Better Buying™

Special Report

Better Buying Institute, June 1, 2020

Payment and Terms and the Need for New Practices

Introduction

COVID-19 caused significant supply chain disruption and eventually brought the apparel and footwear industry to a screeching halt in the first quarter of 2020. With an onslaught of order cancelations, payment term extensions, and shipping delays, suppliers have faced massive risks to their cash flow and business continuity, and workers in their factories, many of whom are women, have lost work. Prior to resuming production, the industry needs to confront prevailing payment and terms practices that may no longer be fit for purpose as we collectively discover a 'new normal' that addresses economic, social, and environmental sustainability.

This Better Buying™ Special Report is second in a series of reports detailing the impacts of COVID-19 and exploring solutions for recovery. In this report, we share findings from recent global supplier surveys about the current payment and terms landscape, the impact of these practices on suppliers and workers, and a new vision for minimally acceptable payment and terms practices. Background data come from Better Buying's annual data collection that took place in Q4 of 2019 that involved 784 suppliers. This has been updated with new data gathered from suppliers around the world who were invited to complete a survey during the period of May 6 through May 20, 2020. Overall, 179 suppliers from 30 countries participated in the May survey.

Key Takeaways from this Report

Sixty percent of suppliers say workers' employment has been impacted by their customers' poor payment and terms practices. This impact falls disproportionately on women.

Regional differences expose how suppliers are experiencing COVID-19-related payment and terms practices differently. Suppliers in Bangladesh have borne the brunt of order cancelations.

Most suppliers believe that minimally acceptable payment and terms practices should be expected of buyer companies. High priority practices include requiring supplier approval for chargebacks or other payment reductions, digital settlement, and payment at sight or upon providing shipping documentation.

Our Evidence

Background on Payment and Terms Practices

Good payment and terms practices are necessary for suppliers' business profitability, as well as their ability to pursue social responsibilities to workers and improve environmental performance. COVID-19 brought about reactive payment and terms practices by retailers and brands trying to manage the crisis at hand. However, it is helpful to understand typical payment and terms practices prior to the pandemic as these were already problematic. COVID-19 amplifies these problems and presents significant challenges for suppliers' ability to recover. The following sections discuss common payment and terms practices across 49 companies rated by suppliers in data collected during Q4 2019. Many of the companies rated are ones that engage with Better Buying and are actively working on improving their purchasing practices. Thus, the data shared here, may reflect a "better" picture that what occurs in the broader apparel, footwear, and household textiles industry.

Length of Payment Terms

Suppliers incur development and production costs that are not recouped until well after shipment of finished goods. The length of payment terms determines how long after shipment suppliers wait for their customers to pay for those goods. Forty percent of suppliers reported terms of over 60 days, and 2.4% reported terms of 120 or more days. The most frequently reported payment terms range was 30 days or less (reported by 26.1% of suppliers), followed by terms of 46 to 60 days (17.0%) and 31 to 45 days (16.6%).

Payment on Time

At the most basic level, on-time payment involves paying invoices in accordance with previously agreed upon terms. On average, 69.1% of suppliers reported their buyer paid all bulk invoices within the specified terms. When delayed, payment was made 26 days late on average. Payment timing can also be impacted by shipping delays, as shipment of finished goods is the point at which the specified payment terms (i.e. 45 days) begin. One supplier commented, "Sometimes we experienced 1 or 2 months delay of shipment. It caused late payment and negative impact on cash flow." In such a situation, maintaining the original payment terms despite delaying shipment is harmful for suppliers and impairs their ability to adhere to their business projections.

Payment in Full

Beyond delays in receiving payment, suppliers often face unexpected reductions to the payments indicated on purchase orders or other agreements with their customers. Better Buying™ collects data about types of payment reductions that were made despite no fault of the supplier, such as poor sales or currency fluctuations that disadvantage the buyer. Around 22% of suppliers reported that not all their bulk order invoices were paid in full, with the most common reasons for payment reductions being late or unsubstantiated claims of quality defects (30.1%), late shipment due to inadequate lead time (27.5%), and unsubstantiated claims about packing (21.8%).

Working Capital Invested in Customers' Orders

Across the 581 softgoods suppliers that submitted optional working capital data in Q4 2019, a total of US$6 billion was invested in their customers' orders and waiting for payment. This amounts to an average US$10.4 million per buyer-supplier relationship, with individual suppliers reporting values ranging from US$0 to US$540 million.

Payment and Terms Practices During COVID-19

Knowing that suppliers were already facing substantial financial pressure due to payment and terms practices that were commonly carried out prior to COVID-19, Better Buying™ collected data to better understand whether these practices are becoming even more challenging as a result of COVID-19 and how they've impacted suppliers and workers.

A total of 94 suppliers chose to report about particular customers' payment and terms practices. Overall, suppliers reported on 56 customers' practices - most suppliers (71.4%) reported about one customer's practices, while the balance of suppliers reported two or three customers' practices. Most of these customers are headquartered in the United States (55.4%), followed by the United Kingdom (12.5%) and Germany (7.1%). They primarily belong to the Apparel, Accessories, and Luxury Goods buyer type (35.7%), followed by Apparel Retail (30.4%), General Retail (16.1%), and Department Stores (8.9%). In total, the value of existing purchase orders and accounts receivable suppliers have with the customers about whom they reported amounts to US$548.7 million. To put this into context, this equates to 56.0% of the value of suppliers' total shipments to these specific customers in the last year. The total value of uncut raw materials currently on hold for these customers is about US$266.6 million. These values represent working capital that is currently tied up for suppliers and, due to the payment and terms practices currently being employed due to COVID-19, increasingly at risk.

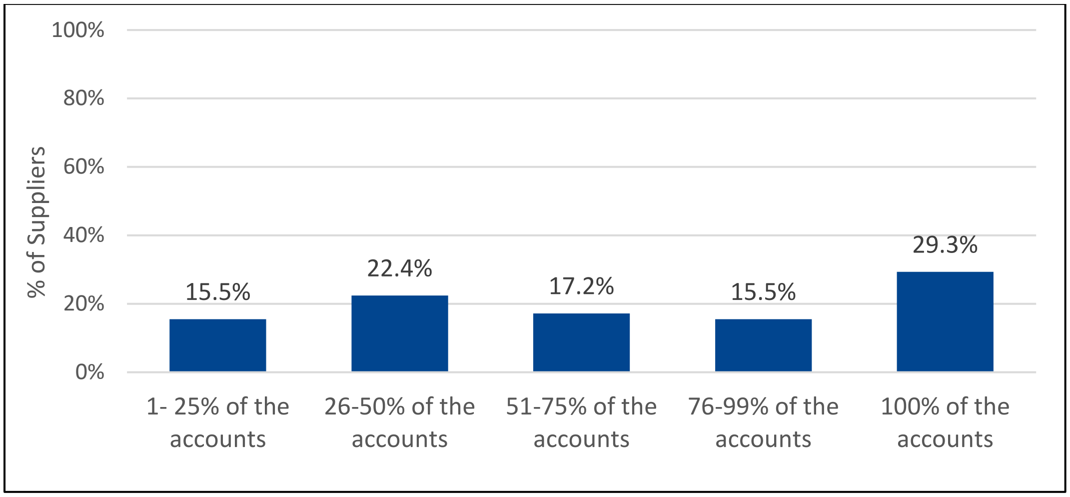
The following sections explore findings related to the practices suppliers have reported are most impactful: payment on time and in full.

> *56.0% of the value of suppliers' total shipments to these specific customers in the last year is currently on hold – and increasingly at risk*

Payment on Time

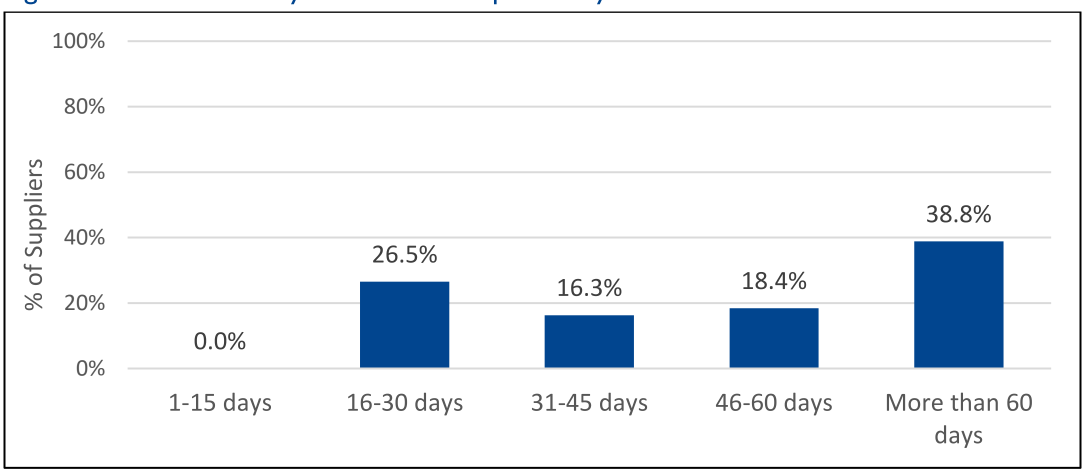
Most suppliers (61.7%) reported that at least some portion of their accounts receivable is past due. Of these suppliers, the most frequently reported response was that 100% of their receivables are past due (29.3%), with another third of suppliers reporting at least 50% past due (Figure 1).

Figure 1. Percent of Total US$ Value of Customer's Accounts Receivable Past Due



Timing of payment has also been impacted by customers requiring term extensions, as reported by more than half of suppliers. These suppliers have already incurred costs through development and production; now they will have to wait even longer to be reimbursed. Meanwhile, they continue absorbing overhead and labor expenses that have to be paid. About 39% of these suppliers have received term extensions beyond 60 days, meaning they are now waiting for payment at least 60 days longer than what was agreed upon in their original payment terms (Figure 2). Another third of these suppliers reported extensions of 30-60 days.

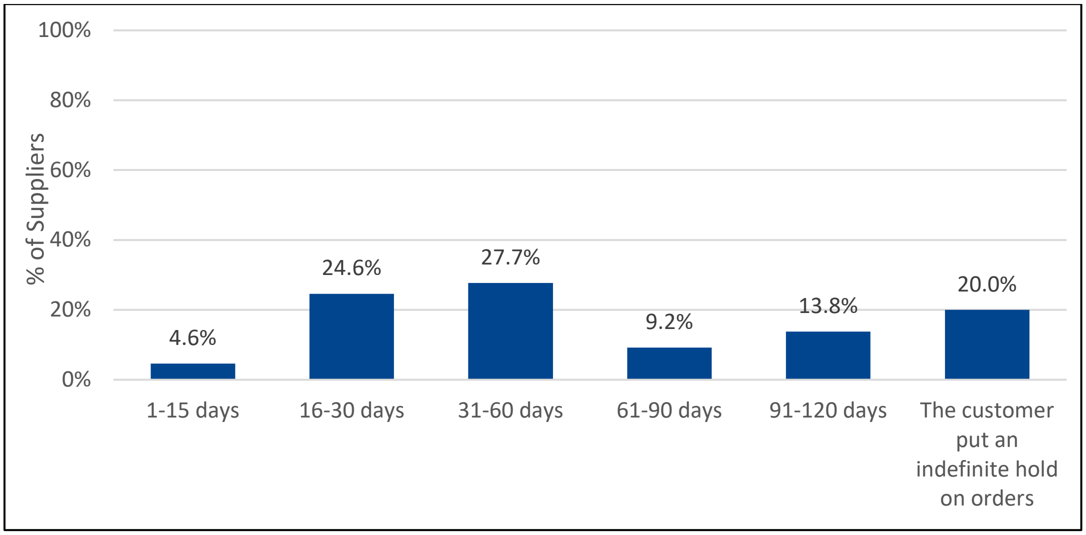
Figure 2. Number of Days Customer Required Payment Terms be Extended



Suppliers reporting larger amounts of their accounts receivable past due also reported that shipping dates had been pushed back for longer periods of time, leading to compounded financial pressures on affected suppliers

Another way the timing of payment to suppliers has been impacted is through their customers pushing back ship dates for existing orders. Most often, the timeline indicated by payment terms does not begin until, at the very least, finished goods have been shipped. Therefore, even if payment terms are not extended, shipping timelines can have a similar impact on the length of time suppliers are waiting for payment. Requirements to push back shipping dates were reported by 69.1% of suppliers. Twenty percent of these suppliers reported their customers have put an indefinite hold on shipments, while about half of these suppliers are facing delays of between 30 and 120 days (Figure 3). Better Buying™ found that suppliers reporting larger amounts of their accounts receivable past due also reported that shipping dates had been pushed back for longer periods of time, leading to compounded financial pressures on affected suppliers.[1]

Figure 3. Number of Days Customer Pushed Back Shipping for Existing Orders



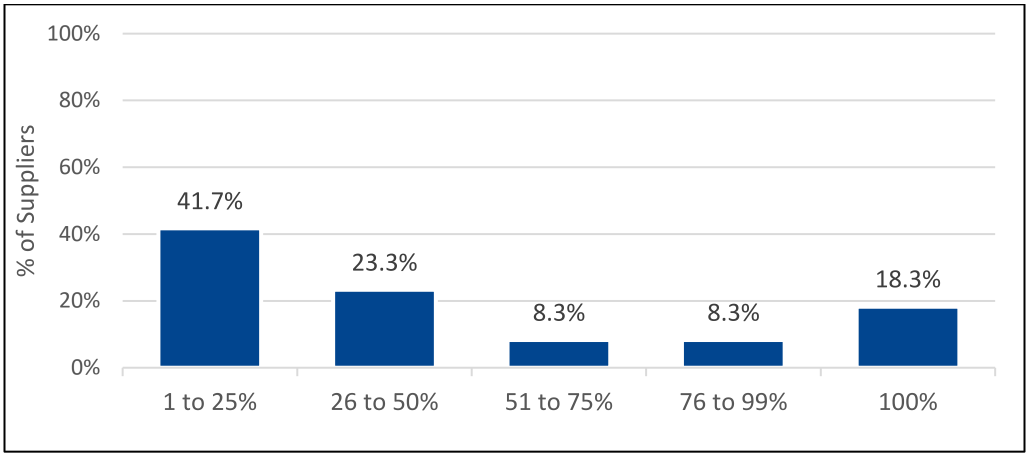
63.8% of suppliers have received cancelations from the customers about whom they chose to report

Payment in Full

Unfortunately, many companies have resorted to outright cancelation of orders, meaning suppliers will not receive any compensation - even if goods were ready or in progress. This has been a major topic in the industry lately, and Better Buying™ found that 63.8% of suppliers have received cancelations from the customers about whom they chose to report. Suppliers most frequently reported that up to 25% of their accounts receivable has been lost due to cancelations, while another 18.3% of suppliers reported a complete loss of their accounts receivable from the customer about whom they reported (Figure 4).

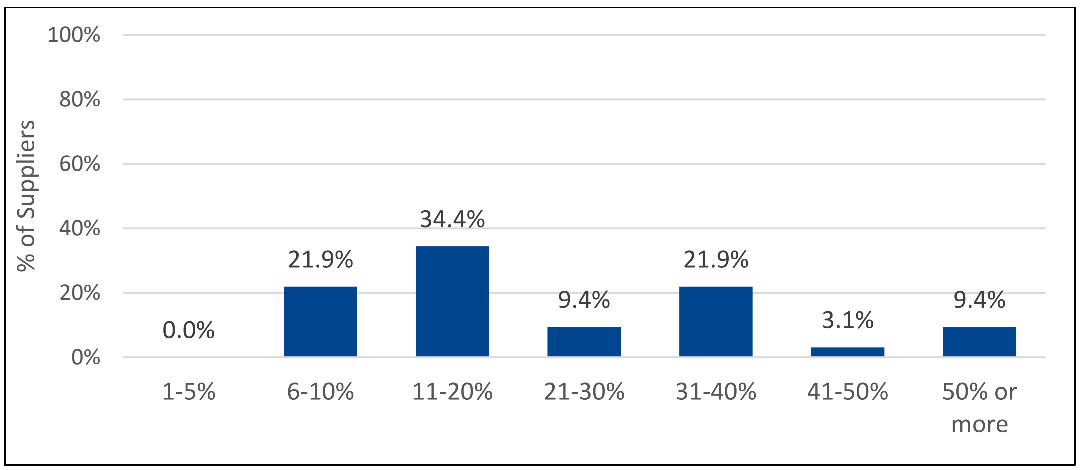
[1] Pearson's r=.33, p=.036

Figure 4. Percent of Total US$ Value Lost to Order Cancelation



Even when orders are not completely canceled, reports of customers requiring payment reductions for both current and future orders, and even for orders that have already shipped, have been circulating in the media for several weeks. Our findings confirm these reports, as 34.0% of suppliers have had the customers about whom they reported require reductions - about a third of these suppliers have faced reductions of more than 30% (Figure 5).

Figure 5. Percent Price Reduction Required on Purchase Orders/Accounts Receivable



In light of such elevated risk related to payment, it is concerning that only 17.0% of suppliers could confirm they have some form of insurance that guarantees payment for orders in the event that these customers default on their contractual obligations. Most suppliers (57.4%) do not have such insurance, a fact that could prove disastrous as more brands and retailers file for bankruptcy or continue making decisions on the basis of their own short-term financial interests.

"Their actions have been despicable and unethical"

Qualitative Findings

In their open-ended comments, suppliers expressed frustration at how these customers have handled the COVID-19 crisis. Multiple suppliers highlighted an increase in single-handed directives from their customers without opportunities for negotiation or dialogue: "We heard no news...no response at all." This issue intensifies for suppliers whose customers have filed for bankruptcy. One supplier described how its customer has "been unresponsive to any enquiry or email with no contact given or any advice. As far as we are aware, the orders are canceled and will not be requested to be delivered in the future." Regarding this customer's lack of transparency and partnership, this supplier asserted, "Their actions have been despicable and unethical."

Other suppliers reported multiple methods their customers have used to shift the burden of the crisis further upstream. With an "arbitrary attitude towards the suppliers," some buyers have resorted to "cancelation of orders without any discussion, ignoring the fact that goods are partially, fully made, or en-route [to] port." One supplier reported their buyer engaged in the "opposite of 'partnership' behavior," saying they are the "most demanding on sustainability yet least understanding of the COVID implications," exercising "zero tolerance, threatening cancelations always." Another described its buyer's opportunistic approach to the crisis, "not paying previous dues, but taking discounted goods from other factories that were canceled by other retailers." This supplier concluded, "That is the most unethical practice a brand can do."

While suppliers' frustration is palpable, several suppliers expressed their willingness to work with their buyers to address the issues they face. These suppliers simply asked for a shared approach. For example, one supplier said, "As we are aware summer product selling is over, it is justified to help [the] customer for summer product but it is unfair to ask for 20% discount on all future orders placed."

Impacts on Workers

The aforementioned practices create a downward squeeze on suppliers, but the impacts do not end there; these practices leave workers in an especially precarious position. In general and due to the long payment terms that are standard practice in the industry, the payment suppliers receive from their customers for work already completed needs to cover ongoing wages, social security contributions, benefits, maintenance of safe working conditions, and adherence to social and environmental compliance standards (as well as overhead and other operating expenses). With delays and reductions - especially when these have been single-handed decisions by the customer without opportunities for fair and transparent dialogue on shared solutions - a supplier's ability to cover these costs is severely jeopardized.

Profile of a Company with Bad Practices

To illustrate how these poor practices can be simultaneously employed within a single company, Better Buying™ compiled seven supplier ratings for one company, "Company DS," that is a Department Store based in Europe/United Kingdom. In total, 86.0% of the suppliers reporting about Company DS's payment and terms practices indicated the customer had canceled orders with them. For most of these suppliers (83.3%), these cancelations resulted in a complete loss of their open accounts receivable with Company DS. All of Company DS's suppliers reported their accounts receivable from the customer was past due. Most frequently, either 100% or 51-75% of the value of accounts receivable past due, each reported by 42.9% of suppliers. Company DS required payment term extensions for 71.4% of suppliers, with 60.0% reporting extensions of more than 60 days. Required price reductions on purchase orders or accounts receivable were reported by 57.0% of Company DS's suppliers. A quarter of suppliers faced reductions of 50% or more off the prices in the purchase orders, while the remainder reported price reductions between 21-40%. Company DS pushed shipping dates back for 57.1% of its suppliers, with half reporting an indefinite hold had been placed on these orders. None of Company DS's suppliers reported any form of insurance that would guarantee payment if the company defaulted on its contractual obligations.

Most of Company DS's reporting suppliers (85.8%) employ between 251-5,000 workers, and 42.9% reported that at least half of their workforce is women. Due to Company DS's poor payment and terms practices, nearly one-third of suppliers have had to lay off between 26-75% of their workforce.

Each poor practice creates a financial squeeze on suppliers, but when a supplier has to cope with multiple poor practices simultaneously from multiple customers, the effects can be disastrous for suppliers' businesses and workers. Any sustainability program has to address these harmful practices in order to achieve its goals and protect both people and planet.

Of the suppliers surveyed, over half (51.1%) employ more than 500 workers (Figure 6). The most frequently reported workforce size was 1,001-5,000 workers (31.9%). These workers are mostly located in China (34.0%), Bangladesh (24.5%), Vietnam (12.8%), and India (9.6%). A small portion of suppliers (2.1%) have laid off all of their workers, and over half have had to lay off up to 50% of their workforce. For 40.4% of suppliers, employment has not been impacted (Figure 7).

Figure 6. Number of Workers Typically Employed for the Customer's Order

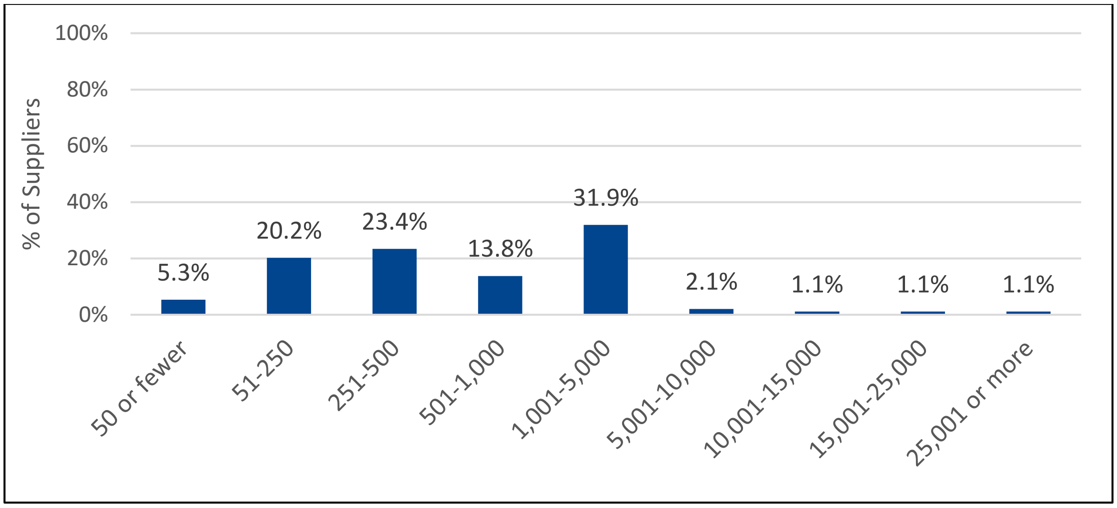
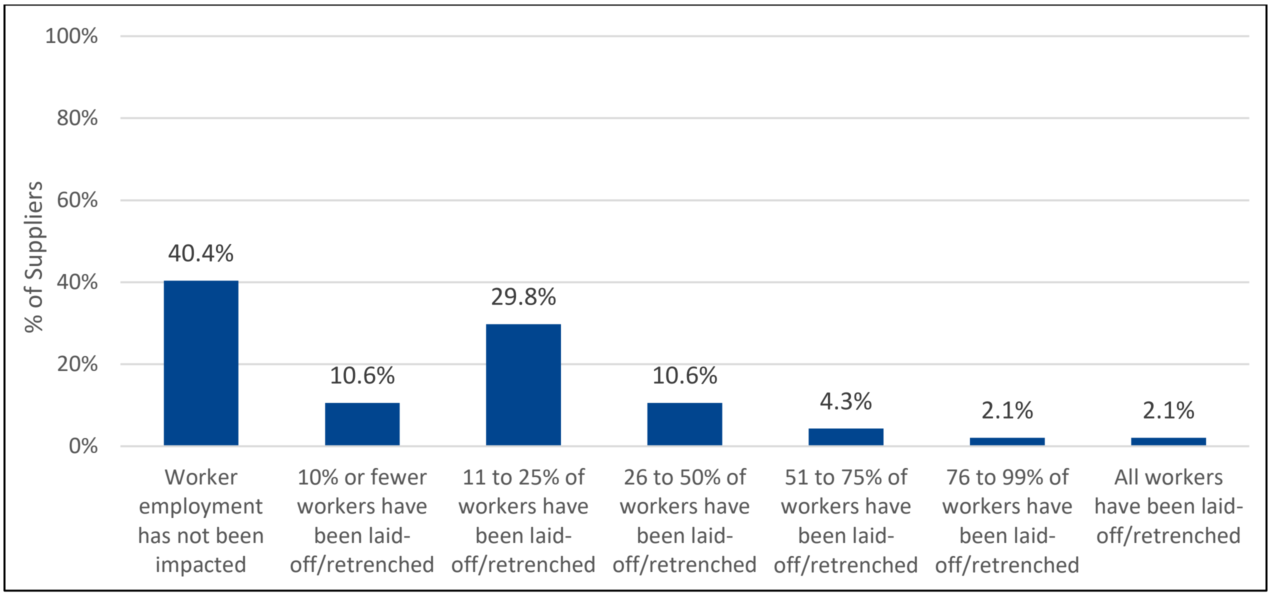


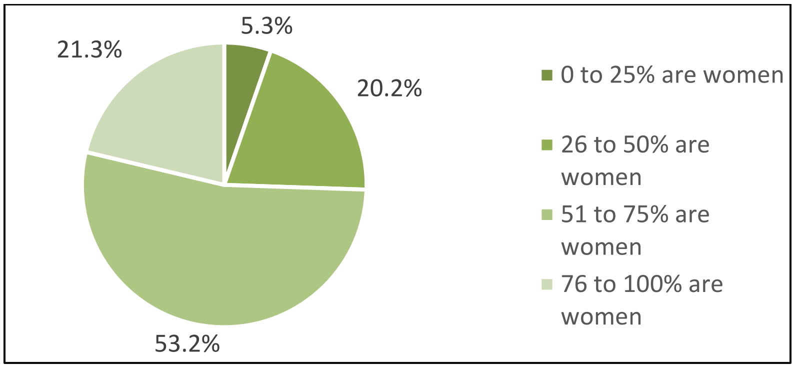
Figure 7. Employment Impacts on Workers as a Result of Customers' Payment and Terms Practices



The impacts of these payment and terms practices fall disproportionately on women. Over three-quarters of suppliers reported that more than half of their workforce is women (Figure 8). Any company with commitments around protecting women in their supply chains cannot ignore the impact of their recent payment and terms practices on women's employment, wages, and livelihoods.

The impacts of these payment and terms practices fall disproportionately on women

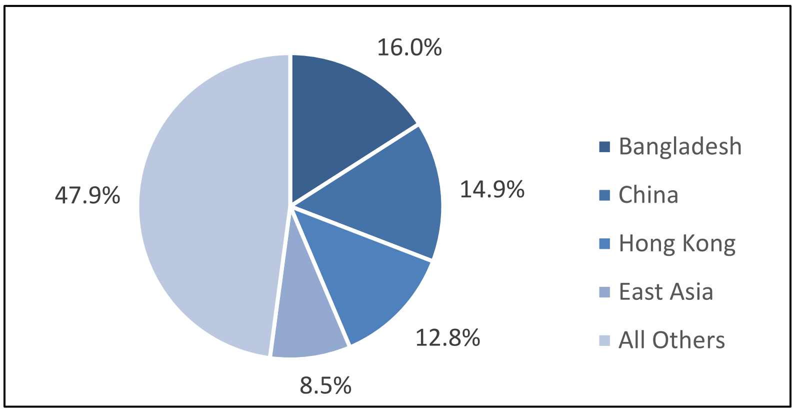
Figure 8. Percent of Women Workers



Regional Analysis

The five countries or regions with the largest survey participation included Bangladesh, China, Hong Kong, and East Asia. Responses from suppliers headquartered in other countries or regions, including India, the United States, Pakistan, Japan, and others, were grouped into the 'All Others' category. Figure 9 shows participation rates for these countries/regions.

Figure 9. Five Countries/Regions with Largest Participation



Note. East Asia includes Singapore (1.4%), South Korea (5.7%), and Taiwan (4.3%). All Others include El Salvador (1.4%), India (5.7%), Japan (4.3%), Mauritius (1.4%), Mexico (1.4%), Netherlands (1.4%), Pakistan (4.3%), Turkey (1.4%), United Kingdom (2.9%), and United States (5.7%).

Better Buying's analysis exposed how COVID-19-related payment and terms practices have not been uniformly applied across sourcing destinations. Statistical analysis revealed significant differences on a few key practices: order cancelations (Figure 10),[2] accounts receivable past due (Figure 11),[3] and required shipping delays (Figure 12).[4] Bangladesh had the largest percent of suppliers reporting a portion of their accounts receivable had been lost due to order cancelations (80.0%). Suppliers in 'All Other' countries reported accounts receivable past due more often than the other countries/regions under analysis (75.6%). Required extensions to shipping dates were most frequently reported by suppliers in East Asia (87.5%). No significant regional differences in employment impacts due to these poor practices were observed.

[2] Pearson's Chi-square=11.70, p=.020, n=94
[3] Pearson's Chi-square=12.43, p=.014, n=94
[4] Pearson's Chi-square=11.24, p=.024, n=94

Figure 10. Regional Differences in the Value of Accounts Receivable Lost to Order Cancelation

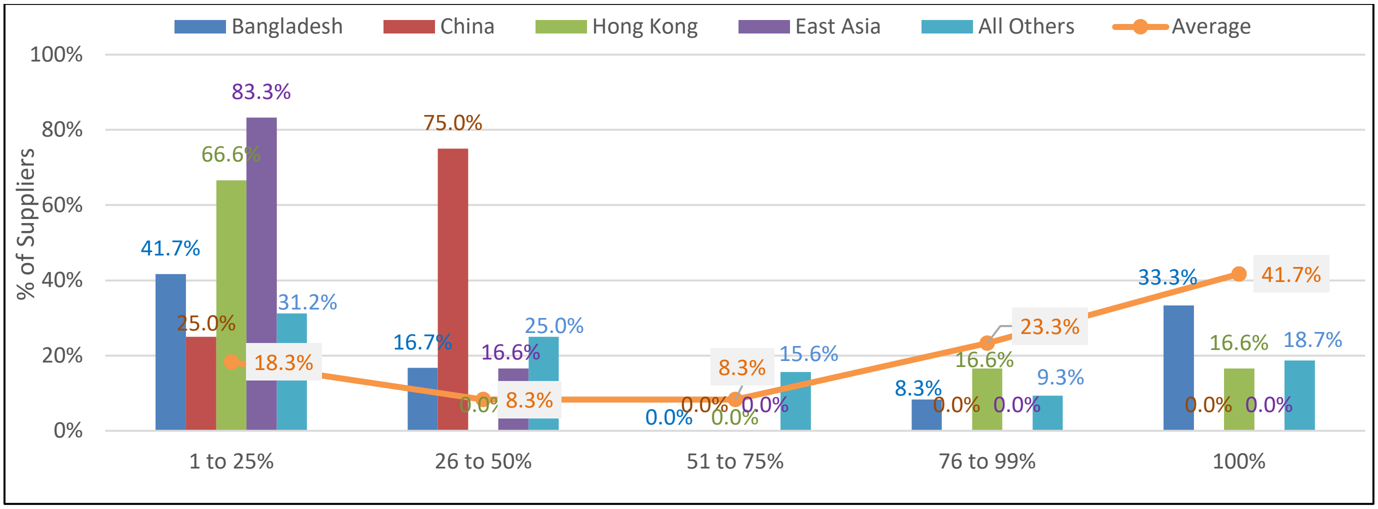


Figure 11. Regional Differences in Percent of Accounts Receivable Past Due

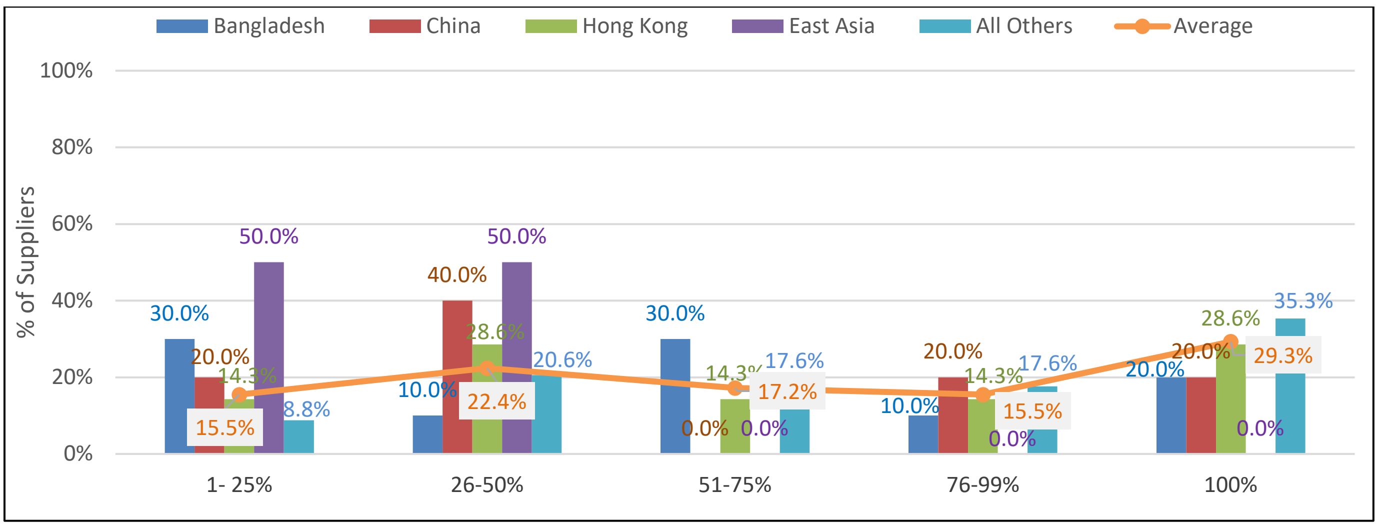
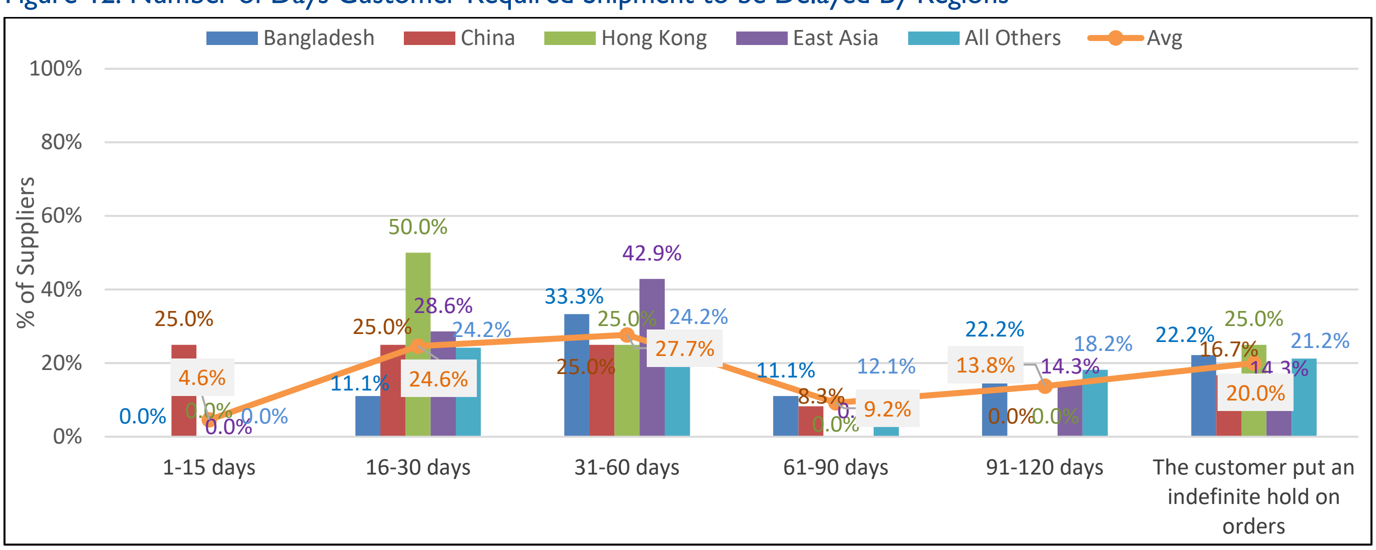


Figure 12. Number of Days Customer Required Shipment to be Delayed By Regions



These differences are important to consider during the recovery phase, as suppliers in different countries and regions have experienced the impacts of COVID-19 in different ways and to different degrees. Some suppliers might be able to start producing again as soon as their customers are ready to place orders, while others might need substantial assistance if they are to stay in business. Rather than applying a blanket approach to supply chain recovery and stabilization, understanding and acting in accordance with these regional differences will lead to beneficial impacts for suppliers and workers.

Suppliers are facing the cumulative effects of all their customers' practices during this crisis

The findings from this global survey are valuable for increasing the industry's understanding of the impacts of COVID-19-related payment and terms practices on suppliers. However, buyers need to investigate what is happening with their own suppliers to enable effective solutions. Suppliers are facing the cumulative effects of all their customers' practices during this crisis, and therefore there is not one universal supplier experience. Engaging directly with suppliers is the best way to understand their needs and identify mutually beneficial solutions.

Best Practices

Suppliers were asked to share specific examples of customers that demonstrated best partnership practices in their handling of the COVID-19 crisis. Specifically, suppliers shared the actions their customers took that and the impact these actions had on their business and workers. A total of 27 suppliers provided this information about 22 buyer companies. Most of these customers are headquartered in the United States (31.8%), followed by Netherlands (13.6%), Germany (9.1%), and the United Kingdom (9.1%).

The most frequently mentioned actions included showing true partnership by working together during the crisis, fair payment (including on-time payment, early payment, and payment to cover any outstanding debts), and limiting or completely avoiding cancelations. These themes are outlined in Table 1. A few suppliers also mentioned their customers' flexibility and willingness to adjust shipping dates, and some even had customers place new orders or pivot to production of personal protective equipment (PPE). While many of these actions should be characteristic of buyer-supplier partnerships all of the time, they stand out in the midst of the poor payment and terms practices being employed by some buyers during the COVID-19 crisis. One supplier commented, "We really appreciate that."

Table 1. Actions that Suppliers Consider Best Partnership Practices

Themes	# of mentions	Sample quotes
Showed true partnership	13	Real partnership in crisis;

		Find solutions together along the whole chain True partnership
Fair payment/ paid for raw materials of canceled orders	11	No bad debts; They enabled an early payment plan in collaboration with IFC and Trade Card that allowed vendors to access money as soon as shipments had left port
No cancelation of orders/partial cancelation	7	Zero cancellation; Didn't cancel most of the stock that was already made
Accommodated production timeline/shipment date	5	Very tolerant of covid19 impact in terms of logistics and supply chain delays; FLEXIBILITY WITH ORDERS
New orders booked	4	Giving new order; Quickly rolled out new order category such as emergency supply items; mask, protective gown etc., so we could keep on running the factories. They continued to place emergency item orders (PPE; mask and gown etc), thus letting us keep running the facilities. We really appreciate that.

The impacts of these actions had direct benefits for suppliers' businesses and workers (and arguably their customers) - these themes are outlined in Table 2. The ability to pay workers was the most frequently reported impact, followed by improved supplier cash flow and the ability to keep factories running. Several suppliers highlighted the link between their customers' payment and terms practices and their ability to provide on-time and complete payment to workers, demonstrating how exercising best payment and terms practices can play an important role in social responsibility.

Table 2. Impact of Customers' Best Partnership Practices on Supplier Business and Workers

Themes	# of mentions	Sample quotes
Workers were paid	8	Because of their good payment practice, we were able to pay the wages timely;

		With the released/completed payment of the liability from the customer, we were able to pay the salary to labors without any pending
Financial impacts	7	Our workers can continue working, while we have money to flow while repaying the overdue invoices. The company … could keep their income flowing
Enabled factories/ facilities to keep running	6	As not cancel any qty and getting new order production flow is good; The emergency supply item orders greatly helped both factories and employees keep their income flowing, thus mitigating the impact from Covid 19 situation. We really appreciate that.
Strengthened buyer-supplier partnership	5	Collaborative behaviour builds trust - strong partnership and future growth together BETTER PLANNING BETTER COMMUNICATION
Continued employment for workers	3	The workers are motivated that they have orders to fulfill and also to see that at the same time all safety precautions are in place; Our workers can continue to work

Nearly half of suppliers (48.1%) reported that the best partnership practices of these specific customers led to benefits for at least 1,000 workers. About 52% of suppliers reported that at least half of the workers benefited were women. These workers are primarily located in Bangladesh (25.9%), Vietnam (22.2%), and India (18.5%).

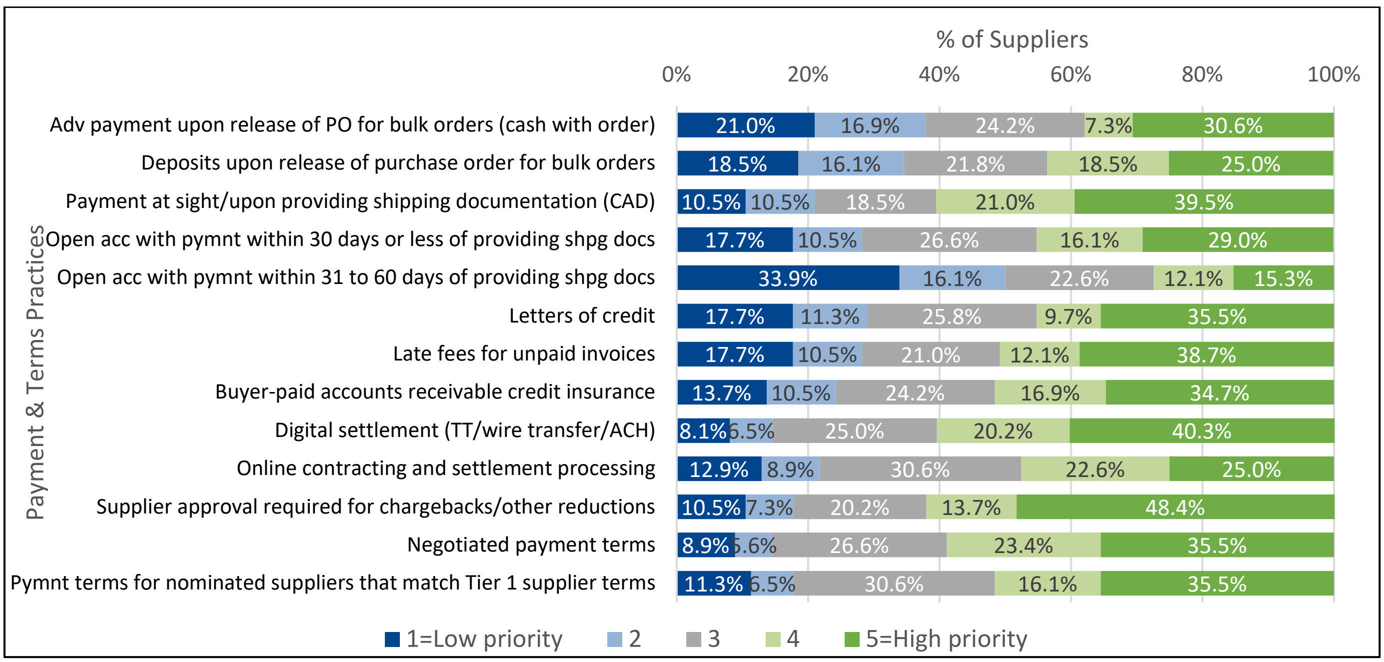
A New Vision for Standard Payment and Terms Practices

The elevated risk brought about by the multiple forms of payment delays and reductions buyers have used to cope with the impacts of COVID-19 will cripple supply chains well into the recovery phase. Due to the expenses incurred during COVID-19 crisis management, some suppliers might not even be able to cope with practices that had served as the industry norm prior to the pandemic. The transition from crisis management to recovery is an inflection point where the industry has a unique opportunity to shape a new and mutually beneficial standard for payment and terms practices. To begin this conversation, Better Buying™ asked suppliers what practices they want the industry to prioritize as we navigate this new normal.

The transition from crisis management to recovery is an inflection point where the industry has a unique opportunity to shape a new and mutually beneficial standard for payment and terms practices

Overall, 179 suppliers provided responses related to industry standards. These suppliers are primarily located in the China/Hong Kong region (26.3%), with the rest in South Asia (18.4%), East Asia (14.0%), US/Canada (12.3%), Western Europe/UK (9.5%), EEMEA (5.6%), Latin America and Caribbean (3.9%), and Asia Pacific region (1.7%). Most suppliers (69.3%) believe that minimally acceptable payment and terms practices should be expected of buyer companies. Figure 13 shows what priority suppliers assigned to each practice. The highest priority practice to implement according to 48.4% of suppliers is requiring supplier approval for chargebacks or other payment reductions, followed by digital settlement (40.3%), payment at sight or upon providing shipping documentation (39.5%), and late fees for unpaid invoices (38.7%). Additional terms prioritized by over one-third of suppliers should be carefully considered as well. No significant regional differences were observed.

Figure 13. Suppliers' Priorities for Minimally Acceptable Payment and Terms Practices



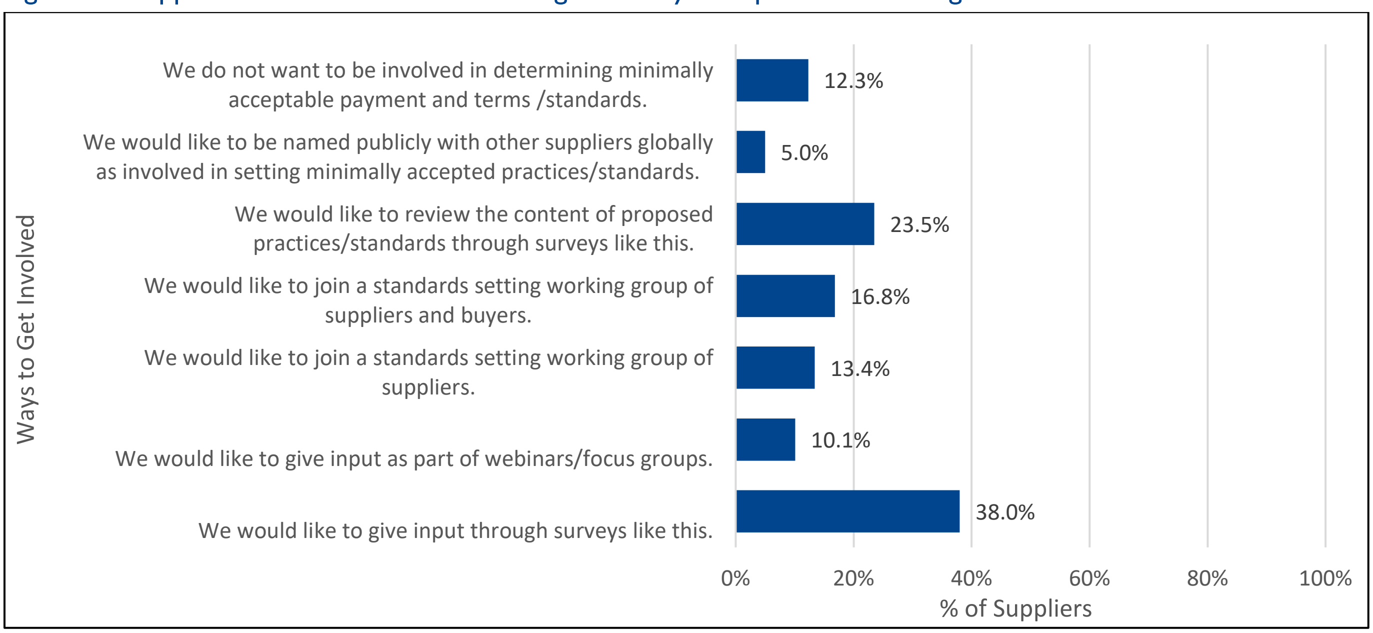
The belief that these practices should become industry standard reflect suppliers' desire for more transparent payment and terms practices, reduced risk to receiving full and timely payments, and for more efficient payment processing. These desires were echoed in suppliers' open-ended comments.

One supplier suggested buyers "give a supplier an option to choose a payment term that fits the supplier's needs, not only the buyer's needs." Others highlighted the need for increased management of nominated suppliers to relieve the tension caused by incompatible payment terms: "While the customers negotiate with the factory for longer credit periods, they should even negotiate with the nominated suppliers for extended payment terms."

Several suppliers asserted the need for payment and terms practices to better align with the business risks they face. For example, "LC should be the only way to do business for high risk trade in RMG." Others asked for deposits on orders: "30% deposit before production and balanced 70% paid against B/L copy for sea shipment." With these changes, suppliers would have improved access to capital at key points in the production process to pay workers' wages and other expenses, protection against poor practices such as those that have been implemented due to COVID-19, and reduced risk to their ongoing business operations.

Now is the time to define these new payment and terms standards. Better Buying™ engaged suppliers about how they would like to be involved in a standard-setting process. The most frequent response (38.0%) was that suppliers would like to continue providing their input through surveys, while 23.5% indicated interest in providing feedback on the content of proposed standards (Figure 14).

Figure 14. Supplier Involvement in Determining Minimally Acceptable Purchasing Practices



About one-third of suppliers (30.2%) want to join a standard-setting working group consisting of suppliers and/or buyers. Should a group of this nature be created, industry association leadership would allow the industry to tap into the valuable expertise of supplier members and ensure their needs are considered. Better Buying™ would support such an effort and work to secure robust supplier input into the resulting discussions.