

Title: Payment Reporting Requirement IA No: BEIS024(F)-1-CCP RPC Reference No: RPC14-BIS-2229 Lead department or agency: Department for Business, Energy and Industrial Strategy Other departments or agencies:	Impact Assessment (IA)			
	Date: 03/11/2016			
	Stage: Final			
	Source of intervention: Domestic			
	Type of measure: Secondary legislation			
Contact for enquiries: alex.shirvani@beis.gov.uk				
Summary: Intervention and Options				RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANDCB in 2014 prices)	One-In, Three-Out	Business Impact Target Status
-£161.43m	-£159.74m	£17.7m	In scope	Qualifying provision

What is the problem under consideration? Why is government intervention necessary?
 UK companies often supply goods and services on trade credit, deferring payment for a period after delivery rather than requiring immediate payment. When customers do not pay on time this causes problems for suppliers, affecting their cash flow, diverting resources towards chasing payment and potentially incurring costs of covering cash flow shortages through raising external finance. When suppliers are entering in to contracts with customers, they may lack information on the reliability of the customers in terms of paying on time. Government intervention can address this absence of information by requiring large businesses to report information on their payment practices and performance.

What are the policy objectives and the intended effects?
 To bring greater transparency on payment practices and performance, overcoming the asymmetry of information regarding payment practices and performance between large businesses and their suppliers. This will mean suppliers are in a better position to make an informed judgment on whether to enter into a contract, negotiate fair terms and challenge late payment when it happens. Intended effects are that it will increase the incentives on businesses to improve their payment practices and performance, reducing the overall level of late payment between businesses.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)
 1: Do nothing: would leave problem of late payment unaddressed.
 2: Strengthen voluntary Prompt Payment Code: would not tackle worst offenders in terms of late payment.
 3: Increase penalties for late payment: risks of not being fully used due to suppliers fearing damaging commercial relationship.
 4: Introduce maximum payment terms: received insufficient support at consultation.
 5: Increase transparency through requiring large businesses to report on payment practices and performance: preferred due to underlying market failure being one of asymmetric information and this directly addresses the absence of information. The scope is limited to large businesses in accordance with the Government's principle that where possible smaller businesses should be exempt from new regulation.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 04/2022				
Does implementation go beyond minimum EU requirements?			N/A	
Are any of these organisations in scope?			Micro No	Small No
			Medium No	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: n/a	Non-traded: n/a

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: _____ Margot James _____ Date: _____ 24 January 2017 _____

Summary: Analysis & Evidence

Policy Option 1

Description: Introduce duty to report on payment practices and performance for large companies

FULL ECONOMIC ASSESSMENT

Price Base Year 2016	PV Base Year 2016	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -177.6	High: -145.3	Best Estimate: -161.4

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	24.6	14.0	145.3
High	30.1	17.1	177.6
Best Estimate	27.3	15.6	161.4

Description and scale of key monetised costs by 'main affected groups'

Costs to business: transition costs of £27.3m (including familiarisation, IT costs, information gathering, changes to processes); ongoing annual costs of £15.4m (including maintenance of systems and processes, cost of preparing, collating, approving and submitting reports twice a year).

Annual costs to government of enforcement: £0.20m (investigating and prosecuting non-compliance).

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0.0	0.0	0.0
High	0.0	0.0	0.0
Best Estimate	0.0	0.0	0.0

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Availability of information to better inform choices for suppliers ahead of entering contracts, increased transparency and accountability of payment performance intended to drive behaviour change and reduce incidence of late payment in the economy. Benefits of this would include reduced cash flow problems, increased liquidity for businesses leading to greater ability to invest in extra capital or employment, lower business exit due to cash flow problems from overdue payment.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: 17.7	Benefits: 0.0	Net: -17.7	
			88.5

Background

Late payment: the problem under consideration

1. UK companies often supply goods and services on credit, agreeing to defer payment for a period after delivery rather than requiring immediate payment. This form of payment, known as 'trade credit' is a common part of business practice in the UK, with just under half of SMEs using trade credit in 2015¹.
2. Late payment occurs when a business has been supplied goods or services on credit but fails to pay within the agreed term. Legally, if no explicit payment terms have been agreed, payment is assumed to be due after 30 days for the purposes of charging statutory interest².
3. Late payment causes problems for businesses that are not paid on time as it adversely affects their liquidity. This can constrain the ability of a business to invest for future growth, and in the worst cases it can force businesses to exit the market. Small businesses are especially exposed to liquidity problems when they do not receive payment on time.

Scale of the problem

4. Evidence on the scale of the problem comes from business surveys that ask questions about the use of trade credit, the extent to which businesses experience late payment and what form of detriment it causes.
5. According to the Small Business Survey³, 52 per cent of SMEs with at least one employee give their customers trade credit, with businesses in the manufacturing (82 per cent), transport/storage (67 per cent), information/communication (64 per cent), professional/scientific (63 per cent) and construction (62 per cent) particularly likely to give credit.
6. Of those that gave credit, 20 per cent claimed late payment was a "big problem" and 41 per cent a "small problem". Exporting businesses were more likely to report late payment being a problem, but internationally-based customers were not necessarily the cause of the problem⁴.
7. Using data from a survey of over 8,000 members, the Federation of Small Businesses found that 51 per cent of its members providing goods or services to larger private sector businesses were paid late in the previous 12 months (up to 2014). For businesses affected, payment on late or extended terms meant reduced profitability for 34 per cent, restricted business growth (29 per cent) and led to them paying their own suppliers late (32 per cent)⁵.
8. An important source of information on late payment comes from Bacs Payment Services' Late Payment Research, a longitudinal⁶ business survey in to payment behaviour. This survey samples private sector businesses with turnover above £50,000⁷, so does not

¹ BRDC Continental (2015): *SME Finance Monitor Q4 2015*

² Section 4(2A) of the Late Payment of Commercial Debts (Interest) Act 1998

³ Large-scale telephone survey of over 15,500 owners and managers, commissioned by the Department for Business, Innovation and Skills. A summary of the methodology is given in p 8-12 of BIS (2016) *BIS Research Paper Number 289: Longitudinal Small Business Survey Year 1 (2015): SME employers*

⁴ *BIS Research Paper Number 289: Longitudinal Small Business Survey*

⁵ <http://www.fsb.org.uk/media-centre/press-releases/five-in-10-suffer-from-late-payment-finds-fsb-pr-2014-04->

⁶ Sample is longitudinal but does replace some businesses that cannot be contacted with other similar businesses on the basis of sector, number of employees and region.

⁷ The sample is weighted by business size. Note that BACS changed its research methodology in 2014 so figures post-2014 cannot be directly compared to figures from their earlier surveys. Sample size: 350 businesses, 300 SMEs, 50 Corporates.

reflect the impact of late payment on the smallest firms, however the survey asks a series of questions specifically relating to late payment and so provides a useful indication on its overall effect on the business community.

9. According to their 2014 Q1 survey, 60 per cent of SMEs and 80 per cent of Corporates experience late payment⁸. A total of £46.1bn is owed to UK businesses in late payments and UK businesses spend approximately £9.16bn per year chasing late payments. The worst offenders for late payments were large companies.
10. According to the SME Finance Monitor⁹, in 2015, 8 per cent of SMEs expected “cash flow/issues with late payment” to be a major obstacle in the next 12 months, with 19 per cent expecting these issues to be a moderate obstacle¹⁰.

Length of payment delay

11. According to the European Payment Report 2016¹¹, UK businesses allow their business customers average payment terms of 29 days, an increase of 11 days compared to that reported in their 2015 report. The average time actually taken by these customers to pay was 29 (an increase of 8 days compared to 2015).
12. 37 per cent of UK businesses have been asked to accept longer payments than they are comfortable with, although this is almost 10 percentage points lower than the European average¹². Businesses in the UK experience longer payment times than those in Germany, Austria and some Scandinavian countries, although the payment times are generally lower than many other countries in Europe. The table below shows the average of agreed contractual payment terms in days and the average number of days that it actually takes for payment to be made across various countries in Europe:

⁸ Corporates defined as 250+ employees, SMEs defined as <250 employees.

⁹ Surveys 5,000 SMEs (turnover less than £25m) every quarter about past borrowing events and future borrowing intentions, information on sample structure available in technical appendix: http://bdrc-continental.com/wp-content/uploads/2016/03/BDRCContinental_SME_Finance_Monitor_Q4_2015.pdf

¹⁰ BRDC Continental (2015): *SME Finance Monitor Q4 2015*

¹¹ Survey conducted simultaneously in 29 European countries between February and April 2016, using an online survey tool, printouts and telephone interviews. Full breakdown of sample structure on p48 of report, available at <https://www.intrum.com/globalassets/countries/norway/documents/2016/european-payment-report-europa-2016.pdf>

¹² European Payment Report 2016

13. Table 1: Average payment times across European countries

Country	Average business-to-business contractual payment term (days)	Average time business-to-business customers actually take to pay (days)
Germany	14	15
Finland	18	23
Norway	18	24
Austria	23	27
Denmark	25	29
United Kingdom	29	29
Sweden	28	31
Netherlands	27	32
Ireland	40	36
Switzerland	30	37
Belgium	31	41
France	41	48
Greece	52	63
Portugal	52	68
Spain	57	69
Italy	60	80

Source: European Payments Index 2016¹³

Costs to businesses

14. Suppliers that are paid late face costs associated with providing the necessary liquidity to cover their own obligations. Internal costs include the administrative costs associated with chasing and recovering payment and the use of management time being diverted to making contingency planning to maintain liquidity.
15. Bacs Late Payment research suggested that SMEs that experience late payments spend an average of £711 per month chasing late payments, whilst Corporates experiencing late payments spend an average of £4,153 per month, with 10 per cent of Corporates incurring costs of over £10,000 a month. SMEs spend an average of 7 hours per week chasing late payments¹⁴ (with Corporates spending an average of 11 hours). A quarter of businesses spend more than 10 hours per week chasing late payments. Two fifths of businesses employ someone to chase late payments¹⁵.

¹³ <https://www.intrum.com/globalassets/countries/norway/documents/2016/european-payment-report-europa-2016.pdf>

¹⁴ A lower estimate came in from a survey from RBS Invoice Finance suggested that small businesses on average spend 130 hours each year chasing late payments, equating to just over three weeks of work, at an average cost of £1,500 per business <http://www.bytestart.co.uk/130-hours-overdue-invoices.html>

¹⁵ Bacs late payment research, Q1 2014

16. **Table 2: Administrative cost of chasing late payments**

	Corporates	SMEs	Total
Business population (turnover >£50,000)	9,000	1,721,000	1,730,000
Proportion experiencing late payments	80%	60%	60%
Businesses experiencing late payments	7,200	1,032,600	1,039,800
Average monthly cost of late payments	£4,153	£711	£734
Total monthly cost of late payments	£30m	£734m	£764m
Total annual cost of late payments	£358.8m	£8,800m	£9,160m

Bacs Late Payment Research Q1 2014

17. The aggregate estimate from the Bacs research of over £9.16bn annual administrative costs to business due to chasing late payments should be seen as a lower bound estimate due to the underlying population of the survey (businesses with turnover in excess of £50,000) does not cover all businesses in the country and so the total cost of late payment may be considerably in excess of this amount.
18. In some case chasing payment is fruitless and leads to write-offs. According to the 2016 European Payment Report, the average share of a company's revenues written off due to late or non-payment was 2.6 per cent¹⁶.
19. Businesses may also face the costs of paying interest in order to raise external finance, or forgoing interest on their own cash reserves by having to access reserves rather than invest them in interest bearing sources of return. According to Bacs, 21 per cent of businesses reported relying on bank overdrafts as a main impact of late payment¹⁷.
20. There can be a knock-on effect of late payment, when one business suffers cash flow difficulties as a result of being paid late by their own customer and as a result is forced to pay its own suppliers late. Research for the Forum of Private Businesses found that among UK SMEs the most commonly cited reason (77 per cent) for paying suppliers late, was late payments further up the supply chain. 41 per cent of suppliers reported paying their own suppliers late in response to late payment¹⁸.
21. When businesses are forced to divert cash reserves in to covering shortages of liquidity, they are less able to invest in extra labour or capital in order to grow their capacity. The Association of Chartered Certified Accountants (ACCA) analysis of the ACCA-IMA Global Economic Conditions Survey (GECS) found that the apparent effect of late payment on business hiring and investment can be mostly explained away as a result of poor access to finance, but after accounting for other influencing factors, late payment meant micro and small businesses were less likely to increase numbers of employees or capital expenditure¹⁹. 28 per cent of UK businesses surveyed in the European Payment Report 2016 answered "yes, definitely" or "yes, probably" when asked if faster payments from debtors would enable them to hire more employees.
22. In some cases, cash flow disruption as a result of late payment can drive businesses in to exiting the market. According to Bacs, the median value of late payment estimated to jeopardise an SME is approximately £175,000, while the median value estimated to

¹⁶ Intrum Justitia (2016) *European Payment Report*

¹⁷ Bacs Late Payment research, Q1 2014

¹⁸ Graydon (2012) *Research on Payment Culture*

¹⁹ ACCA (2015) *Ending Late Payment Part 1: Taking Stock*

jeopardise a corporate is £7.5m. However, outstanding payment of £50,000 would be enough to jeopardise 24 per cent of SMEs²⁰.

23. A European Commission study found that between 2010 and 2013, delay in business to business transactions in Italy increased by 1 day, increasing the exit rate of businesses by 0.08 percentage points. The study suggested that eliminating chronic late payment in Italy, Spain and Portugal would reduce business exits as a share of business population by between 1.5 and 3 percentage points (between 124,000 and 248,000 fewer exits across the three countries)²¹.
24. According to Bacs research, the average amount owed in late payments to an SME is £38,186 and the average amount owed in late payments to a Corporate is £937,000²².

Table 3: Outstanding debt owed in late payments

	SMEs	Corporates
No. of businesses (survey population)	1,721,000	9,000
Proportion experiencing late payment	60%	80%
No. businesses experiencing late payment	1,032,600	7,200
Average amount owed in late payments	£38,186	£937,000
Total amount owed in late payments	£39.4bn	£6.7bn

Bacs Late Payment Research Q1 2014

Legislative responses

25. Previous UK governments and the European Union have legislated to address late payment. The Late Payment of Commercial Debts (Interest) Act 1998 created a statutory framework in the UK for tackling late payment. This was amended in 2002, when the 2000 EU Late Payment Directive was transposed into UK law; and again in 2013, when the re-cast 2011 EU Late Payment Directive was transposed into UK law.
26. Key provisions of the UK legislation are:
 - Businesses are entitled to charge interest of 8 per cent above the Bank of England Base rate for any late payment;
 - Administration costs for chasing late payment can be claimed by business, on a sliding scale depending on the size of debt;
 - Payment contracts must not infringe on a business's right to claim interest and administration costs for late payment;
 - Maximum 30 day payment terms for transactions with public authorities;
 - Maximum 60 day payment terms between businesses, unless they agree longer terms and this is not grossly unfair to the supplier.
27. Few companies exercise the rights provided by this legislation, especially against larger companies. Just 10 per cent of businesses have considered using late payment legislation²³, despite 22 per cent of businesses having ended a business relationship with a customer because of continued late payment²⁴. A study by the Credit Management Research Centre at Leeds University Business School found the most prevalent reasons

²⁰ Bacs Late Payment Research, Q1 2014

²¹ Connell (2014) *The Economic Impact of Late Payments* (European Commission Economic Papers 531)

²² Bacs Late Payment Research, Q1 2014

²³ <http://www.managementtoday.co.uk/late-payment-gets-later/article/1076769>

²⁴ http://www.newsroom.barclays.com/r/2497/smes_turn_away_business_to_fight_back_against_late_payments

for not using the legislation were fear of losing a customer or damaging the relationship, or because of the administrative aspects of applying the charge²⁵.

28. In 2008, a legislative requirement was introduced for certain companies to report on their outstanding trade debt, but the legislative requirement did not provide information that added additional value beyond that already contained in company accounts²⁶. The reporting provision was repealed in 2013²⁷.
29. There are some sector-specific legislative measures which address the late payment issues:
 - The Housing Grants, Construction and Regeneration Act 1996 (as amended by the Local Democracy, Economic Development and Construction Act 2009): setting out provisions that seek to address delays in payment, e.g. a 28 day dispute resolution process for a dispute under a construction contract via third party adjudication, an entitlement to staged payments, and “an adequate mechanism” in contracts to ascertain what should be paid and when;
 - The Groceries Code Adjudicator Act 2013: ensuring supermarkets act fairly towards their suppliers by enforcing the Groceries Supply Code of Practice, which is intended to tackle supply chain practices which transfer excessive risks and unexpected costs to suppliers.
30. There is other legislation addressing late payment in the public sector.

The Prompt Payment Code

31. In addition to legislation, Government is seeking to use voluntary measures to change the culture of business away from late payment. The Prompt Payment Code (the Code) was set up by the Chartered Institute of Credit Management (CICM) in 2008 on behalf of Government, in order to promote a culture of prompt payment²⁸.
32. The Code is voluntary. Signatories to the Code agree to:
 - Pay:
 - 95% of invoices within 60 days and work towards 30 days as the norm
 - Within the terms agreed at the outset of the contract;
 - Without attempting to change payment terms retrospectively;
 - Without changing practice on length of payment for small companies on retrospective grounds.
 - Give clear guidance to suppliers:
 - Providing suppliers with clear and easily accessible guidance on payment procedures;
 - Ensuring there is a system for dealing with complaints and disputes which is communicated to suppliers;

²⁵ Wilson (2008) *An Investigation in to Payment Trends and Behaviour in the UK: 1997-2007* Credit Management Research Centre, Leeds University Business School

²⁶ The disclosure requirement asked companies to state if they adhered to any Code or standard of payment practice. If the company did not adhere to a code it was required to state its policy for payment of creditors, and if there were any differences in this policy for different suppliers. The company was also required to disclose the proportion of amounts owed to creditors compared to amounts invoiced by suppliers.

²⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380183/bis-14-1203-duty-to-report-on-payment-practices-and-policies.pdf

²⁸ This followed an earlier attempt to improve payment culture with a partnership between government and business representative organisations through the Better Payment Practice Group (1997)

- Advising them promptly if there is any reason why an invoice will not be paid to the agreed terms.
 - Encourage good practice:
 - By requesting that lead suppliers encourage adoption of the Code throughout their own supply chains.
 - Avoid any practices that adversely affect the supply chain.
33. Over 1,800 organisations were signed up to the Code as of August 2016. The Code’s signatories make a public commitment to pay on time and pay fairly. Signing the Code acts as a signal of quality in terms of payment practices for other businesses considering doing business with the signatory businesses, and also provides a statement of good practice within the business community. However, whilst the Code demonstrates the intended good practice of its signatories, payment records are not reported.

Development of policy on duty to report

34. In December 2013, the Government published a discussion paper, *Building a Responsible Payment Culture*, which sought views on how to take action on late payment²⁹.
35. There was strong support amongst respondents to the consultation for increasing transparency on payment practices. One of the biggest concerns reported by suppliers was the lack of information about payment practices, and leading business representative organisations including the Federation of Small Businesses, Forum for Private Business and ACCA called for a mandatory disclosure of payment practices.
36. Around half the respondents that regarded disclosure requirements as being beneficial, supported a fully mandatory framework, although other respondents raised concerns about the costs of conforming to a mandatory framework being burdensome for small businesses. Some responses noted that previous requirements on companies to disclose their policy and practice on payment to creditors were subsequently removed on the basis that they were not well designed.
37. In response, the Government committed to “work with businesses and business organisations to develop a new, robust reporting framework that has useful content and is structured in a way that is genuinely helpful to suppliers and customers”, promising to give a legislative underpinning to give force to the reporting framework³⁰.
38. The Small Business, Enterprise and Employment Act 2015 (SBEE) introduced a new duty on large companies to report on payment practices and policies, to be implemented through subsequent secondary legislation. The Government issued another consultation ahead of developing the secondary legislation³¹.
39. Prior to consultation, Government published an initial impact assessment on the pre-consultation proposed requirements for large companies and listed companies to report on their payment practices and policies³². At this stage the main evidence on costs came from a non-representative survey aimed at large businesses, and structured discussions with businesses who potentially fall in to scope and so the estimates were subject to a high degree of uncertainty.

²⁹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273436/bis-13-1234-building-a-responsible-payment-culture.pdf

³⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/315462/bis-14-793-building-a-responsible-payment-culture-government-response.pdf

³¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380183/bis-14-1203-duty-to-report-on-payment-practices-and-policies.pdf

³² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380210/bis-14-1203-annex-e-duty-to-report-on-payment-practices-impact-assessment.pdf

40. Following consultation, the final policy proposals were refined ahead of inclusion in secondary legislation. This final impact assessment assesses the costs and benefits of the final policy proposals.
41. To improve the evidence base at final impact assessment stage the Department for Business, Energy and Industrial Strategy (BEIS) consulted informally with a wider range of businesses than had been originally contacted as part of the initial impact assessment. This revealed that certain aspects of the policy would be likely to lead to higher compliance costs than had been included in the initial impact assessment. To obtain independent estimates of these costs, BEIS commissioned Touchstone Renard to carry out semi-structured interviews with a representative sample of 36 businesses. The research methodology is summarised in paragraphs 86 to 91.

Rationale for intervention

Asymmetry of information

42. Effective markets are generally characterised by high levels of information available to both sides of the market, for instance the buyers and sellers. This provides the right incentives to reward good quality performance. In the product market, when customers have full information about the quality of products available from different suppliers, the suppliers providing the highest quality products are likely to be rewarded with more sales. In credit markets, when lenders have full information on the reliability of a borrower to repay debt, the more reliable borrowers are likely to be rewarded with greater availability of credit and/or on better terms (e.g. lower rates of interest).
43. The use of trade credit between businesses is a form of credit market: when businesses are looking to enter in to contracts with other businesses the market works best when both sides of the market have full information on the reliability of other businesses in terms of making payments on time. When businesses are aware of the reliability of others in terms of paying on time, they are more likely to enter in to contracts with prompt paying businesses and avoid entering in to contracts with those that have poor payment records. This creates incentives that reward prompt payment and helps tackle a culture of late payment.
44. Currently it is difficult to obtain information on the payment practices and performance of other businesses. Whilst signatories to the Prompt Payment Code have a way to signal their own quality as prompt payers, there is no equivalent signal of bad quality for the late payers, especially as court claims tend not to be pursued. Asymmetry of information was one of the biggest concerns reported by suppliers responding to the *Building a Responsible Payment Culture* discussion paper: with 73 per cent (41 organisations) of respondents to the transparency question desiring greater disclosure of payment practices.

Establishing 'norms' of payment times

45. The lack of transparency makes it difficult for businesses to assess whether the performance of their customer or the terms they are offered are comparable to the norm. This tips the balance of power between the supplier and buyer, and allows for a more robust negotiation from the customer, knowing that the supplier is likely to be reluctant to take the risk of leaving a contract if it is unsure whether the alternative options would involve quicker payment. There is a commercial disincentive for suppliers to leave lucrative contracts, even if the cost of transactions is eating away at profit. In industries where there are few large contractors, there is a concern that a second contract will be lost or even that there will be some sort of 'black listing'.

46. Where there is evidence that a customer is requesting terms that are outside of an industry norm and potentially unfair, it is possible for third parties to bring pressure for a return to more normal and fair terms – for example through business representative organisations who ‘name and shame’ certain businesses who are unfair to suppliers.

Signal of effective corporate governance

47. Supplier relationships are an important identifier of a company’s business model and financial structure. When the Board and senior management of companies can understand how they are interacting with their supply chain in practice rather than just in principle, they are in better position to drive change and improve their business relationships. Information such as the extent to which a business is a reliable payer of its suppliers or whether it has a reputation for repeat late payment may not be apparent from the financial sections of annual accounts, but may have some value as a signal to Board and senior management about the quality of management and processes at the company.

Macroeconomic risk

48. Late payment can worsen a shortage of liquidity in the economy when there is a credit crunch or recession. The knock-on effect of one customer paying a supplier late leading to that supplier paying its own supplier(s) late can quickly spread the impact of late payment to multiple firms, increasing the demand for credit at a time when access to credit may be at a premium. As the risk of firms paying late increases during an economic downturn or recession this means the problem of late payment is both exacerbated by difficult credit conditions and contributes to worsening the situation.
49. The policy measure assessed in this impact assessment is not specifically designed to improve the problem of late payment during abnormal economic conditions, and should be seen as a measure aimed at improving the general culture of prompt payment during normal economic conditions. If effective, this would reduce the macroeconomic risk due to lowering the level of outstanding debt from late payment that businesses carried in to a future downturn or recession.

Policy objective

50. The objective of the policy is to bring greater transparency on payment practices and performance to overcome the asymmetry of information regarding payment processes between large businesses and their suppliers.
51. By making this information easily accessible suppliers will have a better understanding of what to expect from their customers, and therefore be in a better position to:
- Make an informed judgment on whether to enter in to a commercial relationship (e.g. whether terms are fair and whether they are likely to be observed, so avoiding the cost of chasing late payments);
 - Negotiate fair terms;
 - Have information making it easier to challenge late payment.
52. The availability of this information should provide incentives on businesses to improve payment practices to distinguish themselves from their peers or at least to prevent being exposed as poor performers relative to their peers. It will also make it easier for business representative bodies, suppliers and other businesses to identify late paying businesses and put commercial and reputational pressure on these businesses to pay promptly. Over time these effects should help change business culture in the direction of normalising prompt payment.

Policy proposal

Scope

53. The reporting requirement will apply to large companies (whether private companies, public companies or quoted companies) and large Limited Liability Partnerships (LLPs). Businesses that could qualify as small or medium-sized will not be required to report.
54. Businesses will be “large” for the purpose of the requirement if they exceed thresholds in the Companies Act 2006 for reporting requirements for “medium-sized”³³ companies. Under the current thresholds, a company qualifies as “medium-sized” in a year in which it satisfies two or more of the following requirements: turnover of not more than £36m, balance sheet total of not more than £18m³⁴ and number of employees³⁵ of not more than 250.
55. In line with this definition, the “large” businesses that will come in scope of the reporting requirement will be private, public and quoted companies, and Limited Liability Partnerships that exceeded two of the three Companies Act criteria³⁶ for medium sized companies in both of the two previous years. Currently these are:
 - £36m annual turnover
 - £18m balance sheet total
 - 250 employees
56. Where a group of companies is owned by a parent company, and the parent company is ‘large’ (it exceeded two of the three criteria in both the previous two years) it will need to report on its payment practices only if its group exceeds the relevant gross thresholds for a group to qualify as medium-sized³⁷. Any companies within the group that exceed two of the three criteria will also need to report individually on their own payment practices.

Number of businesses in scope of the requirements

57. The FAME database reports the accounts of over 9 million companies and LLPs in the UK and Ireland, drawing data directly from accounts submitted to Companies House as well as from other sources.
58. According to FAME, around 12,600 businesses exceeded two of the three criteria in the two most recent years available, 2013 and 2014³⁸. This figure excludes businesses for which data is not available on all three of the criteria: whilst a balance sheet figure is available for all businesses, employment and turnover is missing in some cases. FAME allows missing data to be estimated using characteristics of similar businesses, and when these estimated data are included, around 15,200 businesses exceeded two of the three criteria in 2013 and 2014.
59. It is not possible to identify through FAME the parent companies who exceed two of the three thresholds individually but would be out of scope of the reporting requirements due to the group they head falling below two of the three thresholds on either of the past two balance sheet dates.

³³ Section 465 of Companies Act 2006

³⁴ Regulation 9 of The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015

³⁵ The average number of persons employed by the company in the year

³⁶ In order to be consistent with the Companies Act 2006

³⁷ Group company thresholds: £36m net annual turnover or £43.2m gross annual turnover; £18m net annual balance sheet total or £21.6m gross annual balance sheet total, where net means excluding group transactions. Employee threshold remains at 250.

³⁸ Search for: active companies with a primary trading address or R/O address in England, Scotland, Wales or Northern Ireland that satisfied two of the three of [total assets>18,000], [turnover>3.6m], [employees>250], in both 2013 and 2014

60. Despite this caveat, FAME is the best source of data available to the Government and the only data set containing information on all three of the Companies Act variants that determine whether a company is considered to be large. For the purposes of this impact assessment, the estimated number of businesses in scope of the reporting requirements is 15,200.

Metric requirements

61. Businesses in scope of the reporting requirement will be required to provide information on their payment performance in terms of time taken to pay invoices, and also clearly indicate their payment policies to potential suppliers.
62. The report will ask businesses to set out clearly the type of payment terms they use as standard in their contracts, indicate any maximum payment terms, and whether standard payment terms have been changed in the reporting period (if so, whether suppliers have been notified or consulted on these changes.) This will allow suppliers to understand what to expect when negotiating contracts, and better negotiate the terms they are on, especially if the terms offered are less favourable than an industry average.
63. Businesses will be also required to report on the proportion of invoices paid beyond their agreed terms – this will measure a company’s reliability in terms of paying when their supplier expects to receive payment.
64. Dispute resolution processes are a standard practice among companies, especially where there are large quantities of transactions. Disputes can range from easily resolved reconciliations of invoice against supplied goods or services, to more complex and irreconcilable differences. However, anecdotal concerns have been raised that some businesses use disputes as a method of delaying payment. To prevent this becoming a norm, businesses will be required to clearly outline their disputes resolution processes.
65. Large businesses may provide supply-chain finance to their suppliers to ensure they have access to the finance they need, helping them through any short-term cash-flow difficulties. However, it is not always clear to suppliers when this is offered by their customers. Businesses will be required to report on whether they offer supply chain finance, which will allow suppliers to identify this when they look to distinguish between potential customer companies.
66. Payment codes should demonstrate a commitment of companies to treat their suppliers in a certain fashion. Businesses will be required to state whether they are a signatory of a payment code, and if so, state which one. This will signal to a supplier if a customer is committed to a code of fair payment practice and also indicate an avenue to challenge unfair actions.
67. The provision of e-invoicing often leads to faster payments as these are automated, which may be attractive to a potential supplier who is concerned about timely payment. The possibility of being charged to remain on a supplier list may be something that a prospective supplier wishes to avoid so as to maximise the return they receive for providing goods or services.
68. The full list of metrics that businesses in scope of the requirements will be required to report is as follows:
- Payment terms:
 - Any standard contractual length of time for payment of invoices;
 - Maximum contractual payment period;
 - Any changes to standard terms;

- Whether suppliers have been notified or consulted on these changes.
- Invoice metrics:
 - Average time taken to pay invoices from the date of receipt of invoice;
 - Proportion of invoices paid:
 - a. Within 30 days;
 - b. Between 31 and 60 days;
 - c. Over 60 days.
 - Proportion of invoices not paid within agreed terms.
- Other payment metrics:
 - Process for dispute resolution related to payment;
 - Whether suppliers are offered e-invoicing;
 - Whether suppliers are offered supply chain finance;
 - Whether the organisation's practices and policies cover deducting sums from payments as a charge for remaining on a supplier list, and whether they have done this in the reporting period;
 - Whether the organisation is a member of the Prompt Payment Code or another payment code, and the name of the code.

Contracts in scope

69. Businesses in scope of the reporting requirement will not be required to report on contracts for financial services or contracts which are not connected to the UK.

Frequency of reporting

70. Businesses will be required to report twice yearly, one report relating to the first six months of their first full financial year following the duty coming in to force, and the second report relating to the rest of their financial year. Reports will be due no later than 30 days after the end of the reporting period.

Approval of report

71. The report will require the approval of a director within the reporting company, or a designated member of an LLP. This is to ensure that directors take responsibility for the business' compliance with the duty and the accuracy of the data.

Description of options considered

72. This impact assessment primarily assesses the impact of the preferred option that was developed following the 2013 consultation, *Building a Responsible Payment Culture*. Below is a brief summary of alternative policy options that were considered but not taken forward

Option 1: Do nothing

73. This would leave the current market failure associated with asymmetric information between suppliers and customers in terms of payment practices and performance

unaddressed. This would not be a satisfactory outcome for the business community and so is not preferred by the Government.

Option 2: Strengthen the Prompt Payment Code

74. The Prompt Payment Code could be strengthened with potential further measures for signatories to comply with and an “upper tier” introduced for signatories to agree to more stringent rules. As this is a voluntary code this represents a light-touch alternative to regulation.
75. The effect of this would be limited, given that the Prompt Payment Code is voluntary and likely to lead to improvements more amongst businesses that already had reasonably good payment performance rather than driving change amongst the worst performing businesses. Respondents to consultation felt that whilst the Code was a helpful initiative, it was perceived by businesses as lacking powers of enforcement, and there was not widespread support for the introduction of an “upper tier”. The Government has therefore been working to strengthen the Code, in close collaboration with the Institute for Credit Management. However it was not felt that focusing solely on a voluntary measure such as the Prompt Payment Code would do enough to tackle the problem of late payment.

Option 3: Increasing penalties for late payment

76. Late payment legislation already gives creditors a right to redress in the event of late payment, including a statutory interest rate of the Bank of England reference rate plus eight percentage points, a fixed charge to cover debt recovery costs of £40, £70 or £100 depending on the size of the debt, and additional reasonable costs incurred. Government could legislate to increase the permitted penalties for late payment, potentially with the involvement of a third party such as trade bodies or associations. This would provide a stronger deterrent effect for customers to pay on time.
77. At consultation this proposal was challenged by the argument that the reason existing businesses do not take measures to seek compensation for the late payment of invoices is out of fear of damaging a commercial relationship, and a number of respondents raised concerns that the involvement of a third party would make it difficult to maintain the anonymity of claimants.
78. Whilst the additional costs of this measure would fall on non-compliant firms, the Government decided against pursuing this option as there was not a convincing case that this would tackle the problem of late payment – if businesses faced incentives not to make use of the powers out of fear of harming a commercial relationship it would undermine the effectiveness of the policy option.

Option 4: Implement a maximum payment term

79. Businesses are currently able to agree payment terms that are longer than the default of 30 days (after which, as set out in legislation, statutory interest runs if no payment period has been explicitly agreed) and longer than 60 days so long as they do so freely and the terms are not ‘grossly unfair’ to the supplier. Government could introduce a maximum payment term (e.g. 60 days) with legal sanctions available for exceeding the term.
80. Whilst this would directly tackle the worst elements of late payment, there was a mixed response to consultation for Government to pursue a maximum payment term. There was also limited support for a lesser legislative measure that would require companies to consult ahead of agreeing to payments terms in excess of 60 days due to difficulties in maintaining commercial confidentiality. The Government decided against following this

approach, in favour of promoting transparency through making information on payment times publically available.

Option 5: Increase transparency through duty to report on payment practices and performance

81. This represents the preferred policy option which is assessed in this impact assessment.

Cost-benefit analysis

Appraisal challenges and proportionality of approach

82. A key challenge to cost-benefit appraisal of the policy is that the costs of the policy fall on a specific population of businesses (those in scope of the reporting requirements) while the benefits of the policy could accrue to many parties, largely but not exclusively the suppliers of the businesses in scope of the reporting requirements. The costs of the policy apply directly to the affected businesses – the businesses may incur various costs directly as a result of the government introducing the reporting requirements. However, the benefits accrue indirectly: they depend on some other economic decision taking place between the implementation of the policy and the benefit happening (e.g. behavioural change on behalf of suppliers to contract with faster payers in preference to slower payers or behavioural change on behalf of slower payers to improve their payment performance).
83. As a result, whilst appropriate survey research with businesses that would come in scope of the requirements can identify estimates of the likely direct costs, it is much more difficult to assess the potential benefits, particularly as the magnitude of effect on improving payment performance is not known in advance and even in any subsequent ex-post evaluation it would be difficult to directly observe the extent to which this particular policy was responsible for driving change in payment performance rather than other aspects of Government policy to improve the business and financial environment, or general changes in the economy. In the interests of analytical integrity, this impact assessment has not attempted to quantify the benefits as part of the overall Net Present Value (NPV) estimate of the policy.
84. However, survey evidence from Bacs suggests that the costs associated with late payment currently incurred by business could be considerable and so there would be the potential for significant savings to business if the policy were to work as intended. There is a risk that in not quantifying the benefits, the overall cost-benefit analysis may overemphasise the costs without reflecting the potential for offsetting benefits. Whilst the benefits cannot be robustly quantified due to the uncertainty of the exact behavioural responses of businesses to the extra information provided by the policy and the scale of impact these will have on payment performance, an illustrative quantification of possible benefits has been included in paragraphs 143 to 146³⁹. These illustrations suggest that the policy would need to lead to an overall reduction in this burden of 0.19 per cent to fully net off the estimated annual costs to business of the policy under the central estimated cost.
85. The cost estimates made in the pre-consultation impact assessment were generated from a non-representative sample of businesses; however, subsequent consultation with stakeholders raised concerns that this risked giving an underestimate of the likely costs. In order to gather more robust evidence on the costs, BEIS commissioned a third party (Touchstone Renard) to obtain independent estimates of these costs, on the basis of a representative sample of 36 businesses.

³⁹ As the costs are direct and benefits indirect, only the costs of this policy will be scored under the Equivalent Annual Net Direct Cost to Business and the Department's return for the Business Impact Target.

Research methodology

86. Between August and September 2016, Touchstone Renard contacted 300 businesses with a high-level specification of the proposed reporting requirements and an initial questionnaire. Respondents were subsequently followed up with a semi-structured telephone interview, to probe and understand the company's background, systems, costs of meeting the new requirements and any other issues relevant to compliance that were raised by the respondents.
87. The underlying population of businesses was defined as large companies as defined by the Companies Act. A sample of 300 businesses was drawn from data supplied by the FAME database, and was representative of all the main business sectors, included substantial numbers of both the largest and smallest companies within range in the overall population, as well as a random sample of all companies.
88. The research took place during the summer months and was done to a tight timescale, and so due to lack of availability of Finance Directors or other suitably informed respondents, the actual sample interviewed was relatively small (36).
89. Eight of the respondents were parent companies that provided estimates of the costings across their whole group. These cost estimates were divided by the number of subsidiary companies in the group in order to obtain an estimate per individual company. This enables the per business estimates to be scaled up to obtain whole economy costs by multiplying by the estimated number of businesses in scope of the reporting requirements.
90. Only one estimate has been recorded per observation. Where a parent company has reported group level costs on behalf of their subsidiaries, a single individual level estimate has been recorded. This is because the population estimate affected by the regulations is defined in company, rather than company group terms.
91. There is a considerable amount of variation in the cost estimates reported across the sample. In some cost categories we consider that high outlier figures would act to skew the mean cost upwards in a potentially non-representative manner. To seek to control for both high and low outlier responses, the central estimates in this impact assessment are based on the research's median estimates⁴⁰; and given the clustering around the medians that the research findings show we employ lower and upper bound estimates modelled as increases or decreases of 10 per cent from the central estimate.

Structure of costs

92. The costs quantified in this impact assessment are the direct costs which are incurred by businesses as a result of having to satisfy the reporting requirements. There are currently no requirements for companies to report on their payment practices, so the cost burden imposed by this policy is the cost that falls on the firms in scope of the requirements to satisfy the legal duty to produce accurate reporting information to the statutory timescales required, on their payment practices and performance.
93. In order to take in to consideration the timing in which costs incur and discount future values appropriately, the costs were separated in to one-off "transition" costs, which would be expected to be incurred in the first year of the reporting requirements, and ongoing costs:
 - Transition costs:
 - Familiarisation with the new requirements;

⁴⁰ Or the first cost value to exceed zero should zero be the reported median.

- Adapting or purchasing IT systems;
 - Gathering information needed to update processes;
 - Changing processes.
 - Ongoing costs:
 - Maintaining systems and processes;
 - Preparing reports twice yearly;
 - Collating, approving and submitting reports twice yearly.
94. The costs of transition are assumed to occur once only, in advance of the preparation of the first report. For the purposes of NPV calculation, these are scored in Year 1.
95. Costs of collecting and providing information, sign-off and quality assurance will be recurring in every year of the appraisal period. This impact assessment has regarded the ongoing costs as being constant, although in practice, the costs may reduce over time as businesses become more familiar with the need to report payment performance and streamline their processes.
96. Costs included are the cost of purchasing external equipment, hiring external contractors and the opportunity cost of in-house staff being diverted to activities associated with complying with the reporting requirements instead of working on other profitable activities.

Transition costs

Familiarisation with the new requirements.

97. Businesses are likely to face a one-off cost of familiarisation with the reporting requirements, including time taken to understand and ensure reporting processes satisfy statutory requirements. A named person will typically need to be given responsibility for delivery of the requirements and clarifications may be sought from BEIS or BEIS non-statutory guidance about how to interpret the requirements and other issues such as timing of reports and reporting methods.
98. Estimates of familiarisation costs generally ranged from zero to costs of several thousand, with one estimate of £17,775. The median familiarisation cost estimate was £528.

Adapting or purchasing IT systems.

99. Some businesses will have existing electronic invoice systems or accounts payable software that will either have the capability or can be adapted to capture and report on the required metrics. Other businesses would not have the technical capability available from their existing IT systems and would need to purchase new IT systems. Respondents used a range of IT systems, with the larger companies most likely to use the SAP system and others using a diverse range including bespoke systems.
100. Costs of adapting or purchasing IT systems include all stages of IT development, from specification of requirements by users, through design of solutions (involving business analysts and/or IT specialists), testing and implementation of solutions and user acceptance.
101. Estimates from respondents varied significantly depending on the amount of adaptation expected to be needed and whether external support would need to be purchased. Some respondents indicated uncertainty about the level of costs involved until they had had time to analyse a final detailed specification from Government.
102. None of the respondents to this research were planning to implement new systems or use these new requirements as a rationale for implementing wider enhancements, so the cost estimates here do not include the potential for being combined with 'business as usual' IT

upgrades, but in the wider population of businesses in scope the cost burden of the reporting requirements may be reduced due to combining adaptation of IT systems with planned upgrades.

103. Estimated IT costs ranged from zero to several thousands, with an outlier estimate of £65,000. The median IT cost estimate was £1,000.

Gathering information needed to update processes

104. Managers need to understand what systems and locations are affected, what data are already held and what metrics are already produced. They need assurances about the reliability of the data and may require an audit to be carried out to properly understand how to gather all the components of information that are needed to satisfy the requirements.
105. Businesses will also be required to provide narrative text setting out their payment terms and dispute resolution policy, complete tick boxes stating whether they offer e-invoicing and/or supply chain finance, and whether they have signed up to any payment code. If they have signed up to a payment code they will be required to provide narrative text giving further details. This information is likely to be easily accessible within the firm and be relatively quick to put together.
106. Estimated costs of information were mostly zero or relatively small (up to a thousand), although a small number of respondents gave estimates of several thousand pounds. The median cost estimate was £185.

Changing processes

107. New internal management processes will need to be established in order to comply with the requirements. In order to generate new reports, new procedures would need to be set up to specify for instance what data will be extracted, from where, by whom, at what time, the processes by which it will be quality assured and signed off, how and when it is transmitted to the Government.
108. Around two thirds of respondents estimated costs of changing processes to be zero, although some respondents gave estimates of several thousand pounds. The first cost value to exceed the zero median cost estimate was £85.

Ongoing costs

Maintaining systems and processes

109. Once established, internal procedures need to be kept under review, communicated to the personnel who have to carry them out and updated where necessary. Any changes to the purchasing and accounts payable system could have a knock-on effect on the reporting requirements that would require modification. IT systems could involve software licenses and system support purchased from external suppliers on an annual basis, or provided by an in-house team (incurring an opportunity cost).
110. Over 50% of respondents felt there would be no cost associated with maintaining systems and processes once the initial systems and processes had been set up. The first cost value to exceed the zero median cost estimate was £100 and the upper estimate was £29,625.

Preparing reports twice yearly

111. The key reporting requirement in the policy is the requirement to report on the metrics of payment performance, including metrics on average time of payment and proportions of invoices paid beyond agreed terms, and paid within 30 days; between 31 and 60 days and paid beyond 60 days. The reports will need to also reflect any changes in dispute resolution policy or payment terms.

112. Estimates of costs associated with preparing reports depend on the amount of manual work involved versus the extent to which the company could automate the report using its IT systems. Tasks range from simply running an automated report, to extracting data to Excel and preparing the report from there, and/or generating varying amounts of manual data for transactions and suppliers that for whatever reason are not covered by the routine systems.

113. A number of respondents claimed there would be no ongoing costs associated with preparing the reports once systems had been established, with others estimating costs of a few hundred or a few thousand pounds. The median cost estimate was £593.

Collating, approving and submitting reports twice yearly

114. Costs of collating the information required in to a suitable format depend on the number of separate systems involved: for one integrated system there may be no collation, whereas organisations with multiple, unintegrated systems incur larger costs.

115. A director in the reporting company or a designated member in an LLP will be responsible for approving the data every time it is required to be published. Costs of approving reports depend on the complexity of the underlying data and the confidence managers have in their internal systems: factors that drive the variance between respondents in the expected amount of management time needed for signing off each report.

116. Businesses will be required to provide their data to a central location, to ensure data is presented in a standard format and easily accessible. Businesses will be required to upload the reports to a portal provided by the Department for Business, Energy and Industrial Strategy. Non-statutory guidance will be made available to support businesses to provide the information. No issues were raised by respondents about the cost of submitting reports to a portal and this does not appear to be a significant cost.

117. Estimated costs of collating, approving and submitting reports ranged between zero, a few hundred and a few thousand pounds. The median cost estimate was £319.

Estimated costs per business

118. The table below indicates estimated costs per firm based on the median estimates given in the interviews with firms for the central estimates. Low and high estimates are simply 10 per cent below or above the central estimate.

Table 4: Estimated costs per firm

Transition costs	Low	Central	High
Familiarisation	£475	£528	£581
Information gathering	£167	£185	£204
IT costs	£900	£1,000	£1,100
Changes to processes	£77	£85	£94
Total	£1,618	£1,798	£1,978

Ongoing costs			
Maintain systems and processes	£90	£100	£110
Prepare reports twice yearly	£534	£593	£652
Collate, approve and submit reports twice yearly	£287	£319	£351
Total	£911	£1,012	£1,113

Costs across all businesses in scope

119. To estimate the overall cost burden across all businesses in scope of the regulations, the estimates above have been multiplied by the estimated number of businesses in scope, 15,200.
120. The NPV gives an estimate for the total value of the costs across the full appraisal period of 10 years, with values for costs in future years discounted at a rate of 3.5% per year to reflect the greater value society attaches to present rather than future consumption⁴¹. The equivalent annual cost gives an estimate for a constant annual cost that would give the same NPV over the 10 year appraisal period if costs were constant in every year.

Table 5: Estimated overall costs to business (£m)

Transition costs	Low	Central	High
Familiarisation	7.22	8.03	8.83
Information gathering	2.53	2.81	3.09
IT costs	13.68	15.20	16.72
Changes to processes	1.16	1.29	1.42
Total	24.60	27.33	30.06

Ongoing costs			
Maintain systems and processes	1.37	1.52	1.67
Prepare reports twice yearly	8.11	9.01	9.91
Collate, approve and submit reports twice yearly	4.36	4.85	5.33
Total	13.84	15.38	16.92

Summary			
Present value of business costs	143.76	159.74	175.71
Equivalent Annual Direct Cost to Business (EADCB)	15.91	17.68	19.44

Indirect costs

121. The movement of funds from a customer to a supplier on completion of a transaction is an economic transfer from one agent (the customer) to another (supplier) in exchange for goods or services provided by the supplier. There is a cost or benefit associated with the time that the transaction takes place due to the opportunity cost associated with having access to liquid funds. The later a transaction happens, the greater the benefit to the customer and the greater the cost to the supplier. If the improved availability of information leads to a reduction in late payment this will place a cost on a customer that is offset by an equivalent benefit to a supplier.

Monitoring and enforcement

122. The regulations place a duty on all businesses in scope of the reporting requirements to publish their report by electronic means within the filing period. If this duty is not met, the company and every person that was a director of the company (or for LLPs, a designated member) immediately before the end of the filing period will have committed an offence,

⁴¹ See HM Treasury Green Book, Annex 6

which will make them liable on summary conviction to a fine. If false information is given, the offenders will also be liable on summary conviction to a fine. This follows precedents for similar reporting requirements under the Companies Act 2006.

123. The Government will not be incurring costs of pro-active monitoring and enforcement (such as random inspections) of whether or not companies are filing accurate information on payment times. However, the information will be publically available and visible to suppliers who can raise a suspicion directly with BEIS or take a complaint about poor payment performance with the Small Business Commissioner (SBC). Whilst the SBC is not an enforcement body, it can raise concerns with BEIS about payment performance of a particular business not aligning with its published returns.

Costs of investigation

124. Data from Companies House on compliance for filing accounts suggests around 94 per cent 'hard' compliance (i.e. filing on time) and 99 per cent 'soft' compliance (including late filing)⁴². These figures include all companies required to file accounts, however, we understand from anecdotal evidence from a number of sources that larger companies have higher rates of compliance than smaller companies. As the scope of these regulations relates to larger companies we may expect proportionately higher levels of compliance. Assuming a rate of 3 per cent of non-compliance for these regulations amongst the population of 15,200 firms in scope would lead to around 900 cases of non-compliance per year⁴³.
125. Estimates from Companies House on the administrative process investigating non-compliance indicates that an EO grade member of staff may be expected to spend an average of 4 hours per case managing the complainant, and potentially another hour if the case is referred to prosecution. On an assumption that all cases of investigation take an average of 5 hours, whether referred to prosecution or not, the average administrative cost (in terms of opportunity cost of the EO staff member's time) would be estimated at £80⁴⁴, leading to a total annual cost to Government of investigating non-compliance of £72,000.

Costs of prosecution

126. Data from Companies House on non-compliance for similar reporting requirements⁴⁵ suggests a rate of non-compliance leading to prosecution of around 0.09 per cent across the population of companies required to report. Again the actual rate of non-compliance leading to prosecution amongst the companies in scope of these regulations is likely to be lower due to larger companies being less likely to be non-compliant. Applied to the estimated population of 15,200 businesses in scope of the requirement this would lead to around 25 potential instances of non-compliance leading to prosecution per year⁴⁶.
127. Internal estimates from within BEIS suggest the cost of carrying out a prosecution would range from around £3,000 in the case of a straightforward guilty plea, to between £4,000 and £8,000 for prosecution through a Magistrates Court⁴⁷.

⁴² Companies House monthly statistics, June 2016.

⁴³ $15,200 \times 0.03 = 452$. This figure is doubled as companies have to make two returns per year.

⁴⁴ Full-time EO hourly range at mid-point of BEIS salary: £13.54. Uprating for non-wage labour costs based on 2015 wage data from Eurostat at 20.2% leads to overall hourly cost of £16.28. $£16.28 \times 5 = £81.38$ per case.

⁴⁵ Section 451 Companies Act 2006 (default in filing accounts and reports) and Section 858 Companies Act 2006 (failure to deliver annual return). In 2015/16, out of an overall population in scope of 3.79 million, there were 4,474 charges brought for failing to deliver accounts (0.12 per cent) and 2,341 brought for failing to deliver annual returns (0.06 per cent).

⁴⁶ $15,200 \times 0.009 = 13.68$; doubled to take in to account there are two returns per year makes 27.36; rounded down to 25 due to being a potential overestimate (see explanation in text above).

⁴⁷ These costs may include further investigation from the prosecutions team, preparation from law clerks and lawyers, agents' fees and Counsel fees.

128. We do not know the likely proportion of cases that would involve a guilty plea, or be contested in the Magistrates Court, but would assume that most cases of prosecution of non-compliance would be relatively simple to prove and so would include a large proportion of guilty pleas. Assuming a mean cost of prosecution of £5,000 per case, the total annual cost to Government of prosecuting non-compliance would be £125,000. Some of these costs may be possible to be recovered from the defendant as part of the sentencing process, depending on individual means. However this assessment has assumed that no costs are recovered and the full cost falls on Government.
129. This leads to an overall annual estimated cost to Government of investigating and prosecuting non-compliance of £197,000. For the purpose of calculation of 'low' and 'high' estimates for the NPV, a 10 per cent margin above or below the central estimate has been used, i.e. a low estimate of £177,300 and a high estimate of £216,700.

Table 6: Costs of investigation and prosecution

Estimated rate of non-compliance	3%
Estimated annual cases of non-compliance	900
Cost per investigation	£80
Total cost of investigations	£72,000
Estimated rate of non-compliance leading to prosecution	0.09%
Estimated annual prosecutions	25
Cost per prosecution	£5,000
Total annual cost of prosecutions	£125,000
Total annual cost of investigations plus prosecutions	£197,000

Types of benefit

130. The benefits of the policy are more difficult to identify and measure than the costs. The policy will improve the functioning of the market by providing more information on the payment practices and performance of large businesses, tackling the core market failure of asymmetric information. This will allow suppliers to check the payment record of potential customers before agreeing to enter in to a contract, and will also show large businesses how their performance on paying suppliers rates against their peers, which should act as a behavioural spur to the less prompt payers.
131. The ultimate benefits of the policy should be an overall reduction in payment times, reducing the costs incurred to businesses that suffer from late payment, including:
- Reduced need to pay interest on external finance or forego alternative returns on cash reserves;
 - Reduced administrative costs by not having to chase payments or make contingency plans to find alternative liquidity when expected receipts are late;
 - Increased ability to finance hiring extra employees or increase capital investment due to not needing to use cash reserves to cover for late payments;
 - Lower likelihood of business exit.
132. These benefits will be indirect as they will rely on second round effects flowing from the responses of other businesses. For instance, suppliers with full information on the payment practices and performance of their potential customers will be able to take this in to consideration before entering in to contract. This may lead them to punish slower paying customers / reward faster paying customers through negotiations on the price and terms of a contract, or may lead them to decide not to contract with a slower paying customer.
133. Alternatively, businesses that have a poor record on payment performance that is now in the public domain as a result of the policy may be shamed in to improving their practices and performance, or businesses that are required to report may simply respond to the knowledge that they will have to report on their practices and performance by seeking to improve.
134. If these type of behavioural responses lead to a reduction in payment times or particularly a reduction in the incidence of late payment then it should lead to benefits for the businesses currently suffering detriment as a result of late payment.
135. These benefits are difficult to quantify in advance of the policy coming in to effect as they would rely on assumptions about the behavioural response of businesses and the extent of reduction in late payment. However, an illustration of potential benefits is included in paragraphs 143 to 146.

Benefits for suppliers to businesses required to report

136. Suppliers who contract with or would potentially enter in to contracts with businesses in scope of the reporting requirements will have access to information that they otherwise would not be able to access. This will help inform the decision on whether or not to enter in to contract, as suppliers will be able to compare the payment performance of alternative customers and choose to contract with customers that offer better payment terms.
137. The enhanced information should help suppliers negotiate fair terms and prices in contract negotiations. It could strengthen the bargaining position on agreeing a contract by providing benchmark information against general normal market practices, limiting the

scope for customer businesses to argue for lengthy payment terms⁴⁸. The information is also useful in the negotiation of contract prices, as suppliers knowing that a customer has a lengthy standard payment period will be able to factor the cost of having to cover cash flow needs by other means (e.g. overdraft, external finance) in to the price of the contract.

138. When suppliers do choose to contract with a customer that has a record of slow performance on payment, the information on the customer's performance informs them of the risk, and allows them to plan accordingly.
139. By providing clear information on dispute resolution processes, suppliers facing complications with payment can clearly identify how to escalate an issue, reducing the time and resources involved with chasing a payment or a dispute.
140. Over time, the improved availability of information should lead to general market improvements through competitive pressure: suppliers will be more likely to contract with faster paying customers, driving more business activity to involve faster payers and driving business away from those with poor records on payment. This should lead to reduced payment times, reducing the costs of late payment incurred by suppliers.

Benefits for reporting businesses

141. The underlying market failure of asymmetric information has a negative effect on some of the businesses that will come in to scope of the reporting requirements – namely those with better payment performance. The absence of effective information to compare with rivals means that they do not have the means to signal their good payment performance to gain an advantage in the market. Whilst they could voluntarily incur the costs of reporting and publishing, the information provided would be less meaningful when it was not published alongside the performance of other businesses for comparison. By mandating all businesses that come in scope of the reporting requirements to publish their payment information, the businesses with better performance will be able to signal their quality to suppliers through comparison with businesses with worse performance.
142. Shareholders and investors will be able to use the information to better judge the general cash flow health of a company: whilst a company's liabilities are visible from annual financial statements, the information on payment performance will allow investors to see how quickly a business fulfils trade debts. This could lead to better internal accountability and corporate governance, and also provide a positive signal to potential investors of the quality of a company that has a record for good payment performance.

Illustrative quantified benefits

143. Bacs research quantifies two types of cost to businesses as a result of late payment: the administrative cost suffered due to diverting resources to chasing late payment, and the value of outstanding debt. The cost of resources diverted to chasing late payment is the opportunity cost of the best alternative use of the resources (e.g. staff time) which could be otherwise used for profitable business activities.
144. The cost of having a stock of unpaid debt outstanding is the opportunity cost of having the unpaid debt readily available in cash reserves to the business concerned: for instance allowing the business to invest in capital equipment, hire extra labour, or spend on marketing activities or research and development. Without having that cash readily available, businesses may face an added cost of raising it through external finance in terms of interest payment. Another way in which having outstanding debt leads to a cost to

⁴⁸ Suppliers in existing contracts will be able to compare the payment times of their customers to industry norms, potentially assisting renegotiation of terms.

business comes when it causes cash flow difficulties and forces the business to raise liquidity through external finance, again incurring an interest payment.

145. The exact opportunity cost of outstanding debt will vary from case to case depending on the potential profitability of alternative uses of cash or the terms in which a business can access equivalent funding through external finance. However as a simplifying assumption we can consider that when a business considers the costs involved with diverting resources from other activities to chasing payment, it will do so only to the extent that the potential benefit of collecting the unpaid debt is greater than costs. In other words, the cost businesses incur in chasing late payment is a rough proxy for the opportunity cost of the unpaid debt that will be collected through chasing late payment. We can then illustrate the potential benefits to businesses under scenarios where the costs of chasing late payment were reduced due to an improvement in payment performance.
146. The estimated annual cost to business in terms of administrative cost of chasing late payment is £9.16bn, made up of £8.8bn to SMEs and £359m to Corporates. The table below illustrates the potential savings that could be made under scenarios where the reporting of payment information led to reductions in the administrative costs of chasing payment of between 0.25 per cent and 2 per cent. The reductions would be expected to follow from a general reduction in the volume of late payment, as firms were able to divert administrative resources back from chasing payment back to more profitable opportunities. We do not know what reduction in the incidence of late payment would lead to these kind of reductions in the administrative cost of chasing payments, but have chosen low percentage effects to illustrate the potential for benefits that would offset the costs: just a 0.25 per cent reduction in cost of chasing late payments would lead to £22.9m of benefits to UK businesses.

Table 5: Potential savings to business of reduced admin costs in chasing late payment

Reduction in admin cost of chasing payment	Corporates	SMEs	Total
0.25%	£897,000	£22,025,000	£22,922,000
0.50%	£1,794,000	£44,051,000	£45,845,000
1.00%	£3,588,000	£88,101,000	£91,689,000
2.00%	£7,176,000	£176,203,000	£183,379,000

Risks and assumptions

147. The reporting requirement could cause some perverse incentives amongst businesses. Businesses that have shorter payment terms could have an incentive to extend their payment terms to reduce their risk of having late payments on their reports. This is mitigated against by the requirement for businesses to publish the proportion of invoices paid within 30 days, between 31 and 60 days and over 60 days. The requirement to publish their standard contractual terms will also allow businesses to highlight their short payment terms as a positive.
148. There could also be a risk of businesses falsely disputing invoices to ensure that their ‘paid on time’ figures are positive. We have taken several steps to address this. Firstly, disputed invoices are not expressly carved out of the metrics, and will therefore be counted in some of the metrics. There is also an offence for false statement which we could use to prosecute companies and directors in instances where information published is false or

misleading. It is also within the planned remit of the Small Business Commissioner to investigate small business complaints about payment issues.

149. Businesses that already have a good record of performance in terms of prompt payment may not have previously realised how their performance compared to others. Once this information is available, they may use this to their own advantage when negotiating contracts in order to get a better price. This could result in suppliers having to offer a discount premium when dealing with the fastest paying customers. However, as suppliers will be able to compare the payment speeds of different customers before deciding to enter in to any contract, the level of discount they may offer would reflect the value the supplier places on prompt payment. Over time this could result in the value of prompt payment being reflected in contract prices and thus create a further incentive for prompt payment.
150. The estimated aggregate cost to UK businesses of chasing late payments includes cases where late payers are small and medium-sized businesses. This policy proposal only directly affects large companies, and although the BACS research cited in this impact assessment suggested large companies were the worst offenders, it should be acknowledged that the this measure will potentially reduce costs only in relation to large late-paying companies⁴⁹.

Business Impact

The BIT and Qualifying Regulatory Provisions

151. Section 21 of the Small Business, Enterprise and Employment Act 2015 (SBEE) established a duty on the Secretary of State to publish a target for Government in respect of the economic impact on business activities of qualifying regulatory provisions which come in or cease during the relevant time period. The Business Impact Target (BIT) established in March 2016 was for a saving of £10bn for business and voluntary or community bodies from qualifying measures that come in to force or cease during the Parliament⁵⁰.
152. “Qualifying regulatory provisions” are broadly defined as provisions concerning the regulation of activities of business and community and voluntary bodies, except where they are undertaken by public bodies or as part of delivery of public services⁵¹.
153. The requirement to report on payment practices and performance is a qualifying regulatory provision and therefore all of the direct⁵² costs to business covered in this impact assessment will come in scope of the BIT. Costs of monitoring and enforcement fall on Government and so are not in scope of the BIT but are included in the overall NPV of the proposal.

⁴⁹ There is a theoretical possibility that by encouraging improvements to payment times amongst larger companies, there may be a consequent improvement amongst small and medium-sized businesses due to better general norms of payment culture.

⁵⁰ <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2016-03-03/HCWS574/>

⁵¹ Section 22 of SBEE

⁵² Direct impacts are impacts that can be identified as resulting directly from the implementation or removal/simplification of the regulation.

NPV and BIT score

154. Table 7 indicates the central, high and low estimates for the overall whole economy NPV of the policy (including all quantified costs to business and government, but excluding benefits that have been calculated in this impact assessment for illustrative purposes only), and the business NPV (including only costs that fall on business).
155. As the benefits of the requirements appraised in this impact assessment have not been quantified, the central estimate of the economy NPV of benefits minus costs over the 10 year appraisal period is negative, -£161.4m, with an annual net direct cost to business of £17.7m per year.

Table 7 NPV and BIT score⁵³

	(£m)	Low	Central	High
Whole economy NPV (Benefits - Costs)		-177.58	-161.43	-145.29
Business NPV (Benefits - Costs)		-175.71	-159.74	-143.76
Equivalent Annual Net Direct Cost to Business (EANDCB) ⁵⁴		19.4	17.7	15.9
Business Impact Target score		97.0	88.5	79.5

156. In line with the Better Regulation Framework guidance, the BIT score is calculated as 5 x EANDCB for measures with an appraisal period of 5 years or more and as $t \times$ EANDCB where t represents the number of years of appraisal period, where the appraisal period is shorter than 5 years. The central estimate in this impact assessment is for a score of £88.5m to be recorded against the Department's BIT.

Breakeven analysis

157. Given the estimated annual cost to business in terms of administrative cost of chasing late payment is £9.16bn, the policy would need to lead to an overall reduction in this burden of 0.19 per cent to fully net off the estimated annual costs to business of the policy under the central estimated cost of £17.7m. Under the high estimate, an overall reduction of 0.21 per cent would be needed to fully net off the estimated cost of £19.4m.

Small and Micro Business Assessment

158. Under the Government's Better Regulation Framework guidance, the default option for new regulatory measures is for small and micro businesses to be exempted from new regulatory measures. The requirement to report on payment practices and performance does not apply to small or medium-sized businesses and so there would be no costs to small and micro businesses as a result of these regulations.
159. Small and micro businesses are particularly vulnerable to the costs associated with late payment, especially in terms of liquidity constraints. They should benefit from the ability to access information on the payment practices and performance of larger businesses that are required to publish their payment information.

⁵³ Note that here "low" and "high" are presented in terms of "net benefit"

⁵⁴ The EANDCB has been rounded to one decimal place ahead of multiplying by 5 to generate the BIT score

Wider impacts

Equalities impact

160. The costs and benefits of the policy would not be expected to fall disproportionately on any of the protected groups.

Families Test

161. The costs and benefits of the policy would not be expected to affect families or their formation.