. This brings us to our next point.

[b] <u>No Acknowledgment of 21st Century Best Practices & Technological Disruption:</u> Not only did the new NF-e system in Brazil provide far greater transparency into prevalent business practices, but it provided a way for suppliers to have irrefutable evidence of the exact point at which their business with their clients for that specific transaction had been concluded.

Furthermore, the compulsory inclusion of e-invoicing made way for over-arching improvements in the efficiency of invoice acceptance, processing, and disbursal of accounts payables to a significant degree. In fact, just the simple switch from check-based payments to the prevalence of transactions which came with the e-invoicing platform systems would ensure that as many as 5 days could be shaved off from the payment process.

Thus, Brazil's reform not only improved the application of 21st century best business practices in SMBs through regulation, but simultaneously provided smaller suppliers with government-validated evidence of the timeline of transaction between them and their clients.

The SupplierPay initiative, as lofty as it may be in its goal, failed to acknowledge at

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[46] Ken So. *"5 Reasons Why Obama's SupplierPay isn't Working."* Trade Financing Matters. 5 May 2016. Last Accessed on 31/08/2017. http://spendmatters.com/tfmatters/5-reaasons-why-obamas-supplierpay-isnt-working/

all the improvements to be made in the buyer-supplier relationship by pushing supply chains to adopt the widely-available technological solutions in the marketplace today.

If this seems a small oversight, here's a look at the reality of payment practices in US. The 2013 AFP Electronic Payments Survey showed that 70% of organizations it surveyed were struggling to convert to electronic payments, supplier hesitance and IT barriers being cited as the top obstacles. At the time of the survey, roughly 92% of organizations still used checks when paying major suppliers, with the average company making an estimated 43% of its payments to suppliers by checks.

Keeping in mind then that roughly 92% of organizations could receive at least 42% of their payments at least 5 days faster by switching from check to e-payments, not to mention the myriad of associated benefits and improvement in payment practice efficiency, the lack of support from the White House in a policy aimed at improving B2B payment terms for SMBs was a gross failure.

[c] <u>The Paradox:</u> SupplierPay as an initiative famously suffers from the Prisoner's Dilemma Paradox[47] – a scenario which explains why two entities may not cooperate with each other, even if rationally it would be in their best interests to do so.

While the Obama administration tried hard to outline the importance of a cash-healthy supply chain, both to the economy at large as well as the client specifically, they failed to account for competitive advantages between clients themselves.

If two companies pay their suppliers faster, they receive the same benefits from the transaction, if just the supplier's health and contribution to the supply chain is factored in. However, if one firm delays the payment in order to maintain its cash reserves to invest in other short-term opportunities before paying their supplier, it gains a distinct advantage over its competitor who paid its supplier on time. Since SupplierPay failed to leverage technology such as Dynamic Discounting to provide any tangible monetary benefit to paying suppliers in time, it failed to provide clients with any incentive to relinquish the opportunity costs provided by holding on to those cash reserves.

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[47] Ken So, Trade Financing Matters. 2016.

This is a point we've covered in multiple segments throughout this paper. Today's policies targeting trade credit and its associated problems seem to draw upon one of two stances – since clients are inherently unwilling to pay on time, the law should hold the stick of penalty as incentive for the clients to do right by their suppliers, or; clients pledging to abide by a gold standard are all inherently socially responsible, and so the law should not interfere with this voluntary self-policing.

Rarely ever do we see any policy implementation that utilizes both a stick and a carrot. Even when concurrent policies are put into play to approximate a similar combined effect – such as the EU directive, prompt payment code, and new transparency laws in UK, as of 2016 – they have failed yet to show any tangible improvements. We have to wonder, why? The simplest answer is that all of these policies yet fail to address this Prisoner's Dilemma Paradox, and fall short in providing any positive measurable incentive for clients to stay within reasonable payment terms with their suppliers.

[d] <u>Cost of Early Payment Ultimately Borne By Suppliers:</u> Typically, the enterprises in any supply chain who often face the longest payment terms are non-strategic suppliers, and so rank lower on the client's list of priorities. While there may be a small handful of suppliers which remain relatively less dispensable to the product of any client, that's not usually the case for the greater part of suppliers doing business with a client.

As such, since the client believes it relatively easy to replace these suppliers at comparatively lower turnover costs, they tend to push the boundaries of their relationship in an attempt to leverage upon the suppliers' dependency on the business from them. This often leads to situations where the treatment of these smaller suppliers crosses ethical, and sometimes legal, boundaries in an effort to maximize profit.

One way in which larger clients often leverage these factors is by forcing last-minute discounts on due invoices, or even holding long overdue accounts payables hostage till the suppliers agree to larger discounts on the invoice value. In the absence of regulation, even if clients would uphold their pledge to strategic suppliers in order to improve their payment practice analytics, it would still be difficult to prove lapse of oath if lesser-important suppliers were still being treated with the same or greater payment delays.

This point often brings up the question – if pushing for discounts on invoices is a way for clients to make suppliers bear the costs of early payment, then how is Dynamic Discounting any better as a practice? The answer there lies in the amount of time a business has to prepare for the discount. Dynamic Discounting (DD) requires active negotiation between suppliers and clients beforehand to settle on an Annual Percentage Rate which would work for both the parties involved. Furthermore, the supplier retains the power to choose which invoices would be applicable for DD. This foreknowledge is an important difference when dealing with clients.

If a supplier knows that any invoice between them and their client will be treated with the Annual Percentage Rate (APR) of 20% for example when calculating discount, they can foresee and prepare for the worst case scenario accordingly when managing their cash flow. Over the longer term, it gives suppliers sufficient time to prepare for the discount as if it were a lowering of the value of the provided goods or services when dealing with specific clients, rather than a relatively last-minute monetary loss on an invoice. While the end result may seem the same on the bottom-line profits for a small business, this is not a bottom-line issue but rather a business hack to improve cash flow management.

By providing a sliding scale, it also provides a positive incentive for clients to pay sooner than later, with a tangible monetary gain to offset the opportunity losses which come with paying an invoice earlier.

In practical terms, the difference between DD and discounting is the difference between the case of a supplier knowing a month beforehand to expect a payment of $12,000 on an invoice of $13,000, when they know they'll need $15,000 to maintain a healthy cash flow in the next month - and the case of a supplier expecting the full invoice amount and receiving $12,000 on the invoice half a month after they already needed $15,000 in receivables to maintain a healthy cash flow. That month and a half of foreknowledge between the two cases may not seem like a lot, but more often than not it determines whether or not a small business needs to file for Chapter 11 bankruptcy or it just managing to skate away from the edge.

Importance of Policies Like QuickPay & SupplierPay

Despite the problems with SupplierPay, in general in terms of its objectives as well as specifically with its lack of enforceability, it is nonetheless a step in the right direction. The importance of that step alone, if only as a base policy rather than an impactful measure in actual monetary terms, is best put forth by Mr. Joseph Jordan – Associate Administrator for the SBA.

Two months after the announcement of QuickPay, the New York Times[48] – when prompted by a reader – asked the government that being paid in 15 days sounded good, "But within 15 days of when?"

To this point, as we've discussed before, it was clarified that the initiative aimed at payments being made to contractors within 15 days of the date of acceptance of invoice by the government, the process of acceptance itself adding a big question mark as to the total time it would take for payments to be made from the date of invoicing.

Mr. Jordan accepted this shortcoming, but had a point of his own to make. "When you're talking about five to eight million contracts a year, are there bound to be issues with some individual contracts? Absolutely," he said. "The White House is definitely looking at the total through-put time. There's a clear place where we had control – cutting the 30 days in half."

"Let's not make the perfect the enemy of the good."

That last sentence is the most impactful takeaway from the existence of programs such as QuickPay and SupplierPay, especially the latter.

We are currently conducting business in a rapidly evolving world. The meteoric rise of disruptive technological solutions in the financial world ensures that any policy implemented today can be drastically improved through the use of such solutions within the next year. Is that a reason, however, to wait out that year and put forth a more "perfect"

[48] Robb Mandelbaum. *"For Contractors, How Quick Is Obama's QuickPay?"* The New York Times. 29 November 2011. Last Accessed on 31/08/2017. https://boss.blogs.nytimes.com/2011/11/29/for-contractors-how-quick-is-obamas-quickpay/?mcubz=1

policy directly, even if the original seems somewhat “toothless”, as SupplierPay has been described?

If compared to the EU directive, the SupplierPay initiative has significantly lesser legislative backing and enforceability. Yet, their actual impact on the business environment of affected enterprises can be said to have been somewhat equivalent. In the case of the EU directive, despite its instructions having passed into law, a significant number of EU businesses remained ignorant of their rights. Moreover, an overwhelming majority (roughly 60%) of businesses that knew their rights refused to utilize this method as a way of being paid earlier, simply to protect their relationship with their clients.

Can it be argued then that an approach to resolving overdue accounts receivables to SMBs where the clients themselves are the initiators of faster payments may be a more practical approach rather than just arming suppliers with ways to take them to court?

This last question should not be misunderstood. Throughout this paper, you’ll find significant arguments from my end on the need to provide SMBs with legal protection from exploitation by clients who exceed payment terms or bully for longer ones in order to alternatively finance their business. However, we’ve also seen several examples by now where – ironically – countries and international bodies implementing harsher laws against late B2B payments are experiencing little improvement in the situation overall.

This is a vital point to consider. It tells us that metaphorically arming suppliers to the teeth with ways to prosecute their clients changes little in the case of exploited trade credit by itself, because it changes very little in the clients’ motivations to actually pay their suppliers in time. Since they’re the ones in control of the money, changing their motivation needs to be as high on the list of priorities as providing a basic acceptable framework for payment terms in enforceable laws.

Therefore, allowing clients themselves to actively and publicly choose pledging to pay their suppliers within 15 days of accepting an invoice should arguably have as much impact as enabling their suppliers to take them to court. It would also be significantly faster and more cost-effective, if you remember that SMBs in LA spend 495 days and 42% of the claim amount fighting a client in court.

Are there problems in policies like SupplierPay? Yes. Can they and should they be updated to reflect new research and insights into the problem of late B2B payments between suppliers and clients? Definitely, as soon as possible.

However, as to the question of their impact justifying their existence to being with – Let's not make the perfect the enemy of the good. That's the purpose of papers such as this one - to study the impact of policies in place, reflect upon their strengths and shortcomings, and devise methods through which they can be improved to turn them into best practices, whether for client companies, suppliers, or government policy-makers.

4. LITERATURE REVIEW - II

Private Market Solutions

A] E-Invoicing

Among the various practices which must be implemented in a business organization to effectively reduce DSO to acceptable margins, one particular solution which arose exclusively from the private market and was then implemented in public policy around the world was the practice of Electronic invoicing, or E-Invoicing.

E-invoices are digitalized versions of invoices which have the benefits of entirely paperless processing, thus enabling businesses to convert a vital aspect of their daily operations to more environment-friendly alternatives. However, aside from the altruistic benefits, the advantages of e-invoicing to business are staggering.

By virtualizing the associated business processes relevant to invoicing, companies can improve labor productivity by up to 60%, and save up on 70% of labor, time, and material costs. In 2011, Deutsche Bank projected annual savings of €50-70 million on processing costs alone by making the switch to E-invoicing.

They also simplify record-keeping and improve transparency, while making it easier for firms to identify and analyze key data points from the invoicing processes. In fact, their contribution to enhanced transparency are so immense that politicians across the globe have increasingly called for a mandatory shift to E-invoicing for companies above a certain annual revenue in order to minimize financial fraud. As of 2016, there are 56 countries[49] across the world which have either already or are in the process of establishing mandatory e-invoicing to some degree or other.

Furthermore, besides the benefits of savings and better analytics, the switch to E-

[49] Kate Freer. *"Why Your Suppliers Will Eventually Adopt E-Invoicing"*. 15 October 2015. Last Accessed on 31/08/2017. https://www.corcentric.com/blog/why-your-suppliers-will-eventually-adopt-e-invoicing/

invoicing also shows that it strongly impacts traditional business problems such as late payments as well.

By reducing the processing periods involved, companies have noted that E-invoices shave at least 5 days from their clients' payment procedures. Considering that B2B invoices in countries such as India are paid 63 days after billing, on average, the reduction of 5 days alone from the process bears immense economic significance.

Moreover, the improved visibility and fixed formatting which are a part of E-invoicing processes help avoid common errors in the bill, which are responsible for a staggering portion of late or unpaid invoices.

A study conducted in 2013 by a US firm named TermSync[50] analyzed invoice-related late payment trends by cataloguing and breaking down 10,000 invoices which were more than 30 days past due. In fact, during their analysis, they concluded that 49% of late or unpaid invoices were due to mistakes or missing information within the invoices themselves.

Additionally, a survey conducted by Sage, a UK firm, found that another noteworthy issue leading to late payment was that 16% of firms sent their invoices to the wrong recipient altogether, or had trouble identifying the correct end-recipient. As can be expected, by syncing E-invoicing processes with digital contact information, automated invoice management systems, and computerized fact-checking has enabled companies to do away with several of the most commonplace seller-side errors which habitually resulted in rejected invoices.

As E-invoicing as a market solution has grown and evolved with time, it has absorbed additional features within its purview as well which have helped it combat late payment as a scourge of business culture – for example, integrating online payment links for instantaneous compensation. As the same study by Sage had confirmed, 71% of businesses had noted that cash or check transactions carry the most inaccuracies, thus leading to partial or late payments which would then need to be reversed or further resolved with the buyer company in order to correct – thus causing more delays.

[50] Kathy Hoffelder. *"Why Firms Don't Pay Their Invoices."* CFO.com. 30 July 2013. Last Accessed on 31/08/2017. http://ww2.cfo.com/cash-flow/2013/07/why-firms-dont-pay-their-invoices/

As opposed to that, payment links in E-invoices empower sellers with immediate visibility into payments by the buyer, reduce buyer-seller payment delay significantly by often removing the chances of the buyer entering wrong seller payment information into the system altogether, and even making it easier for sellers to push for advance payments for goods or services rendered.

E-Invoicing Process: How Electronic Invoicing Works

E-Invoicing is usually availed by the means of Enterprise Management (EM) products which handle aspects such as automated record-keeping, computer-aided planning, etc. among business functions such as invoicing, or through third-party services or platforms which integrate with said Enterprise Management solutions in order to provide additional functionality to businesses.

E-Invoice is basically a virtual product created to replace physical invoices in the company's daily functions, and is communicated through modern digital technologies such as e-mail. An enterprise may be on the receiving or sending end of an e-invoice, with many of the products outlined above possessing the capability to process both input and output of these digital products.

When an EM product is used for the purposes of invoicing, the product platform itself contains the relevant details concerning the transaction such as details of goods and services, buyer information, payment term, and other factors such as invoicing due date. Among them, this data may have either been entered manually by personnel or the platform itself may be coded to capture specific data from template-oriented service documents exchanged between the buyer and seller.

Since invoicing is typically done soon after the end of provision of goods or services, the platform may be programmed to either automatically create and send an invoice to the buyer's finance or invoice management department on a pre-set date, or personnel from the seller's organization may initiate the process manually.

While some third-party services or Enterprise Management solutions are capable of providing changeable templates for e-invoices which may then be customized according to the buyer's or seller's requirements, most such services have fixed e-invoice templates which contain relevant data such as:

- Invoice number;
- Purchase order number;
- Quantity or details of goods or services provided;
- Billed amount for goods or services provided;
- Itemized breakdown of goods or services provided, if and where required;
- Net payment term;
- Communication of relevant payment account details, or preferred payment method;
- E-signature, letterhead, or seal of supplier's enterprise, if and where required;
- Breakdown of tax-related add-ons to the billed amount on goods or services, if and where required; etc.

Depending on the relevant regulations concerning the country in which the business transaction is conducted, the e-invoice also has to be registered on specific government portals, and so may also contain such relevant registration numbers where required.

Once the process of invoicing is initiated, the EM platform usually automatically fills the pre-set invoice template with the relevant data fields, attaches it to a canned or pre-written invoice email message, and sends it across to the buyer's invoice management or finance department through the chosen electronic mail client.

Even if the e-invoicing process is handled through the use of a third-party non-EM service, many of such products offer seamless integration with the dominant EM platforms used in their specific countries. For example, Hummingbill Technologies in India provides e-invoicing features which integrate seamlessly with Tally, the dominant ERP provider in that specific market. Through such integrations, layers of private solutions are able to provide reasonable e-invoicing functionality to segments of the SMB market which were unable to leverage them due to high operational costs for large EM suites.

Additionally, while most EM software solutions may not necessarily provide this feature, several third-party e-invoicing services offer partnerships with specific payment gateway providers. This allows such services to provide embedding of add-on tools such as payment links, which buyers can then click and access at any point in order to complete an instantaneous transaction.

As we discussed in the previous section on e-invoicing, studies have revealed that a significant portion of late payment instances between buyers and sellers arise as an outcome of errors in invoicing on the seller-side of the transaction. By minimizing or removing human interaction with the process to the maximum degree achievable, e-invoicing creates a relatively error-free experience in the transaction.

Current State of E-Invoicing

Approximately 75% of the world's commercial invoices are still transacted on paper, but this is a trend which is steadily but slowly shifting towards virtual communication preferences. Today, there are roughly 59 countries in the world where e-invoicing is now mandated by public policy, or is in the process of doing so. Spanning largely across the American & European continents, the businesses in these countries are either being encouraged or transitioned to participate in this paperless electronic invoicing route, to the benefit of various aspects of everyday business life.

Most of the countries with current mandatory B2B e-invoicing legislation and enforcement already in place are:

- Argentina;
- Australia (pilot program by one State Government since 2012);
- Brazil;
- Chile (not legislatively mandated but business norm in the country);
- Denmark;
- Finland;
- France;
- Greece;
- Guatemala (for specific class of business organizations);
- Italy;
- Kazakhstan;

- Mexico;
- Nepal;
- Norway;
- Singapore;
- Spain;
- Switzerland;
- Colombia (pilot program 2016); etc.

Furthermore, with the process started by the 2011 Directive on E-invoicing by the EU and supplemented by further mandates of standardization on member-country legislation in 2013, any EU member country not on the list above is currently in the process of enforcing said mandate before the end of 2016.

B] Dynamic Discounting

Understanding Discounting & Cash Hoarding as Crucial Factors in B2B Late Payment

To understand the place of discounting as a relevant factor, it must first be acknowledged that not all late payments are a result of liquidity issues of buyers. As we've studied in the various country profiles, anywhere between 30% to 40% of suppliers state that their clients faced no known liquidity issues. Rather, trade credit was utilized as an alternative means of financing themselves.

Furthermore, such cases seem to be on the rise. For example, businesses in the United States are currently collectively hoarding more than $1.9 trillion in free cash reserves[51]. Similarly, among the top 500 enterprises listed in the Bombay Stock Exchange in India (excluding banks and financial service firms) it has been noted that free cash reserves grew 11% year on year between 2013 & 2014, and another 12% year on year between 2014 & 2015.

This rise in the free cash reserves among the largest enterprises of various economies across the world is what will be henceforth referred to as the Cash Hoarding Crisis (CHC).

The first visible impact of the CHC is that larger enterprises are now forcing their smaller suppliers to accept longer payment terms in order to stay on the right side of public policy. Dubbed 'supply chain bullying' by associations such as the UK Federation of Small Businesses, this practice was widely seen in the United Kingdom after the first rounds of payment practice reforms by the EU in the 2000s. In fact, it was one of the leading reasons behind the latest reforms which cap payment terms at 60 days. However, such protective payment term caps – even if public policy is not entirely effective in such matters – are absent in other countries such as the United States.

For example, global behemoth Amazon was reported to pay its suppliers after 90 days

[51] Adam Davidson. *"Why Are Corporations Hoarding Trillions?"* The New York Times Magazine. 20 January 2016. Last Accessed on 31/08/2017. https://www.nytimes.com/2016/01/24/magazine/why-are-corporations-hoarding-trillions.html?mcubz=1

in 2014. Further studies in 2015 even reported that its payment practices are getting steadily worse. Where Amazon used to pay its suppliers 24 days on average after receiving payment from their customers, it has now increased that length to 40 days – meaning, suppliers now get paid 40 days on average after the customer has finished paying Amazon.

This points to a clear lack of liquidity issues since the burden of material costs here is being absorbed by the trade credit Amazon is forcing through its suppliers, and it is unclear whether suppliers are compensated for costs imposed by such late payments with any interest-based remuneration from the global corporation.

This is by no means an isolated incident either, with several large enterprises such as Procter & Gamble and many others having been accused of forcing long payment terms on suppliers. Even in markets such as India, while the percentage of unrecoverable B2B receivables has decreased in recent times, there has been a 2.3x rise in the number of accounts receivables which have been going unpaid past 90 days between 2014 and 2015 alone.

This clearly means that – while more enterprises are faithfully compensating their suppliers instead of defaulting entirely, they are also increasingly hoarding cash reserves and only settling overdue accounts receivables in 90 to 120 days past the due date.

The main question this poses then is – Why are larger buyers so interested in cash hoarding? After all, free cash reserves indicate money which is readily available to the corporation as liquid assets, rather than finances invested in portfolios for growth, or already engaged in acquisition of other capital assets or stakes in other firms. The answer lies in opportunity.

Free cash reserves are popular, even at the cost of deteriorating supply chain relationships, mainly because they allow companies to capitalize upon opportunities which may present themselves without notice, such as rapidly pushing an innovative product to market ahead of competition, or other business transactions such as buying out or taking over critical suppliers or other assorted enterprises to improve their bottom-line. They also provide a safety margin for operations.

Therefore, if suppliers wish to amicably get paid on time today or even sooner than the 90-day average which seems to be becoming the norm among large buyers, they need to provide tangible benefits for buyers to do so which outweigh the potential benefits for buyers to leave that money at hand. This is where discounting plays its part.

A recent study performed by WNS, a prominent Business Processing Management enterprise, outlines that while 80% of companies[52] place emphasis on capturing early discounts, only 27% of buyers are actually able to do so because of various shortcomings such as inability to rapidly process incoming invoices, etc.

This is a sharp increase from a similar study conducted in 2013 by Paystream Advisors and DirectCommerce, which stated that only 31% of enterprises considered capturing discounts as a priority. However, this rise in interest in discounts also underscores our point about the CHC, and the growing need for today's suppliers to provide tangible benefits on invoices as an alternative to cash hoarding.

One fact which is still yet to change though is the buyer's ability to capitalize upon the discounts provided to them. In the current scenario, 59% of willing buyers are only sometimes able to capitalize upon discounting benefits, while 14% on average are never able to do so. This is because Static Discounting, which is the usual face of the discounting paradigm offers limited terms within a short window in order for the buyer to leverage the offer. If the time window is passed, the buyer loses all incentive to pay their suppliers within the term period or indeed even beyond. Thus, static discounting fails to leverage the entire payment term to its advantage.

This is where Dynamic Discounting plays a part.

<u>Dynamic Discounting vs Static Discounting</u>

In order to understand and appreciate the innovation of Dynamic Discounting, it first becomes necessary to study and understand traditional discounting measures – usually described as Static Discounting.

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[52] WNS. *"Reduce COGS With Dynamic Discounting."* 11 January 2015. Last Accessed on 31/08/2017. http://www.outsourcing-center.com/2015-01-reduce-cogs-with-dynamic-discounting-64647.html

Static Discounting

Static discounting is an umbrella term for practices which usually leverage negotiations between buyers and sellers in order to provide clients with set discounts, conditional on specific terms, in exchange for paying their suppliers early or on time.

A typical example of static discounting terms is 2.5, 10, 30. These terms denote that if a buyer clears their overdue accounts receivables on a specific invoice by Day 10 of the 30 day payment term from the date of invoicing, they shall receive a 2.5% discount on the value of said invoice from the supplier.

Now, while this practice offers a lucrative return to the buyer in terms of discounting in exchange for releasing the funds owed, it bears several problems as well when utilized in real-world business environments. Chief among those problems is the time taken to process an invoice.

It is common understanding that invoice processing takes longer as the client organization grows larger. Larger buyers have several compliance and record-keeping burdens which may not necessarily be faced by smaller buyers. On top of that, they have several fail-safes and redundancies built into their process in order to ensure the smooth running of their organization. However, these fail-safe measures often lead to delays caused by red-tape.

Therefore, if they have several requirements that must be met when being invoiced, and their suppliers fail to do so – the invoice must be rejected and returned, which causes delays. Furthermore, since invoices then need to be circulated between finance, order processing, invoice management, and other departments before the funds can be released, each step comes with its own time consuming processes.

This means that, on average, it would be quite difficult for a larger buyer – who presumably receives hundreds of invoices, if not in the thousands – to finish processing said invoice by Day 10. This holds true even more so if there are any errors from the sellers’ end. As we’ll discuss elsewhere, that’s not a small matter in itself – with 6 out of 10 invoices being paid late due to sellers' faults, as found in a study by TermSync.

This is where the weakness of Static Discounting is exposed. As soon as the 10^{th} day from the date of invoicing is passed, the buyer loses any incentive to pay the supplier before the due date – which is 20 days later. In fact, since smaller suppliers rarely push for late payment interests, it removes any incentive for the buyer to pay before they choose to do so of their own volition, whether that means 60 days from the date of invoicing or 90 days.

Since buyers depend on remaining competitive any way they can over their peers and rivals, the hoarding of liquid assets provides them with a perception of greater benefit than necessarily paying their supplier at least any earlier than the payment terms provided by their sellers themselves. Even if suppliers get paid regularly on Day 30 in that case, it still counts as a loss against Static Discounting as a measure for early payment capture, since there were about 29 other days in that payment term period which were not leveraged in any way.

Dynamic Discounting

Dynamic Discounting (DD) is a practice which has grown from an exceedingly simple principle: leverage every day to capture payments as early as possible.

In DD, the buyer and seller pre-negotiate an Annual Percentage Rate (APR) which will go on to dictate the discounting available to the buyer. There is no median or average rate, since they can vary as greatly as 3% to 36% per annum. The rate determination is usually shouldered by the buyer, and the negotiation ends when the seller receives a rate upon which both transacting parties can compromise. Various factors play a crucial role in the determination of APR, such as:

- Size of supplier;
- Provisions, goods, or services supplied by seller to buyer;
- Importance of role played by goods & services supplied by seller to buyer;
- Presence or lack thereof of other suppliers either providing or capable of providing similar goods or services to buyer at equitable competitive rates;
- Country or economy in which supplier operates and provides these goods and services to supplier; etc.

In practice, better equality in the power dynamic between the buyer and seller, or the general difficulty in replacing the goods and services provided by the supplier to the buyer, results in lower APRs pre-set between the transacting parties.

For the sake of example, let's assume the buyer has set an APR of 24% and the payment term provided by the supplier is Net 30.

Thus, if the seller has approved DD on a specific invoice, and the buyer decides to pay on the date of invoicing itself, then the discount will be calculated at:
[(APR/365)*Days Remaining Till Due Date] = [(24/365)*30] = 1.97%

However, if the buyer decides to pay on Day 12 or Day 24 of the payment period, the discount percentage would adjust accordingly and scale back to 1.18% or 0.39% respectively.

In this fashion, DD allows buyers to calculate the discounts provided to them throughout the payment term, and then determine the optimal period within that term where the tangible business advantages of clearing the due accounts receivables would outweigh the potential benefits provided by hoarding that same cash amount.

Types of Dynamic Discounting

Multiple Discounting Terms

As with most business principles, the underlying idea behind DD results in several variants. The first among these is the practice of Multiple Discounting Terms which is just as simple as it sounds. It refers to multiple periods within the payment terms where the seller allows discounting as per the APR pre-agreed between the transacting parties.

Before we head deeper into this variant, however, it seems necessary to distinguish it from the practice of just providing multiple discounting dates within the folds of Static Discounting (SD).

An equitable example of this is in SD would be 2, 10, 30; 1, 20, 30. As can be understood, there terms mean that the seller offers the buyer a 2% discount on the invoice if the buyer can clear their accounts receivables by Day 10 of a 30 day payment term. However, if that proves not to be possible for any reason, then an additional term is made available where the seller will provide a 1% discount on said invoice if the buyer pays by Day 20 of a 30 day payment term.

Now, the first problem in this is that the discount terms are rarely ever pre-agreed between buyer and seller. Thus, if the buyer can not clear the invoice by the first discounting date, they are more likely to try and negotiate a higher discount for Day 20 than the 1% allotted to them. This is more than likely to result in further confrontation between buyer and seller, and strain their relationship, as well as cause the buyer to reject the 2nd discounting term in hopes of hoarding the cash for a while longer – if they deem the 1% discount to be too low, in the absence of other options made available.

Thus, this process simply requires sellers to spend even more time debating the money already due with their buyer, and is more negatively disruptive than it yields positive results.

On the other hand, under the DD umbrella, the APR is already mutually agreeable to both buyer and seller. Instead of either of them requiring any more time be spent discussing the actual discount, the sole involvement this practice requires is for the seller to identify periods of discount which would be acceptable to them. After all, simply stating that discount will be scaled throughout the payment period also injects quite a lot of uncertainty of chances of payment for the seller.

Since they are an enterprise of their own, usually with a supply chain below themselves to manage as well, many sellers prefer identifying dates which would smoothen their own operations too.

Thus, as an example, let’s assume that a seller approves DD on a specific invoice, and then informs the buyer that – in a 30 day payment term – discounting will be available on a sliding scale from Day 2 to Day 10, with additional discounting dates on Day 15 and Day 20.

According to the pre-agreed APR, the buyer can then calculate that their sliding discount from Day 2 to Day 10 will range from 1.84% to 1.31%, according to the formula

[(APR/365)*Days Remaining Till Due Date)]. Furthermore, the discounts on Days 15 and 20 will be 0.98% and 0.65% respectively.

Even if these discounts do not seem large, keep in mind that the APR differs from supplier to supplier. Thus, the finally agreed-upon APR is likely to be one which is acceptable to both parties. So, by negotiating an APR beforehand as done in DD practices, the buyer and seller are removing any chance of contention on the matter in the future – thus streamlining the entire process for maximum efficiency.

By providing multiple specific dates within the payment period, sellers reduce uncertainty of payment significantly, and use these prospective dates to calculate and maintain their own operational needs. They also notably reduce the cost of recovery of accounts receivables due by minimizing the amount of active involvement required by their staff in the process.

On the buyer's end, since the APR itself takes into account the discounting rates which would benefit them more than cash hoarding, the actual discounting dates provided to them thus allow them to calculate the maximum benefit which they can capture, past any dates which they wouldn't be able to meet due to liquidity issues or time takes for processing the invoice.

Dynamic Payment Terms

This variant is said to represent *true* Dynamic Discounting. This practice involves the provision of discounting along the entirety of the payment term, once an invoice has been approved for DD.

Therefore, with the pre-agreed APR of 24% within a Net 30 payment term for example, the buyer can calculate the days required to process an invoice, followed by any consideration towards liquidity issues or other invoices requiring greater immediacy, and still have plenty of days left which each provide scaling benefits for paying early.

Thus, if payment is made on Day 9, the buyer would receive a discount of 1.38%. Going backwards or forwards on the sliding scale, payment on Day 6 would fetch a discount of 1.57%, 1.18% on Day 12, 1.11% on Day 13, and so forth right up to 0.06% on Day 29.

This variant of DD is usually put in place with the help of third-party platforms or other ERP solutions. However, such solutions are typically used for their ‘dashboard’ functionality and automation, rather than any inherent necessity. Once the APR is finalized, both buyers and sellers are capable of calculating the discounting depending on the day and date with ease.

C] RCM/CCM/ARM Software Solutions

The rise of Enterprise Resource Planning tools brought about the realization that there are no set aspects of business which cannot be strategized or reasonably accounted for beforehand, through the aid of automated business software solutions.

Thus, it is only natural that the growth in use of trade credit should bring about the rise of software which addresses just that in the day to day functions of a small or large business enterprise. Today, these suites or tools are known by various names - depending on their functionality and scope of operations – as Accounts Receivables Management, Revenue Cycle Management, Credit & Collections Management, etc.

Although these solutions may require updates and maintenance of the integrity of data to be handled by specific personnel within an enterprise, their primary value proposition is that they automate the most mechanical, time-consuming, or repetitive functions of the collections process – especially useful in the case of late B2B payments.

While Revenue Cycle Management software is largely geared towards claims and revenue processing in the healthcare industry, B2B SMBs in general typically operate through AR Management or CCM suites.

In these times of small profit margins and high competitive buying-selling, a study by Paystream Advisors suggests that SMBs with a well-integrated Accounts Receivables Management tool or Receivable Collections Software get paid faster by roughly 20% on average than their counterparts who use manual systems of trade credit management.

Purpose of A/R Management Solutions

Before we discuss the evolution and impact of Accounts Receivables (A/R) Management solutions, it becomes necessary to first understand their objective.

Although A/R is a product of trade credit, and is needed the most in cases where high buyer payment default or long DSOs cut down the profitability of a supplier – or even threaten their survivability – the purpose of ARM is neither to maximize sales nor to minimize the risk of bad debts. In fact, if an enterprise's main aim in integrating ARMs would be to maximize their conversion of potential clientele, then they would simply need to expand the trade credit offered to their buyers. Similarly, if the purpose of a company was to minimize bad debts, then the simplest step to take for them would be to cease all trade credit operations altogether.

This is where private solutions like ARM differ from public policy. They take into account the fact that both trade credit and late payment are unavoidable to a degree in business operations. However, the lending of trade credit from suppliers to buyers involves associated expenses.

Typically, SMBs prefer to pursue their trade credits manually, with either the finance department or recovery associated personnel spending time and resources following up with debtors over clearance of overdue accounts receivables. In the case of mismanaged trade credit lending between B2Bs, the suppliers spend money either hiring dedicated personnel to pursue their overdue A/R, or engage third-party services to do so for them. Moreover, the inevitability of late payments often creates situations where suppliers are forced to accept short-term financing solutions at high interest rates.

These two expenses – the cost of following up and the cost of availing financing – severely deteriorate the profit margin of an SMB. However, since middle-of-the-supply-chain SMBs usually operate on lower profit margins to remain competitive to begin with, such expenses may in fact cause them to incur losses on each sale completed rather than make money, thus threatening their viability in the short or long term.

On the other hand, when managed well, A/R processes integrate the understanding that trade credits are a form of lending which require funds, and these funds have an associated opportunity cost. In the case of trade credit, the various advantages of working for advance payment and the SMB always having their current assets firmly in their possession are traded for greater viability to potential clients as well as a stronger competitive standing against other business peers in the same industry.

However, while freely extending trade credit allows for faster conversion and increases sales, the resultant higher profitability is strictly theoretical until the overdue accounts receivables are actually cleared by buyers. In the meanwhile, the increasing investment in debt collection and recovery efforts raises costs every day. Therefore, in order to justify that trade off, the trade credit process needs to be optimized. That is the purpose of an ARM – not to maximize sales or minimize risk, but to optimize the process and reduce unnecessary costs so that the trade-off between risk and opportunity is justifiable in the long run.

It cannot be denied that an entirely optimal trade credit process is a theoretical construct, since late payments are a multi-faceted problem. The actual state of debt recovery revolves around several external factors affecting the buyer as well, such as their own state of liquidity, market opportunities, relationship with their own supply chain, etc. However, there are several internal forces which can be optimized through the use of ARMs.

Automation

Within the limits of the scope of this paper, ARMs create efficiency by replacing many manual tasks associated with trade debt recovery with automated processes. Communication between suppliers and buyers in the case of late payments takes several forms – follow-ups, personal notices, legal communication, etc.

Among these, follow-ups are usually the process which consumes the most time and resources. Since personal notices are usually communicated to clients via executive personnel at the top of the supplier organization, and legal communication refers to any notices served by the supplier's lawyers to the buyer organization for excessive payment delays or defaults, these tasks can't be automated and so are beyond the purview of an ARM anyway.

For the process of debt recovery follow-ups, SMBs hire personnel – the amount varying on the size of their own operations and trade credit provision – specifically for the task of:

- Confirming with the client that an invoice has been received;
- Confirming with the buyer that the invoice has been accepted;

- Chasing relevant personnel in buyer organization for payment to be released on or before due date;
- Continually following up with buyer organization over tentative payment dates after the due date has been missed;
- Sending several reminder emails, messages, and calls in order to keep the clearance of overdue accounts receivables at the top of the buyer's priority list.

This means that even if a company has 10 clients at a time, out of which statistically 6 clients will not pay by the due date, the supplier SMB is spending funds on hiring personnel whose entire work days are spent solely making calls or drafting emails just trying to receive confirmation of intent of payment from the client, and not even an actual confirmation of payment which is overdue.

ARMs optimize this process by automating several of the outgoing communication channels. Today, ARMs can be pre-set to send out scripted emails and/or text messages reminding clients to clear their accounts receivables before, on the day of, and after the invoice has been dispatched. In this case, automation means that the communication output from a supplier to a buyer can be increased multifold without any increase in the supplier's investment on the process whatsoever. In fact, this allows clients to hire less personnel dedicated solely to recovery, or hand over the task of follow up communication entirely to an existing department with little to no increase in their active daily workload.

Moreover, if the supplier organization has set procedures for delays which trigger communication from their upper management to the buyer organization, even the first notices served in this tier of buyer-supplier late payment communication can be scripted and automated.

For example, if a company has a policy where their CFO gets in touch with the buyer organization CFO or CEO if the payment is still pending after 30 days from the due date (in a Net 30 payment term, this would imply that payment has been pending for 60 days since the goods or services were delivered in full), then they can automate a pre-scripted email from their CFO to go out to the relevant personnel in the buyer organization after the delay requirement has been met in the ARM system.

While this situation may yet require a personal call from the CFO, the automated email still serves as an additional layer of reminders which may still yield a positive result or at least push the buyer organization to contact the CFO and discuss the state of their trade credit, if they seem to be facing problems of their own.

Another significant yet under-rated benefit of automation in the collections process is that it negates two major reasons spearheading B2B debt recovery mismanagement:

- The human element of awkwardness or excessive politeness; and
- Inconsistency in debt collection efforts.

As non-business like as this concern may seem, the personal attitude of the CEO, other leading executives, or the accounts receivables collection team towards repayment of money owed to them makes a notable difference in the success of recovery efforts.

Unfortunately, a large number of SMB or startup founders are more often than not people who are more familiar with the trials and tribulations of developing their product rather than the smaller and larger details associated with the process of recovery of money. Due to this, many SMBs carry large trade debts because of their unwillingness to be confrontational in recovering the accounts receivables owed to them. This is where automation of follow-up plays a large part.

In several interviews with both large clients and smaller supplier CFOs, as well as any late payment recovery best practices guide published by leading authorities, the importance of the initial follow-up is heavily emphasized.

On the client side, executives often speak of their willingness to pay their suppliers when not afflicted with liquidity issues. However, due to the large mass of invoices they invariably need to resolve, some suppliers' invoices may be lost or forgotten. The follow-up helps keep such pending payments at the top of their priority list and helps them maintain a better buyer-supplier relationship. In fact, the simple act of dedicated follow-up is often enough to get suppliers paid either or time or with reasonably small delays, and the automation takes their personal attitude to the recovery process out of the equation.

As far as efficiency and consistency is concerned, automation itself provides a fixed game plan to the personnel dedicated to collection. It lays down a uniform process which then quickly allows personnel to first gain experience into their efficiency and success, and then use that experience to gauge whether a follow up itself would be sufficient for a particular client or if the recovery efforts need to be escalated.

Before this automation, the entire process of calling, waiting, being offered excuses, being left on hold, or not being allowed to communicate altogether was a familiar experience to most SMBs. After the advent of this process, in conjunction with the importance of email in today's business environment, the "nuisance factor" – as it may be called – of receiving automated emails and messages on a regular basis from suppliers yet unpaid helps distinguish forgetful or negligent buyers from purposefully late paying ones.

Trend Predictions and Analysis

Aside from the obvious advantages of automation in B2B small to medium sized enterprises, another massive benefit which ARMs bring to the table as far as late payment in concerned is – they allow you to make informed predictions of the future of your cash flow through trend analysis.

While in the previous millennium, manual record-keeping was a preferred method in businesses to afford the higher management of an organization a personal eye on the payment behavior of their various clients, such methods are no longer feasible.

The pursuit of business itself changed drastically with the appearance of interactive media and the internet. This is marked most profoundly by the fact that while the average life expectancy of a Fortune 500 company in the 1960s was roughly 70 years, that lifespan has now dwindled to 15 years on average and is still falling. This points to the undeniable fact that the competition today is far more cut-throat than it was ever before, and the smallest mistake or unnecessary expense may well put an SMB behind their competitors in this rat race of sorts.

While manual record keeping may still be the preferred methods of accounting and analysis in many small businesses, roughly 30% of SMBs in India eschewing all current ICT tools for example, it is laborious and time consuming. That means that a small business engaging in this process is either spending far too many work hours or monetary resources in order to avail themselves of that creative human touch. It also regrettably opens the door to far too many human errors – each of which put the SMB a little further behind their competitors.

In comparison, ARMs are as accurate as the data they're fed – and in fact many of them have automated data capture to prevent human errors from throwing off their analysis. What a human account-keeper would achieve in days worth of work, an ARM can perform at the click of a single button.

So the question becomes – what data do they provide which would help reduce late payment? The core answer is that ARMs can be used to predict whether or not client A would pay their accounts receivables on time based on past experiences. The software tool would be able to reasonably gauge, if the client will pay late, when a supplier may expect an overdue account receivable to be cleared. This doesn't just help SMBs determine whether to escalate follow-up measures or disengage from that client altogether, but it also reasonably helps them in planning the burn on their lifeline – their cash flow.

Even ignoring the added benefits of in-built record keeping measures in compliance with today's convoluted record requirements, the ARMs help predict:

- Whether a new client's payment practices are viable for the supplier's firm in the short and long term;
- Whether the seller's collections department is operating as efficiently as it can;
- Whether or not a supplier may expect to receive their payment in the next 30, 60, or 90 days;
- Whether a client is a habitual late payer;
- Whether the SMB would benefit from disinvesting from offering habitual late payers goods and services on credit; and, most importantly
- What is the appropriate individual credit limit and overall credit cap which the supplier enterprise can afford to provide to their clients.

Among this data, the last point may arguably be the most important one – and quite difficult for a human account keeper to ascertain without exhaustive amounts of data analysis.

In essence, the trends visible from the ARM's data analysis account for current and predicted cash flow, habitual or late payment of individual customers, expenses related to and tangible outcomes from the efforts of the collections personnel, client acquisition and retention rates, bad debts, etc. to show a supplier whether they would benefit from offering smaller contracts on credit, demand a certain percentage of the payment owed in advance, and even increase the pricing of their goods and services to absorb costs related to late payment and bad debts.

State of The Industry

Although no global or universalized studies exist to gauge the adoption of A/R automation and management software, a set of statistical data compiled by AnytimeCollect in 2014 comes close to creating an adequate picture of the adoption of such tools among mid-sized B2B SMBs.

As per the stat set, roughly 47.93% of B2B SMBs in this segment utilize ERP systems to manage their A/R processes. However, 13.22% use manual sheets and aging reports – employing no automation – while yet another 16.53% use excel and other simple tools to track and manage the same processes.

The survey also reported that mid-sized SMBs also showed low adoption rates of specialized accounts receivable management software with only 4.13% adoption gauged from their studies, emphasizing that 95.87% of the mid-sized SMB B2B segment was arguably using the wrong tools to manage and automate their A/R processes. However, they also cited the Credit Research Foundation finding the adoption rates closer to 26% in the B2B SMB industry, further adding that they believed such findings to be skewed since the members organizations in the CRF mostly doing the studies are generally large enterprise businesses rather than SMBs.

The study further discusses the fact that large segments of the B2B SMB segments today use other software such as their CRM to fill in the gaps for the missing A/R processes, and that these businesses believe it to work adequately since it allows them to follow up with their clients while maintaining some adequate records of transactions for late analyses. However, this is a gross miscalculation on the part of SMBs since there is one major difference between the two – even though CRM software allows for follow up in terms of collections, it fails significantly in automating the workflow and A/R recovery processes.

Without such automation in place, the data entry alone required to complement the CRM with sufficient information for dedicated recovery personnel to pursue their operations makes the process at least as long as – if not actually longer than – manual A/R management. Moreover, since such non-A/R ERP systems still need to be supplemented by manual spreadsheets in order to provide recovery personnel with sufficient information, it is alarming that the survey study found roughly 94% of spreadsheets used by their target demographic to contain critical errors regarding the overdue accounts receivables.

Impact of Accounts Receivables Management Software on B2B Late Payment in SMBs

While extensive data on the empirical impact of Accounts receivables management software is as yet lacking, a report by the Wipro Council for Industry Research stated that use of such automated tools reduced the costs of processing alone within the Accounts Receivables from roughly $59 per transaction in work-hours and resources to roughly $1.5 per transaction.

Furthermore, a 2014 study conducted by the American Collectors Association which aimed to assess the difference in productivity between manual and automated A/R processes revealed the following data[53]:

[1] Average number of calls per collection personnel each hour:

- Manual: 13.5 calls/hour
- Automated: 17.5 calls/hour (29% more productive than manual processes)

[53] *"8 Ways Accounts Receivable Automation Helps Collectors Do Their Job Better."* 3 September 2014. Last Accessed on 31/08/2017. http://blog.anytimecollect.com/8-ways-accounts-receivable-automation-helps-collectors-do-their-job-better/

[2] Average number of active accounts handled per collection personnel:

- Manual: 780 accounts
- Automated: 1713 accounts (119% more productive than manual processes)

[3] Average number of payment promises secured per hour:

- Manual: 6.4
- Automated: 10.5 (64% more productive than manual processes)

[4] Average number of debtor contacts per collector each hour:

- Manual: 6
- Automated: 8.5 (41% more productive than manual processes)

Although smaller businesses often eschew technological solutions, using the "personal touch" philosophy of management to explain away the lack of tech integration in many aspects of their business, in the end conducting commerce seems to come down more to ticking check-boxes off a to-do list for the most part even when it comes to recovering corporate debts than needing any innovation or tailor-fitting using the "personal touch" approach.

As the data above also bears out in this case, simply plugging in these automated processes into your system and leaving them running with little need for supervision allows each individual among debt collection personnel to handle 119% more work load, and can secure over 60% more payment promises each hour, than if they were doing it all manually.

D] Invoice Financing Platforms & Services

Under the umbrella of "Private Market Solutions" so far, we've taken a look at practices such as E-invoicing, Dynamic Discounting, and Accounts Receivables management tools. This is largely due to the fact that the scope of this paper is oriented at studying and understanding the various negative forces influencing the outcome of late payments from an indispensable business phenomenon such as trade credit. Once we have a deeper understanding of such environmental, cultural, commercial, and other forces impacting this practice, the study of various private solutions allows us to better tune public policy towards finding a practical resolution.

Such a study, however, would be incomplete without an understanding of the operations of various small business financing options as well. To be clear, this section does not look at small business loans (asset based loans, etc.) taken for any purpose from banks, non-banking corporations, or even informal or other lenders. Specifically, it deals with any platforms or services which allow suppliers to leverage the total value of their invoice in order to keep a healthy cash flow. Since this is yet a private market solution to late payment, albeit a roundabout one, I believe it firmly lies within the limitations of this paper.

Types of Invoice Financing Platforms & Services

As is well known, the private market can come up with innumerable solutions to a given problem as long as they are within the realm of law. Thus, there are several different ways a supplier may leverage their invoice in order to receive faster access to their overdue accounts receivables.

Regardless of the type of platform or service, however, the supplier typically needs to sell their invoice at a discounted rate. While that may seem like a disadvantage, the discounted amount is usually smaller than the expenses on chasing a client for unknown periods of time to recover one's overdue accounts receivables, or the interest rates offered by most banks to SMBs. This also means that the supplier isn't strapped for cash on a regular basis because 60% of their revenue is stuck in their clients' bank accounts for another 60 to

90 days, as is usually the case.

The most common types of invoice financing are as follows:

[1] Supply Chain Finance: This is a common practice today wherein buyers enter an agreement with either their bank, a third-party financier, or the supplier's bank. While this practice may have several forms such as Pre-export and Inventory financing, this paper will specifically deal with Post-export supply chain financing. Once the buyer is invoiced, and approves said invoice, the financing institution remits the funds, minus the discount on the invoice provided by the seller, to the supplier's account.

From here on, the buyer may either pay the invoice amount to the financing institution on the due date, or may renegotiate an extended payment term with them. Regardless, since the supplier has already received their compensation, the burden of risk is lifted off of them in this transaction.

Typically, this agreement is held between the buyer and their usual bank or another third-party financing company which does business with the buyer on a regular basis. Before entering such agreements, the buyer is normally required to prove their commercial soundness as well as release their payment practices before the third-party agrees to transact with them. In such a manner, the risk is mitigated and borne by the third-party financing institution, though in some cases they may hold some of the buyer's assets as leverage in case of non-payment. Since the risk is best controlled within this financing option, the expense to the supplier may be relatively low based on the buyer's credit rating. A notable example of this practice through a third-party platform is SCiSupplier by Prime Revenue.

[2] Factoring: This is one of the oldest forms of invoice financing. In this practice, the supplier directly sells their invoice at roughly 90% of the invoice value to a third-party commercial financial company, also known as a "factor". From that point, recovering the full invoice amount from the buyer becomes the responsibility of the factor. Once the factor receives the money within the due time period, the remaining 10% of the invoice amount – minus a factoring service fee – is remitted to the supplier.

Before accepting such a transaction, factors typically require the suppliers to release past payment practices of the buyer as well as perform their own due diligence in order to understand the level of risk of non-payment associated with the specific buyer. As such, the risk in this case is held by the factor and may reflect in the service fee demanded from the supplier. However, in some cases, factors may also negotiate agreements with suppliers wherein the invoice is sold back to them if the buyer does not pay within a specific time period.

[3] Invoice Discounting Platforms: This practice, while typically carried through banks or NBFCs, has lately seen a rise in third-party platform providers. On invoice discounting platforms, sellers whose overall risk levels – and not just the risk of non-payment from a specific buyer – have been gauged as acceptable by the platform providers can upload their invoices to said platform at a discounted rate. On the platform, banks, NBFCs, or even individual financiers can purchase the invoice at the discounted rate if they deem the investment worthy of the risk.

Upon the date of maturity, or the original due date, the buyer can remit the fund either directly to the financier or to the supplier who then forwards the amount to the financing institution or individual. In this practice, since the only way to properly assess risk is through the supplier's financial soundness, the chances of non-payment to the financier are higher. Thus, many such platforms negotiate agreements with the suppliers using their services wherein the supplier may have to recompense financiers by reversing the amount paid to them if the buyer fails to deliver the accounts receivables within a given amount of time from the date of purchase of the invoice.

5. FINDINGS

A] Are Public Policies Effective In Tackling The Late Payment Problems In B2B SMBs?

While public policy retains the ability to potentially tackle the problem of late payments from clients to B2B SMBs, it has yet to do so in any tangible fashion. The fact of the matter is that, despite the global policy experiments with trying to tackle the late payment problem from multiple angles, no country so far has shown either consistent or sustained improvement in the payment practices of their business culture.

In US, despite the Obama Administration's efforts through SupplierPay & QuickPay, Fundbox determined that in 2016, the value of unpaid SMB invoices was roughly $825 billion – equivalent to 5% of US GDP[54]. Just to put this in perspective, the entire GDP of US which is derived from Defense-related industries totals to about $730 billion.

As we've discussed before, the average amount of cash reserves an SMB in US currently holds is only sufficient for 27 days of wiggle room. As per Fundbox's own data, since the company provides a technological platform for SMBs to avail short-term invoice financing, 81% of B2B SMB invoices were delayed past 30 days after the due date of payment in 2016.

Furthermore, the average SMB held roughly $84,000 in unpaid accounts receivables, with that number also varying significantly across industries. As an example, the average IT SMB held roughly $163k in unpaid accounts receivables, while the average transportation company held roughly $102k in un-cleared invoices due.

Despite the annual Atradius data lacking proof of any long-term worsening of this

[54] Fundbox. *"Fundbox Reveals How $825B In Unpaid Invoices Stagnates U.S. Small Businesses"*. PR Newswire. 15 November 2016. Last Accessed on 31/08/2017. http://www.prnewswire.com/news-releases/fundbox-reveals-how-825b-in-unpaid-invoices-stagnates-us-small-businesses-300362855.html

situation from the perspective of a B2B SMB, Fundbox's data – gathered as it would have across a more acute timeline – when added to trends such as the push for 120-day payment terms in the last few years clearly show an increasing threat to survivability of smaller suppliers. This threat has yet to be addressed in any meaningful way in US public policy concerning contractual payment obligations in a transaction. Therefore, despite being arguably one of the 2 most influential markets in the world, legislatively it carries within a black hole of sorts when it comes to the protection of SMBs from exploitation by larger clients, and the current policies are entirely incapable of changing that fact.

To be fair, we also have to acknowledge that – irrelevant of other cultural influences which would also incentivize the timely payment of suppliers by clients – policies such as Japan's transaction ban on anyone not honoring their checks or promissory notes *are* in fact effective to a degree.

However, the problem that this policy in particular faces is that reproducing that same influence in any other culture would be difficult, to put it mildly. Particularly if you consider the credit-based business culture of US, the notion that someone attempting to extend their credit through less than ethical means could be blacklisted from the industry at large is an idea that corporations of all sizes would vociferously oppose from taking hold in their environment.

How To Gauge Efficacy Of Public Policies?

While discussing the efficacy of public policy and its tangible effect on the economy, we also have to keep in mind that the ability to reproduce and replicate results across multiple cultures and business ecospheres is a foundational characteristic of a successful public policy experiment.

Three things to ask ourselves whenever gauging the effectiveness of a public policy are these:
[a] Can the policy be implemented as is in other countries as well, with reasonable margins of change to tailor it to each economy? Or, was the policy successful because of the unique characteristics of the economy in which it was enforced, with additional help from the indigenous culture in which it was implemented?

[b] Was the policy successful on its own merit, or were there serendipitous circumstances which aided its effectiveness in an additive fashion? If there were other circumstances unfolding at the same time to which the policy's success can largely be attributed, were those factors studied, and then the policy amended to include the benefits of those circumstances as a matter of law?

[c] If a policy is successful in some places, would it require a significant overhaul of the current systems in most places in order to be put in place?

Now, yes, most public policy is innately a tailored piece of legislation which is framed according to the tools available to law-makers at that moment in time in that economy.
So, it's significantly harder to quantify and cross-compare through tabulations the effect that the EU directive would have if implemented in US, for example. While on paper, the EU directive was a strong push in favor of balancing the power dynamic between suppliers and their clients, the policy entirely failed to put across any tangible evidence of improvement in that area – particularly because as many as 60% of SMBs refused to use that equalizer in their business relationships, ironically to *protect* their long term business relationships.

TL;DR: Do Public Policies Work In Curbing Entrenched Issues Such As Late Payments Or Not?

As they currently stand, no – public policies are incapable of making a tangible difference in the problems associated with trade credit and its systemic exploitation. Indubitably, the reasons why they fail are as complex and diverse as the original problem they intend to resolve.

The largest flaw in the supposed armor which public policy is supposed to provide to SMBs dealing with late payments lies in its own lack of acknowledgment of the state of the judicial bodies. Time and again, we've seen examples in our country profiles of nations attempting to put into place legislation which sounded stringent and reasonably unforgiving to payment defaulters. However, the one thing in common amongst most of those examples was that the payment culture has largely kept deteriorating individually and collectively in trading nations.

The most glaring reason behind this is that the time and monetary costs associated with each attempt at recouping payments makes it an unviable process in the big picture. It may be acceptable for an SMB to take on a client in court once every half decade for a large overdue payment, but with the average small business dealing with hundreds of clients – judicial aid becomes rather cumbersome and deeply unprofitable as an option.

Moreover, it must be noted that even as a form of relief, legal action only serves as a protection for those businesses which weren't paid at all for a long period of time. It serves no purpose when SMBs need help simply getting their clients to pay sooner than they would have otherwise. Since that's a crevice within which the entire Supply Chain Finance industry currently resides, it's quite an oversight on the part of public policy to offer no faster remedies for those cases where bankruptcy and survival hang on the supplier's ability to pay within a span of few months, if not a few weeks, and instead of their current tri-annual or quarterly payment cycles.

This also points to the disheartening possibility that people who craft public policy don't first question whether or not it's practically applicable in their current business environment. Even in nations which have implemented policies that dispense punishment to defaulters, there have been unique cultural elements in play which render these policies irreproducible in other nations. A primary example of this phenomenon is the prevailing system in Japan wherein any business defaulting on their payment as promised through a check or obligatory note will be banned for the next 2 years from being able to transact using the Tokyo Clearing House – which handles roughly 70% of all business transactions in Japan. This effectively turns such a punishment into a significant damper to any possible business in that period for suspended enterprises.

While this may seem as a great example of public policy which recognizes the characteristics of its business culture and employs them wisely, which it is, it is these same reasons which render it ineffective in other places.

To begin with, this is a century-old policy which may well have established a reasonably stable payment culture in Japan, but which understandably also bears no blueprint to update and evolve the policy in keeping with advances through time. As such, even in

Japan, while this policy makes it more profitable to transact using checks and obligatory notes – the same protections also prevent these businesses from employing modern financial technological (fintech) tools to boost their efficiency further to increase profitability.

Furthermore, even in Japan, when the TCH receives any information which may indicate that a business is about to default on its check or obligatory note, it offers said business the opportunity to buy back the check or note before it defaults. In this business arrangement, the TCH forwards the sum promised to the supplier while retaining the check or note. The client will then repay the TCH, with applicable interest. The reason why this policy works well is that it incentivizes the client to treat their suppliers fairly through the threats of transparency and financial accountability

The Importance of Transparency in Public Policy

Without being hyperbolic, the crafting of public policies in the 21st century is an entirely different ball-game to the tools and resources available to politicians at any previous point in history. Indeed, we are now working from a base technological platform sufficiently advanced for "Transparency" as a focus in policy crafting to no longer be avoidable.

Before charging ahead with this discussion though, it is important to briefly understand what constitutes "Corporate Transparency". In essence, it refers to the availability of firm-specific information to those on the outside of said enterprises. Within an economy, it is conceptualized as "output from a multi-faceted system whose components collectively produce, gather, validate, and disseminate information".

However, this element has been reduced so far to naught but a corporate buzzword. A recent prime example (at the time this paper is being written) into the reality of big business when it pertains to visibility into their practices is the ousting of Mr. Cyrus Mistry as the Chairman of Tata Sons, the holding company of the Tata Group[55].

In a long-form letter addressed to the Tata Group's directors and shareholders, Mr. Mistry outlined his analyses of various problems facing the management and governance of

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[55] Aman Malik. *"Tata-Mistry controversy - all that we know so far."* VCCircle. 5 November 2016. Last Accessed on 31/08/2017. https://www.vccircle.com/tata-mistry-controversy-all-we-know-so-far/

the Tata conglomerate, his efforts to establish better corporate social responsibility as well as better compensation and incentives, putting in place cross-group think tanks and strategic bodies to maximize corporate value to future-proof the group, capitulating with his ouster as Chairman by Mr. Ratan Tata – without notice, heed to corporate procedure, or even by-laws established to prevent Mr. Tata from being able to hold said seat at his age.

This event was then compounded by alleged whisper campaigns from the Tata leadership, attempts to place gag orders on directors and board members from Tata Group - more than 50 of whom had assessed and lauded his tenure - from being able to discuss his work performance, threats against other Tata employees and leaders attempting to speak against the corporate misconduct, followed by a lawsuit registered against Tata Sons over the legitimacy of the ouster.

How is this a lesson in transparency, you ask? While Mr. Mistry's efforts to promote transparency into practices at the highest levels of the Tata Group may have come later than they should have from an ethical standpoint, they nonetheless caused the conglomerate to fall out of BrandFinance's top 100 brands for the first time since 2007. Monetarily speaking, this led to a loss of roughly $3.2 billion for the Tata Group as a whole, with various companies within the conglomerate facing significant drops in stock prices over the days after Mr. Mistry's ouster. That end-result is precisely the reason why big businesses battle the inclusion of true transparency into their practices, and the biggest reason why we need more of it.

It is important to recognize that merely 20 years ago, business was run in a world largely devoid of the internet. This does not simply translate to a lack of advertising and marketing in an environment without Twitter and Facebook – but rather had gross implications on burdens of record-keeping of business practices as they were carried out on the field as well as reporting the same to suppliers, investors, and governmental bodies.

For the large part before the dawn of e-business, big enterprises grew out of the public eye, aided in growth by timely exposure for achievements. Investigative reporters and analysts seeking to learn more about the internal workings of any company had to spend a considerable amount of time developing sources, undertaking brutal leg-work to various governmental bodies in order to requisition relevant documents, etc. For every case of malpractice which was uncovered through external investigation, and not through internal whistle-blowers, there was an exorbitant time and monetary cost.

These barriers to sharing information understandably took their toll on the amount of transparency and exposure which could be forced upon any misbehaving corporate enterprise. Particularly, the ability to govern such opaquely-run enterprises dropped further down in the 80s and 90s following the boom in commerce in the wake of new technological advancements. This lack of insight into corporate behavior was then aggravated by the PR spin-doctoring employed at the higher echelons of commerce. As is to be expected, this created hundreds of large businesses which grew to their positions as leaders of global commerce by following less than ethical rules. These circumstances led to corporate leadership going rogue in many cases, often resulting in scandals such as the one which ended Enron.

It isn't a coincidence that the number of major corporate scandals which were caught and reported has roughly tripled since 2001, as compared to the period of 1980-1999. It also isn't difficult to gather why most big businesses would rather keep their key practices, such as supplier payment behavior, under wraps wherever they can help it – even though studies today sufficiently support the premise that enterprises of all sizes would benefit from greater customer acquisition, loyalty, efficiency, and profitability if transparency were enforced.

At the bottom of it all, the current battle to enforce transparency is a fight for philosophical evolution of business management, rather than a strictly material one. While there have been extra-commercial elements which have been pushing for transparency in policies regarding public or private governance since the last half-century, the largest motivators today for these principles are millennials.

Do Corporations Support Transparency In Public Policy?

Before we move on further, however, there is a key question that must be addressed – Despite the popularity of the phrase "corporate transparency", do corporate organizations really want more visibility into their inner workings?

The general myth accepted in the corporate environment is that transparency is a good ideal, one that must be striven for as an achievement. Moreover, customers overwhelmingly respond more favorably to companies which engage with them on social media, often equating ease of communication with transparency as well. However, what does empirical evidence have to say about this belief and its application in practice?

A 2012 study conducted by Transparency International[56], a global body advocating for greater transparency in a fight against corruption, measured the appetite and practice of transparency in the 105 largest listed multinational companies in the world. These companies together were worth more than $11 trillion at the time of the report, and were collectively present in more than 200 countries across the planet.

While they tested different facets of disclosure to meet their goal, companies were evaluated on their disclosure of *materiality* in order to gauge "organizational transparency".

Materiality, as defined by the SEC, is defined as follows:

1. The investment exceeds 10% of the company's consolidated assets;
2. The share in the subsidiary's assets exceeds 10% of its own consolidated assets;
3. The share in the subsidiary's income before tax exceeds 10% of its own consolidated income.

In essence, it was an effort to map significant commercial interests between companies. The results of this test saw global powerhouses such as Apple, Disney, Microsoft, Google & McDonalds at the bottom of the list at 33% transparency, with even widely criticized business organizations such as Amazon sitting at the 50% mark.

In other measures of open disclosure, while it may be harder to gauge intra-organizational transparency as an outsider, glimpses may be offered into their internal practices by people such as Matt MacInnis as well – a 7-year former employee of Apple who "helped build Apple during its renaissance in the 2000s."

MacInnis' experiences at the corporate behemoth detail a workplace where employees were discouraged from talking with one another about projects, even if the person on the

[56] Transparency International. *"Transparency in Corporate Reporting: Assessing the World's Largest Companies."* 2012. Last Accessed on 31/08/2017. https://www.transparency-france.org/wp-content/uploads/2016/05/2012_transparencyincorporatereporting.pdf

other end may be one’s own manager who hasn’t yet been made avail of the information. In fact, the author explicitly stated that this led to an information environment of “haves” and “have-nots”, with “Are you disclosed?” being a constant opener to any professional conversation.

While the insight into Apple by MacInnis may be considered anecdotal, it would be a hard argument to make that any organization so enamored with secrecy that its own employees are left feeling fragmented and compartmentalized would be exceedingly invested in making “corporate transparency” a primary priority.

The Transparency International study is by no means an isolated proof either of the apprehension that corporations hold towards implementing true transparency into their practices. In 2012, Oxfam America’s policy director Ian Gary had commented on the hypocrisy of big corporations. In his article, he spoke of the global Extractive Industries Transparency Initiative (EITI), which counted among its members many leaders of the fossil fuel industry, as well as notable Board members such as Chevron which publicly supported their belief that “disclosure of revenues received by governments and payments made by extractive industries to governments could lead to improved governance in resource-rich countries.”

Considering their purported goal, the passing of the Dodd-Frank Wall Street Reform Act in 2010 should have been a cause for celebration, especially considering that it included Section 1504 – a provision that required each oil, gas, and mining company to disclose their tax, royalty, and other payments to governments in every country of operation.

Since the act was signed into law though, many large corporations have been actively lobbying to cripple the implementation of said legislation and the specific provision by the Securities and Exchange Commission.

The unintended irony of this situation is that it is the limited transparency into governance offered by documents such as the Senate lobbying disclosure forms that allowed vigilant organizations to discover that Chevron was an active participant in these hindering efforts, “targeting not only the SEC, but the House of Representatives, Senate, Department of State, Department of the Interior, and the National Security Council” along with other major corporations, according to Ian Gary. A week before the concerned article, the author continues, the American Petroleum Institute had also begun to threaten the SEC with legal action unless they withdrew Section 1504, and started a new proposal from scratch.

As we know since then, this provision was finally adopted for implementation by the SEC in June of 2016. In the end though, this effort towards transparency was set back a ways when Dodd-Frank was repealed in 2017 as per the wishes of current-President Trump.

A similar battle can be seen raging at the moment in the United Kingdom. In 2015, to combat the grossly compounding effects of late payment practices on the country's economy as well as its small business industries, UK passed a legislation requiring larger companies to publish their payment practices biannually – as we've covered in other sections.

This law was set to be enforced from mid-2016 onwards and would start making the published reports available to the public domain for the purposes of transparency. Even so, the date came and passed without any notice of enforcement from the UK government, nor was any particular reason offered for the delays. After a year of delay, at the time this paper is being written, the reporting regulations are finally being enforced as of 6th April 2017, with no details yet on the public availability of the reported payment practices.

In the end, the most valuable insight offered by the Transparency International's report however is in the big picture offered by their evaluation of these 105 largest companies in the world.

The study in itself divides the goal of transparency into:

1. corporate reporting of anti-corruption programs;
2. organizational transparency as ascertained by disclosure of material assets;
3. disclosure of country-by-country reporting of international operations.

Out of 105 companies, at least 40 companies hold scores of 70-100% in at least 2 of these three criteria of measurement. However, the areas in which data & transparency may be lacking spoke volumes with their absence as well. As an example, HSBC – which has, and continues to garner more than its share of money laundering, sanction-breaking, and other global controversies – only scored 8% transparency on its country-by-country reporting standards.

Thus, we can clearly extrapolate from the numbers that even among the largest corporations across the globe, enterprises which often evoke “transparency” in press releases for future digital projects, the norm is not to exercise open exchange of information. Rather, these enterprises disperse selective information which benefits their overall growth.

As we discussed with HSBC, the data is quite telling in terms of aspects of their operations which companies may wish to keep away from the public eye. Yet another example which we mentioned earlier is Amazon.

While this e-tailing empire scored 50% transparency on disclosure of material assets, their anti-corruption reporting falls to 27% on the score board, while their Country by country operational reporting plummets to 6%.

Among my professional peers and other readers of this paper, those who consume news to remain globally savvy on the corporate arena would know that Amazon is a corporation with several scandals in their wake, including those involving gross maltreatment of employees in their warehouses.

Yet again, their reticence in openly sharing information on their operations in the various other countries in which they have a presence is in keeping largely with the glimpses brought into some of their more questionable practices in the past through investigative reporting.

The point that these large corporations are uncomfortable with true operational or financial transparency is brought home further by events such as the leaking of the Panama Papers in 2016.

At the time, response to the clear webs of global fraudulent behavior visible through the documents between and within many large corporations, governments, and individuals led the 5 biggest economies in the European Union – Britain, France, Germany, Italy, and Spain – to announce an undertaking to share any and all information about the real or “beneficial” owner of any shell companies and overseas trusts.

Yet, even at this time, the United States declined the undertaking. In particular, the fact that a 2015 financial secrecy index published by the Tax Justice Network ranked United States as the third most secretive country after Switzerland and Hong Kong should be sufficient to accurately portray the appetite for corporate or financial transparency both in the American corporate culture as well as the systems of governance.

In fact, the opacity of corporate operations has been seen to be so strongly protected at the state level in the US that in 2016, the New York Times' digital site ran an article titled "Need to Hide Some Income? You Don't Have to Go to Panama."[57]

The aftermath of the Panama Papers was a global environment where corporate secrets which were never intended to be published were overflowing across the public domain, and in US specifically revealed states harboring systems enabling deep corporate shell holdings.

"In Wyoming, Nevada, and Delaware, it's possible to create these shell corporations with virtually no questions asked," said Matthew Gardner, Executive Director of the Institute on Taxation and Economic Policy, a research non-profit based in Washington. In particular, Delaware as a governed state seems to have become notable for its lack of transparency, and is a "magnet for people looking to create anonymous shell companies, which individuals and corporations can use to evade an inestimable amount in federal and foreign taxes."

In fact, it was unearthed that a loophole in the Delaware tax code when combined with the corporate reporting opacity in the state created a way for companies to shift royalties and similar revenues from where they actually did business to holding companies in Delaware, where they weren't taxed.

Even when the US Treasury Department finally indicated post-Panama that it planned on pushing regulations that would require financial institutions to verify the identities of customers who set up accounts in the name of shell companies – a move which should ideally

[57] Patricia Cohen. *"Need to Hide Some Income? You Don't Have to Go to Panama."* The New York Times. 7 April 2016. Last Accessed at 31/08/2017. https://www.nytimes.com/2016/04/08/business/need-to-hide-some-income-you-dont-have-to-go-to-panama.html?mcubz=1

be an enormous victory for transparency – it would ultimately make no tangible difference.

The changes on the Federal level would still not affect existing state laws protecting corporate privacy and minimizing their reporting burdens. This was not an accidental state of affairs. John A. Cassara, a former special agent for the US Treasury Department confirmed that American and foreign law enforcement officials conducting investigations were regularly obstructed by state secrecy laws surrounding shell corporations.

Considering that corporate secrecy is not a particular wish expressed by the average voter, it must be surmised that these state of affairs are explained by political lobbies vying for corporate special interests. The end result can once again be highlighted through ex-Agent Cassara who recalls to the author of a case where investigators had to abandon the enquiry of a Nevada-based enterprise which had received more than 3,700 suspicious wire transfers totaling $81 million over two years.

Not just that, but the state even advertised their protection of corporate secrecy on their website in 2007. As the advertisement read at the time, “Why incorporate in Nevada? Minimal reporting and disclosing requirements. Stockholders are not public record.”

To make the stance of US even more clear when it comes to the transparency of corporations within its own jurisdiction, the United States in 2010 passed the Foreign Account Tax Compliance Act which required financial firms in other countries to disclose details about American clients with offshore accounts – yet still refuses to sign any international standard sharing similar financial information with other countries.

Going back to the steps taken by the 5 EU countries post-Panama though, even they were largely reactionary measures to acute pains brought out by the flaws in the system. In the meanwhile, chronic issues such as late payment and unethical payment practices cause attritional damage to every economy every day and yet go largely unchallenged because no one has sufficient data to penalize the corporate entities which contribute to these problems the most. However, it’s not as if the damage to SMBs themselves caused by such behavior isn’t well known or documented.

Recent studies by Fundbox which were published in March 2017 estimate that the total amount in unpaid invoices across all US SMBs is roughly $825 billion. Furthermore, Fundbox asserts that if all these SMBs were paid on time, they could collectively hire an additional 2.1 million employees, which would reduce unemployment in US by 27%.

Therefore, as you can well imagine, we aren't talking of intangible promised rewards here to the economy if every SMB in a country was paid on time, at least going by the figures from the US – it's literally a potential way to deal a massive blow to unemployment for most countries that could manage to put it into practice today, in a single sweeping piece of legislation.

Instead, 18% of SMBs in US hold back on pay increases or bonuses for employees, while 23% can't hire new employees, or even invest in new equipment.

This means that roughly a quarter of the functioning backbone of the economy which is served by small businesses can't even give anything back to the economy over time. It can't create new jobs, and potentially may not even sustain the ones it creates at the moment.

Since these SMBs can't afford to pay more, and so can't grow the talent pool from which they hire in order to increase working productivity if they were to remain small. Yet, since they can't afford to hire new employees outright either, they can't grow their output capacity.

"When we are not paid on time or slowly, we cannot obtain big customers since big customer accounts require more capital to service." - Supreme Maintenance Solutions.

However, in many cases, the situation gets even more dire. Fundbox reports in the study that 20% of SMBs can't even afford to spend on marketing for their enterprises as a result of the late payments.

"Not paying myself is first because reducing marketing cost is about equivalent to hitting a self-destruct button." – Blackstone Services.

"When we are paid late or slowly, I do not pay myself, we scale back marketing, buying uniforms, etc." – Nightwatch Services.

The impact of lowered or no marketing on a small business is catastrophic, is a statement that should surprise no one involved in business. However, as we discussed earlier in this segment, late payment causes attritional damage to the economy and the firms suffering through it.

Therefore, as payments are delayed, bonuses are held back, then hiring is put on freeze, and then marketing is rolled back. Thus, small businesses enter a spiral where their total potential revenue is constantly growing smaller, while the revenue they do earn comes in late and so shrinks their potential revenue further.

However, what about a point where operations have to be rolled back because the small business can't afford to build up inventory? Fundbox reports that 17% of SMBs face just this issue.

From this point on, SMBs that continue facing their late payment problems as before slowly lose the ability to service their largest contracts, and continue down the spiral till they have to declare bankruptcy. As can be expected, the phenomenon of late invoice payments to SMBs by their clients affects the general survival of small businesses tremendously.

A survey, commissioned by Tungsten and taken in United Kingdom in 2015, reported that as many as 23% of SMBs had at some point faced an insolvency crisis due to unpaid invoices. It should go without saying that – with a statistic like that, it's important to keep in mind that these were the businesses that brushed with bankruptcy and survived. Just to examine that thought from a tangible perspective, the number of commercial filings for bankruptcy in 2015 in US totaled about 30,018.

Thus, we can clearly see that despite extensive, attritional, long-term damage to small businesses as well as the economy as a whole dealt by late b2b invoice payments, transparency into operational details of larger businesses – though effective in combating late payments – is clearly not favored in practice by many of the world's largest enterprises as well as governments.

B] Are Private Market Solutions Effective In Tackling The Late Payment Problem In B2B SMBs?

As Richard M. Salsman, President of InterMarket Forecasting, wrote in Forbes in 2013 – "the real cause [for the 2008 financial crisis]… was government intervention in markets."[58]

This was not a solitary view either, but was echoed in several other credible publications such as the Wall Street Journal and the New York Times as well as in the conclusions of widespread analytical studies. Yet, mirroring this stance stood several other administrative bodies and academic groups who remain entirely convinced that the crisis was a result of straightforward corporate greed.

From my professional perspective, the cause of the crisis was a convergence of factors which can't be explained away in such black and white terms – but this does reveal one essential truth. Regardless of whether there is any merit in discussing self-policing of corporate greed, the government did fail its duty as the final line of defense, owing to major loopholes in regulation. Therein lies the biggest difference between public policy and private market solutions.

As opposed to market solutions, policies are politically inspired and usually driven by a motley crew of forces with discordant objectives. Therefore, regardless of the optimal approach to tackling a problem, public solutions usually only challenge as much of a problem as all the forces involved allow it to bring under control.

This presents a unique problem among policies which rely on legislative regulation alone to create a holistic framework of checks, balances, and solutions to free market

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[58] Richard M. Salsman. *"The Financial Crisis Was A Failure Of Government, Not Free Markets,"* Forbes. 19 September 2013. Last Accessed on 31/08/2017. https://www.forbes.com/sites/richardsalsman/2013/09/19/the-financial-crisis-was-a-failure-of-government-not-free-markets/#f35f8e851c39

exploitation. The need for cross-political cooperation in order to bring in legislation regarding lofty matters such as business regulation means that there will always remain ways for large business interests to enter and distort the required conversation between government and smaller enterprises.

On the other hand, private market solutions usually start as pioneering commercialized services aimed at the same thing as every other business product – improving the client's bottom line. However, the tangible financial benefits of fully adhering to an employed private solution mean that they allow such private products to regulate areas of business which large enterprises would otherwise lobby against forcefully if it came up in a proposed government policy. Taking a look at the few global improvements there have been in matters of payment practices to smaller suppliers, it is undeniable that private market solutions have had a significant part to play so far.

As we've discussed in previous segments, the introduction of services such as e-invoicing, dynamic discounting, invoice financing portals, etc. all brought significant improvements to markets upon their arrival and growth. While the adoption of many of these services is undeniably far slower among smaller businesses than their larger counterparts, as is often the case with the uptake of new technologies, each of them provided invaluable tools for negotiation to smaller suppliers – slowly yet undeniably correcting the imbalances in the power dynamic between buyer and supplier more effectively than most public policies.

Therefore, yes, it can be argued that private market solutions have been more effective *so far* in tackling the late payment problem between larger clients and their SMB suppliers than government policies – even if the benefits were restricted to paying customers of such products.

The first, and most obvious, reason behind the success of private solutions over public policies is that they address the one point we've discussed is lacking among regulations. Private market solutions provide clear visibility into the tangible benefits a buyer would receive from making their payments on time, to allow companies to calculate their gain over the cost of lost opportunities in the short-term. They offer credible financial incentives so as to create more sustainable business interactions between suppliers and their late-paying clients.

The second reason behind their success, however, is the one more important to their efficacy. Unlike public policies, commercialized products are not negotiated agreements between different groups each with their own agenda. They are closed systems which are created specifically to target and eliminate a given set of problems. In the end, their function is no different from a calculator. You input data, and expect a certain output. Whether that output helps save money, or get paid faster, or allows better inventory planning in the near future is all the same for the amount of involvement the supplier has in the solution's internal workings. In the end, the main point here is that a private solution is created as a complete system and framework which works because none of the elements which lend to its efficacy can be cherry-picked or removed – which is an extent of regulation over a business' practices which a public policy can never achieve on its own.

This is also the biggest reason why more private market solutions need to be integrated into government policies.

The Economic & Regulatory Benefits of Inclusion of Private Market Solutions In Public Policy

As we've discussed before, there are several advantages of including private market solutions in public policy. However, considering that the primary and secondary drivers of policy are usually government and big enterprises, it is necessary to outline the advantages of accounting for technological advancements for these interests first while planning policy.

It goes without saying that in this three-way dynamic between small business, big business, and the government, the immediate advantage to SMBs with the inclusion of such policy crafting guidelines would be a proven relief to large chunks of their cash flow woes.

Before we continue with these lists of economic and regulatory benefits, it is important to point out that this is not mere theoretical conjecture. There exist several successful regulatory experiments which centered around taking advantage of increased technological reach to close loopholes in business regulations.

One of the most notable examples is the impact of e-invoicing on Tax regulations and its eventual mandatory status in business transactions in several countries across the globe. However, we shall return to this phenomenon further ahead in the paper.

In 2014, resources published by Taulia – a leading enterprise in several fields associated with SMB payment practices – accurately portrayed the changes in the business environment from the 80s to the 2010s. Between 1980 to 1994, the cash reserves and liquid assets held by all non-financial companies in the US ranged between $600 billion and $900 billion. An up-swell in corporate cash hoarding from 1995 onwards pushed these assets to the tune of $1.7 trillion by 2012 alone.

These values don't just represent the economic growth of non-financial enterprises in the last 20 years – particularly since growth has been minor, and even famously negative on many instances in US markets within that time span. They represent a tangible inclination for medium to larger-sized enterprises to hold on to cash, kept in escrow for non-specific future investment opportunities. However, corporate payment practices aren't the only significant factor which changed in the equation since the 80s. In 1980, Federal Reserve benchmark interest rates stood at 20%, a state of affairs which encouraged creating large cash reserves and accrue interest on the same. Since then, the slashing of interest rates has deteriorated that advantage to a near zero interest rate environment.

Practically speaking though, it isn't enough to discount the negligible return from interests alone. It also becomes necessary to examine more closely the key argument in cash hoarding practices – the opportunity to leverage advantageous opportunities at a shorter notice as and when they present themselves.

The cash reserves stand for the enterprise's ability to make rapid investments that offer short and long term competitive advantages over other businesses, and so the lack of ROI through interest rates alone isn't significant enough reason to make a difference. In that case, here's an example. In FY 2011, Apple's $81.6 billion in cash reserves earned them only 0.77% - a feat only 0.02% better than the previous financial year. To be accurate, despite Apple's efforts at sustaining a fairly paid supply chain, they would have had a statistically better ROI on those cash reserves had they simply negotiated discounts in exchange for even faster payments to their suppliers. Therein lies one of the founding principles to Dynamic Discounting (DD).

The imbalance in business dynamics today, which is a consequential reason behind the late payment epidemic, was largely a result of policy crafting to support as well as regulate large businesses which were booming. Yet, the advantage of DD in this equation is that it was created as a tool to help large businesses operate more efficiently for a better ROI on their assets. A study of the payment habits of 200 large corporations by Paystream Advisors in 2011 revealed that 88% of all invoices generated in B2B transactions across US offered no discount opportunities at all. As we've addressed in previous segments, even among suppliers who do offer early payment discounts, the dominant practice has been to engage in static discounting – which while better than no discounting, its rigidity ensures that it only leverages a small portion of the available opportunities.

On the other hand, the dynamic discounting offered by the sliding scale method ensures that there is tremendous freedom of choice and benefits to both parties involved in the transaction. Yet, if we need to tangibly measure the seeming successes of DD over the opportunities leveraged through cash hoarding, let's not forget Pacific Gas & Electric.

In 2011, the largest utility company in the United States deployed DD across its supply chain. In Year 1, it saved PG&E $31.4 million, and $42 million in 2012. As reported, its ROI 1 year after implementation was >2000%. It is important to note that this return rate included the costs for PG&E themselves associated with integrating and maintaining this system in place, costs which would not necessarily be born either by SMBs or their clients if DD was integrated into public policy.

If that concept seems far-fetched, it's logically a simple step forward from the e-invoicing mandates several countries have in place. In terms of a public policy solution, there is much that can be solved for small business, big business, and governments alike, by operating a business transaction platform for transactions over a pre-determined value.

By merging the benefits of DD with the current policy experiments with e-invoicing, it is possible to create a closed system wherein Governments operating the platform would:

- benefit from greater visibility into corporate transactions and revenue,
- suffer reduced corporate tax fraud,
- enjoy reduced costs associated with investigating and recovering due corporate tax

payments,

- simultaneously improve survivability of SMBs, thus strengthening their economy for the long term;

While it would be an inaccurate statement to say that state-mandated e-invoicing systems such as Brazil’s Nota Fiscal Eletronica are the same as China’s Fapiao, both systems bear crucial similarities in that they are state-run compartmentalized systems which offer great insight for the countries’ tax departments into corporate business practices. Yet, both these systems were conceptualized only after the digitization of business invoices were made possible. As it stands, both these avatars of instantaneous record-keeping with the tax authorities represent the creation of a closed regulatory system from the concept of a private market solution.

6. DISCUSSION

A] Dismantling the Hoard: Accounting for Barriers to Further Private-Led Public Innovation

If we ever aim to successfully resolve the late-payment epidemic across the world, we need to first be able to correctly identify the problem. As they say, to hunt a dragon, find its hoard. In this case, the hoard is roughly sized at around $1.9 trillion among US businesses alone.

By its very nature, the act of not paying one's supplier their accounts receivables by the due date is an illegal one. Since the penalty for not doing so however is barely more than a slap to the wrist in most cases to the larger client, not just the world of business but we as a society as well treat the practice in a rather blasé fashion.

However, those hoards of cash are literally representative of the monies owed by the various conglomerate clients of the world to their smaller suppliers. Thus, they are deeply symbolic with respect to the issue at hand, and symptomatic of various deeper problems.

While we'll continue to the other problems they represent further in the segment, and how that relates to the barriers to innovation, we must first examine the symbolic relationship between the cash hoards and the industries that gather them.

For people who understand the nuances of business, the idea that there is a direct link between cash hoarding by companies and business advantages is a laughable one. One of the largest and most consistent failures with public policy when it comes to governance over business is that all commercial industries are treated as a homogeneous mass. Thus, when policies are crafted, they do so without understanding or accounting for the differences in practices which are bound to occur when two industries deal in products which apply to vastly differing aspects of our lives.

This view is painfully brought into focus through articles like the one written by Scott Wolfe Jr, CEO of Zlien, on the failures of SupplierPay to have any meaningful impact on the construction industry in the United States[59].

As he explains it, "the construction industry has working capital challenges that are unique to many industries." While the traditional idea of a supplier-buyer transaction is relatively simple, transactions in the construction industry may often not follow the usual process associated with a run-of-the-mill purchase of product.

From what we've discussed in previous segments of this paper, SupplierPay was a spin-off program derived from the reasonably successful QuickPay program launched by former President Barack Obama. Essentially, it was designed to encourage any enterprises working with the US Federal government to voluntarily pay their suppliers faster.

As Wolfe explains it though, the construction industry often sees single projects with several layers of participating entities at various levels on the buying and selling sides. Contrary to the expectation of a transaction usually held in business, payments in the construction industry are never a process where the product is exchanged and the payment is transferred from client to supplier, who then distributes those payments down their own supply chain as appropriate.

Instead, invoices in the construction industry are often treated as "application for payment." Since there are several transacting parties on both sides, packets of payments must be approved from the buyers, which then transfers over to multiple suppliers, each of whom then further trickle those monies down the chain. In Wolfe's words, the money has to "trickle down through all of the parties before the capital reaches its destination."

The construction industry's payment practices are further convoluted through the inclusion of contingent payment provisions such as "pay-when-paid" and "pay-if-paid", both of which are used to mitigate or displace financial risks and both of which are symbolic of

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[59] Scott Wolfe Jr. *"Obama's SupplierPay Fails The Construction Industry"* Zlien. 17 July 2014. Last Accessed on 31/08/2017. https://blog.zlien.com/construction-payment/obamas-supplierpay-fails-construction-industry/

increasingly exploited suppliers.

As the name states, “pay-when-paid” refers to a clause where a general contractor does not need to pay their sub-contractor until they get paid. Building upon that, “pay-if-paid” bears the same payment terms, but shifts the risk of non-payment to the sub-contractor. Furthermore, however clear an indication this may be of exploitation of smaller suppliers by larger clients, only 12 states in US have made “pay-if-paid” clauses unenforceable.

Thus, as Wolfe sums it up – “The truth about SupplierPay is that it’s an interesting and ambitious program, but a program that completely fails the construction industry.”

It’s important to not forget that SupplierPay is at this point the only policy response to the late-payment phenomenon by the United States Government put in place for the protection and improvement of SMBs. Secondly, it only covers the sub-contractors and businesses directly transacting with enterprises handling federal contracts.

Moreover, it’s a voluntary program with no clear incentives or penalties on either side, in a legislative environment with shockingly absent regulatory protections against exploitation or abuse of financial leverage between smaller suppliers and larger clients. Therefore, in a policy which already protects a smaller portion of the whole market, it’s quite telling of the state of current policy-crafting that such a lonely measure can still prove completely meaningless to entire industries in that economic environment.

Arguably, the only way then to change these states of affairs is to look deeper into the individual differences between the industries in hopes of better understanding the unique perspectives which may confront legislation aimed at resolving late payment problems.

Going back to the beginning of this segment, we spoke about the cash hoards being symbolic of the problem. Since the early parts of this paper, we’ve also nearly constantly spoken about the potential advantages of cash hoards for companies as a reason to explain why they occur. Yet, that homogeneous approach to evaluating the cash hoards of different industries is no different from the policy analysts who may have worked on programs like SupplierPay.

As any other aspect of business, the event of a company hoarding cash savings is viewed differently by investors depending on the industry. For example, in the case of pharmaceutical companies, every dollar in savings is worth $1.50 to investors. The same dollar saved by an aircraft manufacturer is worth 40 cents to investors.

These aren't figures pulled out of a hat, but rather the results of a valuation model built by Lee Pinkowitz and Rohan Williamson, using 50 years of data for 12,888 different publicly traded companies.

Pinkowitz & Williamson's valuation model goes on to show that the perception of savings in fact may vary so broadly across different industries in the same economy that, while every dollar saved by software companies is valued at more than $2 each, the defense and coal industries look upon cash hoardings rather unfavorably – "with a dollar in savings valued negatively."

Adam Davidson, founder of NPR's "Planet Money", explained the current hoarding situation quite succinctly in his 2016 article for the NY Times.

As an example, he stated that Google's new parent company – Alphabet Inc. – is worth roughly $500 billion, and yet "it has around $80 billion sitting in Google's bank accounts or other short-term investments[60]. So if you buy a share in Alphabet, which has sold for roughly $700 lately, you are effectively buying ownership of more than $100 in cash. With $80 billion, Google could buy Uber and its Indian rival Ola and still have enough left over to buy Palantir, a data-mining startup. Or it could buy Goldman Sachs outright or American Express or most of MasterCard; it could buy Costco or eBay or a quarter of Amazon. Surely it could use those acquisitions to earn more than 2 cents on the dollar."

However, given the realities of the current perception of hoarding as we've learnt from Pinkowitz and Williamson's valuation model - it is hardly surprising that some of the largest cash hoarders in the world are companies like Apple, Google, and Microsoft, rivaled only by General Electric. The current system in place rewards these companies with a 100% increase in valuation for each dollar saved, at least in the estimation of investors.

[60] Adam Davidson, *"Why are Corporations Hoarding Trillions?"*. 20 January 2016.

Davidson also points out that GE holds nearly half of its value in cash, while Apple holds more than a third of its value in the same. Considering these numbers at face-value alone, this points to an alarming trend. Yet, the problem is even bigger than we've portrayed it to be so far. While US businesses may be hoarding $1.9 trillion within US borders alone, there are larger sums being hoarded overseas by American enterprises as well.

As of the last quarter of 2016, US businesses have more than $2.5 trillion hoarded overseas as well. To put it in perspective, that represents nearly 14% of the total US GDP. Unsurprisingly, among the companies topping the charts for overseas hoarders, Microsoft and GE are holding on to more than $100 billion each abroad, with Apple close behind at $91.5 billion.

The figures on both the domestic as well as overseas hoardings represent a dramatic increase in the trend over the past 2 years alone, the total overseas hoards having swelled by over 20% in that time. Between the two cash caches, they total roughly $4.4 trillion of money absent from active participation in the economy and gaining little more value than earnings on interest. Once again, just to put the largesse of these values in perspective – In 2015, the total global credit gap for SMEs in the formal sector was evaluated at $2 trillion.

To be accurate, these corporate hoards are by no means the result of a single problem within the system, and several complicated matters such as the high corporate tax in US have had large parts to play in them. However, this points to an undeniable conclusion.

As reported by Jeff Cox[61] - Finance Editor at CNBC - between the cash hoards, investor cash in zero-yielding money markets, and excess reserves at the Federal Reserves Bank, US faces roughly $9.3 trillion in available cash gaining little to no return on its value within these four categories alone. However, absent extensive tax reform, the only one among those four categories which can be influenced and/or addressed relatively faster remains the domestic hoard held by US businesses. Yet, the hoard in itself represents a closed loop, so to speak.

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[61] Jeff Cox. *"US companies are hoarding $2.5 trillion in cash overseas."* CNBC.com. 20 September 2016. Last Accessed on 31/08/2017. https://www.cnbc.com/2016/09/20/us-companies-are-hoarding-2-and-a-half-trillion-dollars-in-cash-overseas.html

The Economist reported in Q3 of 2016 that the American economy lay in a confusing state. Figures showed that payrolls had been increasing by an average of 190,000 per month in the months preceding the article. The median pay rise in the year leading up had been 3.4%, and American citizens had even increased consumption per person by 5.5% per annum, the fastest such growth in a decade. Yet, the real GDP was only expanding at 1.2% per year.

As can be surmised, the hidden culprit for the slowed growth was business investment, which had fallen for three consecutive quarters at that point and was 1.3% lower than the year before. As an example of the state of various industries, financial firms had invested 21% less in Q1 2016 than they had in Q1 2015.

In analyzing this state of affairs, the Economist put forth three typical explanations for this widespread reluctance to invest. The first suggestion examined was a weak demand for the firms' goods, given a less than heated demand for American goods worldwide at a time when the dollar is considered strong. However, since the average American consumer was spending more, and this question essentially pertained to domestic demand and spending, it was dismissed.

The second reason – tighter credit – was also dismissed because the average rate charged by banks for firms to borrow money was up by just half a percentage point, which is easy enough to offset for American firms which were flush with cash. In fact, as pointed out by the Association for Finance Professionals, firms were accumulating cash at the fastest rate since July 2011.

The third reason suggested by the Economist was that business investments are down because the current slow growth rate left few desirable prospects in the eyes of hoarding companies in which they could invest. This claim is a lot harder to disprove, and has been brought up several times by highly credible and respective voices from political, journalistic, and well as financial fields.

While the first drop in corporate investment interests is attributed by several authorities in the field to the pullback from the energy sector, caused by a prolonged drop in oil prices, it was then seen to spread wider over the US economy in the next five quarters leading up to Q4 2016.

Though the reduction in oil prices had helped the average US consumer, it had also led to reductions in investments in the field as shale oil and gas firms had pulled back on their drilling operations. However, with these energy companies tightening their belts in response to depleting revenue, their supply chains as well had then suffered through the shrinking of their cash flow.

While it may be true that corporate spending typically only accounts for 12.5% of economic activity in the United States, it also clearly had an exponential impact on the economy. Expenditure on equipment and infrastructure, whether physical or digital, creates and sustains thousands of jobs for manufacturers. In fact, such capital expenses from larger clients make up nearly 30% of the sales of Standard & Poor's 500 firms according to David Bianco, chief U.S Equity Strategist at Deutsche Bank. As he puts it, while healthy corporate investment usually indicates at least a 6% sales growth for any company in the S&P 500, 2017 is expected to bring only a 3 to 4% growth at the most.

While we've discussed in several segments of this paper how survivability has become increasingly threatened for SMBs over the past decade, publications such as Bloomberg and the Wall Street Journal continued to report increasing difficulties for larger corporate America as well in Q4 of 2016. With profits slowly falling for five straight quarters in fact, market expectations had even pegged for a 2.3% growth in Q1 2017. However, as we now know, these predictions were proven wildly inaccurate as corporate profitability fell yet another 2.5 % in that period, with orders for US-manufactured durable goods also taking a drop in April 2017.

"We're hardly out of the woods on the profits recession," states Joseph LaVorgna, chief US economist at Deutsche Bank Securities Inc. "Payrolls will downshift this year and continue to slow in 2017. Companies are going to have to employ fewer workers and eventually start to lay them off so as to defend very weak profit margins."[62]

[62] Sho Chandra, *"Sliding Corporate Profits Are a Darkening Cloud for U.S. Workers."* Bloomberg L.P. 21 October 2016. Last Accessed on 31/08/2017. https://www.bloomberg.com/news/articles/2016-10-21/sliding-corporate-profits-are-a-darkening-cloud-for-u-s-workers

While that's a crucial testimony to the current state of US corporate profitability in 2017, the operative words there were "continue to slow." As can be expected, reduced corporate spending usually affects payrolls as much as it does cash flow down the supply chain. However, from the accounts we've read in this segment alone, we know that the current growth in US economy is attributed largely to the increased spending power of the average consumer in recent years.

Yet, with slowing payrolls, those bulwarks of the economy will soon erode as well since corporate spending doesn't seem to be picking up any time soon – barring significant simultaneous disruptions across industries bringing in a sudden positive and organic upward trend, which is an unlikely situation.

Already, it's becoming increasingly difficult for companies to maintain their current wages as the Federal Beige Book reports of more cases of businesses shelving expansion plans due to current wage levels.

Joshua Shapiro, chief US economist at Maria Fiorini Ramirez Inc, says that the "pressure on margins is going to intensify as we go through next year [2017]. It'll result in increasingly aggressive cost-cutting, which means much slower job growth, which will then weigh on consumer spending and the overall economy."[63]

As the Economist points out, economies only grow when they add people to a labor force or get more out of their existing one. However, US is currently doing less of both. Projections from the Bureau of Labor expect the labor force to only grow by an average of 0.5% year on year from 2004 to 2014, while productivity growth is believed to have stalled as well.

In fact, between 2005 and 2014, general productivity of the labor force or output per hour only grew by 1.3% a year, a significant drop from the previous 3%. Furthermore, this was reported to take another dive in 2015 to 0.2%, and yet another in Q2 of 2016 to 0.4%.

Shrinking wage pools also means that companies are increasingly having more trouble

[63] Sho Chandra. Bloomberg, October 2016.

retaining or hiring highly skilled employees, which is further causing great harm to productive output, thus forcing companies to then yet again have to consider more cuts in order to get the most value out of their spending. These pressures of maintaining wages are so distinctly visible in fact, that Shapiro believes that the consumer is still driving the economy, "just going the wrong way."

In short, the economy has once again started moving closer to a perfect storm, and is threateningly close to another recession. As Bloomberg reported, "only once in the post-World War II era… have earnings slid at least five consecutive quarters without coinciding with a recession."

With survivability issues increasingly at all-time highs for SMBs, the number of startups per 100,000 people in US has also halved from 160 in 1977 to 80 in 2013, according to the Kauffman Foundation. Excluding smaller areas of disruption, the market share of the largest enterprises in the world has been steadily rising in most industries, suggesting an increasing lack of competition from newer firms. This should be particularly alarming as traditionally more than 60% of the jobs in the US economy have been created by the SME sector.

Here's the issue. While corporate profitability, spending, hiring, and their effects on the economy have cyclical effects on each other, making it harder to provide one to one correlations, these have been trends which have risen and fallen over the past half-decade while the US economy has continued to suffer through a slow growth.

Yet, one of the few factors among them which have continued unchecked over a longer term has been the deteriorating payment practices between SMB suppliers and their larger clients. One way to potentially track part of this trend is to check Net Cash Flow, which TradingEconomics reports to have dropped by another 2% in Q1 2017

Corporations are now in a state where half their value is stuck in cash, gaining little return, their choice of investments are declining because the collective industry holds on to cash reserves in order to quickly capitalize upon potential profitable opportunities, yet even those cash reserves are now falling in value themselves.

Smaller companies are finding it harder to attract higher-skilled talent, making it more difficult to compete through quality against larger established businesses, increasing monopoly on the market for companies and higher prices on products for the consumer due to lack of competition.

The biggest problems with the phenomenon of cash hoarding however isn't just that it threatens the survivability of SMBs, but that it in itself is a rather contagious phenomenon. Greater cash hoarding and longer accounts payable cycles put in place by the larger clients also force their own supply chain to start creating larger cash buffers in response.

This is by no means an illogical answer, if survivability is the only factor at stake for a small business. However, this largely tends to be a collective trend, as reported on in the United Kingdom in 2015.

We've already in previous segments touched upon the fact that UK SMBs have faced great threats to survivability due to the entrenched practice of late payments in the last decade. We've also discussed that while the latest EU directive to counter this threat was quite favorable in protection of smaller businesses, it was largely meaningless due to the fact that roughly 6 out of 10 businesses had admitted that they would never litigate their clients.

A report released in 2015 by the Hampshire Trust Bank stated that the ratio of SME's current account balances to savings account balances were 1:1.17. In their survey of SMB owners, they also found that only 25% of SMEs felt confident enough to place their savings in an investment product for one year. In contrast, roughly 56% of SMBs stated the need for yet greater cash buffers.

As we've read over the past few pages of this paper, any cash hoarding has a cumulative effect upon the economy. SMBs in particular need to engage in activities ensuring greater net cash flow in order to expand and improve upon their products. However, greater instances of cash hoarding by SMBs means that they are actively rejecting the opportunity to expand their payroll and operations in order to gain more clients, even in a situation where they aren't getting paid by their current clients in time. In short, it's a state of relative stagnation.

This stagnation is already apparent in the US business environment, as portrayed in the 2014 Business Dynamics Statistics report released in 2016 by the US Census Bureau. The report showed the startup industry in US at a stark 8.0% share of all US firms in 2014. This was barely above the all-time low of 7.8% startup share during the worst periods of the recession.

The current stagnation is so prevalently reported upon in fact that in an article released by the Economic Innovation Group stated that the “present stagnation near historically low levels represents a disturbing new normal for American entrepreneurship.”

Their report on the phenomenon in fact points to some remarkable secondary problems arising from this phenomenon as well. As their report shows, the past and current trends of cash hoarding have resulted in geographically uneven distributions of wealth in the economy.

It displays that the geographical locations of larger firms which first concentrated the wealth in major metropolitan centers have left them as the only current remaining supports to the economy at large, since the “geographically uneven nature of the decline in new business starts implies that large swathes of the country will soon contend with a missing generation of firms – ones that should be providing employment opportunities and new foundations for economic growth in the years ahead.”[64]

This report also credits the dynamism of large, connected cities which represent a clustering of knowledge-based economic activity in economies, where people often follow in search for economic opportunities as the root cause for the United States’ recovery following the global financial crisis. This corroborates the previous reports we’d seen crediting the current economic growth mainly to consumer spending in commercial centers of the United States, rather than any contributions from the business community at large.

However, knowing that, their secondary conclusions lead to rather dim futures for the economic state of the United States. As the EIG conclude, in the absence of any response to this trend, “the increasing concentration here may even accelerate, given that today’s largest

[64] Economic Innovation Group. *“The New Map of Economic Growth and Recovery.”* May 2016. Last Accessed on 31/08/2017. http://eig.org/wp-content/uploads/2016/05/recoverygrowthreport.pdf

economic centers are the few remaining places producing tomorrow's new businesses."

As they've said, there has been a geographically uneven decline of survivability in new businesses, with SMBs not centered in large, metropolitan cities struggling more than others. The clear conclusion here is that this will lead to a future with very few job opportunities or indeed any economic growth in large parts of the United States, severely crippling the average consumer's spending power as well as earning potential in these places. In fact, this trend is already underway – with income inequality in the United States at an all-time high.

These conclusions then rest a great deal of burden for the economic growth on the growth of jobs in larger cities. Yet, as we've already discussed, there has been a steady decline in job growth over the last 5 years in the largest sectors of business as well. Prominent sources, as we've included in previous pages of this paper, have already been questioning as to how long the average American consumer alone can bolster the efforts of economic growth with a steadily declining earnings potential.

The question may have come up here for readers as to the relevance of these points in a paper on late B2B payments and their impact on SMBs. However, the reason for that relevance is that late payment as a phenomenon is simply that far-reaching. Understanding the depths of its impact directly correlates to the urgency with which it must be tackled.

When UK reached this particular junction, it urged upon them the need to take drastic measures and implement the mandatory payment practices reporting system. However, the US economy at large has decided to concentrate the majority of their efforts on a different answer. Under any report discussed previously in this paper, a vast majority of SMBs have answered repeatedly that their largest threat to survivability aside from late payments is dearth of access to credit.

UK faced a similar situation, and saw the rise of the so-called "challenger banks", new entrants to the financial market which were emerging to pose competition to the UK's five largest lender banks (HSBC, Lloyds, RBS, Barclays, and Santander). In fact, the Hampshire Trust Bank whose study we referred to above was one of those contenders – an enterprise which at the time was sounding the loudest alarm bells about increasing cash hoarding among

UK small businesses, in order to make them aware of its own higher interest offerings in savings accounts.

We see a similar situation playing out in the United States today, wherein a significant percentage of new disruptive firms in the financial industry have mostly to do with increasing access to credit for the average SMB. In fact, roughly 67% of the current Fintech startup industry in involved with payments, lending, and financing, according to a December 2015 report by McKinsey[65].

Moreover, 21% of all current fintech startups are geared to service B2B SMBs in the payments, lending and financing industries, which is a disconcerting amount considering that only 28% of all fintech startups are engaged with firms of this size.

Now, while it's perfectly normal for free market solutions to arise in response to a need, here's the problem with the current trend. It's a response to the symptom, not the underlying cause – and the sheer amount of resources being invested in managing this symptom currently far outweigh any collaborative, meaningful, or comprehensive effort to identify and solve the entrenched problem within the system.

In itself, that's not a surprising trend. Given the current legislative environment where banking and credit-lending practices have a firm regulatory base, it's much easier for entrepreneurs and their investors to have a clear expectation of challenges and projected revenue in areas dealing with access to credit, than they do if they attempt to break new ground and start investigating solutions to the root cause of the *need* for that credit itself.

Yet again, that statement will not startle even the least savvy of business trend consumers. As is well understood in the realm of commerce, any *true* pioneering initiative – a hitherto unseen philosophy, process, or product – is an uphill battle if one isn't already part of a "unicorn" startup dedicated to that insight, or doesn't have big names from the commercial world associated with the venture at the foundational level.

First, the product has to be diligently researched and developed, while the ROI on the

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[65] McKinsey & Company. *"Cutting through the Fintech Noise: Markers of Success, Imperatives for Banks."* December 2015. Last Accessed on 31/08/2017.

associated expenditures is unclear because there is little to no data yet to provide relevant market analyses.

Secondly, once the product is developed, it has to be actively and constantly explained to prospective buyers – who would rightly question its need since they've never utilized such a product to run their business before.

This step alone is far more onerous than appears at first glance, since large swathes of SMB markets across the world either eschew new technology because they lack proper understanding of it or are apprehensive of the ROI, or in many cases may even not be familiar with the necessary knowledge base and context of the problem in order to accurately assess whether a solution would work or not. This also drastically increases the burden of achievement on marketing and sales departments of such enterprises, which are generally starting new from the ground up and so are usually bereft of access to large-scale marketing practices.

To be clear, it's not that those businesses don't possess the capability to appreciate the problem or its solution – but being a pioneering product, it's more likely that the problem was accepted at face value as a given part of business cultures, and never explored deeper than that, at least not by a large segment of regular businesses.

Thirdly, since there is little to no prior data from live business environments, there exists no conclusive way for the product developer to create or manage expectations of returns on the use of the product. Putting that in context of the numerous priorities which businesses already have to balance within limited resources, it's entirely understandable why an SMB may be apprehensive of engaging products for which they can't at least somewhat predict the ROI beforehand.

Therefore, it's quite reasonable for businesses to then instead engage in what has become the current ideation of "disruption" and "innovation" in a large number of cases. The perfect example of this trend is highlighted in an article for the Financial Times by author Barney Jopson[66].

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[66] Barney Jopspn. *"The first-mover advantage myth"*. Financial Times. 6 March 2012. Last Accessed on

In this 2012 article, Jopson speaks of the $2 billion spent annually by Proctor & Gamble hypothesizing and analyzing new ways in which a "gooey liquid can be engineered, packaged, purchased, and applied in the daily routine of the average consumer," which are far "more varied than the average consumer has the time – or inclination – to care about."

The article continues to speak of the latest result in 2012 of those processes in "innovation" – a new, dissolvable, triple-chamber capsule of laundry detergent called the Tide Pod. The leadership of P&G then goes on to declare in a press preview in Ohio that this product is the biggest "disruption" in US laundry practices since the company's Tide liquid detergent in 1984. "It's been three decades since the lives of people in the laundry room were changed in a meaningful way," adds Alex Keith, P&G's general manager for fabric care.

Now, these statements are obviously marketing hyperbole, given than single-dose capsules were already in common use in Europe, and companies such as Henkel and Sun Products had already released their variant in US markets as well by the time of P&G's Tide Pod.

However, the article then goes on to ask another important question – does it really matter if they weren't the first to offer that product? Here's the thing: If true pioneering was an encouraged practice and was considered as an ideal worth pursuing, then it should have mattered. The fact of the matter remains, however, that it doesn't.

Current ideas of disruption and innovation instead range from versions of "re-inventing the wheel" and supporting it with PR hyperbole - as we saw with the P&G example - to figuring out products and services which may be created in niche cracks supported by the legislative framework in an industry, yet unaddressed or left un-serviced by other established enterprises in that field. In fact, pioneering is dreaded to the point where the business world at large has been actively debating the principle of the "first-mover advantage" since the 1990s and early 2000s.

Aside from a few businesses such as Amazon, which truly created a compelling, new

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31/08/2017. https://www.ft.com/content/6c65423a-63c5-11e1-8762-00144feabdc0 product and then built upon those successes with further innovation – it seems that the lion's share of money in the market frequently goes to firms dubbed "fast followers". Essentially, these represent entrepreneurial individuals and firms which use their advantage of being able to learn from the pioneer's experiences and mistakes to learn more about the current state of the market. That in itself represents an invaluable and often unconquerable disadvantage for the pioneering firm.

As Eric Schwartz, general manager of laundry care at Henkel US, puts it – "At the end of the day… it's about how close to what the consumer wants your offering is." By the very nature of their position, pioneers bear the brunt of the market's dissatisfaction with a new product, while fast followers can then capitalize upon the growing demand with a product that has been better tweaked for consumption using the first-mover's experiences.

Yet again, for those who may wonder about the relevance of this discussion in barriers to solutions for the late payment problem – it is crucial to establish and accept before any legislative discussion that we are absolutely *not* a global society which rewards most pioneering thoughts or solutions. Particularly since, given the current state of policy regarding the matter as well as the lawmakers' obvious familiarity with the issue, it seems as though governments are banking once again on private solutions to provide the answer. Increasingly, relevant policy influencers and crafters such as the Republican party in the United States are calling for regulation cuts for businesses across the board, in an already precarious legislative framework which has left large swathes of B2B transactions unregulated.

This is a cause for concern because as we saw in the breakup of current financial startups – a very small percentage of upcoming businesses actually even address such fundamental issues in cash flow regulation, with bulk of investments instead heading to startups providing greater access to credit. As we've seen in the last few pages alone, taking each entity on the merit of their individual priorities, neither governments nor private enterprises show any notable interest in addressing this problem. An important qualifier in that previous sentence is that the only way to justify the current situation is to evaluate the decisions made on individual stakes and paths to survivability and progress.

Policy-crafting by governments is by its very nature politicized beyond the needs of the people influenced by it. This isn't a critique, but rather a simple statement pointing out that unless governments choose to enact drastic measures regardless of fallout from larger businesses – like the UK government's current measures – government policy alone is unlikely to ever influence this problem significantly.

Similarly, as we noted in this discussion, the rewards for private enterprises to be the first to figure out such problems through technological solutions alone remains meager. Therefore, in a time where big business is banking on government to fix economic states to provide them with more opportunities for sound investments, while all business slowly winds downwards and consumer spending power deteriorates, and small business suffers under the slowing economy while battling for survival each time an invoice is paid late - wouldn't incentivizing the dismantling of those cash hoards, by simply increasing the rate of clearance of invoices and getting more cash flow once more through the system, work as an ideal stimulus package for the economic problems of all parties involved?

B] Progress Report 2017: Upgrading Toolkits For The Ongoing Battle Against Late B2B Payments

66% of US SMBs in Q2 2017 said they have faced working capital challenges in the three months during that period, as stated in a report released by Dun & Bradstreet[67] in collaboration with the Pepperdine Graziadio School of Business and Management. Although we do speak of 2015 & 2016, it's important to remember that this is an ongoing and worsening problem in many sectors of the global economy.

In this particular case, the figure above represents a 22% increase from its equivalent time period in Q2 2016, a drastic leap in the scale of the problem. Unsurprisingly, the report also points out that if the enterprise happens to be women- or minority-owned, they are even likelier to be suffering under it – with 72% of women-owned small businesses and 80% of minority-owned small businesses in US reporting the issue in Q2 2017.

Most worrisome for the bodies engaged in this report, the Q2 PCA Index results also represent the highest percentages of businesses suffering under this issue since its origin in 2012. This has also been the year with the highest reports of slowing accounts receivables impacting the ability for SMBs to grow, with 42% of small businesses now attesting the direct impact that late payments have had on their business expansions, as opposed to only 24% of enterprises in the medium-business size. As remarked above, women- and minority-owned small businesses yet again suffered a higher rate of attrition from this issue, with 47% of women-owned and 44% of minority-owned businesses reporting that their ability to grow was severely impeded by the late payment problem.

Similarly, a report released in the tail-end of 2016 by Ormsby Street, a data-analyst firm in the UK, stated that 9% of new small businesses closed shop *within* their first year of trading as of 2016. Moreover, just 4 in every 10 small businesses would survive to trade past

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[67] Dun & Bradstreet. *"Small Business Demand for Capital Has Hit A Four-Year High Despite Cautious Optimism for 2017."* PR Newswire. 14 December 2016. Last Accessed on 31/08/2017. http://www.prnewswire.com/news-releases/small-business-demand-for-capital-has-hit-a-four-year-high-despite-cautious-optimism-for-2017-300377516.html

their fifth year. Specifically, while information and communication-based businesses have had the highest new business survival rates after one year, businesses in the health and education sectors fared by far the best for longer-term survival.

According to the study, property-based businesses were one of the most likely to fail after one year of trading, but provided a much more comparatively stable option when looking at survival rates over five years. Accommodation and food services, and business administration were the two industries most likely to fail in the long term, with both types of business filling the bottom two places in terms of survivability after three, four, and five years.

While, as we've seen before, there are few economic markers – if any – suggesting the improvement of the late payment phenomenon despite governmental or free market efforts to resolve it – that doesn't mean there aren't ongoing developments in the field to combat this crisis in real-time, often in response to many of the factors we ourselves also discussed in the previous segments.

A notable example of this is H.R 2594[68], introduced to the United States Congress on May 23rd, 2017. Also known as the "Small Business Performance Act of 2017", this bill seeks to address the very discrepancies caused by the unique transactional nature of the construction industry, which as we discussed earlier felt ignored and un-served by existing legislation's one-size-fits-all approach to financing between suppliers and their clients.

Essentially, this Bill seeks to amend the Small Business Act to better protect small business construction contractors (SBCs) in circumstances involving unilateral changes presented to them by the contracting federal agency.

Specifically, this bill adds two clauses to the regulation of the finance flowing through construction projects funded at the top from federal agencies. The first part concerns the addition of an equitable adjustment, wherein any SMB performing a construction contract for a federal agency may request for an equitable adjustment if the contracting federal officer

[68] Kilpatrick Townsend & Stockton LLP, *"Small Business Payment for Performance Act Unanimously Leaves Committee - Will SBC Construction Contractors be able to reduce their financial exposure?"*. 22 June 2017. Last Accessed on 31/08/2017. https://www.lexology.com/library/detail.aspx?g=302422a3-070b-4db4-8f48-6c39ccaeac87

directs any change in the terms of the contract performance without the agreement of that SMB.

However, while that clause pertains specifically to the relationship between the US government and SMBs working on federal contracts, it is the fourth portion of this Act which bears more meaning for our discussions on B2B late payment – given the simple fact that the US federal government is roughly the only body already regulated for its late payments in that specific environment, with no laws existing solely for the regulation of transactions between businesses alone outside of contract precedents and its related law.

This particular segment dictates the flow-down of interim partial payment amounts, which as defined by the Act should be at least 50% of the estimated equitable adjustment request, when such a request is made after the changing of contract behavior by the federal agency. The clause specifies that any SMB requesting an equitable adjustment shall pay to a first tier supplier or subcontractor the portion of each interim partial payment received that can be attributed to the increased costs of performance incurred by the subcontractor or supplier due to the changes in the contract performance. Furthermore, it also creates a legislative duty for that first tier subcontractor or supplier to pay a subcontractor or supplier at "any tier" the appropriate portion of such payment.

The reasoning behind the necessity for such a move was to alleviate the burdens of small businesses which were often caught out without payments when contract behavior was changed, since federal agencies would delay approving higher compensation until the end of a project. This often meant that SMB supply chains would have to wait for full payment while the federal agency and the primary SMB contractor were negotiating the increased compensation.

While this Act may have come under sharp criticism for its exceedingly limited impact on the economy at large, we – as in the readers of this paper – may have a better understanding of background context to appreciate what it does for the current state of US industry. To begin with, while QuickPay and SupplierPay may have provided some measure of security for the SMBs and their supply chain engaged in contracts with the US federal government, we know from other sources that the former as well as latter had entirely failed the construction industry given its unique nature in financing and transactional practices. It is in order to specifically alleviate such problems that Rep. Brian Fitzpatrick introduced this bill, this practice in his words being known as "change orders".

This bill has also already received some acclaim from credible sources such as JD Supra, this publication in particular going on to specify that the "passage of this Bill into law would be a tremendous improvement for construction SBCs. While not perfect, it is a significant improvement over the status quo."

However, as we already know, legislation alone is but one part of this escalating war against the late payment phenomenon – with private market forces upping their technology game in order to keep shifting that erstwhile "status quo" to a more beneficial state for small business survivability.

Toolkits For Informed Choice

Key players in the financial technology arena continue to display the impact free market products can have on late payment, with Taulia for example having crossed the 1 million buyer-supplier relationship mark on their platform in Q3 2016, having transacted close to $30 billion across the platform between February 1st and July 31st of 2016 alone, and boasting of an impressive 100% customer retention rate since launching their platform in 2009. Since their founding, more than $250 billion worth of transactions have been undertaken through the Taulia Network. As per their own reports, between January to September 2016 alone, they have provided more than $1.4 billion in *early* payments offered to suppliers.

Since then, Taulia has gone on to further expand their penetration into the SMB markets through tie-ups with firms such as Hanse Orga to provide greater analytics to their platform users, as well with other tech giants such as Exostar to even provide their Supply Chain Finance offerings now to the Aerospace and Defense industry as well.

In response to their partnership, Doug Russell, Exostar's Vice President of Supply Chain Solutions remarked that while "77% of suppliers [in Aerospace and Defense] say they want to be paid within 30 days, in reality, only 27% are. At the same time, 70% of suppliers indicate they would be willing to pay a small fee in order to accelerate invoice payment."[69]

The appetite for similar advancements in the base technologies of such companies is also apparent for example in the case of Previse, a fintech start-up which just announced the successful completion of a seed funding round worth £2 million for the development of their proprietary artificial intelligence (AI) solution designed to improve instant payments between large corporate clients and their SMB supply chain.

According to Finextra, a UK-based Fintech news publication, 3 out of 5 small suppliers in the UK are paid late by their larger clients, forcing many small businesses to take out expensive, short term credit from banks to cover their cash flow difficulties, thus driving up the price of their products as they're forced to push excessive overhead costs onto clients in a competitive environment. Within the United Kingdom alone, according to the source, roughly 50,000 SMBs go bankrupt as a result of late payments each year.

Previse[70], co-founded by CEO Paul Christensen (formerly Global Co-head of Goldman Sachs' Principal Strategic Investments team), uses a proprietary AI algorithm to sift through "hundreds of millions of data points to score the likelihood that a corporate buyer will ultimately pay a supplier's invoice." This score is then provided to funders, mainly banks and asset managers, who then pay their supplier instantly on the buyer's behalf. In exchange, suppliers offer a small discount on their invoices. Essentially, by improving their risk analysis, Previse hopes to open and secure more sources for money to flow more freely in the economy and re-invigorate the cash flow at the smaller business level.

Elsewhere, e-invoicing cloud-native giant Tradeshift as well announced a partnership in Q1 2017 with SME lender platform Biz2Credit. Even as Rohit Arora, CEO of Biz2Credit, explains their partnership – the digital financial data compiled through the invoices transacting across the Tradeshift platform is key for them to better utilize and maximize the access to capital which their own products offer.

[69] *"Exostar Partners with Taulia to Deliver Supply Chain Finance Solution to Aerospace and Defense Industry",* Exostar. 30 November 2016. Last Accessed on 31/08/2017. https://www.exostar.com/press/exostar-partners-taulia-deliver-supply-chain-finance-solution-aerospace-defense-industry/

[70] *"Previse to give AI Tools to Tackle Late B2B Payments,"* Fintech Finance. Last Accessed on 31/08/2017. http://www.fintech.finance/01-news/previse-to-give-ai-tools-to-tackle-late-b2b-payments/

As backed up by Maxim Rokhline, Tradeshift SVP of Financial Services, the biggest current problem faced by SMEs is a knowledge gap as to the state of their options for payments or financing, or even the cost of capital. Unfortunately, as he continues to explain, even the option to acquire said knowledge for smaller businesses is extremely limited, much less their ability to then plan out their options in a way to increase their survivability.

Similar to Previse's attempt to maximize upon available data on buyers from various sources, Biz2Credit and Tradeshift aim to use their pooled data for "contextual" financing where businesses can be viewed on a case-by-case basis, rather than use industry-level risk assessments to provide immediate cash flow relief or even better credit options for the smaller suppliers in place of the larger buyers.

"It's not just about getting credit," as Arora further explains. "It's also a question of having access to that level of data analytics typically not available to the SME customer that they need to get better in what they're doing, into their cash flow problems."[71]

That statement in particular is quite reflective of the efforts of top businesses hoping to alleviate late payment pressures from the backs of SMBs. Increasingly, the focus is shifting from the big businesses themselves to allowing small businesses access to the *data* that would help them make a better informed decision about their working capital needs and handling of clients in the near future.

While the efforts of FinTech companies in this regard may be relatively recent however, the admission of importance of suppliers having relevant knowledge about their customers is not. As far back as 2015, the UK government had released reports stating that smaller suppliers that regularly just credit-checked their clients beforehand were as much as 30% more likely to survive their first 5 years of trading than SMBs that did no credit checks on clients.

Keeping in mind that only 40% of SMBs altogether currently survive to keep their doors open past their fifth year, this conclusion from the UK government as well as the

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[71] *"The Power of Invoice Data,"* PYMNTS. 17 February 2017. Last Accessed on 31/08/2017. http://www.pymnts.com/news/b2b-payments/2017/tradeshift-biz2credit-sme-small-business-supplier-finance-invoice-lending-alternative-data-analytics-late-payments/

efforts currently underway in FinTech startups engaged in this area point to what may be the most important factor in SMBs being able to manage and plan their cash flow better – their ability to make an *informed* choice with regards to their client.

As individual consumers, we have witnessed in the last two decades the uprising of some of the greatest revolutions in consumer experience. The sheer amount of data available for comparison for a savvy consumer today is overwhelming, the minutest details about similar products from different companies available for us to make an informed choice as to what may best suit our needs. This mantra is now so deeply entrenched in our current modern economy that for a company to not fully disclose their product's strengths and weaknesses have only ever led to negative optics for both the firm as well as the product.

Yet, when we switch hats from consumers to small business operators, that same ability to make an informed decision regarding our own clients is severely limited. However, now more than ever, SMBs need the necessary data to make better choices in buyers.

In 2015, the International Association for Contract and Commercial Management conducted a study, which they released under the entirely self-explanatory title "Payment Terms: Do Large Companies Abuse Their Power?"

This report clearly stated that roughly 70% of companies had adjusted their standard payment terms in the last 2 years[72]. Notably, it pointed out that 18% of all major corporations (in 2015) paid their suppliers in 90+ days, with only 14% of companies with over $40 billion annual revenue however admitting to this practice. Importantly, for SMBs, 51% of the survey's small business respondents stated that negotiation of payment terms was increasingly becoming a more contentious practice.

As per the results of the study by the IACCM, more than 40% of companies had increased their payment terms to longer periods on the buyer side, with another 15-20% of companies having changed their "triggers" for invoice receipt and payment altogether. Where the "trigger" for invoicing and payment in US was once generally accepted as the moment of

[72] *"Payment Terms: Do Large Companies Abuse Their Power?"*, International Association for Contract & Commercial Management, Page 2 (2015). Last Accessed on 31/08/2017. http://cdn2.hubspot.net/hubfs/483419/Free_Resources/Payment_Terms_Survey.pdf

"shipping", these companies are now changing those triggers to receipt and acknowledgement of goods in order to allow themselves more time without changing net payment terms.

However, the most important conclusion in my estimation within this study was its inference on the largest determining factor behind what influenced these changes in payment terms. According to the IACCM, the geography or market sector of an SMB were much less relevant in terms of them being pushed for longer payment terms than just their base negotiation power.

59% of SMB respondents agreed that their exposure to longer payment terms was a result of gross imbalance in their negotiating power, with 43% saying that it was simply the "nature of the relationship". These statements may seem a bit abstruse, however the contention and reason for extensive negotiations become apparent when simply comparing the standard position of buyers versus sellers, with 67% of suppliers still attempting to operate on 30 day terms. However, many of these SMBs also do not expect to be able to work on shorter payment terms for any extended length of time in the coming future, with many anticipating increasing pushes for even longer terms.

This attitude is borne out in other publications as well. For example, an article on the rise of fintech in supply chains in the Harvard Business Review published in 2016 ends thusly – "traditionally, supply chain management has been about sourcing, making, and delivering. Now it's about 'funding' – using the supply chain as a source of inexpensive capital."[73] However, having parsed through the economic data we have in previous segments, it's abundantly clear that these sources of capital are anything but inexpensive – at least for the SMBs in the supply chain, as well as the economy at large.

This is why, now more than ever, it's increasingly vital that SMBs be provided with the *ability* to make an informed choice as to their buyers. This can largely be done through the efforts of companies such as the ones discussed above in making those analytics available to the small business owner, but that too just covers one aspect of this information blackout between small business owners and their cash flow variables. The other aspect of this – the

[73] Dale Rogers, Rudolf Leuschner, and Thomas Y. Choi. *"The Rise of Fintech in Supply Chains,"* Harvard Business Review. June 22 2016. Last Accessed on 31/08/2017. https://hbr.org/2016/06/the-rise-of-fintech-in-supply-chains

reliability of the buyer themselves – can however only be resolved through legislation, UK's current Payment practice reporting "Duty To Report" (DTR) being a prime example of governments coming to the same conclusion as well.

While FinTechs have been lauded in their overwhelming contributions to allowing SMBs to steamline their monetary processes, and reduce costs through increased efficiency and productivity – all of those benefits can be largely neutralized in a single go when buyers then push them to operate on a 90-day payment term instead of the preferred 30.

Thus, in an ever-expanding toolkit for SMBs to be able to better combat the late payment problem, their ability to understand the payment practices of their buyer is unsurprisingly becoming the most important one in its absence.

Among the hundreds of the largest buyers across the planet facing increasing enormous scrutiny into their payment practices, the current public plight of e-tailer giant Amazon and its small business suppliers would possibly fit the bill best to describe this situation. In 2013, non-profit firm MusicBrainz had sent a cake to Amazon's finance department to celebrate the three-year mark of an unpaid invoice. The story had gone viral at the time, giving a glimpse into the challenges faced by small suppliers when trying to get paid on time by their large, corporate buyers.

From that incident onwards, more suppliers were slowly encouraged to speak up as well, leading to a rising tide of public and business backlash against the corporate behemoth. In 2016, the managing director of IT distributor Smithie UK, Steve Riordan, spoke out publicly as well about the state of vendors that have yet to see full payment on invoices billed to Amazon.

"Everybody is scared [of speaking up], but I don't care what anybody thinks anymore," the executive had said in an interview with PCR. "Why are these people getting away with it? In the industry, there are millions of pounds sitting on people's balance sheets that Amazon won't pay."[74]

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[74] *"Amazon Suppliers Divided On How To Tackle Late Payments,"* PYMNTS. 7 June 2016. Last Accessed on 31/08/2017. http://www.pymnts.com/news/b2b-payments/2016/amazon-late-supplier-payments-invoice/

These reports, stretching back years, allowed others the ability to make that all-important informed choice. As suppliers started dropping Amazon as a buyer, many even gave anonymous interviews to news publications in order to make their stance of oppressive payment terms clearer.

"Maybe Amazon thought it was too big to be challenged by distributors or that they could bully their way through this," one anonymous vendor had reported to PCR. Another had simply stated that they "saw the writing on the wall much earlier than some of my competitors, who have clearly been burnt. The only way to get something like this fixed is through legal action." Clearly, the UK government had concurred with that assessment, leading to their pioneering PPR legislation.

Mike Cherry, National Chairman of UK's Federation of Small Business remarked in December 2016 that "Tackling late payments is now a key part of the Government's corporate governance agenda. The comprehensive and regular Duty to Report is the first step to combat a business culture that feels like one where it is OK to pay small firms late. It is not OK – we estimate that 50,000 business deaths[75] could be avoided every year, if only payments were made promptly – adding £2.5 billion to the UK economy."

Adam Smith, considered by many to be the father of Free Market philosophies, argued above all else for a market where "Free exchange" should be created, whether in terms of goods, services, or information, as both sides trading become better off. Considering the success of the Free Market theories, these inferences can hardly be questioned anymore.

However, most notably, while there does exist a relatively free exchange of goods and services today, information on the other hand is extremely one-sided in its flow. Since the larger clients hold the money and have no information of their payment practices revealed in public forums, they have held on to all the negotiating leverage without any accountability – leading to an unparalleled state of control over the actions of their supply chain.

While there exist anti-monopoly laws to prevent any organization or individuals from

[75] *"Boost to small businesses as payment reporting rules unveiled for large firms," Gov.uk. 2 December 2016. Last Accessed on 31/08/2017.* *https://www.gov.uk/government/news/boost-to-small-businesses-as-payment-reporting-rules-unveiled-for-large-firms*

gaining the lion's share of the market in collusion in terms of infrastructure, goods, or services, there have been no such laws enacted to correct the monopoly of information – and this monopoly clearly exists wherever you look at buyer-supplier relationships. Since the largest corporate buyers are inherently B2C enterprises, they have all the information regarding their revenue streams from consumer data, ranging in its breadth from purchasing habits to payment behavior acquired through credit checks or banking information, and now maybe even their internet browsing histories.

Yet, no such information exists for the smaller B2B suppliers who would like to better understand the practices of their potential buyers. The UK on the other hand seems to believe this such a vital imbalance to correct that beyond their PPR laws, they have also recently introduced the position of the Small Business Commissioner – the position described as a "late payments tsar" aimed at identifying late payers and correcting the issue.

While other countries may yet be far behind in terms of any similar Duties to Report, however, US regulatory bodies do seem to be gaining a stronger appreciation for the toolkits that FinTech enterprises provide to their small businesses in terms of survivability – with the Office of the Comptroller of the Currency's current proposal to give FinTechs a federal charter for business in the US.

Time and again, we've noted the difference it makes in the survival of small enterprises when they gain the information to deal with larger buyers on equal negotiating grounds. Without exaggeration, fixing this lack of data in the toolkit of SMBs is and should remain an endeavor of the highest priority.

As long as the dynamics of the relationship between buyers and suppliers remain skewed and unbalanced in favor of one, there will always remain exploitation of the leverage for personal gain, which as we see now is impacting entire economies stemming from the imbalance in *every* buyer-seller transaction or interaction at the micro-level.

While some continue to argue that the quality and competitive pricing of a product is what separates a good small business from a bankrupt one, the fact of the matter remains that with the sheer number of small businesses within the same area and industry, stringent quality control and ultra-competitive pricing with smaller margins are now the most minimal requirements needed to be met by a business to even play the field.

These metrics have largely been maximized in these saturated markets, with further evolutions moving these markers forward by inches, not miles. This is why in today's age data and information have literally replaced all other products at the top of the business food chain. With the money in the hands of the buyer, information is and will remain the only way a smaller supplier can equalize their advantages at par with the larger corporates.

One prime example for this is Brazil's own payment practices which have now started deteriorating as of 2016 by as much as 3% higher late payments in a single year. While Brazil had initially somewhat resisted the increasing march of late payments faced by SMBs in US or UK through marrying technological innovation in their legislation to speed up the nation's best corporate payment practices, those advantages as well are slowly being nullified in this era of one-sided information exchange as can be inference from the worsening statistics.

More importantly, a supplier-side data source on buyers may also help stem the relative "monkey-see-monkey-do" behavior coming out of the smaller competitors at the largest corporate levels as well. As a 2016 Siemens report puts it, one large company in 2013 justified extending its payments terms in the UK to 120 days with the statement :"Extending our payment terms allows us to better align with industry and make sure we compete on fair grounds, while simultaneously improving transparency and predictability of payment processes."[76]

As the report infers, this suggests that since a few large companies started the ball rolling, others have been following suit. Yet, here's the problem. Without Payment Practice data from buyers, there's no way to entirely verify how much of an industry standard these extended payment terms have become, and rob suppliers the chance to build more stable transactional bonds with those larger buyers who prioritize supply chain relationships over longer payment terms.

In the end, yes, money matters – and so access to capital will always be an important

[76] Rupal Parekh. *"Adland's Fears Realized: Mondelez Piggybacks on P&G Payment Terms,"* AdvertisingAge. May 17 2013. Last Accessed on 31/08/2017. http://adage.com/article/agency-news/mondelez-piggybacks-p-g-s-extended-payment-terms/241546/

factor for business growth and survivability. However, backed up by the right information, we may then see a shift in that *need* for capital from simply to maintain the status quo and treading water, to using it for true growth and expansion instead.

Improving Banking Toolkits for SMBs

While the dearth of information for savvy suppliers remains one of the largest problems in need of correction today, it would be inaccurate to blame the entirety of the problem of late payment on that factor alone.

In every Atradius report and other relevant study we perused, the complexities and inefficiency of the current banking systems in place have essentially retained a high place on the list of contributing factors to late payment, usually right after buyers' behavior on that list. This was cited by as many as 44% of SMB suppliers in India in 2016, 25% of SMBs in the Americas in that same year, and 35.7% of the same in Great Britain in 2017.

Even 33% of SMBs in Japan remarked the same complexity of banking and payment systems as a major factor in late paid invoices, given emphasis to the point that it was the opening line of the 2016 Atradius Payment Practices report for that nation. Chinese SMBs concurred with this as well, with 24% of surveyed suppliers in 2016 citing it as a primary cause for late payment, up from 19% of SMBs who'd attributed the same in 2015.

Thus, clearly, this is an ever-present obstacle to swift trade, and banking and other related institutions seem to be listening to the average small business now over these woes. SWIFT's global payments innovation initiative[77], or SWIFT gpi, which went live in early 2017 has already grown to include over 110 international banking institutions and as of June 2017 even includes members such as INTL FCStone's Global Payments Division within its efforts to speed up easy and secure international payments.

Similarly, in June 2017, Starling Bank – a mobile-only bank operating in the UK and the first to launch a current account – joined the Faster Payments scheme by partnering with

[77] *"INTL FCStone Boosts Non-Bank Participation In SWIFT GPI,"* PYMNTS.com. June 12 2017. Last Accessed on 31/08/2017. http://www.pymnts.com/news/b2b-payments/2017/intl-fcstone-boosts-non-bank-participation-in-swift-gpi/

payments-as-a-service enterprise Form3 to provide real-time payments for clients, signifying a clear shift in emphasis on not just providing a banking service to companies, but more importantly a faster, simpler one that reduces the knowledge or skill barriers to entry around using it.

Also in June 2017 came the launch of Mastercard B2B Hub, a platform solution launched by Mastercard to make it easier for small businesses to invoice and process payments. This Hub also includes an online payment automation tool and access to analytics as well to improve the speed and ease of commercial payments made through Mastercard.

"Midmarket and small businesses are growth engines of our economy. The Mastercard B2B Hub is the latest way we are working to meet the broader payment needs of this segment," remarks Colleen Taylor, executive VP of new payments business for Mastercard. "We see this solution as helping organizations maximize every minute and every dollar that they invest in their business. The comprehensive automated payment experience we deliver will help improve supplier relationships and accelerate the conversion of B2B payments from paper checks to electronic payments."

In order to make this Hub's promises a reality, Mastercard[78] has also announced a partnership with AvidXchange as their execution partner in US, in order to extend these services to an industry which, according to Michael Praeger – CEO of AvidXchange – is an underserved segment of over 350,000 businesses strong in the United States alone.

These efforts show that, even though a significant portion of resources are still invested every day into managing the symptoms of late payment and trade credit, recognition that there are easy solutions to resolve the root causes isn't a unique position adopted by this paper. Many troubles faced by SMBs when it comes to getting paid on time can largely be resolved through the adoption of best practices for operations and technological integration, and the problem yet remains that most small businesses will not use these solutions even when they are available for free use.

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[78] Jen Ittenbach. *"AvidXchange Announces Strategic Partnership with Mastercard"* AvidXchange. June 8 2017. Last Accessed on 31/08/2017. https://www.avidxchange.com/news/avidxchange-announces-strategic-partnership-with-mastercard/

7. POLICY RECOMMENDATIONS

A] Basic Policy Framework

Before we discuss possible policy recommendations and their integration with private market solutions in order to create a comprehensive late-payment protection infrastructure, we need to first define the end-game goals for such an endeavor by consolidating the various lessons learnt from the shortcomings of current protections as well as the insight gleaned through our study of the nature of late payment itself.

While theory may suggest that an ideal "end-game" to aim for includes eradication of late payment outside of agreed protracted payment terms, this is an impractical business ideal particularly since late payment will continue to hold some appeal to both buyers and sellers. As such, any practical recommendations must account for the continued existence of late payments to certain degrees and must focus on safeguarding sellers from dominant buyers, enhancing transparency in the process, and making such information as is relevant available for public consumption where appropriate.

To serve as an adequate guideline, the ACCA has put forth 9 conditions[79] which must be met in normative business practices to make trade credit a sustainable business practice while minimizing its negative fallout on individual businesses as well as the economy at large.

1. Buyers' and sellers' standard terms of credit should be transparent;

2. Cash flows to suppliers and sellers should be predictable through explicit credit policies and contract terms;

3. Invoicing, collections, accounts payable and invoice dispute processes should be efficient and transparent, with senior staff taking responsibility;

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[79] Schizas, *Ending Late Payment Part 3*, 8.

4. The status of invoices should be easily monitored throughout their lifetime;

5. Sellers should be aware of the cost of providing credit to customers;

6. Differentiated pricing should reflect the sellers' cost of capital, so that neither they nor their prompt-paying customers are forced to subsidize late payers in the long term;

7. Buyers and sellers should give each other adequate notice before seeking new terms of credit, so that alternative financing can be sought in time;

8. Sellers should practically seek to understand, and buyers should be honest about, the causes of late payment and the viability of late-paying customers;

9. Payment plans should be set out explicitly in contract terms and genuinely troubled customers should opt for these rather than resorting to late payment.

B] Policy Recommendations & Breakdown

While the lessons we've learnt so far from our studies of global markets as well as that of private solutions are vast and inter-connected, they can be broken down into the need to resolve three main areas of concern: Transparency, Infrastructure, and Legislation.

As such, I will also endeavor to break down the policy recommendations required to start correcting the current veering of market forces towards rampant trade credit across those three segments. It should be kept in mind that this format of presentation is to ease understanding and clarify the pressure points on which any policy hopes to act, though several of these policies across all three segments will rightly be far more interconnected than their separation underneath suggests.

Technological Infrastructure

Small businesses in the 21st century have famously been lagging far behind their larger counterparts, when it comes to keeping pace with technological advancements. Companies such as Intuit, when entering a new market and attempting to understand customer behavior in the SMB segment when it came to resistance to technology, attributed the reticence largely to - lack of knowledge regarding operation or return on use of technology, apprehension regarding credibility of tech, and some level of concern regarding the safety of their data in the digital age.

Now, while these are all valid concerns, Intuit had also unearthed in their 2012 MSME White Paper that as many as 30% of the surveyed SMBs in a market such as India were quite satisfied with operating their businesses through manual methods without any automation. Here's the problem with that. As per data from the World Bank, these businesses are foregoing the 750% growth in business and the 113%[80] in profitability which their competitors would enjoy if they integrated Information and Communication Tools into their operational processes.

Increasingly, we do see a need for government to establish at least a standard for certain minimal best practices and procedures in order to alleviate many of the problems we currently see. Most delays in the payment process don't occur due to nefarious conspiracies by clients, but rather a significant portion among them may also be blamed on clerical errors from the seller's end. These problems, and many more, can be mitigated by the government laying the groundwork for some of the technological benchmarks of business operations for smaller and larger enterprises today.

Policy Recommendation 1: The government needs to create and provide an e-invoicing platform, and make e-invoicing through that platform as mandatory for all businesses above a certain level of operations. Additionally, the government can also structure the system akin to the shareable Application Programming Interface (API) of the Unified Payments Interface system in India, which would allow other third-party service providers the ability to build their platform on top of the API while distinguishing themselves using value-added services. All transactional data from the platform will strictly only be shared with the Tax Revenue service of the nation, the sender of the invoice, and its recipient.

Advantage: Such a platform from the government would provide credibility to the high return granted by use of ICTs, and would grant the government in turn with greater visibility into B2B transactions. While it would improve recoupment of taxes owed for the government, for the businesses using the free e-invoicing platform would gain freedom from several common errors while providing a government-certified document verifying the date of invoicing. Most importantly, it would create a minimal benchmark for use of ICTs in business processes.

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[80] Sajda Qureshi. *"As the global divide narrows, who is being left behind?"* in Information Technology for Development, Vol. 18, No. 4. October 2012. Last Accessed on 31/08/2017. http://www.tandfonline.com/doi/full/10.1080/02681102.2012.730656?scroll=top&needAccess=true

Policy Recommendation 2: The government has to start a technological certification grade for companies, similar to the fashion in which ISO stands as a quality certification grade. The grading will be dependent on the percentage and relevance of operational processes in a business which have been switched to automated tools, where appropriate, in order to separate technologically advanced companies from those still reliant on manual processes. This also includes whether a company utilizes digital payment services, or handles payments using checks and cash.

Each grade of technological certification can be accompanied with a reward of a fixed amount of tax credits accessible per grade, the calculation of which is separated from the cost of reaching said grade, for the next 5 years or a time line deemed appropriate by legislators in order to incentivize existing businesses to improve their efficiency through ICTs.

Advantage: This certification grade will acknowledge the indubitable importance of technological integration into business processes. It will serve as an easy identifier of companies with higher operational efficiency and productivity. The grade, since it is officially granted, can also be submitted to risk assessors for faster access to credit. The creation of this grade, and the tax credits accompanying it, would be great impetus for companies to use the free e-invoicing platform we spoke of above.

The minimal benchmark for digital operations that this would no doubt create would also go a long way in protecting businesses from ransomware attacks like those in Q1 2017 - where the patch from Microsoft to address the exploited vulnerability was released 60 days before the attack, but studies show that companies in US take on average 100 days to address such digital updates.

Policy Recommendation 3: The mandatory e-invoicing platform should also include extra features such as Dynamic Discounting and access to basic Accounts Receivables Management tools or plugins. Unlike the e-invoicing feature, while these will be paid services, the payment taken by the platform can be kept minimal - enough to allow the platform to sustain its own operational and maintenance costs without increasing the taxpayers' burden.

Advantage: For the government, which is already gaining access to tax-relevant data, this offers a chance to convert the entire operation into a self-funding unit. It would also work effectively as a strong pro-business stance from the government, since whatever the cost it would still be exponentially cheaper than the alternative ways for smaller businesses to gain access to the same advantages.

Policy Recommendation 4: The government needs to create a Small Business Technological Tookit Academy, which will essentially be an online resource library with information pertaining to the various ICTs, financial tools, and other productivity and efficiency services which are available to their segments today, as well as data on the various benefits of using such tools as small businesses.

In addition to this program, the government can also appoint a Small Business Technology Ambassador, as nations do appoint well-known faces to spearhead awareness campaigns for issues affecting the general populace. The ambassador can partner with other members of the business community, as well as coordinate with partially or wholly government-funded educational institutions, in order to provide seminars on use of technology for small business owners. These can even be offered as special vocational degrees or diplomas, in order to incentivize the uptake of technology in conjunction with the grade certification we mentioned above.

Advantage: While every world leader agrees to the importance of smaller businesses keeping step with technological advancements, few governments have ever offered practical solutions to increase the integration of digital tools in commerce. With an offer of tax credits for time and resources invested by for-profit organizations to educate smaller businesses in better technological integration in partnership with the Small Business Ambassador, it may provide a functional way for larger businesses to invest in the improvement of their smaller counterparts, thus dismantling part of the hoard to get more cash flow while providing them with an estimate of tangible benefits through tax credits beforehand in order to incentivize such a decision. For small businesses, this impetus from the government in conjunction with the technological certification grade would create momentum towards increasing integration of ICTs at the grassroots level.

Compensatory & Mediatory Legislation

While this could potentially be a vast segment in its own right, in these policy recommendations we aim to offer the smaller changes and tweaks needed in existing systems for maximum effect in line with our intended results. This policy recommendation section will also not discuss the need for expansion of judicial candidates in nations to allow for more judges who can shoulder the case burden and help reduce the time taken in each country to resolve a case from start to finish, since that is a systemic problem which yet again traverses too many other complex territories of conversation.

Policy Recommendation 5: Electronic clearing services (ECS) in many prominent lesser or greater developed nations fall under the jurisdiction of the nation's primary financial regulator, such as the RBI in India. Since these services are usually set up for auto-deductions, and these regulators have the authority to oversee payment defaults to a degree, the government can empower such primary financial bodies to enact implementations for auto-charging of interest. The regulatory bodies can also consider suspension of activities for a period of 1 or 2 years, as legislators see fit, for regular defaulters on B2B payments.

Advantage: Experts suggest that the use of ECS is on the rise, and is expected to overtake the use of checks, cash, and other such instruments in the next few years in markets such as the United States. While we may not be able to entirely reproduce the iron-fisted efficacy of the same system in Japan, that may be a good thing owing to fundamental cultural differences. Enactment of this policy would provide more out-of-court consequences to defaulting on payments.

When considered in conjunction with the technological certification we spoke of before, suspension leading to down-grades coupled with the equivalent loss of accessible tax credits would provide more incentive for larger companies to honor their payment agreements. The enforcement of auto-interests, considering that the government may already have access to the relevant information to know when such interest may be applicable due to the e-invoicing platforms, would relieve significant burden on the judicial process from straightforward cases of late payment where only the exchange of appropriate penalty is to take place.

Policy Recommendation 6: Legislation needs to once and for all differentiate between the three levels of enterprise, and it needs to couch within its legal language the course of mediation available to each tier of business regardless of contract clauses.

Advantages: Most nations' legislature already does differentiate between the three different tiers of business, and has some form of small business mediation councils in order to provide out-of-court settlement for aggrieved smaller businesses. However, even though these councils were created in recognition of the skewed power dynamic between larger clients and smaller suppliers, most nations also hold contract law above any such distinction, thus rendering any legal protections redundant. Without legal differentiation available for paths of mediation accessible by different types of business for example, situations play out the way they currently stand in India - where an exclusive jurisdiction clause in a contract then prevents an SMB from approaching the Micro and Small Enterprise Facilitation Councils for legal remedies.

Since larger clients usually push suppliers into standard contracts, all of which will include exclusive jurisdiction processes, gambling the right to access this system without accounting for the imbalanced power dynamic between both parties is a risky endeavor. Empowering SMBs to access such out-of-court mediation processes more swiftly will also relieve some of the current burden on the main judicial processes, while improving the efficiency of the judicial system by allowing jurors with expertise at certain levels of enterprise to be placed on cases relevant to those business tiers.

Policy Recommendation 7: In late payment legislation, the count for the net term and due date of payment must be started from the point of confirmed receipt of goods and services, rather than the confirmed date of receipt of invoice, assuming that they send the invoice within the next working week to the client. The latter, which is currently the norm, is heavily exploited through simple measures such as denying any receipt of invoice. Conversely, if clients were to refuse to provide confirmed receipt of goods and services, it would provide suppliers the option to simply retract those items, rather than have money tied up with client enterprises who refuse to pay on time.

Advantage: The current system, in attempting to protect the buyer from being forced to pay for substandard goods, has veered too far to the other side in its language. While it may be a minor exploit, denial of receipt of invoice to prevent start of due payment count from being triggered is used often and with ease to make smaller suppliers wait for weeks and months for money which was realistically owed a month before for example, but which has only just entered the due count phase of net 30 or 60 due to such loopholes.

Eventually, what was supposed to be a payment received at least 60 days within the final delivery of goods and services turns out to be paid 120 days later, because the client did not even admit to have received the invoice for 40 days and yet paid late nonetheless at the tail end of the transaction. This will be a small step in correcting such inadequacies in the current systems of protection for SMBs.

<u>Policy Recommendation 8:</u> The government needs to create an exploratory high-level body with the authority to either create bills to be submitted to the houses of legislation, or limited authority to work with regulatory bodies to create corrective measures for market forces. As with current bodies of the nature, it will consist of directorial level personnel from industry related govt departments as well as recognized leaders from the business world at medium and large levels of enterprise.

The only cases presented to this body will be high-level market force imbalances perceived by businesses as an aggregate, and so should require a large number of signatories on that same case in order to even be presented to this body – the minimum number of signatories being decided by legislators, similar to how UK and US currently have petition sites for individuals, which guarantee a response from the highest levels of authority should the petition cross a certain number of signatories. This existence of this body is not required to impose extra regulations on business, but in order to correct market forces faster than the current trends.

Advantage: The current rate of technological change far outpaces the rate at which legislation can keep up with it. In its present state, there is a deep divide between small business and the government officials sitting in positions to be able to change what such businesses perceive as gross imbalances in the system. Given the proposed conditions for cases to be presented in front of this body, its biggest purpose is providing grassroots business a direct pipeline as a collective entity to talk about large-scale systemic issues with regulatory bodies in a direct position to alleviate their troubles.

This will allow government to be better informed of the impact of their various policies and well as prominent market forces, and imbue more flexibility upon the regulatory system to allow for faster responses to market developments than the current half-decade to decade on average which it takes for a problem affecting smaller businesses to appear and for the legislative branch to even acknowledge it.

Enhancement of Transparency

We shall not expound upon the need for greater transparency between buyers and sellers in this segment, having done so already in other parts of this paper and having answered the question of benefits to small businesses with access to more relevant operational data from potential clients as well.

Policy Recommendation 9: With an addendum to the usage of data gathered through the e-invoicing platform at the national tax revenue services, the government needs to create a voluntary Prompt Payment Code pledge program. Access to the program will be granted through request submitted from the business' end, and will amend the way in which their data from the e-invoicing platform spoken above is used. The PPC program set up herein will be a grade certification program, and will espouse the fastest industry payment terms as their benchmark standard.

Companies applying to participate in this program will have to accept the use of their transactional data being used to gauge the grade, but higher grades can be granted tax credits as determined by legislators in order to incentivize faster payments in their business culture. The companies will be graded from rank I to V, in descending order of competency of payment practices, and each grade shall be accompanied with its own certification logo that companies can use in their literature as a symbol of success. Each grade shall also be accompanied with their own number of tax credits as reward, perhaps restricted to the top two grades to incentivize better payment practices in exchange for tax credits.

No payment practices need be made public in this manner, since the government will already have the required data through the e-invoicing platform and need use it in their internal affairs to gauge grading without publishing the payment practice figures themselves. This should assuage some fears of sharing this data, and the relevant information for potential suppliers will be understandable through the PPC grade of potential clients almost as well as the exact figures anyway.

However, the worst offenders among these - perhaps even if they haven't applied to the PPC program - should be compiled and displayed in a separate blacklist in order to incentivize businesses from falling within those failing margins of payment practices with their supply chain. Even without any associated penalties or fines levied for a company being graded at V, the presence of a publicly disclosed list of worst offenders will be a powerful driving force in its own right.

Advantages: The fact remains that there exist companies that wish to pay their dues in time to their supply chain, and manage to do so on most invoices. The presence of a payment certification grade rewards such firms by allowing them to brandish the recognition of their government for their ethical payment practices. It can also serve as additional certification accepted by financial institutions and risk assessors in order to gain faster access to credit. The presence of a universally understood grade system with known tiers of required performance would immensely simplify the ability for an SMB supplier to tell with a single glance whether or not to accept a particular enterprise as a client.

8. Conclusion

The sentence that a majority of businesses in the world are suffering under the weight of runaway trade credit and there are few to no protections for SMBs in such situations isn’t a hyperbolic one - by this point, we know it to be an undeniable fact.

This dearth of protections has now become a costly affair. Consider this - we already know that the value received from every dollar increases by 10% for every 15 days it is paid early. Therefore, the converse must also hold true to an extent and hence for every 15 days paid later, we are technically also losing 10% worth of value on each dollar.

Logically, that makes sense as operational costs associated with recovering that overdue account of receivables also increase, thus slowly eating into your profit as an SMB. Moreover, the lack of healthy cash flow mean that paychecks and bonuses even to employees may sometimes become erratic owing to necessity. While the associated drop in morale and productivity for every 15 days a major account is paid late is harder to quantify in terms of cost, one nonetheless might exist in good probability.

Now keeping in mind the sheer volume of businesses which go through such troubles every day, that’s a lot of businesses losing 10% values on a lot of dollars. As I said, this has now become a costly affair, robbing the economy of not just its rightful growth in so much trade already going on through credit, but even slowly eroding its ability to just maintain the jobs it does have.

Whatever policies are implemented in such a situation can no longer afford to be meaningless placatory symbols. The purpose behind this paper was not just to drive home the importance of public policy being practically applicable, but also to bring attention to the three primary pillars requiring work - Transparency, Infrastucture, and Legislation. Correcting these basic points of interaction in the life of a small business alone would resolve most problems associated with late payments as a whole, and balance the status quo into a more fair standing between larger clients and their smaller B2B suppliers.

Lastly, this paper was also created in the hope that it will provide others with some starting points to delve deeper into the study of late B2B payments, and their impact on the economy. As such, I must emphasize - while the current efforts dedicated to increasing access to credit for SMBs is admirable, we are also chaining our SMBs to a future where maintenance of a business alone will require every financial resource an SMB may have at hand, instead of a business with a great product and competent management being able to thrive through access to extra finances. All of this, just by virtue of ignoring the root causes themselves.

The problem of late payment may be intertwined with several other complex financial discussions, but many instances of late payment do not fall under the purview of any of them. Statistical breakdown of invoices across several studies have shown evidence that most instances of late payments are clerical errors, easily avoided through certain best practices and some free automated Accounts Receivables plugins. The impact of cultural idiosyncrasies leading to late payments can then be empirically separated from instances of human error, if some basic benchmarks of business were either to be implemented or suggested by the government. This may lead to access to data with more meaningful cultural insights to be ascertained through payment practices of different nations.

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