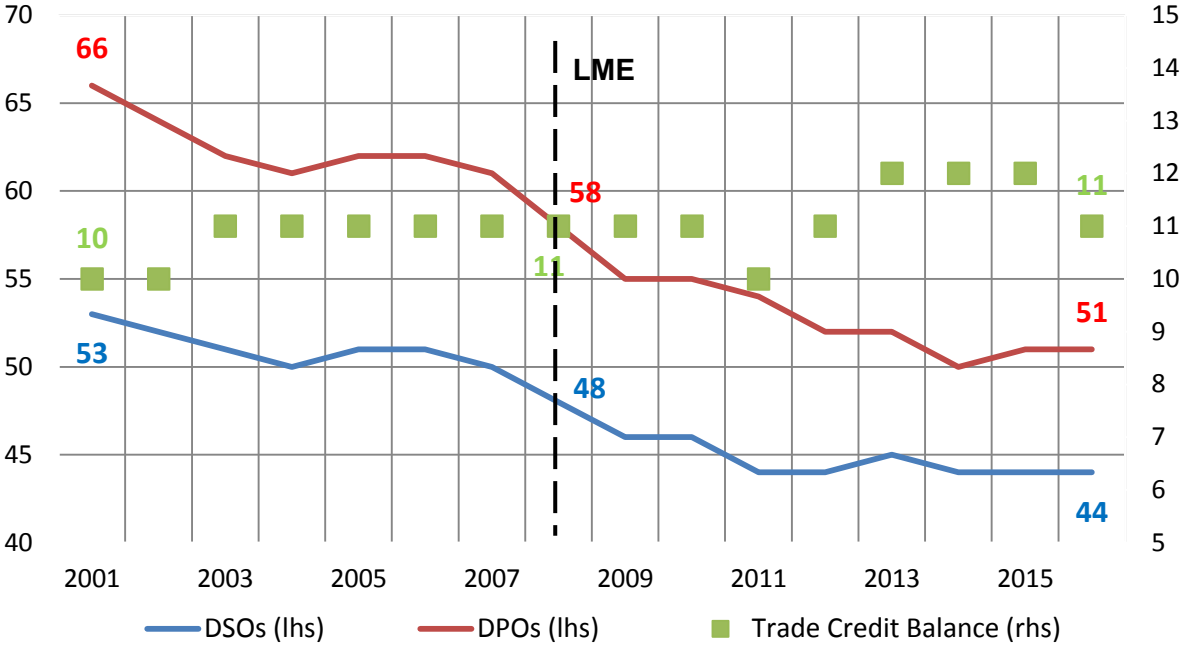


Does reducing days payable outstandings weaken companies?

By Adrien Boileau and Olivier Gonzalez

The Economic Modernisation Act has reduced payment periods, by capping them, for the most part, at 60 days. Today, average payment times are stable, but late payments continue to weigh on the cash flow of businesses, which seem unwilling to pay their suppliers faster so as not to weaken their solvency. Yet reconciling these two goals is possible.

Chart 1: Sharp fall in days payable outstandings (DPOs) and days sales outstandings (DSOs) as a result of the Economic Modernisation Act



Note: scope, non-financial corporations as defined by the Economic Modernisation Act. Unweighted averages of individual ratios: DSOs and trade credit balance expressed in days of turnover; DPOs expressed in days of purchases.

Source: Banque de France –FIBEN database, data to October 2017.

Thanks to the Economic Modernisation Act, DSOs and DPOs have been reduced, but late payments persist

DSOs and DPOs have an impact on companies' cash flows. They often reflect a balance of power between trading partners. Since the entry into force of the Economic Modernisation Act in 2008, trade credit has been the subject of binding regulatory provisions aimed at defining a common legislative framework for all businesses. This framework essentially provides for the introduction of 60-day (or in certain cases 45-day end-of-month) payment deadlines. Chart 1 shows that the Economic Modernisation Act has significantly contributed to reducing DSOs and DPOs since its implementation.

However, while payment periods have stabilised at levels below the legal threshold in recent years, late payments remain numerous ([Boileau & Gonzalez, 2018](#)).

Indeed, in 2016 almost one-third of companies suffered from late payments on the part of their customers. This share, which has remained unchanged over the past 5 years, suggests that a ceiling has been reached. These late payments particularly affect the most fragile companies. According to our calculations, if the Economic Modernisation Act were applied strictly, a EUR 16 billion cash flow gain could be generated for small and medium-sized enterprises (SMEs), which would contribute to strengthening them or even to promoting their development.

Late payments persist even though the legislation has been reinforced with the introduction of penalties for late payments, a lump sum indemnity for late-paying clients and administrative fines in the event of breaches of the law, as noted by General Directorate for Competition Policy, Consumer Affairs and Fraud Control (see also the annual report of the Trade Credit Observatory).

Everything thus happens as if, despite a complete legal arsenal, the coercive model was no longer enough to convince certain companies to further reduce payment periods. It will only be possible to make additional progress if companies measure the extent to which it is in the common interest to adopt more favourable practices in terms of client/supplier relations.

At the individual level, the persistence of late payments shows that companies are reluctant to relinquish some of the resources that trade credit represents. Yet it is possible to reduce DPOs while preserving financial balances.

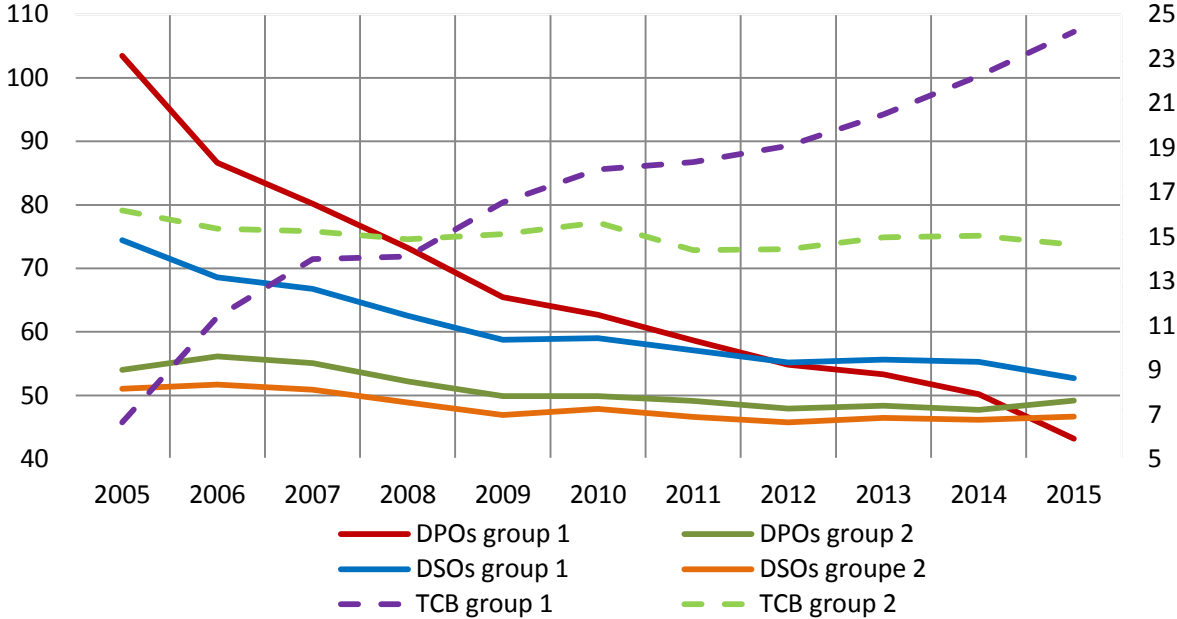
Reducing payment periods and preserving financial structures: two reconcilable objectives

To carry out this analysis, companies were broken down into two groups: the first (called group 1) was made up of the 10% of companies that most reduced their DPOs over the period 2005-2015 and the second (group 2) of the remaining companies. The objective was

to measure the impact of this reduction on the profit and loss account, the balance sheet structure and the investment policy in these two groups.

The main lever used to finance a significant reduction in DPOs is intuitive, it involves better controlling trade receivables. However, DPOs have been cut back faster than DSOs. This has led to a rise in the trade credit position (see Chart 2) of group 1 companies.

Chart 2: Reduction in DPOs partly financed by a better control of trade receivables

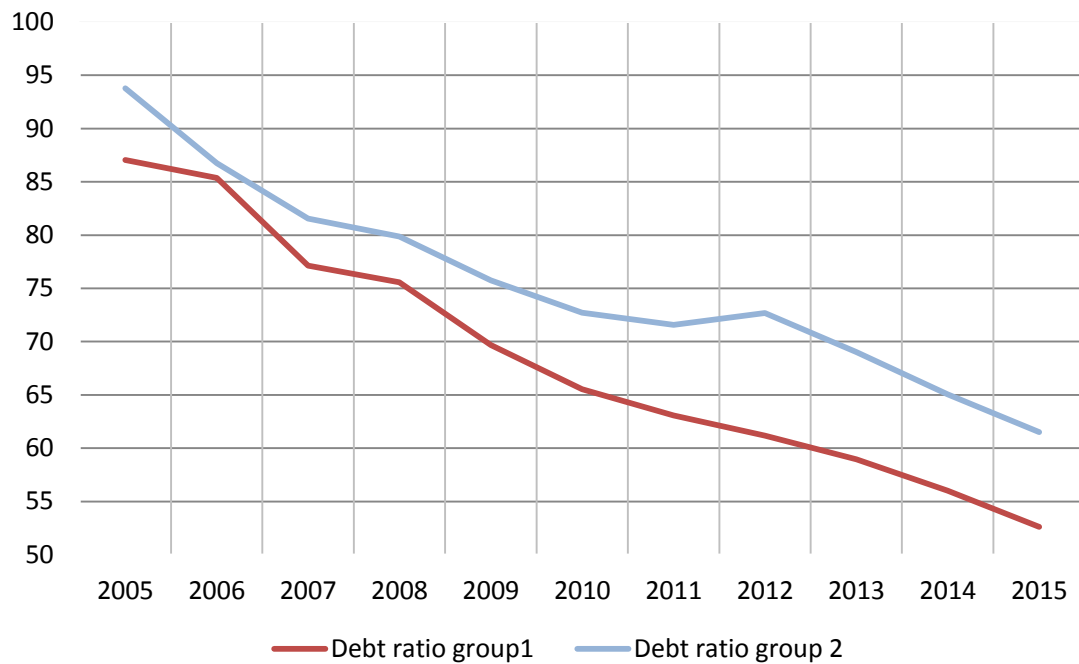


NB: Level in days ; DSOs and DPOs (lhs), trade credit (rhs)

Source: Banque de France

In group 1, further adjustments were therefore required to reduce DPOs. These involved reducing the investment rate and the cash position at the beginning of the period. Their levels were thus aligned with those of group 2.

Chart 3: But the financial structure has been preserved (%)

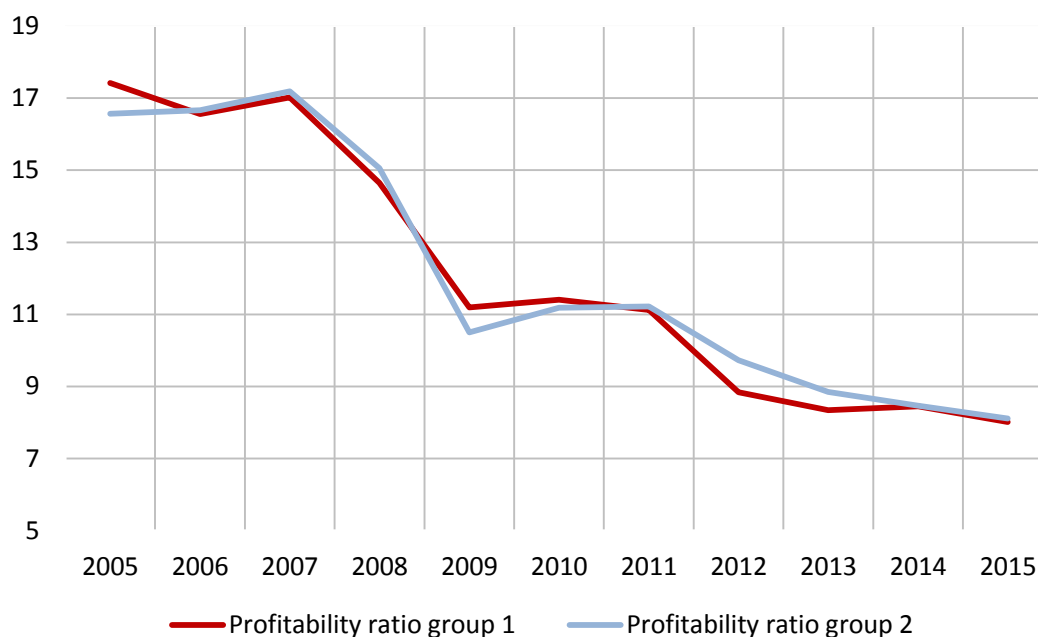


Note: Debt ratio = financial debt / shareholders' equity

Source: Banque de France

By activating these levers, companies in group 1 were able to comply with the Economic Modernisation Act from 2011. They managed to preserve their financial structure (see Chart 3) and maintain their level of profitability. The latter posted a perfectly similar trend in both populations (see Chart 4).

Chart 4: Similar trend in profitability for companies in both groups (%)



NB: Profitability ratio = Self-financing capacity/ Shareholders' equity

Source: Banque de France

The most virtuous companies in terms of payment times were thus able to reduce their DPOs while preserving their financial balance. They used the available margins in terms of cash positions and investment, but above all, they managed to better control their receivables. Companies could therefore reconsider the way in which they view their supplier relations.

Indeed, reducing payment times could be achieved by improving communication between clients and suppliers. This is highlighted by the barometer "Companies mediator/Sidetrade" (May 2018). It shows that the payment of one invoice out of seven is blocked for lack of technical compliance of the invoice with the information system of the client, resulting in an additional delay of 47 days on average. More generally, further progress will be made by raising collective awareness of the importance of establishing more harmonious client/supplier relations, which is reflected in achieving shorter settlement times. Thus, the issue of payment times could be the driving force behind a renewal of inter-company relations, recognised as vectors of efficiency and value creation (see Cai and Zeidl, 2017 on the Chinese case).