TIME FOR CHANGE:
PAYMENT PRACTICES IN LOCAL GOVERNMENT

1. INTRODUCTION

Late payment continues to be a critically important topic for buyers and suppliers alike. A range of initiatives, policies and regulations have been introduced to tackle the issue, but, according to research by the Federation of Small Businesses, late payment is still responsible for more than 50,000 businesses[1] failing each year and it continues to be a point of friction between buyers and suppliers.

There is something of a perversity in these trading relationships, whereby buying organisations that have cash are holding on to it (despite earning minimal returns), while those suppliers that need it find it very hard to raise capital and, when they can, despite low interest rates, find it to be very expensive.

Legislation giving suppliers the right to claim compensation for late payment came into force in 1998, providing interest to be payable on outstanding debts at 8% above base rate. In 2013 this legislation was bolstered by the Late Payment of Commercial Debts Regulations 2013, imposing limits on payment periods – including 30-day payment terms for public sector buyers.

Under Regulation 113 of the Public Contracts Regulations 2015, effective April 2016, councils were required to publish data on the proportion of invoices paid within 30 days. In 2017, the requirement changed to include the amount of interest the authority was liable for.

While legislation has served to bring payment performance into sharp focus, its perceived lack of teeth has dampened its ability to drive a sea change in behaviours.

Oxygen Finance engaged with councils across the UK to understand more about the problem and to shed light on why this is proving such a difficult issue to resolve.

1. Time to act: the economic impact of poor payment practice, FSB,November 2016

154

Questions posed to 154 of the largest councils in the UK

Representing **73%** of local government spend

1.1 RESEARCH METHODOLOGY

Under the Freedom of Information Act, a series of questions were posed to 154 of the largest councils in the UK, representing 73% of local government spend. Just under 100 councils responded, representing:

- £32bn worth of expenditure
- More than 15 million invoices
- 700,000 suppliers

These responses were supplemented with data from UK local authorities where Oxygen Finance has conducted detailed onsite studies. In these studies, payment performance was analysed at invoice level across millions of transactions and billions of pounds worth of spend.

FIG. 1

	#	% # All UK councils	FY 15/16 spend (£bn)	% £ All UK councils
All UK councils	**418**	**100%**	**73**	**100%**
Councils that were asked	**154**	**37%**	**53**	**73%**
Councils that responded	**96**	**23%**	**32**	**44%**

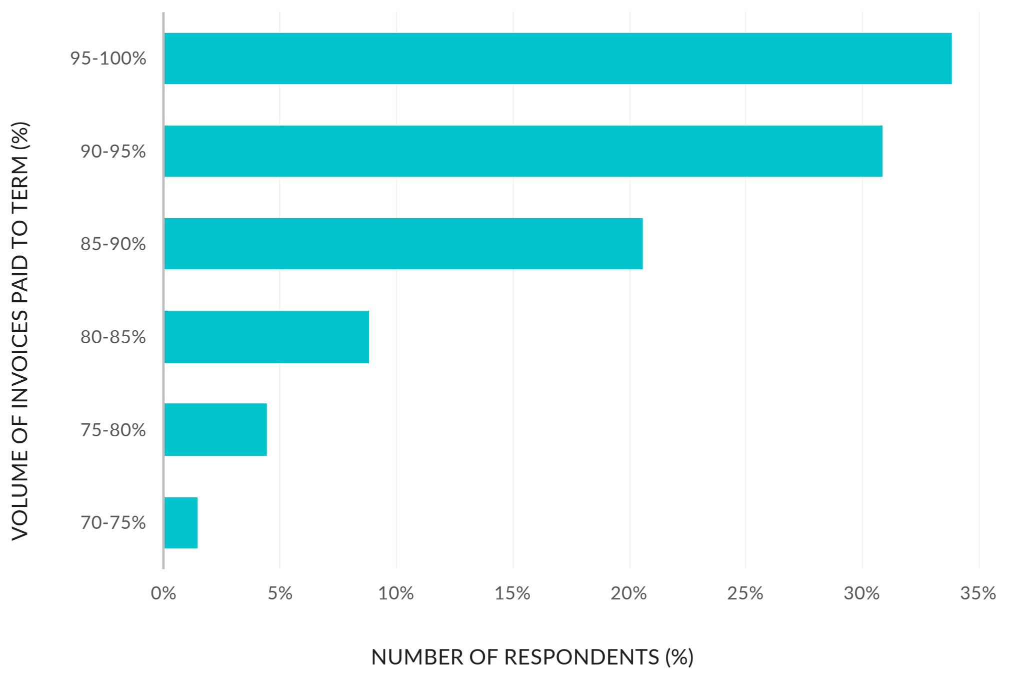
2.

LATE PAYMENT IN CONTEXT

2.1 PAYMENT PERFORMANCE

The majority of councils (84%) recorded the volume of invoices that were paid to term for FY2015/16. On average, 90% of invoices issued to these councils were paid on time.

FIG. 2



2.2 DEFINING 'LATE'

Late payment is when an invoice is paid after the period outlined in a commercial contract, which is typically defined as 30 days. While this might appear to be a pretty watertight definition, there does appear to be a lack of consensus around when a late payment is actually late.

Payment performance is generally measured from the point an invoice is received to the point that it is paid, i.e. the clock starts ticking when a correct invoice is date stamped as received.

Using this measurement, an average 90% are paid to term. However, if payment performance is instead measured against the date of the invoice - only 61% of invoices by volume are paid on time.

It is easy to see how this creates a degree of ambiguity with the supplier, who is likely to have emailed their invoice expecting the clock to start from the date of the invoice.

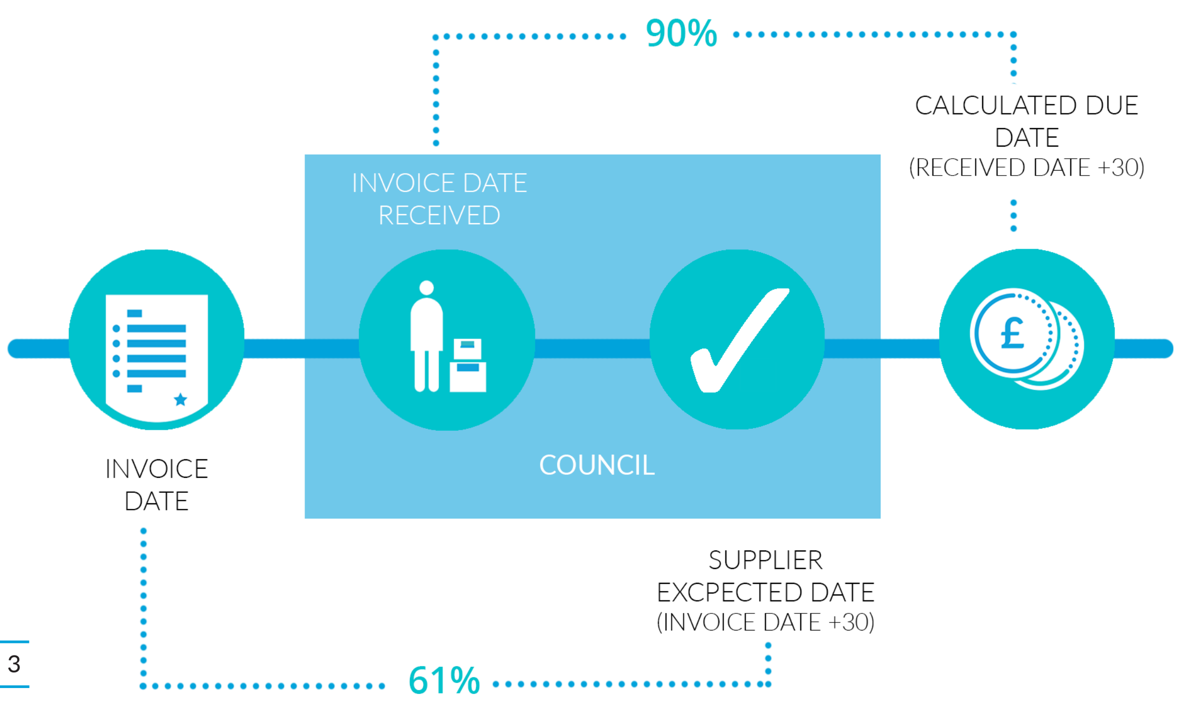


FIG. 3

"87% of councils do not record the amount of late payment charges they would be liable for"

2.3 VALUE VS. VOLUME

Statistics for one council are detailed below and highlight the stark difference that can exist in reported payment performance:

FIG. 4

% of invoices paid on time (FY 15/16)	Volume	Value
Based on invoice date	23%	39%
Based on invoice received date	61%	73%

Based on invoice received date, this council would report 61% of invoices are paid on time. In contrast, when the analysis is based on invoice date there is a sharp drop in performance with just 23% paid to term.

The marked decrease in performance when reporting on volume instead of value could suggest that smaller value invoices are not receiving equal priority.

4m
Invoices paid late

£7bn
To the value of

£160m
Payment liability FY15/16

2.4 CONTINGENT LIABILITY

As many as 4 million invoices to the value of £7bn are paid late annually across local government; this is a conservative estimate based on survey feedback that, on average, just 10% are paid late, when in reality the actual number could be much higher.

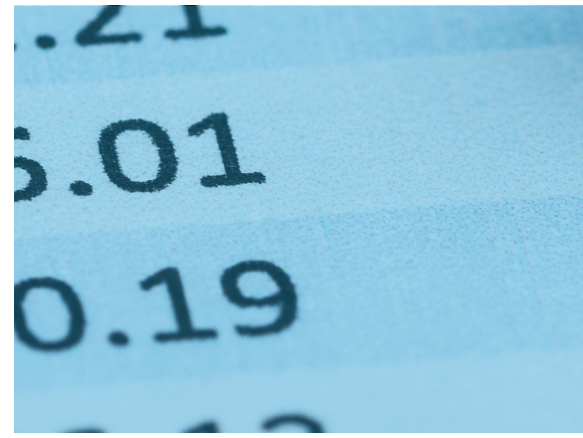
Every late invoice must be reported as incurring a late payment fee (min £40) plus interest at 8% above base rate. On this basis, 4 million invoices would equate to a collective late payment liability for FY 2015/16 of >£160m.

The late payment fees requested by and actually paid out to suppliers was only a fraction of this liability and averaged at c. £1,000 per council. This can perhaps be explained by a reluctance among small suppliers to 'bite the hand that feeds them'.

However, suppliers in England, Wales and Northern Ireland have a six-year window – five years in Scotland - to make a claim for late payment and, for local authorities, the biggest threat comes from changing suppliers for long-term contracts with a high value. For example, one council disclosed a late payment penalty of more than £400,000 in a single year.

Councils would be well-advised to examine their liability more closely - 87% of councils revealed they did not record the amount of late payment charges they would be liable to pay suppliers in FY 15/16. Of those that did reply, the average contingent liability equalled £442,000 – rising to more than £3m in potential late payment fees for one council.

> "Legacy processes and systems are hampering the effectiveness of P2P processes"



3.

THE NEED FOR STANDARDISED SOLUTIONS

3.1 P2P DRIVING EFFECTIVENESS AND EFFICIENCY

The findings show how councils are hampered by legacy processes and systems that may not have been the focus of investment due to financial constraints. This is now impacting on the effectiveness of their P2P processes.

The building blocks of an effective purchase to pay (P2P) process include good quality master data, well defined and understood processes – everyone doing things in the same way, centralised procurement and Accounts Payable (AP) functions and effective technology.

Effective P2P processes can yield a series of benefits, over and above timely payment:

- Improved management information on which better future purchasing decisions can be made
- Enhanced control and compliance - reducing the risk of duplicate or fraudulent payments
- Prompt payment (ensuring suppliers don't build the late payment risk into price and obtaining discounts for paying ahead of contracted term)
- Improved spend and working capital forecasting
- Reduced transactional processing effort and therefore cost.

3.2 ACCOUNTS PAYABLE RESOURCING

The level of resource in AP is an indicator of process health. Poor upfront processes result in rework and manual effort. Councils were asked to reveal the number of full-time employees (FTEs) aligned to their AP function and this was then correlated against their total spend to give an FTE count per £100m of spend.

The most efficient councils employed less than two members of staff for every £100m processed. The least efficient councils have more than four FTEs in AP per £100m of spend.

FIG. 5

Metric	FTEs in AP per £100m spend
Lower quartile	1.88
Median	2.71
Upper quartile	4.15
Mean	3.21

"Councils process 160,000 invoices and deal with up to 23,000 suppliers"

3.3 THE WEIGHT OF THE PROCESS - INVOICES & SUPPLIERS

A typical council processed an average of 160,000 invoices in FY 2015/16. When the volume of invoices was assessed per £100m of spend, there was a very large range in the number of invoices being processed – 4,600 up to 145,000. Clearly, there is an opportunity for invoice consolidation – particularly for those at the upper end of the scale.

Similarly, there are opportunities for significant supplier rationalisation. On average, councils traded with just over 8,000 suppliers in FY 2015/16 but the number ranged from 2,000 to 23,000.

While having fewer suppliers to deal with saves time and, generally ensures better prices, it is equally important to get the right balance to ensure councils aren't over reliant on individual suppliers.

In some circumstances, councils may find the cost of processing an invoice is greater than the invoice value.

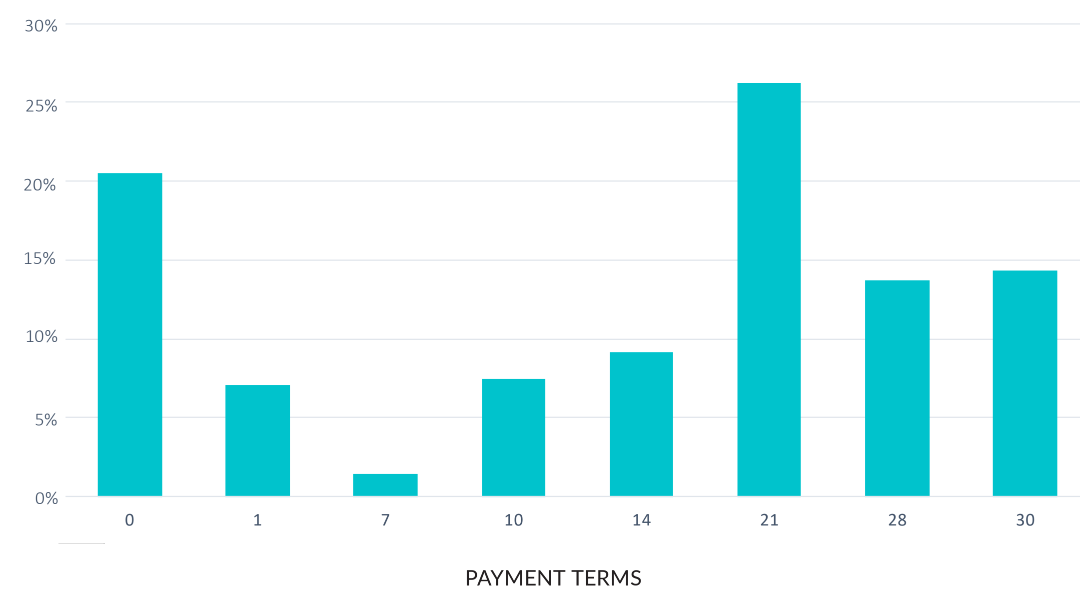
The top performing Councils processed 27,000 invoices and dealt with 1000 suppliers per £100m of spend; these councils have made progress in rationalising their supply base and consolidating invoices. In stark contrast to this, the worst performing councils were handling nearly 74,000 invoices per £100m of spend and dealing with more than 3000 suppliers.

3.4 VARIABLE PAYMENT TERMS

In Oxygen's detailed analysis of councils, it identified an average of eight different payment terms, shown in the graph below, which can make it more complicated to ensure timely payment.

Typically, suppliers to local government are under 30-day terms, but shorter payment terms are often offered for specific contracts or specific suppliers- how this is reflected in pricing is unclear.

% OF TRADE SPEND BY PAYMENT TERMS



3.5 OUTSOURCING OF ACCOUNTS PAYABLE

Councils were also asked whether or not they outsourced their AP function. Just under 10% of councils outsource this activity and where outsourced there is a significantly lower number of invoices per £100m spend.

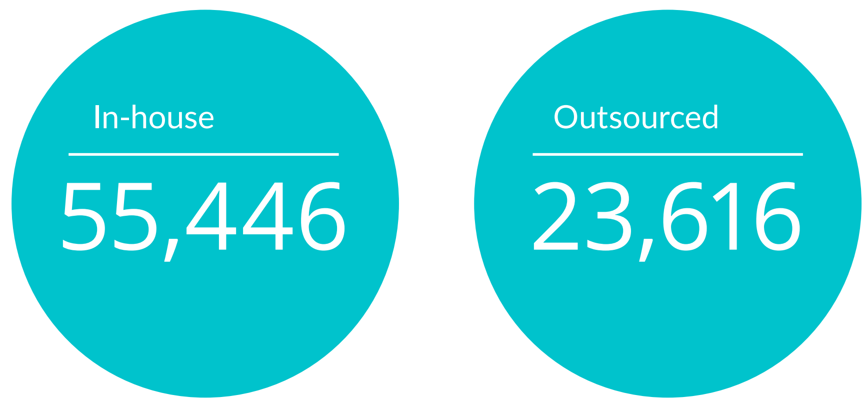


FIG. 6

MEAN # INVOICES PER £100M

4.

EMBRACING DIGITISATION

Automation and digitisation have a role to play in improving payment performance.

Digitisation, such as e-invoicing, can facilitate early payment by reducing processing time, decreasing costs, reducing the risk of errors that might arise from manual data input and providing a robust audit trail helping to aid compliance.

The findings show that use of technology to automate P2P processes is very scarce – this is a very significant opportunity, but one that is perhaps not being exploited due to the perceived capital costs of the software.

Where organisations have invested in automation, they have lower numbers of resources employed in data entry and issue-resolution activities, as well as reduced contingent liabilities. With more effective processes in place, these organisations are also able to embed more sophisticated capabilities such as early payment into their systems, effectively moving P2P from a cost to a saving and income-generating activity.

"49% of councils do not have e-invoicing"

4.1 E-INVOICING

Almost half of councils do not have e-invoicing and, even when a system is in place, it is used to ingest just 18% of invoices.

Potentially, 35 million invoices are being manually entered each year at an average cost of £1.42 per invoice – according to a CIPFA report[2].

The variation in the definition of e-invoicing also causes confusion, with some understanding scanning to be e-invoicing and others assuming it refers to full automation. At Oxygen Finance it is defined as the ingestion of an electronic invoice directly into the ERP without manual intervention.

35m
Invoices entered manually

£1.42
Cost per invoice

2. CIPFA case study, June 2013

5. CONCLUSIONS

It has been nearly 20 years since late payment legislation came into force, yet the issue is still prevalent across UK local government and particularly pronounced when considered from the supplier's perspective.

In 2016, £26 billion was owed to SMEs in outstanding invoices and, according to research by the FSB, late payment results in the failure of 50,000 businesses each year, a loss of £2.5 billion to the economy[3]. Economically and politically, these are uncertain times and businesses cannot afford to be weighed down by further financial pressure.

Local authorities are motivated to support local businesses and there are changes councils can make to help resolve the issue. While they have a regulatory obligation to report on payment performance, councils can also reap wider efficiency gains from taking action whether it be digital transformation or process re-engineering.

Cost savings delivered have the additional benefits of helping councils to counter budget cuts and protect frontline services. The Local Government Association (LGA) estimates almost half of councils will no longer receive core central government funding by the budget year 2019/20, leaving a funding gap of £5.8 billion by 2020.

It is clear that the resolution requires a multifaceted approach, combining new technologies and behaviours to really effect change:

- Re-engineering processes and systems that have been overlooked for investment during a period of severe financial restraint
- Embracing digitisation to aid transparency and efficiency
- Appreciating the potential impact of late payment liabilities and recording liabilities accurately
- Communicating a culture change around payment performance processes to ensure success

3. Time to act: the economic impact of poor payment practice, FSB,November 2016

ABOUT OXYGEN FINANCE

Oxygen Finance is a specialist provider of payment solutions and the leading global provider of early payment programmes. We work with organisations across both public and private sectors to drive savings, improve operational effectiveness and deliver against social value objectives. We have offices in the UK and US and work with a range of technology partners. Our expert teams are experienced at working on large-scale transformation projects and our robust systems manage transactions of more than £10bn per annum.

FOR FURTHER INFORMATION:

CALL: 0121 295 4038

VISIT: www.oxygen-finance.com