

5 Keys to Manage Credit Risk Effectively



Mining Maximum Insight from Your Credit Reports

By Matthew McKenzie

Managing commercial credit risk is important to any small business growing its financial strength. Here are a few basic principles that any business owner can use as a foundation for its credit risk management strategy.

There's actually a single common theme for all five of the principles I'll discuss below: Act, don't react. If you want to manage risk, then you need to learn how to anticipate risk.

Fortunately, with the right risk management tools and a bit of discipline, any small business can achieve this goal. Here are five specific suggestions, including action your small business can take right away.

1. **Don't just focus on new customers.** It's human nature: We like to think that long-term business relationships are stable, solid, and built on a foundation of trust. The truth, however, is that up to 80 percent of bad debt involves business relationships that are a year or more old.

Takeaway: Don't treat credit risk management as a one-time process. [Evaluate credit risk](#) for your customers, vendors, and suppliers regularly, and watch for trends in business credit profiles that signal impending trouble.

2. **Trust your technology tools.** A manual credit-review process might feel more thorough - you can pull in data from multiple reporting sources, mull it over, and make a "big picture" credit decision. Today, however, with so many data sources to choose from, it's more likely that you'll miss or misunderstand critical information.

Takeaway: Work with a business information provider that offers a comprehensive, integrated set of risk management tools. You'll save money and time - and manage credit risk far more effectively.

3. **Trust your colleagues, too!** Some of a credit professional's best allies aren't in the credit department - they're in sales, support, customer service, and even the executive suite. A sales call, for example, might reveal that a customer is downsizing its office, or a business owner might hear through the grapevine that a normally reliable partner is having problems with slow payments.

Takeaway: The more eyes and ears you recruit, the more likely you are to get the information you need to evaluate credit risk in a timely manner.

4. **Take business fraud seriously.** Most small businesses are eager to build relationships with new customers, suppliers, vendors, and business partners. In the process, however, they're more likely to overlook signs that a business relationship is TOO promising.

Takeaway: Apply consistent risk management practices to all of your business relationships. When you see a red flag - a murky business history, unusual references, or too-good-to-be-true terms - put on the brakes until you can get the answers you need to evaluate credit risk.

5. **Your job is to manage risk - not eliminate it.** There's only one way to completely eliminate risk from your business, and that's to close the doors and go home. That's because the more you do to eliminate business risk exposure, the more expensive and time-consuming the process will become. At some point, the costs of eliminating ALL risk exceed the benefits of trying to do so.

Takeaway: Put the right tools, technologies, and processes into place to manage your risk in the most cost-effective manner. Once you achieve this, you can be confident that you're striking the right balance between risk and reward.