Levelling the ‘paying’ field

Why fairer payment terms can kickstart the SME coronavirus recovery

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A level ‘paying’ field

Introduction

Coronavirus has impacted every sector of the economy and its reverberation on small business has been dramatic. Between 23 March and 5 April 2020, a quarter of all UK businesses (of which SMEs represent the majority) ceased trading, and over half of those that continued to trade saw a fall in turnover.[1] Grinding to an abrupt standstill, business owners are rapidly doing what they can to adapt and survive.

Much like an earthquake, coronavirus' aftershocks on the SME economy are going to be hard to anticipate. But we wanted to try. As a starting point, we asked small business owners how lockdown has changed their business, their attitudes and their outlook. After hearing from more than 500 small business owners across the UK, we can share a glimpse of what the world might look like for SMEs in general, and the B2B sector in particular.

Going into the crisis, the small business B2B sector was concerningly inefficient—battling low productivity and late payments. Unsurprisingly, the recent lockdown amplified these challenges.

Not only have many businesses stopped trading, but 40% of B2B respondents said they are owed more than £10,000 in outstanding invoices and nearly a third lack confidence they'll get paid – making their future even more uncertain. So, while their customers are looking for more time to pay, suppliers need the capital to keep their business afloat.

[1] Office for National Statistics, April 16, 2020

Coronavirus has caused a severe trade credit crunch for SMEs, putting a strain on cash flow and on the relationships between customers and suppliers. The reality is that small businesses have been carrying around this trade credit risk for decades by providing long payment terms as standard practice.

Now, and as a direct result of this crunch, there's a growing voice of small businesses who are re-thinking the risk versus reward of offering long payment terms. More than a third of businesses who offer payment terms told us they're more likely to reduce their terms or ask customers to pay in advance in future.

In this report, we focus on how small businesses are coping today and how coronavirus will impact the B2B economy in future. Coronavirus can and should trigger a step-change for small businesses to become more efficient, productive and resilient. In our view, the first and most obvious change is making payment terms fairer between suppliers and their customers. In other words, UK small businesses need a level paying field.

How we can help

At iwoca, we've been building iwocaPay, a new solution that takes the burden of payment terms off the shoulders of small businesses. With iwocaPay, we give suppliers all the benefits of payment terms and none of the risk.

A non-recourse solution, suppliers get paid up front while their customers have the flexibility to spread the cost over 90 days. Helping both suppliers and their customers manage cash flow, we believe iwocaPay will become a key tool to help SMEs have greater confidence as they get back to business.

-Lara Gilman & Robin Jones,
co-leads iwocaPay

The pre-crisis headwinds for SMEs

Productivity, late payments and long payment terms

The SME productivity puzzle that preceded the crisis

To understand the health of the small business economy is to understand the foundations of the UK economy at large. Before coronavirus, the UK's 6 million small and medium business owners employed 16 million people—60% of all private sector UK employment[2]—and accounted for close to 50%[3] of revenue in the economy.

However, a thriving small business sector delivers impact far beyond its macro contributions: small businesses advocate for level playing fields, including fairer paying practices; they are more nimble and adaptable to changing circumstances; and they are critical to driving local economic development.[4]

On the surface, the UK's SME economy seemed strong as we entered the crisis in March 2020. Over the last two decades, the number of SMEs grew by 69% with 2.4 million more businesses today than there were in 2000.[5] However, while more small businesses opened up shop, there were concerns that this sector's resilience was weaker than the headline figures suggested.

Not only does our output per hour lag behind other major advanced economies in the G7,[6] it's only 2.4% above what it was more than a decade ago, in 2007.[7]

Since 2007, our output per hour has only grown by 2.4%

2.4%

[2] House of Commons Library, 2018 , p5
[3] ESRC, 2016, p1
[4] OECD, 2017, p6
[5] GOV.UK, 2020
[6] House of Commons Library, 2020, p5
[7] Ibid, p2

The 'long tail of low productivity'[8] has been regularly cited as a drag on the economy as a whole—and small businesses are a core part of the lag.

Over the last few years, a range of government and private sector initiatives have investigated the underlying causes holding back small business productivity —and poor business efficiency is one of the major barriers. In 2017, Sage quantified the operational overhead, estimating that admin costs alone could total as much as £39.9 billion in lost productivity to the UK economy.[9]

However, as the present crisis deepens, it's the sector's financial inefficiencies that are of growing concern. At the best of times, strained cash flows and unreliable liquidity stifle small businesses' abilities to invest in their operations and capabilities.[10] At worst, strained cash flow drives small businesses out of the market. It's estimated that 50,000 small businesses go out of business every year due to cash flow problems.[11]

£39.9B

in lost productivity to the UK economy

- sage

[8] House of Commons Library, 2018, p5

[9] Sage, p2

[10] Institute of Directors, 2018, p16

[11] House of Commons Library, 2018, p41

On one level, improving access to finance is an obvious fix. Over the past eight years, iwoca has played a critical role in helping small businesses manage their cash flow.

We have invested in making finance available when and where small businesses need it and in doing so, issued more than £1 billion and served 50,000 small businesses. [13]

We remain committed to helping small businesses through the crisis, including making CBILs available to small businesses directly and via partners integrated with our OpenLending platform.

[12] iwoca, 2018

However, we also see an opportunity to solve both operational and financial inefficiencies by focussing on situations where a cash flow problem is compounded by an operational inefficiency.

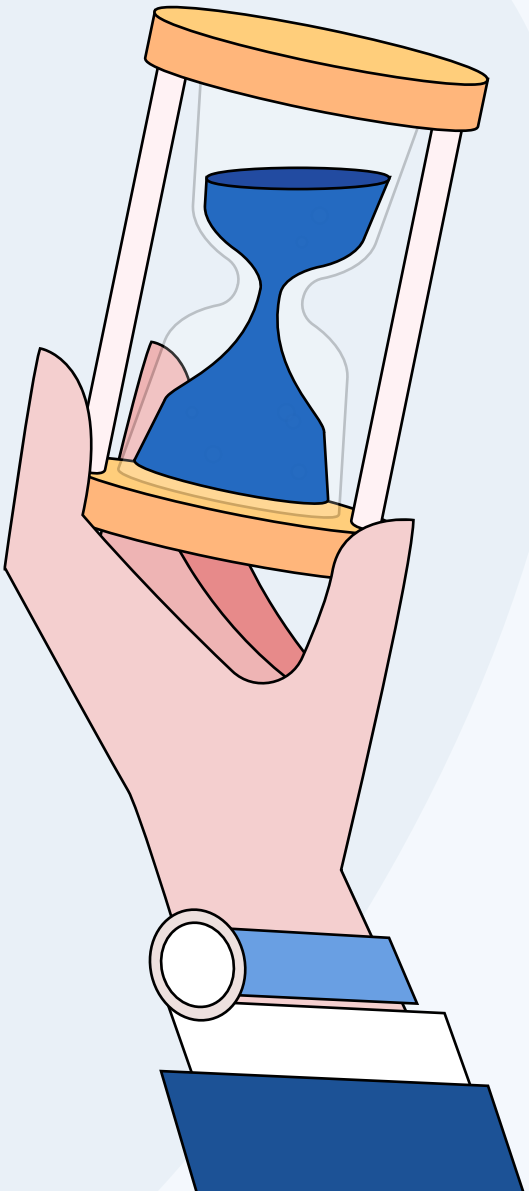
The most obvious example of this is late payments, where businesses not only face cash flow issues, but also waste time and effort trying to get paid. According to QuickBooks, UK small businesses spend 56.4 million hours per year chasing payments.[13] This can be as much as a week of time which could have been better spent investing in their business' growth.

While it's clear that late payments have a severe and immediate impact on small businesses, we believe they are just the most visible symptom of a larger problem in the SME sector.

56.4 M

small businesses spend 56.4 million hours per year chasing payments

- intuit quickbooks



[13] PYMNTS.com, March 16, 2020

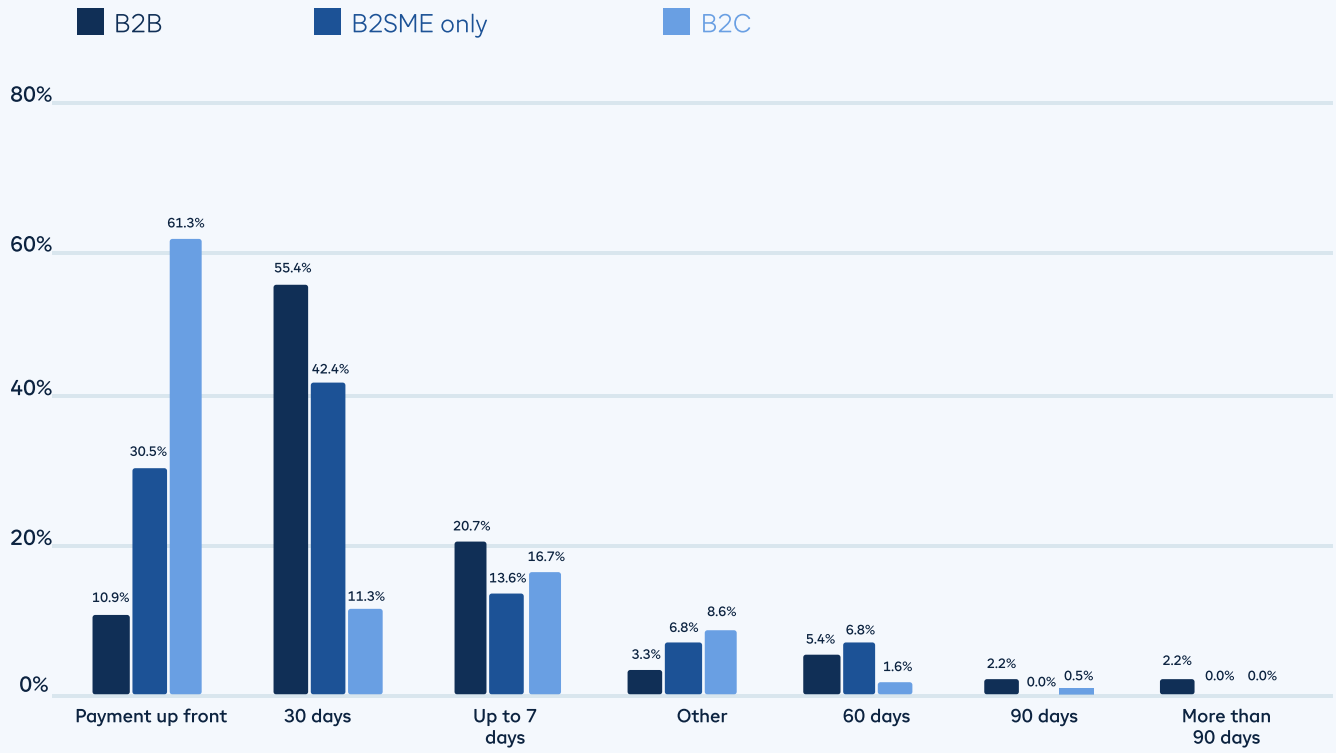
Late payments in the B2B economy: More than just 'David and Goliath'

One major culprit straining cash flow is a power imbalance at the point of purchase, particularly for B2B businesses. B2B businesses are a substantial contributor to the UK economy. It's estimated that 40% of UK businesses derive all or most of their revenue from B2B trade, and a further 42% of businesses derive at least some of their income from it.[14] This huge portion of the economy is also more susceptible to the trade credit risk inherent to offering longer payment terms.

According to our survey, B2B businesses are more than twice as likely to give a customer more time to pay than B2C businesses. The majority of B2C businesses ask for payment up front, while B2B businesses tend to offer 30 day terms. As such, B2B businesses have to manage the cash flow gap between delivering a service and getting paid.

What are your typical payment terms for customers?

(Prior to coronavirus)



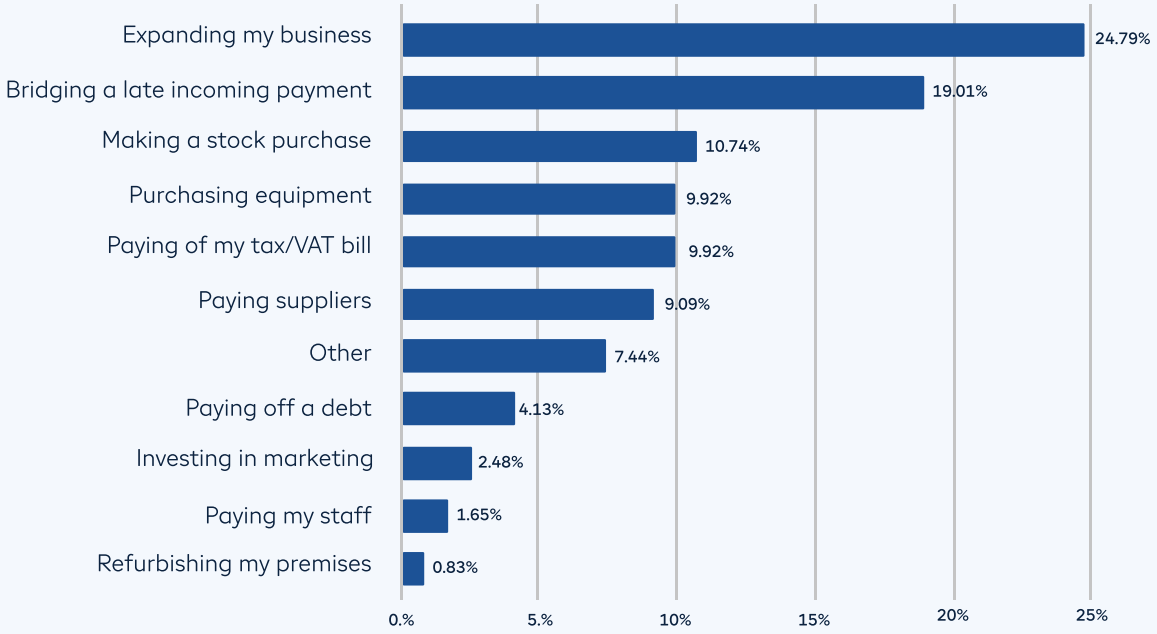
2x

B2B businesses are more than twice as likely as B2C businesses to give payment terms

[14] Business Intelligence Group, 2019

While flexible payment terms are valuable to customers, they put pressure on small business suppliers. Cash flow strain around invoices is a typical reason customers come to iwoca. After expanding their business, "bridging a late incoming payment" was the most popular purpose B2B businesses had for using an iwoca Flexi-Loan.

The primary purpose of using iwoca - B2B businesses only



When we, as an industry, talk about late payments, the discussion is typically characterised by large businesses failing to pay their much smaller suppliers. This 'David and Goliath' storyline is a common one, particularly because larger companies can leverage their purchasing power to squeeze small suppliers and are also less likely to feel the liquidity strain.[15] So the unfairness of this arrangement is palpable.

However, the 'David and Goliath' angle is only part of the story. The late payment problem is not just about Goliath squeezing the supply chain, it's also about SME customers drifting beyond their standard payment terms. According to BACS, not only are small businesses shouldering a huge debt burden of more than £23 billion, but eight out of ten private sector late payments are SME to SME.[16]

80%

of private sector late payments are SME to SME

-BACS, 2019

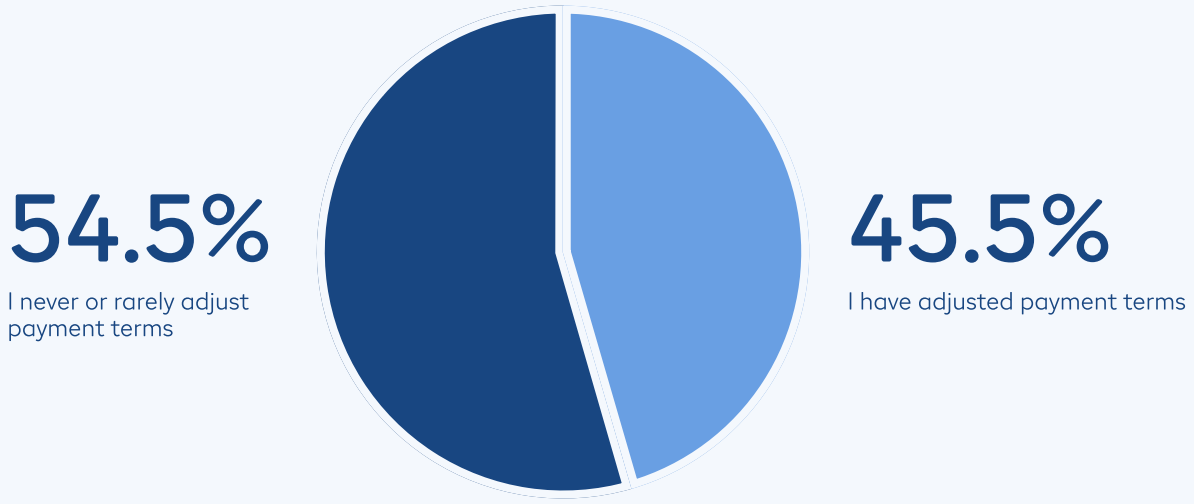
Nearly half of B2B businesses surveyed have adjusted payment terms for customers and two thirds who adjust payment terms tend to give customers more time to pay—making this group even more exposed to late payments.

[15] Department for Business, Energy & Industrial Strategy, 2018

[16] BACS, November 21, 2019

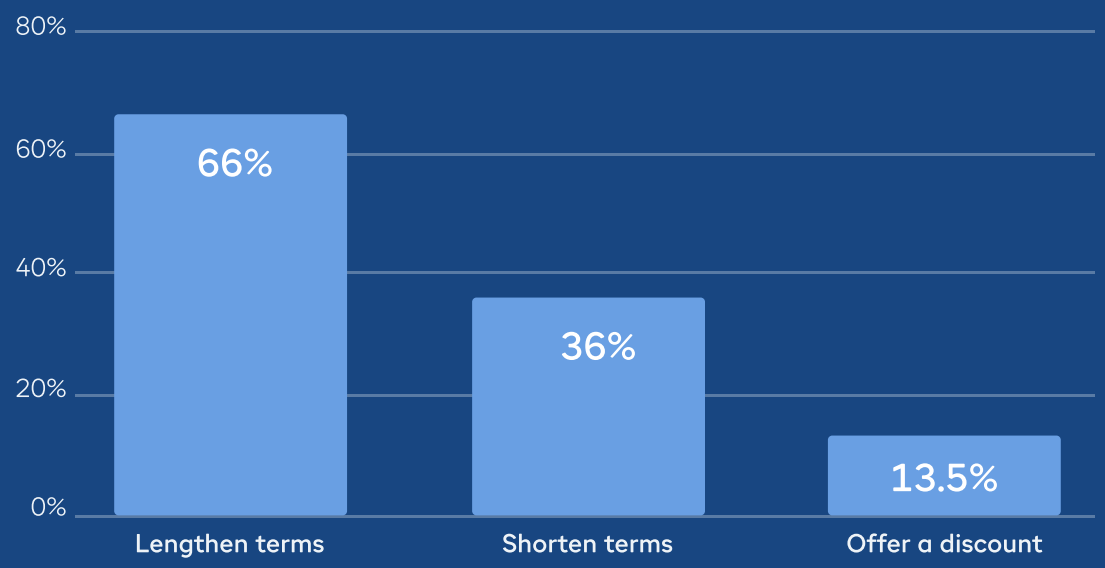
Nearly half of B2B busnesses have adjusted payment terms...

Have you ever adjusted payment terms? (B2B businesses only)



...and more often than not, they increase them.

The most common adjustments to payment terms (B2B businesses only)



B2B businesses are both dependent on and disproportionately exposed to longer payment terms

Payment terms are a core part of how many UK businesses operate. Flexible terms have the capacity to increase a supplier's sales and improve their customer relationships. However, long payment terms (e.g. 30 days or more) can adversely affect a business' cash flow and make it harder to grow, invest in labour and increase output.[17]

The question is: how can businesses better understand, monitor and manage the risks of the terms they offer?

For suppliers, the industry standard approach to payment terms is precarious and inefficient, leaving businesses open to unnecessary risks. Globally, around 7.5% of all invoices are written off as bad debt. In the UK, the same survey estimated as much as £60 billion gets written off. Invoices with more than 7 days payment terms are common, creating a direct link between payment terms and bad debt.[18]

Moreover, business owners may be more exposed than they think. Whether it's the need to maintain long-standing business relationships or due to a lack of confidence or resources, businesses rarely assess the creditworthiness of a customer. Roughly half of B2B businesses surveyed said they never perform credit checks.

49%

of B2B businesses said they never perform credit checks

[17] Department for Business, Energy & Industrial Strategy, 2018, p8

[18] Sage, 2017, p2

32%

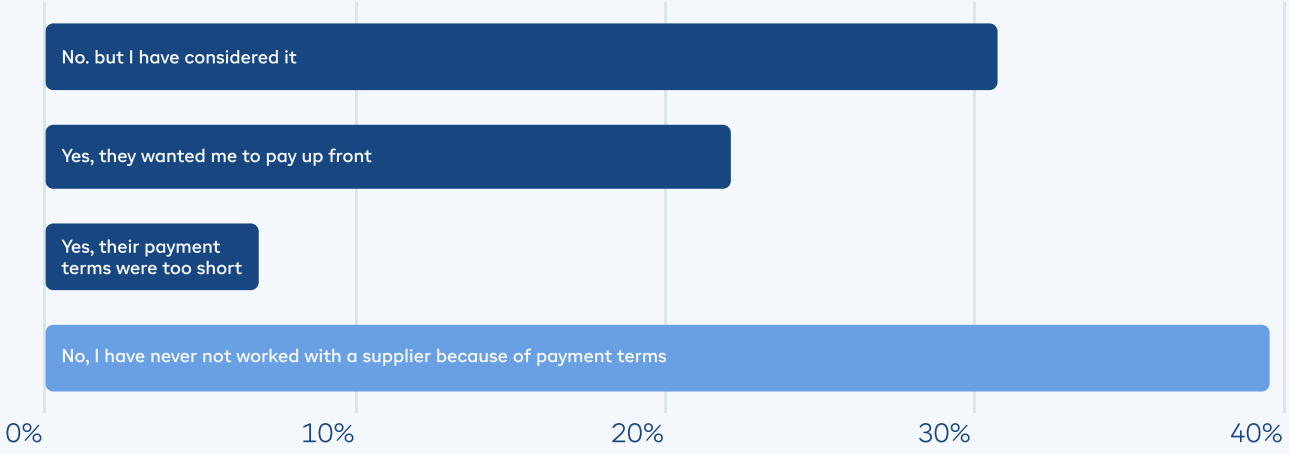
of businesses had lost business because they were unwilling to adjust payment terms.

Payment terms can also impact revenues because many businesses who offer payment terms don't negotiate beyond their standard offer. We found that 32% of businesses had lost business because they were unwilling to adjust payment terms.

The same trend held true for customers. Almost 30% of business customers have considered not using a supplier because of the payment terms they offered. A further 22% said that they have not worked with a supplier because of payment terms.

The customer perspective

Prior to coronavirus, have you ever NOT used a supplier because of payment terms?



Smaller suppliers can feel pressured to offer attractive terms where they do not share equal bargaining power with the customer, and it can cause a race to compete on terms.[19]

A fifth (20.3%) of B2B suppliers report they have offered customers better terms than they would usually receive themselves. This means that some are exposing themselves to a level of risk that they would not impose on others, further illustrating this imbalance at the point of purchase in the small business sector.

20%

of B2B suppliers offer better terms to customers than they receive

Despite the risks, 37%—2.18 million—of SMEs received trade credit last year, up from 31% in 2014.[20] Rather than falling out of fashion, the market for payment terms seems to be growing. Demand from customers and competition from other suppliers has left many B2B businesses in a cycle of uncertainty, exposing them to risk and disrupting (or stopping) the flow of business.

Moreover, and perhaps more worryingly, payment terms culture is creating a huge pot of informal credit, which small businesses are relying on instead of accessing formal and less risky finance from a financial provider. Over a third of SMEs (34%) found that receiving trade credit from a supplier via payment terms was one factor that reduced their need to access formal business finance.[21]

In light of the uncertain road ahead, this has left many businesses in a particularly vulnerable position. In normal times, this situation was just about working, but since the pandemic, attitudes towards payment terms have begun to change.

The first thing I thought when this all started [the pandemic] was, we won't get paid. When you're a small business, that's when the issues start. And it's a knock on effect - if I'm not getting paid, it clogs up my credit accounts which means I can't take on more contracts.

Mike Luxford, founder of MLCS, Ltd.

[19] Department for Business, Energy & Industrial Strategy, 2018, p16 [20] BVA BDRC, 2020, p12 [21] ibid, p12

Keeping (most of) the lights off

How small businesses are coping with lockdown

Small businesses have been hit hard

The immediate result of the lockdown was the closure of all non essential UK businesses. Between 23 March and 5 April 2020, a quarter of all UK businesses temporarily ceased trading, and over half of those that continued to trade saw a fall in turnover.[22] This has had a catastrophic impact on thousands of businesses.

The more resilient online retailers have been hit by supply chain issues while brick-and-mortar small businesses have had to shut their doors or investigate alternative models at a break-neck pace. Some businesses have been able to adapt quickly, like Fortoak Group, a B2B paper products supplier in Loughborough who transitioned to delivering PPE. As a result, they've been able to continue operating with minimal interruption to their revenues.

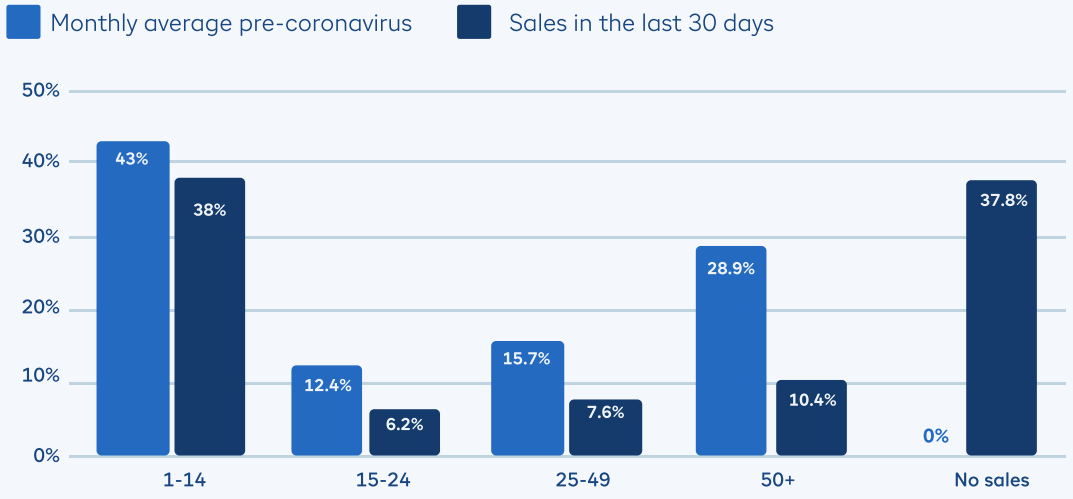
My business was under threat because of traditional products - I used my platform and leverage to get into PPE.

—Alex Vergopoulos, Owner of Fortoak Group

But for many others, business has come to a complete standstill. More than a third (37.5%) of small businesses surveyed reported they hadn't made a new sale in the last 30 days. Before Coronavirus, nearly 100% of businesses who were actively trading told us they were operating with at least one sale per month, and nearly 60% had at least 15 sales per month.

Small business activity has ground to a halt

Number of sales per month pre- and post-coronavirus



[22] Office for National Statistics, April 16, 2020

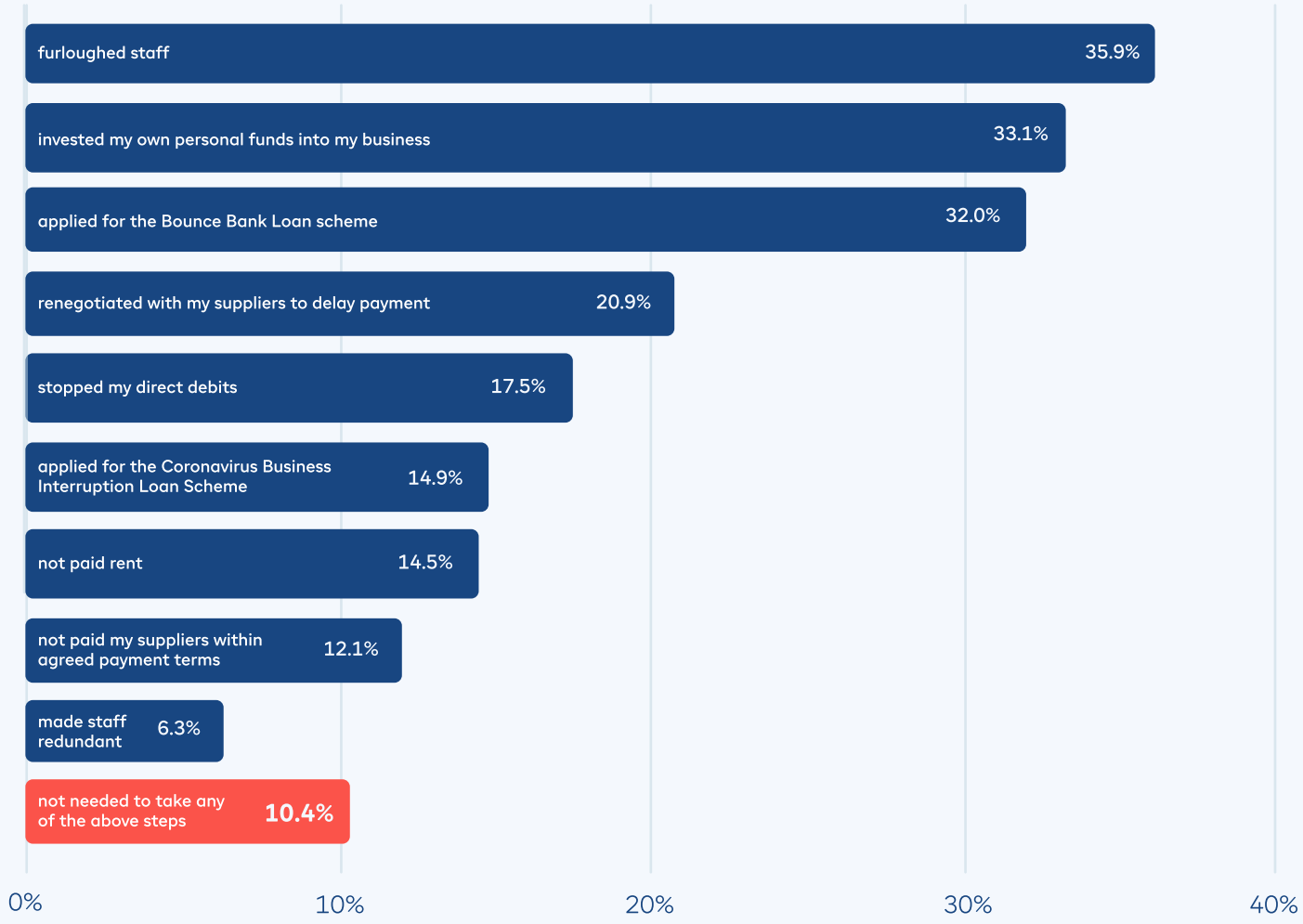
Not only has business stopped, but many businesses haven't been paid for goods and services they've already delivered. This is particularly true for B2B businesses who give their customers long payment terms. Our research found that 40% of B2B businesses have more than £10,000 of outstanding invoices and although 68.5% of these businesses are still confident that customers will pay them, they're not sure when. Solvency is a major concern and nearly a quarter (23.7%) of all respondents aren't confident their business will make it to 2021.

In the immediate term, small businesses are doing whatever necessary to ensure they'll be ready to turn the lights back on as the lockdown eases. 90% of businesses told us they have had to take some kind of action to stabilise their businesses during the lockdown.

But even as businesses take substantive measures to shore up their short-term survival, our respondents indicate that liquidity remains the thing that keeps them up at night.

What steps have you taken to stabilise your business?

I have...



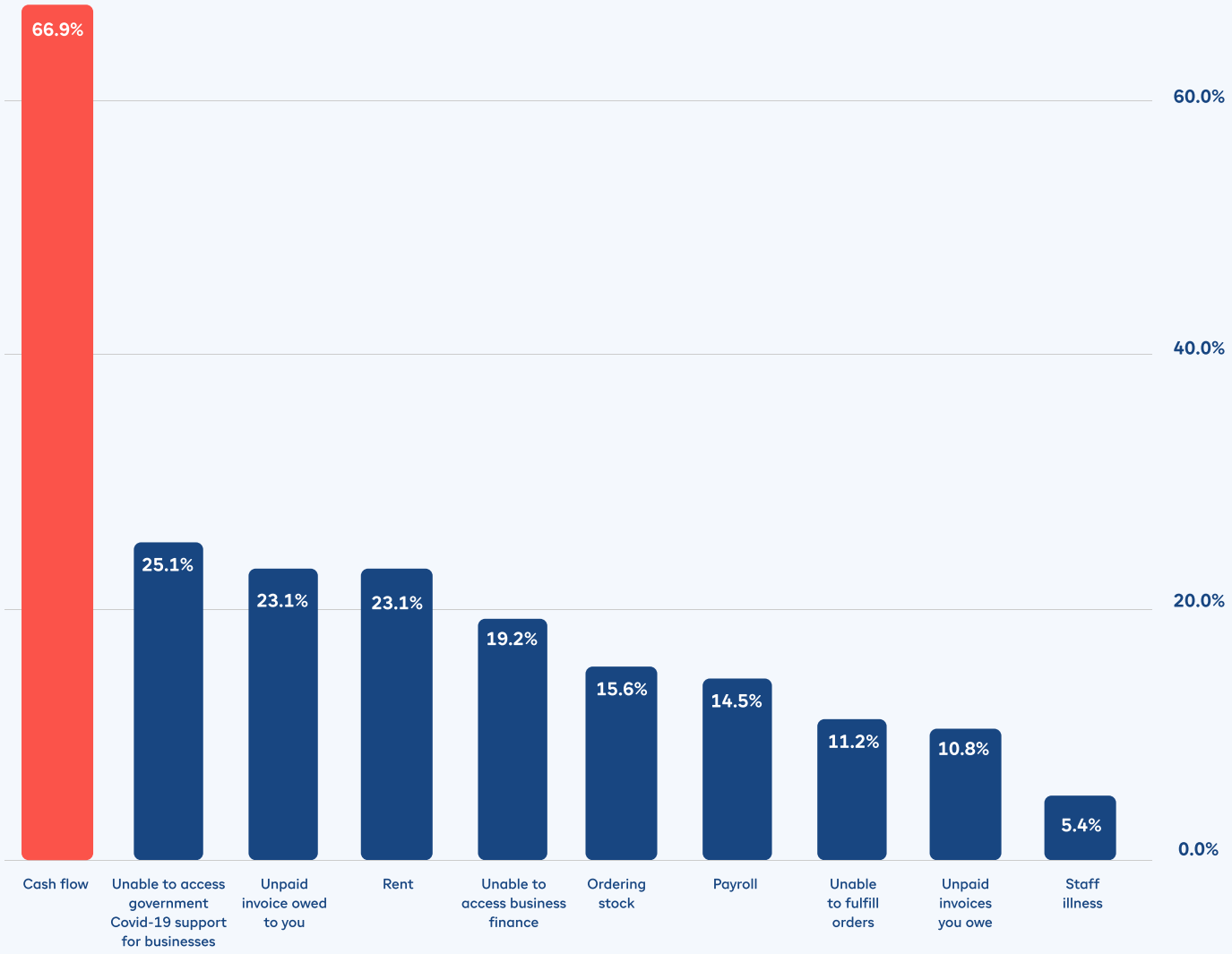
Cash flow remains king

In the short term, having cash at hand is crucial for the survival of most businesses. Across all sectors and sizes, managing cash flow through the crisis is their primary concern, but small business are also facing other challenges to their cash position.

Beyond cash flow, a quarter of small businesses are concerned about the inability to access government funding, and nearly a quarter (23.1%) are concerned about unpaid invoices they are owed as well as rent—often a significant portion of a business' outgoings.

Cash flow is, by far, the biggest issue facing small business

What are the top 3 issues facing your business?



SMEs give the government support mixed reviews

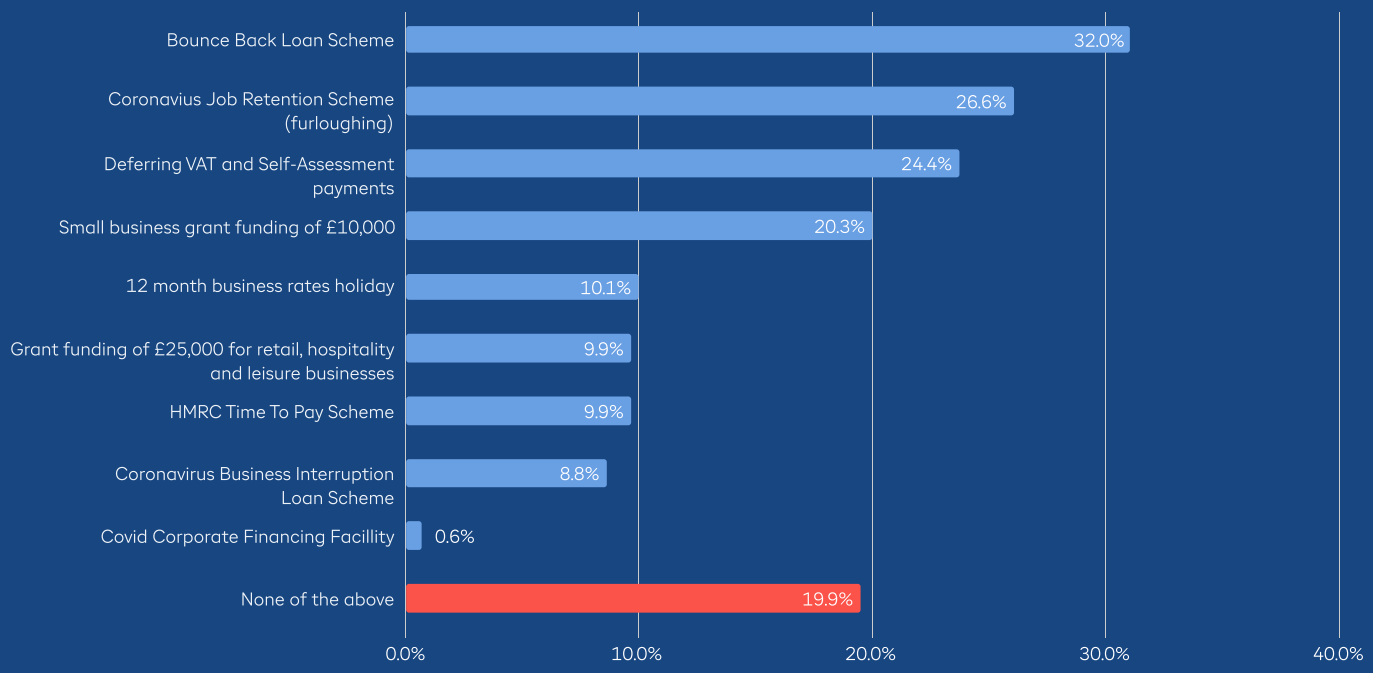
In order to help small businesses through the mandated lockdown, the government has introduced a number of schemes and measures to help–including access to government-backed finance through the Coronavirus Business Interruption Loan Scheme (CBILS) and Bounce Back Loan Scheme (BBLS).

But 1 in 4 businesses (25%) told us they haven't been able to access this cash flow saving support.

It's important to note that at the time of our survey, Bounce Back Loan Scheme, the government's most recent initiative, had only just been announced. Since then, nearly 700,000 businesses have been approved for the BBLS[23] and while questions remain on their long-term impact,[24] their short-term accessibility is significantly broader than CBILS.

At the time of our survey when BBLS had only been made available to small businesses for a few days, nearly a third of respondents had said they accessed the scheme. By comparison, less than 9% had accessed CBILS.

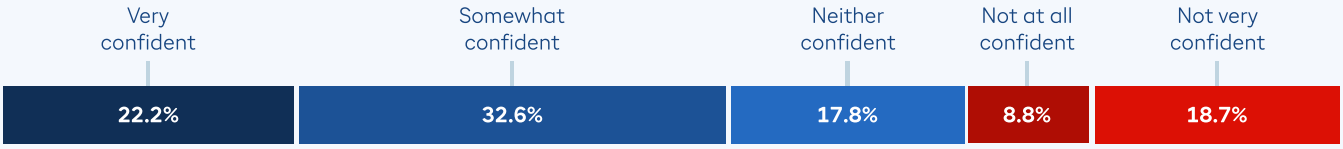
Which of the following schemes have you accessed, been in receipt of or used?



[23] HM Treasury, 2020 [24] The Telegraph, May 21, 2020

While the BBLS has been more successful than CBILS, small businesses remain divided on how the government has handled the crisis. 55% of respondents are confident or very confident that the government has taken the right steps during the crisis—leaving a significant pool of small business owners who are less certain about the support they have received.

How confident are you that the government has taken the correct steps to support small business?



In reality, the polarity towards the government response may be more about the uncertainty small businesses face themselves. Businesses who have survived for decades and through world wars are now unsure if they will have enough liquidity to get to 2021.[25] How the government supports small businesses to access the capital they need to survive will be critical for determining how the SME economy fares over the longer term.

[25] BBC, May 20, 2020

Turning to invoices to unlock capital

Challenges with accessing government support was closely followed by unpaid invoices as the third most pressing concern for small businesses (23%) in our survey. Frustration around outstanding invoices during lockdown is not unique to the UK.

The Sydney Morning Herald captured the global sentiment in their headline: "Forget toilet paper, everyone wants early repayment."[26] It's not surprising, therefore, that invoice finance solutions are on the rise as businesses seek ways to unlock capital. [27]

Forget toilet paper, everyone wants early repayment.

— Sydney Morning Herald, March 2020

As we entered into a steep economic downturn, a culture of long payment terms left businesses exposed to greater risk. Many find themselves with huge unpaid invoices and uncertainty around when they will be paid. Others find themselves being pressured to extend payment terms.

Although the government has put in place schemes to help businesses through this time, it's clear that B2B businesses are carrying customers through this period of uncertainty. This reality is likely to harm their efforts to keep their own doors open.

[26] Sydney Morning Herald, March 30, 2020

[27] Independent, May 22, 2020

Looking ahead

Building a more balanced and productive B2B ecosystem

Coronavirus has highlighted how critical it is for businesses to do more than just make ends meet. In the words of one supplier, “Lockdown highlighted all of the problems with businesses that hadn't thought about what happens if they can’t go to work.”

For the millions of small businesses reopening their doors over the coming weeks and months, it means they’ll be looking at their business through a new lens.

This refreshed perspective could be the turning point for the B2B economy, as businesses look for tools and services that make them more efficient and resilient. Small businesses are already showing a changing appetite around their practices—starting with how they manage their supply chain.

Changing perspectives on business practices

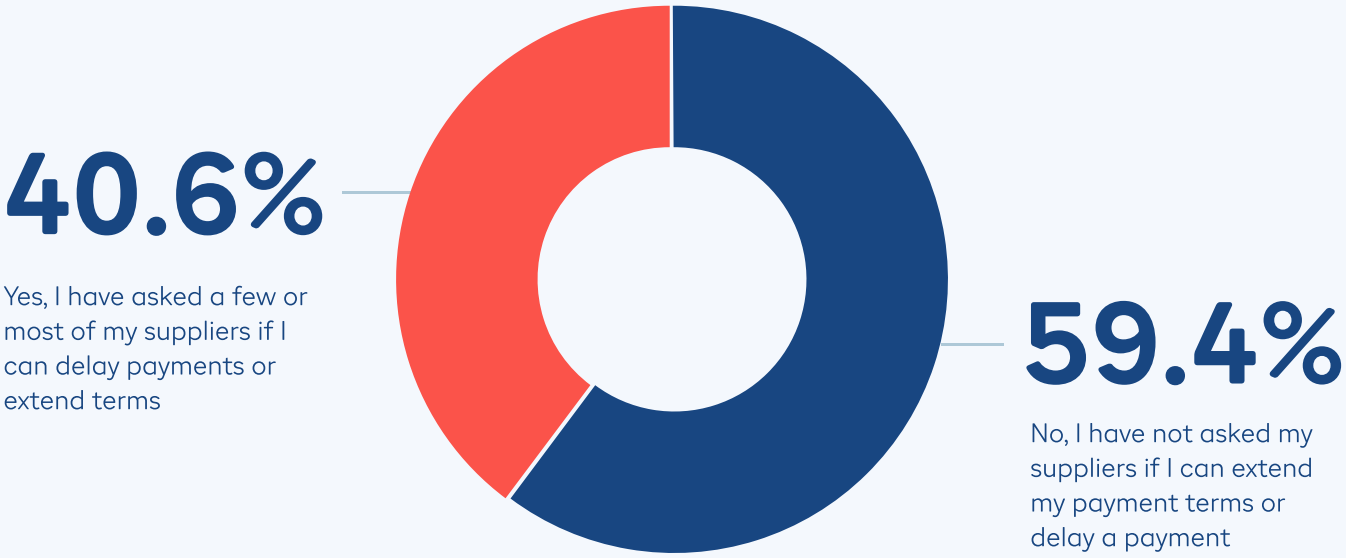
Beyond short-term survival, small business owners are reviewing how they do business. In most cases, it's not going to be business as usual and one thing they're likely to change is their payment terms. More than a third of businesses who offered payment terms are more likely to reduce their terms or ask customers to pay in advance in future. It's unsurprising that many suppliers are less prepared to take on the additional risk.

The challenge is that although many are looking to reign in their payment terms, customers will still expect them. Business customers are already testing their boundaries, with 40% of respondents asking for more time to pay in the last 30 days.

With a marked shift in attitude post-coronavirus to a more risk-averse approach to payment terms, there is a chance that the trust between B2B businesses could erode, which could have an impact at the speed at which the economy recovers.

To remove any potential barriers impacting our economic recovery, efforts should centralise on helping small businesses re-build their business. To this end, making payment terms more effective for both the supplier and the customers will contribute positively to our economy as a whole.

In the last 30 days, have you asked any of your suppliers to extend their payment terms?



Helping small businesses get back to work

There's no quick way to build a more sustainable and efficient SME economy. Over the coming days, weeks and months, more small businesses will reopen, but in a changed and uncertain economy. Our objective is to help businesses have the confidence and capacity to get back to work as quickly as possible. Based on our findings, we believe de-risking payment terms and strengthening the B2B ecosystem are critical components to making that happen.

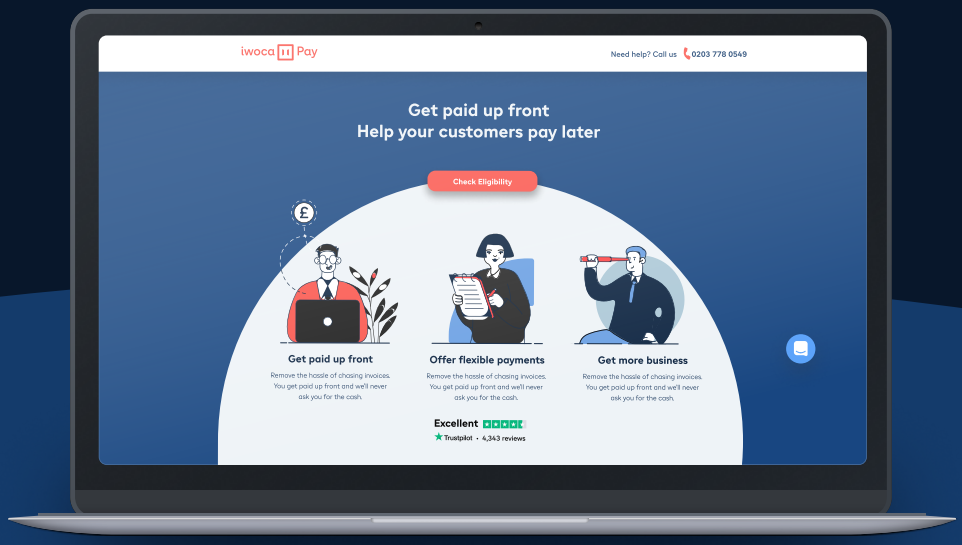
I. Introducing iwocaPay: a better alternative to payment terms

It's clear the problem with payment terms is its major impact on a business's cash flow. But providing customers with an option to pay later or spread their cost is a powerful sales tool for suppliers. In the B2C space, Klarna—a global provider of consumer payment terms—says that average order values increase by 55% when customers can pay in instalments.[28] So the question is, how can we make payment terms more balanced for both suppliers and their customers?

Existing alternatives like invoice finance and trade credit insurance only partially address the imbalance between suppliers and customers. While invoice finance solutions help suppliers access cash, suppliers still bear the risk of non-paying customers in most of these solutions. In contrast, trade credit insurance guarantees the invoice, but the claim payout can be anywhere from 60 to 120 days after the invoice went delinquent, leaving suppliers with another cash flow gap. Neither solution has a track record of adequately addressing the needs of the SME to SME market.

[28] Klarna

This is why we're launching iwocaPay, which lets customers spread the cost of their invoices for up to 90 days. Built specifically for small businesses, iwocaPay gives suppliers all the advantages of payment terms, while mitigating the risk and inefficiency of chasing payments. A non-recourse solution, suppliers get paid up front while customers have an easy financing tool to spread the cost of their purchases. We started building iwocaPay last year as part of our BCR commitments[29] and we believe this solution will be critical in helping businesses get back to work.



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II. Strengthening the B2B ecosystem

Leading up to the crisis, small businesses had under-invested in their own efficiency. One of the most obvious opportunities is to make investing in efficiency easier. To do this optimally requires both industry innovation and government support. On the innovation side, ecosystem players will continue to focus on making digital solutions seamless for small businesses - particularly leveraging practical applications of real-time financial data through OpenBanking.

Accountants and advisers play a critical role helping their small business customers become more efficient, and by extension resilient. A key part is through providing business owners with a clear understanding of the short and long-term view of the health of their business–including identifying tools and services that give business real-time access to finance or financial information. Accountants and advisors are critical to ensuring SMEs invest effectively in their long-term sustainability.

[29] iwoca BCR commitments, 2019

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