

SOFTWARE TIP: Customer credit limits and risk categories

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We have previously talked about the importance of accurate and complete master data, and auditing who is changing what fields. This article highlights the importance of assigning a credit limit to all customer accounts.

By assigning credit limits a company can better manage the risk exposure of their customers. All good ERP systems provide this functionality as part of their standard package. It is then a company decision on how they calculate and assign a credit limit to an account. This calculation can be done at different levels. By individual customer, by payer, or by a “group” which may include multiple businesses with the same owner/s. This clear visibility of exposure supports strong risk management.

The most common method to calculate the required credit limit is to identify the customer payment terms and estimated sales. Eg: if the customer payment terms are 30 days EOM (End Of Month) and the estimated purchases are \$10K per month you would possibly assign a credit limit of \$20K. Some companies include a sales growth component, perhaps 10% making the approved credit limit \$22K. You may need to take into consideration fluctuations in a customer’s monthly purchases.



Companies that are strong on audit and risk management will hold regular review of customer credit limits. This may be quarterly, six monthly or even annually. Due to the sheer volume of customers, some companies may review some of their customers more frequently, such as their top customers, or customers deemed as high risk. A company should not generally offer a high credit limit to a customer with high sales if they are deemed a high risk.

In conjunction with credit limits each customer can be assigned a risk category. This can be configured for your specific customer data base.



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Most modern ERP systems will allow the flexibility of different risk categories. The Risk Category flows into the automated credit hold functionality. When using the automated credit hold function, what happens to the order will depend on your configurations. The risk category will have at least two criteria: 1) does the order take the account above the approved credit limit?, 2) is the account overdue?

We know that an overdue account is not always due to customer slow payment, it may be within our own company, for example, where perhaps a credit note needs to be issued. Because of this, orders that have been automatically placed on hold can be released manually for delivery once the account has been reviewed.

Companies strong on minimising unnecessary exposure will review credit limits robustly. In SAP the FKD43 report includes customer risk category, credit limit and current exposure. This report is a good way to start your review process.

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