

- **Trade Credit** creates debtors (book debts) or accounts receivable. It is used as a marketing tool to maintain or expand the firm's sales. A firm's investment in accounts receivable depends on volume of credit sales and collection period.
- **Credit Policy** The financial manager can influence volume of credit sales and collection period through credit policy. Credit policy includes credit standards, credit terms, and collection efforts. The incremental return that a firm may gain by changing its credit policy should be compared with the cost of funds invested in receivables. The firm's credit policy will be considered optimum at the point where incremental rate of return equals the cost of funds. The cost of funds is related to risk; it increases with risk. Thus, the goal of credit policy is to maximise the shareholders wealth; it is neither maximisation of sales nor minimisation of bad-debt losses.
- **Credit Standards** are criteria to decide to whom credit sales can be made and how much. If the firm has soft standards and sells to almost all customers, its sales may increase but its costs in the form of bad-debt losses and credit administration will also increase. Therefore, the firm will have to consider the

impact in terms of increase in profits and increase in costs of a change in credit standards or any other policy variable.

- **Credit Terms** The conditions for extending credit sales are called credit terms and they include the credit period and cash discount.
- **Cash Discounts** are given for receiving payments before than the normal credit period. All customers do not pay within the credit period. Therefore, a firm has to make efforts to collect payments from customers.
- **Collection Efforts** of the firm aim at accelerating collections from slow-payers and reducing bad-debt losses. The firm should in fact thoroughly investigate each account before extending credit. It should gather information about each customer, analyse it and then determine the credit limit. Depending on the financial condition and past experience with a customer, the firm should decide about its collection tactics and procedures.
- **Average Collection Period and Aging Schedule** are methods to monitor receivables. They are based on aggregate data for showing the payment patterns, and therefore, do not provide meaningful information for controlling receivables.

- **Collection Experience Matrix** Receivables outstanding for a period are related to credit sales of the same period. This approach is better than the two traditional methods of monitoring receivables.
- **Factoring** involves sale of receivables to specialised firms, called factors. Factors collect receivables and also advance cash against receivables to solve the client firms' liquidity problem. For providing their services, they charge interest on advance and commission for other services.