collective wisdom®

SZABO ASSOCIATES, INC. VOLUME 20, ISSUE 2, JUNE 30, 2005

Dear Friends:

As summer begins to sizzle here in Atlanta, many of us in our spare moments start to think about pulling out our roadmaps, hitting the highway, and heading up to the mountains to escape the heat. Just as roadmaps help us get from "here" to "there," this issue's feature article is intended to do the same—to help ensure that your credit policy gets where it needs to go, accommodating climatic change within your organization and the environment in which it operates.

Our summer calendar of events includes our annual Szabo Quality Awards Banquet, where we honor the achievements of our employees, August 23 in Atlanta. We also look forward to attending the Marketing and Interactive Excellence Conference and Expo, sponsored by the Interactive Advertising Bureau, September 26-27 in New York City.

Have a wonderful summer season!

Best wishes,

Pete Szabo, President
Szabo Associates, Inc.

A Roadmap for Effective Credit Policy

Developing and maintaining a well-articulated credit policy is a worthwhile investment of time and effort. A well-written credit and collection policy provides a guide for managing by objectives and measures, a map for negotiating the sometimes "rutty roads" of credit extension and collections. When consistently applied, good policy helps to minimize the risk of unfair credit decisions (and subsequent discrimination lawsuits), helps to establish a positive reputation within the advertising community, helps to avoid costly payment delays that result from sloppy credit and collections procedures, and allows managers to accurately monitor its effectiveness.

The Periodic Review.

Effective credit policy is not static. Every credit policy, regardless of how serviceable over time it proves to be, requires periodic review and adjustment. Changes in the dynamics of your industry, changes in your organizational culture, and changes in the economic climate and regulatory environment can have profound impact on the effectiveness of credit policy.

One time-honored management philosophy that mandates periodic review of credit policy is the results-oriented MBO (Managing by Objective). Organizational self-examination is a basic tenet of MBO. The MBO philosophy requires a clear alignment between policy and objectives as well as measurable specifics that indicate how well the objectives are being met. MBO does not allow for subjective interpretation and uneven performance evaluation, hallmarks of ineffective and flawed policy.

The Sales and Credit Connection.

Good credit policy allows everyone to "win." The purpose of credit is to lend money in order to increase sales and profits. A credit manager's job, therefore, is to promote *profitable* sales. For some, that translates into finding reasons to reject an application as opposed to looking for reasons to approve. With opposing interests often the order of the day, the relationship between the credit and sales departments can be an uneasy alliance, at best.

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The first step in credit policy development or review should be to recognize that credit policy must benefit both a company's accounts receivable department and the sales department. Credit policy that fails to serve both interests is itself a failure.

For that reason, both departments should take an active role in the development of the company's credit policy as well as in subsequent reviews. The ball falls first in the credit manager's court. The credit manager should develop a general outline of credit policy requirements and procedures. Next in line for involvement is the business manager/operations manager, who should provide more detailed points of policy that represent both departments' interests.

Once a sound credit policy is agreed upon and established, reciprocation between departments can help ensure its success. Regularly scheduled meetings attended by the sales manager, business manager, and other sales and management personnel as appropriate can promote understanding of policies in general as well as decisions about specific accounts. They can also bring to light problems with policy and/or procedures prior to a formal credit policy review.

The most helpful reciprocation is attitudinal. Credit should look for ways to accommodate a sale rather than to turn it down, perhaps by offering an alternative payment arrangement. Sales should be aware that credit's determination to minimize past-due receivables and bad debt losses serves them as well. They might be reminded that consistent application of sound credit policies strengthens a company's financial status and reputation, creating an easier "sell" and maximizing the real return on sales' efforts.

Communication between sales and credit is most critical if it is determined that changes must be made to credit policy. Sales personnel may balk at policy that demands a departure from their accustomed procedures or that they perceive will make their jobs more difficult. Involving sales in the review and change process can go far to mitigate concerns that their interests are not being sufficiently considered and valued.

Realizing that both credit management and sales are "art" more than they are "science" can perhaps inspire all involved to apply experience, creativity, and positive attitudes to serving everyone's interests within the parameters of a sound credit policy. The bottom line on this is, no credit policy can be truly successful without the "buy-in" of everyone involved.

The Objectives.

Because overall objectives provide the framework for detailed operations and procedures, both credit and sales departments should agree on what the policy objectives should be. Overall policy objectives, the first part of the credit policy, should address and reflect the delicate and challenging balancing act between credit extension and collection requirements. One company might choose to balance a rather "liberal" credit extension policy with "conservative" collection operations. Another may choose to have a tighter credit extension policy, which lessens the need for strict collection procedures. Yet another may strive to achieve an equal balance between the two. In any case, it should be determined at the outset on which side, if either, the emphasis will be placed. Subsequent reviews may indicate a need to adjust this balance to accommodate changes in the marketplace or organization.

Regardless of how the policy is balanced, the objectives usually focus on the same issues—optimizing sales, minimizing past-due receivables, minimizing bad debt losses, and containing departmental costs while maintaining effectiveness and efficiency. Additional objectives might address customer relations as they relate to credit and collections. An effective policy should embrace the principles of fairness, firmness, courtesy, and consistency in its relations with customers.

The Responsibilities.

A statement explaining who has responsibility for administering the credit policy should follow the statement of objectives. This should include description of the functions and objectives of the credit department.

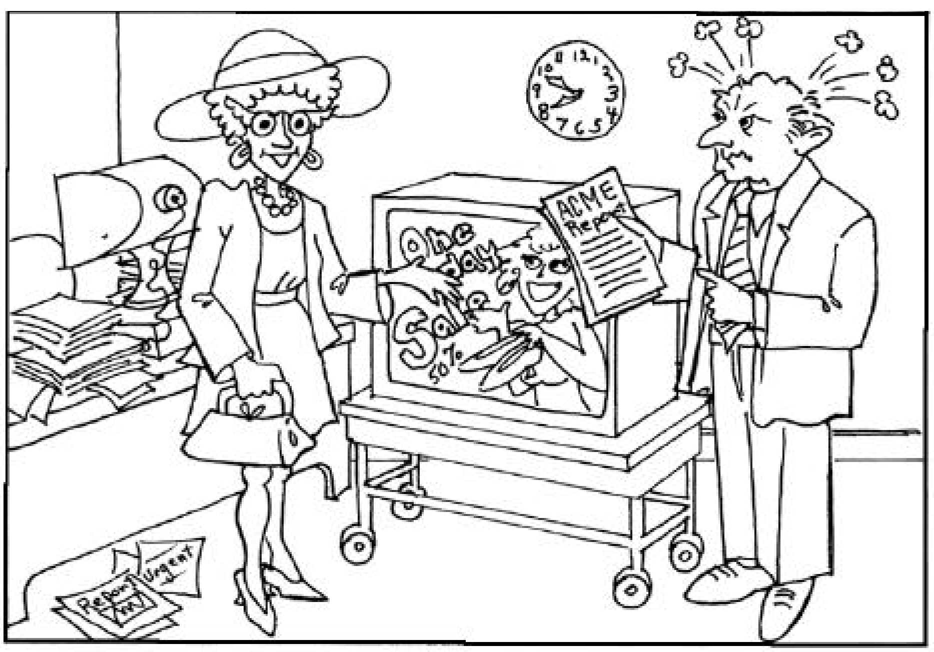
The Terms and Procedures.

Content of the "terms and procedures" section of the credit policy is driven by the overall objectives of the policy. Procedures for optimizing sales should include terms of sale; procedures for credit investigation; and details about dealing with new customers, such as credit application requirements, and expected decision-making time on credit requests.

The "terms and procedures" section of the policy should also include procedures for communicating decisions to customers regarding credit approval or denial. The responsibility for notifying a customer that credit extension has been approved or denied, which should be clearly stated in the policy, usually falls to the credit department.

Procedures for notifying a credit applicant of action taken must comply with the regulations imposed on trade creditors by an amendment to the Equal Credit Opportunity Act (see Szabo *Collective Wisdom*, September, 1990). Simply stated, the law requires that credit applicants be notified of actions regarding trade credit, orally or in writing, within a reasonable time. Since "reasonable" is generally considered to be 30 days, procedures should clearly include the method of communication as well as a time frame that falls within the 30 days following application.

Laws do change, of course. The original ECOA, for example, was designed to prevent discrimination in the extension of credit to consumers, but was later amended to provide business owners with procedural rights. The constantly changing regulatory environment is yet another compelling reason for periodic credit policy review.



"I AM 'MANAGING BY OBJECTIVE.' MY OBJECTIVE TODAY IS TO GET TO THE ONE-DAY SALE BEFORE ALL THE GOOD STUFF IS GONE."

Procedures for minimizing costs of past-due receivables should include detailed procedures for following up on past-due accounts, including invoice dates; mailing dates; the number of days allowed for payment; resolution of disputes and discrepancies; and when to send letters and make telephone calls on overdue accounts. Samples of collection letters should also be included.

Examples of procedures that focus on minimizing bad debt losses are procedures for engaging third-party collectors and outside attorneys, dealing with bankrupt customers, and authorizing accounts to be written off. Procedures focusing on departmental organization and efficiencies might include an organization chart, staff requirements, hiring and training guidelines, performance review criteria, and budget guidelines for the department.

Upon completion, the credit and collection policy should be distributed to the General Manager, Sales Manager, Account Executives, and Credit Manager for administration.

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The Right Turn. Credit policy review may indicate a failure to reach an objective. If so, management must determine where and how the "wrong turn" occurred. Was the objective unreasonable? Did the measures effectively drive the organization to meet the objective? Were organizational restrictions overlooked or ignored? Did personnel lack the necessary tools or resources? Do procedures accurately reflect and support the policy?

The review process is critical not only to evaluating the policy's effectiveness but also to monitoring the consistency of its application. Periodic general policy review should be supplemented by immediate review of every deal that goes sour to determine what caused the failure. Whether the problem occurred because the policy itself was faulty or because it was not administered as prescribed, steps should be taken right away to remedy the situation and prevent such problems in the future.

Principles Remain the Same. A well-conceived credit policy provides a valuable roadmap for sound and consistent management of credit and collections. Periodic review of credit policy —making sure that its objectives are reasonable and are supported by well-defined metrics, evaluating results, and amending the policy as necessary to improve its effectiveness—helps ensure that an organization continues to honor the fundamental principles of credit and collections and thrive in the years ahead. ♦

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