

The Company Newsletter for Supply Chain Finance.

E FACTOR NETWORK NEWSLETTER

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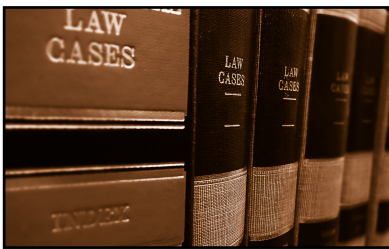
eFactor Diez S.A.P.I. de C.V.
Sociedad Financiera Objeto Múltiple E.N.R.

Company News and Highlights

Supply Chain Finance Solutions for Cash Requirement.



Fintech products and market development based on Fundamentals of Economic Theory and Financial Risk.



COMMENTS ABOUT THE EARLY PAYMENT REGULATIONS.

Written by Edgardo A. Ayala G.

Synthesis.

We will analyze the consequences of the probable law of early payment in Mexico. Including the following points:

- If the regulations of the European Union and Chile are adapted, even if the period is 30 days, it will be opened in larger installments by means of non-abusive contracts
- It will primarily help transactions that are done without contracts
- It would be harmful if it were to impose a period of 30 days on all transactions

Analysis.

The Entrepreneurs Association of Mexico (ASEM) has achieved an important consensus among senators from different parties to build and submit a law set in 30 days from receipt of the invoice, as the maximum period of payment in commercial transactions. The last goal of the initiative is to establish more suitable conditions for companies, especially small and medium-sized enterprises. In our opinion, although we do not doubt that the end is laudable, it is advisable to point out some possible risks of adopting a law that is very rigid, that is to say, that it does not allow greater deadlines if it is in the case of the two parties involved.

Several Early Payment laws have been issued around the world in the last fifteen years. In the European Union, each country can issue its own laws, but the backbone of these is directive 2011/7. Recently, on January 3, 2019, Chile adopted law 21,131 that introduces early payment measures, while in Colombia and Mexico the initiatives in their respective Congresses are discussed.

Contact Info:
E FACTOR NETWORK
info@efactornetwork.com
www.efactornetwork.com
01 800 801 3322

In the European Union 30 days are established if there is no contract, up to 60 days if exist one, and establishes the option that if the agreement is not abusive against the supplier, the deadline may be longer. In case that a company or the government fails to comply with the deadline, a penalty of 40 euros plus interest may be charged. For this purpose, it takes the rate of European Central Banks as a base, plus 8%. In the case of Chile, a maximum period of 30 days is also established, but this can be longer, if there is a non-abusive agreement. Which must be registered in the Ministry of Economy. In case of non-compliance, the Chilean law establishes penalties of 1% of the outstanding balance plus moratorium interests.

It seems that the Mexican initiative follows international standards, especially the Chilean. The good news is that the law will regulate the large volume of transactions, which are made without any contract. It is very common in the business of very small companies, self-employed, freelancers and others. If the buyer uses a contract, those are basic enough to breach the agreement. Even more if the suppliers are tiny, and the quality of buyer invoices are not good. Is unthinkable to consider a worthy option of financing through factoring operations. I think, the law in this sector could reduce the transaction's costs in order to the small suppliers recover the payment, and serve as a real threat to buyers.

The real threat is that the law would be stricter than the international precedent and preclude contracts of more than 30 days for all transactions. If that were the case, then the law would surely hurt more than benefit the suppliers. Imposing such a short period of time on all agents would bankrupt the funding network. Because while suppliers apparently benefit, they also buy from other suppliers. Consequently, they would be forced to relinquish leverage via accounts to pay, excuse using by the 70% of the companies in the country.

Among the large and medium-sized formal enterprises, the suppliers are financed through factoring credits in order to lose liquidity in the payment period, as these companies have access to the financial market and the invoices are of quality, therefore they can obtain competitive rates. Currently, it is not uncommon to get

TIE rates plus a margin that can go in the range of 3% to 8%. Even at a margin of 8%, a vendor can immediately obtain payment by factoring at an equivalent discount of 4% over the invoice value paid to 90 days, or a little more than 5% if it is to 120. With a law that obligates to pay cash, the discount would have to agree with the buyer. But since it is more difficult to change buyers than factoring's financial option, it is expected that discounts are increased, for example 10%. Another disadvantage is that the big buyers would prefer foreign companies that do not demand the early payment.

For these reasons, the law necessarily has to open the option in larger installments, as long as they are mutually agreed. It is not possible to make the law only for economic micro-agents, nor to put a common straitjacket for all companies. As much of the transactions will go by this option to the usual deadlines, then the average payment period is unlikely to decrease significantly. This story has happened with these kinds of laws in Europe.

Implications for the Fintech Sector

The law of early payment does not directly affect the market places that link two economic agents that make a transaction between them, for example, in the crowdfunding those that contribute and those that register projects, in the peer to peer lending the creditors and the debtors or in e-factoring, to financial agents with suppliers. However, in order to make the market more coarse, the contracts should be formalized, adjusting them to the requirements of the soon-to-be-paid law, in such a way as to reduce the transaction costs of the agents acting on the platform and to be sure of the operation. Basically, I think that outside the law of early payment, companies will be more benefited as the Fintech sector strengthens the competition in the financial system and contributes to giving companies better financing options at better competitive rates. 