MACM says European Commission initiative to combat late payments has flaws which need to be addressed

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The Malta Association of Credit Management (MACM) said it supports the European Commission on its initiatives to combat late payments in Europe.

Late payments cause cash flow problems leading to bankruptcies, loss of jobs, financial uncertainties to businesses, especially SMEs, and discourages entrepreneurs to invest, the MACM said in a position paper on the subject.

Although the suggested regulation published by the Commission is a step in the right direction, MACM said it identifies a number of flaws which need to be further analysed and addressed to meet the real market realities.

MACM strongly believes that having a regulation instead of a directive is a positive recommendation as it simplifies cross-border commercial transactions.

Investing in credit management training is also critical as this would result in an educated market which would result in better liquidity and a healthier cash flow – the lifeblood of businesses.

MACM said it is also in favour of the introduction of compulsory and immediate late payment interest rates and fees, although it is believed that the late payment rates and fees require further analyses as to how they can be effectively and efficiently implemented.

Scepticism is evident as to how the authorities will be monitoring those businesses in adhering to the regulation without due bureaucracy for businesses. Nonetheless, MACM is also of the strong opinion that freedom of contract should remain, and imposing a maximum of 30 days credit terms is to the detriment of the economy, commerce, trade and businesses, especially to SMES for a number of reasons:

- It goes against free market economy;
- It goes against the fundamental principles of credit management;
- It does not work for certain industries with longer business life cycles and seasonal products;
- Very often SMEs are themselves buyers and will not be able to negotiate competitive credit;
- Businesses, especially SMEs, would need to find alternative financing which may be more expensive and cumbersome on the operation of the business;
- It may impact negatively on the existing longstanding business relationships;
- Businesses in temporary financial strains would not find assistance from suppliers; and
- Buyers may well find alternative suppliers from outside the EU market.

MACM said it also agrees with the Commission when it stated that in the EU, on average, one out of two invoices in commercial transactions are paid late (or not paid at all) and that late payments increase in times of crisis and economic turmoil. Late payments may have a more significant negative impact on SMEs as they are usually more vulnerable to cash flow strains and late payments may impact their inability to meet their overheads and operating costs.

Besides, MACM said it acknowledges the concern of the Commission that late payments create a domino effect, leading to more late payments in the market. The Commission testifies that in Europe, 70% of EU companies confirmed that being paid on time would in turn allow them to pay their own suppliers on time.

MACM said it agrees with the Commission that in general, late payments reduce businesses' competitiveness, increase financing costs and cause companies to forego attractive business or investment opportunities. MACM is pleased to note that the Commission is also aware that late payments increase the risk of bankruptcies and reduce trust and confidence in the market. This can result in job losses, and reduces participation of SMEs in public procurement, which can negatively affect the provision of essential services like medical care, public transport, law enforcement and others, to the community. Additionally, late payments seriously affect the livelihoods and well-being of small entrepreneurs.

The result of the last survey, conducted by MACM among its members, as at December 2022, shows that the Average Days Sales Outstanding across all industries in Malta was 80.96 days, a slight improvement over the previous year of three days. In 2021 it was 84.6 days. Nonetheless, Malta has one of the longest DSO ratios in Europe.

The main proposals of the European Commission

The Commission is proposing to replace the current directive with a regulation. Contrary to a directive, a regulation is directly applicable and lays down the same provisions across the EU. As a result, those businesses that rely on cross-border trade in the EU are impacted automatically.

The proposed regulation grants some flexibility to the member states, concerning the setting up of enforcement bodies, Alternative Dispute Resolution (ADR) mechanisms, provision of credit management training and financial digital literacy.

The proposal introduces stricter and more streamlined measures to prevent late payment practices in the form of maximum payment terms. The new proposal for a regulation now streamlines the current provisions and introduces a single maximum payment term of 30 days for all commercial transactions, including B2B and transactions between public authorities and businesses. This term will be the same across the EU. The freedom of contract only applies when parties negotiate payment terms not exceeding 30 days.

It ensures that the payment of accrued interest is rendered automatically and compulsory until payment of the outstanding debt is made. Contrary to the current directive, under the new proposal, the creditor cannot waive its right to claim interest for late payment. The rate of late payment interest is +8% above the ECB reference rates, currently standing at 12.5%.

The proposed regulation raises the flat fee compensation from €40 (or equivalent) to €50 (or equivalent) per commercial transaction paid late.

The proposal eliminates the current extension of payment terms to 60 days for public entities providing healthcare and for public authorities carrying out economic activities of industrial or commercial nature as a public undertaking.

MACM propositions

The current directive being replaced with a regulation is plausible as it streamlines the rules across all EU members states. This will be beneficial to businesses involved in cross-border B2B and B2G transactions as the same law would apply to all commercial transactions being carried out across the EU market.

Credit costs money and credit carries an element of risk. In today's business world, businesses should invest in training their employees and adopt good credit management practices to mitigate the risks involved in credit. Deploying good credit management practices would secure better cash flow, increase profit, while maintaining good customer relationship at all times. Enjoying sound cash flow and better liquidity would in turn benefit the economy at large as businesses would grow and prosper leaving a positive economic impact. The Commission should promote and allocate adequate budgets for credit management training programmes to businesses trading in the EU.

A maximum of 30 days credit terms may well meet the needs of certain products which are perishable having business life cycles of 30 days or less. However, in reality, there are other industries where the business life cycles exceed 30 days and may even reach that of 360 days. Certain other industries are also seasonal and would require longer credit terms than 30 days. The one-size-fits-all concept does not work in these circumstances. In practice and according to the fundamentals of the concept of credit, in order to gain and sustain market share through establishing and maintaining good customer relationship in the market, a supplier selling on credit, would invest in its customer by offering competitive credit terms in relation to the business cycle of that particular product in that particular industry. Hence, allowing adequate time to the customer to sell the product to its next customer in the supply chain before effecting payment. For the customer/debtor, trade credit is a form of finance which is less expensive and more practical than any other form of financing, allowing commerce to take its course, while increasing turnover and enhancing business growth. Trade credit is indeed the oil that turns the wheel in an economy!

This regulation was aimed to assist SMEs but the concern is that SMEs will be the most negatively affected by setting a maximum credit terms of 30 days! One has to keep in mind that the majority of commercial transactions in Europe, and in particular in Malta, are undertaken between SMEs. SMEs are often the buyers requesting credit from their suppliers! SMEs are those businesses benefitting most from trade credit given by their suppliers as this form of financing is cheaper and involves much less bureaucracy and is easier to administer. Hence, minimising their operational costs.

In certain markets, such as the Maltese small market economy, a maximum of 30 days credit terms do not make business sense. Very often, businesses in Malta enjoy long business relationships and have been trading between them for a number of years, establishing competitive terms and conditions of sale and enjoy shared knowledge of the product and business life cycle which have contributed to the local business norms and culture. With the introduction of this regulation, these long business relationships will be interrupted to the detriment of the economy at large, if implemented.

Buyers, mainly SMEs, who have been trading with their suppliers on more than 30 days credit terms, may find it difficult to pay within 30 days credit terms as they would require alternative financing which may be too costly. This may lead to loss of business and trade and also bankruptcies.

Having a fixed maximum credit terms of 30 days would not allow a buyer, who may find himself in temporary financial difficulties, to negotiate temporary longer credit terms with the suppliers who would in turn be willing to extend credit for future commercial purposes and better business relationships.

Imposing a maximum of 30 days credit terms would also lead to loss of business within the EU market as buyers would seek alternative suppliers from outside the EU providing longer credit terms. This would have an impact on the EU economy.

Automatic and compulsory late payment interest may serve as a deterrent for buyers/debtors to pay late. Additionally, being compulsory, it would be easier for a supplier to charge interest on late payments as all the competitors would do the same in case of late payment. However, this initiative requires the supplier to invest in a software package to enable proper calculation of late payment interest to be charged to the late payer. The main concern of late payment interest is the rate at which it is calculated – 8% plus the ECB base rate, which at the moment stands at 12.5%, may be hefty and would impact negatively businesses, especially SMEs who are more vulnerable in securing sound cash flow and liquidity. Here again, high interest rates, especially when the economy faces high inflation, may lead to less trade and bankruptcies.

Late payment fees also serve as deterrent for buyers to pay late. A late payment fee of €50 or equivalent is proper and should be incrementally increased in case of repetitive payment defaulting by the same buyer within a specific period of time (one year is the recommended period). Nevertheless, if a seller charges more than €50 in case of late payment, a proper breakdown of costs and expenses involved in the collection of overdue payments should be presented to the late payer in case the latter files an official objection. The only disadvantage is that it may increase the cost of administering and managing Accounts Receivable.

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