

Introduction to Credit Management

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(Key concepts, objectives, and practical steps for effective credit control)

1. What Is Credit Management?

- **Definition** – The process of granting credit, setting credit limits, and collecting payments from customers while balancing risk and profitability.
 - **Core Purpose** – Protect cash flow, minimize bad debt losses, and support sales growth.
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2. Why Credit Management Matters

Business Impact	Explanation
Cash Flow Stability	Timely collections keep operating capital available.
Risk Reduction	Systematic assessment prevents exposure to high-risk customers.
Customer Relationships	Clear credit terms build trust and encourage repeat business.
Profitability	Optimized credit policies increase sales without proportionally raising defaults.

3. Key Components of a Credit Management System

1. Credit Policy – Written guidelines covering:

- Eligibility criteria
- Credit limits and terms (e.g., Net 30, Net 60)
- Discount and penalty structures
- Approval authority levels

2. Credit Assessment – Evaluation of prospective and existing customers using:

- Financial statements & ratios (e.g., current ratio, debt-to-equity)
- Credit scores & bureau reports
- Trade references and payment history

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- Industry and macro-economic analysis

3. Credit Approval Process – Steps to obtain, document, and communicate credit decisions:

- Application ? Initial screening ? Detailed analysis ? Approval/rejection ? Notification

4. Credit Monitoring & Review – Ongoing checks such as:

- Aging analysis of receivables
- Periodic re-rating of customers (quarterly, annually)
- Alerts for overdue accounts or adverse financial events

5. Collections Management – Structured approach to recover overdue amounts:

- Reminder letters & calls
- Payment plans or restructuring
- Use of collection agencies or legal action (as last resort)

6. Reporting & Metrics – Dashboard indicators to measure performance:

- Days Sales Outstanding (DSO)
 - Bad-debt ratio (bad debt ÷ total credit sales)
 - Credit utilization (% of approved limit used)
 - Collection effectiveness index (CEI)
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4. Steps to Implement an Effective Credit Management Program

1. Define Objectives

- Set measurable targets (e.g., DSO ? 45 days, bad-debt ? 1% of sales).

2. Develop a Written Credit Policy

- Align with overall business strategy and risk appetite.

3. Select Credit Evaluation Tools

- Choose credit bureaus, scoring models, and financial analysis templates.

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4. Train Staff

- Sales, finance, and customer?service teams need consistent understanding of terms and procedures.

5. Integrate with ERP/Accounting Systems

- Automate credit checks, limit enforcement, and aging reports.

6. Pilot and Refine

- Test the process with a small customer segment, gather feedback, adjust limits or procedures.

7. Roll Out Company?Wide

- Communicate policy to all stakeholders, enforce consistently.

8. Monitor, Review & Improve

- Monthly KPI reviews, annual policy audit, and continuous learning from collection outcomes.

5. Common Credit Terms & Their Meaning

Term	Typical Meaning
Net?30 / Net?60	Full payment due 30/60 days after invoice date.