Agricultural Engineers Association
British Automation and Robot Association
British Paper Machinery Suppliers Association
British Plastics Federation
British Turned Part Manufacturers Association
Gauge and Toolmakers Association
Manufacturing Technologies Association
Printing Industry Confederation
Processing and Packaging Machinery Association
UK Industrial Vision Association

Engineering and Machinery Alliance
Submission for the consultation on

Building a responsible payment culture

1 Background – EAMA and the sector

The Engineering and Machinery Alliance (EAMA) represents circa 1,400 firms from 10 different trade associations (please see the masthead) mostly SMEs in the mechanical engineering sector with sales of some £6.5 billion.

Typically, our companies supply 'enabling technologies' to other sectors (e.g. automotive, aerospace, medical, power, printing and food industries) in the form of machinery or packages combining services and products. Much but by no means all of this is carried out by small and medium sized niche or specialist firms (SMEs) -- innovative, entrepreneurial companies pushing the boundaries of factory performance, extending the envelope of the physically feasible to new levels in terms of speed, precision and migration into novel technologies and materials.

They account for about a fifth of the UK's mechanical engineering output, and according to HM Customs' data, sector exports account for about 70% of sector sales.

2 Introduction

We lay out our views on the questions posed in section 3 and then in section 4 we lay out a broad solution that would be relevant to sectors similar to ours, where there is a well recognised need to grow domestic SMEs, and by facilitating that growth strengthen the competitive performance of UK supply chains internationally. Ultimately this solution relies on a shared sense of responsibility for the success of the supply chain to which the participating firms belong.

3 Consultation questions

Current Status

Q1 Do you agree that failure to issue purchase orders for public contracts in a timely fashion is a problem and has caused delays in payment? What measures could Government introduce to ensure that this does not happen? How could this be achieved simply and effectively?

- We don't have enough relevant experience to comment directly.
- However, more broadly we note there's a real danger that pre-qualification can crowd out competition.

Q2 Do you think any specific change is needed to make suppliers feel better able to complain or charge interest in instances when they are paid late on public sector contracts? What measures could Government introduce to encourage this?

- Not enough experience to comment, but it seems to us that this should be closely linked to Government's commitment to ensure that a proportion of public sector contracts below £100,000 are handled by SMEs, without cutting back on innovation,

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and that terms for payment are audited to be seen to comply with Government's intentions both in terms of the split of business going to SMEs and the timeliness with which they are paid for their work.

Tackling late payment

Incentivising fair transparent payments practice

Q3 Do you agree that more disclosure of company performance on supplier payment would be useful? If so, do you agree that a voluntary framework would be an effective, proportionate response, or should alternative mandatory options be introduced?

- Credit rating agencies already supply assessments of companies' creditworthiness and suggested debt ceilings (e.g. Mint's Qui ratings). Greater transparency isn't therefore likely to provide 'new' information if the agencies are doing their job reasonably well. But it will open the 'threat' of embarrassing the late payer. We are uncertain as to what advantages would actually accrue from that.
- Will the company concerned amend their ways or will they simply further their relationships with fewer suppliers? We aren't convinced either way. What would be important is that the performance should be taken into account in their credit rating. We presume that it is but don't know exactly how.
- Maybe if that process were better understood by all involved, then the late payers would look to change their behaviour because they would see the benefit they would gain from keeping to their payment terms.

Q4 Do you agree that if a new framework were brought in (whether voluntary or otherwise) it should include the elements described on page 18? Should further elements be included?

- Maybe but please see Q5.

Q5 Are there any other measures related to transparency or disclosure that would incentivise companies to ensure that their supplier payments are managed fairly and efficiently?

- In our sector it's not uncommon to have specific milestones attached to the payment schedule. Some cover complex agreements that aren't solely related to date but to performance to a specified level. The client needs those protections. Without them there wouldn't be any progress. Everyone would simply produce what they've produced before. It therefore seems inevitable that there are going to be 'problems' round a very small number of contracts that will be open to genuine disagreement.
- If there's going to be increased transparency, it will be important for such contracts to be reflected differently from the unethical practices where a purchasing department in a very large company simply imposes an extended payment period on its suppliers to improve its cash flow at their expense because they can.

Strengthening the prompt payment code

Q6 How can the Prompt Payment Code better raise awareness of good practice? Would case studies of how companies manage different stages of the payment cycle be helpful in demonstrating how the Code principles can be applied in practice?

- Anything that raises awareness of better management practice would be helpful.

Q7 Are there any steps that could be taken to encourage more businesses to identify breaches of the Code by signatories?

- This might be an area where trade associations could play a useful role. Please see Qs 13 and 18.

Q8 What further measures would you like to see as either a signatory, or a supplier of a signatory, to give you confidence in the Code as a marker of good practice? In particular, *would it be useful to ask for publication of the maximum payment terms offered by signatories?*

- No comment

Q9 Should a new 'upper tier' be introduced to the Prompt Payment Code for signatories prepared to agree to more stringent rules?

- The very large customer able to offer the multi-million-pound contract is always going to be attractive to suppliers so we don't see an upper tier deriving much competitive advantage from a 'regulatory' or more formalised approach. We would favour a voluntary supply chain approach as long as it was transparent and open to new participants.

Q10 Should businesses be offered incentives to sign up to an 'upper tier' if introduced? What would be an appropriate and effective incentive?

- Payment performance could in theory be an important element in a company's business profile, reflected in its annual report as part of its broader impacts on its environmental and citizenship roles, but we are sceptical as to how in reality the company would derive measurable financial benefit or indeed whether it would have much effect, e.g. on a multinational's behaviour headquartered outside the UK issuing instructions to its subsidiaries in the UK.

Helping businesses challenge late payment

Fines and penalties

Q11 What are the barriers to claiming interest on late payment? What could be done to encourage more businesses to claim interest and late payment charges where appropriate and create an environment in which this is considered the norm?

- Contracts often make reference to rights to claim interest. We believe firms are reluctant to claim because of the amount of work involved and the fact they want to continue to do business with the company in the future, unless of course they see it as the last job they'll do for that client.
- There are simply too many different types of contract to generalise.
- Some firms are in the happy position of being able to insist on 100% payment on delivery. Others may have to work on very tight margins and may even then be squeezed by their client on the technical performance of the component they deliver; and still others on two or three milestone payments that may stretch many months ahead.
- For example, the automotive sector has been notorious for the way it has pursued cost down increments. But we also have to recognise that if they hadn't been, the UK might not be benefitting from the flourishing sector that's based here now.

Q12 Do you believe that further penalties payable to creditors would be a useful means of discouraging late payment? If so, how do you think that they could be implemented given suppliers' inevitable concern not to damage future commercial relationships? Do you have views as to how any such additional penalties should be framed or the level at which they should be set?

- No comment. Please see Section 4.

Q13 Do you see advantages in a third party (which could be Government or another body, such as trade associations) playing a more direct role in the collection of penalties for late payment? If so, how could such a system be implemented effectively given the challenges discussed above?

- There are many different types of supply arrangement that extend beyond the demarcation lines of individual trade associations or indeed most membership organisations (please see Section 4).

- We don't see a role for trade associations collecting payments, but we do see a role for such organisations in collecting data about payment performance and sharing that information more widely amongst their members and maybe beyond.

Length of payment terms
Q14 Should businesses remain able to agree payment terms that are over 60 days? What impact would a hard limit on payment terms have? How would this affect different sectors?

- As suppliers to major OEMs in many different sectors our members are keen to have as short a payment term period as is relevant to their performance under the contract.
- The danger of having a mandated maximum period is that it may then become the norm.

Q15 Under what circumstances do you think that a payment period should be considered to be 'grossly unfair' to the supplier? How could this be defined more clearly? Would it be possible to agree one set of principles for all transactions or would differentiated approaches be more appropriate, for instance on a sectoral basis?

- It is clearly 'unfair' when the payment delay forces the supplier to take on extra financing costs that change its cash flow position from neutral to negative. Negative 3-5% might be considered 'grossly unfair'.

Q16 If businesses remain able to agree payment terms over 60 days, should they have to consult with suppliers and state publicly that they are doing so, or publish reasons explaining why? Should this apply to all businesses or only large companies? How would this help or hinder your business?

- No comment

Sector based approaches
Q17 Are there simple steps that might be taken to make the construction adjudication process quicker, cheaper or both?

- No comment

Q18 What role, if any, could industry or sector bodies play in identifying and promulgating good contractual practices within their sectors and adjudicating on disagreements? Do you see particular sectors as priorities for action? How might Government facilitate this?

- We believe sector bodies such as trade associations could usefully collect information from members about customer companies' payment performance against some agreed framework and share this information with members and where it's clear that a firm's performance is radically out of line with others, inform them of this finding to encourage change.

Credit information
Q19 Do you think that more information on whether companies have a history of late payment would help suppliers negotiate better terms when doing business?

- This information should be available through credit rating agencies that have the skills to carry out the necessary analyses and advise on relevant exposures.

Q20 What can businesses, data hosting platforms and Government do to facilitate greater transparency?

- No comment

<u>Technology</u>
Q21 What prevents small businesses from using technology services to help them with financial management and payment? What could be done to encourage greater take up?

- No comment

Alternative financing options

Q22 Do small businesses have adequate access to the information and support they need to understand the external financing options available to them? What would help raise awareness of these options?

- For SMEs that are struggling or being bullied by larger company customers factoring and invoice financing appear tempting and sometimes are the only avenues open to for the immediate future. But the truth is that banks earn considerably more from these options, so they tend to push them. From the SMEs' perspective they will hobble management's decision making options and may restrict freedom in areas such as exporting or developing new markets, because the bank will most likely impose stricter terms (e.g. reducing the proportion payable on issuing the invoice) and/or raising the charges. If the SME is unlucky the 2% charge may pretty well equal the margin on the job!

Q23 How could working capital options be made cheaper and more accessible to small business?

- No comment

Q24 Would removing contractual barriers to selling invoices (e.g. as a result of a ban on assignment) be helpful to small businesses by increasing their access to services such as factoring and invoice finance?

- No comment

4 Additional considerations to further prompt payment through a clear standard relevant to the sector

- Ensuring prompt payment (i.e. eradicating late payment) is an intractable issue. From our perspective there are simply too many variables to make it amenable to a neat solution or one set of guidelines that will satisfy all participants.
- Of course, the ICM guidelines are important and very useful. They are short and clear and therefore useful. But if they are to be implemented they need to be underpinned by shared interests rooted in the supply relationship, because the contracts they seek to encompass are various and complex – as between supplier and customer for services or products, commodities or manufactured goods, consumer or investment goods, semi-finished or highly engineered product against an active least cost, or cost down background and so on.
- And in many of these relationships it's not only the supplier that's bearing the risk. If the customer requires a highly 'tailored' solution for a specific (maybe unique) application (e.g. even in his own factory), he will only be able to proof performance by running it in real time.
- Various UK manufacturing sectors have stated they want to see stronger supply chain performance in the UK and insist on suppliers meeting certain standards (e.g. BSI, EN, and ISO). Companies are well used to this and to be audited occasionally to ensure they are up to muster.
- Meanwhile, delayed payment has the 'double whammy' effect of 1) increasing uncertainty for the supplier and their financial partner which 2) increases the supplier's costs and raises hurdles for investment, ultimately stymieing SME investment that would provide efficiencies to the benefit of the whole supply chain.
- Taking the principles enshrined in the ICM prompt payment code and drafting them into specific standards for particular types of supply chain relationships could simplify contracts, increase transparency and reduce uncertainty for the supplier and their bank as if the customer then failed to meet the standard they would no longer be able

to claim they met its performance standards, which would have an impact on their standing with their bank and other partners.