PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

First Delegated Legislation Committee

DRAFT BUSINESS CONTRACT TERMS (ASSIGNMENT OF RECEIVABLES) REGULATIONS 2018

Monday 10 September 2018

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Friday 14 September 2018

The Committee consisted of the following Members:

Chair: MR VIRENDRA SHARMA

† Ali, Rushanara *(Bethnal Green and Bow)* (Lab)
† Bruce, Fiona *(Congleton)* (Con)
† Charalambous, Bambos *(Enfield, Southgate)* (Lab)
Coffey, Ann *(Stockport)* (Lab)
† Esterson, Bill *(Sefton Central)* (Lab)
† Fysh, Mr Marcus *(Yeovil)* (Con)
† Harris, Rebecca *(Lord Commissioner of Her Majesty's Treasury)*
† Harrison, Trudy *(Copeland)* (Con)
Lammy, Mr David *(Tottenham)* (Lab)
Mahmood, Shabana *(Birmingham, Ladywood)* (Lab)
† O'Brien, Neil *(Harborough)* (Con)
† Smith, Nick *(Blaenau Gwent)* (Lab)
† Smith, Royston *(Southampton, Itchen)* (Con)
† Stevenson, John *(Carlisle)* (Con)
† Sturdy, Julian *(York Outer)* (Con)
† Tolhurst, Kelly *(Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy)*
Williamson, Chris *(Derby North)* (Lab)

Sarah Rees, *Committee Clerk*

† attended the Committee

First Delegated Legislation Committee

Monday 10 September 2018

[MR VIRENDRA SHARMA *in the Chair*]

Draft Business Contract Terms (Assignment of Receivables) Regulations 2018

4.30 pm

The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Kelly Tolhurst): I beg to move,

That the Committee has considered the draft Business Contract Terms (Assignment of Receivables) Regulations 2018.

It is a pleasure to serve under your chairmanship, Mr Sharma. This is the first time I have served on a Committee as a Minister, and I am extremely pleased to bring forward these positive draft regulations. I am also pleased that the shadow Minister, the hon. Member for Sefton Central, is on the Committee, because he is a Medway person, too—we grew up in the same area. It is great that there are two people on the Committee who know Medway well.

Britain's 5.7 million small and medium-sized enterprises are the backbone of the economy, accounting for more than half of turnover and 60% of employment in the private sector. Finance is the lifeblood of those businesses, yet many of them are denied by their customers the ability to access one particular finance option. That is the anomaly that the draft regulations will put right. In future, SMEs will, if they choose, be able to raise finance on their invoices more easily.

The most recent figures for asset-based finance show that total advances stand at £22 billion, of which more than £20 billion is invoice finance. Around half that is to large businesses, so invoice finance advances to SMEs amount to approximately £10 billion. In comparison, bank loans and overdrafts to SMEs were £165 billion at the end of 2017.

Invoice finance has real advantages—it is flexible, immediate and supports businesses to grow—so why is take-up so low? The answer is that many customers prohibit their suppliers from assigning invoices—or, more accurately, receivables: the right to receive the proceeds from an invoice. That assignment is essential for invoice finance to operate. Such restrictive terms are found in many purchase contracts. An SME supplier is typically unable to negotiate changes. If it wants a contract, it had better just accept the standard terms, otherwise the work will be offered to a competitor.

Why do those contract terms persist? Some such clauses are written as a general catch-all to prevent suppliers from subcontracting services. However, those standard terms are so wide that suppliers are equally prevented from assigning their invoices to finance providers. In other cases, customers may not want to deal with an invoice finance company. They know that the imbalance of power means their small suppliers are unlikely to act against them if they impose long payment terms or simply pay late. A finance company is a different proposition. Whether such onerous terms exist through inertia or deliberate intent, their effect is the same: they prevent suppliers from accessing the finance they need to thrive and grow.

The draft regulations will put an end to that situation for SME suppliers making routine supplies of goods and services. They will allow providers to offer invoice finance even where restrictive contract terms are in place, knowing that those terms will have no effect. The draft regulations do not require any contract to be redrafted, nor are they in any way retrospective. Existing agreements will continue to be enforceable, and the same standard drafting, including clauses prohibiting assignment, may still be used for contracts entered into on or after 31 December this year. Those clauses will simply have no effect. Therefore, the impact of the draft regulations will be felt gradually, as new supplier relationships are created. This is a simple mechanism with no compliance or reporting burden.

To offer invoice finance, providers will simply need to assure themselves that the supply contract was entered into on or after 31 December this year and that none of the exemptions apply—for example, that the supplier is not a large enterprise. The change will also unlock additional finance for existing clients where advances are currently restricted due to prohibitions on assignment imposed by some of the SME's customers. The position for both supplier and finance provider will be simpler and more certain, which will help to create the significant benefits that are expected to flow from the regulations.

Two direct benefits are described in the impact assessment, which reflect the two elements of a typical invoice finance arrangement. The first benefit is a reduction in the discount fees charged to suppliers, which reflects the reduced risk that the finance provider will be unable to collect payment because the assignment was not valid. The annual savings to business from lower discount fees are assessed at £13.7 million. The second benefit is a reduction in the service charge based on turnover. That benefit is assessed at £46.1 million. Both benefits result from the reduced costs incurred by finance providers being passed on to SMEs in a competitive market.

Finally, there will be significant indirect benefits from additional finance becoming available and allowing suppliers to take advantage of new business opportunities. Those benefits are assessed at £84.6 million. All those benefits are calculated from survey evidence and follow-up research, as set out in the impact assessment. The overall outcome is a net present benefit to business of £966 million, which I am sure all hon. Members will welcome.

As with any intervention, it is important to ensure that the benefits do not give rise to unintended consequences. Acting to make contract terms ineffective is a powerful measure, which is typically used where there is an imbalance of power between the parties that cannot be corrected in any other way. After the consultation, and even after an earlier version of the regulations was laid, the legal profession raised concerns about the potential impact of the regulations on the use of English law. As hon. Members will know, English law is one of this country's most valuable exports and forms the basis for contracts in areas as diverse as aircraft leasing, project finance and infrastructure.

We listened carefully to those concerns and my predecessor, my hon. Friend the Member for Stourbridge (Margot James), withdrew the instrument so that they could be properly considered. Following extensive discussions, I am glad to say that these regulations incorporate changes that meet those concerns. I thank all those involved from the City of London Law Society and the trade body UK Finance who have ensured that the original aim was met without putting at risk the position of English law as the leading choice of governing law for international agreements.

The regulations will set suppliers free to access invoice finance when they wish, without being prevented from doing so by their customers. They will do this while preserving the attractiveness of English law overseas and they will bring significant benefits, with a net present value to business of £966 million.

Fiona Bruce (Congleton) (Con): On a point of order, Mr Sharma. Having heard the introduction to the debate, I draw hon. Members' attention to my entry in the Register of Members' Financial Interests. I am a member of an SME LLP firm, but it has had no involvement with invoice finance in relation to its own contracts during the whole of its existence.

John Stevenson (Carlisle) (Con): Further to that point of order, Mr Sharma. I am also a partner in an LLP, but we are not involved in the discussions that the Committee is considering. I refer hon. Members to my entry in the Register of Members' Financial Interests.

The Chair: Thank you very much.

4.39 pm

Bill Esterson (Sefton Central) (Lab): It is always a pleasure to serve under your chairmanship, Mr Sharma. We are reminded that this place is chock full of lawyers—what would we do without them? Answers on the back of a postcard, please. I welcome the Minister to her first Front-Bench duty. As she said, we share a common heritage on the banks of the Medway—she is my dad's MP, in fact. It having been a secret ballot, I cannot possibly divulge whether he voted for her. She and I were also Medway councillors before coming here.

Invoice financing can be described as the process of borrowing money to improve cash flow. The regulations suggest a potential demand 10 times that which is currently met through the use of invoice financing by smaller businesses. However, the Minister used the phrase "unintended consequences" in her remarks, and I caution that we need to beware of the potential downside of overuse of invoice financing—at the moment, an estimated 40,000 businesses use it. I say that because customers who see their suppliers relying or over-relying on invoice financing could and sometimes do question their stability. There is a balance to be struck in deciding whether to use something such as factoring, or the assignment of receivables, which is the correct legal term.

There is also a cost to using invoice financing, which is estimated at between 0.5% and 5% of the value of the invoice. As the Minister rightly said, one clear benefit of these regulations is the likely reduction in those costs, because of the reduction in risk and in the time taken up in applying invoice financing. Nevertheless, there is a cost, and it applies only because firms are having to use invoice financing in the first place, because there are alternatives. I shall spend a little time talking about some of them.

As the explanatory memorandum on the regulations tells us, invoice financing is related to cash flow. Note 7.1 describes the importance for businesses of "having adequate cash flow", but in the same sentence that is set against the requirement to

"access…external sources of finance in order to invest and grow."

It is very important to recognise the difference between funding and finance for cash flow on the one hand and longer-term finance for investment and growth on the other. They are very different, and the sources of finance should be very different—they cost very different amounts. Invoice financing is not the answer to long-term finance for investment or growth. The phrasing of the explanatory note is a little misleading, as it could suggest that invoice financing plays a part in long-term investment for growth.

Invoice financing is used for cash flow, but in many cases the question is why, because if customers pay promptly, there is no need to use it. We have faced the scourge of late payment in this country for far too long. In my three years on the Front Bench, I have spent a lot of my time discussing it. We have tried at length to address the topic in a couple of the Bill Committees on which I have served. It is the role of the small business commissioner to look at the problem, but his powers are very limited—they are limited to signposting and he has no powers to intervene. I have argued in Committee that he should be given such powers and I will return to that point later. The regulations have the potential to be a distraction from the problem of the lack of prompt payment.

We have a prompt payment code to which many large firms are signatories, but the reality is payment in 60 days—there is a 30-day payment term for Government contracts. The problem is how the code is enforced through the supply chain. As we saw with Carillion, far too often small firms were being paid late and the payment terms were not being enforced. Carillion, which was a signatory to the prompt payment code at the time, extended its payment terms to 120 days from the 60 days of the code. There is a requirement to publish performance against the prompt payment code, but the code is voluntary and therefore there is no assurance of compliance and, in any case, the 60-day requirement is that 95%, not 100%, of invoices are paid within that time.

The Federation of Small Businesses wants better access to invoice financing, and I agree with it, but it is also concerned about late payment. It estimates that large firms owe £6,142 to their small suppliers. It has campaigned on that for 10 years, but the concern remains that large firms use their smallest suppliers to help their cash flow by delaying payments. Some 40,000 firms use invoice discounting, but 50,000 go bust every year as a result of late payment. Thirty-seven per cent. of Federation of Small Businesses members are experiencing cash-flow difficulties, 30% use overdrafts to manage their cash flow and 20% are experiencing a slowdown in profit growth. Welcome though the proposals are, the figures the Minister cited from the explanatory notes estimate the financial benefits of the measure to be in the tens of millions of pounds, rising to the hundreds of millions which, in terms of the economy, are very small benefits.

Invoice financing has its place. Making it harder for large customers to prevent its use is helpful, but that is not the whole answer to the challenges of SME finance. I am struck by the fact that, according to the Federation

[Bill Esterson]

of Small Businesses, only 9% of businesses approached their bank for finance in 2016. That is a tiny figure. There is a real problem in accessing finance. Today's measures will address a small part of that problem but there is the bigger challenge of improving both access to finance for long-term investment and growth and the terms and reality of the payment of invoices.

We need a system with teeth. I have on many occasions recommended the Australian system of buying in arbitration, with fines for persistent late payment—a recommendation that found its way into Labour's manifesto last year. Highways England uses project bank accounts, and I encourage the Minister early in her term of office to use her influence to have them considered much more widely for large Government contracts. They protect against insolvency and improve the reliability and promptness of payment.

I support the proposed change and the Opposition will not oppose the regulations, which lower costs and risks, but I repeat the call I have so often made that we need to improve payment practice. The Government must lead by example through Government contracts and by enforcing terms through the supply chain and helping with access to finance. That is how we will deliver the support that our SMEs need.

4.48 pm

Kelly Tolhurst: I am grateful for the Committee's consideration of the regulations, and to the hon. Gentleman for his contribution to this important debate. I will touch on a number of the elements he rightly brought up.

The hon. Gentleman is absolutely correct that there are two types of benefit to invoice financing: a factoring element and a discounting element. He is also right that it is one tool within the overall finance packages from which businesses are able to draw. The measures before us will aid the growth of invoice financing so that where suppliers want to enter into a contract agreement with invoice financing, nullifying the term allows them to do so. However, invoice financing on its own does not solve the problems with accessing finance. It is one tool—the regulations try to widen the scope for businesses to access it, but there are two different elements.

It is true that many small businesses have applied for finance with banks, but many have not. They decided that they would rather stunt their growth than borrow because of the fears around long-term borrowing. We know, however, that they will often be willing to improve their cash flow, which enables them to grow and invest. Without the ability to access invoice financing, many small businesses would not be able to take up the contracts that they want to, which enable them to grow.

Rushanara Ali (Bethnal Green and Bow) (Lab): The Minister will be aware that there is a shortfall in lending to SMEs of £35 billion relative to the pre-crisis period. She referred to just under £1 billion that would be made available through this policy, which is welcome, but is a drop in the ocean compared to the bigger challenges facing SMEs. SMEs have created 2 million jobs since 2010 and power our economy. With the uncertainty of Brexit, life will get worse for SMEs. Will she say something about the broader picture of what the Government will do to address the pre-crisis gap of £35 billion? That is the bigger question that the Government need to address. Lots of work had been done to address the lending issues facing small businesses, but as she knows from her impact assessment, it has not happened to the extent that it needs to.

Kelly Tolhurst: The Government are looking at many different ways to increase small businesses' access to finance. Having run a small business, I know how crucial that is. While this statutory instrument represents just under £1 billion of net present benefits, it is a gain. Because we are making this decision, this element of finance will be available to more SMEs, which can only help. It will also aid the ability of new invoice financers to come into the marketplace, which we welcome, because that brings more jobs and more receipts into the Exchequer.

I have covered the cash-flow issue. Many businesses will not now take an overdraft. Instead they can take out finance invoice and manage their business needs as a small business. It is difficult for small business owners to get access even to what we might regard as small sums, so many suppliers will use this as an ongoing tool. Factoring may suggest that a company has been in financial difficulties. That factoring can now take place on a private and confidential basis, so that customers are not aware of that financing on their faced invoices.

The hon. Member for Sefton Central mentioned the small business commissioner, whom I was pleased to meet for the first time last week. He is doing wonderful work with small businesses in the battle against late payments to ensure that they can receive some of the moneys they are owed. The hon. Gentleman is right to mention the prompt payment code, particularly in relation to Carillion. However, he will know that we are looking to consult widely on late payments. Since I have been in my post I have been particularly concerned about that, so I have been looking at it personally. I look forward to launching that, so that we can assess it and, as a Government, take forward more measures to help small businesses.

We all agree that businesses should be able to access the finance they need, choosing whatever options are most suitable for them. The Government are committed to ensuring that businesses can secure the finance they need to invest and grow. It is not about favouring one type of finance over another. Invoice finance will not be the right choice for every business, but that should be a decision made by individual entrepreneurs, not made for them through onerous terms imposed by their customers. The regulations ensure that restrictive terms will no longer apply to SMEs while protecting freedom of contract for large enterprises. That change will allow thousands of small businesses to access invoice finance for the first time and will reduce the cost for existing and new clients alike. I commend the regulations to the Committee.

Question put and agreed to.

4.56 pm

Committee rose.