

Introduction to Credit Management

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Key concepts, objectives, processes, and best practices

1. What Is Credit Management?

Aspect	Description
Definition	The systematic process of granting credit, setting credit terms, monitoring receivables, and collecting payments to minimize risk and maximize cash flow.
Scope	Includes credit appraisal, policy formulation, credit limit setting, invoicing, collections, and dispute resolution.
Stakeholders	• Credit Manager – oversees the function. • Sales & Marketing – initiates customer relationships. • Finance/Accounting – records receivables and cash flow. • Customers – borrowers of credit.

2. Objectives of Credit Management

1. **Risk Mitigation** – Reduce probability of default and bad?debt losses.
 2. **Liquidity Optimization** – Ensure timely cash inflows to meet operating needs.
 3. **Customer Relationship Management** – Offer competitive credit terms without compromising financial health.
 4. **Profitability Enhancement** – Balance sales growth with cost of financing (interest, collection expenses).
 5. **Regulatory Compliance** – Adhere to laws (e.g., Fair Credit Reporting Act, GDPR) and industry standards.
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3. Core Components of the Credit Management Cycle

Stage	Activities	Typical Metrics

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1. Credit Policy Development	• Define credit objectives.	
	• Set eligibility criteria, payment terms, and limits.	Policy adherence rate
	• Establish collection procedures.	
	• Gather financial statements, credit reports, trade references.	
2. Credit Evaluation	• Perform quantitative scoring (e.g., Z-score, Altman model).	Credit score, approval ratio
	• Conduct qualitative assessment (industry outlook, management quality).	
	• Assign credit limits based on risk rating.	
	• Choose appropriate payment terms (net?30, net?60, early?pay discounts).	Average credit limit, limit utilization
3. Credit Approval & Limit Setting	• Verify that the order is within the approved limit.	
	• Issue accurate, timely invoices with clear terms.	Invoice accuracy %, days sales outstanding (DSO)
	• Track outstanding balances, aging reports.	
	• Review credit limits periodically (quarterly, annually).	Aging buckets, delinquency rate
5. Monitoring & Review	• Send reminders, make collection calls, negotiate payment plans.	
	• Resolve invoice disputes promptly.	Collection effectiveness index, dispute resolution time
	• Write?off uncollectible accounts after due diligence.	
	• Recover through legal action if justified.	Bad?debt ratio, recovery rate
6. Collection & Dispute Management		
7. Bad?Debt Management		

4. Credit Assessment Tools & Techniques

Tool	Use	Advantages
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Financial Ratio Analysis	Liquidity (Current Ratio), Leverage (Debt/Equity), Profitability (ROA).	Quick snapshot of financial health.
Credit Scoring Models	Assign numeric scores based on historical data.	Objective, scalable.
Trade Reference Checks	Verify payment history with existing suppliers.	Real-world performance insight.
Commercial Credit Bureaus (e.g., Dun & Bradstreet, Experian)	Obtain credit reports, risk ratings.	Standardized, widely accepted.
Cash Flow Forecasting	Project future cash generation to assess repayment capacity.	Forward-looking, aligns with loan repayment schedules.