



What in the World Are Credit Policies and Why Do We Need Them?

Prepared by:
Michael R. King
Gammage & Burnham



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Legal Alert

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Michael R. King
mking@gbllaw.com
602-256-4405

QUESTION: WHAT IN THE WORLD ARE "CREDIT POLICIES" AND WHY DO WE NEED THEM?

ANSWER: CREDIT POLICIES ARE LONG-TERM GUIDELINES AND PLANS FOR YOUR BUSINESS. WITHOUT THEM, YOU RISK THE FUTURE OF YOUR BUSINESS THROUGH LOST SALES, BAD DEBT WRITE-OFFS, OR BOTH.

You need to establish, implement and communicate effective credit policies throughout your organization. Credit policies need to be practical. You should not create policies if you or your business do not intend to follow them. Your credit policies must "fit your business." They must work in the "real world" as it exists today. Be careful of anachronistic or outdated credit policies, but also be careful of futuristic policies which cannot be implemented within your current technological capabilities. For example, setting a policy of charging finance charges when your computer system is incapable of including that information on the monthly billing statements is not only futile, but dangerous.

So, what are good credit policies? They are the "long-term picture" goals and plans for the business. As such, they should never be "cast in concrete," but should be goals that help the credit operations of your business function as management intends. Toward that end, credit policies must be flexible, they must cover nearly all major situations and be aligned with your company's business goals and objectives. Remember that the policies must be verifiable statements concerned with the overall operation of the Credit Department. They are not detailed. The detailed statements are the credit procedures, which will be discussed in future newsletters.

Credit policies need to be broad enough not to require frequent revisions. In order to provide stability to the credit operations of your business, the credit policies should not change often. Nevertheless, credit policies should be reviewed twice a year to verify their continued applicability in light of business, market, economic or other significant changes that might impact credit operations. Consider whether the policies continue to protect your business and consider whether the policies provide adequate measures to permit proper growth.

Should you determine that the credit policies need to be changed, how do you go about that process? You know that the credit manager, chief financial officer, operations manager, and sales manager should all provide input for creating or revising credit policies. But consider who else in your organization should be consulted about creating or revising credit policies and involve them in the process as well.

As we will discuss with credit procedures, credit policies have some similar attributes. First, credit policies must be written. Second, they must be properly distributed to all appropriate personnel. Third, they must be clearly dated. Fourth, they must be reviewed on a regular basis for updating. Fifth, they must be readily available for review and use. In other words, credit policies that exist only in the mind of the credit manager will be useless to the rank and file. The same is true of credit policies which are incomprehensible, outdated or buried in the back of the bottom drawer of the file cabinet.

Remember that your credit policies are your long term goals for the credit operation of the business. Without those "maps" you have little chance of piloting your business to financial success.

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