C2C RESOURCES

"Creating a Corporate Credit Policy"

The process of granting credit involves three basic steps. The first is the gathering of credit information from the customer and outside sources. Second, the information is analyzed to determine creditworthiness. Making the credit decision is the final step.

The framework within which these steps occur constitutes a company's credit policy. Without a clearly defined credit policy a company does not know how to interpret the information it receives on its customers. A well-defined, properly disseminated credit policy provides a structure to optimize profits while protecting against losses.

Putting your credit policies in writing makes decisions more consistent. Written policies also provide an unambiguous standard against which to evaluate staff performance. Without written credit policies, credit analysts tend to set their own parameters, which can inadvertently run counter to corporate objectives.

Purpose

The purpose of a credit policy is quite simple: to make a profitable sale. An effective credit policy defines the parameters (the sale of a company's goods for services) that are most likely to ensure growth and profitability. Upon careful review, many companies will find their credit policies are not as effective as they should be. This can be remedied by analyzing the current credit policy and making changes directed toward increasing profits within the corporation's tolerance for risk. That often means increasing the volume of sales in creditworthy customers. It should be noted that your credit policy is not your collection policy. While the two need to be integrated, they are separate functions with different goals. Credit strives to make a profitable sale while collections seek to maximize cash flow no matter what job has been done on the credit side of the equation.

Optimizing your policy

The first step in updating an existing credit policy or designing a new credit policy is to define your sales objective and the type of companies you are targeting for sales growth. Next look at how many potential accounts are turned down because of the company's credit standards. You then need to determine what needs to be done so that some of those sales can be approved while only causing a minimal increase in the credit risk contained within your receivables portfolio. You should also look for ways to increase sales to those customers who are excellent credit risks.

Your credit philosophy

As you work through this evaluation process, you need to take into consideration whether your company's culture is liberal or conservative in regard to granting credit to new customers. The distinction between liberal and conservative credit policies centers on risk. How much risk your company will tolerate is determined by both the internal corporate culture and the nature of the company's products and marketplace.

A more liberal credit policy might be right for the following situations:

- Increasing market share in a competitive industry
- Attracting sales in a new industry or market
- A decreasing market for a product or service
- Gross profit margins on an item being sold are large
- Inventory is unusually large or needs to be quickly reduced
- Inventory tends to become obsolete quickly

In contrast, a more conservative credit policy might include these situations:

- A company sells a unique item that customers cannot buy elsewhere
- Products are being customized to a customer's specifications
- General economic conditions are unfavorable
- A company's financial condition is so extended that it cannot afford to take risks
- The possibility of credit losses in a particular industry is unusually high

Do not work in a vacuum

Your company's credit policy should be a meaningful document that has a demonstrable impact on improved sales and profitability. When drafting or redesigning your company's credit policy, you set the agenda for encouraging creditworthy sales. In the long run, asking other functions for their input in putting together a corporate credit policy will serve to make the credit department's job easier by preempting sources for internal conflicts. This involvement by other corporate functions in either drafting or updating your credit policy is essential. You need to be sensitive to the ways your credit department affects other departments and vice versa. Broad involvement engenders a proprietary interest in the credit policy, which will tend to improve compliance. Equally important, you dramatically communicate to other departments the significance that the Credit Department places on sales growth and profitability.

Once you understand the purpose of having documented credit policies and have determined the strategic approach to the credit that will best serve your company's interests, it is a relatively simple matter to begin formulating and documenting your credit policies. Regardless of the sales volume of your company, your written credit policy should contain the following elements.

General policy statement

The general policy statement is a summary of your company's credit philosophy. It should explain the purpose of credit policies in a way that is understandable to noncredit professionals. It should also explain that sales are vital to the growth and profitability of your company. In short, your company's credit policy should be to extend credit to all applicants who fall within appropriate risk parameters. You should note that all credit decisions will be made on a realistic appraisal of verified information to determine each customer's ability and willingness to pay according to your credit terms.

Objectives of the credit department

The objectives of the credit department are to work in cooperation with the sales department to promote sales and to insure profitability by finding a suitable credit basis upon which to do business with a customer. No customer shall be denied the opportunity to purchase product until every means of selling to that customer on a reasonable credit basis has been exhausted. The structural organization of the credit function and its reporting authority (usually to finance or treasury) should be clearly enunciated. Any coordinating responsibilities, especially with your company's overall corporate policies and the activities of the sales department, should also be laid out. In addition, the responsibility of the credit department to help build broad and durable customer relationships for the company should be stipulated.

Credit approval procedures

The credit approval procedure begins with completion of the sales application. Typically, it is the responsibility of the salesperson to make sure that the customer has provided all information. A copy of the sales application should be attached and incorporated as a part of the credit policy. The basic information for the approval of credit is: bank references, trade references, organizational details (type of structure, years in business), and miscellaneous "qualifiers" such as the credit history of the principals or a personal guarantee. All credit line requests in excess of a specified amount should require financial statements, and where a personal guarantee is being considered, those of the principals as well.

The sales application is designed to obtain limited information that is critical to the credit function's due diligence. Less than full disclosure will hinder the credit approval process. Verification of the information on the sales application is performed with a customer investigation checklist, which should be attached and incorporated into the credit policy.

Terms of sale

The company's terms of sale need to be specified along with an explanation of any prompt payment discounts offered. If your company offers several different terms of sale, the circumstance under which each is offered needs to be clarified. Late payment service charges on all past due invoices should also be stipulated here. You need not always bill late charges, but if they are included in your credit agreement and signed by the customer, you could then apply them to delinquent accounts depending on need, e.g., accounts sent for third-party collections. You should check state usury laws before establishing late charges.

Periodic review of credit lines

The credit department will conduct annual reviews of customer credit lines to identify potential problems and to determine which customers' credit lines can be increased. The decision to increase a credit line should be based on the financial condition of the customer as well as their credit history with the company. The process for notifying the sales department of credit line increases and decreases also needs to be clarified.

Correspondence with customers

Copies of form letters should accompany your credit policy. Since credit correspondence will refer to selling terms, the sales department should also receive copies. Common credit letters include:

- Announcement of credit extension – Informs the customer of its credit line and the requirements that must be met to increase the line.
- Refusal of credit – Advises the customer that open credit terms have been denied due to a specific deficiency and explains COD or cash in advance procedures.
- Periodic review of credit line – Informs the customer that its credit line has been increased or decreased.
- Discount letter – Advises the customer of its savings from taking advantage of any prompt payment discounts.
- Old credit balance – Reminds the customer of its credit balance and encourages the customer to place an order to take advantage of the available credit.

Policy exceptions

From time to time there will be the need to make exceptions to your credit policy. These should be initiated in writing by the sales department, then reviewed and approved by management.

Conclusion

Putting together a corporate credit policy is not rocket science. Just the same, it requires careful thought and planning in order to company personnel both within and without the credit function.

Sample Internal Credit Management Policy Time Line Credit Action	
Day 1	Delivery of product or service
Day 15	Courtesy call from credit department
Day 31	Call customer as to status of payment; obtain promise to pay
Day 32	Fax confirmation of promise to pay

Day 45	Phone call to customer regarding broken promise to pay
Day 46	Fax confirmation of promise
Day 60	Final verbal demand for payment
Day 61	Fax confirmation of promise of payment
Day 80	Free 10 day demand letter.
Day 90	**Place account with C2C Resources % Sven Nelson 866-341-6316**

The worst thing any credit department can do is to NOT have an internal collection policy. Our Info Search program is designed to help you stay one step ahead of the game by giving you information a debtor would rather not tell you. All we need is the name and telephone number of the slow pay or payment plan customer. We will be able to tell you if we are already collecting debt from them on behalf of other clients and what type of information we have been able to gather.

There are 3 stages of a past due account:

STAGE 1: The customer wants more time to pay or wants to pay a little at a time.

STAGE 2: The customer starts breaking promises.
The customer starts avoiding contact.
The customer stops paying you.

STAGE 3: The customer disconnects his phones.
The customer sends you a bankruptcy notice. The customer's business ceases to operate and closes its doors. The customer's business ceases to operate and closes its doors.

For more information regarding C2C's Products and Services contact;

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