Early Payment Schemes

EPS have been introduced with varying degrees of success by a number of Tier 1 Contractors (**Buyer**) over the past few years as a response to the Government initiative on Fair Payment terms within the Construction Industry.

In essence all EPS share a common goal, which is to allow access of the supply chain (**Supplier**) to relatively inexpensive finance without necessarily affecting other lines of credit or borrowing.

The principle is that the Buyer, due to its superior credit worthiness enters into an agreement with the funding bank to extend an EPS to its suppliers. The lending bank is therefore prepared to advance the Supplier early funds based upon the promissory note provided by the Buyer, namely the certified payment certificate.

This promissory note being the surety that the supplier will have access to the funds at some point in the future. Due to the perceived low level of risk the lender is able to advance the funds to the supplier at preferential rates and usually much lower than the supplier would obtain if left to its own devices.

When payment becomes due the Buyer pays the money to the lender bank and the debt is settled.

This simple agreement in principle is very effective in ensuring cash flows through the supply chain. For the Buyers part, his is undertaking to ensure that when he issues the certification the works are properly carried out, as his own reputation with the lender bank would be materially affected if on a regular basis the certificate upon which the bank relied to release payment was under paid.

For the Supplier the small cost of finance is affordable compared to other invoice factoring products and payment is virtually assured.

A further perceived benefit is the reduced likelihood of the Buyer to pay less just a few days before payment becomes due, as they will have the added problem of explaining to their Bank why their promissory note could not be relied upon.

So what went wrong?

In some instances the Buyer has used the fact that they have become the gateway to cheap finance for their supply chain, that they have extended their terms from 30-40 days to 90 days thus realising 50 days of free working capital at no cost to themselves and minimal cost to their supply chain.

One Buyer organisation openly justified extending terms by 50 days by stating that it had realised and additional £180million of working capital which it had now used to fund more profitable Development projects for the benefit of its Supply Chain!

The payment is a secured loan to the supplier, and whilst the lender should have done its due diligence and only be offering the scheme where the credit worthiness of the Buyer is without reproach, the debt is still with the supplier and therefore in the event that the Buyer ceases to trade and cannot honour the payment certificate the Supplier has a debt to the lender which must be settled.

In the case of Carillion, the unthinkable happened to the Buyer, and the scheme has failed because the Buyer can no longer honour its promissory notes so the lending bank is now looking to the Supply chain member to repay the now unsecured load made against the Carillion payment certificate.

The scheme is not without precedence, elsewhere in Europe, prior to the global financial crash of 2008, in Spain Contractors routinely paid its accounts in 180 days, but issued a promissory note (Confirma) to its supply chain within 30 days, and this could be used to draw down payment early, for a nominal rate of interest.

In 2008 when hitherto sound Contractors started to suffer financial collapse, many of its supply chain not only found its customers were going out of business, but also they became liable for debts up to 180 days after the works were completed.

In 2010 the Spanish government acted to remove this form of payment scheme and move to a legal maximum payment term than could not be extended by contract or negotiation.

There should be no doubt that EPS when properly administered and fairly enacted provided much needed financial support to SME where other streams of borrowing don’t exist or are too expensive. The lending bank however has a duty of care to properly administer the account and remain vigilant to the activities of the buyer. The Buyer must curtail the use of the facility to allow for good cashflow through the supply chain and not to extend payment terms to maximise its own working capital betterment