Rich Getting Richer: Better Payment Terms, Discounts Offered

Cash flow is the lifeblood of any business. Some are lucky enough to have a better inflow and outflow than others and can establish themselves as a powerful giant within their industry. Others are not so lucky even when they play by the trade credit rules.

“The current U.S. trade credit system creates an uneven playing field for established, high-margin firms and those scrambling to gain their footing. … and current trade credit systems may deprive fledging companies the opportunity to grow in the fiercely competitive, global economy,” states the first SMB Receivables Gap Playbook released earlier this month by PYMNTS and Fundbox.

This society of business-to-business (B2B), small- and medium-business (SMB) and trade credit payments can be unfair for the smaller, less established and low-margin businesses. “Well who says life is fair? Where is that written? Life isn't always fair,” according to the film “The Princess Bride.”

The Playbook reviewed how different businesses, based on years in operation and operating margins, are impacted by cash flow and trade credit practices, with a focus on payment terms and early-pay discounts. The more than 1,000 respondents were broken down into six business personas based on these categories: early-stage (1-5 years in operation), intermediate (6-10 years), established (11+ years), low-margin (losing money to earning 25% margin) and high-margin (between 25% and 75%).

Low-margin firms are forced into tight payment windows as well as accepting longer payment terms, resulting in high-margin and more established firms earning better terms and more cash flow flexibility. Among the key findings were high-margin companies paying late because they can, but low-margin businesses paying late because they are left with no other choice. High-margin businesses are also more likely to extend payment terms past 30 days, in the 61–90-day range.

“All credit managers are aware customers are forcing extended terms,” said Christian Pedersen, CCE, credit manager with Emcor Services Aircond. There is a new trend of 90-day and 120-day extended terms increasing even more. “Years ago, customers’ CFOs would write to request to extended to 45-day or 60-day terms. Today, the majority of extended terms notice letters fall into a few different categories: Accept extended terms if you want to continue to do business with the customer, or they offer the option to get paid sooner by third-party service payments with fees to avoid extended terms,” said Pedersen.

“One option to accommodate extended terms requests is for the credit manager working in coordination with sales executives and senior management to revisit pricing tiers that correspond to extended terms demanded from customers, and they can develop a standard memo to issue to customers as a resonance when an extended terms notice is received,” added Pedersen.

“Established, high-margin firms offer … buyers longer payment periods and [can] be more generous with early payment discounts compared to enterprises with lower profit levels,” states the Playbook. Just under 85% of established, high-margin firms offer terms of 16–90 days, while early-stage, low-margin businesses are at just over two-thirds. However, early-stage and intermediate high-margin businesses nearly mirror their established counterpart.

The lower the margin, the less likely the business will offer an early payment discount. Less than 4% of early-stage, low-margin businesses receive a discount of more than 7.5%, but more than 9% of

established, high-margin firms receive the same discount. High-margin companies are also receiving larger discounts than low-margin firms in the 3–5% and 5–7.5% discount ranges. This coincides with payment terms received.

Roughly a third of early-stage, low-margin businesses receive payment terms of 1–15 days, while only about 10% of intermediate, high-margin businesses are giving such short terms. This trend continues across the board with high-margin businesses “earning” better payment terms compared to low-margin ones, especially in the 31–60-day period. Smaller firms often offer discounts they can’t afford because they need cash flow, hurting their bottom lines, notes the Playbook.

One factor that impacts all B2B transactions regardless of size or time in businesses is late payments. Nearly three-fourths of respondents said they are paid late by more than 11% of their customers. However, businesses reported they are more likely to be paid late than pay late themselves.

“Low-margin firms receive smaller discounts for paying early when buying, but are still required to meet tighter payment windows than high-margin companies. These businesses must also often accept longer payment terms when selling than those with greater operating margins,” concluded the Playbook.

-Michael Miller, managing editor