

The late payment directive

Following a European Directive to combat Late Payment in Commercial Transactions transposed into Maltese Law by Legal Notice 272 of 2012, earlier this year, BusinessToday speaks to Josef Busuttil, Director-General, Malta Association of Credit Management (MACM).



Josef Busuttil, Director-General, MACM – a central national organisation for the promotion and protection of all credit interest pertaining to Maltese businesses.

Duncan Barry

Are late payments in Malta a cause for concern?

"Late payment in commercial transactions is considered as one of the main concerns of the Maltese business community. Some companies, across all sectors of the Maltese economy, are facing liquidity problems, which are evidently seen and remarked in their audited accounts filed at the Registry of Companies. We also see a great deal of bartering going on, especially in the construction industry, with building developers exchanging property as payment to their sub-contractors. Bartering has a direct negative effect on cash flow and hence late payment."

Other firms complain that as a result of late payment, they are unable to restructure appropriately in order to face the new challenges and opportunities of today's market demands.

"People in business know well that in Malta, customers request long credit terms from their suppliers, sometimes running to 120 days - depending on the industry - and still fail to honour these credit terms by paying later than these agreed credit terms, or even worse issue post-dated cheques upon due date. Hence continue to benefit from the suppliers' money.

"For some other industries, the Government is far from leading by example. There are local firms that are granting long credit terms and are owed substantial amount of money from the Government.

Law Courts statistics collated by MACM show that in 2011, 5220 Judicial letters, under Section 166A, claiming an amount of €12,826,000.00 c.a. were filed at the Magistrate and Superior Court and the figures for the first six months of this year are very close to last year's. One has to keep in mind that this is only the tip of the iceberg since creditors prefer to settle their outstanding debts outside court for better efficiency and cost effectiveness.

How do late payments effect SMEs?

Credit is the oil that keeps the wheel turning in business and it is the responsibility of the creditor and the debtor alike that credit is granted / extended ethically, sensibly and in a formalised manner.

Extending credit to customers is therefore healthy, both for business enterprises and the economy, as it helps in the selling process and in maintaining long-term customer relationship. But credit costs money and should not be abused in any way. If it is not managed diligently by the supplier, or the customer does not adhere to the agreed credit terms, it can have negative impact on the cash flow of the supplier, especially SMEs, which are more financially vulnerable due to their size and resources.

Research and studies, conducted by various institutions, including the European Union, contend that as a result of defaults in commercial payment, heavy administrative and financial burdens are placed on businesses, particularly those that are small and medium in size.

"A report issued by the European Union referred to late payment as the major cause of business insolvencies, threatening the survival of businesses and resulting in numerous job losses. The same Report cited that differences between payment rules and practices constitute an obstacle to the proper functioning of the EU internal market by limiting commercial transactions between Member States.

"One has to keep in mind that late payment has a domino effect. If a supplier is not paid on time, he may not be able to honour his own commitments himself. In such instances, firms would need further injection of money either from the owners of the business or by means of a bank overdraft. But here again, money costs money - bank interest has to be paid!

Therefore, SMEs, being more vulnerable due to their size and power in their respective markets, will feel the pinch more than large organisations and it is estimated that more than 90% of Maltese firms fall under the definition of SMEs.

"Unfortunately, such firms may be undercapitalised and work on tight cash flow and budgets. Therefore, being paid late by their customers makes it even difficult for them to meet their short-term obligations and to survive in today's competitive environment, let alone invest in future projects to enable them to expand their business and grow.

"On a final note, one has to keep into perspective that late payment does not only cause cash flow problems but may also lead to bankruptcies, loss of jobs, financial uncertainties to businesses and discourages entrepreneurs to invest. Thus, restricting the economic growth which is much vital to an economy like our country's.

Who can one turn to when faced with such situations, now that a directive is now in force?

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 larger firms and the government.

For the government-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 payment, suppliers will be entitled to 8% 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 €40 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.

Here in Malta we do have a fast track judicial system under section 166A by which a firm can obtain judgement after 30 days but it is only limited to amounts not exceeding €23,000 c.a. What if the outstanding amount is higher than this amount? The original directive states that an enforceable title should be obtained within 90 days irrespective of the amount of debt!

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 also make use of an efficient and reliable Credit Management Information Systems. Members of MACM have the facility to search for pertinent credit-related information on their prospective and existing 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% 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 relationship with customers, gaining and sustaining competitive advantage in the market whilst 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 and the law court may sometimes help businesses to recoup debts, it is only referred to as a last resort. Court procedures are expensive and are not always a good tool to use.

Therefore, good credit management practices should always prevail as it is the recipe for business success. MACM provides Training Programmes leading to the ICM(UK) Diploma in Credit Management to ensure that the people working in the local field of credit management are qualified and adequately skilled to perform their duties profitably and also to ensure sound cash flow in our economy.

What is MACM's stand on the directive?

MACM - The Malta Association of Credit Management - is pleased to note that the EU Commission acknowledges that late payment is causing bankruptcies and is harming the cash flow of businesses within the EU. From the onset, MACM took an active role in the consultation exercise conducted by the Commission, both as the Maltese body representing the credit interest of the local business community, as well as an active member of FECMA - the Federation of European Credit Management Associations.

An EU-wide consultation and surveys were conducted in order to understand better the magnitude of the late payment problem and its effect on businesses.

MACM is also satisfied to note that following this consultation, the EU commission has issued a Directive (2011/7/EU) to revise the original Directive (2000/35/EC) which turned out to be ineffective following a Report by which the difficulties related to late payment faced by businesses have been identified and highlighted. Suggestions were made following a diligent impact analysis of the proposals made by European businesses and organisations similar to MACM.

The Commission's Report on late payment and its consequences clearly noted that the public authorities are not leading by example and are paying their suppliers remarkably late. Reading between the lines, the figures published in this Report revealed that although the suppliers are extending credit terms to the public authorities and often grant better credit terms than they usually grant to their business customers, public authorities are paying later than the business customers.

The Report itself states that... *"Late payments by public administrations undermines the credibility of policies and contradicts declared policy objectives to provide for stable and predictable operating conditions for enterprises and foster growth and employment."*

It continues to state that... *"Given the importance of public procurement in the EU (more than €1,943 billion per year) late payment by public authorities has a strong negative impact on enterprises, notably SMEs. Many public authorities do not face the same financing constraints as businesses and late payment in their case is avoidable. It should therefore be more severely sanctioned when it occurs."*

Hence, MACM is also pleased to note that the EU Commission has pointed out that *"diverging payment attitudes across the EU might hamper business participation in public tenders, which not only distorts competition and undermines the function of the internal market, but also reduces the capacity of public authorities to get best value for tax payers' money."*

In a Press Release published on the 8th April 2009, the then European Commission Vice President - Gunter Verheugen, who was responsible for the Enterprise and Industry, said that *"Late payment by public administrations should be no longer tolerated."* He went on to refer to the Commissions' Proposal Paper intended to combat late payment in commercial transactions, whereby he said that *"this proposal provides an important impetus to overcome the economic crisis by helping to avoid further bankruptcies and promoting businesses cash flow in order to reinforce the competitiveness of European enterprises in the long term."*

MACM's main concerns remain on how this Directive, which was transposed to the local legislation by LN272/2012, will be implemented and adhered to by the government and by certain industries which are currently being faced by liquidity problems.

About the Directive

The new Directive covers not only business-to-business but also business-to-government transactions.

This legislation applies to payments made as remuneration for commercial transactions carried out between private and public undertakings, between

undertakings and public authorities, and between main contractors and their suppliers and subcontractors.

The period for payment agreed by the parties in the contract of sale may not exceed 60 calendar days. However, the parties may expressly agree for a longer period as long as the extension of time is not grossly unfair to the creditor.

The creditor may proceed with the claim for late payment against the client without reminding him that the amount is due.

In the case of transactions between undertakings and public authorities, the period for payment shall be 30 calendar days if not expressly agreed in the contract and may not exceed 60 calendar days if fixed in the contract.

Agreement between the creditor and the client to extend the date of receipt of invoice is null and void. In addition to the interest charges on late payment, the creditor is entitled to reasonable compensation for the supplier's own recovery costs at a minimum of €40.

When the contract of sale provides for the retention of title between the seller and the buyer, the seller is entitled to retain title over the goods until the price has been paid in full by the buyer.