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EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT

Accompanying the document

Proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on combating late payment in commercial transactions

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Executive Summary Sheet

Impact assessment for the revision of the Late Payment Directive (Directive 2011/7/EU)

A. What is the problem and why is it a problem at EU level?

Each year around 18 billion invoices are exchanged in the EU. That's more than 500 every second and of those almost 50% are paid late. Late payments affect liquidity and predictability of cash flows, in turn increasing working capital needs and compromising a company's access to external financing. As a result, growth and competitiveness are affected, productivity is reduced, and the likelihood of redundancies and bankruptcies increases. The effects of late payments are felt along supply chains, as the payment delay is often passed onto suppliers. Small and medium-sized enterprises (SMEs), that rely on predictable streams of cash are heavily affected by these negative effects. Late payments also have damaging social effects. Some sectors are more vulnerable than others to late payment. For example, the construction sector. The root cause of late payments lies in the imbalance in the bargaining power between a small supplier and a big client, since paying late is an attractive form of zero-cost finance for the debtor. The drivers causing the problem include insufficient preventive measures, unsuitable deterrents, and insufficient enforcement and redress mechanisms.

What should be achieved?

General objectives:

A. to strengthen companies' competitiveness and growth by improving the payment discipline of public authorities, large businesses, and SMEs;
B. to protect SMEs against the negative effects of late payment by laying down rules that promote fair and timely payment in commercial transactions.

Specific objectives:

1) to prevent late payment from occurring;
2) to facilitate timely payments;
3) to empower companies and ensure more fairness in payments in commercial transactions.

What is the value added of action at the EU level (subsidiarity)?

The EU has been tackling late payment in commercial transactions for the past 30 years. This initiative revises existing EU legislation (Directive 2011/7/EU) and therefore can only be done at EU level. Some EU Member States have adopted tighter rules than those set out in the Directive. For example, capping payment terms in business to business (B2B) transactions when the creditor is an SME and setting up enforcement bodies. To avoid an uneven EU single market, it is necessary to ensure that the rules are enforced in the same way.

B. Solutions

What are the various options to achieve the objectives? Is there a preferred option or not? If not, why?

Policy option 1: to prevent late payment from occurring

Policy measures under this option aim at preventing late payment by ensuring fair payment terms. Maximum payment terms are set, also for the verification procedure to check compliance with the contract requirements. Provisions providing SMEs with training on credit management and financial literacy are also included.

Policy option 2: to facilitate timely payments

Policy measures under this option aim at addressing late payments by strengthening enforcement of the rules and ensuring that payment terms are respected. The current Directive's deterrents, namely, the entitlement for late payment interests and the flat fee compensation are made more effective by making interest on late payments mandatory and increasing flat fee compensation. Enforcement is a key driver for the problem of late payments. Therefore, the options that have been assessed differ according to the powers entrusted to a national enforcement body designated by EU Member States. The option also includes synergies with public procurement to protect subcontractors in public work contracts.

Policy option 3: to strengthen redress mechanisms, ensure fair payment conditions and empower companies

Policy measures under this option promote fairness and the availability of effective redress mechanisms if payment conditions are not met. EU Member States will need to establish mediation tools that are easily accessible to SMEs and address unfair contractual terms and practices through their national law.

The preferred option. Each option has potential benefits but also poses some risks when implemented alone. The impact assessment concluded that the preferred way forward consists of a package of the most effective and efficient measures under the three policy options. The impact assessment also concluded that a regulation is the preferred form of the legal act.

Preferred policy package: 1a+2a+3b

- Cap payment times at 30 days in B2B transactions.
- Verification or acceptance procedure capped at 30 days (no derogation).
- EU Member States facilitate availability of credit management and financial literacy training, including digital payment tools for SMEs.
- Late payment interest is automatic ('entitlement' concept eliminated), the ending day for accrual of interest is clarified.
- Flat fee compensation owed for each transaction paid late and increased to EUR 50 to reflect inflation.
- EU Member States to designate bodies responsible for enforcing the law, carrying out investigations on their own initiative or through complaints, empowered to issue administrative sanctions and publish the name of offenders. Use of digital tools for more effective enforcement.
- In public works contracts, contracting authorities and contracting entities must check that payment to the main contractor has been passed onto the direct subcontractors.
- EU Member States to set up a national system of mediation to solve payment disputes in commercial transactions.
- EU Member States to address the question of unfair contractual terms and practices through their national law.

What are different stakeholders' views? Who supports which option?

Results of the consultations: 939 replies to the SME panel, 117 replies to the public consultation (PC), 137 responses to the call for evidence, several meetings with stakeholders. Almost 83% of the SME panel and 36.7% respondents in the PC support the capping of payment terms, with a preference for 30 days. A limited number of business associations oppose the capping, and/or call for sector exceptions. Almost 81% of SME respondents confirmed that interests and compensation fees are never paid. 84% of SME respondents considered the setting up of enforcement bodies as useful or very useful. Almost 60% of respondents to the PC agreed that public authorities should put in place mechanisms to check that main contractors pay their subcontractors on time. Setting up a national mediation system received positive responses both in the call for evidence and the PC. The SME panel also gathered a comprehensive overview of unfair practices to circumvent the law.

C. Impacts of the preferred option

What are the benefits of the option?
On an aggregate level the impact will be beneficial for businesses. Reduced payment times, estimated at 35%, will free up cash flow and improve the predictability of payments. Smaller market players will be less likely to face unfair payment terms and will have effective means of redress when faced with late payments. Hassle costs of chasing debtors (estimated at 340.2 million man-hours, equal to EUR 8.74 billion) will be significantly reduced. Setting up mediation would allow companies to save EUR 27 million in avoided court cases per year. This initiative also increases fairness in business relations. Public authorities benefit from mediation systems, both directly, if they wish to settle a dispute with a supplier, and indirectly by reducing the burden on the judicial system. Overall, this leads to a reduction in late payments meaning fewer bankruptcies and associated costs to the public purse. Consumers are not directly affected by this initiative.
What are the costs of the preferred option (businesses and public authorities)?
Most costs affecting all businesses are one-off costs. These include updating standard invoices to reflect new payment terms and adjusted compensation fees, estimated at EUR 243 million. Recurring costs are mainly borne by debtors that currently pay late: automatic payment of interest and (increased) compensation, potential administrative fines, and the loss of hassle-free credit when forced to pay on time. These costs can be completely avoided if debtors pay on time. The costs associated to the public purse appear limited and proportionate. Public authorities would face some costs to designate and run the enforcement and mediation bodies. These costs are estimated at EUR 70-105 million per year for the EU-27 (EUR 60-65 million for enforcement bodies and EUR 10-40 million for mediation services).
What are the impacts on SMEs and competitiveness?
Impacts on SMEs: The SME filter classifies this initiative as 'highly relevant' The preferred option was supported by SMEs in the SME panel and in the public consultation. Whereas all SMEs are expected to benefit from the initiative, micro-SMEs, that are more exposed to the problem, stand to benefit more. From the **creditor**-side, late payments prevent companies from growing and forces them to waste resources 5-10% of total administrative work on average is spent chasing debtors. This is time that SMEs could have used more productively, for example, to get training or seek new business opportunities. From the **debtor**-side, the larger the company is the more likely it pays late. On average, around 41% of SMEs are expected to benefit from capping payment terms at 30 days. Broader effects are expected for microenterprises (50%) while the capping of the verification procedure at 30 days could benefit up to 66% of SMEs. Making payments of interest and compensation fees compulsory will improve the current situation, where 81% of SMEs and 93% for microenterprises currently never receive such compensation. Stronger enforcement rules will improve payment performance. Measures supporting subcontractors in public work contracts will have a positive impact on SMEs (on average 80% of the value of a large construction project is subcontracted to SMEs). National mediation systems will lead to monetary benefits for those businesses that currently rely on court litigation, and faster dispute resolutions for those businesses that currently avoid going to court to recover unpaid debt. **Impacts on competitiveness**: The effect of the preferred option on price/cost and innovation competitiveness is expected to be positive. With an increased aggregate cash flow in the economy, businesses have more liquidity to invest in innovation or to pass cost reductions to

consumers. The redistribution of the liquidity in the economy is fairer because every business is paying for the liquidity they need and use. Conditions for doing business would be more predictable, resulting in a more favourable business environment.

On international competitiveness, companies that import or export are bound to face mismatches in the length of payment terms (between their accounts payable and receivable). The assumed risks related to these mismatches are addressed under market conditions by providers of trade finance (for example, cash-in-advance, letter of credit). In addition, the risk that non-EU businesses undercut EU businesses by offering long payment terms in a non-EU market is further limited by the fact that many EU partner countries, such as Canada, the US, Türkiye and the UK already have rules on late payments.

Will there be other significant impacts?

All policy options will impact on employment, fairness in the business culture and wellbeing of entrepreneurs. None of the policy options will have a direct environmental impact. None of the policy options will cause significant harm to the environment.

Proportionality?

All policy options comply with the principles of proportionality and subsidiarity. They only impose costs to businesses that are necessary to achieve the objectives and leave room for Member States' discretion (for example, designation of enforcement bodies, implementation of credit management training and redress measures, identification of unfair payment practices). The impact assessment also identifies discarded options.

D. Follow up

The Commission will monitor and evaluate the impacts of the initiative 4 years after the entry into force of the new legislation. The European Payment Observatory and reports produced by the Member States on their own initiative or by third parties will also support the monitoring process for this initiative.