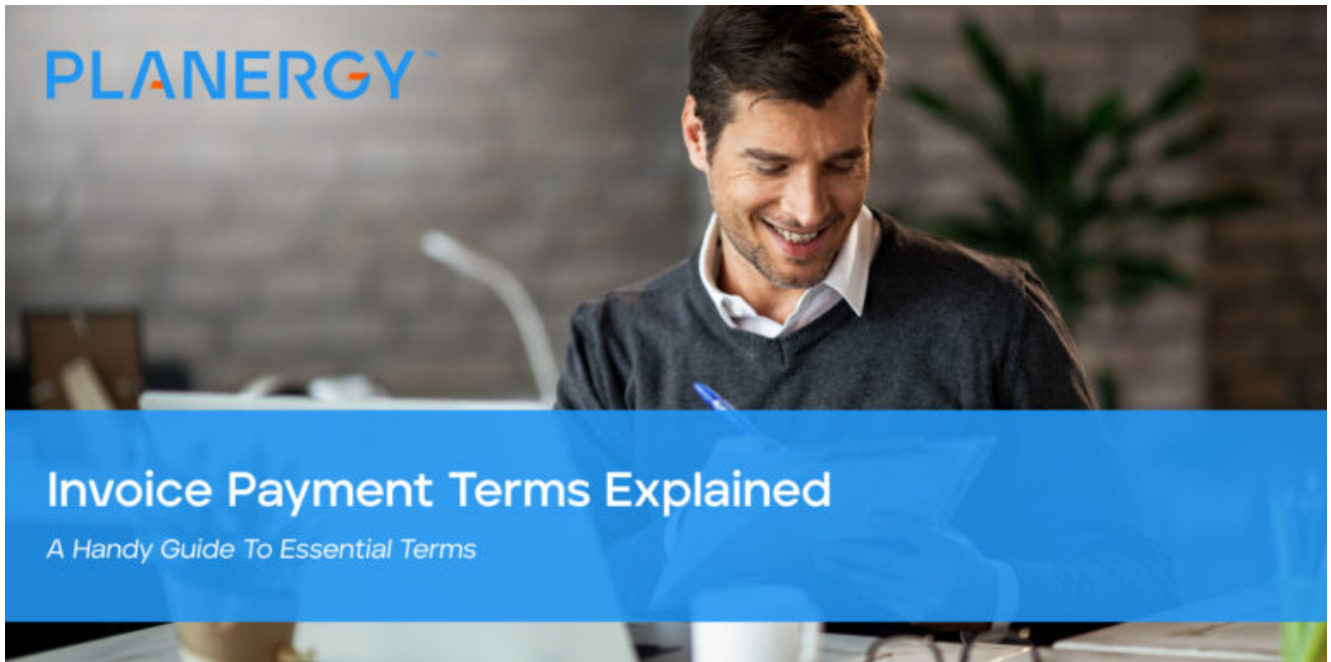


Invoice Payment Terms Explained



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As a business owner, receiving payments on time from your customers is paramount to maintaining positive cash flow and a profitable bottom line.

The best way to receive payments on time is to assign the proper payment terms to your customers and enforce the terms consistently.

Understanding payment terms is equally important for businesses that are on the receiving end of an invoice.

Managing invoice terms properly allows business to carefully plan their payment process to enhance cash flow.

The fact is that every business issues and receives invoices, which is why a better

understanding of payment terms and how to use those terms to your advantage can be beneficial.

What Are Payment Terms on an Invoice?

Payment terms are one of the most important components of an invoice. It's impossible to expect your customers to pay you on time if you don't include payment terms on the invoice.

Including payment terms on a customer's invoice lets them know exactly when you expect payment.

Depending on your business, you may include default payment terms for all of your credit customers, or you may assign individual terms to each customer.

Whatever method you use, invoice due dates should be clearly stated on any invoice that is sent to a customer.

What Are Common Payment Terms?

Business owners have numerous choices when it comes to setting payment terms for their customers, with each of the terms having advantages and disadvantages.

What Are Common Payment Terms



• **Payment in Advance**

Payment in advance is typically used for special orders or large construction projects where there is a significant monetary investment on the part of the business before the project or service can begin.

Though some customers may balk at having to pay a deposit upfront, businesses that perform custom work can end up losing a lot of money should the customer not follow through on the order.

Payment in advance is also common when dealing with customers with bad credit or no credit.

• **Payment Due at Time of Service**

Payment due at the time of service is similar to payment in advance but instead of a deposit, immediate payment is expected at the time goods are received or services rendered.

Payment due at time of service is also known as cash on delivery, or COD.

• **Due Upon Receipt**

Due upon receipt indicates that payment is due when the customer receives the invoice.

Again, businesses with limited cash flow that want to sell on credit may use this payment term, since it's trusting the customer to pay, but requires payment immediately upon invoice receipt.

In most cases, due upon receipt payments are due by close of business the following business day.

• **Net 7, Net 10, Net 30, Net 45, Net 60, Net 90**

Net terms indicate the number of days from the date of the invoice that payment is due.

For example, if your invoice date is November 20 and the invoice terms are Net 30, the customer is expected to pay the invoice by December 19.

While some small businesses use the same term for all customers, many businesses assign terms based on each customer.

For example, businesses may assign Net 7 or Net 10 terms to newer customers to see how quickly payment is received while terms for long-time or prompt-paying customers may be more relaxed.

• **1% 10 Net 30; 2% Net 30**

Some businesses may provide an early payment incentive to their customer by offering a small discount if the business pays early, usually within 10 days from the date of the invoice. 1% Net 30 means that if your customer pays you within 10 days of the invoice date, they are entitled to take a 1% discount off the total of the invoice.

If they don't pay within 10 days, they will need to pay the entire invoice amount within 30 days from the invoice date.

If the terms are 2% Net 30, they can take a 2% discount off of the invoice total, with the same requirement to pay the full amount within 30 days.

• **End-of-Month (EOM)**

End-of-month invoice terms aren't commonly used.

EOM payment terms mean that the total amount due is payable at the end of the month regardless of when the invoice was issued.

• **1% -2% -or 3% Late Fee for Payments Received After Due Date**

If you intend to charge your customers a late fee when a payment is past due, the late fee notice should be included in the payment terms on the invoice.

For example, if your terms are Net 30, but you're charging 2% interest on late payments you can include that as a message on the invoice:

Please note that payment is due within 30 days. A monthly late fee of 2% of the amount due will be charged on any overdue payments.

Any late fees should also be spelled out on any contract or agreement you have with your customers. Most late fees range from 1% to 3%.

Businesses also have the option to charge a flat fee when a payment is late.

For more information on late fees and restrictions, it's best to check with your local or state laws governing late fees.

What Are Typical Invoice Payment Terms?

The most common invoice payment terms are Net 10, Net 30, and Net 60, with Net 30 being the most common invoice term used by small and mid-size businesses.

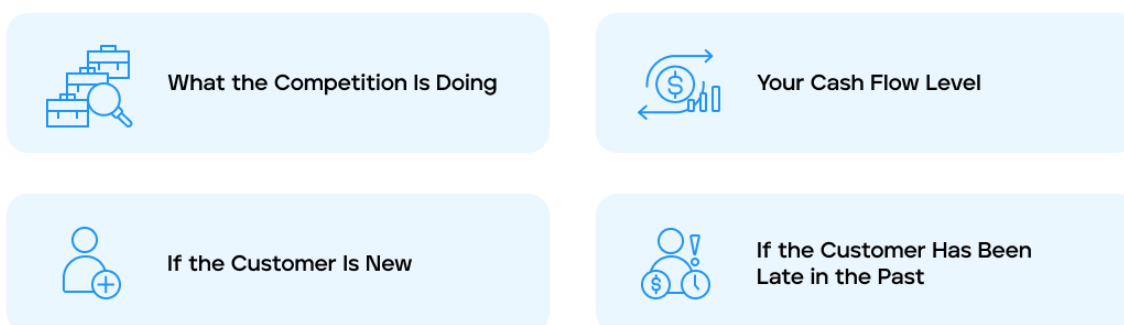
Net 30 invoice terms mean that your customer has up to 30 days from the invoice date to pay the amount due.

For example, if you issue an invoice on December 3, your customer will have until January 2 to pay the invoice before it's considered late.

When issuing invoices and setting payment terms, it's important to consider other factors before assigning payment terms to your clients.

These factors include:

Factors To Consider Before Assigning Payment Terms to Your Clients



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- **What the Competition Is Doing** - If your closest competitors routinely use Net 30 terms, you may want to do the same to remain competitive.
- **Your Cash Flow Level** - Before determining what payment terms to give your customers, you'll need to take a look at your cash flow. Can you afford to give customers Net 60 payment terms or will you need to have cash coming in a lot sooner to maintain your cash flow?
- **If the Customer Is New** - For newer customers, you may want to give them more conservative payment terms, such as Net 10 until they establish a pattern of prompt payments.
- **If the Customer Has Been Late in the Past** - If your customer has a history of late payments, you may want to change their payment terms to

payment in advance or due on receipt.

Each business should evaluate its customer payment history, and cash flow, and determine the invoice payment term that works best with their current situation.

What Are Standard Invoice Payment Terms?

Many small business owners set standard payment terms for their customers.

For instance, when setting up your accounting software application, you can create default payment terms for all of your customers, overriding the default terms when desired.

For businesses just starting to sell on credit or new businesses, assigning default terms to customers is efficient, since your customers don't have a current payment history.

As your customer build their payment history with the business, you can adjust terms as you see fit.

What Are the Advantages of a 30-Day Invoice Payment Term?

Net 30 payment terms are common for a reason.

For newer businesses, Net 30 terms provide a regular cash flow into the business. In addition, offering credit terms to customers can help boost business and build your customer base while providing a payment option that suits their needs as well.

Offering Net 30 payment terms also helps your business remain competitive with similar businesses offering credit terms and helps build customer loyalty to your business.

Offering Net 30 terms also opens the door to offering your customers an early payment discount, which is beneficial to your business and your customers.

How Do You Calculate Interest on an Invoice?

If you decide to charge interest on late payments, you'll first need to determine the monthly interest rate you wish to charge, which is usually between 1 to 3%, though that can vary.

Once the interest rate is determined, you can calculate the interest due on a late payment.

For example, your company decides that it will be charging an interest rate of 2% on all late invoice payments.

You have one customer who has not paid their \$750 invoice that was due October 31 and it's now November 15.

To calculate the interest owed as of November 15, you would multiply the invoice total by the interest rate, divide the total by the number of days in the month, and then multiply by the number of days late.

$\$750 \text{ invoice total} \times 2\% / 30 \text{ days in November} \times 15 \text{ days late} = \7.50 late charge

This means that as of November 15, your customer now owes you \$757.50. If payment is not received by November 30, the amount owed would be \$765.

If you don't want to charge interest on an unpaid invoice but still want to assess a late fee, businesses have the option to charge a flat rate fee on any late payments.

For example, you could charge your late-paying customer an additional \$5 each month that their invoice remains unpaid.

Remember, if you intend to charge late fees of any kind, the customer must be notified in writing before you charge an interest rate or any type of late fee to a past-due invoice.

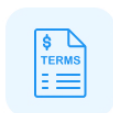
Best Practices for Using Payment Terms

in Your Business

Many small business owners emphasize sales, but if you're selling on credit, you're not receiving cash into your business until your customers pay their invoices.

Knowing how to use payment terms to your advantage can help you maintain positive cash flow while remaining competitive in the marketplace.

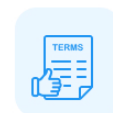
Best Practices for Using Payment Terms in Your Business



Be Clear About Payment Terms Upfront



Invoice Promptly



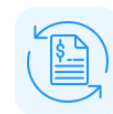
Set the Terms That Work for Your Business



Enforce the Payment Terms



Accept Multiple Payment Methods



Consider Automating Your Entire Invoicing System

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• Be Clear About Payment Terms Upfront

Whatever terms you decide to offer your customers, make those terms clear upfront.

Even if you bill all of your customers at Net 30, any new customer should be advised about these terms and when full payment is due.

If you plan on charging late fees or penalties, this should also be made clear up front, or the late fees may not be enforceable should your customers become delinquent.

• **Invoice Promptly**

Invoicing promptly results in timely payments. A delay in invoicing means later payments and interrupted cash flow.

Customers are also more apt to pay an invoice faster if it's received shortly after products have been received or services received.

The best way to invoice promptly is to use an automated accounting software or invoicing software application that streamlines the entire invoicing process.

• **Set the Terms That Work for Your Business**

Not all businesses operate the same. For some businesses, it's essential to get a deposit upfront before work can begin.

This is especially true for businesses that handle a lot of special or custom orders or for construction and contracting companies.

For other businesses, the standard Net 30 may work great, or you may find it best to personalize invoice terms for all of your credit customers.

Finding the method that works best for you will help you get paid on time.

• **Enforce the Payment Terms**

While determining the appropriate payment terms for your business is important, it's equally important that those terms be enforced.

That means staying on top of payments received and instituting prompt follow-up on invoices that are past due.

• **Accept Multiple Payment Methods**

The easier you make it for your customers to pay you, the faster they're likely to pay by the payment due date.

Accepted payment methods such as debit cards, credit cards, and gift

card payments, along with ACH, and other online payment methods help ensure more timely payment.

▪ **Consider Automating Your Entire Invoicing System**

If you find yourself falling behind on manually invoicing your customers or you're finding it difficult to produce accurate invoices, consider moving to an automated accounting software application that creates prompt, professional invoices, real-time accounts receivables reports including non-payment notifications, sends automatic late payment notices, and automatically calculates late payment amounts.

Assigning the right payment terms is essential for maintaining cash flow for your business. The more automation tools you invest in, the better your business will fare.

What's your goal today?

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