

# Capital Corner

## Can You Really Afford to Take Advantage of Early-Pay Cash Discounts?

*By Jim Morphey, Vice President of Corporate Development, GE Capital, Commercial Distribution Finance*

---

*Early-Pay Cash Discounts (EPDs) have been around since the beginning of financing in this industry and can some times be a terrific way to boost your Gross Margin. Are EPDs right for you? That depends!*

If you have an excess cash position, EPDs may provide a better return than just about any other investment you could make in this low-interest-rate environment. For example, terms of 1.5% 10/Net 30 provide you the opportunity to earn a 27% return in exchange for accelerating your payment by 20 days.

The formula used by accounting professionals to calculate the return rate on such discounts is (Amount of discount/discounted price) multiplied by (number of days in the year\*/number of days paid early).

\*Accountants use a 360 days year. For example you are offered 1.5%/10, Net 30, the equation is  $(1.5/98.5) \times (360*/20) = 0.27$  or 27%.

However, many publically traded companies stretch their payables out for as long as possible to maximize their cash flow, even though they have plenty of opportunities to take advantage of EPDs from their suppliers. These companies have determined that it is advantageous in most cases to operate on their supplier's full terms, particularly now when many are looking to conserve cash. What do these large and well-financed enterprises know that you don't?

Let's do the math on matching payment terms. If you don't have lots of excess cash the old adage; "turns should always match terms" becomes even more important. In the example above, in order to match 10 day payment terms, your inventory turns will need to equal 36x's for it to make sense for you to accelerate your payment by 20 days! In our industry, inventory turns equivalent to 12x's (30 days) or more are considered Best-in-Class and extremely rare.

In order to evaluate whether or not to take advantage of Early-Pay Cash Discounts, you need to evaluate several factors carefully:

- Inventory and Accounts Receivable Turns
- Cost of Capital which includes, but is not limited to cost of debt

As we mentioned in prior Capital Corner articles, understanding and regularly monitoring your inventory and accounts receivable turns is absolutely essential to understanding your cash flow health. Your Cost of Capital includes: your borrowing costs from your bank, the amount of equity you have invested in your business, your leverage and your opportunity costs of not having the cash you accelerated your payments with to invest elsewhere.



You should also consider your available credit lines as you will most likely need to finance the accelerated payment somehow. In the end taking advantage of early-pay cash discounts might look very attractive, but they also might result in a future liquidity crisis since your excess cash will be sitting on your floor in inventory and not earning you any interest. As we talked about in prior columns, inventory normally loses value with time.

For more information on this topic, the U.S. Small Business Administration has published a summary : [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/pub\\_fm4.pdf](http://www.sba.gov/idc/groups/public/documents/sba_homepage/pub_fm4.pdf)

For more information, visit [www.cshpi.com](http://www.cshpi.com).



Jim Morphey is the Vice President of Corporate Development for GE Capital, Commercial Distribution Finance. Jim has 37 years of management experience in Trade Credit as well as the floor plan, factoring, and consumer finance business devoted almost entirely to the domestic consumer electronic, appliance, and outdoor power industries. His background includes assignments in Operations, Credit, Sales Management at the national level with Whirlpool, Whirlpool Financial Corporation, Transamerica Distribution Finance, and GE Capital. Jim is a 1974 graduate of Northern Illinois University with a B.S. in Management. He is a member of AFP (Association for Finance Professionals) and earned Certified Credit Executive (CCE) certification from the NACM/CRF (National Association of Credit Management/Credit Research Foundation) Graduate School of Credit & Financial Management at Dartmouth . He also received his Certification as a International Credit Professional from FCIB (The Association of Executives in Finance Credit and International Business). He resides with his family in Southeastern Michigan.

**IMPORTANT NOTICE:** This article should not be considered specific financial advice for your business. If you have questions about managing your business, please contact your financial consultant. This publication provides general information and should not be used or taken as business, financial, tax, accounting, legal or other advice, or relied upon in substitution for the exercise of your independent judgment. For your specific situation or where otherwise required, expert advice should be sought. The views expressed in these articles reflect those of the authors and contributors and not necessarily the views of GE Capital or any of its affiliates (together, "GE"). Although GE believes that the information contained in this publication has been obtained from and is based upon sources GE believes to be reliable, GE does not guarantee its accuracy and it may be incomplete or condensed. GE makes no representation or warranties of any kind whatsoever in respect of such information. GE accepts no liability of any kind for loss arising from the use of the material presented in this publication.