

# Check is in the mail?

Failure to pay vendors on time is unethical

## Question:

**I am a small business owner. We have a massive amount of capital tied up in overdue accounts receivable. My accumulating experience is that it is now common practice for large companies and municipalities to manage cash flow by delaying payments to vendors. This puts an enormous strain on a small company — any business advisor will agree that cash flow is the most critical item in the life of a small company. Business growth requires the reinvestment of profits into new products and services. More and more, growth in the small-business sector is constrained by earned income that is not going into business growth but rather into funding receivables that are extending out 60, 90 and even 120 days. In my own experience, it is large companies and public entities that are responsible for withholding the majority of the funds. To a large extent, they do it simply because they can. They have opted to improve their bottom line by taking (not negotiating) extended payment terms. I am extremely troubled by this trend and wonder what your thoughts are.**

## Answer:

At the outset, let me observe that the practice you outline in your question sounds like smart business. Think about it. By extending payment terms to vendors, companies are able to favorably impact their bottom lines in the short term. So, viewed solely through the lens of a company's economic self-interest, practicing extended payment terms makes a lot of sense.

At the same time, from my "people perspective," I have to wonder about the impact such practices have on the other bottom line (i.e., corporate culture)? What does it say about a company when it is willing to demand prompt services from its vendors on the one hand and then delay payments for those very same services on the other?

As I've written previously, high-performance organizations take care of both the bottom line and the other bottom line. The leaders of high-performance organizations are mindful of financial performance and also focus on engaging in socially responsible organizational actions. Examined from this perspective, what you outline in your question is hard to defend. Frankly, it is an "I win, you lose" posture that has consequences far beyond the immediate transaction.

Let me explain. If we accept that the practice you outline is fairly widespread, and I happen to believe it is, there are some very real economic effects that result.

First of all, let's talk about what it takes to be a small-business owner and entrepreneur. You must identify a market need, develop a marketable and profitable solution to meet that need, produce a business plan that shows a healthy company is possible and probable, find investors willing to invest and take the risk, start up the business, hire employees, navigate through the

regulation minefield, bring the product or service to commercial readiness, find customers, convince the customers of the effectiveness of the product or service, sell the product or service, produce the product or service at a profit, deliver the product or service on time, get paid for the product or service, and finally, grow the company to the point it can pay dividends to the original investors.

Further, let's factor in the fact that many small businesses that have survived the past several years of economic uncertainty cannot afford to antagonize large customers. Raising prices and/or charging interest may not be practical solutions.

Finally, to really bring the discussion home, let's insert some real numbers that bear upon the scope of the issue you raise in your question.

The U.S. Small Business Administration reports that nationally, small businesses make up 99.7 percent of all employers, employ more than half of all private sector employees, and contribute more than 50 percent of non-farm private gross domestic product.

According to information from the U.S. Bureau of Economic Analysis, the private sector gross state product for Wisconsin in 2002 was \$170 billion, or roughly \$14 billion per month. Using these figures, we can estimate that approximately \$7 billion per month is done by small business in Wisconsin. This would also be the total amount of accounts receivable outstanding if every invoice was paid in 30 days.

However, as you point out, not every invoice gets paid in 30 days. Using a hypothetical example, let's say the average small business gets paid in 50 days. Again, drawing upon the data from above, that would mean \$4.7 billion dollars was earned but not available for use by small businesses. That's a lot of money that could be used to drive a lot of growth for a lot of small businesses.

What if the receivables extend beyond 50 days, to 60 or 75 days or more? In that scenario, the reality for some small-business owners is that cash flow becomes a crisis situation. Some must borrow money in order to make payrolls.

I suppose you could argue that extended receivables are just a cost of doing business, that the money will eventually come in, that it's only a one-time shift of funds out a month or more. Further, you could argue that the money stays in Wisconsin anyway, just in the hands of large companies.

I suggest that these arguments miss the central point — that the lack of prompt payments to small business affects their economic well-being, and that the economic well-being of small businesses is central to the economic well-being of our region, our state, and our country.

In the final analysis, there are no easy answers here. However, a good starting point might be to try to get a dialog underway.

Start with contacts and leaders at your client companies. Extend the dialog to like-minded others involving a cross section of

the business community. Again, invite leaders from the entities with whom you are having difficulty. Have an informed, objective discussion in which the focus is on the problem, not the people.

Include some research of the kind I offer within this article. Examine the problem from multiple perspectives in order to generate a variety of possibilities. For example, maybe it is possible to lower your prices if the customer agrees to quicker payment terms.

Finally, if agreements or understandings are reached, make sure they are based upon objective criteria (e.g., a new payment terms policy) that are explicitly defined.



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