Developing a Credit Policy

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All business organisations are subject to higher operational costs, limited resources, and shorter product life cycles. Markets are also becoming more competitive and the move from selling to relationship marketing (focusing on customer loyalty and building meaningful customer relationships) is on top of every successful organisation's agenda.

One of the tools applied to support and enhance relationship marketing is Credit Management. But, extending credit to customers simply because competitors are granting it and without taking into consideration the risks and costs involved in credit is a risky tactic which could damage sound sales, effect negatively the cash flow of the supplier and restrict profitability. The current international credit crunch suggests that granting credit responsibly and not greedily is critical for both the supplier and the customer.

Extending credit should be researched and the factors associated with the managing of accounts receivables (A/R) should be well analysed and evaluated. In other words, a business organisation should develop an effective and efficient credit policy before extending credit to customers.

There are no two business organisations alike in terms of their assets and competencies. This would mean that there is no one good or perfect credit policy. This is not an issue of one size fits all. Every organisation should develop its own policy to achieve its specific corporate aims, views, and objectives with the resources available and according to the internal culture of the particular business organisation. However, a credit policy should always address the approval of credit applications; the administration involved; the management of A/R; and finally the collection of dues. A credit policy should also focus on the cashflow and profits of the business organisation though long-term customer relationship.

Developing an effective Credit Policy entails a thorough analysis and evaluation of the organisation's capabilities, which should include all its assets and competencies. This must take account the financial exposure that the organisation can endure, the skills and systems available to the organisation, the human resources required, and the amount of working capital available by the business to invest in its customers.

Competent staff from other departments within the organisation should be motivated to contribute towards the development of the Credit Policy, as this would contribute towards:

- getting holistic views,
- enhancing better understanding and acceptance of the Credit Policy by the participants,
- managing trade-offs at an early stage, and
- participants would feel a sense of belonging to the developed Policy.

The Credit Policy should be written, well communicated and accessible to all the internal stakeholders.

An effective Credit Policy should include the following sections:

- Objectives of the credit function,
- Procedures for opening new accounts,
- Obtaining information on new customers,
- Assessing and evaluating new credit requests,
- Trading terms and conditions – flexibility is critical to satisfy customer's needs,
- Authority levels and responsibilities,
- Invoicing procedures,
- Monitoring customers' buying and paying behavior,
- Procedure relating to complaints and disputes,
- Targets, benchmarks, and deadlines for the credit function,
- Performance management tools,
- Communication,
- Collection of dues,
- Defining overdue and bad debts,
- Procedure of debt collection from defaulting customers,
- Analysing the changing needs of the markets / customers,
- Identifying innovative internal systems for better efficiency.

The credit policy is also effected by internal and external factors, which should be considered in the development stage. A credit policy is not a static document. It should evolve and change in parallel to the business environment. It should be developed and reviewed on an ongoing process to meet changes in the market and to exploit market opportunities. Factors may include:

- The customers buying patters,
- The customers needs and requests,
- The type of industry,
- The competitors' offers,
- The supplier's strength in the market,
- The type of products or services provided to customers,
- Production and warehouse management,
- Distribution systems,
- The credit terms from trade suppliers and the bank's overdraft limits,
- Costs of third parties involved, such as factoring, debt collection agencies, etc.

Nevertheless, the implementation and control of the Credit Policy is often a key determinant in the success of an effective and efficient Policy.

This may require changes in the internal culture of the business organisation, new job assignments, and active internal politics. Effective internal communication should be employed to reach the opinion leaders within the organisation in order to enable them delivering positive messages to their respective colleagues.

However, this should be aided by commitment and support from the corporate management team. No one should expect all the staff to be equally supportive. Hence, the importance of explaining the objectives and the aims of the Credit Policy to these internal '*opposers*', who should also be encouraged to give their feedback and be part of the Team.