

# Early Payment Discounts: Realizing Value in Accounts Payable



## IN THIS ARTICLE

- What Is an Early Payment Discount?
- Different Types of Early Payment Discounts and How They're Calculated
- Benefits of Early Payment Discounts
- What Are the Disadvantages of Early Payments Discounts?
- How Streamlining Accounts Payable Gives Cash Flow Flexibility to Help Gain the Benefit of Early Payment Discounts
- Should You Offer an Early Payment Discount?
- How Do I Enter an Early Payment Discount in QuickBooks?
- Are Early Payment Discounts Worth It?

Early payment discounts are a win-win for both customers and suppliers. Customers receive a discount for paying before the due date and suppliers receive payment earlier than expected.

Is it a good idea for businesses to offer early payment discounts? And if you're a customer, what are the advantages of paying invoices early? Read on and see if

early payment discounts are a good idea for your business.

## **What Is an Early Payment Discount?**

An early payment discount is offered by vendors and suppliers as a way to incentivize their customers to pay early. Early payment discounts can be particularly useful for suppliers that have a lot of late-paying customers, since offering a cash discount to those that pay on the due date (or before), may convince them to pay earlier.

Early payment discounts can be beneficial for both buyers and sellers. Buyers get the benefit of paying less for items purchased, while sellers get the benefit of early payment, avoiding a high accounts receivable balance as well as time-consuming collection activity.

Offering an early payment discount can also help improve the supplier's cash flow, especially important for those that offer a generous line of credit to customers.

The opposite side of early payment discounts would be invoice late fees, where you are charged additionally if you pay after the due date for the invoice.

There are numerous ways that suppliers can offer discounts to their customers, depending on the current relationship with the buyer, as well as how simple or complicated you want to make the early payment process.

Traditionally, most prompt payment discounts are initiated by the supplier and offer a discount between 1% to 5% if payment is made early. But a new method, dynamic discounting, is also gaining in popularity that can be initiated by either the buyer or the seller, with terms agreed upon before invoicing.

## **Different Types of Early Payment Discounts and How They're Calculated**

There are three types of early payment discounts that may be offered, and they can vary from business to business. Though any payment discount can be negotiated between parties, these are the three most common early payment

discount options.

## • **Static Discounts**

Static discounts are probably the most common type of early payment discount. A static discount offers a predetermined discount in the invoice terms. What it lacks in flexibility it makes up for in simplicity, with the terms spelled out clearly.

For example, if your supplier wanted to offer you an early payment discount of 2% if you paid within 10 days, it would be included on the invoice as 2/10 - net 30.

Those terms mean that you can take a 2% discount off the invoice total if you pay within 10 days.

If you choose not to take advantage of the discount, that's fine, but you'll have to pay the total amount of the invoice within 30 days.

Jim received a \$2,500 invoice from his supplier with the following terms; 2/10 - net 30. The invoice is dated 10th of June 2022. Before he sets up his payables, Jim needs to calculate how much the discount is:

$$\$2,500 \times 2\% = \$50$$

$$\$2,500 - \$50 = \$2,450$$

If Jim decided to take the discount, he can pay \$2,450 by 16th of June. If he pays later, he will need to pay the entire \$2,500.

## • **Sliding Scale Discounts**

A sliding scale discount is similar to a static discount but offers the customer some flexibility in when to pay the invoice.

For example, if you were to utilize the sliding scale discount on the \$2,500 invoice with the same terms, customers would still be able to take the entire discount if they paid within ten days.

However, with the sliding scale discount, you can continue to take a

fraction of the discount up to the day that it's due.

Here's an example of a sliding scale discount and what you would pay each day on a \$2,500 invoice until day 30.

<b>Day</b>	<b>Discount %</b>	<b>Discount Amount</b>	<b>Total Paid</b>
10	2.0%	\$50.00	\$2,450.00
11	1.9%	\$47.50	\$2,452.50
12	1.8%	\$45.00	\$2,455.00
13	1.7%	\$42.50	\$2,457.50
14	1.6%	\$40.00	\$2,460.00
15	1.5%	\$37.50	\$2,462.50
16	1.4%	\$35.00	\$2,465.00
17	1.3%	\$32.50	\$2,467.50
18	1.2%	\$30.00	\$2,470.00
19	1.1%	\$27.50	\$2,472.50
20	1.0%	\$25.00	\$2,475.00
21	.90%	\$22.50	\$2,477.50
22	.80%	\$20.00	\$2,480.00
23	.70%	\$17.50	\$2,482.50
24	.60%	\$15.00	\$2,485.00
25	.50%	\$12.50	\$2,487.50
26	.40%	\$10.00	\$2,490.00
27	.30%	\$7.50	\$2,492.50
28	.20%	\$5.00	\$2,495.00
29	.10%	\$2.50	\$2,497.50
30	.0%	\$0.00	\$2,500.00

This method provides the customer with a sliding scale discount, no matter how early the invoice is paid, with the discount percentage dropping each day past ten days until the maximum number of days (30) is reached.

If Jim were offered a sliding scale discount from his supplier, he could take the entire discount of \$50 if he pays within ten days.

But with the sliding scale, he can wait until day 20 to take the early payment discount and still save \$25. However, if he waited until day 30, he would then be required to pay the full amount of the invoice.

## • **Dynamic Discounts**

Dynamic discounts are the newest types of discounts offered. A dynamic discount is typically an agreement between the buyer and seller and is usually negotiated on an invoice-by-invoice basis.

Beneficial to both parties, and particularly useful for large invoice amounts, a dynamic discount allows suppliers to choose when they will be paid in exchange for a discount for the goods and services purchased.

With updated credit terms and a discount rate that is dynamically adjusted based on when the customer pays, many suppliers are looking to offer dynamic discounts to their customers.

Jim recently received an invoice from his supplier for \$4,500. Because he has a good relationship with the supplier, Atlantic Brass, and orders from them frequently, he calls and asks for a discount.

The credit manager agrees to reduce the invoice amount by \$150 if Jim agrees to pay within ten days of the invoice date. And if Jim pays within 15 days of the invoice date, he will still get a discount, but it drops to \$100.

Finally, if Jim pays within 20 days of the invoice date, he can take a \$50 discount. If Jim doesn't pay within 20 days, he will have to pay the invoice in full.

Jim agrees to the offer from Atlantic Brass and pays \$4,350 within ten days, living up to his end of the agreement as well.

Because this is a one-time deal, each time that Jim receives an invoice from Atlantic Brass, he will need to request a discount if he wishes to

receive one.

## Types of Early Payment Discounts



Static Discounts



Sliding Scale Discount



Dynamic Discounts

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## Benefits of Early Payment Discounts

Early payment discounts wouldn't be so popular if they didn't benefit both suppliers and customers. Customers benefit from the savings that a discount provides. Early, timely bill payment can also improve metrics, resulting in increased business credit scores that can make it easier to obtain a loan, find investors, or even negotiate better terms with suppliers.

But buyers aren't the only ones that benefit from an early payment discount. Suppliers can also take advantage of the early payment discount; which can improve cash flow while reducing the number of invoices that end up in collections.

Offering early payment discount terms can also help build a better supplier/customer relationship by increasing loyalty between the two parties, leaving both sides satisfied.

## What Are the Disadvantages of Early Payments Discounts?

While the advantages are clear, there are some disadvantages to offering or taking advantage of early payment discounts. For buyers, paying an invoice early, particularly a significantly large one, can create cash flow problems, particularly if paying one invoice early leads to a late payment on other invoices.

For suppliers, while an early payment discount can lead to a reduced accounts receivable balance, for those on a tight operating margin, even a small discount can impact financials.

Another issue that suppliers may run into is customers who take the early payment discount, but don't actually pay early, leaving suppliers with an even tighter margin without the benefit of early payment.

## **How Streamlining Accounts Payable Gives Cash Flow Flexibility to Help Gain the Benefit of Early Payment Discounts.**

If you're still processing AP manually, you know how time-consuming it can be to review and match documents to an invoice, route the invoice for approval, and receive the invoice back in time to take advantage of an early payment discount.

Streamlining the AP process with a procurement solution, such as PLANERGY, integrates your purchasing activity with accounting software, like QuickBooks.

AP automation software results in quicker three-way matching, faster approvals, and better cash management capability so you can take advantage of those early payment discounts if you desire.

## **Should You Offer an Early Payment Discount?**

Though a great idea in some cases, offering early payment discounts isn't always a good solution for all businesses. A few things you may want to consider before making the commitment:

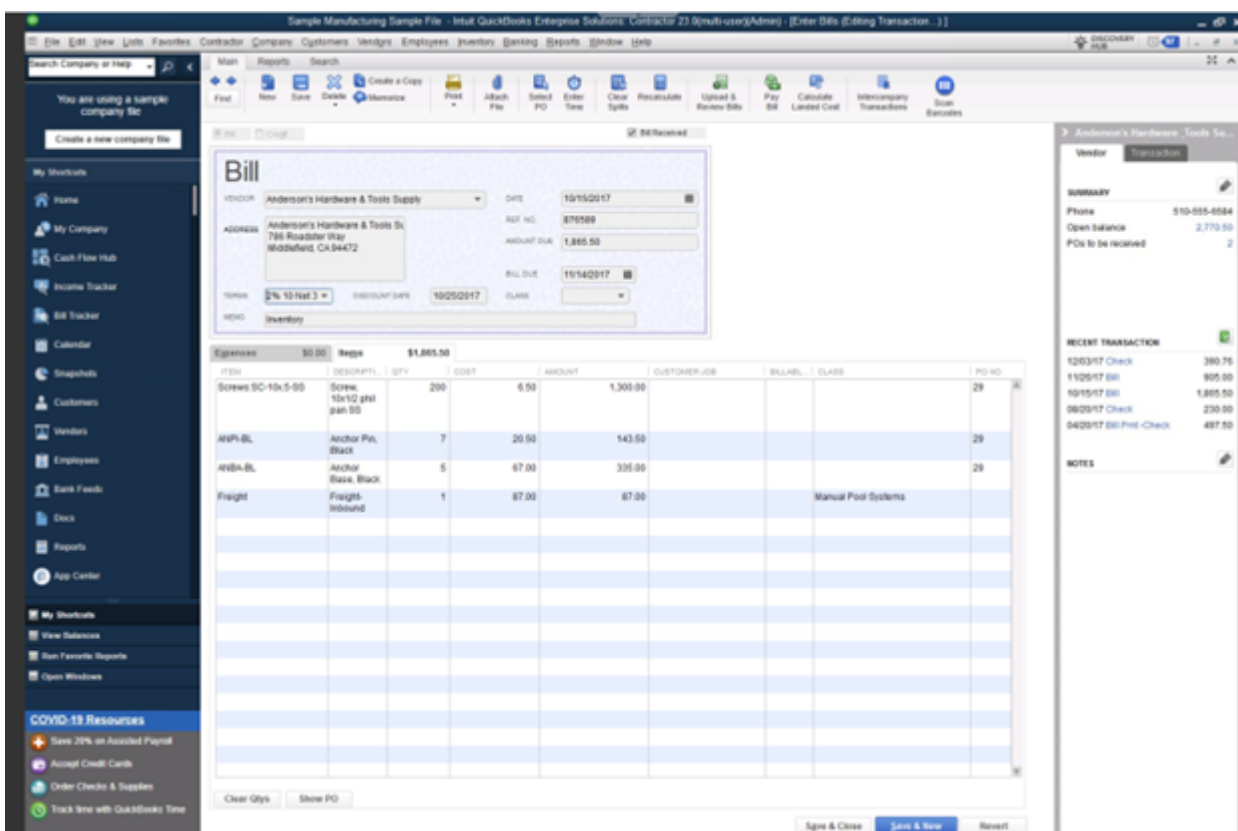
- What is your current profit margin? If your profit margin is razor-thin, offering a discount to your customers may be counterproductive. You'll get paid earlier but at less of a markup.
- Do you need to improve your cash flow? If cash flow is tight in your business, offering customers an early payment discount may be one way to improve it.

- What is the competition doing? If the majority of your competitors are offering discounts to their customers, it might be a good idea if you did as well.
- Do you spend a lot of time following up with your customers? If the majority of your customers pay late, offering an early payment discount may encourage them to pay you a little earlier. But don't count on it.

## How Do I Enter an Early Payment Discount in QuickBooks?

For QuickBooks Desktop Enterprise users, you can easily enter an early payment discount. Your first step will be to enter the appropriate terms during the setup process. For example, if your vendors typically offer you a 2/10 Net 30 discount, you can enter that as a payment term.

With the payment term in the system, you can then enter the invoice with the appropriate due date(s) for both the discount and the full amount.



You can also add a discount when paying the bill by highlighting the bill to be paid and clicking on the Set Discount option below the bill.

**Discount and Credits**

**BILL**

Vendor	Anderson's Hardware & Tools Supply		
Ref. No.	876589	Amount Due	1,865.50
Date	10/15/2017	Discount Used	0.00
Original Amt.	1,865.50	Credits Used	0.00
		Amt. To Pay	1,865.50

**Discount** | **Credits**

Discount Date

Terms: Net 30

Suggested Discount: 0.00

Amount of Discount:

Discount Account:

Discount Class:

**Done** | **Cancel** | **Help**

Here you can enter the appropriate discount amount, even if the bill was not entered with the discount term.

For QuickBooks Online users, there is no easy way to enter early payment discounts. Instead, QBO users will need to manually enter a discount as a line item when processing the bill. If you only have occasional discounts from vendors and suppliers, this wouldn't be a problem.

However, you'll have to set up the due date to correspond with the due date for the discount, or you'll end up taking an early payment discount without actually paying the invoice early.

If early payment discount amounts and due dates are not appropriately recorded in your accounting software application such as QuickBooks, other issues may arise including the following:

- The correct due date for the early payment discounted invoice will not appear
- You may end up taking the discount, even if you don't pay the invoice on time
- Your outstanding payables balance will not accurately reflect the correct amount due

# Are Early Payment Discounts Worth It?

Are you still wondering if early payment discounts are worth it? For both suppliers and customers, early payment discounts can be beneficial for their bottom line. For suppliers, early payment discounts can improve cash flow while reducing the amount of time spent trying to collect payment on past-due invoices.

Customers can also benefit from early payment discounts, saving a significant amount of money on the cost of goods sold while also helping their credit rating. Suppliers and customers alike benefit from early payment discounts by helping to build loyalty and strengthen buyer and supplier relationships.

But whether you're a supplier or a customer, it's important to streamline your AP processes, which will allow you to automatically offer discounts for invoices, while ensuring that customers are able to process invoices quickly, before the discount period expires. Implemented properly and used at appropriate times, early payment discounts work for both suppliers and customers.

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