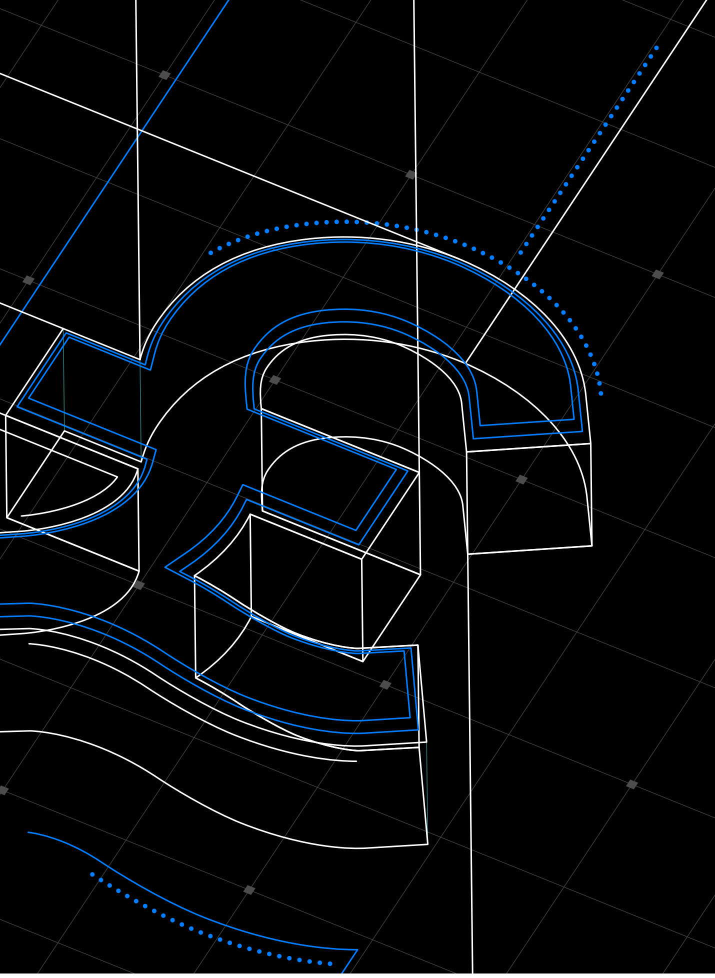

Digital negotiable instruments

Ideally suited to combating late payment

Matthew Hatton, Head of Product Innovation, Traxpay

> **Government efforts to tackle late payments will bring great benefit to all those in supply chains, especially SMEs.**

This month, stricter payment rules for UK government contractors have come into force. Suppliers will be prevented from winning government contracts worth more than £5 million if they do not pay their invoices within an average of 55 days. In a year's time, that will drop to 45 days, with the intention that it eventually becomes 30 days. From October 2024, the Procurement Act 2023 will mandate that all public procurement contracts include a 30-day payment term, which the suppliers must extend right down the supply chain to any subcontracts that wholly or substantially contribute to the performance of the public contract. The EU is going even further, proposing to replace the Late Payment Directive (2011/7/EU) with a new, stricter Late Payment Regulation.

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These regulatory initiatives are intended to protect suppliers but may have unintended consequences. Even with 30-day terms, many suppliers will still require early liquidity through selling receivables. With shorter financing periods, traditional providers may withdraw from this aspect of the market or feel compelled to raise interest rates to compensate. This would hit the long tail of SMEs in supply chains particularly hard, effectively excluding them from existing sources of liquidity.

Debtors (buyers) will certainly face challenges to manage their own liquidity to be able to meet 30-day maximum terms across the board. Cash-rich buyers who offer dynamic discounting may find such programmes uneconomical as the reduced payment period is too short to apply a worthwhile discount amount. Buyers who use third party funds for supply chain financing (reverse factoring) may also find that banks are less keen to offer such services for anything other than very large transactions. Of course, this further limits suppliers' access to liquidity, too.

All this is not to say that government efforts to tackle late payments are misguided. Quite the opposite: they will bring great benefit to all those in supply chains, especially SMEs. The problem is that traditional working capital and supply chain finance solutions are often only commercially viable for providers where the terms are 60, 90 days or longer. In contrast, solutions based on digital negotiable instruments are perfectly suited to these new, shorter payment term regimes.

On the payables side, digital promissory notes (DPN) can be used by buyers to unilaterally extend payment terms without adversely impacting suppliers: faced with the need for additional liquidity to settle invoices due in a few days, the treasurer can raise a DPN which is purchased by a bank or non-bank investor. The supplier is paid on day 30 or earlier, but the buyer can enjoy an additional period before having the honour the DPN. Such "post maturity finance" can even be combined with early payment discounts, creating a new version of reverse factoring, one which is far more flexible and easier to set up, commercially viable for all parties and based on digital versions of instruments which in paper form have been in use for centuries.

Similarly, for receivables, a digital bill of exchange (DBOE) can be issued by a supplier to a buyer, whose digital signature commits the buyer to making payment on the maturity date of the DBOE, which will match the payment term of the underlying invoice(s). This provides the supplier with additional assurance that if the buyer does not honour the DBOE (i.e. does not pay on maturity), the supplier can protest the DBOE in court, which must, under The Bills of Exchange Act 1882, recognise a signed DBOE as proof that the debt is valid. DBOE also give the supplier another option for receivables financing: if liquidity is required before the invoice due date (DBOE maturity date), the supplier may be able to sell the DBOE to an investor. DPN & DBOE help to resolve the main issue for SMEs regarding late payments identified by the Université Libre de Bruxelles: lack of enforcement rooted in the fear of entrepreneurs of losing their clients and the length of judicial proceedings, since these could take years before a judgment. Clearly defined procedures for protesting overdue bills of exchange that drastically reduce the time to obtain a judgement already exist. The digital use of respective registers like the Register of Protests in Scotland will be another powerful element to reduce late payments.

For those unfamiliar with paper or now digital versions of these instruments, the topic may seem rather esoteric. In fact DPN and DBOE are robustly established in law, ideally suited to automation and efficiency in digital trade, powerful tools to help reduce late payments, and straightforward to implement. With the fine work being done by the likes of ICC and the C4DTI initiative, awareness of these instruments will spread at pace, and it is up to solutions providers to bring the innovation.

Matthew Hatton is Head of Product Innovation at Traxpay, a tradetech member of ICC UK and ICC Germany. Traxpay's Dynamic Financing Platform© offers a range of supply chain finance and working capital optimisation solutions and is at the vanguard of using digital negotiable instruments in this context.