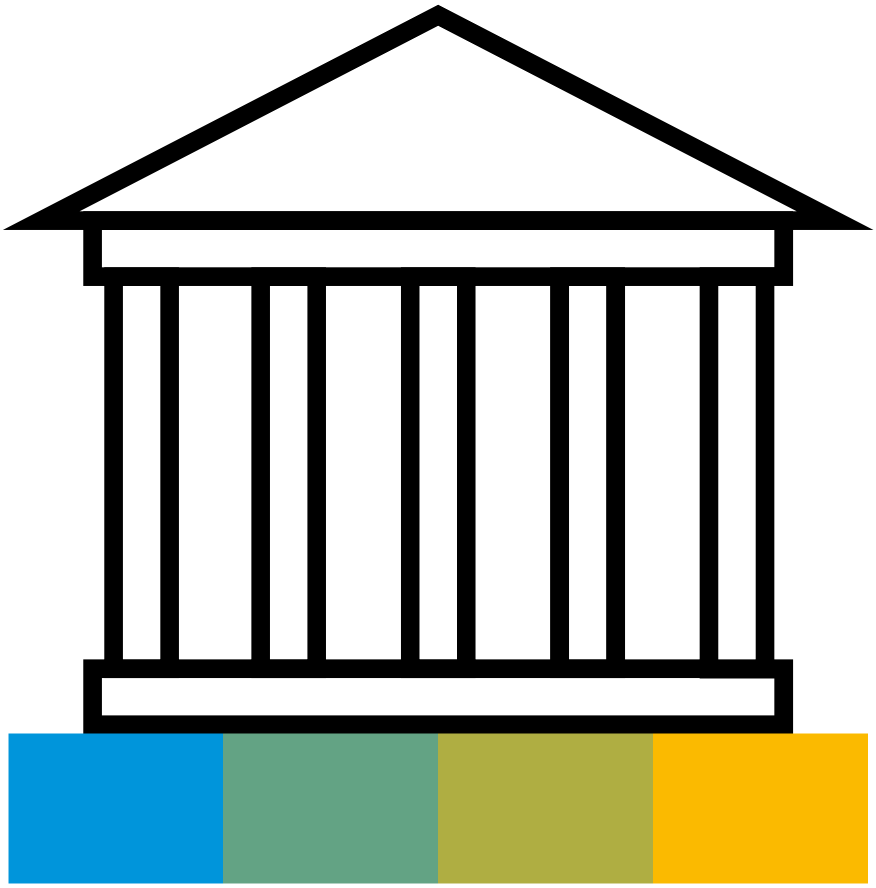
SAP White Paper
Source to Settle

DPO and On-Time Payment Performance, from Metrics to Legal Mandates

Mitigate the Risk, Cost, and Cash Impacts of European Source-to-Settle Regulations



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Legislation governing business-to-business (B2B) transactions is growing in Europe. Suppliers have been legally empowered to collect interest for late payments, and governments are authorized to dictate acceptable payment terms between buyers and suppliers. Meanwhile, in 2016, 62% of European B2B payments were late.[1] The consequences are risk, cost, and working capital challenges for organizations. Improvements in end-to-end, source-to-settle (S2S) performance are imperative among these new challenges.

€596 billion
Of annual cash flow is at risk from reductions in days payable outstanding (DPO) collectively in Europe if organizations comply with the payment-term regulations[2]

€3.4 billion
Of annual cost is at risk from late-payment penalties in Europe collectively if organizations comply with the late-payment penalty regulations[3]

1. "Payment Study 2016," CRIBIS D&B, July 2016
2. Source data for analysis from S&P Capital IQ.
3. Source data for analysis from S&P Capital IQ.

Regulations

EUROPEAN PROMPT PAYMENT AND PAYMENT-TERM LEGISLATION IN SHORT

The European Union adopted Directive 2011/7/EU in February 2011 to "combat late payment in commercial transactions," but it also includes guidelines on payment terms.[4] There is some complexity in the process of a directive moving from the European Commission, to European Parliament, to European Council, and down to the countries, but what's important is only national governments have the power to turn the directive into law. They can choose to adopt fully word for word, adopt but modify, or not adopt at all.

The majority of countries in the European Union have imposed the directive into law. For example:

- Suppliers are allowed to charge interest for late payments, which varies by country but starts at 8%.
- Payment-term limits are guidelines and vary drastically by country, but generally:
  - Government to business is 30 days
  - Business to business is 60 days, but can be longer if both parties agree contractually and provided they are not grossly unfair
- Several countries have imposed stricter payment-term maximums, such as:
  - Germany: It has a 30-day maximum. The law implies that a higher payment term, while possible to negotiate, is likely to be considered unreasonable in case of a dispute.[5]
  - France: Transportation spend cannot exceed 30 days, and all spend is limited to 60 days.
- The days allowed are based on when the invoice or goods is received, not when the invoice was created, which is the typical baseline for most companies to calculate a due date. As is the case above with payment terms, the invoice start date also varies by country.
- Legislation is applicable to the buyer's contracting country.

Representative case law of companies actually enforcing payment terms is yet to be seen. Similar late-payment legislation has been implemented in the past. Many contracts contain agreements on late payments and interest, and businesses are hesitant to enforce both payment terms and late-payment rules for fear of damaging the partner relationship and losing revenue.

GLOBAL IMPACT

While the majority of legislation exists in Europe, there is also legislation in other regions of the world. For example, the United States under the Obama administration created the SupplierPay initiative in 2014, requesting pledges from large companies to pay small businesses more quickly and lowering their short-term borrowing costs. Companies such as Apple, 3M, and Lockheed Martin signed this pledge,[6] but its impact is still not fully understood.

4. "Late Payment Directive," European Union, available at http://ec.europa.eu/growth/smes/support/late-payment_en.
5. "Late Payment Directive: FAQs, The Provisions of the Directive," European Union, PDF available at http://ec.europa.eu/DocsRoom/documents/16222/attachments/1/translations.
6. "Fact Sheet: President Obama's SupplierPay Initiative Expands; 21 Additional Companies Pledge to Strengthen America's Small Businesses," Office of the Press Secretary, The White House, November 2014, available at https://obamawhitehouse.archives.gov/the-press-office/2014/11/17/fact-sheet-president-obama-s-supplierpay-initiative-expands-21-additiona.

Late Payments

LATE-PAYMENT LANDSCAPE

In Europe, 62% of payments were made late (only 38% on time), and 10% of payments were made beyond 30 days late in a recent CRIBIS Dun & Bradstreet study analyzing actual payments (not a survey) for more than 5 billion transactions with 27 million companies globally.[7]

Paying late is not a difficult concept to grasp. Perhaps the magnitude is shocking to you, but the real difficulty is pinpointing root cause so proper corrective action can be taken. The source-to-settle process is end to end with underlying dependencies. What happens upstream has impacts downstream and vice versa, so taking a holistic evaluation approach is key. Although the speed of electronic payments has been largely solved in Europe, the core issues of visibility, tracking, and on-time payments are still a major challenge.

62%

Of payments were made late, and 10% were more than 30 days late in Europe in 2016[8]

14x

Lower invoice error rate for top-performing companies versus average companies[9]

9%

Of organizations have real-time visibility into supplier performance and related risks for proactive improvement[10]

8 to 10

Payment terms should be the goal for organizations

7. "Payment Study 2016," CRIBIS D&B, July 2016.
8. "Payment Study 2016," CRIBIS D&B, July 2016.
9. SAP Performance Benchmarking 2017.
10. SAP Performance Benchmarking 2014.

THE TOP 10 ROOT CAUSES FOR LATE PAYMENTS

There are as many reasons for late payments as there are companies. The following list is derived from our extensive experience:

- Decentralized, manual, and paper-based invoice processing requires more time, effort, and people to move invoices through the system.
- Invoice processing is plagued by lack of knowledge and poor communication, incomplete internal knowledge of rules and regulations, limited external communication of invoice best practices to ensure accurate and timely payment is received, and no visibility into granular and operational metrics related to payment performance.
- Workflow automation for purchase order and invoice approvals has not been implemented.
- High rate of purchase order errors (price, quantity, and so on) causes rework during invoice processing.
- Decentralized contract management contributes to variations in the source of truth for discrepancy resolution.
- The baseline date for starting the payment clock or establishing the due date is the invoice date rather than the invoice receipt date or goods receipt date.
- Lack of a payment-term standard or policy driven by the CFO and CPO leads to term proliferation and increased invoice processing complexity.
- The absence of a purchasing channel strategy, such as the use of purchasing cards, or poor compliance with company standards can cause unnecessary invoices to flow through the system.
- Payment terms are very close to the time it takes a company to receive, process, and pay an invoice.
- Inaccurate vendor master data or system functionality leads to payment-term discrepancies between a contract, purchase order, invoice, and, ultimately, the calculation of a correct due date.

15%

Of organizations have a robust master data architecture implemented and optimized for easy integration of new systems[11]

37%

Of invoices are received electronically on average[12]

16 days

Average invoice approval cycle time, more than 2x longer than top performers[13]

11. SAP Performance Benchmarking 2014.
12. SAP Ariba Benchmark Program 2015–2016.
13. SAP Ariba Benchmark Program 2015–2016.

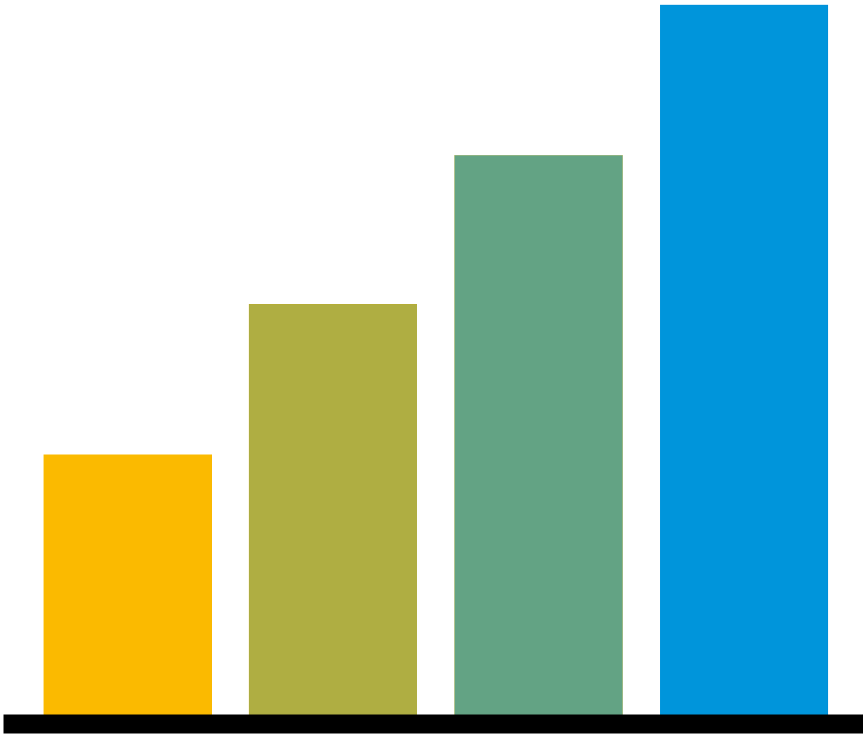
So What Does It All Mean?

The source-to-settle regulations in Europe impact cost, cash flow, and risk for organizations, as shown in the following table.

Value Driver	Business Impact	Financial Impact
Cost	Application of penalties, starting at a minimum of 8%, for late payments[14] Legal fees to dispute noncompliance	Paying one day late for every billion of annual spend at an 8% interest rate is an annual cost of 220,000.
	European market Analysis of 3,593 companies in Europe with annual revenue greater than €1 billion and available cost of goods sold (COGS) data results in total COGS of €15 trillion.[15]	The resulting collective cost of late-payment penalties is €3.4 billion annually for the European market.[16]
Cash flow and working capital	Payment terms and days payable outstanding (DPO) will be lower for certain geographical locations and categories of spend if currently above acceptable standards. Improvements in DPO, the cash conversion cycle, working capital, and cash flow will all be limited by traditional payment-term extension initiatives. Suppliers will have more leverage in rejecting longer payment terms. Manipulations using delayed payment at month end, quarter end, and year end will no longer be an option and will have consequences.	A one-day deterioration of DPO and payment terms for every billion of annual addressable spend is an annual cash-flow loss of 2.7 million.
	European market 3,020 companies in Europe had annual revenue greater than €1 billion and DPO between 0 and 200 days. 1,060 companies representing €5 trillion in annual COGS had DPO higher than 60 days for a combined average DPO of 101 days.[17]	The resulting collective cash-flow loss is €596 billion annually, moving DPO down to the regulatory standard of 60 days for the European market.[18]
Risk	Irrevocable damage to reputation if legal actions are taken with public visibility Enforcement of interest charges for late payments and payment-term standards Opportunity for a supplier to open an entire contract if contractual payment terms are longer than the new standards Difficulty in contesting legal disputes if unable to trace the life of a purchase order to a payment and all the touch points in between	

14. "Late Payment Directive," European Union, available at http://ec.europa.eu/growth/smes/support/late-payment_en.
15. Source data for analysis from S&P Capital IQ.
16. Source data for analysis from S&P Capital IQ.
17. Source data for analysis from S&P Capital IQ.
18. Source data for analysis from S&P Capital IQ.

2.7 million
Annual cash flow impact of a one-day deterioration in DPO and payment terms on 1 billion in annual addressable spend



220,000
Annual cost impact of paying one day late on 1 billion in annual spend at an 8% interest rate

Call to Action

Stricter regulations for B2B transactions can impact cash, cost, and risk for companies. It will take improvements in strategy, technology, people, and process to adapt to these challenges.

Strategy
- Implement supply chain finance to improve DPO, the cash conversion cycle, working capital, and cash flow by extending payment terms beyond legislative restrictions
- Establish payment-term standards and policies per spend category and geographical location
- Install metrics to monitor performance, identify gaps, recognize root cause, and develop corrective actions

Technology
- Use business networks with electronic ordering and invoicing to reduce data errors, decrease processing cycle times, and increase collaboration between buyers and sellers
- Implement electronic workflow for purchase order and invoice approvals with automated structures, alerts, escalations, and reporting
- House contracts in a centralized, easily accessible location and integrate into transactional processes where possible
- Maintain a single instance of the supplier master centrally, manage and maintain the data proactively, and connect the supplier master to business processes

People
- Educate all relevant internal key stakeholders about the risk, cost, and working capital impacts of late payments
- Inform external key stakeholders of best practices to receive timely payments, such as invoice requirements, electronic invoicing, and so on

Process
- Implement payment-clock best practices and start counting invoice due dates based on the invoice receipt date or goods receipt date.

Consider all of the above holistically and have options. The source-to-settle process is end to end with many connected subcomponents affecting one another. It's not a one-size-fits-all approach, and it's important to have dynamic options aligned to strategic corporate goals, best practices, and regulations.

LEARN MORE

SAP® Ariba® solutions deliver best-in-class, source-to-settle capabilities in the cloud to facilitate the realization of the best practices and benefits discussed in this article, as well as value for both buyers and suppliers on Ariba Network and innovative new business models so you can grow your business.

For more information, go to www.ariba.com/solutions/financial-supply-chain-management or contact us at www.ariba.com/about/contact-us.

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