

Credit in the Business World

Chapter One

NACM

Learning Objectives

- ↑ The historical development of credit
- ↑ The primary reasons credit is offered
- ↑ The important elements of credit
- ↑ The credit process and where credit fits in a business cycle
- ↑ The different types of credit
- ↑ The Federal Reserve System and its impact on the economy

Credit in the Business World

- ↑ A Brief History of Credit
- ↑ Primary Reasons to Offer Credit
- ↑ Modern Credit
- ↑ The Credit Process
- ↑ Types of Credit
- ↑ The Federal Reserve and the U.S. Payment System
- ↑ Federal Deposit Insurance Corporation
- ↑ Check Processing

A Brief History of Credit

Credit in Early America

- ↑ First use of credit in early America – 1620
- ↑ Group in Toledo, Ohio created National Association of Credit Men in 1896
- ↑ This group evolved and expanded into today's NACM

Primary Reasons to Offer Credit

- ↑ Increase Sales
- ↑ Competition
- ↑ Promotion
- ↑ Credit Availability
- ↑ Convenience
- ↑ Demand
- ↑ Price

Modern Credit

↑ The word credit comes from the Latin: **credere**

↑ Credit defined: **Credit is the transfer of economic value now, on faith, in return for an expected economic value in the future**

Important Elements of Credit

↑ Risk of Nonpayment

↑ Timing

↑ Security

↑ Extra Costs

↑ Legal Aspects

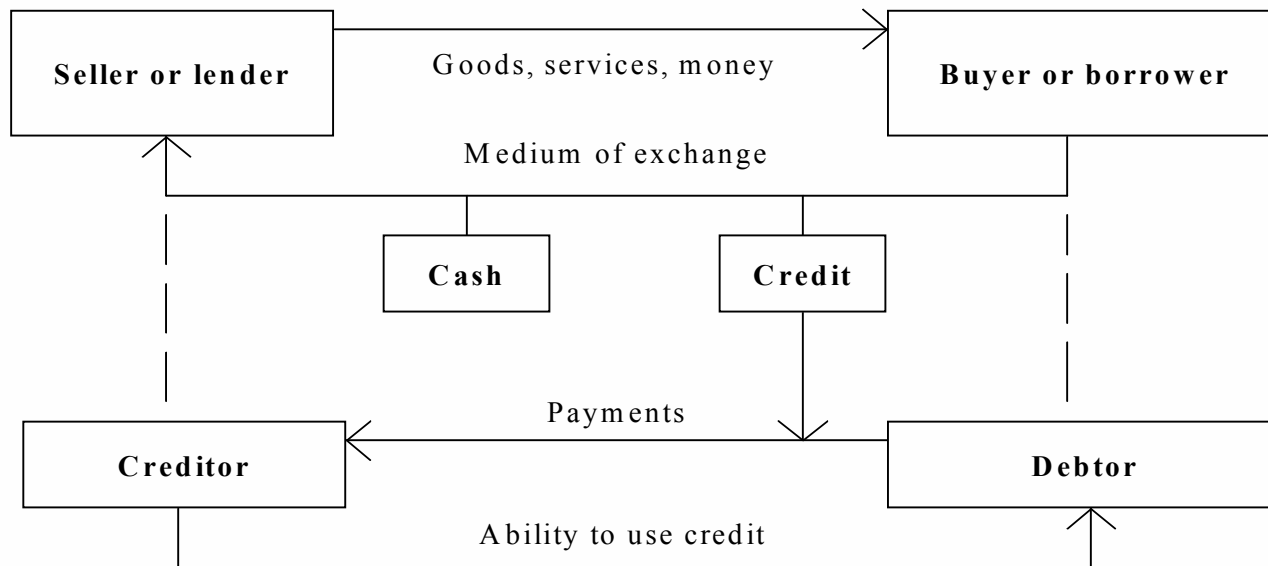
↑ Economic Influences

The Five Cs of Credit

- ↑ Character
- ↑ Capacity
- ↑ Capital
- ↑ Conditions
- ↑ Collateral

Credit Transaction

THE CREDIT TRANSACTION



4

The Credit Process

- ↑ Sales makes contact and order is taken
- ↑ Credit department reviews customer for creditworthiness
- ↑ Order is shipped on credit
- ↑ Payment is made on time/within terms

The Operating Cycle

- ↑ Operating cycle: the period of time between the acquisition of material, labor and overhead inputs for production and the collection of sales receipts
- ↑ Production stage — material converted into goods
- ↑ Collection Stage — customer pays for goods that were purchased on credit

Public Credit

↑ Federal

↑ State

↑ Local

Private Credit

Is extended to or used by individuals or businesses to carry on the exchange of goods and services in the private sector.

Investment Credit

- ↑ Bonds, or fixed-income securities
- ↑ Asset-backed bonds
- ↑ Debentures
- ↑ Secured bonds
 - > Mortgage bonds
 - > Equipment trust certificates (ETC)
 - > Collateral trust bonds

Consumer Credit

↑ Open-end Credit

↑ Closed-end Credit

↑ Incidental Credit

Agricultural Credit

- ↑ Relates to the farming industry and the family farmer
- ↑ More risk to creditor
- ↑ Many laws treat this type of credit separately

Business Credit

- ↑ Important Characteristics
- ↑ Unsecured Open-Account Credit
- ↑ Secured Credit

Bank Credit

The commercial banking system is the greatest originator of credit to the business and financial community. It is the primary, or first, source of credit in use today.

The Federal Reserve and the U.S. Payment System

- ↑ Federal Reserve Banks
- ↑ Federal Districts and Branches
- ↑ Demand for Reserves
- ↑ Changing the Reserve Requirement
- ↑ Supply of Reserves

Role of the Fed

- ↑ Administrator
- ↑ Banker
- ↑ Controller
- ↑ Guardian
- ↑ Lender
- ↑ Regulator
 - > Reserve requirements
 - > Discount rate
 - > Open market operations

Federal Reserve Banks

- ↑ The Federal Reserve is divided into 12 districts
- ↑ Each district managed by a district bank
- ↑ Federal reserve banks generate their own income

Federal Districts and Branches

Each of the 12 district banks, with 25 regional branches spread across the nation, has its own Chairman and nine-member Board of Directors.

Each district bank is identified by a letter and corresponding number.

Demand for Reserves

↑ Required reserves

↑ Excess reserves

Changing the Reserve Requirement

↑ Increase reserves

↑ Decrease reserves

Supply of Reserves

↑ Lending

↑ Buying

↑ Discount rate

> Increase in rate

> Decrease in rate

Federal Deposit Insurance Corporation (FDIC)

To provide insurance protection for depositors if their bank fails.

Check Processing

↑ The MICR line contains the following information:

- > Routing number
- > Payor account number
- > Sequence number
- > Encoded check amount

Electronic Funds Transfer

- ↑ Fedwire
- ↑ Automated Clearing House (ACH)
- ↑ The Clearing House Interbank Payments System (CHIPS)