A SUSTAINABLE AND COMPLIANT PAYMENT STRATEGY: **THE IMPORTANCE OF PAYING SOONER RATHER THAN LATER.**

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The trade-off between suppliers' payments terms and working capital is an important cash-management and business decision which requires careful assessment of the benefits and costs.

To support these considerations, since late 2017 Businesses in the UK[1] are required to publish their payment performance statistics bi-annually and submit the information via a government web-portal. Failure to provide this information exposes the business and its directors to reputational risk, criminal offence and fines.

The purpose of the new regulation is to put pressure on businesses to take responsibility of excessively long payment terms, which ultimately contribute to the large amount of unpaid invoices (£67B in 2015)[2] and consequent risk of suppliers' bankruptcy.

In light of this new regulatory framework, businesses will have to adapt a broader payment strategy which also includes the reputational and reporting aspects as well as the cash management considerations previously mentioned.

As leading global provider of integrated payments and working capital solutions, American Express back a wide variety of UK businesses to adopt a fully compliant payment strategy which supports both buyers and suppliers' operational and reputational goals.

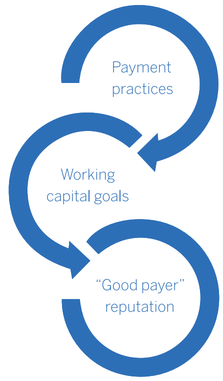


Fig 1: Schematic representation of the components of a sustainable and compliant payment strategy.

In this paper we focus on understanding UK Manufacturers' payment practices, taking in consideration the payment data available from the implementation of the Reporting on Payment Practices and Performance Regulation. We also draw some solution recommendations on how UK Manufactures should embrace a sustainable and compliant payment strategy and enhance their reputational goals.

Industry description

According to the ONS[3], the Manufacturing sector in the UK is valued £385B and a CAGR of 1.61%[4].` Compared to the overall UK output, UK Manufacturing output is about 19% of GDP. Despite the modest growth over time, from September 2016

[1]The Reporting on Payment Practices and Performance Regulations 2017 (Department for Business, Energy and Industrial Strategy)
[2]Source: Asset Based Finance Association (ABFA)
[3]UK Organisation of National Statistics (2016)
[4]Based on the past eleven years

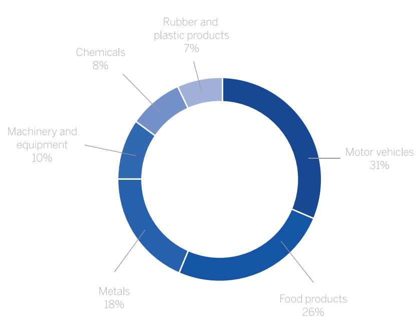
the UK Manufacturing Purchasing Managers' Index (PMI), which measures the performance of the manufacturing sector, has been consistently over 50 indicating an expansion compared to the previous months.

Some of the factors impacting this sector are volatility of the pound against other currencies, changes in local and global demand for UK manufactured products, geo-political events such as Brexit and consequent changes in global trade corridors.

Although the UK Manufacturing sector is made up of a number of industries, almost 70% of the output is actually generated by the following six:previously mentioned.

1. Motor vehicles
2. Food products
3. Metals
4. Machinery & Equipment
5. Chemicals
6. Rubber and Plastics

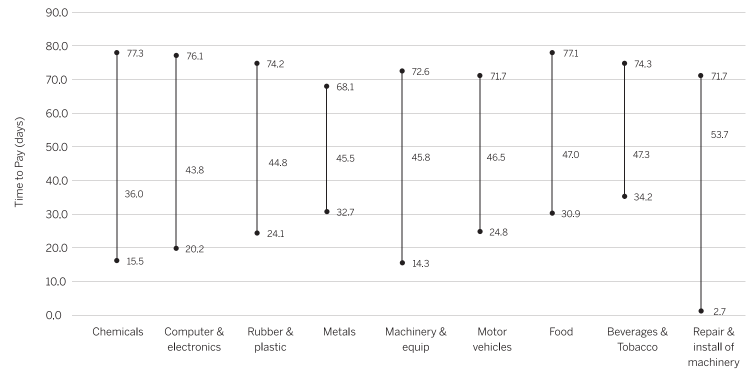
Fig. 2: UK manufacturing segmentation



Payment practices

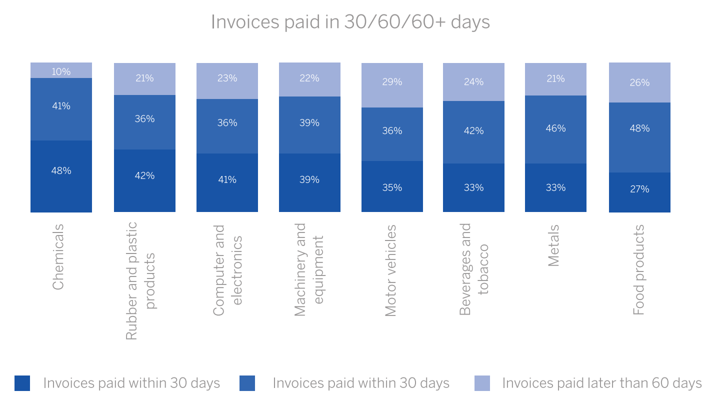
The payment practices across these six industries are relatively broad and trends are not always well defined. For example the average time-to-pay[5] shows that smaller Chemicals[6] pay their suppliers on an average of 36 days, although the variability across this industry is significant (from a minimum of 16 days to a maximum of 77 days). Likewise, food manufacturers are the worst payers in this group, having an average time-to-pay of 47 days, which includes 31 days for the quickest to 77 for the slowest payer.

Fig. 3: Average time to pay across UK Manufacturers.



An indication that Chemicals are generally good payers compared with other UK manufacturers is the fact that almost half (48%) of invoices are actually paid within 30 and only 10% beyond 60. Food manufacturers instead pay only 27% of their invoices within 30 days and the rest with terms of 60 days or longer.

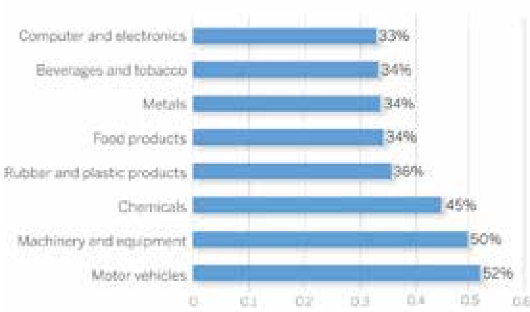
Fig. 4: Invoices paid on 30/60/60+ days by industry



However, Chemicals are not on the most virtuous payers if considering that on average almost 45% of invoices are still not paid on-time. Food manufactures are actually doing better, with only 34% of invoices not paid within the agreed terms.

[5] Time to pay is the time from the date of receipt of an invoice to the payment
[6] The dataset used in this analysis is from 2017-2018 and based on published payment information from the UK Government website. The average revenue of these companies is that £120M

Fig. 5: Percentage of invoices paid on time.



Working capital goals

In order to refine our understanding of UK Manufacturers' payment strategies, we need to take in consideration the working capital implications[7]. In particular we calculate two key financial ratios to assess the trade-off between payment terms[8] and cash-flow[9].

For example, the data shows that over the last five years, DPO of Food manufacturers have actually increased at a similar pace (5% CAGR) than their operating cash-flow. This close correlation may show that one of the key considerations for the industry was to leverage on more flexible payment terms in order to drive operational liquidity.

Fig. 6: Days Payables Outstanding and Cash-flow margin for Food manufacturers.

Good payer reputation

The data offered by the implementation of the UK Duty to Report provides the visibility of payment practices across the industry and will certainly impact the overall approach to payment terms. For the moment it is still early to identify a clear impact due to the limited historical payment data but overtime it will become more accurate and greater insights will be available. However as discussed we have been already able to put Food manufacturers on the spot for their extensive payment terms.

Forward-looking businesses will ensure to already have the understanding of how this new regulation will impact the way they manage their payment strategy and will adopt corrective actions to comply with the new regulation, in particular with regards to reporting.

Recommendations

As our brief analysis of the UK Manufactures' payment practices has shown, it's not possible to recommend one-size-fits-all payment solution due to the diversity and number of industries which composes this sector. However, the good news is that there are many solutions available to businesses and which allow to manage an optimal balance between operational and reputational goals. For example, Supply Chain Finance may appeal to companies which offers long payment terms to improve or maintain their cash-flow (in our analysis Food manufactures) whilst allowing suppliers to offer Early Payment Discounts or rise finance at a convenient rate. The only caveat about this approach is that SCF does not solve for the reporting and reputational issues so a business whose payment terms are long, will still have to publicly report those initial terms even if supplier is getting paid faster by the financing intermediary in the tripartite SCF agreement.
In that perspective, the optimal balance would be a solution which still offers extended payment terms, enhanced cash-flow but also the reputational benefits of reporting shorter payment terms to suppliers.

American Express is uniquely positioned to support your payment strategy thanks to the relationship with both buyers and suppliers and the ability to initiate and finance payments. As result a business can benefit from the transparent reporting of shorter payment terms and improve their overall reputation. Thanks to American Express extensive experience in payment and working capital we can help your business realising the benefits of a sustainable and compliant payment strategy.

[7]Dataset included 539 UK Manufacturing firms with average revenues of £2 billions
[8]Days Payables Outstanding are calculated as Trade Payables divided by COGS and multiplied by 365
[9]Cash-flow margin measures how much cash has been generated from operations per every £ in sales. Data covers 2017-2018.