

MANAGING CASH FLOW WITH TRADE TERMS

Trade terms — also called “terms,” “supplier terms,” “trade credit,” “net terms,” “purchase terms” and “payment terms” — are an agreement between a company and its supplier for the timing and amount of payments. Common business-to-business trade terms are “net 30” or “net 60,” meaning that a business has 30 or 60 days from the invoice date to pay in full for the purchase. To motivate early payment, suppliers will sometimes offer an incentive, such as a discount of 1% or 2%, for invoices that are paid within 10 days.

Trade terms can make sense for industries in which supplies, inventory or raw materials are typically purchased and paid for over time. These include agriculture, automotive, construction/contracting, electronics, health service providers, medical equipment, manufacturing, restaurant and retail and wholesale trade. The deferred payment option allows the purchasing business more time to generate revenue, which can help ease cash flow issues all around.

Ask your existing vendors and suppliers about trade terms, if you do not have them now. If you have a longstanding relationship, they may be more apt to offer various payment arrangements, such as discounts for early payment or longer payment windows. This is particularly true if you drive high volume. Protect your standing with vendors and suppliers by requesting extended terms if you are experiencing trouble making payments, rather than simply paying late. If your existing vendors do not offer trade terms, or you would like to build on their trade terms



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arrangements, see our related story on page 4 and worksheet on page 5 to learn other ways that you can reap the benefits of cash flow management that trade terms offer.

— **TRADE TERMS AND CASH FLOW**

Here are some ways trade terms can help you improve your company's cash flow.

— *Control cash*

Cash flow is a perennial challenge due to the timing between when business expenses are incurred and payment is received. For example, a contractor might need to purchase



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building materials that a customer will not pay for until the job is done. Taking advantage of extended payment terms — such as 60 days — may allow the contractor to complete the job and receive payment from the customer before paying for the supplies. This payment flexibility can help with cash flow.

— *Defer payments*

In a cash crunch, you can use trade terms to defer payment until additional cash comes in. Think of a clothing boutique owner who needs additional products to stock her store, but lacks the money to buy them. Using trade terms, she can purchase \$10,000 worth of inventory, with an agreement that, if partial payment is made in 30 days, she can defer paying the balance for another 30 days. She now has the inventory she needs but has to pay only \$1,000 at 30 days, and she has 60 days to pay the balance. This gives her breathing room to sell the clothing, pay her suppliers and make a profit.

— *Earn discounts*

When your business is enjoying a strong cash position, you can use the early payment discount feature of trade terms to keep more of your hard-earned money. Here's an example: A computer store spends \$10,000 to

TRADE TERMS FAQ'S

- Q: How do trade terms differ from other forms of credit?**
- A: Loans, credit and charge cards, and other forms of credit typically incur interest charges more quickly than trade term arrangements. Trade terms generally do not incur interest if payment is made within the designated window. Trade terms also sometimes involve a discount for rapid payment of an invoice.
- Q: How do trade terms compare to small business loans?**
- A: Small business loans are long-term commitments that involve an extended payment schedule, similar to a home mortgage. Trade terms are generally shorter-term commitments.
- Q: What are the risks of using trade terms?**
- A: As with any form of credit, you need to be certain that you can eventually pay the balance. Failure to do this might damage your credit rating and create problems when your business tries to obtain credit in the future.

purchase specialty computer hardware, with an agreement for a 1% discount if payment is made within 15 days. The store owner immediately sells the custom systems that it assembles from the hardware, allowing him to pay early, for which he receives a \$100 discount. If his sales generated a 10% margin, he earned \$1,000 in profit, in which case the \$100 discount increases his profit by an additional 10%.

— *Keep working capital*

Business owners often complain that purchasing expenses leave them little cash to make strategic investments. Deferred payment terms enable you to keep working capital on hand to purchase new equipment, hire additional staff, launch an advertising campaign or make other investments to grow your business.

— *Establish payment history*

Trade terms can create a credit record that enables you to take advantage of future opportunities. Participating in a financial arrangement in which you commit to and then hold up your end of a financial deal sends a signal to the larger business world that your company is a responsible financial entity. Building a strong payment history makes it clear to potential partners and investors that you have the kind of financial habits that can make you an attractive business partner.



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— **TRADE TERMS
AND SUPPLIERS**

Trade terms are an important tool for suppliers who are continually seeking to find new customers and outlets for their goods. When suppliers offer trade terms to customers, it becomes easier for companies to buy from them. At the same time, mutually agreed-upon terms that businesses can afford ensure that suppliers receive timely payments for their goods.

For example, a manufacturer of high-end clothing that would like to have more retail outlets might have been challenged to arrive at satisfactory terms with stores. Stores might have balked at paying quickly for items before having a chance to sell them.

By establishing trade terms, the supplier and the boutiques are more likely to agree on a payment plan. With trade terms in place and the deal secured, the supplier benefits by adding a new customer and revenue stream.

Trade terms can help suppliers in many ways, including:

- Strengthen their operations by spreading business across more customers.
- Ease the process of securing new customers by providing more payment options.
- Ease collections concerns by providing a financial arrangement to which customers can commit.

— **TRADE TERMS AND SMALL
BUSINESS OWNERS**

Business owners often find themselves challenged by cash flow issues caused by the need to purchase materials, supplies and other critical tools before receiving payments from customers. Many entrepreneurs in this situation use personal funds, tap credit sources with an associated fee or require pre-payment from customers.

These options each have a downside. Business owners who use personal funds for business expenses may put their own money at risk and miss out on a chance to earn returns while these funds are tied up in the company, not to mention the bookkeeping headaches that often result from the mingling of business and personal expenses. Credit sources, such as charge and credit cards, may carry a cost that can cut into profits. Asking for partial payment from customers upfront can be effective, but it can't

be relied upon and may inconvenience valued customers.

This lack of a perfect solution puts some smaller businesses at a disadvantage against larger companies that typically have more cash at their disposal. Trade terms offer an option for these business owners to satisfy their customers and grow their businesses without the burden of having to pay immediately. ■

PLUM CARD OFFERS VALUABLE TRADE TERM BENEFITS

The Plum Card® from American Express OPENSM offers another option for receiving Trade Terms that is comparable to those typically negotiated by suppliers requiring payment in cash or by check. With the Plum Card, Trade Terms become easy and standard, enabling Cardmembers to take advantage of delaying payment in order to have more time to generate revenue. Besides the quality and servicing benefits associated with all American Express OPEN Cards, the Plum Card's unique features include:

- **Receiving Trade Terms.** Use the Plum Card to make purchases with any supplier that accepts American Express® Cards, in any industry, even if the supplier doesn't offer individual trade terms. (If you already have trade terms arrangements with some or all of your vendors, you might be able to use the Plum Card to build on their existing discounts or defer payment beyond their net terms – without interest).
- **Early Pay Discount.**¹ Pay your balance within 10 days of the statement closing date and get a 1.5% discount on eligible purchases made that month.
- **Defer Pay Option.**² Defer payment for up to 30 additional days with no interest if you pay 10% of your balance by your "Please Pay By" date.
- **Choice of payment options.** Choose each month to Pay Early **OR** Defer Payment, as long as your account is in good standing.
- **Flexible billing period.** Match your payments to your business cycle, paying either at the beginning of the month (days 1-9), mid-month (days 10-19) or month's end (days 20-31).

Apply for a Plum Card from American Express OPEN and we'll waive the first year's annual fee of \$185 for the Basic Card.

To apply, visit <http://www.plumcard.com> or call 1-866-805-1243.

¹ Pay your balance in full within 10 days of the statement closing date and get a 1.5% discount on eligible purchases made that month. The discount will appear as a credit on the following billing statement.

² Pay 10% of the balance from new activity on your billing statement plus the entire amount of any previously deferred payment or amounts past due by the "Please Pay By Date" on that statement and you can extend payment on the rest until the closing date of your next billing cycle without penalty.

WORKSHEET

MANAGING CASH FLOW WITH TRADE TERMS

Business owners use trade terms to manage their cash flow needs, either by deferring invoice payment so they can use their cash on hand for other purposes, or by receiving discounts on early payment. Use this worksheet* to determine how trade terms can benefit your business, or use the savings calculator at <http://www.plumcard.com>.

It is helpful to have a monthly invoice from one of your key suppliers to refer to for this worksheet.

EARLY PAYMENT SAVINGS

Follow these steps to calculate the savings you can obtain by paying in full within 10 days.

1. Enter the invoice amount. (If you don't have the exact number on hand, choose a number that is representative of a common expense as an estimate.)
2. Calculate your potential savings by entering your Trade Terms early payment discount (The Plum Card's Early Pay Discount is 1.5%)
3. Multiply the invoice amount, or your estimated expense, by the discount to determine your savings.

Formula:

Monthly Cost	x	Discount	=	Potential Savings
\$		\$

Examples:

\$3,000	x	0.015	=	\$45
\$7,500	x	0.015	=	\$112.50
\$10,000	x	0.015	=	\$150
\$50,000	x	0.015	=	\$750

Note: This worksheet is for illustrative purposes only. Actual results may vary.

continued



WORKSHEET

MANAGING CASH FLOW WITH TRADE TERMS

DEFERRED PAYMENT SAVINGS

With the Plum Card, you can defer payment for up to 30 additional days, interest free, if you pay 10% of the balance by your “Please Pay By” date. Follow these steps to calculate your potential savings.

1. Enter the monthly invoice amount (or your best estimate) to calculate your potential savings.
2. Multiply that number by (1 - 10%).
3. Find the Annual Percentage Rate (APR) that you would have paid using an alternate payment method, such as a credit card or line of credit. To get your monthly interest rate, multiply the APR by the number of deferred days divided by total days.
4. Multiply the invoice amount from step 2 by the interest rate from step 3 to see the full amount of interest you will have saved by deferring payment for 60 days (i.e., the normal 30-day payment terms, plus the extra 30 days that the Plum Card offers).

Formula:

Invoice Amount	x	Interest Rate	=	Potential Savings
(\$ x [1 - 10%])	x	(APR x [60/365])	=	\$

Examples:

\$5,000	x	15%	=	\$110.96
\$10,000	x	10%	=	\$147.94
\$25,000	x	6%	=	\$221.92
\$62,000	x	12%	=	\$1,100.71

Learn more about how the flexibility of Trade Terms can help your business — visit <http://www.plumcard.com> or call 1-866-805-1243.

To learn more about our products and services, call 1-800-NOW-OPEN or visit us at www.open.com
 For more OPEN Book Insights, and other resources to help you grow your business, visit www.openforum.com

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