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A Study of Debtor Management of an Indian Company

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Abstract: *Trade credit is considered as an essential marketing tool, acting as a bridge for the movement of goods through production and distribution stages of customers. When a firm makes an ordinary sale of goods or services and does not receive payment, the firm grants trade credit and creates account receivables which will be collected in the future. However the extension of credit involves risk and cost. So, it is required to control and manage debtors.*
In this research paper we study and examine the debtor management system and credit policy of an Indian company. Data is collected through both primary and secondary sources. The staff member, employer's member provided us the information regarding the credit policy of the company, payment mode used by the dealers, techniques used in debtor management that is DSO (Days sales outstanding) and aging schedules, different dealers of the company and some information about invoice preparation. Statistical tools are used to summarize and analyze the data. The credit policy of the company is very strict. No policy violation is allowed in the company. That is the reason that company's brand image, goodwill and creditability is very high. Company is able to collects its debt on time. From the past 7 years company is facing no case of any bad debts.
Key Words: *Receivable management, Days sales outstanding, trade credit, credit policy.*

DEBTOR MANAGEMENT:

Debtor management means the process of decisions relating to the investment in business debtors. In credit selling, it is certain that we have to pay the cost of getting money from debtors and to take some risk of loss due to bad debts. To minimize the loss due to not receiving money from debtors is the main aim of debtor management. There must be a proper internal control system in the organization otherwise it will be difficult to recover the amount from the debtors.

NEED OF THE STUDY:

The receivable and credit management is vital tool of financial management. Receivable management provides a base and support to the liquidity and working capital requirements of a company.

OBJECTIVES OF THE STUDY:

1. To study and critically examine the credit policy and procedure and existing account receivable management system.

2. To critically evaluate the liquidity position of the firm.

RESEARCH METHODOLOGY:

Research Methodology is a process used to collect information and data for the purpose of making business decisions. The methodology may include publication research; interviews; surveys and other research techniques and could include both present and historical information. Research Methodology is a systematic way to solve any research problem. It may be understood as a science of studying how research is done scientifically.

REVIEW OF LITERATURE:

There are few research papers available on the topic of Debtor Management in which different authors have defined according to their different point of view.

Boggess W.P (1967), noted that carrying costs are those costs of capital measured as thecompany's internal required rate of return on funds committed in receivables where asnormal credit costs are those costs for supporting the credit function, for example legal collections.

Rosse and Wasterfield (1988), distinguished two costs; the carrying costs and opportunity costs. To them carrying costs are those associated with credit extension and extension of receivables. They include the required rate of return from bad debts and the costs associated with credit analysis, monitoring and collection efforts. They further argued that opportunity costs are costs related to loss of sales and as a result of refusing to grant credit.

According to Horne Van (1989), a firm should evaluate its credit policy in terms of returns and costs. The costs involved include; the selling costs, administration costs, collection costs and bad debt losses. Van Horn however identifies these costs as involving in the implementation of credit sales. He further emphasizes that a firm can realize sales because of credit sales, which leads to larger profits.

Suk. H, Kim.SH and Rowland (1992) have conducted a survey among 94 Japanese companies in USA (1992) found that they differed in working capital management practices from the US companies in terms of lower levels of inventory and higher levels of accounts receivables. The study revealed that the US firms piled-up their inventories; Japanese firms had higher percentage of receivables to total assets.

Balstansky (1993) noted that collection procedures are efforts applied in order to accelerate collections from slow paying customers and to reduce bad debt losses. Collection procedures could be defined for each credit customer. This should be done in an organized manner that will accelerate cash receipts without endangering the relationship with the debtor.

Stoner (1997) describes organisational performance as the ability to operate efficiently, profitably, survives, growand lead to opportunities and threats. Stoner (1997) singled out the production processefficiently as the key factor governing business performance. There is also emphasisupon innovation for profitability, assets management and overall entrepreneurship for achieving lasting performance.

According to Pandey (2001), in order to analyze customers and set standards, two aspects are considered; the average collection paid and the default rate. To him, average collection paid refers to the period in which debts remain outstanding, and default rate is the ratio of uncollected receivables to the total receivables.

Pandey (2001) identifies 5C's of credit as a measurement in setting standards. The 5 C's include; character, capacity, condition, capital, and collateral.

Julius Kakuru (2001) noted that though extending credit is beneficial, it involves costs which are inevitable in some cases, and these costs include; collection costs, bad debt losses, administrative costs and opportunity costs. To him, collection costs are incurred at the time of collection of receivables. These could be in form of sending reminding letters, meeting telephone charges and making reminders through the press in some cases.

Deloof, M (2003) found a significant negative relation between gross operating income and the number of days accounts receivables, inventories and accounts payables of Belgian firms. These results suggested that managers can create value for their shareholders by reducing the number of day's accounts receivables and inventories to a reasonable minimum. The adverse relationship between accounts payable and profitability inconsistent with the view that less profitable firms wait longer to pay their bills.

Reddy &Patkar (2004) studied the size and its components and liquidity management in factoring companies. Also they attempted to study the correlation between the liquidity and profitability of factoring companies. They concluded that the sundry debtors and amount due to creditors are three major components of current assets and current liabilities respectively in determining the size of the working capital.

Reddy Sudharsana G. Shri and Reddy Raghutha S. Shri (2005) in their study attempted to evaluate the receivables management practices in the selected small scale industries at Peenya industrial estate in Bangalore. The major findings of the study are: prime reason for granting credit facility is as sales promotion technique, bills receivables are the main form of credit sales. The credit worthiness of customers is judged based on their past association with the customers. Units collect dues from the customers directly and also through representatives and units do not prefer to the court of law in regard to defaulting customers.

According to Survey carried by **Enterprise Uganda(2007)** one of the mostprevalent challenges identified during business health checks is that Scale businessenterprises are associated with poor credit management and financial records which makes entrepreneurs unable to make business decisions on the sound financial records. Also these businesses cannot access loans because they don't have effective creditmanagement systems and end up accumulating a lot of debts which are eventually written off.

RamaduJanki P. & Rao Durga S. (2007) under their study – "Receivables Management of the Indian Commercial Vehicles Industry", revealed that the industry had managed receivables efficiently whereas a few individual companies had far less satisfactory scores in this respect.

Vadakarai (2007) in his study titled with "A Study on Receivables Management Variables and

Investments in Plant & Machinery" found that the receivables management variables depend upon the investment made in plant & machinery/equipments.

Sources of Data Collection:

While conducting the study two types of data is taken into consideration that is primary data and secondary data.

- **Primary Data:** The staff member, employer's member guided us, gave us lot of knowledge and information about the MIS system of the company, different products of the company, credit policy of the company, payment mode used by the dealers, techniques used in debtor management that is DSO (days sales outstanding) and aging schedules, different dealers of the company and some information about invoice preparation. They shared their experience of job with us and guided us about the project thoroughly.
- **Secondary Data:** Secondary Data is the data which is collected by other than the user. The secondary data is also used during the study. While conducting study the manuals of the company is studied.

SCOPE OF THE STUDY:

The sale of goods on credit is an essential part of any modern and competitive economic system like India. Credit sale and therefore receivables are treated as marketing tools to aid the sale of goods. The study aims at analyzing the debtors and outstanding amount of the company. It is hoped that this study will help the company in reducing its investment in Accounts Receivable. The scope encompassed with the debtors section of the company which is a part of finance and accounting department.

TOOLS AND TECHNIQUES USED:

Some statistical tools and techniques are used in the study to analyze the data. These tools are as follow:

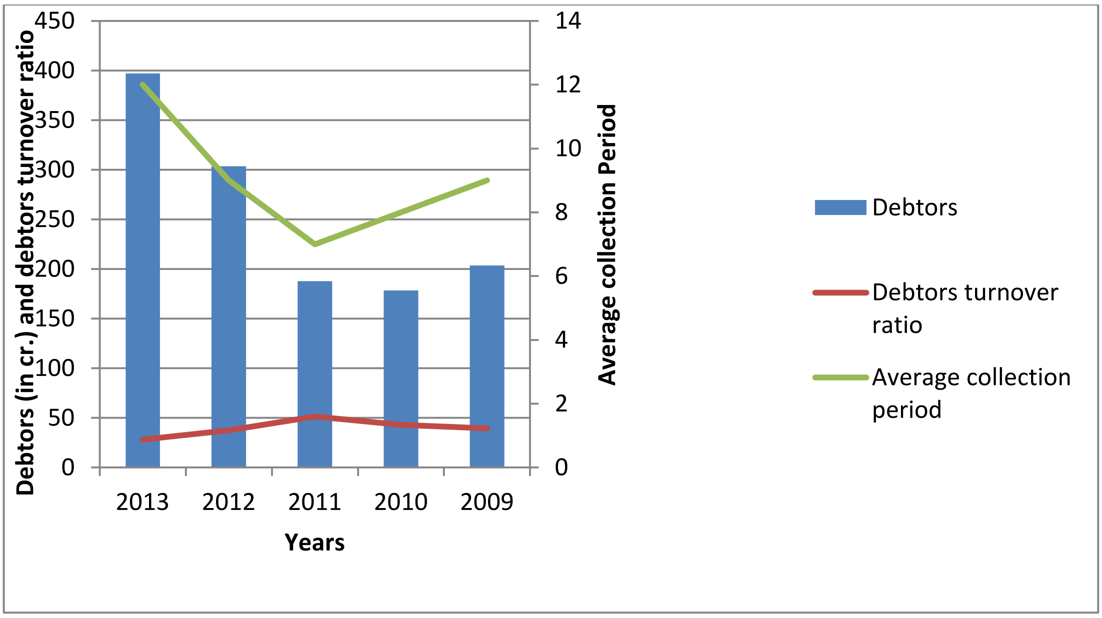
1. Statistical tools used to summarize and analyze the data are bar-graphs and tables.

2. Ratio Analysis and bar-graphs are used for designing the research.

3. MS-EXCEL and PIVOT TABLES are also used.

Debtor turnover ratio and Average collection period of an Indian company

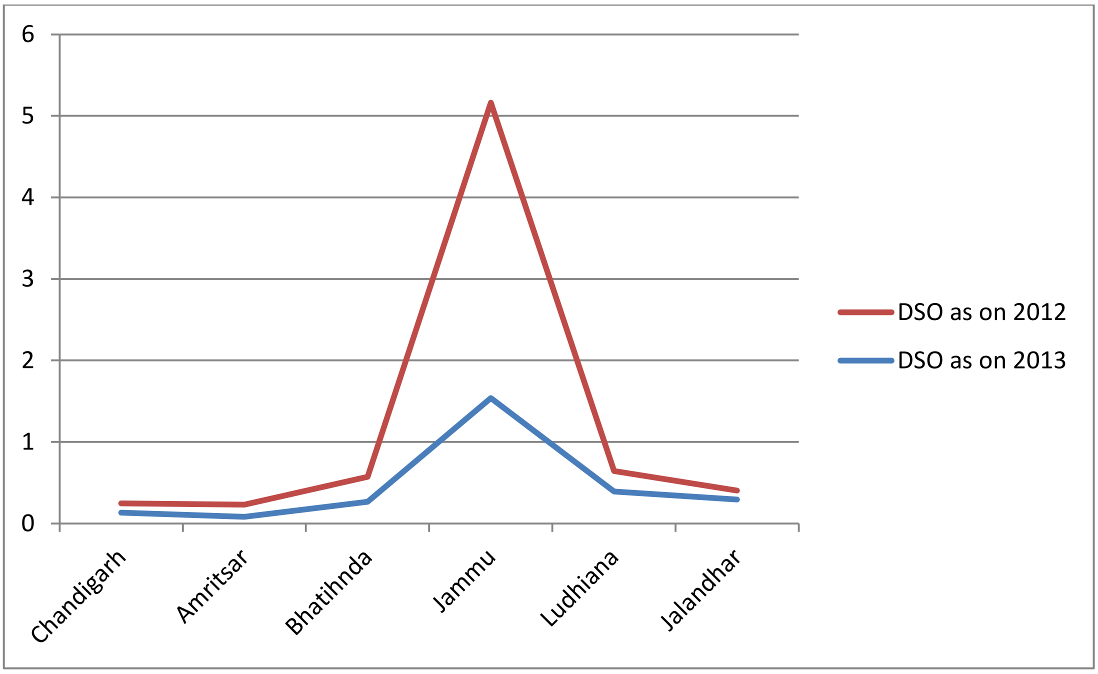
	2013	2012	2011	2010	2009
Debtors (in Cr.)	397.22	303.45	187.74	178.28	203.70
Sales (in Cr.)	11168.94	11357.96	9660.29	7647.77	8021.59
Debtors Turnover Ratio	28.11	37.42	51.45	42.89	39.37
Average Collection period	12	9	7	8	9



ANALYSIS:

In the year 2009 debtors' turnover ratio was 39.37%, in the year 2010 it was 42.89%, in 2011 it was 51.45%, in 2012 it was 37.42% and it 2013 it was 28.11%. It indicates debtors turnover ratio of the company was initially less then it starts rising and further it falls. Even the debtors turnover ratio has fall but the fall is not much very wide and company's sales volume also increases from past few years due to which company is able to manage its debtors well. Company is adopting effective measures to increase its debtors turnover ratio and collecting back its dues.Average collection period of the overall company was less in the year 2011 and further it rises. It means there are very less defaults by the customers in 2011. But in 2013 sales level as compare to 2011 has been increased, no doubt average collection period has also been increased but it is offset by increased sales and profits. Now also the company's brand image and creditability is very high. Company is able to collects its debt on time. From the past 7 years company is facing no case of any bad debts.

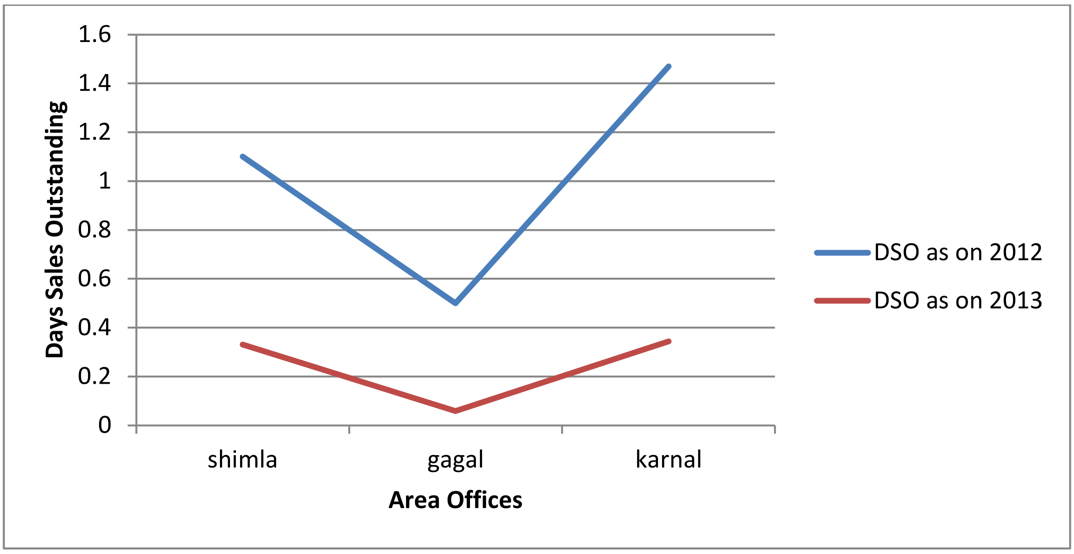
Comparison of DSO of 2012 and 2013



INTERPRETATION:

While comparing the DSO as on December, 2012 and December, 2013, highest DSO is in the 2012. Jammu area office in both the period had the highest days sales outstanding. When we compare the days sales outstanding according to area office wise, all area offices Bhatinda, Jammu, Chandigarh, Ludhiana, Jalandhar and Amritsar shown improvement in days sales outstanding which means clients are paying fastly then in 2012. DSO in 2013 had been declined. A high DSO means the company is using its own cash to fund the business rather than recovering cash owed to it by clients and using that to fund the business.

COMPARISON OF DSO OF 2012 AND 2013



INTERPRETATION:

While comparing the DSO as on December, 2012 and December, 2013, highest DSO is in the 2012. Karnal area office in both the period had the highest days sales outstanding. DSO in all area offices i.e. Shimla, Gagal and Karnal has been decreased from the year 2012 which shows improvement in the days sales outstanding which is a good sign of the company's performance. It indicates clients are paying their debts on time or within the credit period.

A high DSO means the company is using its own cash to fund the business rather than recovering cash owed to it by clients and using that to fund the business and high DSO shows that clients are paying slowly.

BENEFITS:

Apart from the costs, another factor that has a bearing on accounts receivables is the benefit emanating from credit sales. The benefits would depend upon the credit policy adopted by the firm, i.e. a conservative or a liberal credit policy. The impact of liberal credit policy is likely to have forms:

- SALES EXPANSION
- SALES RETENTION

LIMITATIONS OF THE STUDY:

1. The study covers limited area only related to the specific topic.

2. Some of information is kept confidential by the company.

CONCLUSION:

The system of the debtor management is going well in the company with the systematic way and an effective financial control process is being followed by the company to deal with the debtors. The credit policy of the company is strict and for all types of customers same type of the credit policy is followed by the company. No policy violation is allowed in the company. The credit limit and security of the dealer will depend upon its previous sales and its security deposited with the company. The maximum credit limit given by the company is 100000. The maximum credit period of the company is 30 days. In the ageing schedule of 2013, there were more parties involved as compare to 2012. In both of the sales unit the credit sales in the year of 2013 is more than that of 2012.

Days sales outstanding (DSO) is an important tool used by the company to determine its liquidity position. The days sales outstanding analysis provides general information about the number of days on average that customers take to pay. The working of the system is going effectively and efficiently In sales unit Punjab and Jammu the maximum days sales outstanding is the year 2012 that is 3.62 days (for whole year approximately 4 days) in Jammu area office and it is 1.54 days (for whole year approximately 2 days) in Jammu area office. The reason behind maximum DSO (days sales outstanding) in the area office Jammu is that there are two government parties in Jammu and it becomes difficult to collect overdue amount from government parties. In sales unit Himachal and Haryana the maximum days sales outstanding is the year 2012 that is 1.47 days (for whole year approximately 2 days) in Karnal area office and it is 0.34 days (for whole year approximately 0 days) in Karnal area office.

Lastly, the overall Debtors Management System of the company is efficiently managed and no bad debts had been occurred from the last 7 years.

RECOMMENDATIONS:

Proper verification should be done before entering the data into SAP system and regular training should be given to the employees working on it. In Punjab and Jammu sales unit attention must be given to the Jammu area office because two government parties are involved in this area, as the days sales outstanding is high their and mostly the overdue balance is also from their office as compare to other area offices. In Himachal and Haryana sales office attention must be given to the Karnal area office, as DSO of Karnal area office is higher than other area offices. In both of the sales unit, their accounts and sales record must be checked. They must be accountable for any deviations in the records.

More efforts must be made by the sales unit Punjab and Jammu to reduce the quantum of outstanding amount as their aging report shows a gradual increase in outstanding amount in the year 2013 as compare to 2012 to improve the liquidity position.

Monthly or on quarterly basis, the sales records of all the area offices must be checked.

Customer selection must be done on the basis of their background and repayment policy. Feedback of the customers should be taken at regular interval. Customers must be sent reminders once in a month or after 15 days as per the requirements regarding their balances.

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