Chapter 2: Paying the Bills on Time

Buyers are receiving high scores for paying bills on time and in full, but suppliers are incurring big opportunity costs due to payment terms

With all the talk about lengthening payment terms, it might be surprising that Better Buying's question about payment and terms focuses on such a simple thing: **Were you paid on time and at the price agreed in the contract?**

Our consultations with suppliers explored how lengthening payment terms impact the financial health of the supplier business and its ability to provide decent working conditions. Suppliers told us that it was even more important for the buyer to simply ***"pay us what you said you would pay, when you said you would pay it!"***

Buyers rated in the pilot test received the highest scores on payment and terms. The average score for this category of purchasing practices was 5 stars on our 5 star Better Buying scale – the highest measured. In fact, nearly 95% of supplier ratings indicated that the buyer paid on time and in full as agreed in the contract. We hope this trend will continue as more ratings are submitted.

Yet lower scores on payment and terms were received—the lowest being 2.5 stars. Three of the 30 suppliers' ratings indicated they were not paid on time, and the **delays in payment ranged from seven to 25 days**.

While none of the suppliers indicated that their payments had been reduced for things out of their responsibility, an optional question Better Buying asks whether the buyer used any practices to avoid full payment for orders over the last season. This question revealed more problematic findings.

Seven of the submitted ratings (approximately 14% of all ratings) reported one or more problems, including the following:

- discounts/rebates required by the buyer after price was agreed (2 ratings)
- unsubstantiated claims of quality defects (2 ratings)
- requirement to provide discount or switch currency used in the order due to currency fluctuations (2 ratings)
- reduction of payment for arbitrary administrative procedures (1 rating)
- raw material price reduction (1 rating)

What other financial pressures do buyers place on suppliers?

Other important pieces of information Better Buying is gathering from suppliers, with optional questions not included in the scoring, focus on a concern we heard in supplier consultations over the last couple years, which was ***"as a manufacturer, we are increasingly being asked to finance our buyers who are some of the largest brands and retailers in the world."***

Thirty-eight suppliers reported how many days lapsed between the time they incurred expenses on the buyer's largest order and the time they were paid. **The payment lag ranged from 30 to 180 days (the average was 98 days).** Some suppliers also reported the total amount that had to be financed to produce the buyer's largest order (or alternatively, how much of their capital was tied up in producing the order). **We learned that suppliers are waiting 3 to 6 months for bills worth hundreds of thousands of dollars to be paid. For buyers placing larger volume orders or purchasing products with higher unit costs, that number soars into the millions!**

Failure for buyers to pay bills when expected is obviously critical given the high correlation between supplier business success and provision of decent working conditions. When coupled with lengthy payment terms, financing costs can pile up. Even if suppliers are financially able to avoid debt financing, tremendous opportunity costs are incurred while their working capital is tied up waiting for payment.

How can you use the information Better Buying provides about buyers' payment and terms?

Buyers, do you pay your bills on time and in full? This would be a good subject for a conversation with your accounting department, especially since supplier financial health and provision of decent working conditions are so closely linked. Are your sourcing personnel incentivized for getting supplier agreement on longer payment terms? Maybe changing that and shortening terms would allow your suppliers to install important safety or environmental upgrades to facilities.

Investors, when buyers push financial risk onto suppliers do you reward this as best practice or does it present unacceptable material risks?

Suppliers, as more ratings are submitted and information about specific buyers' purchasing practices is released, you'll be able evaluate your existing client base and vet potential new clients for the material risks they present to your business.

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