Briefing Note

5 January 2024

Proposal for a Regulation combating late payments – Why consignment & other contractual arrangements are not an answer

Negotiating payment terms enables businesses to organise the provision of services and distribution of goods in the most efficient way to serve their customers with a wide choice of products at the right time and location, and at the best price. This is because it allows retailers and wholesalers to hold an inventory that offers choice and affordable prices, including niche, innovative products, and products that respond to seasonality. Having stock also supports resilience in case of unexpected shocks like natural disasters, war and pandemics by ensuring availability of products. It also supports SMEs by enabling them to own their business i.e. have assets, which are a buffer when they have setbacks, and offers them collateral when they seek finance.

The Commission now proposes to limit all payment terms in the economy to 30 days. This leaves retailers as debtors with limited choices. It also removes the solution that wholesalers can provide for their business customers as debtors, in the form of supplier credit, or other solutions that have developed over time (e.g. mutually beneficial payment terms, trade credit insurance).

Without the freedom to negotiate payment terms, there are only two options for debtors:

1. Finding finance to fill the financial gap.
2. Finding a different contractual approach to negotiating payment terms beyond 30 days.

1. How likely is it that the financial gap can be filled by financing institutions?

We estimate that bringing payment terms to 30 days will create a massive liquidity gap in the range of EUR 100-150 billion for retailers in Europe.[1] The knock-on effects will be felt by the entire supply chain. Wholesale will also be hit if they stop advance payments to suppliers, their business customers' viability is affected or their value proposition of providing supplier credit is undermined.

If finance is found, it will be expensive as interest rates are high and are currently more than or equal to the profit margins that the sector operates with (1-3% in food, 4-6% in non-food) and its long-term effect will be to downgrade businesses' credit rating (the profit per euro invested will decrease significantly).

[1] See here: https://www.eurocommerce.eu/2023/11/late-payment-proposals-impact-on-retail-and-wholesale-in-europe/.

SME retailers are already struggling to access finance for investments and banks are unlikely to finance inventory. Wholesalers will not be able to support their business customers as they traditionally have by offering supplier credit for longer than 30 days.

The cost of the finance will not be possible to absorb with low margins typical in retail and wholesale. Consumers may need to help to fund that financial gap. If consumer prices rise as a result, this makes retailers and wholesalers operating within Europe less attractive, especially considering the fierce competition from those intermediating sales online, often between non-EU suppliers and EU consumers.

2. Will the benefits outweigh the costs of replacing negotiation with finding new contractual approaches?

Different contractual approaches to negotiating long payment terms exist that could enable compliance with a 30-day payment term. Each alternative solution that the proposal will force businesses to seek would fundamentally change business models in the economy **to the detriment of both retailers and suppliers**. It would favour models such as commercial agency, currently used for specific needs, just to meet the new requirements of a standard 30-day payment term.

Differentiating rules so that payment terms are only limited to 30 days for negotiations between large debtors (buyers) and smaller creditors (suppliers) ignores the direct route to market retailers and wholesalers provide for SME manufacturers. Over half of sales in French supermarkets are of products manufactured by SMEs.[2] Introducing more administrative burden favours a shift by larger companies to reducing the number of suppliers, as managing more frequent payments, or more complicated arrangements (e.g. consignment), at scale, introduces complexity.[3] Excluding transactions between large players works assumes large manufacturers are at the end of the chain ill-fitting the reality of the value chain. For example, in electrical wholesale, the components for light fittings might be supplied by an SME to a large manufacturer, who in turn supplies to an SME wholesaler who supplies to a larger buyer.

Our analysis of possible solutions is set out in the Annex, but each alternative is likely to have negative consequences.

Replacing negotiation of payment terms with contractual arrangements is likely to:

- Fundamentally change business models by encouraging the development of less efficient and less transparent solutions to meet the 30-day payment term.
- Introduce more complexity.
- Reduce transparency.
- Make doing business riskier.
- Make EU-based operators more vulnerable to non-EU competitors.
- Reduce consumer choice.
- Moving to rental, leasing or consignment means no ownership of property and no/reduced collateral to offer a bank to secure long-term finance for investment, or short-term temporary finance to fill a cashflow gap (e.g. caused by a bad month or weather delaying seasonal sales to ensure salaries are paid) or abnormal expenditure (e.g. paying a rental deposit).
- Affect the most retail in town centres and rural areas that have lower footfall.
- Negate the investment in Payment Observatories by making it more difficult to observe agreed payment dates and compliance.

[2] See here: 2020 VERF DRAFT full working document (eurocommerce.eu)

[3] See the experience in Estonia referred to here: Feedback from: EuroCommerce (europa.eu)

The major difficulties that reducing payment terms to 30 days will cause for retailers and wholesalers of all sizes will be compounded by additional complexity introduced by seeking contractual solutions. Cloaking something currently transparent in secrecy or complexity creates an absurdity, misaligned with the objective of the proposal.

To find out more, visit our webpage and read our position paper.

Annex

Option 1: Ordering what you are certain to sell

Retailers and wholesalers can choose to limit the range of products they offer to the most popular.

Less risk: more popular items are more likely to sell so suppliers can be paid quickly.

Less choice: more popular items only will be stocked, limiting the availability of innovative and/or niche products; increases market entry barriers for new untested/riskier products; favours products manufactured by those with higher marketing budgets. This will harm consumers as well as suppliers.

Less competitive: more vulnerable to online alternatives with wider choice; lower incentive/riskier to introduce new innovative/niche products.

Removes scale: less likely to meet minimum order requirements and lose savings from bulk orders (if storage is not available).

Reduces proximity: less popular items are only available online or to order.

Reduces variety: less attractive and differentiated shopping areas.

Option 2: Shift to just-in-time

Retailers and wholesalers could switch to holding as little inventory as possible and instead order small shipments to replace items and fulfill orders.

Less risk: easier to match supply with demand so sellers can be paid quickly.

Less choice: Lower incentive to sell innovative, diverse and/or niche products. This will mean less choice for consumers as many products will no longer be widely available.

More complex & higher costs: higher administrative burdens, requires more allocation of resources; more popular items are more difficult to source on demand and could lead to shortages; few just-in-time suppliers to source from; higher market entry barriers; increased transaction costs associated with order instore and shipment to home delivery.

Less competitive: orders placed at a cost premium; more vulnerable to online alternatives with wider choice and faster delivery.

Removes scale: less likely to meet minimum order requirements and lose savings from bulk orders for retailers (if storage is not available) and bulk production for manufacturers (and the many economies of scale this brings).

Reduces proximity: less popular items are only available online or to order; less stock available for immediate sales; changes the character of shops to showroom/shopping windows.

Detrimental effect on suppliers: drives up underlying costs for (SME) suppliers/wholesale (loss of efficiencies of scale and timing in acquiring raw materials, planning, production and logistics) and creates barriers to entry.

Detrimental effect on wholesale: increases likelihood they will be bypassed with more orders directly

	from (large, professional) manufacturers. **Detrimental effects on the environment**: smaller and more frequent shipments will increase costs for suppliers and retailers but also their carbon footprint to transport and logistics.

Option 3: Commission-Agent Structure

Retailers could switch to becoming commercial agents, i.e. a self-employed intermediary that has the authority to negotiate the sale or purchase of goods on behalf of another or in the name of another.

Less risk: payment made to suppliers only when a product is sold.

More complex & higher costs: increased complexity and administrative burden if an agency is given for multiple product lines.

Incompatible when you add scale: may be possible for small contracts or specific goods, but not when scaled up for businesses that wish to serve all consumers and business customers in multiple Member States.

Less stability: contracts are fixed term with no guarantee of renewal (e.g. if direct-to-consumer takes off); less predictability of payment and lack of control of income; SME entrepreneurs in particular made more vulnerable to setbacks and no collateral to obtain credit.

Less entrepreneurship: less control on assortment and opportunity to differentiate; less freedom to decide pricing strategy.

Higher prices: unable to shield consumers from higher prices, as retail price maintenance permitted for intermediaries.

Less investment: no fixed assets/loss of collateral makes it more difficult to get finance or favourable terms for investment.

Reduces collateral for other creditors: no fixed assets means less proceeds in bankruptcy for creditors (e.g. utilities, property owners, etc.).

Option 4: Consignment

Retailers could switch to using consignment, where goods are put in their possession to sell on behalf of another in return for a percentage of the revenue from the sale in (sometimes a very large percentage) in the form of commission.

Less risk: payment made to suppliers only when a product is sold.

More complex & higher costs: more complicated contractual arrangements as well as systems (e.g. software) to keep track of goods and their ownership.

Incompatible when you add scale: may be possible for small contracts or specific goods, but not when scaled up for businesses that wish to serve all consumers and business customers in multiple Member States. Retailers and wholesalers (including SMEs) may have thousands of suppliers – it will be costly and burdensome for distributors to keep track of contracts and ownership of goods – and for suppliers to know which of their goods are where.

Less stability for retailers and wholesalers: less predictability of payment and lack of control of income, for both retail and wholesale.

Less stability for manufacturers: contrary to a negotiated payment term, in consignment contracts suppliers do not know when they will be paid, as this will only occur once the goods have been resold.

Less entrepreneurship: less control on assortment and lower opportunity to differentiate; less freedom to decide pricing strategy.

Less investment: no fixed assets/loss of collateral makes it more difficult to get finance or favourable terms for investment.

Reduces collateral for other creditors: no fixed assets means less proceeds in bankruptcy for creditors (e.g. utilities, property owners, etc.).

Higher prices for consumers: in consignment, products in retail stores are owned by the suppliers; retailers may have fewer incentives to compete on prices.

Option 5: Scheduling payments/installments

Retailers and wholesalers can agree on payments by installments or schedules that better match (expected) cashflow.

Less risk: easier to match payments with cashflow.	**Same risk of failure:** no discretion (e.g. ability to renegotiate with suppliers) if cashflow does not match predictions increasing risk/the cost of mistakes - particularly when the final customer is a consumer whose behaviour cannot be perfectly predicted and can be influenced by factors out of control (e.g. weather, global events, mood, etc.). **Uncertainty for suppliers**: if entire assortments are paid by retailers by installments, suppliers will face high burdens in keeping track of their cash.

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