Invoice Late Fees and How to Avoid Them



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As a small business owner, you do everything you're supposed to. You invoice your customer immediately.

You send timely reminders regarding payment. You provide multiple invoice payment options. But their payment is still late.

Because of those late payments, you suddenly realize that you won't have the funds to pay your vendors and suppliers.

Instead of ignoring reminder emails and not responding to phone messages, you pick up the phone and notify your vendor that you're unable to make your payment on time this month.

The vendor agrees to waive the late fee as long as they receive the payment in the next ten days.

However, the next day the buyer receives an invoice payment reminder with a late fee included.

Now you don't know if you should make another call, ignore the late fee and just pay the original invoice amount, or pay the late fee.

These are just a few of the questions and concerns business owners typically have around late payment fees.

Some of those questions include:

- Should you charge a late fee?
- Should you pay a late fee?
- When should a late fee be waived?
- What can I do to avoid late fees?

Whether you're sending invoices, receiving them, or both, if you're struggling with late fees, we'll help answer these questions and a few more.

What Are Invoice Late Fees?

Every business that sells to a customer on credit expects to be paid on time.

When that doesn't happen, many companies charge late fees; an additional charge that is imposed on overdue invoices.

As part of the negotiated terms between a buyer and a seller, there is always an

acknowledged due date for any purchase made on credit.

If that due date comes and goes without payment, vendors, suppliers, and lenders have the option to charge an invoice late fee.

Late fees should always be explained in an initial contract or purchase agreement made between a buyer and a seller and should not be arbitrarily imposed simply because of an overdue payment.

What Is the Purpose of Late Fees?

Late fees generally serve three purposes.

1. They impose a penalty on the late paying customer
2. They serve as compensation for the additional time and money spent to collect the past-due payment
3. They are incentives for a customer to pay their invoice on time

For example, Company A is late paying their $500 invoice to their supplier, Company B. Company B hits Company A with a late fee of $20.

Because Company A operates on a thin profit margin, they pay the late fee and take measures to ensure that future payments will be made on time.

What Are the Different Types of Late Fees?

In most cases, businesses use one of three different types of late fees:

- ## Fixed Late Fee

  A fixed late fee imposes a flat amount on a past-due invoice.

  This type of late fee is applied to a customer’s account the first day the payment is considered late.

- ## Interest-Rate Late Fee

  Instead of a fixed late fee, businesses can charge interest instead, calculating the late fee based on an interest rate.

  For example, a business can charge a 2% interest rate monthly, with the interest rate calculated daily.

- ## Hybrid

  One of the problems with an interest rate late fee is that for smaller amounts due, the interest rate fee doesn't serve as a detriment.

  The solution is to charge a hybrid late fee, which imposes a flat rate late fee on the unpaid invoice, with an interest rate imposed after a specific number of days.



What Is the Standard Late Fee for Unpaid Invoices and How Is It Calculated?

Late fees are calculated based on the original due date of the invoice.

For instance, if an invoice is due on November 12, and payment has not been received by November 15, your late fee interest rate would be calculated starting November 13.

If you impose a flat rate late fee, you can send notice of the late fee as of

November 13.

For example, instead of charging a late fee of *$20*, Company B decides to impose a monthly interest rate of 2% that will be calculated for each day Company A's payment is late.

The daily interest payment due would be *$0.33*, so if the payment is ten days late, Company A would owe Company B *$3.30* in late fees, making the total due *$503.30*.

Many businesses choose to impose a late fee based on the amount owed.

For example, if an invoice is *$500* or less, a business may use a flat rate fee, while an invoice that is more than *$500* may be charged an interest rate plus a flat fee.

What Happens if a Business Receives an Invoice Late?

For both buyers and sellers, it's important to note the date when the invoice is received.

If an invoice is sent electronically, this is usually not an issue, but for invoices that are mailed, there are several reasons why an invoice may be late, which can impact both invoice processing and the invoice payment date.

For instance, you receive an invoice with a due date of November 30, with terms of Net 30.

Unfortunately, your business didn't receive the invoice until November 20, leaving your business with ten days to pay the invoice, not the original Net 30.

In these cases, it's best to call the business and ask for a new invoice with the proper due date.

You also have the option to pay the invoice by the original due date, but that may not always be an option for a business with limited cash flow.

Another option would be to arrange for the vendor or supplier to email you future invoices, which helps eliminate this issue going forward.

How Do You Explain Late Fees to Customers?

Before charging your customers a late fee, you'll first need to create a late payment policy.

Your late payment policy can be created using a template and should include the following:

- How the late fee will be calculated. Is it a flat fee, will interest be charged, or will you charge a combination of both?
- What are the parameters around the late fee? Is it charged immediately, or is there a grace period offered?
- Will you send payment reminders to customers and how often will those reminders be sent?
- Are there any exceptions to the policy? For example, if a customer does not receive an invoice on a timely basis, will the late fee be waived?

Once your late fee policy is established, you'll need to ensure that it's communicated to your customers, preferably as part of your original contract.

You can also provide the policy as a separate document, or by including the policy in the terms and conditions spelled out on the invoice provided to your customers.

What Should You Do if You Need To Pay an Invoice Late

Good communication is vital for developing and maintaining vendor-buyer relationships.

If you know that you'll be unable to pay an invoice by its due date, the best thing you can do is contact the vendor or supplier and let them know that the payment will be late and provide them with a date that you expect payment to be made by.

Any follow-up due date that you provide your vendors and suppliers with must be adhered to.

What Is a Late Fee Waiver?

A late fee waiver is when the late fee is waived by the seller.

If a buyer has a good relationship with a seller, the seller may decide to waive the late payment fee, particularly if the buyer has a history of paying on time.

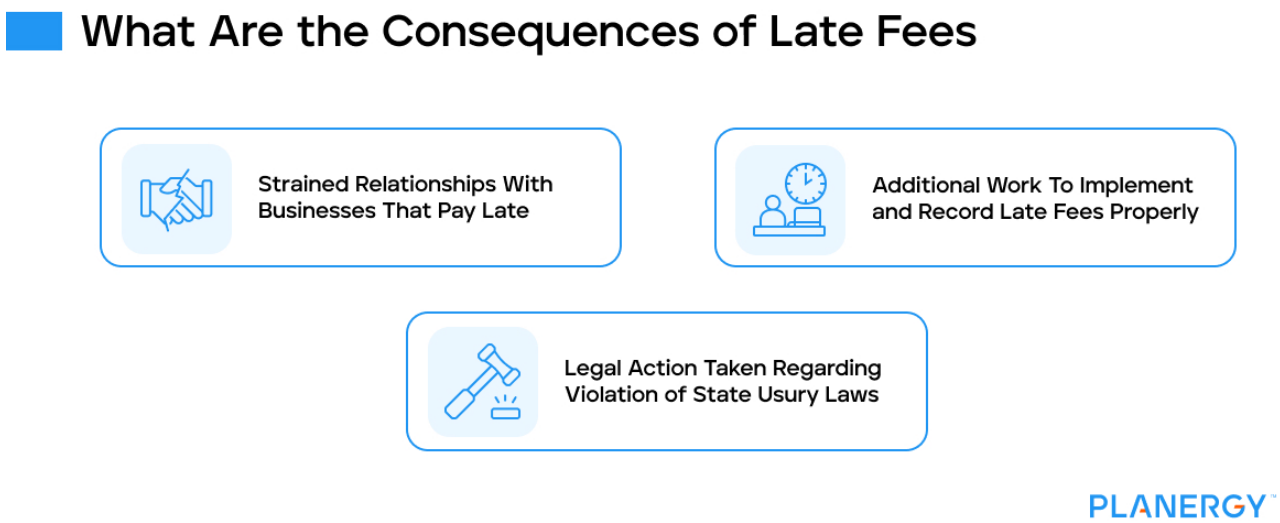
It's entirely up to the seller whether they want to waive the fee, but it's certainly within the buyer's right to request that the late fee be waived.

What Are the Consequences of Late Fees

For sellers, instituting a late fee policy can be beneficial, providing a strong deterrent against late payments.

But there are some potential consequences to implementing a late fee policy:

- The possibility of strained relationships with businesses that routinely pay late
- Additional work for accounting staff to implement and record late fees properly
- The possibility of legal action taken regarding violation of state usury laws



If the majority of your customers pay close to or before their due date, there's

probably little reason to implement a late fee policy.

But for businesses whose customers consistently pay late, having a late fee policy in place may lead to more timely payments.

For buyers, the consequences can be costly.

Consistent late fees can result in increased interest rates charged, being saddled with less favorable payment terms which may include being required to pay the total amount due up front, and even past due invoice amounts being transferred to a collection agency, resulting in damaged credit and a serious reduction in buying power.

Difference Between Invoice Late Fees and Late Payment Charges

In many cases, invoice late fees and late payment charges are used interchangeably.

However, a late fee usually refers to a flat rate fee that is imposed on customers that pay late while late payment charges often refer to a late fee amount based on an interest rate.

It’s important when including payment terms for customers that you specify exactly how your late payment fees are structured.

What Causes Late Payments?

There are numerous reasons why payments are late. The most common reasons are:

- ## The Invoice Was Received Late or Not at All

  To ensure your customers pay you on time, make sure that they receive an invoice as soon as goods and services are delivered.

  The best way to do that is to switch to an automated invoicing system that provides your customers with invoices electronically, ending invoices

getting lost or delayed in the mail.

The Invoice Was Paid but the Payment Never Posted

Again, this is a fairly common occurrence for businesses using a manual accounting system.

Although it’s a cliché, checks do get lost in the mail.

Another issue may not be the buyer paying late but the seller posting the payment to the wrong customer account or losing the check once it’s been received.

The Customer Is Disputing the Invoice

If your customer is actively disputing an invoice, don’t expect to receive payment on time.

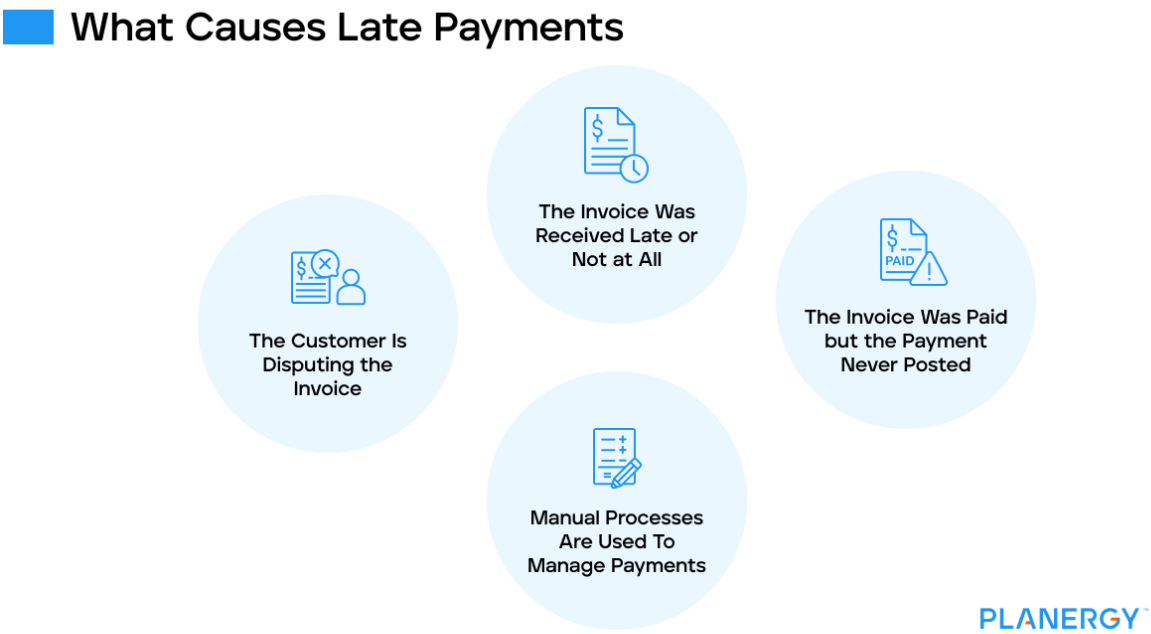
Instead, spend a few moments addressing the issues to determine their validity and proceed from there.

Manual Processes Are Used To Manage Payments

One of the biggest delays in processing payments is using manual AP systems.

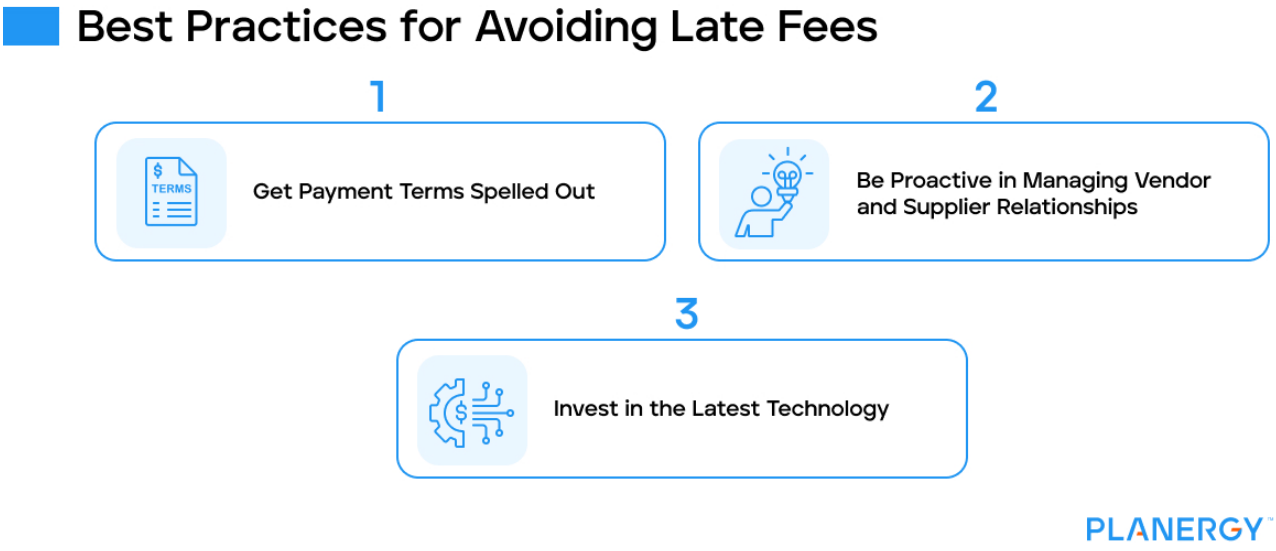
Using checks and balances such as three-way matching is essential for paying invoices accurately, but if completed manually, they also take a lot of time.

Invoice approvals are also another bottleneck commonly seen in companies without AP automation.



Best Practices for Avoiding Late Fees

If your business has been hampered by late fees assessed by vendors and suppliers, there are some measures you can take to eliminate them.



1. ## Get Payment Terms Spelled Out

   Sellers should always have clear invoice payment terms spelled out for their customers by including their complete credit policy such as payment terms, late payment policy, late payment penalties, and acceptable payment methods.

2. ## Be Proactive in Managing Vendor and Supplier Relationships

   Maintaining communication with your vendors and suppliers is an essential part of doing business.

   The more valuable your business is viewed, the more flexible your vendors are likely to be should you run into financial difficulties like offering a payment plan.

3. ## Invest in the Latest Technology

   By choosing an end-to-end procure-to-pay application like PLANERGY, you can eliminate many of the issues that often result in late payments including delayed invoice approvals, time-consuming three-way matching, and numerous data entry errors.

   Automation also:

   - Provides centralized, cloud-based storage, eliminating endless stacks of paper
   - Allows you to make prompt payments and take advantage of early payment discounts
   - Integrates with related applications, eliminating duplicate data entry
   - Streamlines the entire invoice process from invoice receipt to payment, eliminating time-consuming delays
   - Reduces the possibility of fraud
   - Provides accurate reporting options that allow you to keep on top of payment due dates and better manage cash flow

Make Late Charges a Thing of the Past

Everyone benefits from an automated accounting software application.

For sellers, switching to an automated system allows them to create and distribute accurate invoices timely, resulting in faster payments.

For buyers, being able to process an invoice in days instead of weeks can eliminate late payment fees. With automation, both sides win.

What's your goal today?

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