


Advanced Credit Policy Module 1

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I. Introductory Material

- A. For whom this course is intended
- B. Texts and Excel files for the course
- C. Themes of each of the modules
- D. Course procedures
- E. Formulating credit policy:
costs and revenues

II. Chapter Notes for Chapter 1 of Decisions

A. The credit/sales conflict

B. Budgeting: monitoring policy outcomes

C. Types of costs affected by credit policy

1. Costs of sales
2. Credit Investigation costs
3. Cash discount expense
4. Bad debt expense
5. Accounts receivable carrying cost
6. Collection and administration costs

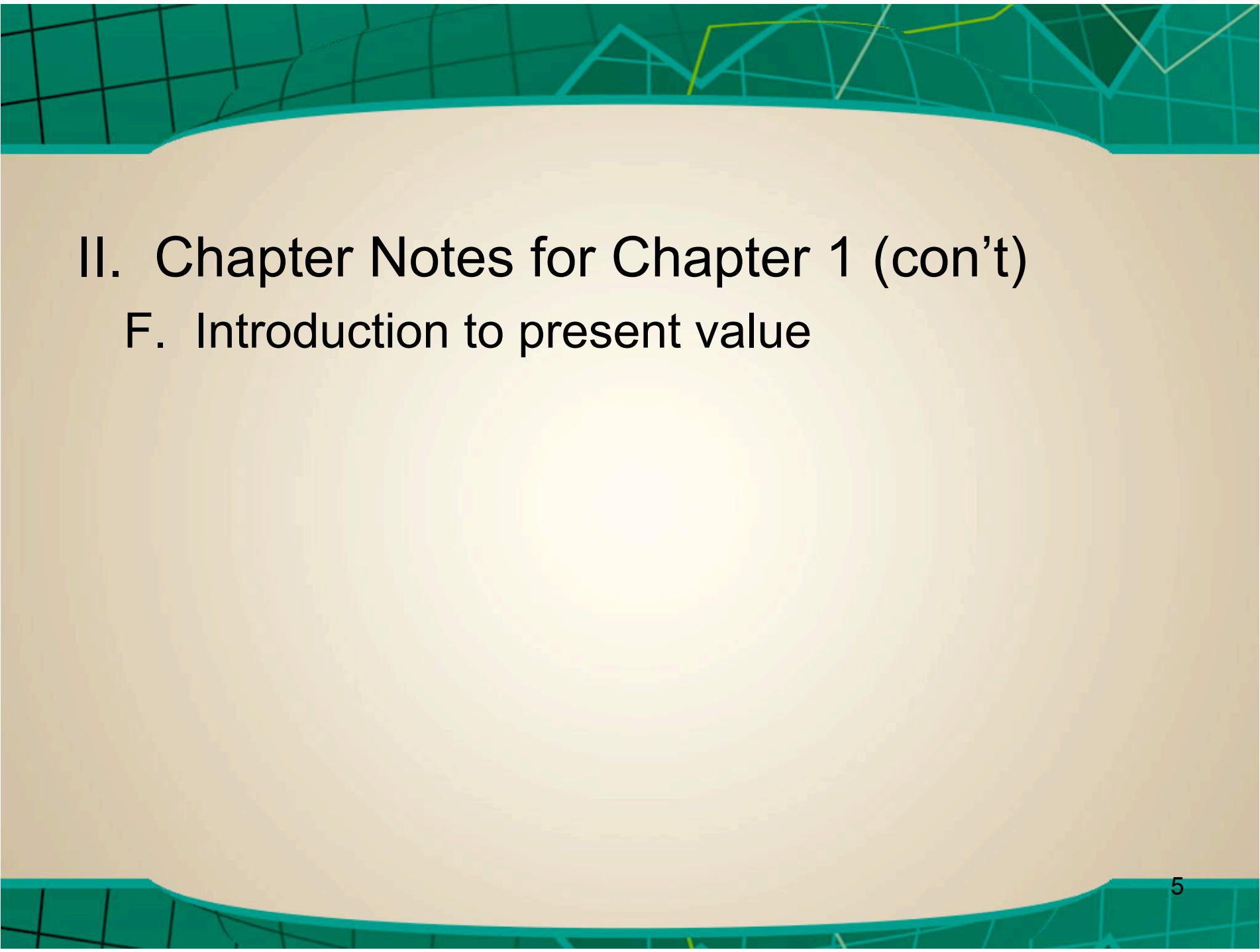
II. Chapter Notes for Chapter 1 (con't)

D. Principles of modern finance

1. The principle of marginality
2. The principle of valuation

E. The income statement method of evaluating costs and revenues

1. Estimating the effect on sales
2. Direct costing vs. full costing
3. Calculating bad debt expense
4. Accounts receivable carrying cost
as an opportunity cost



II. Chapter Notes for Chapter 1 (con't)

F. Introduction to present value

III. Chapter Notes for Chapter 2 of Decisions

- A. Focus: how much credit investigation to perform
- B. What credit investigation does
- C. Policy implications of costly investigation
 1. Tradeoff against bad debt expense
 2. Full investigation isn't optimal

III. Chapter Notes for Chapter 2 (con't)

D. Review of the Mathematical Model of Credit Investigation

1. Small order sizes and bad debt expense
2. Larger order sizes and investigation level
3. Credit investigation and order size
4. Why a customer can get a small initial order approved but not a large one
5. Profit margin and credit investigation policy

III. Chapter Notes for Chapter 2 (con't)

- E. Order size, credit investigation budgets, and bad debt expense budgets
- F. Budgets and the assignment of debtors to analysts
- G. When credit investigation expenses are important and when they are not

IV. Chapter Notes for Chapter 3 of Decisions

- A. Focus of chapter: how to make credit decisions using the results of credit investigation
- B. Credit standards analysis for customers with small order volumes
 - 1. revenue/cost analysis:
 - cutoffs based on credit rating
 - 2. computing bad debt expense

IV. Chapter Notes for Chapter 3 (con't)

C. A present value under for large customers under full credit investigation

1. Basics of model structure
2. Cash flows in this model
3. Review of the model's formula for expected present value
4. A numerical calculation example

IV.C. (continued)

5. Parameter estimation

- a. Sources for S , V , a , b , T , k , and d
- b. Estimating R (recovery in default)
- c. Estimating c (time to pay)
- d. Estimating X (default probability)
 1. Benchmarks for X
 2. Adjusting X based on financial analysis

6. Sensitivity analysis and breakeven X

IV. Chapter Notes for Chapter 3 (con't)

D. Situations that complicate credit-granting decision making

1. The possibility of future sales and when this is relevant
 - a. Changes in credit-worthiness over time
 - b. The role of brand loyalty
2. Potential synergistic benefits from credit-granting

You may now pause to do the problem

- If your webinar connection times out as you are doing the problem, refresh your web browser.
- To do this click the button on your web browser that looks like a circle with arrows
- The webinar will reload and you may fast forward to this point.

I. Analysis of Meritorious Molders

- A. Alternatives in making credit-granting decisions
- B. Analysis by the traditional judgmental method (5 Cs)
- C. Analysis by the one-order E(PV) model

A Present Value Analysis of Meritorious Plastics

Parameters:

Symbol	Meaning	Estimate
S	Sale in dollars	\$30,000
V	Cost of Sale in dollars	\$25,500
a	Time until V is paid (days)	20
T	Tax rate	35%
b	Time until tax is paid (days)	45
c	Customer's time to pay (days)	120
k	Seller's yearly cost of capital	15%
R	Recovery rate	5%
d	Time until recovery (years)	1.5
X	Probability of Nonpayment	13%

Benchmark X: $10\%(120/360) = 3.33\%$

A Present Value Analysis of Meritorious Plastics

Value of Term 1: $-V/(1+k)^a$	(\$25,303)
Value of Term 2: $-(S-V)T/(1+k)^b$	(\$1,548)
Value of Term 3: $(1-X)S/(1+k)^c$	\$24,912
Value of Term 4: $XRS/(1+k)^d$	\$158
Value of Term 5: $XT(1-R)S/(1+k)^d$	\$1,052

Present Value of Granting Credit	(\$729)

A Present Value Analysis of Meritorious Plastics Sensitivity Analysis of X

X	E(PV)		
0.0%	\$1,784		
2.5%	\$1,301		
5.0%	\$817		
7.5%	\$334		
10.0%	(\$149)	Breakeven X	9.23%
12.5%	(\$632)		
15.0%	(\$1,116)		
17.5%	(\$1,599)		
20.0%	(\$2,082)		
22.5%	(\$2,565)		
25.0%	(\$3,048)		

Is R estimate correct?

If $R = 0$, $E(PV) = (\$832)$, Breakeven $X = 8.87\%$