Section I: Goals and Responsibilities

Step 1 - Mission Statement of the Credit Function

Definition

The mission statement is the statement of purpose. What is your department trying to accomplish? The *mission is not a statement of your goals.* Your goals are put into place to support the mission. The mission statement describes in what ways you are supporting or interacting in the overall company's mission. It defines your role in the unified vision.

Illustration

A Company with high margins and an aggressive sales growth target may have a mission statement like this:

The mission of the Gorman Inc. credit department is to facilitate an annualized 20% growth in top line performance by assisting in the sales process. The credit department's role is to develop strong customer relationships by granting aggressive but appropriate credit limits and terms, easing the establishment of new accounts by processing applications quickly while protecting the margins by managing risk of loss represented by fraud, failure or severe delinquency

Developing a Mission Statement

Before a mission statement can be adequately defined, a general understanding of the environment or market in which your company operates must be obtained.
In developing the mission statement, there needs to be a basic understanding of the following:

A) Nature of the Marketplace
B) Competition
C) Location of your Customers
D) Growth Plans
E) Margins
F) Internal Company Structure

Exploring these areas will ensure that your credit department's mission statement is directly in line with the marketplace and your company's overall mission statement.

Step 2 - Goals of the Credit Department

Definition

Now that you have identified the key components of your mission statement, you can set your specific goals. Your goals are put into place to support the mission statement. In order to be effective your goals must be:

- *Understandable*
- *Measurable*
- *Realistic*
- *Re enforceable*
- *Be tracked for quick feedback*

Illustration

The mission statement in Step 1 could be supported by the following goals.

Goal 1: DSO less than 45 days.
Goal 2: Less than 2% Past Due 90 Days
Goal 3: Approve or Decline 90% of Application within 24 hours.

Setting Goals

This is where you take your mission statement, which is more strategic in nature, and turn it into a tactical plan. Setting appropriate goals is the most critical part of a credit policy. The entire credit policy, credit department processes, and evaluation systems for the department will be built to ensure achievement of these goals. If your goals are set incorrectly, achievement of them will simply ensure you end up in the wrong place.

Now is the time to roll up your sleeves, reach for your calculator and crunch some numbers.

Step 3 - Organizational Responsibility

Definition

Organizational responsibility is a distinctive way of saying, who is responsible for the major actions in the department and what authority levels currently exist for approvals and credit limits.

Illustration
Below are some common areas in which organizational responsibilities need to be defined.
Credit Limit Approval Example

Credit Assistant	Up to $5,000
Assistant Credit Manager	Up to $50,000
Credit Manager	Up to $200,000
Director of Credit	Up to $1,000,000
VP of Finance	Over $1,000,000

Declines
The Credit Manager must approve all declined credit applications. A letter of denial from the Credit Manager will be sent to the applicant with a copy forwarded to the sales representative.

Alternative Terms

- Cash In Advance
- Letter of Credit
- Progress Payments

Setting Organizational Responsibility

This sounds like a simple and straightforward step in developing a credit policy; however, it is not without its traps.

Trap number one is over engineering. Many companies set up elaborate approval authorities which end up adding many steps to the approval process. These steps cost time, money, and can dramatically increase turnaround time. The exact opposite of what you are trying to accomplish.

Trap number two is not assigning any staggered approval authority and having the Credit Manager approve all orders. Except in the smallest of credit departments this can lead to backlogs, which leads to slow turnaround or applications being pushed through without adequate research.

Bottom line --it is all about balance and resource allocation. Let low exposure, low risk approvals happen quickly without being passed to the credit manager for approval. Have high exposure, high risk approvals passed to higher levels for approval.

Section II: Managing the Customer Relationship

Step 4 - Credit Evaluation

Definition

Now that we have finished the foundation of our credit policy it is time to get into the nuts and bolts. Steps 4 through 6 focus on how you approach your credit approval process. You start with a high level view of how you plan to evaluate credit. When you get to this step resist the temptation to define a step by step process. At this point we are defining policy and parameters.

Illustration

Here are a few of the parameters, which can be defined with regards to credit evaluation.

- *A credit investigation will be conducted on all new applications.*
- *A complete and signed credit application is required.*
- *Credit data will be obtained from an outside source on any request over $5,000.*
- *Any branch requesting credit based on headquarters must be confirmed verbally with it's headquarters, with location and purchasing limits confirmed.*

- *All new requests under $1,000 are approved for COD.*
- *Any request over $100,000 will be faxed directly to the Director of Credit for immediate evaluation.*

Credit Evaluation

Probably the most important points to consider when reviewing your credit evaluation is that not all applications are created equal. Efforts should be scaled based upon risk and exposure. The more risk and exposure the more due diligence needs to be done. The old 80-20 rule truly applies to credit evaluation. 80% of your department's resources should be targeted towards 20% of new applicants. However, this is exactly where credit mangers earn their paychecks... which 20%?

Common patterns we often see is that Credit Applications that fall outside of the norm end up consuming a great deal of our time and resources.

For example, A low dollar order comes in from a small business. Since the order amount is so low, outside credit information is not checked. At this point the application is sent to trade calling where it sits for five days while a clerk makes four calls and sends three faxes. At this point, this small request application has cost quite a bit in both time and money ($X in calls, 5 days). Sound Familiar!

A good credit evaluation policy will direct valuable resources to where they are needed most and only use resources, which will effect the final decision.

Step 5- Credit Limits

Definition

Now it is time to review the factors that must be considered when setting and managing credit limits.

Illustration

Here is an illustration of a credit limit policy using D&B data elements.

If CreditScore	and Net Worth	and Employees	Then Credit Limit
> 74	10+ Million		$250,000+
25 - 75	10+ Million		$100,000
<25	10+Million		$25,000
> 74	$100,000 - 10 Million		$30,000
25 - 75	$100,000 - 10 Million		$15,000
<25	$100,000- 10Million		$10,000
>74	<$100,000		$25,000
25-75	<$100,000		$10,000
<25	<$100,000		$5,000
> 74	Unknown	50 – 99	$15,000
50-75	Unknown	50 - 99	$10,000
25-50	Unknown	50 - 99	$ 5,000
<25	Unknown		$0

***This template is for illustration purposes only, your credit limit policy should be based upon factors unique to your industry and your company.**

Credit Limits
Knowing what factors to consider when determining the credit limits is the easy part, deciding what to do with them and what action to take is the hard part. In fact, determining how to set credit limits is probably the most difficult step in developing your credit policy.

Because it is difficult to determine what is the right amount to set for a credit limit, many credit departments simply set the credit limit to the original order amount. While this works for the first order, it does not take into account the full potential of the account. This often leads to constant rework due to the customer frequently exceeding their credit limit.

Step 6- Terms of Sale

Definition

These are the terms offered to customers and the conditions under which they vary. If multiple terms of sale are offered, the general conditions under which each is applied is described.
Illustration
The following are examples of terms of sale.

- Net 30
- 2% 10 Net 30
- COD
- Letter of Credit

Terms of Sale

In today's marketplace there is almost no such thing as an account declined. The true question is not approval, but under what terms are you willing to do business with this customer... open account, secured credit, COD, CIA, or even credit card. All are terms with varying risks.

Step 7- Account Monitoring

Definition

About the only thing in business that is constant is change. Once you completed your credit evaluation and the account is setup, how are you going to monitor it? What role will account monitoring play to anticipate changes in risks? This is Step 7 in developing a credit policy.

Illustration

Following are a few excerpts from a credit policy regarding account monitoring.

- *Perform an annual review of all active accounts and update credit limits where appropriate.*
- *Monitor all existing accounts for changes in ownership and reprocess/reinvestigate business as a new*

account upon notification of change.

Account Monitoring

In today's 'Do more with Less' credit department, account monitoring is typically the first thing that falls behind. This usually results in a gradual shift in the department's efforts from proactive to reactive. When account monitoring is allowed to fall behind, credit limits become out of date causing frequent credit limit bumps and credit holds. It can also lead to some unpleasant surprises when a company has been deteriorating without you knowing about it.

Step 8- Credit Holds

Definition

This is the part of your policy, which defines under what conditions orders may or may not be delayed for credit reviews. This is a necessary evil for every credit department. Credit Holds are, however evil, necessary to limit risk because of the impact they have on workload, shipping/service delays, and customer service.

Illustration

The following are illustrations of credit hold policies.

- *The credit department prior to release must review any account that is currently 120% of their credit limit.*
- *Any account over with a past due balance over 60 days must be reviewed by the credit department.*

Credit Holds

When setting up a credit hold policy there are a number of factors to consider. The hardest part is to properly balance the risk with the need to minimize delays and on-demand reviews. The most well intended policy can lead to an avalanche of credit holds.

For instance, one of our examples above is to hold anything with a balance past due over 60 days. What if the amount is $1,300 on a customer who does $500,000 a year in business? What if it is a dispute? Etc. When setting your policy, define which accounts you really want to put on hold, then design the policy to pinpoint those accounts. This is easier said than done.

Step 9- Collections

Definition

What will be done to speed up recovery of past due accounts while maintaining the customer relationship? This balance between customer service and bringing in money as quickly as possible is one of the most difficult in the organization. Preserving the relationship with good customers is critical even when occasional disputes or slowness occurs. On the other hand, to effectively manage collections, you must be able to know when to identify a true risk and take quick decisive action.

Illustration

There are as many different approaches to collections as there are managers. Here are a few:

Collections

- *Age - Begin collection activity when the past due amount ages beyond a certain point (60, 90, or 90+).*
- *Dollar Amount Past Due- Prioritize based upon the total dollar amount past due.*
- *Risk/Data Segmentation - Managing the collection process based upon individual risk and exposure. Prioritizing from high risk-high exposure, down to low risk-low exposure.*

Have a plan for collecting that focuses efforts where an investment of resources will produce the greatest results for the business. This sounds simple and obvious, but in today's environment of limited resources it is easy to get into a reactionary mode. This leads to a shotgun approach for collections treating all segments of the portfolio essentially the same.

Base your collection plan on factual data and track the plan performance. Business today is too complex for management decisions based solely on intuition. Do the analysis necessary to prove out your plan. Since not all segments of the portfolio perform the same, the collection plan must consider both the current and the desired performance of each portfolio segment.

Section III: Implementation, Management & Maintenance

Implementation

Once you have gone through all the hard work, inter-departmental communication, and analysis to develop a comprehensive credit policy, you still are not finished. The best credit policy in the world is not worth the paper it is written on if it sits in someone's desk drawer unused. Now you must turn the written policy into processes and procedures. You must educate everyone about what the policy is and work with them to build step by step processes to support and implement the policy.

Just as when you developed the policy, an implementation cannot be something that only happens within the credit and collections department. Any and all functions within this area of the supply chain must be copied, educated, and procedures reviewed to ensure they support the credit policy. All must be working towards a unified vision.

Management

Just as the functions within an organization must be managed, so must the credit policy. Especially since the policy goes well beyond a single departments line of responsibility. Misinterpretations, opportunities, and conflicts will occur which need to be clarified and discussed. Procedures must be documented. Coordination between departments and functions must be clearly defined. Quality controls must put into place to ensure the plan is being implemented effectively. And, foremost, a communication plan must be enacted to ensure that results, victories, procedure changes, and issues are communicated to all involved. Learn from mistakes, and improve.

Maintenance

The credit policy must be maintained as a living document. One that is dynamic and keeps pace with the changing business environment and resulting organizational goals. Periodic reviews are crucial not only to ensure that the policy is still reflective of the organization, but that the processes and procedures are still effectively supporting the policy.

The entire purpose of the credit policy is to serve as a blueprint for your relationship with your most valuable asset, your customers. Maintaining the integrity of the policy will ensure that it is accomplishing its mission.