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Jörg M. Ries, Christoph H. Glock, Kurt Schwindl

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The influence of financial conditions on optimal ordering and payment policies under progressive interest schemes

Jörg M. Ries[11], Christoph H. Glock[2], Kurt Schwindl[3]

[1] Cass Business School
City University London
106 Bunhill Row, London EC1Y8TZ, UK

[2] Department of Law and Economics
Technische Universität Darmstadt
Hochschulstr. 1, 64289 Darmstadt, Germany

[3] Department of Business and Industrial Engineering
University of Applied Sciences Würzburg-Schweinfurt
Ignaz-Schön-Straße 11, 97421 Schweinfurt, Germany

In many business-to-business transactions, the buyer is not required to pay immediately after the receipt of an order, but is instead allowed to postpone the payment to its suppliers for a certain period. In such a situation, the buyer can either settle the account at the end of the credit period or authorize the payment later, usually at the expense of interest that is charged by the supplier on the outstanding balance. Some payment terms, which are often referred to as trade credit contracts, contain progressive interest charges. In such cases, the supplier offers a sequence of credit periods, where the interest rate that is charged on the outstanding balance usually increases from period to period. If a buyer faces a progressive trade credit scheme, various options for settling the unpaid balance exist, where the financial impact of each option depends on the current credit interest structure and the alternative investment conditions. This paper studies the influence of different financial conditions in terms of alternative investment opportunities and credit interest structure on the optimal ordering and payment policies of a buyer on the condition that the supplier provides a progressive interest scheme. For this purpose, mathematical models are developed and analyzed.

Keywords: Trade credit; progressive interest rates; inventory management; economic order quantity; retail industry

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[1] Corresponding author. Tel.: +44 (0)20 7040 0974, E-mail: joerg.ries@city.ac.uk.

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