



Taking action to address late payment

Against a background of legislation aimed at reducing payment delays, companies in all European countries are experiencing lengthening payment times

By Nick Biggam



It is clear that many European companies continue to face problems with late payment. An estimated one billion invoices default each year in Europe and turn into debt collection cases. For various reasons, EU directives and regulations that have been implemented over the recent years unfortunately are not shortening payment cycles. Traditional business payment practices continue to prevail.

Companies questioned by Intrum Justitia, Europe and Ireland's leading debt collection agency, in a recent annual pan-European payment survey have cited payment uncertainty as the most significant obstacle to growth in international trade. Long payment delays and non-payment are making companies think twice before doing business overseas, thereby disrupting cross-border trade and the Internal Market and adversely impacting on EU competitiveness. As a result, many potentially important business deals are not being concluded and capital is not working effectively. Money is tied up in late payment when it should be working and being invested, creating growth and jobs. And against a background of

legislation aimed at reducing payment delays, companies in all European countries are experiencing lengthening payment times.

The increase of the European average payment delay from 15.1 days in 2004 to 16.8 days in 2006 represents the equivalent of €25 billion, which is almost the value of the GDP of Luxembourg. And in Ireland, where the total value of overdue receivables is around €2,700 million, the picture for businesses is consistent with many other European countries. Payment duration is the longest on payments by business and in particular public sector organisations. And few organisations take steps to utilise the provisions of late payment legislation, with the majority of companies even unaware of its existence.

The Argument For Action

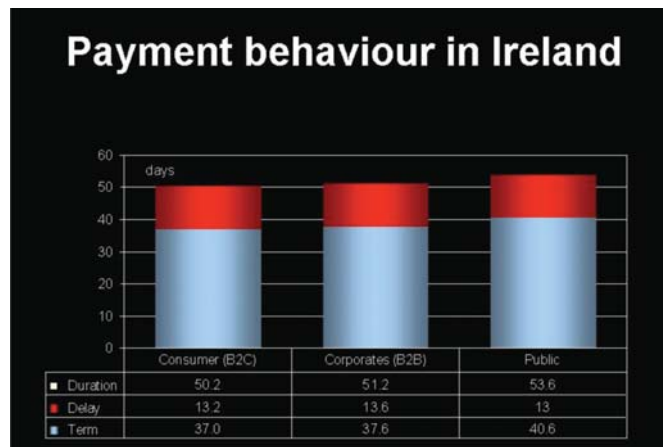
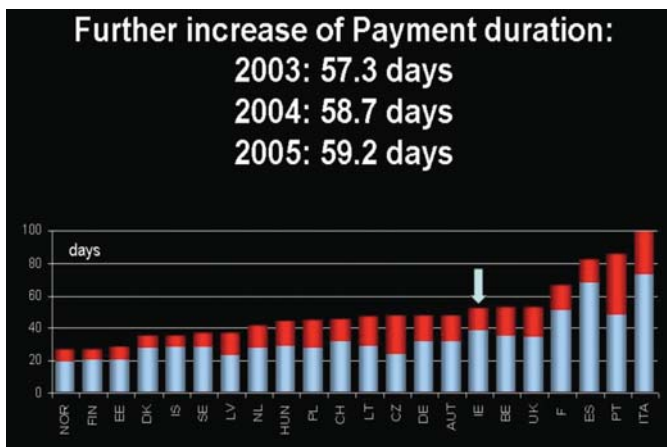
If we look in more detail at the differences between the best and the worst performing countries, we can see exactly what impact late payment is having on businesses in these countries and how companies here in

Ireland can learn and benefit from improving customer payment behaviour.

The total amount of accounts receivables outstanding for Irish companies is, on average, about 90% higher than for Finnish companies (among the best performing in relation to payment behaviour) with the same total revenue. This means, that Irish companies have a significantly higher working capital requirement than their counterparts in Finland.

In the same way that there are significant variations in payment duration, there are also comparable variations in levels of bad debt write-off between countries. Finland has among the lowest bad debt write-off rates, at 0.7%, while in Ireland the average rate is 1.1%. This means a company in Ireland needs 50% more additional turnover to compensate for lost profit through bad debt write-off than comparable companies in Finland.

Given these comparisons it is not surprising, but nevertheless alarming, that our research





confirms 4 out of 5 companies in Ireland currently suffer from varying degrees of liquidity squeeze and 1 out of 4 companies has serious concerns about the future.

Clearly more companies in Ireland need to be acting now to improve payment behaviour and reduce their levels of bad debt write-off.

What Actions Should Companies Be Taking?

Research and experience show that there are a number of relatively simple actions companies should be taking to address this situation. At the outset, it is evident that ensuring we know the creditworthiness of customers to whom we deliver on invoice is essential. However, Intrum Justitia's research has shown that implementing effective procedures to follow-up on late payment is just as important. And in this respect, we can see how we can learn from cash collection policies adopted by companies in other countries.

Once again taking Finland as the best practice model, more than 50% of Finnish suppliers send out 2 reminders, about 13% just 1 and less than 5% of companies in Finland remind more than 3 times. In Ireland just one out of three companies send out 2 reminders, about 5% just 1, and about 13% remind at least 4 times before taking legal actions.

Finnish companies also not only remind less often but they send out their written reminders in shorter time periods and in particular they start the reminder process sooner after due date. About 80% of Finnish suppliers dispatch their first reminder within the first two weeks after due date and just 1% wait 4 or more weeks. In Ireland about 50% of suppliers dispatch their first reminder within the first two weeks after due date but more than 20% are waiting 4 or more weeks.

The common practice in Finland regarding time period between two reminders is one or

two weeks and more than 80% of the companies act according to this practice. Many Irish companies also remind in comparatively short time periods (about 70% of Irish suppliers dispatch their written reminders in time periods of one or two weeks) however unlike the Finnish companies the share of the Irish companies reminding in comparatively long time periods of at least 4 weeks is much higher: 20% compared to 2%.

The final and most significant difference in credit management practice between companies in Ireland and markets such as Finland, relates to how the cost of late payment is handled. To pay late in Finland and other similar countries is very expensive for the debtor, since suppliers generally start to charge late payment interest from the very first day of late payment and charge to the debtor all costs caused by late payment. And companies do not hesitate to escalate non-payment cases, including interest and costs of late payment, to specialist collection agencies and on for litigation. In Ireland, by comparison, it is generally the supplier which incurs all costs of late payment and companies remain relatively slow to introduce 3rd party collection agencies and legal firms into the collections process.

So what lessons should be learned from companies in other markets and what actions should companies in Ireland be taking to ensure early improvements in customers' payment behaviour? The following 4 point plan is a good start:

1. Know your customer – and use all external bank, trade reference and credit information sources that are available.
2. Draw up and implement a clear and consistent rules-based credit policy and ensure your sales team and clients fully understand this policy.
3. Implement contractual payment terms for all customers, with discounts for early payment and clear penalties for

late payment, incorporating EU late-payment legislation.

4. Implement a best practice collection process following the “2-2-2 plus Formula” (see below).

Our 2-2-2 Plus Collections Formula:

- The first reminder should not be sent out later than 2 weeks after due date.
- More than 2 standard reminders are pointless. (After the 2nd reminder we recommend escalation of the collection process to a 3rd party agency or legal firm to start taking further action.)
- Reminder periods between reminder letters should be 2 weeks.
- The ‘PLUS’ represents advance credit checks, charging late payment interest and reminder costs from the very first day of late payment.

It's not rocket science but experience and research in other markets has shown that this approach does work and will have an impact on companies' customer payment behaviour and in turn their cash position.

Nick Biggam is Managing Director of Intrum Justitia Ireland Limited, Ireland's leading provider of Credit Management Services and a part of Europe's leading Credit Management Services group.

For further information please visit www.intrum.ie



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