

Making Credit Decisions



Class Objectives

- Approval of credit for new customers
- Establishing credit limits
- Implementing credit limits for existing customers
- How to use credit scoring
- Credit approval for and management of marginal accounts
- Making credit decisions using limited customer information
- Conducting reviews of credit limits

New Account Philosophy

- The Role of Credit is to Support Sales
- The Role of the Credit Manager is to Protect Company Assets (A/R)
- The key is to find a way to make the sale while ensuring payment will be received.



Accounts for New Customers

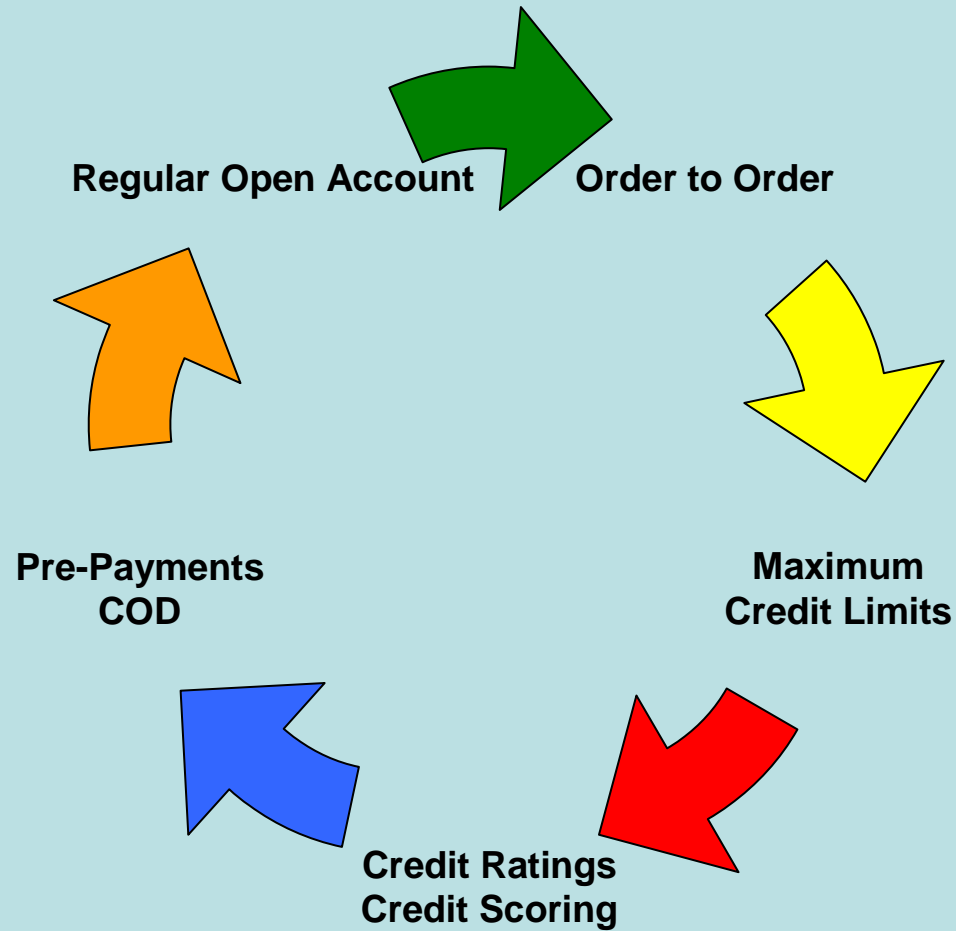
Should be approved quickly

Can be the first impression of how credit will handle the account.

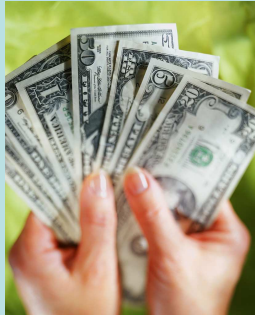
Promotes good will with sales and the customer

Sets customer expectations from the beginning

Ways To Approve Credit



Things to Think About When Extending Credit



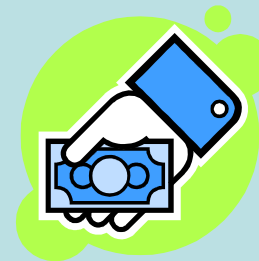
What is My Profit Margin?



How Much Credit Are Other Suppliers Giving?



Does the Customer Have the Resources To Pay?



When Can The Customer Pay?



Is the Customer Credit Worthy?



What Are The Terms of Sale?

Other Considerations

- Your company's financial position
- Your competitive edge
- How quickly you need to turn receivables to cash so you can meet your monthly obligations
- Size of the customer's project
- What can your company afford to lose?

Lost Profits

Loss	2% margin	3% margin	4% margin	5% margin
\$300	\$15,000	\$10,000	\$7,500	\$6,000
\$500	\$25,000	\$16,666	\$12,500	\$10,000
\$1,000	\$50,000	\$33,333	\$25,000	\$20,000
\$3,000	\$150,000	\$100,000	\$75,000	\$60,000
\$5,000	\$250,000	\$166,666	\$125,000	\$100,000

Impact of Credit Policy

- You can be tight on credit approval and loose with collections
- You can be loose on credit approval and tight on collections

But

If you are loose with credit approval and collections or too tight with credit approval and collections you are headed for disaster. You must have a balance.

Decisions Based on Limited Information

- Lack of bank information
- New business with no or low payment history
- No personal guaranty
- No response to credit references
- No signed credit application just a fact sheet

Something to Think About

Should you tell the customer what his credit limit is?



Should You Tell the Customer What His Credit Limit Is?

Pro's

- Opens the door to talk about expectations
- Reduces embarrassment of holding orders if over the limit

Con's

- Limits sales if prompt pay
- Customer may think he is worth more
- If you don't talk to customer about it you may extend too much credit.
- Courts may rule against you if you exceed the given limit

By Payment
Record

Amount
Competitors
Grant

Low to Begin
With Increase
Later



Establishing Credit Limits

By Credit
Rating

By Formula
Credit Scoring

By Expected
Sales Vs.
Terms



Establishing Credit Limits Based on Your Own History

- Number of years you have been doing business with this customer
- What limits he has had in the past
- Pay habits over time
- Current payment trend



Staying Competitive in the Marketplace

- What terms are your competitors offering
- What high limits show on a credit report

Note:



Talking to competitors about terms can be an anti-trust issue. Never agree to match competitor terms unless there is a competitive reason to do so.

The higher the limit the higher the risk.

Credit Scoring

CREDIT LIMIT TABLE

<u>D&B Rating</u>	<u>Credit Limit</u>	<u>D&B Rating</u>	<u>Credit Limit</u>
5A1	\$1,000,000	CB1	\$25,000
5A2	\$1,000,000	CB2	\$25,000
5A3	\$300,000	CB3	\$7,000
4A1	\$750,000	CC1	\$10,000
4A2	\$500,000	CC2	\$10,000
4A3	\$250,000	CC3	\$3,000
3A1	\$300,000	DC1	\$5,000
3A2	\$150,000	DC2	\$5,000
3A3	\$100,000	DC3	\$1,000
2A1	\$100,000	EE1	\$5,000
2A2	\$100,000	EE2	\$5,000
2A3	\$30,000	EE3	\$1,000
1A1	\$75,000	FF1	\$1,000
1A2	\$75,000	FF2	\$1,000
1A3	\$25,000	FF3	\$500
BA1	\$50,000	GG1	\$1,000
BA2	\$50,000	GG2	\$1,000
BA3	\$15,000	GG3	\$500
BB1	\$30,000	HH1	\$1,000
BB2	\$30,000	HH2	\$1,000
BB3	\$10,000	HH3	\$500

Preset Filter for the Instant Credit Decision				
Rules and Criteria	Red Declined	Yellow Conditions	Green Approved	Explanation of Rules and Criteria
<i>(One Failed Rule Equals Decline)</i>	<i>(Number of Instances or Occurances)</i>			<i>(Description)</i>
 30 – 59 days past due	4 or more	3	2 or less	If Applicant has a Tradeline delinquency within the past year or 12 months.
 60 – 89 days past due	3 or more	2	1 or less	
 90 – 119 days past due	3 or more	2	0	
 # of Trades Past Due	4 or more	3	2 or less	If Applicant has a Tradeline delinquency within the past month or 30 days.
 # of Trades 60+ Past Due	3 or more	2	1 or less	
    # of Trades 90-180 Past Due	3 or more	2	0	
 Collection	3 or more	2	1 or less	If Applicant has any Accounts in the Collection Section
 Tax Liens	3 or more	2	1 or less	If Applicant has any Tax Liens in the Public Records Section

Limiting Exposure

- Reduce exposure on marginal accounts with lower credit limits and shorter terms

Note:

Anytime you make special deals to limit exposure of marginal accounts you run the risk of forgetting to follow up.

Example 1

- Customer credit report shows customer is paying suppliers on time
- Your Sales person says he anticipates sales of \$5,000 per month.
- Terms are set at Net 60 days
- Minimum terms will need to be at least \$10,000

Example 2

- Marginal customer and you want to limit exposure
- Customer expected to buy \$5,000 per month
- Terms set at N10 days
- Credit limit could be less than \$5,000

What is a Marginal Account?

Slow Payments

Finances are Inadequate

Weak Management

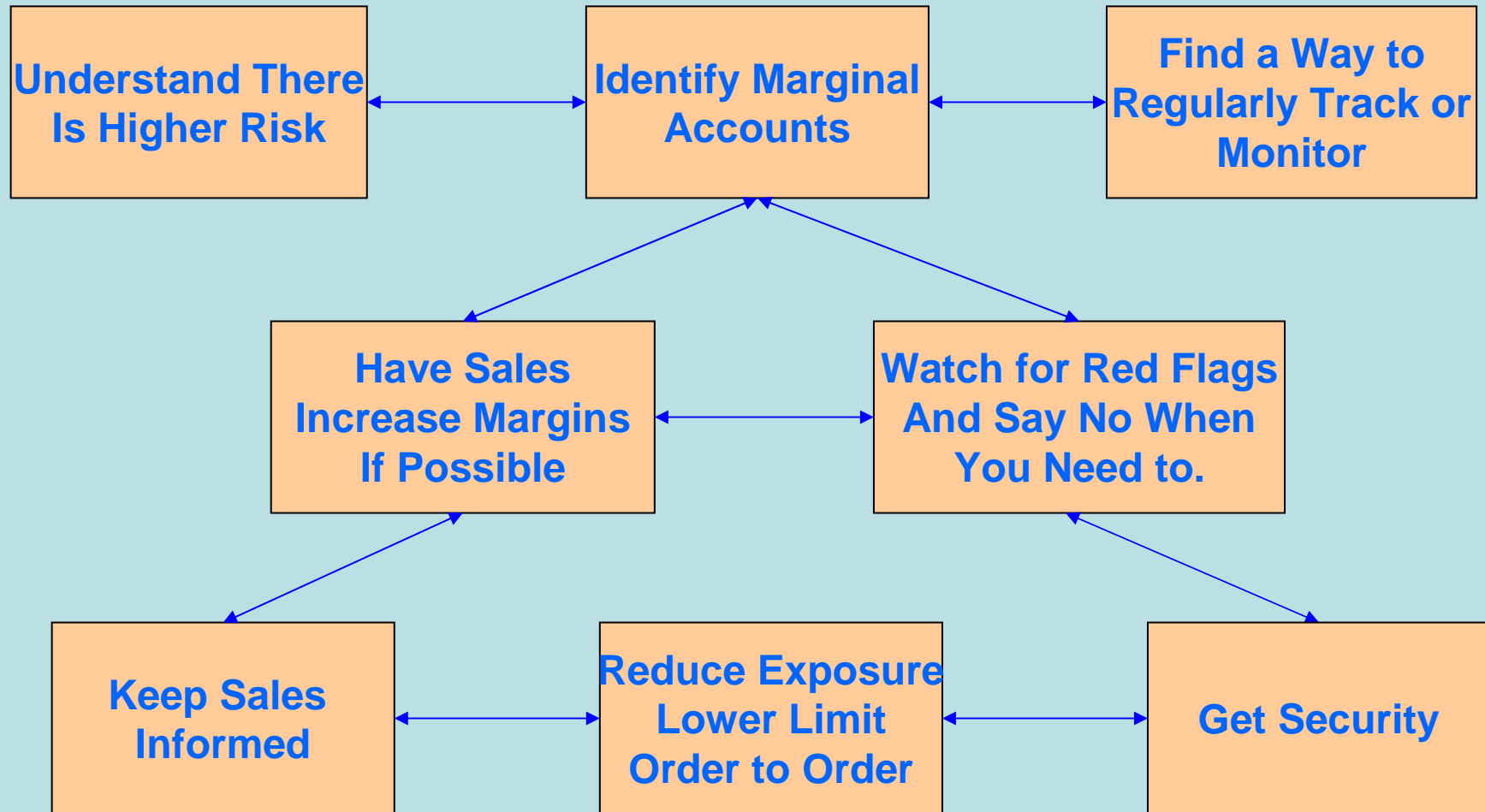
Poor Credit Rating

Low Profits

High Maintenances



Keys For Managing Marginal Accounts



Question

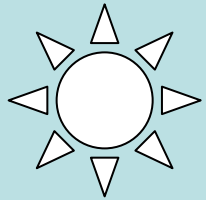
Do you think the use of credit limits helps you manage your A/R?

- **Yes**
- **No**
- **Credit Limits don't matter because in our company they don't mean anything.**

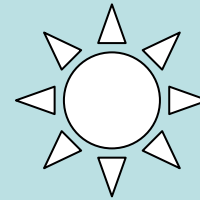
Reviews of Credit Limits

- Regular reviews of credit limits/files should be done:
 - Review your history and customer payment trend
 - Do you have a signed application or contract
 - New Credit report
 - Customer's potential growth
 - New bank information
 - Trade group information

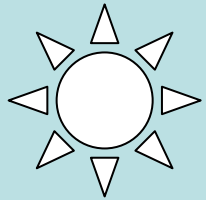
Exceeded Credit Limits



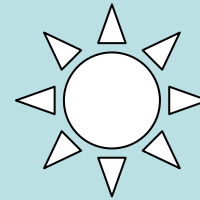
Should be Reviewed.



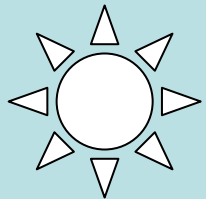
When Was The File Last Updated?



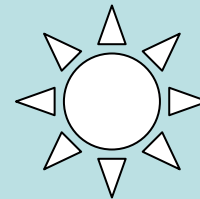
Is account Prompt?



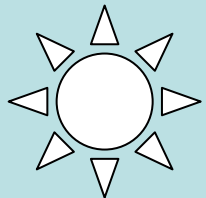
Has Credit History Changed?



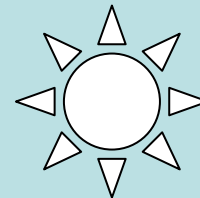
Are Other Suppliers Still Selling?



Does This Customer Have Extended Terms?



Have Sales Increased If Yes Why?



Does Sales Have A Strong Relationship With This Customer?