

EU Directive to combat Late Payment in Commercial Transactions

Legislate or Educate?

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On 20 October, the European Union voted in favour of a new Directive to combat late payment in commercial transactions within the EU market. This Directive will replace the existing Directive 2000/35/EC.

The scope of the European Commission and Parliament is to change the present business culture that of paying late for the supplies of goods and services received.

The new Directive does not apply for business-to-business transactions only but also for business-to-government dealings. Government departments and governmental organisations are cited as the worst payers in Europe and this piece of legislation may help suppliers to get paid from the government after 30 days.

When this Directive will be transposed into our legislation both public and private sectors have to pay their bills for goods and services provided by their trade suppliers by not later than 30 days. Nevertheless, in business-to-business transactions, the Directive allows credit to be extended up to 60 days if both parties agree. However, extending credit beyond 60 days is only permissible if "expressly agreed" by the creditor and the debtor in the contract of sale and provided that it is not "grossly unfair" to the creditor. This provision is aimed to protect SMEs that in many cases are forced to agree on longer credit terms, especially when they deal with bigger firms.

For the public-to-business payments, the general deadline is also 30 days. If the payment periods are to exceed 30 days, this has to be "expressly agreed" and "objectively justified in the light of the particular nature of the contract". This new Directive allows Member States to choose a payment period of not more than 60 days for public entities providing healthcare.

In case of late payments, suppliers will be entitled to eight per cent plus the ECB intervention rate as late payment interest from their customers. Interest charges will come into effect 30 calendar days from date of invoice or supply of goods/services. Suppliers are also eligible to claim a minimum of EUR40 to compensate for the expenses incurred to recover past-due money from the trade customer.

Other implications in this Directive relate to Retention of Title of goods and an obligation on all EU Member States to ensure that an enforceable title will be obtained, irrespective of the amount of the debt, within 90 calendar days of the lodging of the creditor's action or application at the court.

At face value, this piece of legislation may seem plausible. However, I find it difficult to believe that it will be effective, let alone a good tool to change the present late payment culture of Malta and the rest of Europe.

Firstly, in Malta, legislation is required to support the Retention of Title clause and to obtain an enforceable title within 90 days irrespective of the amount of debt as we do not have this supportive legislation in place; secondly, standardising the credit terms does not work in practice. It sends a wrong message to the business community as this principle goes against any good credit management practice.

Credit terms should be determined flexibly by the supplier, according to the cost of money at time of granting credit (the opportunity cost of granting credit); the level of competition in the industry or market (the harsher the competition, the better credit terms); the cost of the product at point of sale; and the specific risks involved in granting credit.

An English veteran in the credit industry recently said that, "The implication of the EU directive is that the shorter the credit period the better. And that flies in the face of much of what businesses know to be the case: that is, that longer credit periods can give you a competitive advantage, can show faith in trusted customers, and especially at this time, can give buyers the time they need to finance their purchases".

The EU Commission acknowledges that the Late Payment Directive 2000/35/EC was ineffective and in my opinion, the new Directive will also be unsuccessful. Culture takes time to change and the best recipe to change culture is by means of education. The business community needs to be educated when it comes to granting and extending credit. Investing in credit management training programmes that focus on good customer services, synergy between the sales and the credit functions, competition, sound cash flow management and long-term profit is key for the success of firms in today's business world.

The people working in the field of credit management should be trained and skilled to analyse the credit worthiness of their prospective credit customer in a profitable manner and relevant to today's market needs. Firms should use efficient and reliable Credit Management Information Systems. Members of MACM have the facility to search for pertinent credit-related information on their prospective trade customers, which information helps them take profitable and relevant credit decisions. Forming part of a Credit Circle, as MACM, is always advisable in order to act proactively.

Good credit management practice insists that trade creditors should always present a credit agreement to their customers. These agreements should detail the credit terms and the conditions of sale and should be duly signed by both parties. A sample of a Credit Application Form is available from the MACM website www.macm.org.mt – as the saying goes *patti chiari, amicizie lunghe*.

The credit practitioners should also strive to issue invoices, which are properly dated and addressed; accurate, complete and informative, providing good description of goods/services. An invoice should be a simple document requesting payment for goods/services provided and it should not include any advertising clutters. It should be issued on time and any disputed invoices should be settled promptly by the supplier to the benefit of both parties. No supplier should expect to get paid if invoices are not issued clearly, accurately and timely!

One of the main concerns for many businesses is the managing of past-due accounts receivables or overdue accounts, as they are commonly referred to. Statistics show that approximately 40 per cent of the total assets of a firm relate to Accounts Receivables and hence this asset requires good protection. But how skilled and knowledgeable in this subject are the employees managing this asset?

Skilled credit practitioners would know how to listen to their customers and get to know their customers and the reason/s for paying late. Categorizing overdue customers according to the reasons for paying late would then help to focus the limited resources where it pays most. Thus, ensuring sound cash flow and securing long-term profit, while encouraging existing customers to continue buying profitably.

Having a skilled team of credit practitioners would also benefit from long-term working relationships with customers, gaining and sustaining competitive advantage in the market while being more successful in the collection of dues.

Trained credit staff would also strive to be flexible, to innovate and to improve their systems and procedures to ensure better customer service. The credit function is a peoples' function and it is people and people-driven processes that are the real source of sustained competitive advantage – which is the name of the game in today's business!

Although legislation may sometimes help businesses as a last resort, good credit management practices should always prevail as it is the recipe for business success.

Mr Busuttil is the director general of Malta Association of Credit Management (MACM), a not-for-profit organisation, providing a central national organisation for the promotion and protection of all credit interest pertaining to Maltese businesses. MACM represents the credit profession across all economic sectors. It is a centre of expertise for all matters relating to credit management in Malta. MACM offers a range of services to local creditors, including credit management information systems, credit management education, training, conferences, seminars, and lobbying activities. It is the ICM (UK) accredited training centre for Malta. MACM is a member of the Federation of European Credit Management Associations – FECMA. MACM is the distributor of Graydon International Credit Reports in Malta.