2 Credit in the Company

Overview

Business is concerned with the sale of goods or services for a profit. This chapter discusses the role and structure of the credit department in a business setting from strategic and organizational points of view. It also covers the credit department's goals and the relationships between the various departments. The daily activities of the credit department including collections are described.

THINK ABOUT THIS

Q. How is the role of credit perceived by different departments in the company?

Q. How can the use of credit facilitate the overall direction and objectives of a company?

DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- Why credit is a function of business.
- The strategic role of credit.
- Where credit typically fits within the business organization.
- The role of credit in financial management.
- The role of credit in the operating cycle.
- The goals and core activities of a credit department.

Chapter Outline

Credit as a Business Function

The word **business** *first appeared around the 14th century and originally meant "purposeful activity."* Today, the inclusive term "business" designates the activities of those engaged in the purchase or sale of commodities or in related financial transactions. In other words, a **business organization** *is a combination of functions, people and materials aimed at producing goods or services, and selling them to customers at a profit.* The sale of most commodities is accomplished through the extension of credit.

The credit department is an integral part of the business organization. It is the link between customers and many other business functions such as marketing, sales, production, shipping, customer service and accounts payable.

The role of the credit department continues to evolve. The credit department is involved from the time the order is solicited to the time the cash is collected. This **order-to-cash** responsibility reaches well beyond the financial evaluation of a customer's ability to pay and collecting that payment. The credit department represents a business decision that requires both financial and strategic decision-making to ensure that a proper balance of benefit is derived from sales against carrying the cost or potential loss.

Strategic decision-making is part of strategic planning, which is the key component that underlies credit policy and procedures. *The art of devising or using plans to achieve a goal is called* **strategy. Strategic planning** *entails the coordination of long-range plans with a particular focus on strategies, controls and desired results.*

External factors such as social, political, economic, legal, technological and competitive pressures impact a company's strategic plan. These external factors must be weighed in light of internal business factors such as production capacity, financial strength, human resources and sales. Both external and internal factors are assessed in terms of risk and reward. The role of strategic planning underlies the framework from which any policy, including credit policy, is formulated. Clearly defined goals affect the credit department's ability to shape the resulting credit policy.

Comprehension Check

Discuss what the term **business** means.

What is meant by the term **order-to-cash?**

Define the term **strategy.**

What factors impact a company's strategic plan?

The Strategic Role of Credit

The credit department is involved with the customer cycle from placement of the order to the collection of payment. The cycle involves gathering and analyzing all information available which culminates in the best possible position to mitigate risk.

Consider the following broadly defined credit-related areas:

Amassing Information

The more information available about a customer or potential customer, the greater the quality of analysis. That same information also has strategic implications; it can strengthen a company's understanding of its customer base and lead to expanding that base. The credit department is, in effect, an information and business intelligence warehouse within any company. The information gathered by a credit department can be used by a purchasing department to screen vendors or by the sales department to help find new customers.

Credit Analysis

Credit analysis provides a business protection from financial risk and, depending on a company's strategic goals, becomes an important factor in the sales decision. By assessing the risk of whether a customer or potential customer has the ability, and/or willingness, to pay when the credit account becomes due, the credit grantor can avoid risk, improve profits, sell more to better-paying customers and forecast cash required to operate and invest.

Securitization

Securitization *includes but is not limited to letters of credit, Uniform Commercial Code (UCC) filings, liens and guarantees.* The credit department must ensure that all accounts are properly securitized to protect against defaults.

Collection

While the credit department is responsible for the enforcement of payment terms, credit terms are a part of a company's strategic business plan. Whether credit terms are restrictive or liberal will have a direct impact on that plan as well as on the credit process. Cash forecasting is a sequential event for the credit department.

Cash Application

Cash application is the function of matching and applying customer payments to accounts receivable, which represents transactions booked by the company for products or services sold to customers on unsecured, open account credit. This process is related to the timing of cash flow and the cost of carrying a receivable. The strategic implication of the cost of carrying receivables is related to a company's financial strength and its ability to gauge its need for cash flow or, in other words, properly forecast future cash requirements to meet payroll, expenses and other such demands for cash.

Deduction Resolution

The financial implication of the cost of carrying unresolved deductions or customer disputes affects a company's operating costs. Deduction resolution has very critical strategic implications because it is directly related to customer satisfaction, which in turn impacts sales.

Comprehension Check

Discuss a credit-related area that has both a financial and strategic implication.

Credit within the Business Organization

The credit department is responsible for the management of accounts receivable. From an accounting perspective, accounts receivable plays an important part in a business organization. Accounts receivable is a current asset and a component of **net working capital,** *which is the excess of current assets of a business over its current liabilities.*

Net working capital is calculated by subtracting current liabilities from current assets:

Net Working Capital = Current Assets – Current Liabilities

In larger companies, the finance department or the treasury department is responsible for the management of working capital. In smaller or family-owned businesses, the owners or top executives usually manage working capital.

As a result of this **balance sheet logic,** the vast majority of credit departments report to either the treasury or finance department. A 2015 NACM survey of its membership found that approximately half of participating credit executives said they meet with either a chief financial officer or treasurer once per month to discuss credit department performance, metrics, etc. Another 18% said they meet quarterly with upper management.

Some of the finance-related functions that the credit department manages include:

- Protecting and managing the investment in the accounts receivable portfolio.
- Cash forecasting.
- The timely conversion of receivables into cash.
- Financial analysis.
- Handling of collateral that secures a customer's account.
- Deposit of funds and the relationship with banks.
- Handling customer deductions.
- Evaluation of economic trends on sales, receivables and collections.

Comprehension Check

Using balance sheet logic, explain where the credit department falls within an organization.

List eight finance-related functions that the credit department manages.

The Role of Credit in Financial Management

Managers practice financial management when they:

- Obtain cash from investors.
- Use that cash to buy productive assets.
- Operate those assets to produce additional cash.
- Return cash to the business and/or investors.

Comprehension Check

What is the goal of cash management?

A key component of a company's financial activities is managing cash flow or cash management. *The goal of* **cash management** *is the efficient management and use of cash in a manner that is consistent with the strategic objectives of the business.* A major goal of cash management is to manage cash flows in order to increase the long-term value of the business while balancing the inflow and outflow of cash so that the business can meet its demands for cash by creditors, banks, investors, stakeholders and owners.

The management of cash flow can be divided into the following three broad areas:

Managing Cash Inflows

Cash inflows *are the funds collected from customers or obtained from financial sources*. Cash flows into the business from the sale of goods or services, from the return on interest-earning assets in the form of interest or from the return on equity securities in the form of dividends. Cash also flows into a business when it borrows money or obtains money from other sources outside of its normal operations.

Internal Cash Flow Management

This includes managing the company's cash reserves and investing cash or transferring cash among the operating units of a business or various bank accounts. Excess cash is usually invested so that it earns interest, becoming a productive asset.

Managing Cash Outflows

Cash outflows *are the funds disbursed from cash reserves to pay for purchases of inventories, to pay for operating expenses such as salaries, rent and insurance; to pay for the purchase of long-lived assets such as buildings or land; or for the repayment of debt principal or payment of dividends.*

The credit department plays a crucial role in managing the cash received from the sale of goods or services. The timely collection of cash is critical to maintain the proper balance of cash inflows and cash outflows.

Comprehension Check

List and describe the three broad areas of cash flow management.

Credit and the Operating Cycle

The **operating cycle** *comprises the activities a company performs to produce and sell its product or service.* A business must first purchase the resources it needs to make its product. It then sells that product and collects the funds from the sale. *Cash flows into and out of the business during the operating cycle. Cash flows out of the business during the production stage, when it purchases the resources needed. Cash flows into the business when it sells the product to a customer.* Rarely do these events occur at the same time; the challenge of business is to maintain sufficient levels of cash throughout the operating cycle to ensure smooth and ongoing operations.

The **collection stage** or **cycle** *begins after the sale of a product is made or services are rendered. With new or high-risk accounts, the collection cycle can begin as early as the credit department's receipt of an order or customer application as the credit department makes provisions for a strict collection plan strategy. In more routine sales, the collection cycle begins with the sale.*

The order is received and the customer placing the order is reviewed for creditworthiness to arrive at the credit decision. Sometimes, and depending on the credit policy, an order/customer passes all credit indicators and the order is approved. If the credit indicators point toward further credit investigation, the necessary steps are taken to make the sale while reducing the risk.

Upon approval, the order is recorded as a sale and an invoice is created. The events of recording the sale and creating an invoice are usually simultaneous. At this point the receivable is created. The invoice is, in effect, a memo or record of the sale and should include an itemization of products or services purchased.

The order is then shipped. The timing varies from company to company; sometimes the order is shipped as soon as the order is approved and the creation of the invoice follows. Sometimes, shipping and invoicing occur simultaneously. In other companies, the invoice is created after the order is shipped. The important point is that the work of the credit department continues after the order is shipped by monitoring the receivable.

In a perfect credit world, payments are received when due. The accounts receivable is reversed when the payment is received, and the cycle begins again. The reality is that not all invoices are paid as they come due. Among the reasons are errors, discount violations, incomplete or incorrect payments or deductions. The disputes must be settled with chargebacks or credit memos. In some cases, the order is canceled and a new invoice is issued. Invoice disputes are usually resolved by direct communication with the customer and other departments within the company key to the transaction. Financially distressed customers that do not pay invoices as they are due must be followed closely with an understanding yet aggressive collection effort. When a direct collection effort is not successful, a third party—a local NACM Affiliate, a collection agency or a collection attorney—can be used. In cases of insolvency, the business must be assessed to determine whether it can be financially rehabilitated or whether it should be liquidated. Depending on its policy and strategy, a company may or may not continue to offer credit to a financially distressed customer. Some businesses continue to sell to customers, even during a bankruptcy proceeding while other businesses terminate credit to customers based on the severity of the situation.

Reprinted from Chapter 1 (Figure 1-1)

Comprehension Check

Describe the **operating cycle.**

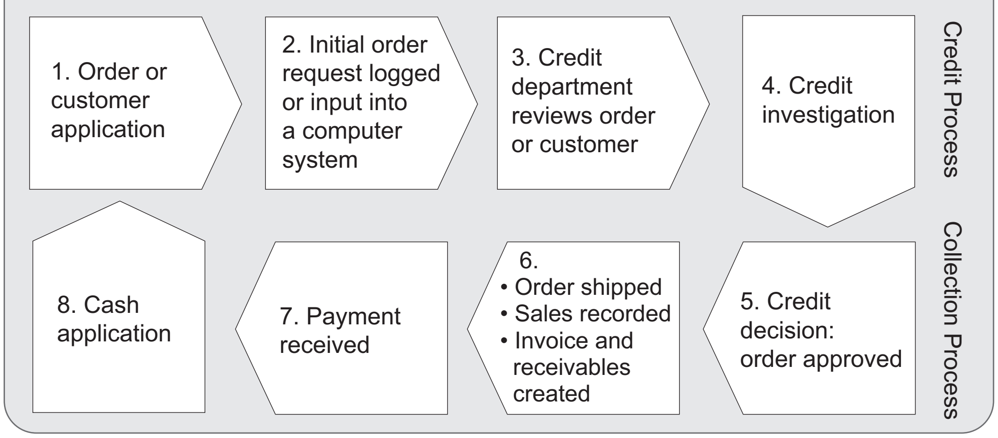

Figure 2-1 **Credit and Collection Process**

The Core Activities of the Credit Department

The credit function is a valuable asset to a company's business. Using creative methods to structure transactions so that sales can be approved, the credit department makes a significant contribution to sales and profit maximization by knowing when and how to accomplish the sale while minimizing risk.

The core activities of the credit department are:

- Customer and credit analysis.
- Developing credit policy.
- Managing the collection function.
- Setting credit availability thresholds.
- Management reporting.

Comprehension Check
List the core activities of the credit department.

Required Areas of Knowledge

To accomplish these goals and to perform these core activities, the following areas of knowledge or skill sets are required:

A Thorough Understanding of the Accounting, Financial Analysis and Finance Disciplines

All three of these disciplines come into play during the analysis of the customer. A mastery of both accounting and financial analysis is needed when interpreting information about a customer. Basic concepts in the area of finance, such as the time value of money, assist in determining the cost of offering credit terms from the perspective of both the buyer and seller.

A Comprehensive Understanding of Business and Credit Law

Many elements of the credit function require a thorough understanding of legal concepts. For example, a credit application may be used as a legal contract between the seller and the buyer. A cardinal rule of any credit investigation is: Know Your Customer (KYC). Is the customer a corporation, partnership or sole proprietor? Who are the owners? Antitrust laws, the Equal Credit Opportunity Act and the Fair Credit Reporting Act all affect what the credit department can and cannot do. Securing a credit transaction involves the Uniform Commercial Code.

Sound Business Communication Skills (Writing and Presentation)

The credit department must compose and send a variety of written communications to the customer as well as create meaningful reports for management. In management meetings, credit managers must be able to clearly explain credit issues in order to have input in general business policies and practices. Excellent verbal communication skills are critical when dealing with internal business functions and with customers.

General Management Skills Including Expert Negotiation Skills

As with most business functions, general management skills are a must. The ability to effectively manage, inspire and motivate credit department personnel is critical to the success of any credit department. As business changes, so do management techniques. There has been a shift to the team concept, which demands an understanding of how sales, credit and management/ownership work together to achieve the goals of the business. Additionally, expert negotiation skills are invaluable in the collection area. General management skills also include the ability to assign responsibility, delegate authority and maintain accountability for the results.

Customer Service Skills

The credit department interacts with the customer and also serves as the intermediary with a variety of other business units such as the sales department, the purchasing department, manufacturing or production and so on.

Analytical Skills

The ability to analyze both the customer's financial condition and general economic conditions and trends is key to a successful credit department.

Computer Skills

Most companies rely heavily on constantly evolving technology (e.g., computer automation software, Enterprise Resource Planning (ERP), cloud data storage, electronic credit applications, etc.) to enable the credit department to investigate the status of an order at any point in time. Often these specialized tools are critical to the credit function by helping managers analyze, plan and develop department objectives, policies and programs. More companies are using credit-scoring programs to evaluate credit and financial information on credit applications as these metrics can help reduce costs through automating some processes. This can include approving customers for open account credit automatically based upon applicants meeting specific criteria defined and determined by the credit, sales, management and ownership teams. Use of ERP systems, such as SAP and Oracle, as well as credit-focused bolt-on software options designed to close gaps left by "off-the-shelf" system options, continues to expand as companies increasingly find the efficiencies gained by implementing or upgrading a system justify the high cost and time commitment. Credit professionals are increasingly being asked to participate in ERP implementation in the early planning phases so potential problems can be addressed before the cost of fixing errors or closing gaps skyrockets. NACM members should consult the checklist, *Implementing ERP Systems,* posted in the NACM Knowledge & Learning Center.

Comprehension Check

Discuss some of the areas of knowledge or skill sets required for credit management.

The Credit Department's Goals

It is the responsibility of the credit department manager to plan and direct the activities of the credit function within the guidelines of company policy.

The goals and objectives of every credit department are:

- Increased sales and profits through skillful handling of the credit function.

- Improved quality of work performed due to greater accuracy, thoroughness and care exercised by every member of the staff.
- Decreased cost per unit of work performed resulting in improved planning, direction and supervision.
- Mitigating bad debt losses.
- Monitoring credit department costs.
- Measuring performance.

Comprehension Check
List six goals and objectives of every credit department.

The goal of the department is to achieve an optimum combination of profitable sales, turnover of accounts receivable investment, bad-debt expense and credit department operating expense.

The Credit/Sales Relationship

Continually fostering a symbiotic credit/sales relationship is one of the most important goals of the credit manager. A primary objective of the credit department is to support sales; with that support, sales can be made that otherwise would not have taken place. The credit/sales relationship should be evaluated on a regular basis to ensure that the expectations and goals of the organization are being met.

One of the major contributions of the credit department to the sales function is to work with customers and sales representatives and to find ways to approve orders. For example, a credit manager may be able to suggest a financing method not previously considered by the customer or may be helpful in locating sources of capital for a customer.

Also, what may be called a **marketing risk** should be distinguished from a credit risk. For example, to achieve adequate geographic distribution in marketing a name-brand product, it may be necessary to sell to a company that may not be creditworthy. **Marginal accounts** *or accounts with poor payment history, inadequate working capital or a deteriorating financial condition* are taken on for strategic reasons and should be identified as such when accounts receivable is analyzed. The credit department must communicate the risks to sales and management while guarding the confidentiality of the sources of information relating to the customer.

Comprehension Check
How can a less creditworthy company be used as a marketing strategy?

The Credit/Purchasing Relationship

Purchasing departments often check the financial condition of new supply sources through the credit department to ensure that the vendor or subcontractor will be able to deliver goods or services as agreed.

An interruption in the supply chain because a vendor could not get raw material or product on credit can cause a business to miss manufacturing or delivery deadlines and therefore affect sales and collection of accounts receivable—the company's cash flow. Worse yet, if the company is involved in a supply contract and cannot perform, then the company could be held in breach of contract. Knowing and understanding a company's suppliers and vendors is also a function of the credit department's responsibility to avoid risk except this potential risk is different from the typical credit function

Besides inquiring into the backgrounds of potential suppliers, the credit department can also analyze a supplier's financial condition. At times, the credit department is called upon to collect or adjust debit memos issued to cover claims for defective material or to settle other chargebacks. The credit department can assist in negotiating with suppliers. For example, it can arrange for other types of security, such as letters of credit, UCC-1 filings and liens. The credit department may also see to it that setoff rights are retained when its company both sells to and buys from another company. Under most state laws, a creditor has the right to offset mutual debts it owes against the debtor's liability to it.

The Credit/Manufacturing Relationship

When overproduction leads to excess inventory, it may be necessary to dispose of the goods through sales to accounts that may not ordinarily be viewed as creditworthy. Just as with marketing risk, the credit department should closely follow these production risk sales in order to minimize collection costs and bad debts.

Sometimes orders are put into production "subject to confirmation" by the credit department before shipment. An **approval subject to confirmation** *usually means that the customer is being asked to do something before goods are released, such as pay an overdue balance, reduce an outstanding balance to an acceptable level or submit an interim or annual financial statement.* This allows the goods to be manufactured for delivery on time to the buyer. While most of these conditional approvals result in the release of goods when they are ready, they do represent a production risk.

In periods of shortages, a customer may order goods well in excess of actual requirements in the hope that the amount allowed will be close to the quantity actually required. The credit department can be instrumental in spotting orders that are out of proportion to the relative size of the customer. A credit manager can usually recognize this practice and keep the sales and manufacturing departments from being misled into believing that growing sales have made additional production facilities necessary.

Comprehension Check
Describe an approval subject to confirmation.

The Credit/Information Systems Relationship

As a company implements new technology, the first goal of the credit department is to get involved early in decision-making and planning in order to present valuable data about the credit process. Applying technology to the credit process requires a detailed examination of what information is necessary and what is not. *Breaking down key processes into primary activities, including actions, decision points and information/transportation flows,* is referred to as **process mapping** which is critical to implementing new technology. Technology can improve the flow of information, speed decision-making and standardize the credit process, which will continue to increase efficiencies and reduce costs.

Electronic Data Interchange (EDI) *is the movement of data electronically from one computer to another in a structured, processable format.* EDI has revolutionized the management of information and cash flow. The information needed in a typical business transaction may include items such as a request for a quote, a purchase order, a purchase order acknowledgment, shipping documents, an invoice, a payment advice and a freight bill. EDI converts these documents to electronic messages routed directly between the parties, either in a standard, widely-accepted format or in a proprietary, mutually agreed upon format.

Comprehension Check
Define the term **electronic data interchange.**

Credit Department Relationships with Other Departments

Determining the status of a customer's account often requires close cooperation with the accounting department. The credit department frequently accounts for payments received and for collateral taken in settlement of customer accounts, credit adjustments and corrections of sales.

Federal and state laws, as well as the proper use of legal documents, play a critical role in business and require the credit department to interact extensively with the legal department or with counsel. The credit department also plays a key role in bankruptcy proceedings.

Comprehension Check

How does the credit department interact with other departments to meet the goals of the organization? Choose one and be specific.

In cases when a customer has difficulty with one of the company's products, it may be necessary for the credit department to consult with the engineering or manufacturing group about corrections or replacements to be made before payment of the account can be collected. Logistics may wish to determine the financial responsibility of carriers and may require assistance in the collection of claims for shortages or damages.

A close relationship must also exist with the human resources department. The credit manager should take an active role in creating job descriptions for credit personnel, recommend salary ranges and coordinate training programs.

Organizing the Credit Department

Each function performed must be planned for within the organizational structure of the credit department in order to ensure a smooth flow of credit. Two essential functions are **defining responsibility** and **staffing**.

The credit department's structure should be flexible, yet delineate responsibility for each function to be performed and for each customer account. Regardless of the size of a credit staff, a company must have continually educated, qualified individuals to address its workload. Key functions of the credit manager include forecasting staff requirements, working with human resources on accurate and current job descriptions as well as budgeting for growth and crucial training opportunities.

Day-to-Day Administration

The Credit Approval Process

Certain procedures must be followed before a credit decision can be made. The relationship with the customer must be established; essential information about the account must be obtained, analyzed and stored; and the data must be evaluated so that the processing of future orders may be facilitated.

Customer relationships are usually initially established through the sales department by direct sales calls, marketing and advertising programs. Customer orders come through the sales department, which furnishes the necessary credit information about the prospective customer.

Few companies make shipments on open account to a new customer without some sort of credit investigation. Trade experience, financial statements and bank references about the customer should be reviewed. Credit reports may also be used, as well as direct interviews or correspondence with the prospective customer and information gathered online.

The credit department is usually the only group, other than sales, to have substantial contact with the customer. This may happen when the credit investigation fails to provide sufficient data to warrant approval of the amount of credit requested. When additional information is required, correspondence should be sent or site visits arranged to meet the management team. Although the sales force is ordinarily not involved in the financial conversations with a customer, they should be kept informed of the discussions. Sales has the primary responsibility for dealing with customers, so communication is critical.

Special documentation may be necessary. The credit process may require involvement of legal counsel for both the seller and buyer. A security agreement along with filings under the Uniform Commercial Code should be made if collateral is required. Guarantees and/or subordination agreements should be at the ready in the event some form of indemnity is determined to be necessary to do business with a particular customer. A letter of credit and other special documentation may be called for in international dealings.

The credit file is the place for information on a customer's account, including its history and current status. It must be readily accessible but handled in a confidential manner. Many customers require that a confidentiality agreement be signed stating that all information will be held in confidence. Printed or digital credit files should be reviewed periodically to ensure customer information is manageable and not obsolete. Storage of this information—including on electronic, cloud-based platforms—must be done in a secure manner not just to keep customers happy, but to avoid potential legal problems and/or fines.

Financial statements should be analyzed with appropriate tools and techniques to aid the evaluation. Statements received directly from the customer should be promptly acknowledged.

All of this information, and more, helps the credit manager to make a decision regarding order approval while minimizing risks and easing potential responses in the event of a customer default. Establishing credit lines or limits can aid in processing further orders. The credit professional should communicate promptly with the customer regarding a credit decision and specify the parameters of the relationship. This will help minimize questions and future disputes.

Account Establishment

The ultimate responsibility for the status of a customer account rests with the credit department. It is essential, therefore, to set guidelines for account establishment. By having the customer complete a credit application, much of the needed information can be obtained.

The account must be precisely identified with its correct legal name and address. Additional identifiers may include an alpha-numeric identifier, a DUNS number, bank transit number or a Social Security or Employer Identification Number (EIN). It is important to obtain customer billing instructions and accounts payable contacts; credit terms should be clearly communicated and agreed upon.

Payment processors or receivers of electronic payments must have guidelines for handling errors, short payments or overpayments, and terms and discount violations. They should know how to communicate with customers and with the sales and credit departments to resolve problems.

Collectors should minimize customer slowness and resolve problems arising from such items as returns, shipping claims covering shortages and damage, pricing disputes or allowances for advertising and promotion.

Order Processing

Every order that falls within established credit parameters should be processed quickly for shipment to the customer. Orders over the limit, a new account or past due balances, etc. should be reviewed by the appropriate person along with the account status, the credit file or other pertinent information. Wherever possible, orders should be released for shipment quickly. If it is necessary to hold them until a credit deficiency is remedied, both the sales department and the customer should be notified.

Accounts Receivable Administration

The sum of all customer account balances must agree with the accounts receivable control account in the general ledger. This total reflects the company's investment in accounts receivable.

As a shipment is made, its invoice is posted to the customer account. Credits and payments are also posted, so at any time the sum of the open items represents the balance due from the customer. From a credit perspective, accounts receivable administration reflects the credit parameters established for customers, along with a historical summary of the transactions that have taken place. Thus, it may involve customer identifiers, credit limits, credit ratings, daily shipping amounts, aging of open items, terms and a payment summary. **Quantitative data** *for reports include number of invoices, checks, credits, discount or other terms violations, short payments and overpayments.* The ledger should also contain a summary of order activity along with the impact on the balance due of any orders that have been approved or held but not yet shipped. This will provide an accurate view of the account as it looks when those orders are shipped and billed.

Collections and Adjustments

The collection aspect consists of cash inflows from accounts receivable. Most customers pay invoices as they are due and need no special collection effort. They may send payments directly to the creditor, to a lockbox or to a third party.

Comprehension Check
What are the day-to-day steps in credit processing?

Lockbox Operations

A **lockbox** *is a check collection system operated by a bank.* The bank receives and processes checks and then transfers the information to the company. The bank maintains post office boxes for receipt of payment at a central post office. Check and deposit information, along with other remittance data and any returned documents, are sent to the company after the deposit has been processed and the checks are entered into the clearing system.

Comprehension Check
What is a **lockbox?**

Collecting Accounts Receivable

A collection effort is needed when payment is not received for invoices when they are due. It may only consist of a statement but can also include letters, phone calls, emails, visits and third-party collections. The resolution of disputes about how much is due is also a function of the collection effort. The customer may require an invoice copy or proof of delivery; clarification of prices, terms and discounts; information concerning damaged or undelivered merchandise; or explanation of some other adjustment claim. Usually sales and other departments are consulted to resolve these items.

Control and Follow-Up

The concept of control and follow-up is to identify and remedy reasons for nonpayment. For instance, credit policy and credit guidelines should define the actions for pursuing delinquent accounts and resolving disputes. Credit policy should also establish important benchmarks such as the industry average for payment trends.

Key Terms and Concepts

Approval subject to confirmation, 2-9
Business, 2-2
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Comprehension Check

1. Discuss what the term **business** means.
2. What is meant by the term **order-to-cash?**
3. Define the term **strategy.**
4. What factors impact a company's strategic plan?
5. Discuss a credit-related area that has both a financial and strategic implication.
6. Define the term **net working capital.**
7. Using **balance sheet logic**, explain where the credit department falls within an organization.
8. List eight finance-related functions that the credit department manages.
9. What is the goal of cash management?
10. List and describe the three broad areas of cash flow management.
11. Describe the **operating cycle.**
12. List the core activities of the credit department.
13. Discuss some of the areas of knowledge or skill sets required for credit management.
14. List six goals and objectives of every credit department.
15. How can a less creditworthy company be used as a marketing strategy?
16. Describe an **approval subject to confirmation**.
17. Define the term **electronic data interchange.**
18. How does the credit department interact with other departments to meet the goals of the organization? Choose one and be specific.
19. What are the day-to-day steps in credit processing?
20. What is a **lockbox?**

Summary

- The term business dates back to the 14th century and encompasses all organizational functions that seek to create a product or service, which are then sold to a customer for a profit.
- The credit department is involved in the business process from **order-to-cash.**
- Credit plays a strategic role in a business' future goals and broadly involves **amassing information, credit analysis, securitization, collection, cash application and deduction resolution.**
- The credit department is responsible for a company's accounts receivable and is an integral part of a company's **working capital.**
- A credit department typically manages:
  - Protecting and managing the investment in the accounts receivable portfolio
  - Cash forecasting
  - The timely conversion of receivables into cash
  - Financial analysis
  - Handling of collateral that secures a customer's account
  - Deposit of funds and the relationship with banks
  - Handling customers' deductions
  - Evaluation of economic trends on sales, receivables, and collections
- The **collection cycle** commences directly after the sale of a product or service and it is important to understand that the work of the credit department continues even after the product is shipped.
- The core activities of a credit department are customer and credit analysis, developing credit policy, managing the collection function, setting credit availability thresholds and managing reporting.
- Goals of the credit department are, but are not limited to, the following:
  - Increased sales and profit
  - Decreased cost per unit of work
  - Mitigating bad debt losses
  - Monitoring credit department costs
  - Measuring performance
- The credit department maintains a relationship with other departments in a business including the sales, legal, purchasing and manufacturing departments.
- Day-to-day administration includes the credit approval process, account establishment, order processing, accounts receivable administration, as well as collections and adjustments.
- Credit policy is a critical component when extending credit, pursuing delinquent accounts and resolving disputes.

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