Regulatory Impact Statement: Better Business to Business Payment Practices

Coversheet

Purpose	
Decision Sought:	Analysis produced for the purpose of informing Cabinet decisions
Advising Agencies:	Ministry of Business, Innovation and Employment (MBIE)
Proposing Ministers:	Minister for Small Business
Date:	2 December 2021

Problem Definition Summary

Feedback from small businesses indicates that they can be harmed by late payments and lengthy payment terms, and this may have wider implications for economic efficiency. Lengthy payment terms sometimes provide efficient commercial outcomes, but both lengthy payment terms and late payment may be the detrimental result of bargaining power imbalances and information asymmetries between firms. These problems are difficult to deal with effectively through our available regulatory and non-regulatory tools.

There is evidence that average business-to-business payment times have improved over the last five years, and initiatives such as government payment performance improvements and technology solutions appear to be supporting this trend. While we know that late payments by debtors can occur, and are problematic in some sectors (for example, supermarkets) we don't know the scale or prevalence of the issue and whether practices are intentionally exploitative. Late payment practices may be endemic to particular industries or sectors, or confined to a comparatively few participants in each market. There is a need to keep building an evidence base to better target any future policy interventions.

Executive Summary

Government intervention is required to reduce the impacts of existing market power imbalances and information asymmetries on business-to-business payment practices, and provide the economy-wide information needed to better target future interventions if required. While average business-to-business payment times have improved to some extent over the last five years, there is evidence that small businesses continue to be harmed by lengthy payment terms and late payment.

This paper considers three options for meeting the policy objectives:

- **Option 1: Non-regulatory interventions only.** There are several non-regulatory approaches that are either currently being explored or could potentially be explored, such as:
    - publishing government payment times,
    - further leveraging government procurement to require, rather than just encourage, government suppliers to pay their own subsidiary suppliers in a timely manner,
    - a voluntary Code of Conduct on payment practices, and
    - a periodic survey of payment practices or a voluntary payment reporting register.

- **Option 2: Introduce a legislated business-to-business payment practices disclosure and publication regime.** This option would require large businesses to publically report every six months on data that demonstrates their payment practices with regards to late payments and length of payment terms.

- **Option 3: Introduce legislated maximum payment times for businesses.** This option would set maximum payment times for all businesses and the ability for businesses to charge interest on late payments.

MBIE's preferred option is Option 2: Introduce a legislated business-to-business payment practices disclosure regime. This option is the most likely to achieve the policy objectives of bringing greater transparency to business-to-business payment terms and practices in New Zealand, thereby giving businesses better information to inform their decision-making when engaging in trade, and incentivising larger businesses to mitigate reputational risk by improving their business payment practices. It will also provide a comprehensive evidence base on business payment practices across the economy that will support the government in determining if there is a broader problem with extended payment terms, the scope and extent of that problem, and whether further regulatory intervention is warranted.

We consider that a business-to-business payment practice disclosure regime is the most efficient option for achieving the policy objectives, and that it would work well alongside the Fair Trading Act 1986 (FTA) by bringing greater transparency and visibility to some of those practices that the FTA is intended to regulate. The costs to entities required to disclose information are expected to be low.

Targeted consultation during July-August 2021, indicated general support for disclosure requirements and publication of payment time information. The majority of stakeholders considered that it would be an important part of any proposal to improve business-to-business payment, a natural starting point, and a logical approach to addressing the behavioural dimension of poor payment practices. There were however some small businesses that would still like the certainty of a mandated payment period to shorten payment times. As highlighted below, due to time constraints, the option of a payments disclosure regime has not been widely consulted, and we therefore recommend that if the Government wishes to proceed with legislation, an exposure draft of the Bill be put out for public consultation prior to it being finalised for introduction.

Limitations or Constraints on Analysis

Timeframes

Following further policy work on initial proposals to address late business-to-business payments and extended payment terms, a business payments disclosure regime has now been proposed. This was based on consideration of the evidence available and the most efficient regulatory approach. The resulting tight time constraints have limited the opportunity for a more comprehensive cost benefit analysis and consultation. The proposal to require reporting entities to disclose their payment practice information on their websites, was a later addition that has not undergone as much analysis.

Quality of data

The cost benefit analysis in this RIS relies upon information gathered through submissions from interested parties to MBIE's discussion document, MBIE's targeted consultation with stakeholders and reviews of relevent international cost benefit analyses. While helping to build a qualitative assessment of the costs and benefits of the options, these sources did not provide quantitative data on the costs and benefits of the options in the New Zealand context.

Limitations on consultation

The amount of feedback received during public consultation from February-April 2020 was negatively impacted by the COVID-19 pandemic and restrictions. Previous consultations on the business payment practices also discounted the use of a disclosure and publication regime up front, therefore we have not widely publically consulted on the concept of a payments disclosure regime. These limitations were mitigated, in part, by a subsequent round of targeted consultation with key stakeholders in July-August 2021.

However, due to these limitations on consultation, we recommend that if the Government wishes to proceed with legislation, an exposure draft of the Bill be put out for public consultation prior to it being finalised for introduction.

Responsible Manager(s) (completed by relevant manager)

Daniel O'Grady

Manager Small Business Policy

Small Business Policy

MBIE

2 December 2021

Quality Assurance (completed by QA panel)

Reviewing Agency/Agencies:	MBIE
Panel Assessment & Comment:	MBIE's Regulatory Impact Assessment Review Panel has reviewed the Regulatory Impact Statement prepared by MBIE. The Panel considers that the information and analysis summarised in the Regulatory Impact Statement meets the Quality Assurance criteria. In making this assessment, the Panel noted there has not been wide consultation on the preferred option but considered this is mitigated by the broader consultation that has occurred and the intention to consult on an exposure draft of the proposed legislation in due course.

Section 1: Diagnosing the policy problem

1.1 What is the context behind the policy problem and how is the status quo expected to develop?

Poor payment practices can hurt businesses and the wider economy

It is common practice for businesses to supply goods and services on trade credit to their business customers. Trade credit is where payment is deferred for a period after delivery, for example, within 30 days of the invoice date or by the 20th of the month following the invoice date, rather than requiring immediate payment.

Late payments can have a detrimental impact on businesses, causing stress and uncertainty. Extended or lengthy payment terms can also sometimes cause harm, particularly when the supplier has no choice but to accept the terms on a 'take it or leave it basis'. The impacts of late and lengthy payments include; disruption to hiring and capital investment due to uncertain cashflow, a need to source additional financing, and an increased risk of insolvency in the case of already capital constrained firms.

Where there is harm from such practices, it tends to fall disproportionately on small businesses. Small businesses are less resilient to poor payment practices because they are less well-equipped or resourced to weather such practices[1]. Many businesses are also reluctant to push for prompt payment because they fear damaging the relationship. This can often be a manifestation of a power imbalance between parties in many business to business trading relationships.

Poor business payment practices can have flow-on effects for the wider economy, particularly in times of economic uncertainty.

Current business-to-business payment performance

Introduction to the evidence used in this section

Much of the evidence provided about payment times in this document are sourced from the cloud accounting software providers Xero and MYOB. Cloud accounting software typically provides a user friendly accounting software service, allowing users to work in the same set of books regardless of location or operating system. Cloud accounting is fairly widespread among New Zealand businesses, with MBIE's Small Business Monitor estimating that around 45 percent of all businesses use cloud accounting services.

Xero customers account for around 360,000 of New Zealand's approximate 1.4 million business entities (of these around 560,000 are officially counted as economically significant businesses[2]). The Xero customer population includes a number (possibly a majority) of sole traders. Xero is not used by large firms. MYOB's customer base mainly consists of small to medium enterprises. This includes approximately 1.2 million businesses and over 40,000 accountants and other professional partners

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[1] MBIE Better for Business' Business Health research in late 2020 showed that a fifth of businesses had no cash or financial reserves, and a further 29 percent only had sufficient reserves to allow them to continue operating for a matter of weeks

[2] Statistics NZ, 2020

across New Zealand and Australia. MBIE estimates that around 240,000 of these are operating in New Zealand.

The insights produced by MYOB in this document are derived directly from their customer base. Xero data has been weighted to better represent the general business demography of firms with fewer than 100 employees. It is important to note that the Xero- and MYOB-using SME population may be biased towards those with better financial management (as they have revealed a preference for investing in financial management tools), so the insights may overestimate how well firms are doing.

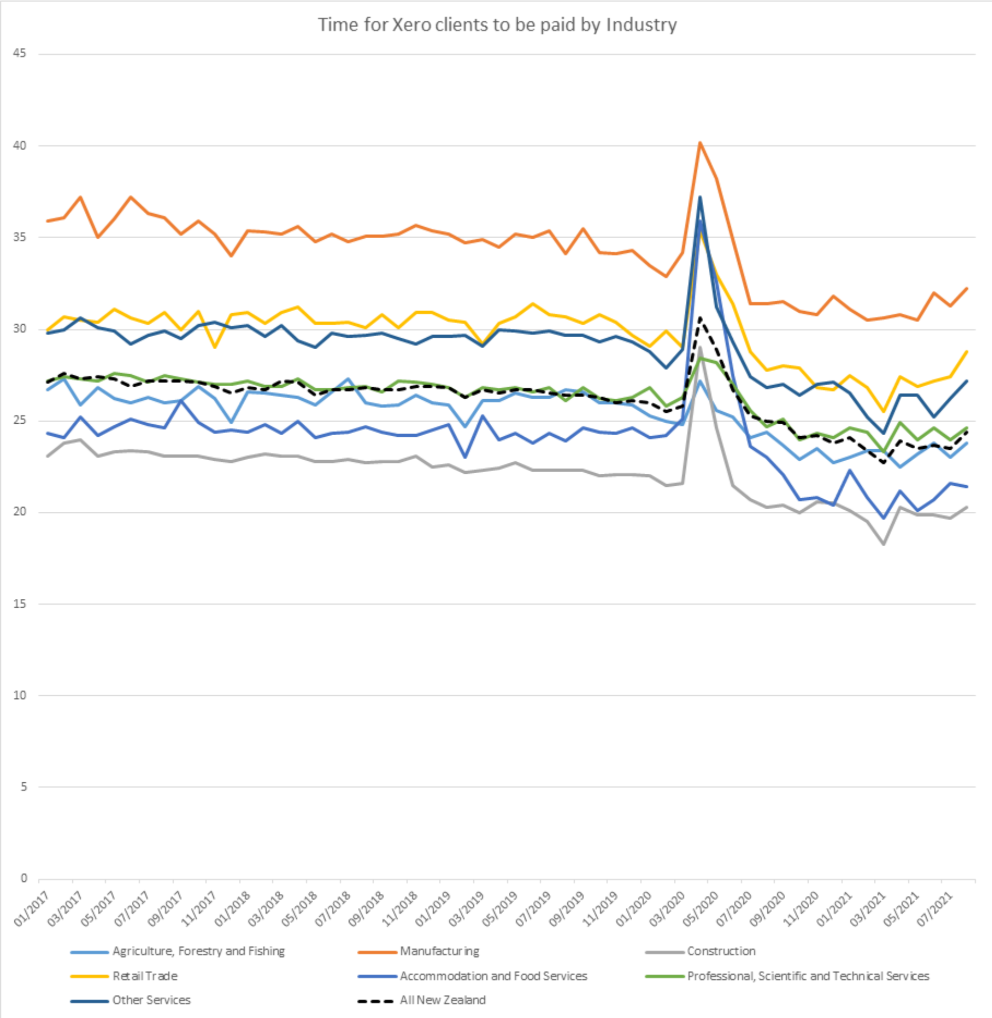
Analysis of Xero data by industry is presented below, but note that Xero customers within each industry may not represent the overall industry (e.g. rental, hiring and real estate Xero customers are thought to be mostly real estate agents, differing from the overall makeup of that industry). The Xero data has not been weighted by industry, as industry categorisations are not available for many Xero customers, so some descriptive data may be skewed towards certain industries.

Payment times

Xero data shows:

- In recent years, the length of payment and late payment times have been decreasing. In June 2021, the mean time that a Xero client waits for payment after issuing an invoice was 23.6 days, down from around 26 days in February 2020. MYOB customer data shows a longer average invoice payment time in 2021 for SMEs, at 27.7 days. This is down 1.4 days from the 2019 MYOB average[3].
- There is considerable variation from the average payment time across industries, meaning the average does not adequately nuance firms' payment behaviour.
- In times of crisis and economic shock, payment times increase. Where COVID-19 public health measures have put in place large scale restrictions to business operations, Xero data from Australia, the UK and New Zealand has shown significant increases to payment times. This is consistent with businesses delaying payments to their suppliers in order to manage cash flow.

[3] MYOB Insights and Considerations: SME payment times, October 2022



Confidential advice to Government [redacted] This shows that even after accounting for industry norms, there seems to remain a large part of the variance which could be attributable to individual firm behaviours.

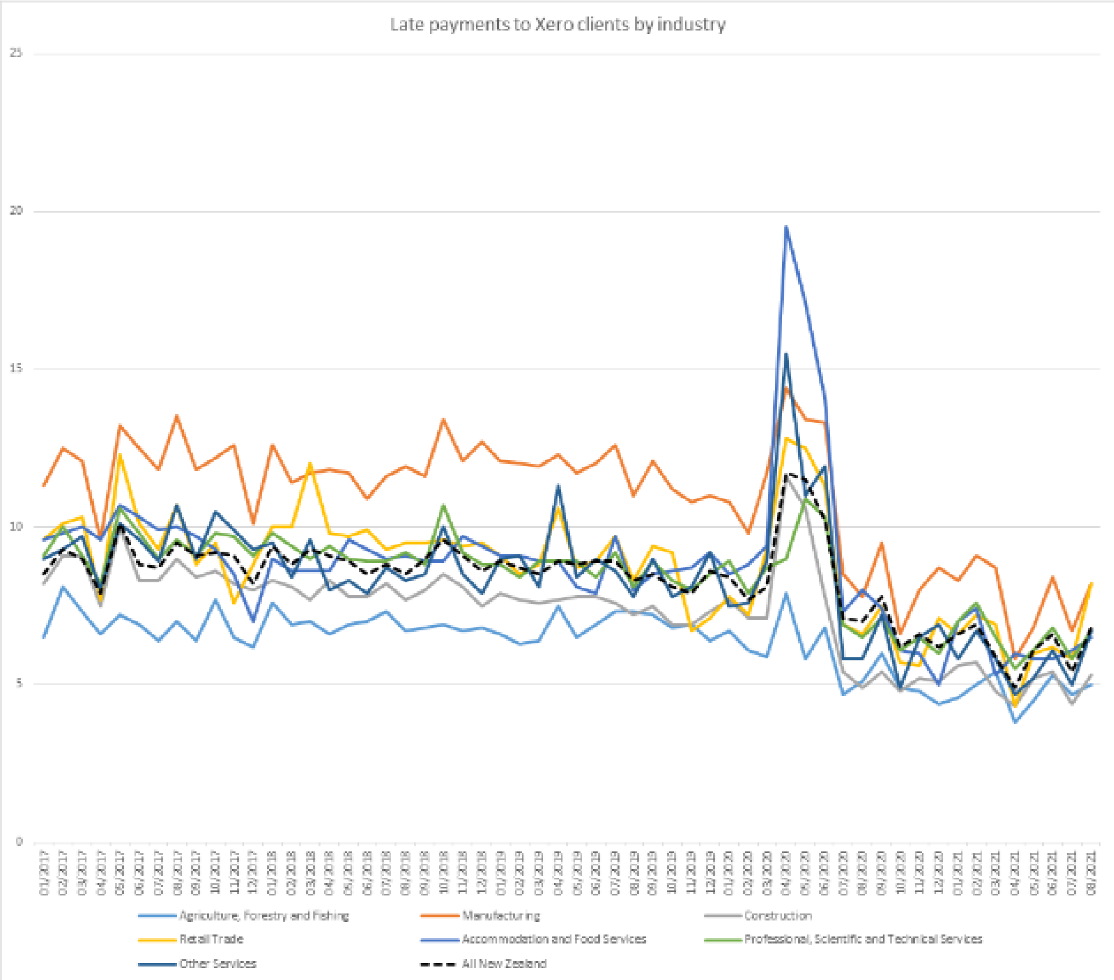
Late payments

Confidential advice to Government

Aggregated and anonymised MYOB customer data shows that on average, between 44-56 percent of invoices SMEs send in New Zealand are paid late.

This data also shows that as business size increases beyond $40,000 turnover, so does the proportion of invoices that are paid late. More than half (52 to 56 percent) of larger SMEs with $2M or more in turnover are paid late. When comparing average payment terms for this group (20.7 to 21.2 days) with payment times (28.8 to 30.2 days) for this group, it appears that (on average) payments can be late by up to 9.6 days.

Xero data shows that in June 2021, Xero clients were paid on average 6.8 days late, down from around eight days late in February 2020.



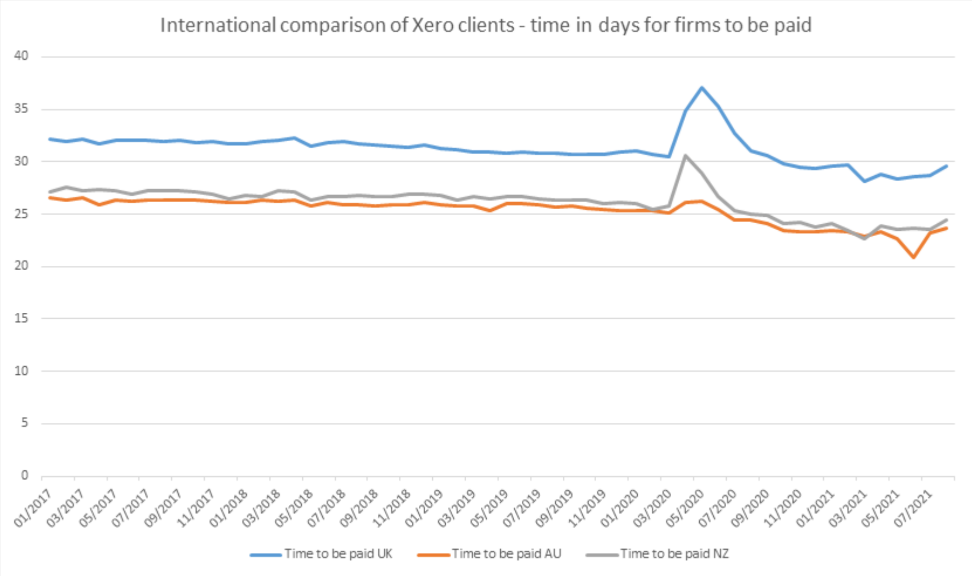
Xero does not report on bills that are written off, however MBIE understands that the value of written off revenue can be significant for SMEs, with around 10 percent of bills owed to be waiting for more than 90 days after the date of invoice. It should be noted that some of these bills will be disputed, and the debts that are written-off are largely the 'can't/won't pay' debtors who will be less sensitive to pecuniary interest charges (for example, if a debtor is unable to pay the invoice amount then they will also not be able to pay interest).

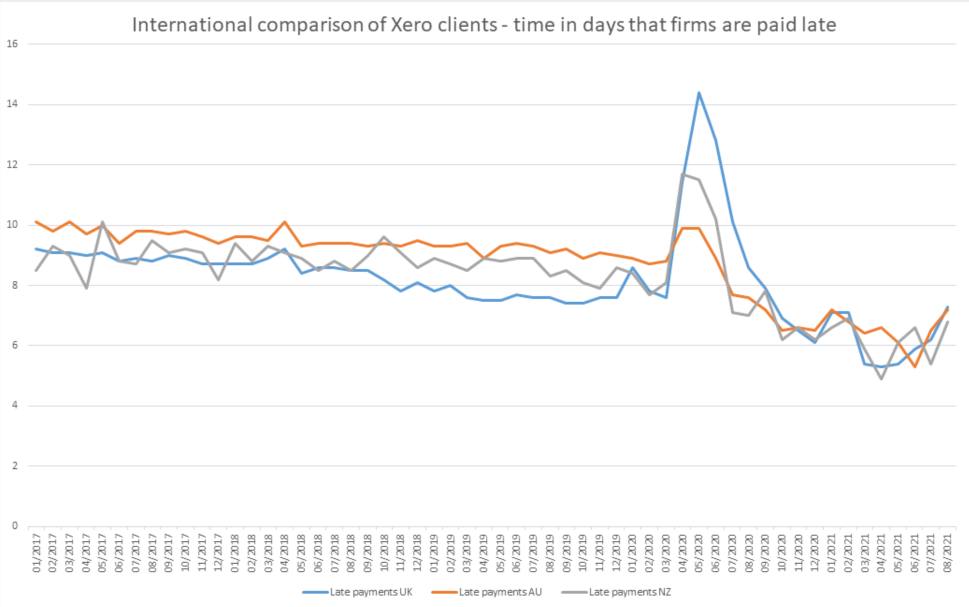
International comparison of payment times

By international comparison, according to Xero data, mean payment times in New Zealand are faster than in the UK and slightly slower than in Australia, and since 2017, payment times have been trending downwards across all three countries. According to MYOB data, New Zealand SMEs are being paid 3.5 days slower than in Australia[4].

The average number of days that firms are paid late is also trending downward across all three countries.

4 MYOB Insights and Considerations: SME payment times, October 2022

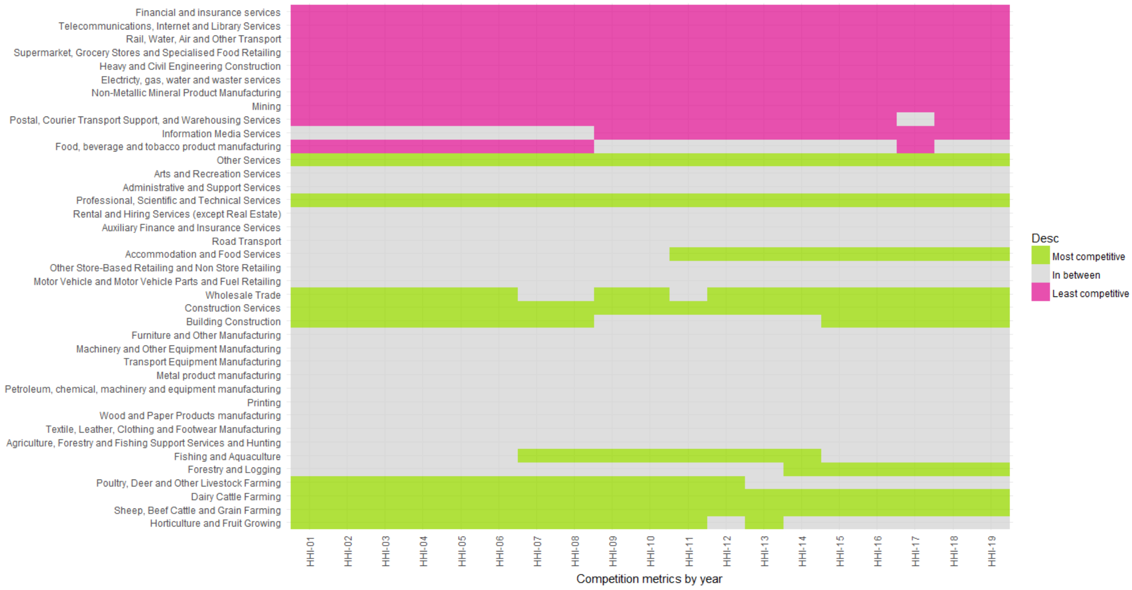




Market power imbalances can shift costs and risks onto suppliers, including lengthy payment terms

Largely based on the theory of competitive markets, where there are several competing purchasers and a supplier whose good or services have broad appeal among these purchasers, if there are unreasonable expectations regarding price or other terms from one purchaser (such as payment times) a supplier will be likely to find another purchaser who is willing to buy goods on more favourable terms. Where there are few purchasers however, suppliers can more easily be given 'take-it-or-leave-it' terms that aren't as favourable as those that would be offered in a more competitive market.

Market power can (but will not always) indicate where large purchasers have the power to dictate payment terms to their suppliers, leaving them little room to negotiate. The Hirschman-Herfindahl Index is a measure of market share concentration in an industry/sector and a proxy for market power. It demonstrates that several key sectors are highly concentrated and, as a consequence, many of these industries are heavily regulated, but not all.



The draft report of the Commerce Commission study into supermarkets has found that competition for the wholesale purchasing of groceries is not working well for many suppliers. With only two major grocery retailers, which between them have a high estimated market share, in many instances there is limited competition for the purchase of suppliers' products. This can create an imbalance of bargaining power and the major grocery retailers can use their buyer power to shift costs and risks onto suppliers, insist upon uncertain terms of supply, and limit suppliers' dealings with other grocery retailers. This includes the threat of delisting their products from supermarket shelves if a supplier does not agree with the major grocery retailer, for example, on contract terms, margins or pricing[5]. Supermarkets comprise around seven percent of GDP spend and any change to the regulation of them will have a large impact – including on their supply relationships with small businesses.

Power imbalances are not typically an economy-wide problem except in a few instances, but there will also likely be localised markets where local suppliers aren't offered much choice as to who their customers are. That said, while a single firm may dominate over other equivalent-sized businesses within an industry, it is large firms that are generally better resourced and equipped to access advice and negotiate terms.

Government has a lot of purchasing power

The Crown is a significant purchaser in the economy, comprising around 42 percent of GDP spend in the year to June 2020. Since 2020, 34 core government agencies have been required to report quarterly on their payment performance, with the aim of achieving the target of 95 percent of invoices paid within 10 working days. This initiative has led to an overall improvement in payment times, with the target of 95 percent of invoices paid within 10 working days achieved by the third reporting period (July – Sept 2020).

Further payment performance improvements within the wider public service will deliver significant benefits. Building on the success of the 95 percent payment within 10 days work, a further communication to Ministers and their agency Chief Executives encouraging the adoption, support and

[5] Market-study-into-the-retail-grocery-sector-Draft-report-Executive-summary-29-July-2021.pdf (comcom.govt.nz), page 7

implementation of e-Invoicing is underway. It will provide the impetus for widespread implementation and adoption of e-Invoicing by central agencies and further improve payment processing times.

Innovation and technology are providing tools to change behaviours

The disruption of COVID-19 has been a catalyst for significant innovation, rapid adaptation, improvements to e-commerce platforms and practices, new ways of working and the expedited adoption of digital tools/solutions by firms. In the period from December 2018 to June 2021, firms using cloud-based or desktop accounting software has increased from 48 percent, to around 60 percent. MBIE's B4B business unit's representative research of New Zealand businesses, shows that 79 percent of all businesses who employ one staff member or more use some form of accounting software. This is compared to only 39 percent of businesses with no staff using accounting software.

The market has also stepped in to develop tools to assist firms with their accounts receivables and cashflow management, including tools to undertake automated debt collection. Only 10 percent of firms with employees continue to pay by cheque or in-person at the bank[6]. As many of the trading banks continue to phase out cheques, this may drive more businesses to automated accounting systems.

Shifting attitudes and expectations around payment times are also likely to be playing a role in shorter payment times. Evidence suggests that the traditional mentality of requesting payment by the 20th day of the following month is starting to wane in favour of faster payments[7]. This sits within the context of the rapid growth of real-time payments over the last decade[8].

New Zealand's current regulatory framework

Regulatory instruments

The Consumer and Commercial regulatory system provides generic regulation of payments between businesses. The system is focused on enabling consumers and businesses to transact with confidence and:

- access and understand the relevant information,
- be protected from high levels of detriment from actions outside their control,
- have access to appropriate redress avenues if things go wrong,
- provide businesses that are paid late have several options for recourse, which are:
    - send notices reminding customers of their contractual obligations,
    - enlist debt collectors,
    - take the matter to the Disputes Tribunal if the money sought is under $30,000, and

6 B4B business unit's representative research

7 For example, MasterCard (2018), *Business Payments 2022: How Industry 4.0 is defining the future of business payments*, https://www.mastercard.us/content/dam/mccom/en-us/business-payments/documents/business-payments-2022-whitepaper.pdf

8 Deloitte, *Real-time payments are changing the reality of payments* https://www2.deloitte.com/content/dam/Deloitte/us/Documents/strategy/us-cons-real-time-payments.pdf

  - take the matter to court: a court may make a range of orders, including payment of the money owed and awards for damages.

The Commerce Act 1986 and the Fair Trading Act are the two primary legislative vehicles and are enforced by the Commerce Commission as the independent regulator.

Some sectors which are highly concentrated, also have additional regulator oversight such as electricity (the Electricity Authority), fuel (new fuel regulations have come into force that will enable fuel companies to access cheaper fuel more easily and in more locations, resulting in greater competition in the market) and telecommunications.

Recently passed changes to the Fair Trading Act are intended to bring small businesses within the scope of the Fair Trading Act's existing prohibitions on unfair contract terms and introduce a new prohibition against unconscionable conduct to protect businesses and consumers. These changes will come into force in August 2022. The changes are similar to those in Australian law and are based on pre-existing legal tests. The expected outcomes from this legislation are to provide an avenue for the Commerce Commission to address unfair and unconscionable conduct – including unfair payment terms in standard form contracts.

Action against unconscionable conduct can be taken by the Commerce Commission or via civil proceedings. Only the Commerce Commission can apply to the court to seek a declaration of an unfair contract term. We propose to work with the Commerce Commission as they develop their guidance for businesses regarding the changes to the Fair Trading Act.

The Interest on Money Claims Act 2016, provides for the award of interest as compensation for a delay in the payment of debts, damages, and other money claims in respect of which civil proceedings are commenced.

The retention money provisions in the Construction Contracts Act 2002 (CCA) provide greater protection of payment for those construction sector contractors and sub-contractors who are owed retention money for work done, and ensures the money held in retentions is responsibly managed. A bill to amend the CCA to strengthen and clarify the retention money regime in the Act has had its first reading and was referred to Select Committee on 8 June 2021.

Non-regulatory, behavioural and financial

In addition to the regulatory settings, there are a number of initiatives underway within central government that:

- Signal to the wider economy expectations of what is acceptable payment practice (e.g. the requirement for government agencies to pay 95 percent of all invoices within 10 working days). When put into practice, this establishes a reliably quick source of cash flow that can be passed on throughout the economy.

- Support firms to adopt and utilise digital technologies that support the management of their business – for example, Digital Boost and the Regional Business Partners Network.

- Build on the digital platform to enable businesses to connect across the ecosystem – for example, Business Connect, New Zealand Business Number and e-Invoicing.

International approaches

As indicated above, late payments and lengthy payment terms are not unique to New Zealand. Other jurisdictions have implemented a range of regulatory approaches in an attempt to address the issue with mixed results. This provides a useful counterfactual for us to assess our proposed approaches.

Australia

Payment Times Reporting Act 2020

The Australian government has recently legislated for the mandatory reporting of payment times for large businesses with the Payment Times Reporting Act 2020. The Payment Times Reporting Scheme aims to improve payment times for Australia's 3.5 million small businesses. From 1 January 2021, large businesses and large government enterprises with a total annual income of over $100 million, must report their payment terms and practices for their small business suppliers. The Australian Government will publish the reports twice a year on a public register.

Outcomes

It is too early for a formal evaluation of the scheme (a baseline has been set on 30 September 2021), but anecdotally Australian officials are aware of large scale renegotiation of payment terms, towards shorter payment times.

United Kingdom

Late Payment of Commercial Debts (Interest) Act 1998

This legislation allowed for interest and debt recovery to be payable on late payments in the public and private sectors. The legislation was amended in 2002 and again in 2013 to implement the *EU Directive 2011/7/EU on combating late payment in commercial trans*actions. The EU Directive set maximum payment terms for both government (30 days) and private organisations (60 days) and entitled suppliers to claim interest when payment is received late.

Outcomes

Evidence from the UK in 2016, indicated that few companies exercised the rights provided by this legislation, especially against larger companies. A study by the Credit Management Research Centre at Leeds University Business School (cited in the UK Government's Payment Reporting Requirement Impact Assessment) found the most prevalent reasons for not using the legislation were fear of losing a business customer or damaging the relationship, or because of the administrative aspects of applying the charge[9].

European Commission research has found evidence of businesses increasing their payment times to meet the maximum 60 days. In Europe, it is also often the state sector that is the slowest payer reflecting a large multi-layered bureaucracy in operation there[10].

Prompt Payment Code

In 2008, the UK Parliament introduced the Prompt Payment Code (PPC). Signatories to the PPC undertake to:

9 Payment Reporting Requirement Impact Assessment, November 2016, UK Government

10 Conversation between MBIE officials and Anotonella Correra, DG for Internal Market, Industry, Entrepreneurship and SMEs, European Commission (24/8/21)

- pay 95 percent of all supplier invoices within 60 days,
- work towards adopting 30 days as the norm,
- avoid any practices that adversely affect the supply chain, and
- pay suppliers on time without attempting to change payment terms retrospectively and without changing practice on length of time for payment for smaller companies on unreasonable grounds.

Upon strengthening the PPC in 2015, the PPC's Compliance Board, which includes the UK's Small Business Commissioner, now regularly reviews the payment performance of those organisations that are signatories. Those not conforming to the code are suspended until they submit an action plan to achieve future compliance.

Outcomes

Analysis of government data conducted by the Chartered Institute of Procurement & Supply in early 2019, found that those companies signed up to the code paid 12 percent of their invoices later than 60 days on average, only slightly better than businesses who were not signed up to the code (15 percent)[11].

Any size of business, public or private, can sign up to the voluntary code - we understand that as of December 2020, only 2,700 businesses had signed up.

<u>Small Business, Enterprise and Employment Act 2015</u>

The Small Business, Enterprise and Employment Act introduced a new duty on large companies to report on payment practices and policies, to be implemented through secondary legislation.

- In 2015, Public Contracts Regulations were introduced, requiring public sector buyers to publish payment performance. To ensure compliance with a 30 day payment term, a mystery shopper service investigates concerns against the public sector.
- From 2017, large businesses with £36 million turnover, £18 million on their balance sheet or over 250 employees were required to report every six months on their payment terms and standards. In 2017, the UK government also appointed a Small Business Commissioner to provide advice to small businesses and manage complaints.

<u>Small Business Commissioner and Late Payments etc Bill 2019-21</u>

The Small Business Commissioner and Late Payments etc Bill had its first reading in the UK Parliament's House of Lords in January 2020 and is awaiting a second reading. The Bill proposes increasing the powers of the Commissioner to enforce a new 30 day statutory maximum payment time with effective mechanisms for redress[12].

Consultation

In 2018, the Small Business Council (SBC) was formed for 12 months to provide advice to the Minister for Small Business and to develop a New Zealand small business strategy. The SBC presented the Government with its 'New Zealand Small Business Strategy: Empowering small businesses to aspire,

[11] Supply Chain Finance Final Report, March 2020, Australian Small Business and Family Enterprise Ombudsman

[12] Supply Chain Finance Final Report, March 2020, Australian Small Business and Family Enterprise Ombudsman

succeed and thrive' in July 2019. The strategy identified business-to-business payment times as an area of focus[13].

Following the release of this strategy, consultation on business payment practices in New Zealand commenced on 26 February 2020 with the release of a discussion document. The document specifically sought submissions on proposals to apply a maximum payment time for business-to-business payments, after which interest could be charged by a supplier of goods and services. In total, 31 submissions were received, including from a number of industry groups covering 6000 industry body members or businesses. This equates to around one percent of all New Zealand's small to medium enterprises (SMEs).

The majority of submitters supported a maximum payment term in legislation. Of those who submitted, all businesses with 20 or fewer employees were in favour of a legal maximum payment term and one offered no opinion. The businesses with more than 50 employees and industry bodies were evenly split on the proposal. A variety of reasons were given by supporters of a legal maximum payment term. A clear theme from submitters was that current practices result in businesses effectively providing free finance to their customers. Submissions also noted that modern technology facilitates efficient payment practices and a maximum payment term would ensure that businesses have adequate working capital to meet their obligations.

Views varied on what the legal maximum term should be. Of those who proposed a maximum term, many submitters supported a maximum term of 20 days. Reasons submitters were in favour of 20 days included: more frequent receipts making it easier for businesses to meet their own payment obligations, spread cash flow, and reducing artificial peaks in demand. There was also some support for the 20th day of the following month as this would cause less disruption to existing business practices and limit the costs imposed on businesses.

Submitters from larger businesses noted the impact a maximum payment term may have on their cash flow and capital requirements if they are required to pay for the goods and services they have purchased before they have received payment themselves. Large businesses and industry bodies generally preferred that non-regulatory options are explored and implemented before the government moved to a regulatory approach.

During July and August 2021, MBIE undertook further targeted consultation with a number of submitters on the original discussion document from February 2020. The following themes emerged from these discussions:

Extended payment times can be mutually beneficial in the course of business, but there are instances where they are not

- **There are a variety of reasons for extended payment times.** The main reasons identified were: prompt payments not being a priority of business-to-business negotiations, satisfaction with the status quo/perceived cost of change, inability to pay, disputed invoices and exercise of market/bargaining power.

- **There is no consensus of what a reasonable maximum payment time should be**. Ideas about this tends to differ by industry. There are factors that can vary widely between firms: profit margins, the nature of goods and services and extent of seasonal or lumpy revenue or costs – a maximum payment time should consider these limiting factors.

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13 The New Zealand Small Business Strategy (mbie.govt.nz)

- **Benefits in speeding up payment times include:** fewer firms with bargaining power competitively increasing payment times, directing new capital into productive investments at the expense of less powerful businesses, payment defaults more quickly realised and smoothing periods of high demand driven by paying on the 20th of the month following invoice date.

- **There are a wide range of views regarding contracting out of a maximum payment time.** Most stakeholders accepted that there will be new working capital required for some firms. Disagreement here centred on a firms' ability to absorb new debt. Some firms supported contracting out for any fair agreement (especially where it comes to offering credit financing), and others would only apply contracting out in exceptional and very well defined circumstances.

- **A minority, but significant view is that any contracting out considerably diminishes the ability for regulation to drive down payment times.** Contracting out will still be subject to the inherent power imbalance issues.

There are some potential costs to all businesses in implementing faster payment times and penalty interest

- **Most stakeholders believed that the finance systems to enable prompt payment are widely available**. However there would be a cost in adjusting their back end systems to accommodate prompt payments, and there are still a significant amount of firms without sophisticated payment systems that will require significant investment.

- **There is widespread acknowledgement that some firms would simply have to service new working capital**. Generally, this is seen to especially impact or disrupt those without a predictable flow of revenue on a month by month basis (as they'd have to lend), and others without agency to speed up their payments – for example some farmers may need a lot of adjustment to accommodate prompt payment times.

- **Adding penalty interest charges to an invoice and collecting on it is not straightforward**. In terms of tax treatment and ledger adjustments, a right to charge interest may be rarely exercised because it can generate more costs than benefits, and it may jeopardise the business relationship.

- **Regarding phasing, a popular view is that it is large firms that will be best positioned to absorb the required new working capital associated with a maximum payment time.** There are opposing views which assert that, even for large firms, a maximum payment time would be especially disruptive, and years could be required to adjust capital structure.

1.2 What is the policy problem or opportunity?

Summary of the problem definition

Feedback from small businesses indicates that they can be harmed by late payments and lengthy payment terms, and this may have wider implications for economic efficiency. Lengthy payment terms sometimes provide efficient commercial outcomes, but both lengthy payment terms and late payment may be the detrimental result of bargaining power imbalances and information asymmetries between firms. These problems are difficult to deal with effectively through our available regulatory and non-regulatory tools.

There is evidence that average business-to-business payment times have improved over the last five years, and initiatives such as government payment performance improvements and technology solutions appear to be supporting this trend. While we know that late payments by debtors can occur, and are problematic in some sectors (for example, supermarkets) we don't know the scale or prevalence of the issue and whether practices are intentionally exploitative. Late payment practices may be endemic to particular industries or sectors, or confined to a comparatively few participants in each market. There is a need to keep building an evidence base to better target any future policy interventions.

Late payments and lengthy payment terms can be harmful to business performance

Late payments and lengthy payment terms impact the working capital of a business and put pressure on small businesses and the supply chains they operate within. Late and lengthy payment terms can:

- increase the need to pay interest on external finance (small businesses usually pay a higher interest rate on finance than larger firms),
- increase administrative costs by having to chase payments or make contingency plans to find alternative liquidity when expected receipts are late,
- reduce the ability to hire new staff or increase capital investment (and therefore business growth) due to needing to use cash reserves to cover late payments, and
- create a greater risk of insolvency in the case of already capital constrained firms.

Responses from MBIE's 2018 survey of New Zealand businesses[14] offer qualitative evidence of business owners' perceptions of how the settings and practice in this space impact on them and their business operations. Of the businesses surveyed:

- 49 percent said late payments hurt their cash flow,
- 48 percent said it increased their stress levels, and
- 30 percent said it impacted their ability to grow.

This survey also found that businesses experiencing cash flow problems because of late payments often delay paying their own invoices (25 percent), cover their business expenses by organising overdrafts or personal loans with their bank (31 percent) and/or use personal savings (38 percent)[15].

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[14] In August and September 2018, MBIE commissioned a survey of 1,254 businesses across New Zealand about their experiences of sending and receiving invoices

[15] In August and September 2018, MBIE commissioned a survey of 1,254 businesses across New Zealand about their experiences of sending and receiving invoices

Research conducted by MYOB as part of its 2021 Business Monitor found:

- In terms of frequency of late payments, 28 percent of SMEs say they ‘sometimes’ struggle with late payments from customers. One-in-ten SMEs say they ‘often’ struggle with late payments,
- One-in-five (20 percent) of SMEs say they spend six hours or more invoicing and chasing payments each month, and
- Almost one-in-five (17 percent) SMEs say worrying about their business finances is affecting their mental wellbeing[16].

More than a quarter (28 percent) of New Zealand’s SMEs polled in MYOB’s 2021 Business Monitor – a survey of more than 1,000 business owners and decision makers – said that late payments from customers will be one of their biggest business pressures over the next 12 months[17].

Small businesses are more likely to be negatively impacted

Small businesses represent 97 percent of all firms in New Zealand[18]. They account for 28 per cent of employment and contribute over a quarter of New Zealand’s gross domestic product (GDP)[19].

The impact of poor payment practice is likely to be more significant for small businesses. We consider it is small businesses who are less well-resourced and equipped than larger businesses to manage non-payment, late payment and the imposition of extended payment terms.

- We would expect that extended payment terms would increase finance costs disproportionately for small businesses, who tend to have less access to capital and pay more for working capital than large businesses.

- Small businesses are less likely to have the bargaining power or capability to negotiate in response to pressure tactics. Such tactics may result in the benefits of a contract being shifted to the larger party (who typically holds greater bargaining power).

- Similarly, small businesses may not always be aware of a larger business’s lengthy payment terms during negotiations for supply of goods or services, and may have little bargaining power to alter those terms regardless.

In some cases, small businesses are not in a position to effectively enforce their payment terms, likely due to their limited resources, the difficulties of the civil debt enforcement process, and the possibility of effective retaliation by the larger business. As detailed above, businesses are already empowered to charge interest and debt recovery fees, enter into contractual arrangements that have clauses to prevent or discourage late or non-payment, and seek legal redress for contractual or legislative breaches. Despite the availability of these options, businesses often do not consider it worth pursuing late payments due to the cost involved, or because businesses worry it could damage relationships with their business customers – potentially to the point that the business customer in question refuses to do business with them in future. This may be particularly the case where there are only one or two large purchasers for that business’s products or services. In MBIE’s 2018 survey of New Zealand

16 MYOB Insights and Considerations: SME payment times, June 2021

17 MYOB Insights and Considerations: SME payment times, June 2021

18 Defined as businesses with fewer than 20 employees

19 MBIE Small business factsheet 2019, Statistics NZ source data

businesses[20], only five percent of those surveyed stated that they actually charged penalties when customers had not paid an invoice on time.

In other cases, small businesses may avoid dealing with poor payers. This is not always possible, due to a lack of information about payment practices, limited due diligence resources, and, in some cases, the larger business' market power in the relevant market (for example, a monopsony).

Poor business payment practices have wider implications for the economy and broader wellbeing outcomes

In September 2019, Xero's Small Business Insights showed more than half the 350,000 New Zealand businesses on its platform were owed at least $7,000 on any given day. Based on this, Xero estimated New Zealand small businesses were owed about $7.4 billion in unpaid invoices. Data showed that on average, half the overdue invoices were at least 16 days past their due date and still payment pending[21].

According to Xero analysis, if large businesses paid all invoices to Australian Small and Medium Businesses (SMBs) on time rather than on average 23 days late[22], it could effectively transfer $7 billion in capital from large businesses to SMBs. By reducing their financing costs and encouraging them to invest, Xero calculated that this could deliver a benefit to SMBs of $4.38 billion over ten years. In terms of the broader economic impact, analysis undertaken for Xero found that there would be a net positive benefit of $2.54 billion in net present-value terms over 10 years to Australia from reducing late payments[23].

Xero analysis in Australia also shows that long payment times may have a domino effect across the economy, as an SMB paid more slowly than average tends to pay its suppliers more than a week later than an SMB paid earlier[24].

However, there are a range of legitimate reasons for extended payment terms

While extended payment times are often problematic for firms, only some reasons relate to intentionally exploitative behaviour, and longer payment times can also be mutually beneficial in the course of business. We have heard from consultation that there are a range of reasons that businesses may pay their suppliers on extended credit terms, including:

- where longer payment terms are mutually agreed and mutually beneficial to the buyer and seller (for example, in recognition of the buyer's seasonal revenue),
- the nature of the good or service supplied means that there is a long lag between purchase and when the good or service can realise a return (for example, in the primary sector, exports and imports, construction),

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[20] In August and September 2018, MBIE commissioned a survey of 1,254 businesses across New Zealand about their experiences of sending and receiving invoices

[21] https://www.stuff.co.nz/business/115639278/small-businesses-waiting-on-about-74-billion-in-overdue-payments

[22] Of those who received a late payment, payments arrived an average of 23 days after they are due

[23] Paying the Price: the economic impact of big businesses paying Australian small businesses late, Xero, June 2019

[24] Paying the Price: the economic impact of big businesses paying Australian small businesses late, Xero, June 2019

- the financial situation of the buyer necessitates a longer than usual payment time as a result of factors out of their control (for example, disruption to forecast revenue due to bad weather), and
- disputes arising regarding the nature, quality or quantity of the goods and services received.

We need to continue to build an evidence base

We need to continue to build an evidence base to deepen our understanding of the problem and better target policy. Poor payment practices by some businesses cannot be taken as evidence of systemic problems across the economy. While we know that late payments by debtors can occur, and lengthy payment times are problematic in the supermarket sector, outside of this sector we don't know the scale or prevalence of the issue, whether it is systemic, and if it is intentionally exploitative. Late payment practices may be endemic to particular industries or sectors, or confined to a comparatively few participants in each market. Business-to-business commerce is dynamic. so late payments between some businesses may occur sporadically while other business transactions may be characterised by continuous late payments. We also cannot verify whether the problem is concentrated in transactions between SMEs and large business, or whether late payments are spread across all firm sizes.

Rationale for intervention

Market power imbalances

Having a productive, sustainable and inclusive economy is vital for New Zealand's economic and social wellbeing. One element for achieving this goal is for businesses to operate in an environment that provides healthy competition through fair and reasonable business practices.

Appropriate risk allocation between parties is an important feature of well-functioning markets. In a workably competitive market, risks tend to be allocated to the party best placed to manage them. All things being equal, when a party is exposed to unfair risk, they would no longer supply the good or service to the other party, would have a ready market to supply elsewhere, and would seek to recover the money via civil action.

Where markets don't function as well as they should, and where businesses suffer harm, is when there is an imbalance of power between the parties so that one party is placed at a disadvantage and in the position of price taker (including terms and conditions). This harm can be further perpetuated when one party deliberately withholds payment past the agreed payment due date without good cause.

Late and lengthy payment times can be (but are not exclusively) imposed by firms that have market power. Power imbalances are not typically an economy-wide problem except in a few instances, but there will also likely be localised markets where local suppliers aren't offered much choice as to who their customers are. That said, while a single firm may dominate over other equivalent-sized businesses within an industry, it is large firms that are generally better resourced and equipped to access advice and negotiate terms. There is currently limited financial incentive or pressure for improvement for larger businesses with market power to improve their business payment practices.

Information asymmetry

When businesses are considering whether to enter into a contract with other businesses, the market works best when both sides have access to reliable information on whether businesses will pay on time. All things being equal, businesses are more likely to enter into contracts with businesses that pay on time and do not ask for lengthy payment terms, and avoid dealing with poor payers. This creates incentives that reward prompt payment[25].

Where there is a high degree of reliable information on business payment practices across large firms, businesses are also likely to have more power when bargaining terms to identify and call out requests for payment times that exceed the norm or average payment times.

In New Zealand, it is difficult to obtain information on the payment practices of other businesses beyond word of mouth and the media. There is a market for purchasing “payment analyses” of businesses, but it is not clear how accurate or complete a picture this would provide businesses that purchase this service. It would also quickly become expensive if a business has a large number of purchasers; one company we found charges $119 per payment analysis and $77 for a Risk of Late Payment report. There is also no way for this market to produce the reputational effects that would influence payment practice behaviour change.

Macroeconomic risk

Large firms that pay large invoices late, are more likely to create a multiplier effect that can spread the impact of late payment more widely to multiple firms. For example, $1,000 owing to business A, may be required by business A to pay the $1,000 that they owe to business B, who in turn are awaiting payment prior to paying business C. As we saw during the 2020 and 2021 COVID lockdowns in New Zealand, the incidence of late payment tends to increase (for example to manage cash flow while revenue has decreased). This multiplier effect presents a particular risk during times of economic uncertainty or downturn where one large business’ cash flow problems can have wide reaching impacts, compounding uncertainty in a difficult economic environment.

1.3 What objectives are you seeking in relation to this policy problem or opportunity?

Options have been developed to meet the following objectives:

1. Create incentives for good business-to-business payment practices that have beneficial effects for firms and across the economy.

2. Increase transparency around business-to-business payment terms and practices in New Zealand to:
    a. Help businesses decide who to do business with.

    b. Provide a source of information that contributes to an evidence base on business-to-business payment practices, including supporting the government and its agencies in determining if there is a broader problem with extended payment terms, the scope and extent of that problem, and whether further regulatory intervention is warranted.

[25] Payment Reporting Requirement Impact Assessment, November 2016, UK Government https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/586815/payment-reporting-requirements-final-impact-assessment-sig.pdf

Section 2: Deciding upon an option to address the policy problem

2.1 What criteria will be used to compare options to the status quo?

We have assessed the options against the following criteria:

- Effective in incentivising better business to business payment practices that have beneficial effects for firms and across the economy.
- Effective in improving the quality and availability of information on business-to-business payment practices.
- Minimises unintended consequences. The intervention should be sustainable over time and should minimise opportunities for negative unintended consequences, including avoidance and arbitrage.
- Efficient. The intervention should be as simple and low cost as possible to achieve the objectives, both for businesses to comply with and the regulator to administer.
- Coherent. The intervention should make sense in the context of the broader regulatory framework governing business to business transactions.

2.2 What scope will options be considered within?

The scope of this analysis is business to business payments practices. It does not include consumer to business transactions.

2.3 What options are being considered?

We have identified the following options to be considered:

- **Option 0: the status quo.** This option takes into account other relevant interventions already planned or underway.

- **Option 1: Non-regulatory interventions only.** There are several non-regulatory approaches that are either currently being explored or could potentially be explored, such as:
  - publishing government payment times,
  - further leveraging government procurement to require, rather than just encourage, government suppliers to pay their own subsidiary suppliers in a timely manner,
  - a voluntary Code of Conduct on payment practices, and
  - a periodic survey of payment practices or a voluntary payment reporting register.

- **Option 2: Introduce a legislated business payment practices disclosure and publication regime.** This option would require large businesses to publically report every six months on data that demonstrates their payment practices with regards to late payments and length of payment terms.

- **Option 3: Introduce legislated maximum payment times for businesses.** This option would set maximum payment times for all businesses and the ability for businesses to charge interest for late payments.

2.4 Options analysis

This section analyses the options against the assessment criteria outlined above.

Option 0: Status quo

Interventions already underway or planned across the economy may have an impact on the problem in the absence of any further intervention. In the period since the original consultation commenced in 2018, a number of government-backed proposals to better support businesses, including SMEs, have been completed or are underway. Some of these directly address the key issues identified (power imbalance, excessive use of market power), while others are intended to drive behavioural change (upskilling business owners, digital enablement). The market also provides a range of tools to support better payment practices, such as financial account management software e.g. Xero and MYOB addressing the technical causes of slow payment and AI solutions like Debtor Daddy to chase late payments at minimal cost and stress to the business owners.

However, more significant improvement in payment times without further action is unlikely because small businesses lack the information and market power to negotiate better payment terms and large businesses have no financial incentive or pressure for improvement. There is also a reasonable risk under the status quo that the extent of the issue of problematic payment practices, particularly for small businesses with more limited market power, will remain unknown. This is more likely to allow payment practices that are detrimental to the growth and prosperity of small businesses to perpetuate.

Option 1: Pursue non-regulatory interventions only

Effective in incentivising good business-to-business payment practices that have beneficial effects for firms and across the economy

The government could lead by example by publishing government payment times and by requiring government suppliers to pay their own subsidiary suppliers in a timely manner. This would send an important signal to the market, and influence payment times across the suppliers it deals with and the broader supply chain to those suppliers. There is the potential here to ensure good payment practices across a sizeable portion of the economy, as government suppliers are likely to sub-contract to a large number of subsidiary suppliers. There is currently however a lack of visibility as to who these suppliers are and the number of businesses that would be impacted.

Developing a Code of Conduct to commit to paying promptly was not explicitly considered when we consulted on options in February 2020. However, subsequent discussions with Business NZ suggest that the development of a business-led voluntary Code of Practice could be a useful non-regulatory tool. Business NZ consider voluntary adoption is likely to drive good business behaviour, and lessen the rationale for any further legislative response from government. Such a pledge may be effective in incentivising prompt payments from the larger businesses.

Both Australia and the UK have a voluntary code of practice for payment practices. While Australia's Code is a 'business-led' initiative, the UK scheme is government-backed, administered by the Office of the Small Business Commissioner (SBC). We understand the impact of the voluntary Australian Supplier Payment Code has been limited because the vast majority of businesses have failed to participate in it. In May 2020 the Code had been in place for almost three years and had attracted only around 80 large business signatories out of the 120 signatories, and out of approximately 3,400[26]

[26] Based on the total number of businesses identified by the ABS as being required to report under this scheme.

large firms in Australia[27]. We also understand that the UK model has had limited impact: after a decade of government-backed support, only around of 10 percent of businesses in the recently implemented UK Payment Practices and Performance Reporting scheme identified that they were a code signatory[28].

Effective in improving the quality and availability of information on business-to-business payment practices

A periodic survey of payment practices or a voluntary payment reporting register could be pursued to bring greater transparency to business-to-business (B2B) payment terms and practices in New Zealand. However, these voluntary measures are more likely to be taken up by the good payers, meaning the poorest practices are unlikely to come to light. Evidence from Australia indicates that their National Payment Transparency Register, established in December 2017 to encourage businesses to report their payment performance voluntarily and for this information to be published, only attracted 29 firms to sign up by mid-2019, and the firms that registered were already good payers[29].

Minimises unintended consequences

The key unintended consequence of these approaches is that alone they are unlikely to achieve the stated policy objectives.

Efficient

We consider the non-regulatory options to be in general less efficient, as they come with a cost to businesses and government while being less likely to meet the stated objectives. Non-regulatory approaches would carry transition costs for businesses, including becoming familiar with any new code of conduct and potentially making IT changes or upgrades. They would also carry financial implications for government and would require cross-government resources to establish.

Coherent

The identified non-regulatory approaches would not contradict or hinder existing law including the Interest on Money Claims Act and the Fair Trading Act.

Option 2: Introduce a mandatory public disclosure regime for payment times

The key design features of this option are:

- Large businesses would be required to publically report on data that demonstrates their payment practices with regards to late payments and length of payment terms, twice yearly.

- The threshold for reporting would be all those entities that meet the one-month filing frequency test due to meeting the income threshold of taxable supplies greater than $33 million as per s.45 of the Financial Reporting Act, and irrespective of corporate form. In the 2020 tax year, Inland Revenue report approximately 3,200 GST registered entities in New Zealand with turnover of over $30 million, out of an estimated more than 1.4 million entities (including

[27] Payment Times Reporting Scheme Regulatory Impact Statement, May 2020, Australian Government

[28] Payment Times Reporting Scheme Regulatory Impact Statement, May 2020, Australian Government

[29] Payment Times Reporting Scheme Regulatory Impact Statement, May 2020, Australian Government

smaller companies, partnerships, trusts, associations and individuals who have to file tax)[30]. This figure captures firms slightly below the threshold to be established, and will not include all of the groups of organisations (who collectively have revenue above $33 million) caught through this threshold, but it gives a reasonably approximation the likely number of businesses that will have to report.

- A regulation making power in the legislation would set the reporting requirements demonstrating information that would relate to some or all of the following:
    - the reporting entity's practices in relation to late and overdue payments made,
    - the reporting entity's practices in relation to the payment terms it sets,
    - the payments terms that the reporting entity receives, and
    - the late and overdue payments received by the reporting entity.
    - other information relating reporting entities' payment practices that would better inform business decision making

- Reporting requirements would be chosen according to how effectively the information would give effect to better business decision making, and provide a means for reporting entities, conscious of their reputation, to improve payment practices.

- Reporting entities would be required to register and disclose the required information on a Better Business Payment Practices register, administered by MBIE. Reporting entities would also be required to disclose the required information on their own websites in an easily accessible location.

- Reporting entities would be required to certify their information disclosures.

- The compliance and enforcement regime would focus on ensuring that reporting entities register, report on time and in the correct format, and do not file misleading disclosures. A range of compliance tools and penalties would be available, including infringement notices, compliance notices, and pecuniary penalties for more egregious offences.

Effective in incentivising good business-to-business payment practices that have beneficial effects for firms and across the economy

There is some uncertainty around the extent to which a public disclosure regime would influence firm behaviour toward better payment practices. We expect that greater transparency is likely to bring about behaviour change as businesses' overdue and lengthy payment practices become visible to commentators and communities. We have seen how sensitive some organisations are to maintaining their reputation through the behaviours that have come to light due to availability of the Wage Subsidy Scheme (WSS) data. Community members take a real interest in this data and change their own buying behaviours and this, in turn, has led to some businesses returning funds which they may not have in the absence of public scrutiny.

Targeted follow-up conversations during July-August 2021 with a number of submitters on the original February 2020 discussion document, including the Cabinet-appointed Small Business Advisors,

[30] Stats NZ, *Business Demography Statistics*, 2020. https://www.stats.govt.nz/information-releases/new-zealand-business-demography-statistics-at-february-2020. Estimate of 1.4 million entities based on B4B analysis.

indicated general support for disclosure requirements and publication of payment time information. The majority of stakeholders considered that it would be an important part of any proposal to improve business-to-business payment, a natural starting point, and a logical approach to addressing the behavioural dimension of poor payment practices. Submitters noted that:

- Early indications (pre-formal evaluation) from Australia are that this kind of initiative is making a big impact on payment practices.
- A public disclosure regime acts on the behaviour of firms and leverages reputation, and does not rely on the ability to collect debt through the courts or dispute resolution mechanisms.
- Many comments that the WSS public reporting seemed to make a big difference to firm behaviour – especially where profits increased during the pandemic.
- There were however some firms that would still like the certainty of a mandated payment period to hasten payment times.

There is a risk that business culture, economic conditions and incentives to maintain good relationships (among other factors) will all continue to drive market behaviour and may limit the impact of a public disclosure regime on payment practices. We note that while the publication of a searchable database of business recipients of the COVID-19 WSS revealed that public pressure can influence firm behaviour, the WSS has a strong social licence element to it that may not extend to commercial transactions between businesses.

On balance, however, we consider this option is likely to be a useful tool, as part of the suite of regulatory and non-regulatory measures underway, to help reduce the impact of the existing information asymmetries and bargaining power imbalances on business payment practices.

Effective in improving the quality and availability of information on business-to-business payment practices

The mandatory nature of this option makes it likely to be highly effective in improving the transparency of business payment practices and building an economy-wide evidence base on business payment practices.

Requiring entities to also publish their disclosures on their own websites adds another layer of transparency allowing businesses and commentators to access payment practice information directly on reporting entities' websites. It also allows reporting entities to provide a contextual narrative on their websites on what drives their payment practices.

Minimises unintended consequences

In developing this model we considered whether large businesses should be required to report on, or disaggregate, payments to small businesses only in order to better target the policy problem. This option was discarded partly to reduce the risk of an unintended consequence where reporting entities choose not to trade with small businesses to avoid having to report on payment times. In the New Zealand context the costs of this approach would also far outweigh the benefits.

Efficient

We consider this option would achieve the policy objectives in a low cost and simple way:

- The definition of 'large company' has been designed to ensure entities captured by the reporting requirements should be easily able to self-identify and reduces the likely impost imposed by the disclosure legislation as enterprises already have the capabilities required to file GST returns on a regular frequency and the underpinning data is the same.

- Feedback from consultation is that disclosure of payment information would be easily achievable for large firms, as large businesses are highly likely to already have the accounting systems and processes in place to automate reporting.

Coherent

This option aligns with the recently passed Fair Trading Amendment Act 2021 (FTAA) which is intended to provide an avenue of recourse against unfair terms in standard form contracts, and against unconscionable conduct. This option would work alongside the FTAA by bringing greater transparency and visibility to some of those practices that the FTAA is intended to regulate.

Option 3: Introduce a legislated maximum payment time

The key design features of this option are:

- A 20 day maximum payment term, implemented across all sizes of businesses and contracts[31].

- Property deals, intellectual property contracts, employment contracts and security arrangements would be exempt, as would contracts already under the Construction Contracts Act.

- Limited ability to contract out of the maximum payment time.

- All businesses regardless of size would have the right to claim interest. Interest would be applied using the calculator in the Interest on Money Claims Act, namely the base rate published by the Reserve Bank using the retail six month term deposit rate, plus a premium rate.

Effective in incentivising good business-to-business payment practices that have beneficial effects for firms and across the economy

A maximum payment term could be effective in helping to establish norms of payment practice that increase the bargaining power of suppliers and allow them to pressure business customers for fairer payment terms. However, it is not clear to what extent this would occur without greater public exposure of poor behaviour or a greater likelihood of interest being charged.

In both the UK and the EU, there is no evidence of improved payment practices as a result of legislation which gives a business the right to charge and collect interest if payment is not made within the mandated payment times. Survey data[32] reveals that the vast majority of businesses (around 90 percent) will not enforce their rights to charge interest, for fear of negatively impacting the business relationship, and a lack of efficient or cost effective remedy procedures.

In New Zealand, interest can already be provided for in contractual arrangements and is also payable on monetary awards from the court (in the absence of a contractual term). As noted above, in MBIE's

[31] Options considered include 30 days, 20 days, 10 days, or phased over time to 10 days.

[32] For example, https://op.europa.eu/en/publication-detail/-/publication/400ecc74-9a54-11e5-b3b7-01aa75ed71a1#document-info

2018 survey of businesses only five per cent of businesses surveyed say they actually charge penalties when customers have not paid an invoice on time.

While extended payment times are often problematic for firms, longer payment times can also be mutually beneficial in the course of business. We note that it could be possible for the legislation to allow for the contracting out of payment times in certain circumstances to try and provide for legitimate extended payment practices. However, there is a significant tension between designing a regime that is sufficiently flexible to accommodate the complexities of the economy, but which could potentially allow the problematic behaviours experienced to continue, and being so prescriptive that parts of the economy are adversely affected.

Effective in improving the quality and availability of information on business-to-business payment practices

We consider there are alternative interventions to drive improvements in payment practices that would be more effective than mandated payment times in improving the quality and availability of information on business-to-business payment practices. Under this option the government could potentially survey businesses to monitor payment practices under the new legislation and publish its findings. However, without legislative backing such a survey would be voluntary (therefore likely to be incomplete and not capture the poor payers). An alternative avenue for information on compliance with maximum payment times would be to monitor the number of firms that take action through the formal channels on late payments. This is unlikely to provide a strong evidence base, however, because as noted the majority of businesses are unlikely to enforce their rights to charge interest.

Minimises unintended consequences

Given our current knowledge and the feedback we have received from consultation, we consider there to be a significant risk of unintended consequences in legislating to require all businesses to pay within a set number of days without a clearer understanding or the size and nature of the issue. Without a stronger evidence base, there is a large degree of uncertainty as to the full impacts from any change that looks to significantly influence people’s payment behaviours at a nationwide level. There are diverse and complex settings that have come about organically through the market functioning as it should, and many of these payment practices are to the benefit of all participants. Risks include:

- Short maximum payment terms could put small businesses with ‘lumpy’ revenue under considerable financial pressure, forcing them to put greater reliance on external finance or even increasing the risk of insolvency.

- In an export-based economy such as New Zealand, a maximum payment time may put an unnecessary additional burden on exporters who are already facing COVID-19-related challenges around supply chains, freight, and labour.

- Businesses may see a maximum payment term as a recommended term and may increase terms to the legislated maximum. European Commission research has found evidence of this occurring[33].

Efficient

There are likely to be costs to most businesses in implementing a regulated maximum payment period and penalty interest, and there is a good chance that these costs lie disproportionately with small

33 Conversation between MBIE officials and Anotonella Correra, DG for Internal Market, Industry, Entrepreneurship and SMEs, European Commission (24/8/21)

businesses who may then not realise commensurate benefits from the changes, and are typically less resilient to the potential costs of change.

For example, it is more likely that small businesses who operate on 20th of the month following invoicing will need to update their accounting systems to facilitate quicker payments, and long standing backend management practices. Smaller businesses proportionally require greater effort to accommodate new regulatory requirements, and so to justify change the benefits of making and receiving faster payments would need to be significant.

Coherent

This option creates complex interactions with existing legislation that would need to be worked through in more detail. Businesses are currently free to negotiate terms, subject to new rules in the Fair Trading Act prohibiting unfair contract terms and unconscionable conduct.

2.5 How do the options compare to the status quo/counterfactual?

	Status Quo	Option 1: Non regulatory tools	Option 2: Legislated public disclosure regime	Option 3: Legislated maximum payment times
Effective in influencing firm behaviour to avoid late payments and lengthy payment terms	**0**	**0/+**	**+**	**0/+**
Effective in improving the quality and availability of information	**0**	**0**	**++**	**0**
Minimises unintended consequences	**0**	**+**	**+**	**-**
Efficient	**0**	**0**	**+**	**-**
Coherent	**0**	**+**	**+**	**0**
OVERALL ASSESSMENT	**0**	**0/+**	**+**	**0/-**

Key	
++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

2.6 What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

Our preferred option is Option 2: Legislated business-to-business payment practice disclosure regime. This option is most likely to achieve the policy objectives of bringing greater transparency to business-to-business payment terms and practices in New Zealand thereby giving businesses better information to inform their decision-making when engaging in trade, and incentivising larger businesses to mitigate reputational risk by improving their business payment practices. It will also provide a comprehensive evidence base on business payment practices across the economy that supports the government in determining if there is a broader problem with extended payment terms, the scope and extent of that problem, and whether further regulatory intervention is warranted.

As discussed above, we consider a business-to-business payment practice disclosure regime to be the most efficient option for achieving the policy objectives, and that it would work well alongside the Fair Trading Act by bringing greater transparency and visibility to some of those practices that the FTAA is intended to regulate.

Targeted consultation during July-August 2021 indicated general support for disclosure requirements and publication of payment time information. The majority of stakeholders considered that it would be an important part of any proposal to improve business-to-business payment, a natural starting point, and a logical approach to addressing the behavioural dimension of poor payment practices. As noted above, the option of a payments disclosure regime has not been widely consulted, and we therefore recommend that if the Government wishes to proceed with legislation, an exposure draft of the Bill be put out for public consultation prior to it being finalised for introduction.

2.7 What are the marginal costs and benefits of the option?

Affected groups	**Comment** *Nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated entities – large entities in scope of disclosure requirements	Transition costs (one-off): • familiarisation with the new requirements • adapting or purchasing IT systems • gathering information needed to update processes • changing processes	Low UK (2016) estimate: 1,798 Pounds per firm Australian estimate: approx. $2,000-$3,000 AUD per entity or group	Medium
	Ongoing cost of twice yearly reporting • maintaining systems and processes • preparing reports twice yearly	Low UK (2016) estimate: 1,012 Pounds per firm p/a	Medium

	• collating, approving and submitting reports twice yearly	Australian estimate: approx. $2,000 AUD per entity or group p/a[34]	
Regulator	Capital investment and implementation activities (one-off)	$3.5m	High
	Ongoing costs: • ongoing capital related costs • monitoring and evaluation • compliance and enforcement activities	$1.4-2m per annum	High
Consumers	Additional compliance costs may be passed on to consumers through increased prices. Low likelihood.	Low	Medium
Total monetised costs		Low	
Non-monetised costs		Low	
Additional benefits of the preferred option compared to taking no action			
Regulated entities	Indirect benefit from the opportunity to increase business reputation by demonstrating good payment practices.	Low-medium	Low
Suppliers	If businesses respond by improving payment practices, there should be indirect benefits to suppliers from increased cashflow, including: • reduced need to pay interest on external finance or forego alternative returns on cash reserves • reduced administrative costs by not having to chase payments or make contingency plans to find alternative liquidity when expected receipts are late • increased ability to finance hiring extra employees or increase capital investment due to not needing to use cash reserves to cover for late payments	Medium. It depends upon decision-making by entities following implementation of the disclosure regime.	Low

[34] Estimates based on total administrative cost estimations in Australian RIS. Note that the Australian disclosure regime has more complex reporting obligations.

	• reduced stress associated with the uncertainty generated by late and extended payments • lower likelihood of business exit		
Total monetised benefits		Medium	
Non-monetised benefits		Medium	

Further information on the preferred option

While the direct costs of this option fall on the entities that are captured by the disclosure requirements, the benefits are likely to accrue indirectly to the businesses that supply those entities (although not exclusively). It is difficult to assess the indirect benefits to suppliers because they depend upon decisions made by the regulated entities in response to this intervention. We have estimated indirect benefits to suppliers to be at a medium level, as we consider greater transparency is likely to bring about behaviour change as businesses' overdue and lengthy payment practices become visible to commentators and communities. Behaviour change by firms will be monitored as part of a monitoring and evaluation framework for the regime.

By reducing small businesses' finance costs and encouraging them to invest and hire, improved business-to-business payment practices could deliver broader indirect benefits to the economy that are not captured in the above table.

If large entities respond by improving payment practices, there could be an indirect 'improvement cost' to them associated with reduced access to free or cheap cashflow or credit provided by suppliers. We have not assessed improvement costs in the above table as it would be a voluntary choice for the business to improve.

Section 3: Delivering an option

3.1 How will the new arrangements be implemented?

New legislation would be required to implement a better business payment practices disclosure regime.

Reporting entities would be required to register and report within six months of the legislation coming into force. This provides sufficient time for reporting entities to familiarise themselves with the new reporting obligations and make any necessary adjustments to their reporting systems.

MBIE would communicate the existence of the new obligations to reporting entities through a range of channels, including Business New Zealand, CAANZ, IoD, Chambers of Commerce, Regional Business Partner Network, Xero, MYOB, NZX and through business.govt.nz. We would also proactively communicate with any large enterprises already providing financial reports under the requirements of the Companies Act. MBIE is exploring the possibility of establishing information sharing arrangements with the Inland Revenue Department to identify all entities that meet the criteria. Should that outcome be achieved we would propose a standard communication to inform the entities of their new obligations.

Comprehensive guidance would be made available to reporting entities on how to comply with the new obligations.

MBIE would also communicate the existence of the new disclosure regime to interested parties, such as smaller businesses and suppliers, through a range of channels. This would include making user guidance available.

3.2 How will the new arrangements be monitored, evaluated, and reviewed?

The regime would be monitored, evaluated and reviewed to ensure that it is achieving the policy intent. The focus of the monitoring would be on tracking the progress in delivering the outputs, and short and medium-term outcomes. The monitoring exercise may identify issues that indicate the need for early review or amendment of the regime, including any adjustments to the design of the BBPP register.

A formal monitoring and evaluation framework would be established. This would include: the logic model underlying the regime (inputs and activities, outputs, outcomes, impacts); key success measures; data to be collected (including baseline), sources of data, methods of data collection and analysis; and, reports to be produced and timetable for reporting. The BBPP register will be one of the key sources of data for monitoring and evaluation purposes.

Both an outcome evaluation and a process evaluation are proposed. The outcomes evaluation will assess the progress towards achieving the intended outcomes and impacts of the regime. The process evaluation will assess whether the regime has been administered and implemented as intended and resulted in the delivery of desired results.

MBIE officials will continue to discuss the evaluation approach being adopted by our counterparts in the Australian Treasury, and will seek to optimise benefits from alignment.

Formal evaluation and review of the regime would be undertaken within three years of commencement. The terms of reference for the review would be informed by the monitoring data and findings.