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Stimulate Growth with Early Payment Options

By: Jason Kirkpatrick (Article appeared in the May 2007 issue of "The Logistics Journal")

Many third parties understand that the right payment policy can go a long way towards building better relationships with carriers. But not everyone understands how early payment options can contribute to a company's bottom line and become a catalyst for growth.

Because the transportation industry is highly competitive, third parties and carriers have been forced to reduce costs by adopting more efficient systems. With advances in technology, these systems now include new methods to electronically exchange invoices, proof of delivery documents and payments. The savings from these processes go beyond the cost of paper, printing, postage, handling and storage. This is because electronic systems are uniquely positioned to reduce the direct cost paid to carriers. Electronic systems offer flexibility that traditional check processing systems can't provide.

According to the Institute of Management and Administration (IOMA), one third of companies that adopt electronic processes are also able to negotiate more favorable payment terms with their vendors. This occurs when payment policies not only meet the expectations of the vendor, but also yield a superior return to the payer. When these principles are applied to the transportation industry, they form the basis of a new relationship between third parties and their carriers; one that attracts carriers in unprecedented numbers. Yet, despite these promises, only a small number of third parties have implemented electronic systems that also benefit carriers.

By maintaining the status quo and ignoring their carriers' changing cash flow needs, these companies are missing the opportunity to build stronger relationships. Like all other businesses, carriers gravitate to customers who pay them more efficiently and without delay. As a result, third parties who are willing to narrow the payment cycle with carriers are in the best position to build loyalty and forge a more profitable business relationship.

To fully understand this concept, you need to consider which of your customers you prefer to work with, the ones that pay you fastest and utilize direct deposit, or the ones that pay you by check and require lengthy collection periods. Carriers evaluate their customers in the same way. They allocate resources to customers based on objective criteria, such as rate, reputation and terms. Since most third parties have competitive rates and solid reputations, it's increasingly important to promote favorable payment policies as a way to differentiate your company from the competition.

One of the key elements of a favorable policy is early payment options. It's important that your company provide a multiple number of payment options in order for your carrier to find one that meets their needs. When implemented properly, these serve as an inducement to attract carriers who are experiencing increased working capital requirements due to higher costs of operation. To maximize their effectiveness, these options can be combined with electronic document exchange and direct deposits.

The first step in creating a program is to set parameters. You'll need to decide how many options to offer and at what cost. Most companies center their program on the commonly accepted term of 2/10, Net 30, where a 2% discount is offered to the payer, in exchange for settlement within 10 days of its receipt, or the full value of the invoice in 30 days. In the current business environment, a single payment option is simply not enough to attract and retain carriers, especially if the option doesn't provide for next day pay.

The better approach is to provide carriers with multiple options, each with a corresponding discount that recognizes the time value of money. To accomplish this, it's probably best to model other options around the 10 day example and make sure that the options are priced proportionally. By using the 2%, 10 day guideline, a payer would offer a 20 day option at a 1% discount and a 1 day option at a 3% discount. And, with the right software, other incremental options can be offered and made selectable by the carrier on an invoice by invoice basis.

When creating a schedule of payment options, it's important to remember that the purpose of the program is to create a better, more attractive business relationship with your carriers. Your purpose is to provide your carriers with the flexibility and convenience of accelerating a single invoice or group of invoices when necessary. Therefore, it's important that the options you present to carriers are seen as optional and competitive.

As a general rule, carriers avoid mandatory discounting and accelerate invoices selectively. Other carriers, especially the ones who factor invoices, will accelerate terms more frequently. For profit minded third parties, there is a real opportunity to expand relationships with these carriers. With the right program, one that includes the electronic exchange of documents and next day pay, these carriers can be induced to do business with you and avoid the factoring company. When this occurs the carrier can be offered a more competitive rate with less risk and the third party is the beneficiary of discounts that are otherwise unavailable. Since the majority of these savings will fall directly to the company's bottom line, it's clear these discounts can have a dramatic affect on a company's profitability.

In almost every instance, third parties can benefit by exchanging documents and payments electronically. Significant cost reductions are available to companies in one of two forms. First, most companies can benefit by reducing the time and cost of processing mail and printing and mailing checks. Second, these systems will allow third parties to market themselves to carriers in a unique and more robust way. Instead of focusing on reputation and rate, third parties can market themselves to carriers based on payment terms. This can be done by building systems that allow carriers to manage invoices and payment options electronically and reduce their day's sale outstanding.

Today, there is little question that the right payment policy, supported by modern technology, can go a long way towards lowering cost and at the same time promoting and expanding carrier and customer relationships.

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