Improving Resiliency for MSMEs

Promoting timely payments for Micro, Small & Medium Enterprises within the APEC region

Final Report, July 2021

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1. Problem definition

A power imbalance exists where large companies – and to a lesser degree government agencies – can effectively borrow from Micro, Small & Medium Enterprises (MSMEs) by delaying payments to them.

The delay in payments results in cashflow issues for MSMEs that are often credit constrained and rely on timely payments to operate their businesses.

Based on the international literature, which is primarily from Europe and the US, delayed payments[1] to MSMEs result in:

- more MSMEs going bankrupt[2];
- lower economic growth[3];
- less employment[4].

Covid-19 appears to have exacerbated the issue lengthening the timeliness of payments[5].

[1] "Delayed payments" can either be:

- payments that are made after the agreed deadline, hence in breach of contractual terms; or
- payments made beyond a reasonable timeframe. Whilst not technically illegal, there is no obvious reason why this should occur: payments can now be done online and the money transferred quickly in most economies. Large organisations are likely to have the means to pay promptly.

For simplicity both are called delayed payments in this report, as they have similar causes and effects.

[2] It has been estimated that 25% of bankruptcies in Belgium and France in 2016 and 60% of bankruptcies in the Czech Republic in the same year were caused by late payments. See European Commission, 2018, Business-to-business transactions: a comparative analysis of legal measures vs. soft-law instruments for improving payment behaviour

[3] Impacts are likely to differ significantly across economies, depending largely on the average payment term, the average delay and how much the lateness is reduced by. In the European Union, analysing the impact of reducing the delay to zero, the European Commission has found GDP would increase would between 0.005% in Finland and 0.19% in Greece. See European Commission, 2014, Economic Impact of Late Payments.

[4] Fundbox, using data from over 39 million invoices made through its platform, estimated in 2017 that in the US at any point in time MSMEs were owed about US$825bn in unpaid invoices – equivalent to 5% of GDP. If the invoices were all paid in time the businesses could hire 2.1 million more employees. See Fundbox, 2017, 6 Ways Slow Payments Affect Small Businesses.

Also it is estimated that US businesses in 2016 were holding $1.9 trillion in liquidity potentially to improve their valuation. See Walker, A., 2017, A Hoard of Unpaid Invoices: Dissecting Economies & Private Market Forces To Solve B2B Late Payments Rochester Institute of Technology.

Hence, while a direct link must be determined, it appears to be the case that some larger companies are actively attempting to delay payments to increase their liquidity without using the funds to hire or invest. See Delaying Payments to Suppliers Helps Companies Unlock Cash.

[5] Across the European Union, business to business payment delay between agreed term and actual term increased from 6 days on average in 2019 to 14 days on average in 2020. See Intrum, 2020, European Payment Report 2020.

2. Research objective

APEC Business Advisory Council (ABAC) wants to identify effective measures to reduce payment delays to MSMEs to promote MSMEs' performance and economic growth at large.

We looked at the solutions implemented across APEC to assess the costs and benefits to different parties and the economy as a whole.

2.1. Why does this problem exist?

Large corporations can expand their operations vertically and increase control over their supply chains. They can also more easily access global markets to meet their demand for inputs. Hence, they can reduce their reliance on a single supplier. MSMEs have generally fewer options available to them.

Companies are aware of the imbalance. Larger corporations can then pay on longer timeframes and sometimes delay payments without risking harm to their business. They have market power.

Government agencies also have the ability to delay payments to MSMSEs, due to their financial strength and similar power imbalances.

MSMEs instead have to meet more stringent timeframes and risk losing a supplier if they delay their own payments.

2.2. How does it affect different types of firms?

Delayed payments have different effects on different sizes of businesses. When a large corporation faces a delayed payment, it does not impact their cashflow as much (proportionately) and it can borrow more easily – and more cheaply – than an MSME. It has more options available to it to smooth cashflows across multiple payees.

Large companies are able to borrow using assets and capital when in need. They are seen as less risky by lenders and can borrow on more favourable terms. MSMEs are unable to borrow money as easily and efficiently.

A single delayed payment also has different consequences on cashflow depending on the size of the business. A company with many debtors that receives one payment late is not as negatively affected as a company with one major debtor receiving the same payment late. In the latter scenario the company's cashflow is essentially entirely halted.

Businesses know this too. Bigger companies can delay payments to MSMEs for their inputs and ask for timely payments of their outputs, increasing the liquidity they hold. In other words, cash comes in faster than it goes out[6].

Accordingly, big firms can effectively borrow from MSMEs without their explicit consent.

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[6] See Forbes, 2020, Big Companies Overhaul Discounts And Payment Terms And The Writ Rolls Down Hill Onto Small Business and IndustryWeek, 2016, 'Extending Payment Terms' Is Just Another Term for Pilfering.

Hence in unregulated markets, large companies can benefit from delaying payments while negatively impacting MSMEs.

Government agencies face a different set of incentives associated with delaying payments. They are unlikely to put the additional liquidity to productive use, since both their revenues and costs are largely pre-determined (the latter being predominantly salaries). They have a budgeted fiscal envelope for each year and are less likely to be making investments to support their own cashflow.

Given these circumstances, we would suggest delayed payments to MSMEs from government organisations are more likely to be due to inefficient payment systems than an effort to retain liquidity for their own benefit.

2.3. Delayed payments have material macroeconomic consequences

The net effect of delayed payments is – according to our literature scan – negative for the economy as a whole. Delayed payments to a MSMEs mean they have less liquidity available. This results in MSMEs not being able to employ as many people as they wished for or invest in capital.

Research has shown that the losses to MSMEs outweigh the benefits to larger companies[7]. Thus, improving the timeliness of payments would likely provide opportunities for increased economywide employment and GDP.

In some cases, delayed payments may also cause bankruptcies for MSMEs. Being unable to borrow easily, a delay in even a small amount owed may force the MSME to close down.

Research indicates delayed payments have worsened during the COVID-19 crisis[8]. This has exacerbated the negative impact of COVID-19 felt by many MSMEs businesses and resulted in further economic losses.

2.4. Scope and limitations

Due to the limited budget and time available our analysis focuses on the relevant policies implemented APEC wide, but it is not meant to be a legal analysis. As explained later, most of the measures across APEC have been implemented very recently. Hence, it is still too early to determine their long-term effects.

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[7] Alphabeta found that in Australia if large businesses paid MSMEs on time, MSMEs would gain $4.38bn over 10 years while large businesses would lose just $1.84bn. See Alphabeta, 2019, Paying the price.

[8] Mexico: see Atradius, 2020, Mexico: does doubling of write-offs signify deep economic stress?.

USA: see Cortera, 2020, Businesses Batten Down the Hatches.

Singapore: see Atradius, 2020, Singapore: businesses face worsening payment practices.

We could not find detailed economy-wide studies that looked at the full implications of measures to improve payment timeliness across APEC. We are happy to review any such studies that are brought to our attention by ABAC representatives.

3. Global overview

Several economies have implemented a myriad of different solutions…

The first economy to introduce payments timeliness regulation is the US with their Prompt Payment Act in 1989[9]. There has been little progress elsewhere in APEC until quite recently.

European governments have been more active. France adopted similar legislation to the US in 2000[10] and other European economies followed suit in the late 2000s.

…but most of the action has happened since COVID-19 hit

The COVID-19 crisis brought the issue of delayed payments to public attention, prompting governments to take remedial measures around the world. The bulk of policy changes across APEC have been implemented in the last few years, and more seems to be underway.

A plethora of combinations exists

The design of prompt payment policies varies widely around the world. However they can be broadly summarised in the following groups:

- **Deadline for payments**: these policies impose a maximum term for credits to be paid. Countless options exist, depending on five key features:
    - Who is paying
    - Who is receiving the payment
    - What sector/product/service is affected
    - The term period
    - Whether the term can be extended or not.
- **Disclosure**: this approach mandates firms to disclose their timeliness of payments. It can include creating a public registry to share the information. Generally, this applies to large firms and is published in yearly reports such as the annual financial report.

  Disclosure approaches tend to be a form of moral suasion, rather than being punitive or directive. They aim to highlight to suppliers, shareholders and the wider public which large firms are prompt payers and which are laggards. This may subsequently influence the behaviour of both buyers (to avoid getting a bad reputation) and sellers (who may seek to supply only those who pay promptly).
- **Remedial measures**: these measures make it simpler for MSMEs to take legal action if payment deadlines are missed. A common type of remedial measures is creating

[9] See USCode, 1988, 31 USC Ch. 39: PROMPT PAYMENT

[10] See WIPO Lex, 2006, Commercial Code

Alternative Dispute Resolution (ADR) schemes such as mediation, arbitration and adjudication. The aim is to avoid going to court, making the process simpler and cheaper for MSMEs, going some way to addressing the power imbalances described above. These measures are normally implemented alongside payment terms regulations.

- **Government support**: this involves raising awareness and providing resources so that all types and sizes of businesses are more informed and able to make better decisions. It can take many forms such as providing online tools or educational material. This tends to benefit MSMEs proportionately more, as they are less likely to have the resources to access such material in the absence of government support.

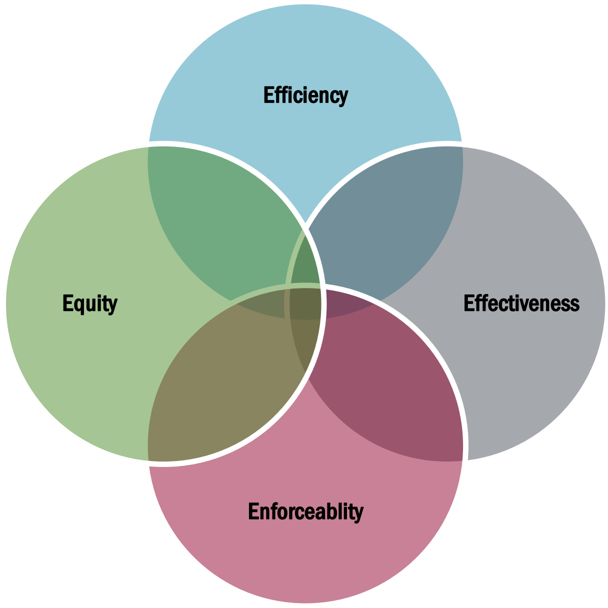
Announced APEC economy policy packages have a wide range of these features, often published in languages other than English, making an analysis of every single possible measure extremely demanding and unfeasible for this project. To give a sense of scale, the European Commission in 2018 identified across Europe alone 170 different prompt payment interventions[11].

However, we can say deadline for payments policies in particular seem to be commonly used in APEC, but their expected costs and benefits depend crucially on their specific legal design features. And as noted earlier, we have found no ex-post evaluations of these policies to provide any empirical support for this research.

With these caveats in mind, we next look at what APEC economies have done so far to promote prompt payments to MSMEs and assess the most promising options.

[11] See Reference 2.

4. Assessment framework



Delayed payments are undesirable as their net impact is negative for MSMEs, people and the economy. The question becomes how to best reduce payment terms without unnecessarily damaging stakeholders who benefit from the status quo (i.e. larger firms).

To explore which policies might produce the best outcome, we use a simple efficiency, effectiveness, enforceability, and equity (EEEE) framework, used from the perspective of the economy as a whole (not just MSMEs).

- **Efficiency**: using resources appropriately. Multiple policy instruments can be used, so we want to determine which would reduce payment delays at the least cost.
- **Effectiveness**: achieving the desired outcome. How successful policies are in changing the behaviour of firms in the desired direction.
- **Enforceability**: whether the law can be applied. To have a positive impact legislation has to be easy to apply and enforce.
- **Equity**: ensuring fairness in the achieved outcome. It is worth considering how well a policy reduces power imbalances and allows for increased competition and distributed benefits.

We evaluate options and solutions that have been implemented within APEC against these four criteria, with a view to identifying best practice policies.

5. Assessment of APEC measures

5.1. Eight economies have moved already…

Eight APEC economies have implemented measures aimed at reducing payment lateness. Two more at least are looking at implementing similar policies.[12] Given most of them have come into force in the last couple of years it is too early to be able to determine their impacts.

In Table 1 we have summarised the costs and benefits of each measure. A list of all the different policies and some design details is in the appendix.

5.2. …mainly to introduce deadlines for payments

All but one of the APEC measures we found are types of deadline for payment policies. The exception is Australia, which has introduced a mandatory disclosure regime.

5.2.1. Disclosure measures are likely to be less effective than more direct options to reduce payment terms

At best, disclosure measures enable MSMEs to use the disclosed information to choose suppliers with shorter payment terms. If enough MSMEs take this approach, a disclosure regime will incentivise firms with longer payment terms to pay more quickly.

However, this assumes MSMEs have the time, resources and ability to effectively choose between suppliers, which may not always be the case, especially in smaller economies.

At worse, disclosure measures are an additional compliance cost for larger firms that do not induce any significant change in payments behaviour.

It is important to note that payment term is just one of the factors to consider when choosing a company to trade with. And disclosed average payment terms are likely to look similar across firms in the same industry, which provides little opportunity for MSME's to identify 'good' or 'bad' payers.

The disclosure policy approach commonly used is to mandate a breakdown of total payments within certain windows of time. But this does not necessarily provide enough information to suppliers to know which timeframe would apply to them.

[12] Canada is looking at implementing deadline for payments in the construction sector. In New Zealand a limit term to all payments is under review.

For Canada: see Government of Canada, 2019, Federal Prompt Payment for Construction Work Act S.C. 2019, c. 29, s. 387

For New Zealand: see Ministry of Business, Innovation & Employment, 2020, Improving business-to-business payment practices in New Zealand

5.2.2. Designing effective payment deadlines policies is challenging

Deadlines for payments are the most direct way to address the problem of delayed payments to MSMEs. They can be simple and easy to apply.

Unintended consequences abound

However, determining the "right" deadline is not an exact science. Indeed some policies do not include a specific deadline. Not all focus solely on MSMEs.

And perverse outcomes can occur. Defining a legal deadline for payments creates a new default setting. Most businesses affected will move to use this new legislated term, *even if before the legislation they were paying relatively quickly*.

This occurred in Europe after a payment deadline was introduced EU wide. Most firms seem to have changed their payment terms and used the mandated maximum time limit. The result was that the average payment term *increased* in economies which previously had shorter payment terms[13].

More nuanced policies may lift administrative and enforcement costs

A possible solution is to have different deadlines for different sectors, services, or goods. This is likely to shorten the payment terms more effectively. But the trade-off is greater complexity in implementing and enforcing.

Even with specific deadlines, striking the right balance may be difficult. The shorter the payment term, the bigger the benefit for sellers, but the bigger the cost for buyers (in terms of reduced options for using their liquidity).

Generally, a short deadline will benefit MSMEs which normally face short terms when buying and long terms when being paid. However, a term that is too short may reduce the ability of buyers to operate efficiently – especially smaller buyers wanting to manage their cashflows.

Supporting deadline payments legislation with clear penalty systems for non-compliance is crucial for the measures to materially drive changes in behaviour – there must be a clear and material incentive created to encourage firms to comply.

If penalty regimes are not introduced, a softer option is to implement and fund ADRs to support MSMEs in negotiating their preferred outcome without incurring the sometimes prohibitive costs of requiring than court proceedings.

Making specific provisions for MSMEs alone may also have unintended consequences. MSMEs that face payment terms longer than mandated may chose not to report the issue fearing they may deteriorate important business relationships. Larger firms may choose not to do business with MSMEs to avoid having a mandated deadline.

Any legislative change generates costs, benefits and trade-offs...

[13] See Reference 2.

Even if a measure is effective in reducing payment delays to MSMEs, it may not be the optimal solution economywide. While some studies suggest that improving timeliness for payments to MSMEs could spur economic growth, it hugely depends on how different companies use capital[14] [15].

It is possible that larger companies are more investment efficient than smaller ones. Hence by borrowing from MSMEs through delayed payments, larger companies may be producing higher returns for the economy than MSMEs would be able to generate with the same liquidity. We have not been able to identify sufficient evidence to determine these impacts.

…but there are fewer trade-offs with government buyers

When the government is the buyer the economic effects of delayed payments are much clearer. It is hard to justify on economic terms government agencies delaying payments to firms.

When a public entity holds additional liquidity by delaying payments, it is unlikely to be used elsewhere to generate jobs or investment returns. This will have a net cost to the economy, as it could have been used more productively elsewhere if paid out sooner.[16]

Firms might generally expect agencies to comply with the terms and they have an option to appeal in case they are wronged. Government agencies are risk averse and publicity-shy. and They will tend to avoid making commercial decisions that result in public complaints by sellers that might end up on the front page of the newspaper, embarrassing their Minister.

As such, as long as the term deadline is sufficiently shorter than the status quo, introducing legislation on prompt payments by government agencies is likely to be effective and have fewer trade-offs involved.

Unsurprisingly, deadlines to government payments is one of the first and most common measures to have been imposed both globally and more recently within APEC.

[14] Alphabeta (see Reference 7) found that in Australia there would a positive net impact of $2.5bn over 10 years by eliminating payments made after stipulated deadlines. However, it does not explain in detail how transferring $7bn from large businesses to MSMEs would create such benefit.

[15] Lytton Advisory found a positive impact by reducing payment terms in the resources industry in Queensland. However, the study is limited. It looks only at a single region and a single industry and is based on data from 140 firms. Moreover, the model looks at impacts up to 24 months, so no long term effects are assessed. Lastly, the model chosen is a cash flow impact analysis creating scenarios through Monte Carlo simulations, which does not consider macroeconomic impacts. See Lytton Advisory, 2018, Economic analysis of impacts of extended payment terms.

[16] Little evidence exists for APEC. A study by Barrot and Nanda has found that reducing government payment terms from 30 to 15 days for MSMEs creates an increase in employment. However, they warn the effects may be small in highly competitive labour markets. See Barrot, J. and Nanda, R, 2016, Can paying firms quicker affect aggregate employment?, NBER Working Paper, no. 22420.

TABLE 1: EEEE ASSESSMENT OF APEC MEASURES

Measure type	Parties involved	Currently enacted in	Efficiency	Effectiveness	Enforceability	Equity
Disclosure	Large companies to MSMEs	Australia	High: small cost imposed on companies doing additional reporting, MSMEs can indirectly benefit	Low: unlikely to affect behaviour significantly	High: simple to monitor compliance	High: gives more information to MSMEs to allow them to choose better business partners
Deadline for payments	Govt to all companies	Japan, USA	High: companies can use liquidity better than government agencies	High: agencies likely to be very responsive to changes in timeliness	High: public entities likely to follow regulations and require little monitoring	Medium: benefits all businesses equally without tilting towards MSMEs
	Govt to MSMEs	People's Republic of China, USA	High: government loses almost nothing; MSMEs can use cash from prompt payments to employ or invest more	High: agencies likely to be very responsive to changes in timeliness. May incentivise public entities to choose large companies over MSMEs	High: public entities likely to follow regulations and require little monitoring	Medium/High: Benefits MSMEs doing business with public entities.
	Sector specific: construction	Canada (Ontario), USA (some States)	Medium: depends on use of cash and net effect. Benefit to parties facing late payments, costs to parties delaying payments. Benefit for payments from government.	High: tailoring terms for sectors allows for targeted measures. Most companies are likely to follow the regulations	Medium: may be complex to navigate legislation when many deadlines are present	High: generally benefits MSMEs more than other companies
	All Companies	Chile	Medium: depends on use of cash, time length change, and net effect. Benefit to parties facing late payments, costs to parties delaying payments. Depends on term length	Medium: most companies are likely to follow the regulations. Hard to find one size that fits all.	High: depends on enforcement scheme, but generally harmed parties likely to report breaches	High: treats all equally. Likely to benefit MSMEs proportionately more than others
	All to MSMEs	Thailand	Medium: depends on use of cash and net effect. Benefit to MSMEs, costs to parties delaying payments. Depends on term length	Medium: most companies are likely to adhere. Hard to find one size that fits all. May disincentivise businesses to choose MSMEs	Uncertain: MSMEs may not report breaches out of fear to lose business	High: benefits MSMEs by reducing the power imbalance

6. Conclusion and recommendations

Without legislative change, large firms can borrow from MSMEs by delaying the payments to them while being paid early due to the power imbalance. Government agencies can also delay payments without apparent sanction. This results in MSMEs underperforming and facing significant economic costs. COVID-19 seems to have exacerbated the issue.

Some APEC economies have already implemented legislation to improve timeliness of payments. It is difficult to determine the full impacts of such policies at present as many are relatively recent developments.

Using our EEEE framework we have considered the costs and benefits to economies and different types of firms of different policies. It proves tricky to be able to find the perfect measure on paper – much depends on specific design clauses and the ability to address the risk of unintended consequences.

Consequently, we recommend:

- **Governments must take the lead and shorten payment terms.** Provided the measures do in practice improve payment timeliness (i.e. the deadlines chosen 'bite'), there is little doubt that disbursing 'lazy' public funds to firms – be they MSMEs or not – will improve economywide efficiency and support additional private sector job and investment growth.
- **Direct measures are preferable**. Indirect 'signalling' measures such as disclosure rules without the right incentives and sanctions may not affect timeliness materially and can become just an added cost for reporting businesses.
- **Treating MSMEs differently may result in unintended consequences.** If large firms or government only have to pay MSMEs promptly, and not other types of firms, this may generate a bias against buying from MSMEs.
- **Get the data first.** To be able to determine what the "right" payment term should be, it is important for governments in every economy to look carefully into the status quo and get a good understanding of what options might best improve timeliness.
- **More evidence is required.** More ex-post studies looking at the economywide, long term economic impacts of different measures to improve payment timeliness would help create a better evidence base for informed policy making in APEC.

7. Appendix: list of APEC policies and legislation

Country	Measure	Effective from	Type	Short description
Australia	Payment Times Reporting Scheme[17] [18]	1 January 2021	Reporting – large enterprises to MSMEs	Every 6 months, large entities must publicly report on payment terms and practices towards MSMEs supplier.
Chile	"Establishes payment in thirty days" [19] [20]	16 May 2019	Payment deadline – all firms	Credit limits of 30 days (initially 60 then reduced to 30 in 2021).
Ontario, Canada	Construction Lien Act Amendment Act, 2017[21] [22]	1 October 2019	Payment deadline – constructions sector	Construction project owners have 28 days to pay their contractors
Japan	"Law Concerning Prevention of Delayed Payment of Government Contract"[23]	16th December 2019	Payment deadline – government to all firms	Government to pay within 15 days.
People's Republic of China	"Regulations on Guaranteeing Payment of Small and Medium-sized Enterprises"[24] [25]	1 September 2020	Payment deadline – government to MSMEs payments	Government departments must pay MSMEs within 30 days, or at most within 60 days under some exceptions.
Thailand	Guidelines on Fair Trade Practices	19 June 2021	Payment deadline – payments to MSMEs	Credit limits of 30-45 days, depending on good/services type, when purchasing from MSMEs.

[17] See Department of Industry, Science, Energy and Resources, 2021, Payment Times Reporting Scheme

[S] See Pwc, 2021, Payment Times Reporting

[19] Biblioteca del Congreso Nacional de Chile, 2019, Ley 21131 | Establece pago a treinta días

[20] Carey, 2019, Law No. 21,131 sets forth a thirty-day term for payment of invoices

[21] See Ontario, 2017, Construction Lien Amendment Act, 2017, S.O. 2017, c. 24 - Bill 142

[22] See Gowling Wlg, 2019, Sooner than you think: getting ready for prompt payment in Ontario

[23] See e-Gov, Act on Prevention of Delayed Payment of Government Contracts (Act No. 256 of 1945)

[24] See The State Council of the People's Republic of China, 2020, Order of the State Council of the People's Republic of China

[25] See The State Council of the People's Republic of China, 2020, Key takeaways from new regulation on payments to SMEs

	Relating to Credit Terms with SMEs[26] [27]			
USA	Prompt Payment Act[28]	14 February 1989	Payment deadline – government to all firms	Government to pay businesses within 30 days.
	Accelerated Payments for Small Businesses Act of 2019[29]	20 December 2019	Payment deadline – government to MSMEs	Government to pay MSMEs within 15 days.
Various States, USA	Prompt Payment (state) law[30]	2011-2021	Payment deadline – construction sector	Different states have imposed different deadlines on payments for construction projects between 7 and 30 days.

[26] See Thailand Trade Competition Commission, 2021, Announcement of the Trade Competition Commission

[27] See Chandler MHM, 2021, Thailand: OTCC Prescribes Maximum Credit Terms in Favour of SMEs

[28] See USCode, 1988, 31 USC Ch. 39: PROMPT PAYMENT

[29] See Congress.gov, 2019, H.R.2322 - Accelerated Payments for Small Businesses Act of 2019

[30] See Levelset, 2021, Guide to Prompt Payment Laws in all 50 states

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