The role of technology and transparency in addressing late payments: Sage supplementary submission to the EU Late Payment Directive Consultation

Recommendations

1. Embed digital solutions within legislation to facilitate increased invoice transparency and faster invoice payments.
2. Foster a culture of prompt invoice payment to ensure businesses, especially SMEs, are not disadvantaged by late payments.
3. Ensure legislation allows Europe to exploit future payment trends, such as machine learning and industry-specific software.

About Sage

Sage is the market leader for integrated accounting, payroll and payment systems, supporting the ambition of the world's entrepreneurs. Like many of the businesses we serve, Sage began as a small business and has grown beyond what seemed imaginable. Today, over 11,000 Sage employees support millions of entrepreneurs across more than 20 countries as they power the global economy. We are also embedded in Europe's small and medium-sized enterprise (SME) ecosystem, with over 3,000 employees serving 2 million customers across the continent, generating €612 million in revenue.[1] We help drive today's business builders with a new generation of solutions to manage everything from money to people. Our social and mobile technology provides live information so you can make fast, informed decisions anytime and anywhere in the world.

Our views on the revision of the Late Payment Directive

Over the last decade, technological advances have played a substantial role in reducing the impact of slow or late payments. Accounting software in particular has helped to accelerate the pace of which invoices are being paid by making critical information available. Each year across Europe, thousands of SMEs become bankrupt waiting for their invoices to be paid. As late payments have a significant and adverse effect on cashflow, jobs are lost, and entrepreneurship is stifled.[2] **Sage research on SMEs across Europe shows that cashflow and liquidity problems are second only to rising costs as a barrier to growth**[3]. Furthermore, the European Late Payments Report 2022[4] revealed 6 out of 10 companies are worried that the risk of late payment will grow this year.

SMEs form the backbone of Europe's economy. In Europe, there are 22.8 million SMEs that employ 64% of the continent's workforce, accounting for 52% of value added to Europe's business ecosystem.[5] The EU also has SME digitalisation embedded in its political priorities for the next decade, aiming for 90% of SMEs to reach at least a basic level of digital maturity by 2030.[6] There is still much progress to be made, since as of 2021 only 55% of SMEs had met this goal.[7]

Sage welcomes the EU's proposal to revise the Late Payment Directive. As part of the policy options that are being considered, facilitating timely payments through modern digital payment tools is crucial to ensure that European businesses and SMEs can achieve growth. As such, **Sage urges EU lawmakers to take a pro-digitalisation approach and foster the use of digital solutions to address late payments with the revised Directive.** Sage and the University of Edinburgh's Smart Data Foundry analysed 58 million

[1] Sage's key EU markets include Austria, Belgium, France, Germany, Italy, Poland, Portugal, and Spain.
[2] European Commission, Late Payment Directive
[3] Sage survey (February 2023) of 4,000 SMEs in France, Germany, Portugal, Ireland and Spain
[4] European Late Payments Report, 2022, Intrum.
[5] European Commission, 2022, SME Performance Review 2021/2022
[6] European Commission, Europe's Digital Decade : digital targets for 2030
[7] European Commission, 2022, Digital Economy and Society Index (2022) Thematic Chapters

anonymised SME invoice records and found that **in the last decade, digitalisation has enabled a massive reduction in payment times, from 81 days to 36 days**.[8]

We believe **the key to unlocking the problem of late payments is through legislation and fostering a culture of embedding digital technology within business administrations**. In particular, transparent payment behaviour will arm smaller companies in a negotiation to ensure more balanced contracts and it will arm regulators to tackle late payment offenders.

The Role of Technology in Reducing Late Payments

The potential policy options for the revision of the Late Payment Directive include a pillar on facilitating timely payments by using modern payment tools. This following section unpacks where technology can play a key role in enabling timely and efficient payment. Our findings are derived from *Payment Speed and Timeliness for UK Small & Micro Businesses:* a report commissioned by Sage in partnership with the Smart Data Foundry (SDF).[9]

1. Technology has shortened the path to cash for SMEs over the last decade.

In Europe, approximately 60% of SMEs have reached at least a basic level of digital maturity – compared to roughly 90% of large enterprises.[10] In this way, the role of technology in enabling SMEs to grow and innovate is significant. The Internet, digital payments, standardised open banking APIs, POS systems and accessible machine learning have all enabled software-as-a-service (SaaS) solutions that SMEs can both afford and easily implement. Mobile phones enable the use of technology anywhere. The small screen interface required developers to make solutions simpler, which, in turn, further increased accessibility.

Today, SME owners can issue an invoice in real time through email or SMS, from their mobile phones as soon as transactions are concluded. **The development of digital invoicing tools as a component of accounting software has played an important role in improving the speed, consistency and quality of invoicing.** E-invoicing is also an identified priority for the EU and a key focus within the VAT in the Digital Age (ViDA) package, according to which it will become the default form of invoicing in the EU.[11] ViDA will help to address the issue of late payments by mandating e-invoicing for cross border transactions and making e-invoicing the default method of invoicing, thus creating the necessary conditions to support wider e-invoice mandates throughout the EU.

Invoicing software is readily accessible from mobile phones and can effortlessly be integrated into other business management software, further streamlining the process. SME owners can issue an invoice in real time through email or SMS, from their mobile phones as soon as transactions are concluded, thus enabling invoices to be delivered much quicker. This also removes dispute potential regarding invoice delivery times: with paper invoicing, many customers use invoice delivery as excuse to delay payment. Payment times are also improved by removing human error, significantly improving the consistency and quality of generated invoices. Workflow solutions allow for automated reporting on and management of unpaid invoices, and processing payments accurately. Micro businesses often employ cash accounting and use their current account as a ledger. This has become easier as more transaction data is displayed on electronic bank statements. Banks have therefore started to incorporate invoicing and other accounting features in current accounts, which means that micro businesses can perform their accounting, cash flow management, and even filing digital tax returns through their banking application.

Sage is committed to extending its business-to-business e-invoicing capabilities in line with the needs of SMEs to comply with EU legislation. This will also deliver benefits to SMEs beyond compliance by driving efficiency through digital transformation of highly manual accounts payable and accounts receivable processes. SMEs will benefit by saving time, gaining faster and more accurate insights into their cashflow which will enable faster payment across their supply chain. Sage already provides customers in France with business-to-government e-invoicing capabilities, as mandated.

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[8] Smart Data Foundry, 2022, Payment Speed and Timeliness for UK Small and Micro Businesses (Press Release)
[9] An overview of the report and the full report are available online.
[10] European Commission, 2022, Digital Economy and Society Index (2022) Thematic Chapters
[11] https://taxation-customs.ec.europa.eu/taxation-1/value-added-tax-vat/vat-digital-age_en

> ***Example – Cashflow Management:*** *Futrli by Sage — a cashflow forecasting software platform that also helps SMEs focus on customers that consistently pay late or assessing the impact of shortening payment terms. The platform enables SMEs to maintain healthier cashflows and make intelligent business decisions by having data-driven three-way forecast financials (profit and loss, balance sheet, cashflow) using propriety prediction algorithms.*

2. Technology plays a key role in enabling customers to pay or be paid on time.

Once an invoice has been issued and the payment date approaches, SMEs can automate the process of encouraging the customer to pay – known as the dunning process. Several FinTechs have built solutions to automate emails, SMS messages and other communications to customers. This relieves the SME owner of manual work and improves the often-inconsistent approach to chasing slow payers (often driven by emotion and current cash flow requirements). Many of these solutions ensure that the original invoice and other key documentation are sent along with reminder notices, which plays a helpful role if the debt moves into litigation, as the documentation trail is captured, and time stamped.

Accounting software has played a pivotal role in accelerating the dunning process, as programs now enable users to keep track of client status and automate the process by sending out periodic reminders. This is useful for micro-businesses as it removes the human element of chasing up clients, which historically has been a major hurdle in chasing payments as SMEs are wary of protecting client relationships. For larger SMEs, there exist Accounts Payable (AP) solutions integrated into accounting platforms, which businesses can utilise to manage large volumes of invoices across different suppliers.

> ***Example 1 – Process automation:*** *a Fintech (Saltare) turned the dunning process around: they offer customers the option of offering early payment in exchange for a discount. A customer can, for example, make an electronic offer to its creditor to pay in seven days instead of 30 in return for a 1% discount on the invoice. The creditor then has the option to accept or reject the offer, depending on its own cash flow requirements. There are also platforms that provide conventional early payment services to SMEs as well as negotiating discounts for their customers, such as Taulia and PrimeRevenue.*
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> ***Example 2 – AI-enabled automation:*** *- Sage has introduced AI-enabled in-built AP Automation capabilities within many of its accounting products to reduce the time spent by SMEs on manual data entry of invoice details and enable more efficient workflows resulting in faster payments to suppliers.*

3. Technology has accelerated the payments process.

With the advent of digital commerce, a growing proportion of B2C business is conducted online, where payment is typically required upfront, which either eliminates the problem of unpaid accounts or shifts it to card issuers. MasterCard, Visa, PayPal, Stripe, and others have made online payment reliable, safe, and easy.

Mobile payment technologies, such as Apple Pay and Google Pay, have further streamlined the payment process, both online and offline, by eliminating the need to enter card information or to present a physical card. Solutions like Square made it easier for even the smallest vendors to accept credit card payments on the spot. These methods of payment have drastically reduced the time between the decision to pay and the actual payment, which previously constituted a good portion of late payment time (for example, writing a cheque, sending it via post, cashing it, and waiting for the bank to release funds).

For both B2C and B2B business, having a payment method on file also plays an important role in allowing SMEs to extract payment automatically on the due date. Similarly, banks have simplified processes for customers to save payment information and make recurring payments without having to re-enter data. A recent development in open banking, known as Variable Recurring Payments (VRP), enables customers to consent to a third-party deducting a variable amount from their account with specified intervals on behalf of an SME. VRPs are more secure, cheaper, faster, and less prone to error than typical direct debit or card payments and could, over time, partly or fully replace direct debit payments. GoCardless, for example, utilises “pull-based payment collection” to allow customers to authorise SMEs to make deductions directly from their bank accounts.

Example – Digital Invoicing: *Sage partners with Stripe to get payments made 2x faster. We enable our SME customers to fully digitise all invoicing and get paid through credit and debit cards in real-time, rather than spend time manually collecting and chasing down payments. With invoice payments, companies can halve payment times and have unparalleled transparency of cashflow with full end-to-end reconciliation of accounts.*

4. Technology-facilitated transparency is crucial to foster a trustworthy invoicing system

To reduce the systematic risk of late payments to the SME sector and the broader economy, **greater transparency in relation to payment behavior will create the right incentives to reward prompt payers and identify late payers**. It will also empower a prompt payment ombudsman to address those large offenders creating risk to the SME sector. A late payment provides a financial benefit to the buyer and a cost to the supplier. As such, problems can arise if a contract is struck with a buyer intending to pay late know the supplier is too small to practically challenge it in court. That is in effect a hidden cost that results in an unbalanced contract.

To tackle these late payment costs, transparency should be aligned with e-invoice lifecycles. We anticipate that this should help contracts to be balanced, with prompt payers being rewarded as they represent a lower cost and/or risk. It should identify those large buyers who are creating a systematic risk to SMEs that an ombudsman could tackle.

5. Innovation in invoice financing.

For invoice insurance and factoring, SMEs now have vastly more options. Today, given improvements in data accessibility and management, single invoices can be financed, insured, or factored using simple devices such as mobile phones at low cost. Companies such as Nimbla, InvoiceInsure, and Allianz offer single invoice insurance, whereas Novuna, MarketFinance, HSBC, Lloyds, and various other banks offer invoice financing services.

Example – Invoice Financing: *Sage partners with French fintech, Finexkap Group to provide SMEs with access to working capital financing. Through real-time analysis of data, it allows for a calculation of risk, and makes SMEs aware of the availability of short-term financing at a competitive cost.*

<u>**Payment trends that will have an impact in the coming years**</u>

Sage urges the European Commission to ensure that the revision to the Late Payments Directive enables Europe to exploit the below payment trends:

1. **Increasing integration:** Open banking and access to other financial data through APIs allow data to be accumulated from disparate sources to create joined-up workflows. This will allow processes to become increasingly automated and streamlined. For example, invoices can contain payment links that ensure the correct reference accompanies the payment message, and that, once paid, this reference can be extracted from the bank and used to update the accounting system, marking the invoice as paid and reconciling the cash deposit in the bank account instantaneously.

2. **Reducing risk:** For B2B business, it is already much easier for SMEs to obtain credit information on potential customers before granting credit. Fintechs such as Know-it and Creditsafe interface with larger credit reference agencies, Companies House, The Gazette and other sources of business data. They now sell credit insights on demand to SMEs, who no longer need to pay for expensive subscriptions to information services. SMEs can use this information to monitor their existing customers and credit-check potential customers. These services often include notifications of changes in customer behaviour and fraud alerts.

3. **Leveraging machine learning**: Machine learning can be used to optimise reminders. Innovative Fintechs have started experimenting with carrots and sticks and the impact on the path to cash for SMEs (for example, in an invoice reminder, a business may offer a discount for early payment, or politely refer to charging penalties for late payment, or even allude to reporting a customer to credit reference agencies). These kinds of solutions also extend to collections, where they can be used to humanise the process and protect the brand of the SME. Machine learning could also be used for the implementation of invoice factoring and financing. Using performance metrics for different customers, AI could learn if it is optimal for an invoice to be factored or financed during any part of the process.

4. **Adopting Industry-Specific Software:** An emerging trend is for the development and adoption of industry-specific solutions that offer specialized accounting functionality and applications. Vendors of such software are familiar with each particular business sector and can offer support tailored to a company's needs. For example, Sage offers Brightpearl, a management system for retail businesses that includes financial management functionality. The system enables real-time business insights and allows Sage to offer end-to-end retail financial management services. Users can choose their accounting modules and platforms, as well as work with a single vendor in this space.

5. **Using Smart Contracts:** Smart contracts can perform certain functions automatically if predefined conditions are met (for example, the contract could automatically generate an invoice once a service is provided and extract payment when the invoice becomes due). Blockchain, and its security features, is an integral part of smart contracts.