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Decoding the European Commission's Late Payments Proposal: *Boon or Bane for Business?*

PrimeRevenue **Perspective**

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The European Commission's Late Payments Proposal: Boon or Bane for Business?

In 2011, the European Commission enacted the European Union's Late Payment Directive, which aimed to reduce payment terms for all B2B transactions. The directive specified a payment term of 30 days with the latitude to extend to 60 days or more in situations where the longer payment term is "not grossly unfair to the creditor."

Since the directive went into effect, there have been numerous challenges to its efficacy. They include ambiguity in the directive's language, industry differences in the cash conversion cycle, and weak enforcement across member states (among others).

To streamline and clarify the directive's intentions, the European Commission proposed a Late Payment Regulation in September 2023 that will:

- Shorten maximum payment terms to 30 days: The proposal introduces a single maximum payment term of 30 calendar days for all commercial transactions within the EU, including business-to-business (B2B) and transactions between public authorities and businesses. Parties can still agree on shorter payment terms if they wish.

- Enforce automatic late payment interest: Interest on late payments will become automatic and mandatory, calculated based on the European Central Bank's refinancing rate plus 8 percentage points.

- Strengthen enforcement measures: The European Commission's 2023 report on the Late Payment Directive highlights significant disparities in enforcement effectiveness across member states. The new regulatory proposal aims to improve the enforcement of late payment rules by requiring EU member states to establish dedicated complaint mechanisms and to impose effective, dissuasive, and proportionate penalties for non-compliance.

What is the Current Status of the EU Late Payment Regulation?

The proposal is currently in the co-decision stage, meaning both the European Parliament and the Council of the European Union are involved in its adoption. Research suggests the average co-decision procedure takes around 18 months from the Commission's initial proposal to final adoption. However, the actual timeframe varies significantly by proposal. More complex, politically charged, and far-reaching proposals often take longer. For example, the EU's 2016 General Data Protection Regulation (GDPR) took approximately four years from proposal to adoption. Once a regulation is adopted, EU member states typically have two years to transpose it into their national laws.

What are the Chances the Regulation Successfully Navigates the Legislative Process?

The likelihood that the new Late Payment Regulation will be passed into law is questionable. The co-decision process is arduous, allowing up to three readings with each additional reading potentially extending the timeline. Acceptance rates of Parliament's amendments fluctuate depending on the topic, and rates diminish sharply from first to second reading and second to third readings. The percentage of co-decision adopted at first reading between 2014 and 2019 was 75 percent, dropping to 25% at second reading.**1**

1 Matei, A., Ciora, C., Dumitru, A. S., & Ceche, R. (2019). Efficiency and Effectiveness of the European Parliament under the Ordinary Legislative Procedure. Administrative Sciences, 9(70). Published 12 September 2019

Late Payments has become a heated and politically charged issue in recent years. While shorter payment terms can help alleviate the cash flow burden on suppliers, does a one-size-fits-all 30-day payment term make sense across different industries?

Manufacturing, construction, energy, and agriculture are examples where supply chain complexities necessitate an extended cash conversion cycle. Longer (albeit fair) payment terms are necessary for certain capital-intensive operations as they ease the burden of initial costs and prevent the majority of free cash flow being tied up in operations.

There are also the often-connected issues of economic necessity and political climate to consider. Many buyers are facing limited liquidity access as banks tighten lending, forcing them to rely to some degree on longer supplier payment terms to stabilize cash flow. Meanwhile, populism is on the rise particularly in the EU. It's possible the new Late Payment Regulation as it currently stands could perhaps be perceived as EU overreach that plays into the hands of anti-EU political parties.

Finally, there is pessimism about the effectiveness of directives or regulations pertaining to late payments – at least in their current scope. Despite a longstanding directive, late payments increased in 2023 to an average of 49% of all B2B sales for Western European countries[1] and 46% of all invoiced B2B sales in Eastern European countries[2].

1 Atradius Payment Practices Barometer 2023, Key Trends for B2B Payments and Cash Flow, Western Europe
2 Atradius Payment Practices Barometer 2023, Key Trends for B2B Payments and Cash Flow, Eastern Europe

What are the Unintended Implications of the EU Late Payment Regulation?

While the intention behind the Late Payment Regulation may be noble, there are potentially far-reaching unintended consequences that should be considered.

They might include:

- **Material negative financial impact on EU buyers that will have a downstream impact on suppliers and consumers.** The regulation would increase the working capital requirements by many billions of euros for companies operating in the EU. Businesses in certain industries will not be able to calibrate their cash conversion cycle to accommodate 30-day payment terms. The end result would be less capital to invest in growth and other important initiatives – including major EU strategic initiatives like energy transition.

- **Incentive for buyers and suppliers to do business outside of the EU.** Depending on how the regulation is applied to contractual law, buyers and suppliers may choose to do business with non-EU entities where there are less stringent payment term regulations.

- **Elimination of early supplier payment programs that are critical to cash flow management.** Suppliers all over the world rely on early payment programs to improve cash flow. These programs offset the impact of longer payment terms by allowing suppliers to get paid in less than 30 days, while at the same time allowing buyers to calibrate payment terms according to the nuances of their cash conversion cycle. Suppliers that are used to getting paid on Day 7, 10, 15 or 20 will be subjected to longer payment terms in most scenarios as buyers will have no incentive to pay earlier than 30 days.

Our Perspective on EU Late Payment Regulation

The EU Late Payment Regulation is an attempt to resolve the burden late payments unfairly place on suppliers – particularly on small and mid-size businesses. However, it's worth asking if the regulation (as it currently stands) is overreaching and harmful not just to buyers but to the very suppliers it aims to protect.

In the current economic climate, businesses need access to diverse liquidity options – especially low-cost options that don't negatively impact the balance sheet. That can also include a legislative framework that deals with late payment, but in a way that doesn't create additional cash flow burden for buyers and suppliers.

Tens of thousands of suppliers in the EU participate in early payment programs that take late payment out of the equation, while also providing affordable access to capital. Removing access to these programs would have a negative cash flow impact.

As the EU tries to tackle the issue of late payment, it's important the issue is solved in a way that promotes trade between buyers and suppliers and avoids unintended negative consequences. Any threat to financial stability across the supply chain is ill-advised and ill-timed in the current economic climate.

About PrimeRevenue As one of the leading providers of financial supply chain payments platform, we help organizations in 90+ countries optimize their cash flow to efficiently fund strategic initiatives, gain a competitive advantage and strengthen relationships throughout the supply chain. Headquartered in Atlanta, with offices in London, Prague, Hong Kong and Melbourne, PrimeRevenue's diverse multi-funder platform processes more than $300 billion in payment transactions per year. For more information, visit www.primerevenue.com.