

The Chartered Institute of Building

submission to

The Department of Business
Innovation and Skills (BIS)

on the consultation

Building a responsible payment
culture

28 January 2014



Building a Responsible Payment Culture response form

The closing date for this consultation is **31/01/2014**.

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Please tick the box that best describes you, your company or organisation

	Large business (over 250 staff)
X	Medium business (50 to 250 staff)
	Small business (10 to 49 staff)
	Micro business (up to 9 staff)
	Business representative organisation/trade body
	Charity or social enterprise
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	Individual
	Central government
	Local Government
X	Other (please describe) Professional Body

About the CIOB

The Chartered Institute of Building (CIOB) is at the heart of a management career in construction.

We focus on those entering and already in a management career in construction by delivering qualifications and certifications that meet the needs of a changing industry. We work with members, employers, academia and governments across the globe to drive forward the science and practice of management in construction.

Our submission has been developed for the public benefit and is also informed by feedback from our members.

General Comments

Late payment poses a significant threat to the construction industry. Generally, for a project to finish on time, on budget and to a high quality, prompt payment is required so that progress is not halted due to issues with cash flow.

Late payment is also a significant obstacle for small businesses in the sector. This is reinforced by analysis in *Construction 2025*, the Industrial Strategy for construction, which found that over a third of construction SME employers are paid later than they require under their normal terms of business.

A widely held view is that clients and tier 1 contractors retain money for as long as possible, whereas sub-contractors wish to obtain their money as soon as possible. Longer payment periods affect all levels of the supply chain and those lower down may become cash starved, forcing greater reliance on borrowing and, potentially, risk insolvency.

The question of how to address this imbalance is something that has lingered in the construction industry for decades, despite a raft of legislative measures and payment codes that have been set up to tackle the issue. We are therefore fully supportive of the aims of this discussion paper in addressing this vital issue.

Response

Question 1: 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?

Simple measures can be taken to ensure that payments are not delayed. For example, all invoices should be legally compliant and include a valid purchase order number as well as the correct details of the payee. Non-compliant invoices are often sent back to the supplier which in turn may lead to a delay in payment. Of course, all public sector bodies should be following UK and EU Public Procurement Regulations.

Question 2: Do you think any specific change is needed to make suppliers feel better able to complain or charge interest in instances when there paid late on

public sector contracts? What measures could Government introduce to encourage this?

As highlighted in the discussion document, despite legislation being in place to tackle late payment, few companies utilise their rights and only 10% of businesses stated that they have considered using late payment legislation¹. Suppliers, many of whom are SMEs, may lack the knowledge or understanding of legislation that enables them to charge interest at the Bank of England base rate plus 8% for any late payment.

Additionally, suppliers may also be concerned about jeopardising commercial relationships. For businesses that are reliant on a constant stream of work from clients, it may be justifiable to receive late payment rather than complain about late payment and risk losing future work. Furthermore, some suppliers may also consider the cost of pursuing and charging interest for late payment to not be financially viable and the cost of taking action may be more than the actual amount of monies owed. Within the private sector particularly, these issues open up avenues for clients and larger contractors to withhold payment. By understanding that suppliers may be hesitant to complain or charge interest in instances when paid late they can operate without too much concern about potentially incurring penalties or complaints.

Indeed, public authorities, under the EU Directive which came into force on 16 March 2013 should be paying suppliers within 30 days of receipt of an undisputed invoice and suppliers could be notified by a third party to inform them that payment is late.

Additionally, more could be done to give confidence to suppliers about what they are entitled to in the event of late payment. There are a range of resources available to help smaller businesses adopt good credit management skills as well as help bring them up to date with relevant legislation. A good example is the Institute of Credit Management's *Managing Cashflow Guides*².

Question 3: 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?

Yes, a voluntary framework would be an appropriate response and would demonstrate a commitment to corporate social responsibility and transparency. However, voluntary frameworks must be monitored against a series of agreed key performance indicators (KPIs), and any company registering under the framework must be able to demonstrate this through measurable targets and not merely playing lip-service to it. Arguably, although mandatory options would provide effective regulation, with businesses placed on a level playing field, we feel that it would be difficult to legislate for, particularly under the current government where the onus is on deregulation.

Question 4: 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?

Yes, the elements described are suitable but we advise that KPIs are put in place to

¹ Management Today, [Late Payment Gets Later](#), 23 June 2011

² Institute of Credit Management, [Managing Cashflow Guides](#)

ensure compliance and business performance can be measured. Furthermore, any new framework needs to be aligned with current policies and the new supply chain charter that is being developed for the construction industry.

Question 5: 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?

No comment.

Question 6: 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?

Yes, we believe that case studies demonstrating best practice in the payment cycle would be helpful for demonstrating how the Code principles can be applied in practice. Any guidance should be brief and informative, drawing details of where complications and risks may be most likely to occur.

Question 7: Are there any steps that could be taken to encourage more businesses to identify breaches of the Code by signatories?

Mandatory publishing of payment performance on data portals such as contracts finder or data.gov.uk would be a useful mechanism for disclosure. This would enable suppliers to observe payment trends and identify breaches.

Whistleblowing procedures may also be a viable option for disclosure and should be considered in any future legislation.

Question 8: 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?

Publishing maximum payment terms and the reasons for doing so by signatories would be beneficial to those in the supply chain to see whether competitors are offering better terms.

Question 9: Should a new 'upper tier' be introduced to the Prompt Payment Code for signatories prepared to agree to more stringent rules?

No, the Prompt Payment Code has not yet been successful in bringing an end to the culture of late payment. We believe bringing in a new 'upper tier' will add to bureaucracy and the policy should seek to rectify issues with the code before looking at this area.

Question 10: Should businesses be offered incentives to sign up to an 'upper tier' if introduced? What would be an appropriate and effective incentive?

See response to question 9.

Question 11: 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?

The complications identified in question 2 often act as barriers to businesses claiming interest on late payment. Although using the legislation is a statutory right and not designed to jeopardise existing customer relationships, many businesses in the supply chain do not have the confidence to use it and often it is perceived that, in most cases, will represent an end to the relationship with the client. Indeed, research conducted by debt recovery law firm Lovetts indicates that only around 33% of small businesses are claiming for late payment (as of early 2013), this is despite robust legislation being in place to empower businesses to tackle payment terms³.

As highlighted in our response to question 2, SMEs can use a range of resources to build confidence in their credit management skills as well as help develop their understanding of relevant legislation. However, business culture remains a major obstacle to using such legislation particularly given the perceived threat inherent for SMEs in an established supply chain.

Question 12: 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?

We do not believe that increasing the penalties payable to creditors would discourage late payment and would in fact lead to businesses and clients adopting longer payment terms. As highlighted in the discussion document, for statutory penalties to be effective, suppliers need to be prepared to use them and current evidence indicates that the vast majority of those suppliers are not.

Question 13: 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?

Yes, we agree that this approach may lead to the reporting of businesses that are repeat offenders of late payment. Suppliers suffering from late payment may see it as a more suitable method for disclosing payment practices – particularly if they can report clients anonymously. The third party regulator can also act as a mediator where there has been a complaint against a business although late payment has been as a result of an administrative error; the company is in temporary financial difficulty or as the result of a business further up the supply chain being responsible for the

³ Debbie Abrahams MP, [The Report from the All Party Inquiry into Late Payments in Small and Medium-Sized Enterprises](#), July 2013

initial delay in payment.

Question 14: 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?

We believe that flexibility is a key business asset – decisions should be in line with business requirements and in certain situations we believe that businesses should be free to negotiate longer payment terms with suppliers. However, if these terms are indeed rejected, it should not hamper outstanding or future relationships between the businesses. If a supplier suddenly loses work as a result of this, they should be free to complain to the third party regulator as highlighted earlier.

Question 15: 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?

The construction industry has a history of payments terms being frequently extended, particularly towards the lower end of the supply chain and the regulations may have a significant impact in addressing this. Whilst the regulations allow parties to commercial contracts to agree payment periods longer than 60 days, this will only be enforceable if the extended period is not "grossly unfair". There is a risk that if contractors impose extended payment terms on subcontractors without negotiation or justification, they could find those terms subsequently challenged in the event of a payment dispute, and face additional claims for compensation, recovery costs, and interest at a higher rate than envisaged under the contract.

There is a strong educational aspect to this. Businesses entering into commercial contracts after 16 March 2013 should be aware of the 2013 Regulations and pay particular attention to the payment periods, and rates of interest, stipulated in them. Although commercial parties may still negotiate payment periods which are longer than 60 days, it is possible that in the event of a dispute, this may not be considered a substantial remedy for late payment, and will be unenforceable. If unenforceable, suppliers will be entitled to claim interest at the statutory rate of 8% above base rate from 60 days after the debt became due.

Question 16: 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?

In the event of businesses being able to agree payment terms over 60 days we agree that suppliers need to be fully consulted and the information should be publically disclosed. We believe that there are some situations where businesses are cash starved and they should not necessarily be penalised for negotiating deals that will allow them to pay suppliers at a later date. However, by publishing this information keeps suppliers informed on activities and as of which can use this date to seek business with other clients.

Question 17: Are there simple steps that might be taken to make the construction adjudication process quicker, cheaper or both?

We would support better guidance for and training of adjudicators so that they understand the full extent of, and the limitations on, the powers and duties given to them. The process itself should also be part of the active education of businesses and we suspect that there is still a tendency to see adjudication as the default position in resolving some of the more complex contractual issues (see also CIOB Complex Contract⁴) and that this can sometimes complicate the implicit nature of what the process is – quicker and cheaper resolution of matters of dispute.

Question 18: 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?

In the construction industry, the Government Construction Strategy is clear that construction needs to evolve some of its practices, and that partnering and collaboration are key facets to moving this forward. A key driver, particularly as the industry moves forward into ‘digital’ means (including digital, accountable and verifiable payment), will be what can be learnt from other sectors. The role of the representative bodies should be in the dissemination of this information, and promoting the benefits that prompt payment can have throughout the supply chain.

Question 19: Do you think that more information on whether companies have a history of late payment would help suppliers negotiate better terms when doing business?

We do not believe that signalling out historically poor performance in payment is the best way of improving the industry. Instead, those companies with a history of late payment should be monitored and better educated about ways to improve performance. Furthermore, if the Code is voluntary, it is likely that poor performers will opt out of registering if the Code stands to damage their profits.

Question 20: What can businesses, data hosting platforms and Government do to facilitate greater transparency?

No comment.

Question 21: 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?

There is often a perception that technology services automatically mean high costs in terms of technology and training for small businesses. However, the case is clear for having an effective financial management system that addresses both short- and long-term business performance. This may be achieved by streamlining invoicing and bill collection; reducing accounting and administration errors; ensuring compliance with tax and accounting regulations and offering flexibility and expandability to

⁴ The CIOB, [Contract for Complex Projects](#)

accommodate both change and growth.

Question 22: 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?

Access to finance is one reason why it is problematic for small businesses to do business in the UK. Improving the flow of credit to viable SMEs, and helping to diversify external financing options including help through government schemes run through BIS and HMT, would support the development of new routes to finance. As the recent (January 2014) speech from the Prime Minister indicated, SMEs is a key coalition government priority and engaging the banks is a vital facet of this.

Question 23: How could working capital options be made cheaper and more accessible to small business?

SMEs must be aware of the positives and negatives associated with the various short-term financing options including letters of credit, bank loans, overdrafts and debtor finance facilities thus making an informed decision when making their choice. How these can be made cheaper is to a degree self-evident and where applicable would also relate to the banks.

Question 24: 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.

Do you have any other comments that might aid the consultation process as a whole?

We are happy to be involved in this debate as it develops and please feel free to contact us for further queries.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

Yes No