NAME: ISATU BANGURA

ID: UB80010LE89227

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**CREDIT MANAGEMENT**

**1.1 INTRODUCTION**

Ensuring the protection of company from late customer defaults and late payment is very important. To achieve this, an effective and efficient policy of credit management must be set up. Credit management is the process of granting customers credit, the setting of terms and conditions of payments to allow them to make full payments of their bills on time, payments recovery, as well as to ensure that employees and customers comply with the credit policy of the company. The existing customers should also be made to undergo periodic review processes.

**1.2 SUPPORTING CREDIT AND DEBT MANAGEMENT WITH NECESSARY DOCUMENTATIONS**

When a contract is established with a customer, below are the some tips to be considered:

**DELIVERY AND PAYMENT CONDITIONS**

The contract should be thoroughly checked to ensure that the conditions of the delivery and payment are met and explanations about any provision in the agreement should be made well communicated and understood, like the applicable conditions and their acceptance.

**REVIEW OF CONDITIONS**

A qualified lawyer should be consulted to review the conditions which are paramount before entering into the contract.

**CLARITY OF PAYMENT PROCEDURES**

There should be clarity of the payment procedures, idiosyncrasies and policies of the client as well as the identification of whom the invoices should sent to and asking for the acknowledgement of receipts.

**EARLY INVOICES**

When a service has been provided or a work has been completed, an invoice should be made and sent. There should a heightened level of certainty of the address, company name to facilitate prompt response. The recipient should also be asked to acknowledge the receipt of the invoice.

**INVOICES**

The following includes ways in which the chance of invoices been paid promptly is increased:

The name of the company, telephone number, address, contact name and email address.

Purchasing order

The quantity and nature of goods or services

Payment details

The specified period of payment

The price in the suitable currency

The terms printed on the back of the invoice.

With simple debt and credit management guidelines it should be of importance to bring about a decrease of late as well as non-payments.

**MONITORING THE PAYMENT PROGRESS OF CLIENTS**

Regardless of all the measures, it is unfortunate that this does not guarantee that customers will make prompt payment of their bills. It is at this point that the policy and services of credit management should of utmost importance. Monitoring customer’s progress in payments to be certain that they are complying with the contract agreement can aid in avoiding surprises that are unpleasant. Each customer should be reviewed with an align frequency to recognize the risk presented by the customer. In the occurrence of late payments, the lawyer should not be phoned immediately because maintaining good customer relationships is core for every business.

When an invoice stays unpaid after three months regardless of your reminders, considerations of transforming into a professional debt collector should be adopted, like implementing the strategies used by a debt collector agency or a trade credit insurer. If further help is required, consultations should be made to for additional services for credit management. There are a plethora of benefits of credit management that even the risks cannot be covered by a well-defined system.

**ROLE OF CREDIT MANAGEMENT**

The main function of credit management comprises of all the activities of the company which aims at ensuring that invoices of customers are paid within the stipulated terms and conditions of payment. A credit management that is effective will serve as a way of preventing non-payments or late payments. Accuracy serves as a reinforcement of the liquidity or financial position of the company, which makes it a critical element in a business.

**ESSENTIALS OF CREDIT MANAGEMENT**

There are some companies that do their uttermost to introduce a new business, but at the last hurdle in which they try to ensure that deals are transformed into earnings, they may falter. Poor credit management is the main cause of bankruptcies. This signifies the importance of credit management as it involves a lot rather than reminding customers to make payments. Instead, it includes acquiring a thorough process and examination in which possible non-payment reasons are detected. In most cases, it assists in taking into account whether a product or a solution has been delivered as well as the discrepancies the invoice contains.

A credit management that is effective has a comprehensive process that consists of:

The determination of the credit rating if the customer in advance

Monitoring and scanning customers frequently for credit risks

Maintaining good customer relationships

The detection of late payments in advance

To prevent bad debts from arising

To detect complaints duly

**BENEFITS OF CREDIT MANAGEMENT**

When credit management is effectively and accurately implemented, contributes directly to the profit of the company because it lowers late payment and also improves cash flow. Furthermore, the company’s optimum available liquidity and sufficient cash flow can be utilized for investment options or acquisitions. Ultimately, it boosts the professional image of the company as well bringing about positivity.

**CREATION PROCESSES**

In principle, an effective credit management comprises of two core steps. It is important to first determine the strategy to be implemented and also specify the procedures that will be appropriate. The steps are:

**STRATEGY**

The first step of a credit management is to determine the strategy to be used. This can be achieved through:

The customers that are accepted to the business and the stated conditions

The customers monitored by the business

The customers that are no longer accepted and their exit period

**APPROPRIATE PROCEDURES**

The second step of an effective credit management is the preparation of appropriate procedures. This can be achieved through:

Knowing the process of invoicing

Know what the invoice is like

When to send a writing reminder

When to conduct a telephone reminder

When a debt collector agency should be engaged

Awareness of the role of an employee in a particular issue

Making a choice between in-house management and outsourcing

**SYSTEMS REQUIRED MINIMIZING CREDIT MANAGEMENT RISKS**

Companies across the globe utilize a variety of systems and applications in order to limit credit management risks as well as to update the company’s data. These systems can aid in designing as well as setting up credit management. There are five systems required to minimize risks involved in credit management and they are:

**SYSTEM OF ACCEPTANCE**

This system is typically based on the credit information and to also determine whether a new customer can be granted acceptance or not. This system comprises of processes can be operated manually or automatically.

**SYSTEM OF MONITORING**

This is a system that checks the whole portfolio to look for an insight continuously into suppliers as well as existing customers. In relation to chain parities, the latter is more important.

**SYSTEM OF INVOICING**

This is a system that sends invoices automatically or manually and invoices are sometimes sent as digital invoices. This system ensures that reminders are aligned logically.

**SYSTEM OF BOOKKEEPING**

This system ensures that every receivable and payable is booked in it. This system serves as the basis which provides an insight into receivable risk as well as the cash flow.

**SYSTEM OF CUSTOMER RELATIONSHIP MANAGEMENT**

This system of customer relationship management outlines information that relates to contact and contracts, agreements with customers of the company. This system processes complaints for the benefit of a better insight into non-payment backgrounds.

**THE AUTOMATION OF RECEIVABLES MANAGEMENT**

When credit management is automated, every system that was mentioned can be interlinked. This will lead to high efficient flow of work and a greater insight which will promote an easy generation of cash flow as well as customer reports. When credit management information is linked automatically, this will decrease the percentage of new customers who have not paid. The automatic integration of debt collections in a process, non-paying customers of the company will also decrease.

**TYPES OF CREDIT MANAGEMENT**

Credit comprises of many types and examples of such are consumer credit, mortgage loans, bank guarantees etc. There are several types of credit management but the most essential of them all are eight and they are:

**BUSINESS CREDIT**

This simply refers to the credit that revolves in the dealings of businesses such as sale of goods on credit in which the particular customer will promise to make payments in the future. This also involves the buying of goods on credit in which the customer promises his supplier to make payments to him in the future. This credit is granted on the basis of the financial capability of the borrower like credit takers. In some scenarios, it can be granted based on the relationship that exists between the individual requesting the credit and the giver of the credit. It can also depend on the rules of the business. In large companies, every customer has the same credit rule.

**CUSTOMER CREDIT**

This simply refer to goods, money, or the services which are provided based on agreements made with customers regarding later payments as well as the charges that are included. Consumer credit is particularly designed in a way that facilitates the achievement of benefits for consumers. This type of credit involves personal loans, hire purchase goods, vehicle finance, credit insurance etc. this credit type of credit is granted on the basis of the creditworthiness of a consumer. The same rule of credit is applied to all customers of the company. Goods purchased on EMI are also an example of consumer credit. Overdraft facilities given by the bank is also a consumer credit.

**ROTATION CREDIT**

This type of credit involves continuous credit given by the lender as well as extending the credit to the borrower for as long as the account is frequent and open by frequent payments such as credit cards, wherein the credit is granted and a credit limit is also stated along with monthly or quarterly payments to be made. The continuity of the account is a must until closure. In other words, there is a credit extension each month.

**BANKS CREDIT**

This is a type of credit that extends the credit of the customer. In a bank credit, loans are issued as well as credit facilities by the bank to their customers. The credit received by the consumer is based on their creditworthiness, the financial statement analysis, and the value of the assets that are given to customers as security. Examples are housing loans, cash credit facilities, mortgage loans etc. discounting of bills of exchange, bank guarantee as well as letter of credit are found in credit facility of the bank.

**AN OPEN CREDIT**

An open credit has the feature of both rotation credit and an installment credit. When the limit of an open credit has not been set, when the credit card is issued, it cannot be used by anybody for the entire month, and when the month ends, the cardholder will receive a bill to re-pay in order to continue using the service. Telephone bills, gas bills, electricity bills, etc. are some examples of credit that is available. In other words, it can utilize first and payment made later as well as ensuring that there is availability for everybody.

**AN INSTALLMENT CREDIT**

This is a type of credit that extends a bank’s credit. When credit is obtained from banks through loans, the fixed installment per month is set by the bank as loan repayment as well as interest for a certain period until the loan is re-paid with its interest. A penalty is charged by the finance company or bank when there is a situation in which the borrower is unable to make payment for the installment.

**A SERVICE CREDIT**

In this type of credit, credit is granted for the services benefitted from earlier. Just as lawyers ask once a case comes to an end for their final fees, the same applies for accountants as they charge after the returns are filled. Some examples of a service credit are gas bills, electricity bills, post-paid bills and telephone bills. The borrowers of a service credit can pay after they have availed the service at regular intervals. If the receiver of the service fails to make payments at the fixed interval, this may result in the cancellation of the service or a penalty will be charged for late payments.

**A MUTUAL CREDIT**

This is a type of credit in which money is not utilized. If an individual owes another individual for a particular thing that another person owes the first individual, then there is mutuality in the credit. The credit can be canceled between them. In a case where there is a remaining balance after the cancellation, then that amount can be settled through the use of cash or something equivalent to cash. In every business, one individual can serve as a creditor as well as a debtor. Hence, payments can be settled by them mutually.

**CREDIT RISKS**

This type of risk arises in a situation where an individual or a corporate does not fulfill their debt requirements. It is probable that the principal and interest to be paid on the debt will not be received by the lender as it is highly required to service the debt that will be extended to the borrower. On the lender’s perspective, the existence of credit risk will bring about a disruption in cash flows as well as increasing the costs of collection, since the hiring of a debt collection agency may be forced on the lender in order to strengthen the collection.

The rate of interest that will be charged on the loan will serve as a reward from the lender in acceptance to endure credit risk. In a market system that is efficient, high rate of interests can be charged by banks for loans that are of a high risk to compensate for the high default risk. An example is when a corporate borrower who has a steady income along with an excellent credit history can be eligible to attain low rate credit rather than what will be charged to borrowers of high-risk.

Contrarily, when a transaction is being conducted with corporate borrowers that have a bad credit history, it is the decision of the lender to either charge a high rate of interest for the loan or reject the application for the loan completely.

**10.1 TYPES OF CREDIT RISKS**

There are several types of credit risks but the most paramount are:

**THE DEFAULT CREDIT RISK**

This type of credit risk arise in a situation where a borrower is cannot fully fulfill his loan obligation or where a borrower has held on to the loan till after 90 days above the time for repayment. Credit-sensitive financial transactions like securities, bonds, derivatives and loans may be affected by credit default risk.

The default risk level can vary as a result of a larger change in the economy. It can as well occur due to changes in the economic situation of the borrower like recession or an increase in competition and this can affect the ability of the company for principal as well as interest payments on the loan to be set aside.

**A RISK OF CONCENTRATION**

The level of concentration risk occurs as a result of exposure to one counterparty or sector. It also offers a promising potential for the production of wide number of losses which threatens the core operation of the lender. This type of risk arises from observations which are largely concentrated on portfolios which lack diversification, and have correlated returns on underlying assets.

An example is when the corporate borrower heavily relies on a major buyer for its core products. This corporate borrower will have a maximum concentration level of risk as well as a potential to also incur losses of great amounts when the principal buying ceases the buying of products.

**RISK OF A COUNTRY**

This is a risk that arises when the payment of foreign currency obligations are freeze by a particular country. This can result to a default on the obligations of that country. The performance of macroeconomics and the political instability of the country are mainly associated with this risk. This can also negatively affect the operating profit or the value of the country’s assets. Changes that occur in the environment of business will also affect all the companies that are operating within that particular country.

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