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PAYMENT BACKLOGS: A BIG PROBLEM FOR SMALL BUSINESSES

Synthesis

The low rate of private investment limits the capacity for growth of the Polish economy. Against the background of the countries of our region, Poland stands out due to the lowest rate of investment. In last ten years, business investment in the new EU member states from Central and Eastern Europe amounted to, on average, 16.1% of GDP while in Poland to 10.7% of GDP only. The low investment rate means less machinery and equipment in companies, lower productivity and, consequently, lower wages. The problem of too little investment also shows in the size of the Polish enterprises - the ratio of their assets to GDP is among the lowest in the EU.

Among the main driving forces of modern economic growth are far-reaching specialization and the emergence of increasingly complex value chains. Cooperating companies use trade credit, that is deferred payments system. By design, this provides an effective solution, because the contractors often know about each other a lot more than their banks. In result, the cost of trade credit can be much lower than the cost of bank credit. Trade credit should not be considered a substitute for bank credit - we cite research showing that trade and bank credits are to a large degree complementary, and complement each other. At the same time, however, lengthening of supply chains and growing importance of deferred payments, means that problems of individual enterprises can quickly spread to cooperating companies. Therefore, although on the one hand, trade credit facilitates closer cooperation, on the other hand, it makes the company more vulnerable to payment backlogs.

Payment backlog is an intuitive concept, but its precise definition is not easy. While one can easily determine which payments are not delayed, payments made after the date specified in the contract do not automatically classify as backlogs. Possible causes of the delays are highly varied- from the bankruptcy of a contractor, through his ill will (he could pay but he does not) to disputes concerning the quality of the supplied goods, or simply a time-consuming procedure

The cost of payment backlogs is not limited to the cost of maintaining the liquidity of the company. In addition to the interest on bank loans (assuming that the company has access to credit) one should also take into account all the additional costs associated with the monitoring of payments from contractors, chasing late payments, and growing risks caused by the delays. It is even harder to determine additional costs associated with the reduction of investment and scale of operations caused by disturbances in the financing of such companies. In a study commissioned by FOR in preparation for this report, in accordance with the established practice

of the study of this topic, we asked entrepreneurs about the total costs incurred to their companies by payment backlogs, costs not limited to purely financial expenses.

The scale of the problems with payment delays at the macro level is strongly linked to the economic situation - problems with backlogs are rising during slowdowns. During the economic slowdown in 2011, payment backlogs were the biggest barrier to investment for small and medium-sized enterprises.

Payment backlogs generated largest costs in the construction and telecommunication sectors and the lowest in the industry. Low cost of payment delays in the industry is probably the consequence of a stable portfolio of large customers, which are easy to monitor and easy to press in the case of delays. However, we did not find direct evidence of a link between the increasing size of enterprises and the sector in which they operate.

The results of the study commissioned by FOR show that entrepreneurs who had problems with payment backlogs as their main reasons pointed bankruptcy of contractors and payment backlogs that their contractors experienced themselves. These results indicate that backlogs at a point in the supply chain can spread to the cooperating companies.

One should note the importance of the informal economy - for companies operating in sectors with a significant share of gray economy (e.g., construction) risk of payment backlogs is four times greater. Entrepreneurs that hide part of its business from tax, are also less honest in timely fulfillment of their obligations to suppliers. As payment delays in one company can easily spread to another, enterprises that honestly pay all their taxes may suffer from backlogs of their business partners operating partly in the gray zone.

Our results indicate significant differences in the perception of the causes and effects of backlogs, both among the companies that actually experienced them, and others. Although payment backlogs are not a particularly strong barrier to investment to enterprises in general, their significance is larger for those that experienced the problem. In other words: for over a quarter of Polish enterprises payment backlogs are one of the most important barriers to investment growth.

Companies that experienced payment backlogs in the past, use much more security when entering into new contracts. Also more often they indicate legal measures and reporting to debtor registers. Importantly, when it comes to preventing of payment backlogs, information about delays in public-law payments and in private payments are reported as equally significant by enterprises judging potential contractors - in both cases 80% of them would disqualify the candidate.

Problems with payment backlogs cannot be easily solved by decrees- they need a much broader range of activities, both by economic authorities, as well as industry associations and companies themselves. This is not only Polish problem - small and medium-sized enterprises in other countries have the same problem. However, a law requiring companies to pay on time would not solve this problem - the contractor would not pay on time when he is bankrupt or when he questions the quality of the delivered products. Furthermore, even if there is a possibility of

redress in court, companies adopt such solutions only reluctantly, not wanting to antagonize its customers. Therefore, we offer much broader recommendations.

For the government, we indicate the need to take measures to reduce the gray economy and to facilitate access to information on public-legal liabilities, which will allow companies to judge the credibility of potential contractors more accurately. The government should also take care of the favorable conditions for innovative companies seeking market solutions to problems of backlog (e.g., micro factoring).

For industry associations, we point to the need to develop and enforce standards for both payment terms, and quality of supplies. Developing and maintaining of standards can be helped by certificates awarded to reliable companies timely fulfilling their contractual obligations.

For the enterprises, we recommend that in addition to timely paying their own bills they should put more efforts in verifying the reliability of contractors and more widely use the services of credit bureaus, not only in a passive way (by downloading information) but also actively, by reporting unreliable contractors. With a limited efficiency of courts in the fight against backlogs, crucial factors are: improving access to economic information (both positive and negative) and fighting against social acceptance of delayed payments.