

Financial Selling 104-D: Increasing IRR with Payment Terms

FROM TFP TO YOU

Financial Selling 104-D (FS104-D) looks at IRR and ways extended payment terms (financing) can increase this financial metric.

Understanding how IRR can affect your sales effort, gives you an edge over the competition. If your solution offers a higher IRR, your customer's associated project will be better poised for approval.

Whether or not financing is ultimately used is moot. **Leveraging extended payments in the financial analysis to show the best financial metrics is the take-away here.** If the purchase decision can be influenced by the IRR, a savvy account executive will put forth the best value!

At **Technology Finance Partners**, our job is to make the financial side of the sales effort easier.

Global sales and strategy consultants re-inventing the way software is priced, valued and sold.

Continuing on the theme demonstrated in FS104-A, B & C, incorporating extended payments in to a solution offer can improve the financial metrics that buyers consider. We will continue to use the same numbers and review the internal rate of return (IRR).

Definition: The IRR of a project is the calculated discount rate, whereby the net present value (see FS104-C regarding NPV) of a cash flow stream is equal to zero. Since the NPV is determined using the company's hurdle rate, IRR is generally compared to the hurdle rate.

Scenario 1	Year 1	Year 2	Year 3	Total
Benefits	\$750,000	\$1,000,000	\$1,000,000	\$2,750,000
License	\$500,000			\$500,000
Maint.	\$80,000	\$80,000	\$80,000	\$240,000
PS	\$500,000			\$500,000
Total Costs	\$1,080,000	\$80,000	\$80,000	\$1,240,000
Net Benefits	(\$330,000)	\$920,000	\$920,000	\$1,510,000

3-Year IRR = **55%**

Scenario 1 provides a familiar 3-year view where the 3-Year IRR is clearly greater than any company's hurdle rate (typically 10-15%).

Similar to our ROI and NPV discussions in FS104-A & C, one can calculate the IRR for any given period of time (i.e., 1-Year IRR, 2-Year IRR, etc.). Aligning to the customer's standard is ultimately the approach to take.

What is the impact of extended payments? Because of the time value of money calculations, extending costs in to years 2 and 3 results in a higher IRR. Consider the results in Scenario 2 – pushing out the costs results in a higher IRR. Scenario 2 was based on simple annualized calculations, in some instances you can defer all project costs, map monthly costs and virtually send the IRR to "infinity" as there would be no upfront cost from which to calculate return.

Scenario 2	Year 1	Year 2	Year 3	Total
Benefits	\$750,000	\$1,000,000	\$1,000,000	\$2,750,000
Lic/Yr1 Maint	\$193,333	\$193,333	\$193,333	\$580,000
Maint.		\$80,000	\$80,000	\$160,000
PS	\$500,000			\$500,000
Total Costs	\$693,333	\$273,333	\$273,333	\$1,240,000
Net Benefits	\$56,667	\$726,667	\$726,667	\$1,510,000

3-Year IRR = **75%**

While ROI, payback & NPV are commonly discussed, IRR maps directly to your customer's hurdle rate. If IRR is a requested metric by your customer, you now have the tools to provide the best possible IRR for your solution.

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