



## DELAYED PAYMENTS ADVERSE MICRO SMALL AND MEDIUM ENTERPRISES

### Policy options and Best practices

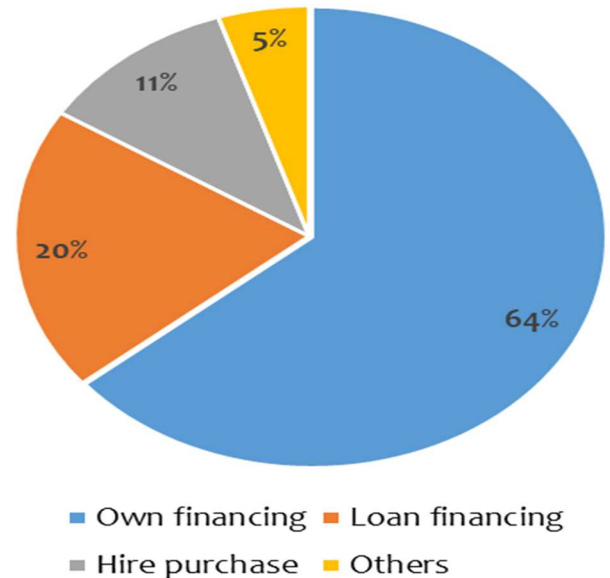
#### Introduction

Uganda's domestic private Sector is dominated by Micro Small and Medium Enterprises (MSMEs) comprising approximately 1,100,000 enterprises. MSMEs are potential engines of growth for innovation, wealth creation and economic development. However, the majority of these enterprises are on a micro to small scale; and are predominately informal and young. Most of these enterprises are characterized by a high enterprise mortality rate and don't usually survive to celebrate more than 5 years, with over 90% of them often not surviving beyond the life of their proprietor. Majority of them are family owned, home based, with no formal management structures and clear address; and employ basic technology with rudimentary tools.

At the moment, MSMEs are spread across all sectors with 49% in the service sector, 33% in commerce and trade, 10% in manufacturing and 8% in other fields. These enterprises account for approximately 90% of the entire private sector, employ more than 2.5 million people, generate over 80% of the country's manufactured output and contribute 18% to the country's GDP.

However, MSMEs face peculiar challenges, especially in accessing finance due to a number of factors. Some of these include, the high interest rates of up to 23% per annum compared to Kenya (9%) and Tanzania (12%), coupled with limited access to collateral. Even the capacity for these businesses to undertake loan repayments has been undermined by delayed payments by buyers of their goods and services. This situation has further been compounded by the high level of informality of many of the MSMEs, challenges of information asymmetry, inadequate internal financial and management systems, competition from large enterprises, and lack of professionalism, both internal and external, among others.

#### Major Sources of Finance



**Source:** Ministry of Trade, industry and Cooperatives, March 2018

While most of these issues have been identified by many research and business development analysts, the impact of delayed payments on MSMEs' access to finance is a silent but damaging factor which has yet to be discussed extensively and explicitly addressed.

**A report published by Sage Foundation in the UK revealed that late payments cost Small and Medium Businesses a total of \$3trillion globally. The study also revealed that 1 in 10 invoices are paid late, and 8% are either never paid or paid so late that businesses are forced to write them off as bad debt.**

## The Impact of Delayed Payments on Micro, Small and Medium Enterprises



Deeper investigation into the challenge of access to finance reveals that other than the identified causes of limited access to finance, MSMEs face challenges of delayed payments. Delayed payment has always remained a ball and chain to the small and medium enterprise sector's growth. Most SMEs' cash flow can hardly withstand the burden of late payments yet because of the need to obtain and secure a market for their products, they usually extend credit in the form of delayed payment. It has therefore become a way of doing business because not extending such preference could lead to loss of potential customers hence less market opportunities. The main perpetrators according to MSMEs mainly include supermarkets, government, schools, hotels, and corporate institutions like banks and telecommunication companies.

While efforts have recently been made to address the issue through mediation, a legal provision is necessary to provide for a regulatory framework within which buyers and sellers can avoid the issue of protracted payments. Such a provision would provide clarity for governance in the relationship between MSMEs and their large buyers.

The recent amendment of the Sale of Goods and Supply of Services Act, 2017 attempts to address this challenge. Notably, under Article 11 on *Stipulations as to time*, the Act provides that (1) Unless a contrary intention appears from the terms of the contract, stipulations as to time of payment are not taken to be of

the essence of a contract of sale or supply of services. The amendment Act further provides under Article 35 on *Payment and delivery are concurrent conditions* stipulated that (1) Unless otherwise agreed, delivery of goods and payment of the price are concurrent conditions, namely, that, the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer must be ready and willing to pay the price in exchange for possession of the goods. However, these provisions and the entire law do not stipulate the maximum time within which a payment should be made. The Act also disregards the necessity of stipulating time of payment in a contract of sale or supply of services under Article 11.

MSMEs' major concern of delayed payments is that this has a bearing on their finances in the long run especially given that a number of them depend on such large firms as their major source of market.

### **1. Delayed payments Curtail planning, research and innovation**

According to most MSMEs delayed payment by customers can result into a financial crisis further impeding planning, research and innovation to enhance productivity or grow the product chain. This is because in effect, such MSMEs would be extending credit, usually at a zero interest rate, to their customers, limiting the MSMEs' cash flow. Retailers might be immune to this problem, but if you are in business-to-business selling, you are sure to face this problem. Selling on credit has become a way of doing business. A supplier is likely to lose a customer if they are not willing to offer their product or service on credit.

### **2. Delayed payments Slows down business growth**

Indeed many MSMEs rely on corporate businesses and other large buyers to sustain their operations because it is a market that is guaranteed and lucrative. MSMEs' other sources of revenue is random buyers. However, in a sector in which there are many players, business becomes very uncertain if a supplier must rely on speculated buyers. Nonetheless, a number of MSMEs are gravitating more and more towards waiting for

speculated buyers because, like many other small enterprises, MSMEs cannot generally afford to have debtors not paying immediately for goods or services delivered. But, this has slowed down business growth, something that continues to limit the potential of MSMEs to contribute to economic development in the country.

### **3. Delayed payment could lead to failure of MSMEs' to be tax compliant**

MSMEs are taxed under the presumptive income tax system which is a method used to tax small business enterprises with sales turnover categorized into grades from 10 million to 50 million Uganda shillings. Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts.

It's noteworthy, that despite existing delays in payments, such expenses including staff pay checks, utility bills, material bills and other operating costs must be covered, regardless of whether or not payments accruing to the business have been made. These delays, in the same way, adversely impact on the company's ability to be tax compliant. Tax compliance means making tax payments and producing and submitting information to the tax authorities on time and in the required formats.

### **4. Delayed payments; and its impact on gender equity and women economic empowerment**

More than 25% of the SME sector comprises women. Therefore, the sector plays a critical role in the eradication of poverty among women and households; and is therefore instrumental in fostering gender equality.

However, given women's low bargaining power and weak capacity to demand for prompt payments, buyers' of such SMEs' products tend to take advantage of these circumstances. Given women's multiple roles coupled with other limitations to ably access credit owing to the lack of property potentially acceptable as collateral, the extent to which delayed payments may affect women if compared to men differs.

Therefore, a policy framework to address this anomaly is imperative; and it should also take into account the impact this anomaly has had on women entrepreneurs over the years.

## **Policy Options and Best Practices**

Cash flow is the lifeblood of every ongoing business concern. Therefore, the need for prompt payments cannot be over emphasized. However in order to address this challenge there is need to put in place an appropriate policy framework. While the government designs regulations to the Trade Licensing Act, 2015, it is imperative that the regulations extensively address this anomaly.

### **Best practices from United States, Europe and India**

- Governments are increasingly introducing programs to address late payments, in most cases with mixed results. In the U.S., the federal government's successful QuickPay initiative requires federal agencies to pay small business contractors and subcontractors within 15 days. Following on "QuickPay" was the "SupplierPay" program, which is a federal government and private sector partnership designed to encourage large companies to pay their suppliers more promptly. After just over a year, the program listed 47 participating large buyers on its website that had pledged to pay their suppliers faster. Although this number represents a small percentage of the big corporates doing business in the U.S., it has made a difference.
- The Prompt Payment Code is an industry-led, voluntary program in the UK administered by the Chartered Institute of Credit Management on behalf of the Department for Business Innovation & Skills. Its signatories agree to a maximum 60-day payment term, with a goal of establishing a 30-day term as standard practice. The Prompt Payment Code has been in effect since 2008. In addition, the European Late Payment Directive, launched in the European

Union in 2013, recommends maximum payment periods of 60 days for companies and 30 days for public authorities. According to a 2015 report from the Asset Based Finance Association (ABFA), this directive registered a 6% positive effect.

- In India, if the buyers fail to pay MSMEs within the stipulated period as mandated by the Small and Medium Enterprises Development Act, the private sector has demanded that such buyers should be made to pay interest at double the prevailing prime lending rate.

### **Policy recommendations**

- Although only recently amended, the Sale of Goods and Supply of Services Act, 2017 should be amended to explicitly stipulate the maximum time within which suppliers/ sellers should be paid for their goods and services by buyers. The Act should also be amended to provide for a requirement to stipulate time for payment within contracts made to govern buyers and sellers relationships such as Supermarkets, Hotel, Schools, government and MSMEs.
- Similarly, the Government of Uganda should fast-track amendment of the national Markets Act, 1942 which has been overtaken by events and therefore no longer fits within the needs to the current market. The Act should be amended to provide for a regulatory framework that addresses challenges such as delayed payments by buyers to sellers.
- In view of the country's large informal trade sector, the Trade Licensing regulations and Retail Trade Regulations which are currently under development by the Ministry of Trade, Industry and Cooperatives should explicitly provide for the maximum period within which buyers should pay suppliers/ sellers upon delivery of goods and services. Legislating for this will ensure that small suppliers such as

MSMEs are legally protected from this challenge.

- MSMEs should enforce clauses that provide for the maximum time within which they should be paid upon delivery of their goods and services. This will in effect facilitate actions by MSMEs for the application of fines to such buyers for protracted payments to be determined in the same way as late delivery charges have been applied.

### **References**

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