Terms of Sale (Terms of Payment)

Rod Wheeland
NACM Commercial Services
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There are three standard elements to terms of sale:

1. The credit period;
2. The cash discount, if any;
3. The service or late charge, if any.

The **credit period**, sometimes referred to as the net credit period or maturity, represents the time allowed for payment of the face amount of the invoice. For example, terms of NET 30 allow thirty days from the date of the invoice for payment. Watch for "ROG" terms on purchase orders as this starts the clock at the date of receipt, not the date of the invoice. The credit period helps define "delinquent" or "past-due" as non-payment or failure to pay within the credit period.

Cash discount, an inducement or premium for early payment, is usually stated as a percentage of the sale amount (before freight, insurance, taxes, and other add-ons). It may be expressed as a dollar amount. For example, terms of 2/10 Net 30, indicate a two per cent discount is granted for payment received within ten days of the invoice date, and a net credit period of thirty days, after which the invoice is considered delinquent. Unearned discounts are those taken by the debtor after the discount period.

Anticipation is a type of premium for early payment. It occurs most frequently in industries with longer terms such as NET 180 or NET DUE OCT 1 (sold on April 15 or May 1, for example). Twelve percent anticipation in such a case would mean that the debtor may deduct one percent per month or fraction thereof on a daily basis for payment before the maturity.

Service / Late Charges are expressed as a percentage and represent the charge to the debtor for the additional costs incurred by the creditor when the invoice is not paid according to terms. Service or late charges are not interest on money loaned and should not be identified as interest.

Factors Influencing the Terms of Sale

The terms of sale for a specific company may be affected by any of the following factors:

1. The Industry. The environment within which one competes and the amount of competition has a primary effect upon the parameters of terms of sale.
2. Place within the Industry. Industry leaders may set or determine terms; industry followers

are compelled to meet the industry standard to compete effectively.

3. The Operations Cycle. The time that it takes the customer to process, sell the product, and collect payment is often cited as the basis for terms. The fallacy in this view is that the buyer theoretically should have committed sufficient capital to purchase the supplies and materials necessary to produce the product. In practice, often the creditors commit substantial capital in the form of involuntary loans while the debtor works to convert products to cash.
4. Raw Materials as a Product. As a result of the rapid transformation of this type of product, terms are usually short.
5. Perishability. As a result of the rapid depreciation in value of this type of product, terms are usually short.
6. Seasonal Demand. The cyclical nature of the sales of such products may result in longer terms (for example, in the case of dry goods).
7. Consumer Acceptance. Popular consumer products often have shorter terms.
8. Durability. More durable goods can support longer terms.
9. Cost. Relatively inexpensive items are usually sold on shorter terms.
10. Profitability. Higher margins support longer terms.

The first two factors are of prime importance in terms of sale. The type of product, its markets, and internal financial issues also are significant factors in any discussion of terms of sale.

Classification of Terms of Sale

There are five general types of terms of sale:

1. Net terms
2. Single payment or "lumped" terms
3. Cash terms
4. Datings
5. Advances, progress payments

Net terms are based on the invoice date. Terms of Net 30 would indicate that payment in full is due thirty days from the date of the invoice. For practical purposes, we usually consider "date to date" if terms are Net 30; that is, if the invoice is dated January 20, payment is due on February 20. Net terms with a cash discount are stated as the percentage, the number of days allowed for the early payment, and the credit period: 2/10 Net 30.

Single payment or "lumped" terms are often used when customers make multiple purchases during a specific period:

EOM or End of Month. Invoices during the month are summarized on a monthly statement and the credit period begins with the first day of the new month. For example, Net 10 EOM, means that payment for purchases in the previous month is due on the 10th day following the end of the month, for example the four invoices dated in January are summarized on a statement dated January 31, and the balance is due on February 10.

As of the 25th is sometimes used with EOM terms, effectively giving an additional thirty (30) days for invoices dated after the 24th of the month. For example, the invoice dated February

25 does not appear on the February statement since the company books are closed on the 25th. This invoice appears on the March statement.

PROX or Proximo. This means the next or next following; Net 10th Prox means net due on the 10th of next month, effectively, the same as Net 10 EOM.

MOM or Middle of Month. Billings are issued twice monthly, usually on the first and the fifteenth. For example, Net 10 MOM terms might be used on statements issued on the first and fifteenth with the balance due on the tenth and twenty-fifth.

There are several types of **Cash terms**:

CWO, CIA, CBD, COD. Cash with Order, Cash in Advance, Cash Before Delivery, and Cash on Delivery. Cash with Order involves a relationship such that an order will not be accepted unless accompanied with a payment. Cash in Advance often involves taking an order and placing it in a holding or pending file until the payment is received. Cash Before Delivery involves developing the product, possibly packing and labeling it, and holding it in the warehouse or on the dock until payment is received. Cash on Delivery involves the processing of the order, packing and labeling of the goods, transfer to a common carrier for delivery or into the company's truck, and delivery to the buyer with expectation that payment will be rendered to the driver. Each involves a differing level of company contribution of time and resources. For example, if a COD customer obtains a comparable product from a competitor, the products may be refused at the customer's dock. The selling company has invested time and resources in processing the order. On the other hand, the buying company's need may be so great that expeditious handling is needed. The appropriate version can only be determined if you know your customer.

Net Cash. This term is accepted to mean in effect net due on receipt. The assumption with Net Cash terms is that the buyer will not receive the invoice for a few days, will require a few days to process the invoice, and payment will be in the mail for a few days.

Bill-to-Bill or Drop Delivery. This is sometimes used by companies making weekly deliveries to a buyer. At the time the weekly delivery is made, it is expected that a check for the previous weeks invoice will be given to the driver.

Sight Draft with a Bill of Lading. A sight draft is a check-like instrument drawn on the buyer's bank. The order bill of lading, attached to the draft, controls the title to the goods. The seller of the goods forwards the draft and bill of lading directly to the buyer's bank. When the bank receives the draft, it contacts the buyer and the buyer approves payment. The bank accepts the draft, releases the bill of lading to the buyer and wires the payment to the seller's bank. The seller has been paid, and with the bill of lading the buyer may take possession of the goods. Sight drafts may also be used as collection devices.

Datings. The most common type one sees involve the sale of seasonal goods, for example, clothing. Often these terms are expressed as net due on a specific date, such as Net 10/1 or Net 4/1. These usually involve a longer credit period and sometimes involve anticipation. Another type of dating is the "extra," such as 30x, 60x, or 90x. Used in conjunction with a company's regular terms, e.g. Net 30, extra days represent that period of time beyond the regular terms. For example, Net 30, 60x means in effect that the credit period is 90 days. These types of terms are often used as promotional devices to clear slow or dated stock.

Advances or Progress Payments - In fabrication or construction projects involving many months or years of work and large quantities of materials and labor, such payments may be included in a contract.

Shipping Terms

An understanding of basic shipping terms is important to the Commercial Credit Manager. Often the Credit Department is instrumental is resolving questions or disputes on these matters in order to gain payment.

There are two factors of interest to the Credit Department:

1. Which party bears responsibility for the freight charges?
2. When does title to the goods pass from the seller to the buyer?

The determining factor for both questions is the FOB (Free on Board) point; that is, the point at which responsibility for freight charges begins and the title passes to the buyer.

FOB Destination or Your Dock indicates that the seller chooses the carrier and ships the goods prepaid (the seller pays the freight) and the title passes to the buyer upon receipt of the goods by the buyer.

FOB Factory, Shipping Point, Mill, or Warehouse indicates that the buyer (the consignee of the goods) has the right to specify the carrier (as an agent of the buying company), the buyer pays the freight, and the title to the goods passes with the bill of lading when the carrier loads the goods at the seller's dock. The goods may be shipped collect or "prepay and add" (the selling company prepays the freight charges and adds it to the invoice).