

Full Length Article

An Analytical Study Of Credit Policies And Profitability

Farooqui Mohd Qutbuddin¹, Gaddamedi Pavan², Hussain Ali³, Syed Abdul Mannan⁴

^{1,2,3}Students; MBA Department, Shadan College of Engineering & Technology, Hyderabad. India.

⁴Assistant Professor; MBA Department, Shadan College of Engineering & Technology, Hyderabad. India.

Email: abdulmannansyed123@gmail.com

Accepted 07-05-2026

Author(s) Retains the Copyrights of This Article

Abstract:

Credit policy is one of the most significant financial management tools influencing organizational profitability and sustainability. Effective credit policies help firms manage receivables, reduce default risk, improve liquidity, and enhance profitability. This paper analytically examines the relationship between credit policies and profitability in banking and corporate sectors. The study focuses on various components of credit policy such as credit appraisal, credit standards, collection policies, trade credit management, and risk assessment mechanisms. The research also evaluates the impact of credit risk management on profitability indicators such as Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM). The study is based on secondary data obtained from research papers, banking reports, and financial journals. Findings indicate that strong credit policies positively influence profitability by minimizing non-performing assets, improving cash flow efficiency, and strengthening financial performance.

Keywords: Credit Policy, Profitability, Credit Risk Management, Banking Sector, Trade Credit, ROA, ROE, Financial Performance.

Introduction

Credit policy refers to the set of guidelines, rules, and procedures adopted by organizations and financial institutions for granting, managing, and recovering credit provided to customers or borrowers. In the modern financial environment, credit policies play a significant role in ensuring smooth business operations, maintaining liquidity, minimizing credit risk, and enhancing profitability. In banks and financial institutions, credit policies determine important operational aspects such as loan approval standards, credit appraisal procedures, risk assessment techniques, recovery mechanisms, and monitoring and collection strategies. Similarly, in corporate organizations, trade credit policies influence customer relationships, sales performance, accounts receivable management, and working capital efficiency. An ineffective or poorly designed credit policy may result in increased bad debts, higher non-performing assets (NPAs), poor cash flow management, reduced liquidity, and declining profitability. Therefore, developing and implementing an effective credit policy is essential for achieving organizational growth, financial stability, and long-term sustainability.

Objectives of the Study

The primary objective of this study is to analyze the concept, significance, and role of credit policies in organizational and financial performance. The study also aims to examine the relationship between credit policies and profitability by identifying how effective credit management practices influence financial outcomes. Another important objective is to evaluate the impact of credit risk management on organizational performance and operational efficiency. Furthermore, the study seeks to examine various credit management techniques adopted by banks, financial institutions, and business firms, and to provide suitable suggestions for improving profitability through efficient credit policy formulation and implementation.

Research Methodology

The study is descriptive and analytical in nature and is primarily based on secondary data sources. Information has been collected from a wide range of reliable sources, including research journals, banking reports, published articles, financial statements, RBI publications, textbooks, and international financial studies. These sources provide valuable insights into the relationship between credit policies, risk management practices, and profitability indicators.

The collected data has been systematically reviewed, organized, and analyzed to understand the influence of credit policy frameworks on organizational financial performance and to identify best practices in credit management.

Concept of Credit Policy

Credit policy is a structured framework that defines how credit is granted, controlled, monitored, and recovered within an organization or financial institution. It establishes the standards and procedures used to manage credit-related decisions effectively. The major components of credit policy include credit standards, credit period, credit terms, collection policy, and credit monitoring. Credit standards refer to the criteria used to assess the eligibility and creditworthiness of customers or borrowers before extending credit. The credit period specifies the duration allowed for repayment, while credit terms include repayment schedules, interest charges, discounts, penalties, and other contractual conditions. Collection policies determine the procedures and methods used for recovering outstanding payments or overdue accounts. Credit monitoring involves regular evaluation and supervision of credit accounts to detect potential repayment issues and reduce default risks. A well-designed credit policy aims to maintain an appropriate balance among risk management, liquidity maintenance, sales growth, customer satisfaction, and profitability.

Credit Policies and Profitability

Profitability refers to the ability of a firm, bank, or financial institution to generate earnings from its operations and utilize its resources efficiently. Key profitability indicators commonly used in financial analysis include Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM). Effective credit policies contribute positively to profitability by improving receivables turnover, reducing credit defaults, enhancing cash flow management, increasing customer retention, and minimizing bad debt expenses. Proper credit policies allow organizations to extend credit to reliable customers while controlling potential financial risks. In banking institutions, strong credit policies help maintain loan quality and reduce non-performing assets, thereby strengthening profitability. Various research studies indicate that organizations with efficient credit risk management systems tend to achieve better financial performance and stronger competitive advantages compared to those with weak credit management practices.

Credit Risk Management and Profitability

Credit risk refers to the possibility that borrowers or customers may fail to repay loans or fulfill their financial obligations within the agreed period. Since credit risk directly affects financial stability and profitability, banks and firms adopt several methods to manage and control it effectively. One important technique is credit appraisal, which involves evaluating the borrower's repayment capacity, financial background, credit history, collateral security, income stability, and overall risk profile before granting credit. A strong credit appraisal system reduces the likelihood of loan defaults and improves the quality of credit portfolios.

Another important aspect of credit risk management is credit monitoring. Continuous monitoring helps ensure timely repayments, early identification of risky accounts, improved customer follow-up, and better recovery performance. Organizations that maintain effective monitoring systems are more capable of reducing financial losses and strengthening profitability. Research studies consistently demonstrate that systematic credit monitoring has a positive impact on operational performance and long-term financial outcomes.

Trade credit management also plays a significant role in determining corporate profitability, particularly in non-banking business organizations. Trade credit policies influence sales volume, customer relationships, accounts receivable turnover, and working capital management. Research conducted on Indian pharmaceutical firms has shown that efficient trade credit policies improve profitability by reducing ambiguity in credit operations, increasing receivable turnover, and strengthening cash flow efficiency. Therefore, effective credit risk management and well-structured credit policies are essential tools for improving profitability, ensuring financial discipline, and promoting sustainable organizational growth in both banking and corporate sectors.

Analytical Discussion

A positive relationship exists between credit policy and profitability in financial institutions and corporate organizations. A flexible credit policy can increase sales, improve customer satisfaction, and strengthen market competitiveness by allowing easier access to credit facilities. However, excessively liberal credit practices may result in higher default rates and increased bad debts. Therefore, an effective credit policy should maintain a balance between profitability and risk exposure. Research studies indicate that factors such as proper credit appraisal, efficient debt collection mechanisms, and strong governance

practices significantly contribute to improving organizational profitability.

Non-Performing Assets (NPAs) have a substantial negative impact on profitability, particularly in the banking sector. High levels of NPAs reduce interest income, increase provisioning requirements, and weaken investor confidence. As a result, financial performance indicators such as Return on Assets (ROA) and Return on Equity (ROE) are adversely affected. Studies conducted on Indian banks consistently show that rising net NPAs lead to a decline in overall profitability and financial stability. Technology also plays an important role in modern credit management systems. Financial institutions increasingly adopt Artificial Intelligence (AI), data analytics, credit scoring models, and automated loan processing systems to improve operational efficiency.

These technologies enhance decision-making accuracy, strengthen fraud detection mechanisms, improve recovery efficiency, and support better customer risk profiling. Consequently, technology-driven credit management practices positively influence profitability by reducing credit risk and improving financial performance.

From a comparative perspective, significant differences exist between public and private sector banks in their approaches to credit management. Variations in credit appraisal methods, risk management practices, monitoring systems, and recovery strategies often lead to differences in profitability levels. Comparative research on Indian banks suggests that institutions with stronger credit risk management frameworks generally achieve better financial performance and profitability outcomes.

Table 1: Public and private sector banks differ in credit management approaches

Sr. No.	Parameter	Public Sector Banks	Private Sector Banks
1	Credit Approval	Conservative	Faster and flexible
2	Technology Usage	Moderate	Advanced
3	Risk Management	Traditional	Data-driven
4	NPAs	Higher	Lower comparatively
5	Profitability	Moderate	Higher

Findings of the Study

The study identified several important findings regarding the relationship between credit policies and profitability. Firstly, it was observed that credit policy has a direct and significant impact on organizational profitability. Well-structured credit policies contribute to improved financial performance by ensuring efficient credit allocation, minimizing defaults, and maintaining healthy cash flows. Secondly, effective credit risk management plays a crucial role in reducing bad debts and non-performing assets (NPAs), thereby strengthening financial stability and profitability.

The study further revealed that strong credit appraisal and continuous monitoring systems enhance financial

performance by improving the quality of credit decisions and reducing repayment risks. Proper assessment of borrower capacity, creditworthiness, and repayment ability enables organizations to avoid risky lending practices. Another important finding is that technology-driven credit management systems significantly improve operational efficiency by enabling faster credit evaluation, better monitoring, data analysis, and automated risk assessment.

In addition, the study found that trade credit policies have a substantial influence on corporate profitability, particularly in business organizations where credit sales and receivable management directly affect working capital and cash flow. The findings also

indicate that private sector banks generally demonstrate better profitability levels compared to many public sector institutions due to stronger credit management practices, efficient monitoring systems, advanced technological integration, and effective risk management frameworks.

Suggestions and Recommendations

Based on the findings of the study, several suggestions and recommendations are proposed to improve credit management practices and enhance profitability. Organizations should implement strong and systematic credit appraisal systems to assess customer and borrower creditworthiness accurately before extending credit facilities. Banks and financial institutions must regularly monitor their loan portfolios to identify risky accounts at an early stage and minimize the possibility of defaults.

The integration of advanced technology into credit management systems is highly recommended, as digital tools and automated systems can improve decision-making, risk analysis, monitoring efficiency, and operational effectiveness. Firms should also establish balanced trade credit policies that support sales growth while controlling financial risk and maintaining adequate liquidity. In addition, organizations must adopt proper recovery and collection mechanisms to ensure timely repayment and reduce overdue accounts and bad debts.

Employee training and skill development in credit risk assessment should be enhanced to improve the accuracy and effectiveness of credit-related decisions. Employees involved in lending, appraisal, and monitoring activities should receive regular training in financial analysis, risk evaluation, and regulatory compliance. Furthermore, banks and financial institutions should strictly adhere to Reserve Bank of India (RBI) guidelines relating to credit risk management to ensure regulatory compliance, sound lending practices, and financial stability.

Conclusion

Credit policy is a vital determinant of organizational profitability, operational efficiency, and long-term financial sustainability. Efficient credit policies enable firms and banks to reduce credit defaults, improve liquidity management, strengthen cash flow, and maximize earnings. The study concludes that there exists a strong and positive relationship between effective credit management and profitability across both banking institutions and corporate organizations. Organizations that maintain balanced credit standards, robust appraisal systems, efficient monitoring procedures, and effective collection mechanisms tend

to achieve superior financial performance and stronger market competitiveness. In the rapidly evolving financial environment, technology-based credit risk management practices are becoming increasingly important for improving operational efficiency, strengthening risk control, and sustaining profitability. Therefore, organizations must continuously review and strengthen their credit policies to adapt to changing market conditions, regulatory requirements, and business challenges in order to ensure long-term growth and financial success.

References:

- 1) Singh, S., Naveen, L., Acharya, A., & Gupta, N. (2024). *The impact of credit risk and debt coverage on profitability of banks: A comparative study on Indian public & private sector banks*. *IITM Journal of Business Studies*, 11(1), 247–260. <https://www.journals.acspublisher.com/index.php/jbs/article/view/16855>
- 2) Farhan, N. H. S., Tabash, M. I., & Yameen, M. (2020). *The relationship between credit policy and firms' profitability: Empirical evidence from Indian pharmaceutical sector*. *Investment Management and Financial Innovations*, 17(2), 146–156. [https://doi.org/10.21511/imfi.17\(2\).2020.12](https://doi.org/10.21511/imfi.17(2).2020.12)
- 3) Butola, P., Dube, P., & Jain, V. K. (2022). *A study on impact of credit risk management on the profitability of Indian banks*. *International Journal of Management and Sustainability*, 11(3), 103–114. <https://doi.org/10.18488/11.v11i3.3068>
- 4) Wanjohi, A., & Baimwera, B. (2016). *An analysis of the effect of credit risk management on profitability of commercial banks in Kenya*. *International Journal of Finance and Accounting*. <https://doi.org/10.47604/ijfa.165>
- 5) Biswas, M. R., Nath, S. D., Biswas, P. K., & Rashid, M. A. (2021). *Effect of credit risk on commercial banks' profitability: A case study of Bangladesh*. *Indian Journal of Commerce and Management Studies*. <https://ijcms.in/index.php/ijcms/article/view/12>
- 6) Davis, E. P., & Karim, D. (2022). *The effects of macroprudential policy on banks' profitability*. *International Review of Financial Analysis*, 80, 101989. <https://doi.org/10.1016/j.irfa.2021.101989>
- 7) Baker, H. K., Pattnaik, D., & Kumar, S. (2022). *Trade credit and firm profitability: Empirical*

- evidence from India. International Journal of Finance & Economics*, 27(4), 3934–3953.
- 8) Pandey, S., & Samanta, A. (2021). *Impact of credit risk on the profitability of selected commercial banks listed on the National Stock Exchange. Journal of Economics, Business and Market Research*.
<https://www.scitcentral.com/article/73/2033>
 - 9) Almaqtari, F. A., Hashid, A., Farhan, N. H. S., Tabash, M. I., & Al-ahdal, W. M. (2020). *An empirical examination of the impact of country-level corporate governance on profitability of Indian banks. International Journal of Finance & Economics*, 25(2), 1912–1932.
 - 10) Lalon, R. M., & Morshada, F. (2020). *Impact of credit risk management on profitability of commercial banks in Bangladesh: An estimation of dynamic panel data model. International Journal of Finance & Banking Studies*, 9(3).
<https://doi.org/10.20525/ijfbs.v9i3.874>.