Better Buying™ Deep Dive Report

2020: VOLUME 1, NUMBER 3

"Better" Payment and Terms

Payment and Terms are typically part of contractual agreements that state the amount, timing, and form of payment for the goods produced by a supplier. Based on these contractual agreements, suppliers plan how to cover their own expenses such as worker wages, vendor invoices, rent and utilities, and others.

Good payment and terms practices are important because of their impact on suppliers' business profitability, and on suppliers' ability to pursue their social responsibilities to workers and improve their environmental performance. For example:

- Without contracts detailing how much they will be paid or when that payment will be made, the business relationship can be misunderstood or exploited, with suppliers forced to expend additional resources chasing payments or reconciling discrepancies, or worse--left with unexpected financial losses.
- When payment contracts are created but not kept, suppliers' administrative costs increase and their own business viability is put at risk as they struggle to find the cash needed to pay their expenses.
- Unexpected costs, financial losses, and cash flow challenges threaten suppliers' ability to pay workers their full wages and benefits, making workers' livelihoods vulnerable and increasing their dissatisfaction with their employer. These financial difficulties can also prevent important investments in environmentally friendly production methods.
- The business partnership between the buyer and supplier is eroded. After all, if the supplier cannot trust the buyer to fulfill the obligations set in a legally binding agreement, how can they trust that other critical actions required to successfully carry out business will be followed?

KEY TAKEAWAYS FROM THIS REPORT

1

On average, the ten companies participating in consecutive ratings cycles improved in four out of seven Payment and Terms practices – one company improved in all seven practices.

2

Surveyed suppliers had a total of US$6 billion invested in their customers' orders and waiting for payment, or an average of US$10.4 million per buyer-supplier relationship.

3

Suppliers most frequently mentioned reduced payment terms and more efficient payment processing as opportunities for improved Payment and Terms practices.

WHAT DOES BBPPI DATA SHOW FOR BEST PERFORMANCE?

The Better Buying™ Purchasing Practices Index (BBPPI) measures several practices associated with Payment and Terms: whether suppliers are paid for samples, the extent that sample invoices are paid on time, whether payment terms are defined in contractual agreements, the extent that payments are made by the date in the contract and made in full (including the reasons why payments were reduced), the length of the payment terms, and whether advance payments or favorable terms are provided to the supplier.

This Better Buying™ Deep Dive Report uses data collected during Q4 of 2019 for the 25 brands and retailers that received company reports. In the Payment and Terms category, it is possible for a company to earn 100 points. Payment on time and in full are the most heavily weighted practices in this section – the bulk of the available points are awarded for strong performance on these practices.

Payment on time and in full are the most heavily weighted practices in the Payment and Terms section

Numerical scores on the Payment and Terms category for these 25 companies ranged from 44.4 to 85.3, with an average score of 66.0, which is equivalent to 2.5 stars. Within this group, the best-scoring Buyer Type was Apparel, Accessories, and Luxury Goods with 3 companies with average scores from 83.7 to 85.3, equivalent to 4 stars.

ABOUT THE BEST SCORING COMPANY

The company with the highest score in Payment and Terms, "Company 4," received a numerical score of 85.3 and belongs to the Apparel, Accessories, and Luxury Goods buyer type. This company invited all its suppliers to participate and had a response rate of 79.7%. Figure 1 displays Company 4's performance against the average performance of all companies receiving a 2020 report, as well as the highest and lowest scores achieved by a company in each of the Payment and Terms practices about which Better Buying™ collects data. While Company 4 had the highest overall score in the Payment and Terms category, they often did not have the highest score on individual practices, suggesting further room for improvement.

Payment for Samples

Company 4 performed above the average of the comparison companies on both promising payment for sample invoices and paying 90-100% of those invoices on time. However, Company 4 did not have the best performance on either measure. One company had 100% of suppliers report being promised payment for sample invoices, while 6 companies had 100% of suppliers report 90-100% of sample invoices were paid on time. Compensating suppliers for the costly development they undertake on a company's behalf supports suppliers' bottom line.

Payment Terms Defined in Bulk Purchase Orders or Other Agreements

Companies generally had strong performance on this measure, with no fewer than 91.3% of suppliers reporting that payment terms were defined in such agreements. Company 4 lags behind the comparison companies slightly (93.6% of Company 4's suppliers versus 95.7% of the comparison companies' suppliers). Eight companies did have 100% of their suppliers report that payment terms were defined – all companies should strive for the same.

STARS RECEIVED	ALL BUYER TYPES (n=25)
★★★★★	0
★★★★½	0
★★★★	3
★★★½	1
★★★	6
★★½	6
★★	3
★½	5
★	0
½	1
☆	0

Table 1. Average Star Scores in Payment and Terms

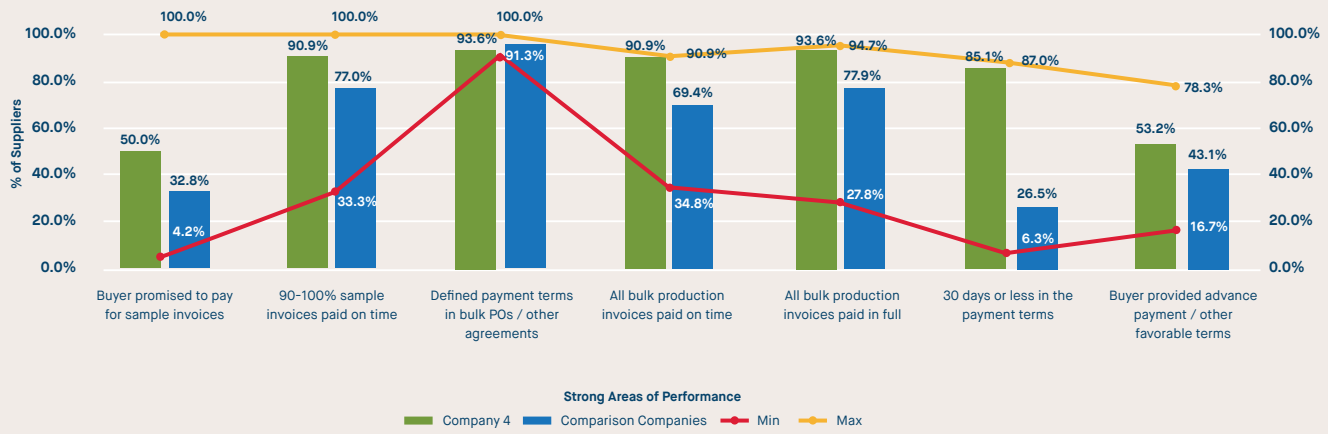

Figure 1. Strong Areas of Performance in Payment and Terms Category

On-Time Payment of Bulk Production Invoices

This measure is one of two areas where companies' performance is heavily weighted. Company 4 not only had above-average performance for on-time payment of bulk invoices, but also had the largest percentage of suppliers reporting that all bulk invoices were paid on time (90.9%). On average, only 69.4% of suppliers for the comparison companies reported the same. For six of the 25 companies, more than half of their suppliers reported not all bulk invoices were paid on time. When payment was delayed, Company 4's payments were delayed by 4.3 days on average, while the comparison companies' payments were delayed 26.3 days. On-time payment is a contractual obligation with potential consequences for payment of wages and supplier business viability. For these reasons, improving the rate of on-time payment to suppliers is critical.

Payment in Full for Bulk Production Invoices

Company scores in the Payment and Terms category are also heavily influenced by payment in full. Company 4 again exceeded the average on this measure, with 93.6% of their suppliers reporting that all bulk invoices were paid in full as opposed to 77.9% of suppliers for the comparison companies. Performance varied substantially on this measure, from a low of 27.8% to a high of 94.7%. Of the suppliers reporting that Company 4 did not pay in full, two-thirds of those reported reduced payments due to unsubstantiated claims about shipping/logistics and about packing. Meanwhile, the lowest-scoring company's (Company 1) suppliers reported the company uses 7 different types of payment reduction practices about which Better Buying™ collects data (Company 1 also had the smallest percent of suppliers reporting full payment of all bulk invoices). The most commonly reported reason for reductions reported by this company's suppliers was unsubstantiated claims about packing (46.2%). As with on-time payment, the consequences of unexpected payment reductions can have detrimental effects on both suppliers and their workers.

WHAT DOES "BAD" LOOK LIKE?

The lowest-scoring company, "Company 1," received 44.4 points. About 59% of Company 1's suppliers reported that 90-100% of bulk invoices were paid on time, though two of the 25 companies did have even fewer suppliers reporting the same. Only 56% of Company 1's suppliers reported that 90-100% of bulk invoices were paid in full, the poorest performance of the 25 companies under analysis. None of Company 1's suppliers reported payment terms of 30 days or less – in fact, 78% reported terms of 90 days or more.

Length of Payment Terms

None of Company 4's suppliers reported payment terms of more than 60 days. For suppliers of the comparison companies, the most frequently reported payment terms were 30 days or less (reported by 26.5% of suppliers), followed by terms of 31 to 45 days and 46 to 60 days (each reported by 16.5% of suppliers). For the company with the lowest Payment and Terms score, 77.8% of its suppliers reported payment terms of more than 75 days.

Net 120 terms are extremely long. It does tie up quite a bit of operating capital for both the vendor and the factories

Advanced Payment and Favorable Terms

Finally, 53.2% of Company 4's suppliers reported that the company provided advanced payment or favorable terms, compared to 43.1% of suppliers on average in the comparison group. For another company that received 4 stars in the Payment and Terms category, 78.3% of its suppliers reported that they were provided such benefits. This suggests ample opportunity for all companies to keep improving in this practice. For 15 of the 25 companies in this analysis, more than half of their suppliers reported they did not receive advanced payment or favorable terms. Among the comparison companies, the most frequently reported favorable terms were digital settlement (22.6%) followed by early payment options (14.7%). Only 2.5% of suppliers reported that their buyers paid for volume orders in full on or before shipment. Interestingly, all 53 suppliers submitting softgoods ratings who reported their buyers issued letters of credit also reported that the 19 buyers they rated treated them as partners in business growth[i].

Letter of Credit on site would be the best payment option as we would receive the money as soon as possible. Would be better for our workers and our company.

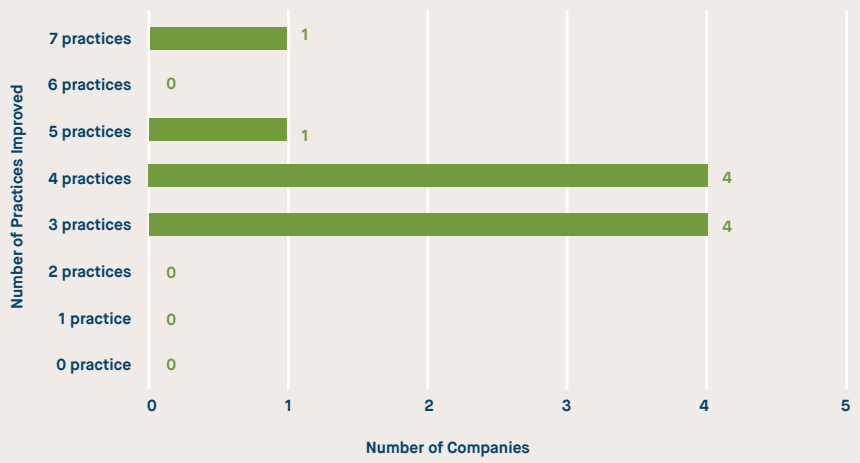

Figure 2. Companies' Improvements in Payment & Terms Category

YEAR-OVER-YEAR IMPROVEMENTS IN COMPANY SCORES

Better Buying™ is already finding year-over-year improvements in purchasing practices for companies that have engaged in multiple consecutive ratings cycles. Ten companies participated in both 2019 and 2020, improving their scores in four out of seven Payment and Terms practices on average – one company improved in all seven practices (Figure 2).

For the two most impactful practices measured in the Payment and Terms category, payment of bulk invoices on time and in full, performance improved for half or more of the companies (Figure 3). There was also a large average improvement across all ten companies for both practices (20.0% and 17.3%, respectively), with one of them improving its on-time payment by an impressive 63.3%. Figure 4 shows how companies are improving in the area of late payments; the number of days payments were late decreased by an average of 10 days compared to one year ago.

A DEEPER LOOK INTO PAYMENT AND TERMS

In addition to providing better understanding of how companies are doing compared with each other, another purpose of the Better Buying™ Deep Dive Reports is to look more deeply at the entire data set across all company ratings for trends and insights on a particular purchasing practice challenge of solution.

Suppliers have a total of over US$6 billion invested in their customers' orders

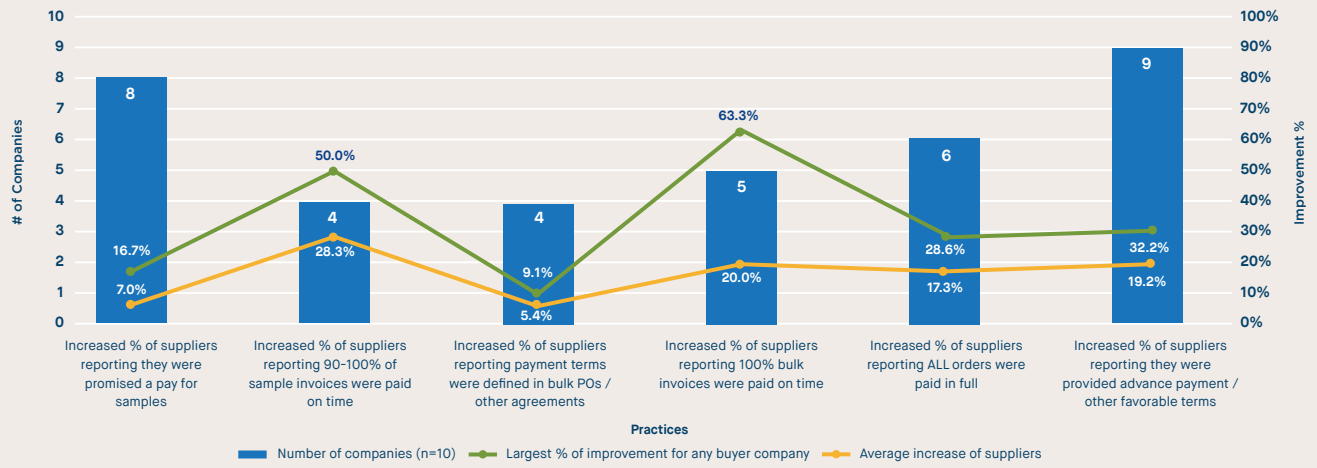

Figure 3. Nature & Extent of Payment & Terms Improvements

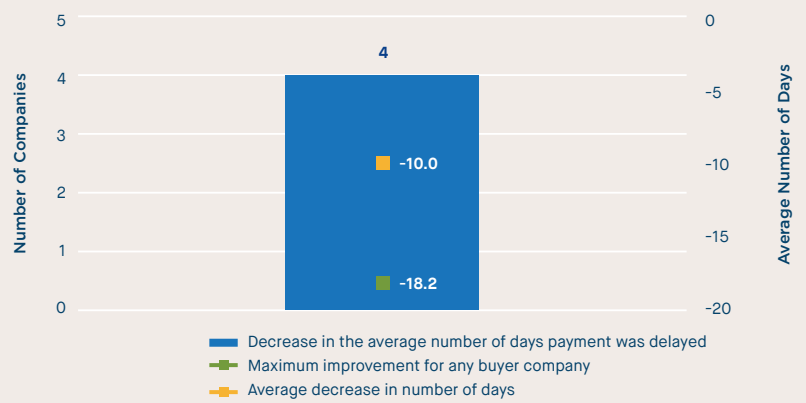

Figure 4. Reduced Average Number of Days Payment was Delayed

Payment Terms & Pricing Practices

Better Buying™ finds that suppliers reporting shorter payment terms are also more frequently reporting a larger percent of orders priced to cover the cost of compliant production, an area measured in the Cost & Cost Negotiation category[ii]. The correlation between these two practices isn't large, but would indicate that companies with better payment terms also tend to have better pricing practices. Concomitantly, those with worse payment terms also have worse pricing practices, leading to dual financial pressures on suppliers.

Working Capital

Based on a general understanding of the large amounts of suppliers' money that is held up while they are waiting for payment from their buyers, Better Buying™ began collecting data on this topic to quantify suppliers' financial vulnerability and highlight the potential implications for both suppliers and their workers. Across all 581 ratings submitted by softgoods suppliers in Q4 2019 that submitted this optional data, they reported having a total of over US$6 billion invested in their customers' orders and waiting for payment, or over US$10.4 million per buyer-supplier relationship. The values reported by individual suppliers ranged from US$0 to US$540 million. It is important to keep in mind this is the working capital tied up for just one customer; suppliers have additional capital tied up with other customers as well. This capital begins accumulating as soon as development begins for a customer – suppliers continue to incur costs throughout the production process, yet wait for payment well beyond shipment of finished goods (60% of suppliers reported payment terms up to 60 days). Furthermore, in the absence of advance payments or letters of credit, some suppliers will have accessed this money through an open line of credit with high interest rates.

The amount of time that working capital is tied up combines with the actual dollar amount tied up to restrain suppliers from making investments in technology for efficiency and improved environmental performance. Furthermore, suppliers with large amounts of working capital locked up in their customers' accounts receivable increase their risks of financial catastrophe if their customers default on the payments. Additionally, the intense strain on the bottom line and on cash flow that comes with customer default places vulnerable

workers in dire situations, such as what is happening at present in response to the Coronavirus pandemic. The amount of working capital tied up varies substantially by region. Suppliers headquartered in East Asia reported significantly more working capital tied up (US$26.4 million for the average buyer-supplier relationship) compared to suppliers headquartered in all other regions except for Asia Pacific, which had only an average of US$6.1 million tied up but notable variability in the amount for specific buyer-supplier relationships. That being said, the suppliers that reported more working capital tied up also reported larger annual volumes shipped, indicating that the size of the supplier company is a factor [iii].

Many [nominated] suppliers required advance payment which is why there is a need for high working capital

WHAT ARE SUPPLIERS ASKING FOR?

In their qualitative comments, suppliers mentioned several opportunities for improvement. Their comments are grouped into themes that are described in Table 2. Not surprisingly, given the working capital tied up, the most frequently mentioned improvement made by suppliers related to reducing the payment terms. More efficient payment processing is also desired.

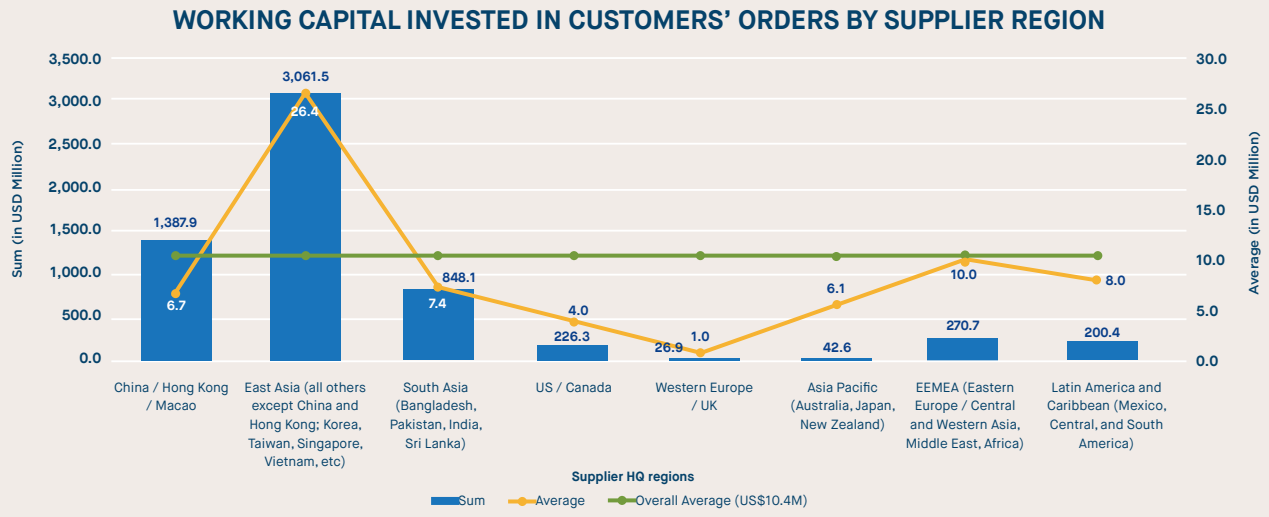

Figure 5. Working Capital by Supplier HQ Regions

THEME	# OF MENTIONS	SAMPLE QUOTES
Reduced payment terms	53	Net 120 terms are extremely long. It does tie up quite a bit of operating capital for both the vendor and the factories. Please if we can reduce the payment lead time. IT WILL HELP IF THE PAYMENT TERMS ARE REDUCING TO 30DAYS. The payment terms has been moved to 75 days, which we believe is on higher side. Usually payments terms are between 30 - 45 days.
Increased efficiency in payment processing	44	For the most part things proceed without issue, but given extensive growth and use of third parties and 3PLS, sometimes receiving and notification of that to paying arm is delayed. Buyer pays invoices with paper check. Preferred payment terms are via ACH. Invoices are provided immediately goods are despatched - however, there appears to be a problem with these being receipted into the [buyer company] purchase ledger. Buyer uses trade card which is very good and efficient. Buyer has set up a E platform for payment with partnership with banking organization "self billing finance" which help supplier for funding as well as less cost in operation.

THEME	# OF MENTIONS	SAMPLE QUOTES
Secured payment terms or Letters of Credit	19	Credit insurance is needed to avoid exposure/risk (recognise this is not something {buyer company} can directly provide) but it is needed. credit insurance limit was reduced and we have more and more difficulties getting the invoices paid in the agreed time frame. Letter of Credit on site would be the best payment option as we would receive the money as soon as possible. Would be better for our workers and our company.
Early payment or deposits on volume orders	16	Buyer should reduce Early Negotiation Charges At sight payment is preferable or maximum 30days is helpful because if we want to get earlier payment then we have to consider 2.65%...less payment then actual amount which is huge loss. New Factory cash flow can be an issue. Recommend customer offer some in advance payment so that materials and labor can be partially covered. Propose payment of down payment for the purchase of material and trims.
Payment for samples	16	A lot of samples are developed and waste. No samples are invoice means a lot of money lost. A considerable amount of money is invested by us in sampling, print development and product development for which the buyer does not pay.
Alignment between buyer's and nominated suppliers' payment terms	14	Buyer is asking for 75 days payment term but nominate material supplier 25% are asking for payment in advance. Other supplier that is not advance payment material supplier are maximum giving 30 days credit terms which we have to bear for all the payment interest lost. Customer should consider to consolidate material supplier and make a better payment term before hand so all the cost will not bear in one party hand. Many of such suppliers required advance payment which is why there is a need for high working capital.

Table 2. Qualitative Comments Related to Payment and Terms

BETTER BUYING™ CHECKLIST FOR IMPROVING PAYMENT AND TERMS FOR SUPPLIERS

Good Payment and Terms practices are critical for suppliers' business sustainability, as well as their ability to achieve social and environmental sustainability. Without comprehensive terms or functioning contracts, trust between buyers and suppliers disintegrates and leads to increased instability in the business partnership. The following checklist can guide companies as they work to strengthen their practices and, by extension, their supplier partnerships even in the midst of significant supply chain disruption.

- ✓ Increase the rate of on-time payment, with the aim of 100% of bulk invoices paid according to the specified terms.
- ✓ Pay all bulk invoices in full. When situations arise in which the supplier is truly at fault, verify these shortcomings with the supplier prior to authorizing the payment reduction.
- ✓ Automate payment processing to avoid miscommunications and use methods that result in the shortest processing time possible.
- ✓ Reduce payment terms to 60 days or less and provide letters of credit or deposits on bulk invoices.
- ✓ Discuss with your suppliers the costs they incur related to working capital tied up in your company's production; engage in dialogue about mutually beneficial ways to address these costs if they are problematic.
- ✓ Join the Better Buying™ Learning Loops program to engage in dialogue with suppliers about new ways to work together to find sustainable business success for all parties.

[i] Pearson's Chi-square=7.67, p=.006, n=814
[ii] Pearson's r=.07, p=.029
[iii] Pearson's r=.24, p=.000