Credit Policy Creation/ Selling to New Companies

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TCD RECEIVABLES MANAGEMENT

Agenda

- The purpose of creating/updating your credit policy
- How to obtain buy-in from other parts of your company to ensure compliance
- The importance of defining risk tolerance and minimum requirements of a customer buying on credit terms
- The top elements necessary to include in your policy
- Selling to New/Small Entities
- The difference between credit decisions and business decisions as defined by the policy

TCD RECEIVABLES MANAGEMENT

About the Speaker

- Manages 700,000 open items daily for 20+ companies
- Provide trade credit analysis, collections, and deductions management services through hosted cloud SMART tool
- 27 Analysts work multiple portfolios
- 43 years of Credit Management Experience, including 30 as a Consultant

Why do Companies Need Credit Policies?

- Provides clear direction and intent of Financial leadership of the company

- Allows for continuity in Credit Departments and ensures the Credit Department manages to the corporate policy.

- A well designed credit policy allows for goals to be set, processes to be followed, and results to be measured. It ensure *credit practices mesh with sales & marketing practices*

Legal Considerations of a Credit Policy

- Anti-trust laws in some countries (including the U.S.) dictate that all "like customers" must be treated "alike" in respect to terms and pricing . Exceptions must be documented and justified in the Credit Policy

- U.S. Federal Equal Credit Opportunity Act must be cited in every application given to all U.S. customers, including commercial businesses.

- Regional Credit laws dictate how and when to decline customers. Written notifications must be given as well as the reasons for the decline if requested.

Credit Policy/Business Realities

- Most, but not all, trade credit losses and slow-pay situations are completely predictable and preventable.

- Every company should carefully design their standards for customers to qualify for credit.

- Overall strategies defined in a credit policy set the stage for specific processes and technology needs in the credit area.

Sales & Marketing Impact on Credit Policy

- Help to create and approve the Policy
- Define "types" of customers for Policy
- Advise Policy makers on gross margin variances
- Participate in Credit Committee
- Suggest/implement roles of Marketing & Sales Personnel into credit management

Credit Committee

- Determines Changing Risk Tolerance
- Helps forecast upcoming Credit needs
- Makes Business Decisions outside of Credit Recommendations
- Reviews major process issues for resolution
- Approves/oversees automation initiatives

Critical Elements of a Policy

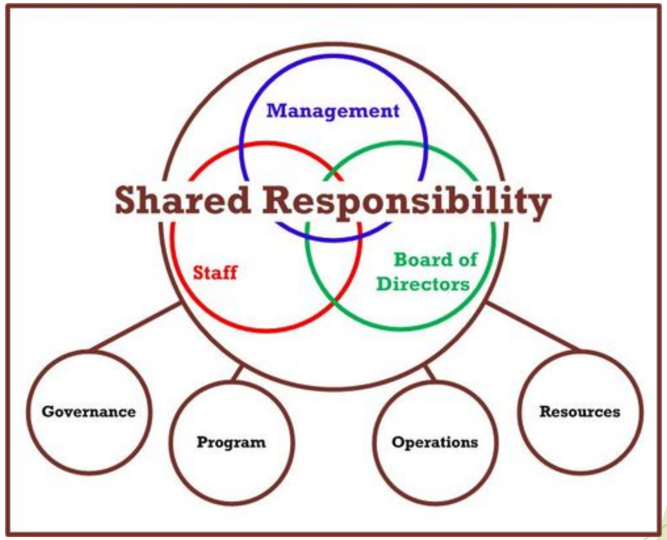
- Define classes of customers and how they will be treated
  - Type ie, Manufacturer, Distributor, Small Retailers, Big Box, etc
  - Internal division customer by industry
  - Terms, pricing
  - Compliance with laws

Policy Elements: Terms

- Standard terms
- Terms exception
- Extended terms process & authority levels
- Cash discounts & chargebacks
- Service charges

Policy Elements: Responsibilities and Authority

- Clarify responsibilities and authority levels of all involved in the process
  - Sales “handoff” to Credit for new customers
  - Involvement of Sales (or not) in collection activity
  - Communicating bad news to customers
  - Credit line authorizations by dollar amounts



Policy Elements: Risk Tolerance

- Based on margins, competitive situation, sales goals, product type
- The lower the risk tolerance, the higher the credit underwriting and requirements
- **Credit Departments should NOT be making decisions based on their experience or "judgment" but rather based on the Policy requirements**.
- Every customer should receive a credit line decision, as well as a defined "risk of default" ie, "very high, high, medium-high, medium, etc" based on a specific set of criteria.
- CFO's should use the ratings as defined by the policy to decide how much risk the company should take in total and then dictate requirements to the Credit Department.

Risk Tolerance Example

- **Low Margin Distributors**
- .2% of sales bad debt expense budget
- 5% delinquency rate
- 10% delinquency rate

- **Higher Margin Margin End Users**
- .4% of sales bad debt expense budget
- 8% delinquency rate
- 14% delinquency rate

Policy Element: Credit Approvals

- Credit approval/new customer/renewal requirements
  - Information sources
  - Qualifications of new customers
  - Roles in process
  - Renewal process & timing
- Credit limit formulas
  - Scorecards
  - Automatic increases
  - Negative information impact

Policy Element: Underwriting Requirements

Lower Margin Example

- 1% 10, net 11
- Signed applications, financially informed >$100,000
- 3 years in business minimum

Higher Margin Example

- Net 30 days
- Signed applications, no financials necessary
- No minimum years in business

Policy Element: Levels of Analysis

Three levels of analysis:

- Yes/no (small dollars)
- Standard analysis (medium level exposures)
- Complete financial analysis (larger or high risk exposures)

How Do we Sell to Customers that are New or Very Small?

Are they a high risk?

- Accurint/Lexis Nexis/ClearID Confirm checks
  - If nothing, automatic line (<$15k)
  - If negatives exist that impact cash flow, cash/credit card only

What if a smaller company without a credit history needs a larger line?

- Bank information
- Personal Credit
- Security

Policy Element: Security Option

- Security Options
  - **Personal Guarantees**
  - **Standby Letters of Credit**
  - Cross-corporate Guarantees
  - Financing Statement (UCC's)

Policy Element: Type of Decision

Credit Decision

--Based on specific, objective data found

--Follows Credit Policy guidelines

--Determined by Analytical Credit Scorecard and/or Analysis as defined by risk tolerance

Business Decision

--Bridges gap between Sales need and Credit decision

--Sometimes short-term in nature

--Must be authorized at a high level, preferably by Credit Committee

Policy Element: Collection strategy

- Risk-driven process
- Processes for larger past dues
- Small dollar follow-up
- Escalation process
- Roles & Responsibilities defined
- *Collection technology programmed for follow-up as prescribed in the credit policy.*

Policy Element: Measurements

- DSO/Days over Best DSO
- Bad debt % of Sales
- Past due % trends
- Bad debt projected vs Actual
- DSO Projected vs DSO Actual
- Unauthorized discounts and deductions (portal prevention)
- Reason code trends
- Disputes/deductions collected back
- Activity reports: calls per hour, credit files per hour, deductions worked per hour

Automated Measurement Example

Summary Metrics:

Measure	**2021-10**	**2021-09**	**2021-08**	**2021-07**	**2021-06**	**2021-05**	**2021-04**	**2021-03**	**2021-02**	**2021-01**	**2020-12**	**2020-11**	**2020-10**
Monthend Past Due (000s)	7,974	9,564	9,080	10,124	9,241	9,452	9,813	8,150	8,586	8,920	10,265	7,713	8,267
Monthly Sales (000s)	16,752	29,039	29,761	30,509	27,482	29,421	27,716	23,659	20,841	21,721	23,671	20,769	23,548
Days Sales Outstanding (DSO)	41	38	38	39	38	41	44	42	40	41	38	38	40
Best Possible DSO	32	28	29	29	28	31	32	30	28	29	25	28	29
Days over Best	9	10	9	10	10	10	12	12	12	12	13	10	11
Pct A/R Past Due > 60 Days	5	4	5	6	7	6	6	7	7	6	7	6	5
6 Month DSO	38	38	39	43	42	45	45	40	39	40	38	39	42
12 Month DSO	41	43	44	47	45	48	48	43	42	43	41	41	43

Questions on Credit Policy/ Selling to Small Companies?

Thank you so much!

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