

Late payment and the supply chain

Business analysts comment that the world is getting smaller, with technological innovation enabling business to be conducted across national borders. Effective payment systems are a key driver of global economic systems.

Within the European Union, this is certainly recognised by the European Commission, who have stated that “one in four insolvencies is due to late payment; leading to the loss of 450,000 jobs each year and resultant increases in unemployment within the European Union”. This scenario can quite easily be applied to other regions of the world. At the organisational level, it is small and medium enterprises (SME's) that are more affected by cashflow problems than larger enterprises.

The Chartered Institute of Purchasing & Supply (CIPS) recognises the importance of good payment practices. One of the roles of the procurement professional is to manage risk within the supplier base. Late payment within the supplying organisation can be an indication of cashflow difficulties. Thorough pre-contract supplier evaluation sourcing activities should aid the identification of vulnerable suppliers. In the manufacturing industry, a full order book is no guarantee of supplier soundness. Insolvency is often the result of the supplier experiencing financial difficulties caused by cash flow problems.

Though the focus has been on late payment, there are tangible benefits through paying suppliers on time. These include:

- The ability to focus on greater value adding activity, such as fostering innovation from the supplier base, rather than utilising resources on managing purchase ledger activities.
- The potential to secure genuine cost reductions with suppliers who no longer have to factor late payments into their cost of sales activities.
- The benefits to the reputation of the organisation in the marketplace.

CIPS encourages purchasing professionals to do the following in relation to late payment:

- Firstly, recognise that your supplier has the right to seek legal redress for payment made late according to contract terms. Payment obligations should be built into the company Corporate Social Responsibility (CSR) effort.
- Make payment issues an integral part of your supply chain, starting with the identification of customer needs; moving to credit checking potential suppliers (part of pre-contract supplier evaluation), through to invoice reconciliation. Organisations should have a standard referral/approval process in the event of an error or dispute.
- Seek to achieve fair and equitable payment terms with your suppliers and incorporate them into your terms and conditions of contract. For example, electronic invoicing (e-invoicing), also referred to as ‘Electronic Invoice Presentation and Payment (EIPP) may be beneficial to both you and your supplier. Automated, web based purchase to pay (P2P) systems may be used where appropriate, to facilitate the payment process and eliminate the need for manual intervention.
- Pay your invoices on time, according to contract.
- Monitor, measure and report on the effectiveness of your payment systems, setting internal service level agreements (SLA's) for procurement and finance.
- Gain senior management commitment for a process to clear disputes quickly.
- Communicate your company payment policy with your finance department. The purchasing professional may be able to actor in a genuine discount from the supplier for earlier payment.
- Consider the rules relating to operating in territories outside the United Kingdom and any special considerations for foreign currency transactions/ payments.

Conclusion

Cash flow is the lifeblood of any organisation, the management of which can determine the financial viability of an organisation. The procurement professional has a key role to play in mitigating financial risks of potential suppliers. Effective payment processes can enable both the buying and supplying organisation to allocate greater resources on value adding activities, thereby improving competitiveness within the supply chain.

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