CG22:20

Early Payment Schemes

NATIONAL ACCESS & SCAFFOLDING CONFEDERATION

Introduction

This Guidance Note has been produced in order to provide NASC members with a background knowledge of Supply Chain Finance and a brief understanding of the potential benefits and drawbacks of early payment schemes which are currently being offered by many of the larger main contractors in the construction industry.

What is Supply Chain Finance (SCF)?

SCF is a Government backed initiative that allows large companies to help their supply chain access credit, improve cash-flow and allow financing at a much lower cost, enabling growth and further job creation. This is widely used in the pharmaceutical and technology industries and has become more prominent in the construction industry over recent years.

With SCF a bank is notified by a main contractor that an invoice has been approved for payment. The bank is then able to offer a 100 per cent immediate payment to the subcontractor at lower interest rates, knowing that the invoice will ultimately be paid by the larger company.

These schemes can be called many different things such as EarlyPay, Supply Chain Finance Initiative (SCFI) and Early Payment Facility (EPF). All of these are essentially SCF just with specific terms and conditions relating to the main contractor who you are dealing with.

How Does it Work?

1. Subcontractor completes works for main contractor

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2. Subcontractor submits invoice / application for payment to main contractor

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3. Main contractor approves invoice / application for payment

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4. Main contractor uploads payment details to banking platform

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5. Subcontractor is paid value of invoice less small finance charge

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6. Main contractor pays the bank for the amount of the invoice on the maturity date

What are the potential Benefits of SCF?

- Gives access to payments early, for a small fee.
- It provides cheap funding to smaller firms based on the credit quality of the main contractor you are working for.
- Entirely optional whether you enter into the agreements and also whether or not you take the payments early, incurring a fee, or leave them until the due date with no finance charge.
- It allows you to receive 100 per cent of the invoice value, less a small finance fee, rather than the 70 to 90 per cent generally offered through traditional finance products such as factoring. This can help free up money for growth, boost cash-flow or allow your business to refinance existing debt.
- It can help you to become more profitable as the overall cost of finance is reduced.
- It can reduce the issue of late payments and allows better visibility of incoming payments as the main contractor has to administer the process within tight timeframes.

How will this affect your company?

Each SCF scheme will have its own parameters so you should always make sure you have all of the relevant details for the Scheme prior to signing up. The following is an example of an early payment scheme used by main contractors.

A subcontractor is due a payment of £10,000 in relation to a valuation on 28th March (Day 0). Under the main contractors 42 day payment terms this would be received on 9th May (Day 42).

Under the EarlyPay scheme the payment could be uploaded on to the on-line banking system on 25th April (Day 28) with a maturity date of 4th June (Day 65).

If the subcontractor has elected for same day payment on 25th April (Day 28), an interest charge of £21.92 would be deducted by the bank and £9,978.08 would be received immediately.

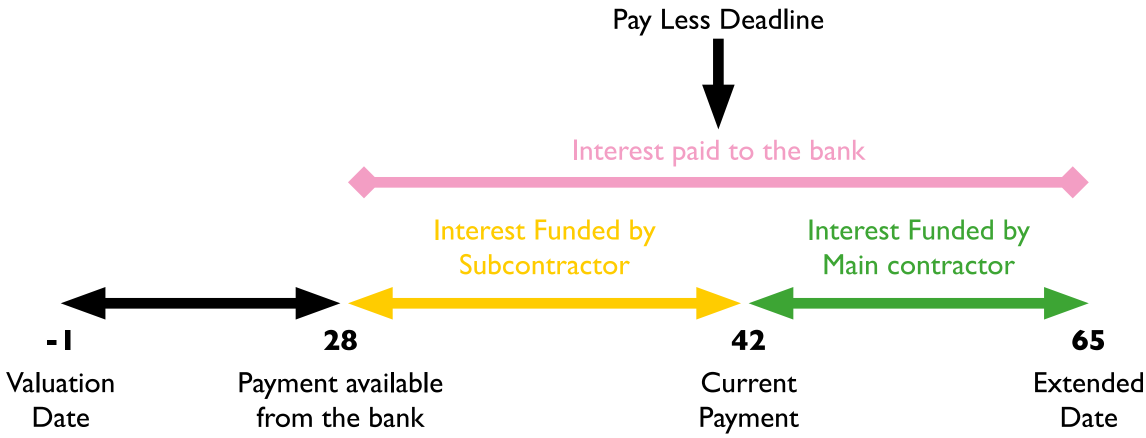
£14.25 (26 days) of the total interest cost would later be automatically refunded by the main contractor meaning that the cost to the subcontractor for receiving payment 2 weeks early would be only £7.67.

The interest is calculated as follows:

$$\pounds 10{,}000 \text{ @ } 2\% \times \frac{40}{365} = \pounds 21.92$$

$$\pounds 10{,}000 \text{ @ } 2\% \times \frac{14}{365} = \pounds 7.67$$

Example Timeline:



What are the possible draw backs?

- There is obviously a finance fee applicable to any payments drawn down early. However as highlighted above the interest chargeable is very likely to be cheaper than any other form of loan or financing.
- The scheme is potentially confusing to administer. Each main contractor will have their own SCF agreement and the payment terms and finance fee percentages are likely to vary across each of these.
- The standard payment terms are likely to increase if you are registered on one of these schemes, meaning that for example your 45 day payment terms may increase to 60 days unless you decide to draw the cash early and incur the finance fee.
- There has been a degree of bad press about some main contractors' administration of their SCF schemes. Some retain a right to issue a pay less notice even where it has approved applications. There is a risk in this as the main contractor is unlikely to approve any later applications unless they reflect withheld amounts contained in the pay less notices. If the subcontractor, in order to obtain approval and therefore payment, reflects the sum in a pay less notice on its applications, it will not be able to then dispute the withheld amount.

Summary

SCF can be a useful and cost effective means of finance, if you require it. It is however essential that you get a full understanding of any scheme before you register. Make sure you know how it affects payment due dates, as the base dates are likely to extend, and how much it will cost you in order to receive the payment early. You should always be given the option whether you enter in to the scheme or not, if you are told you have to be part of any SCF scheme it would be advisable to seek further advice prior to signing any contract.

NASC
NASC, 4TH FLOOR, 12 BRIDEWELL PLACE, LONDON EC4V 6AP
TEL: 020 7822 7400 FAX: 020 7822 7401
enquiries@nasc.org.uk www.nasc.org.uk