LESSON - 12

RECEIVABLES MANAGEMENT

12.0 Objective :

After studying this lesson, you should be able to:

* Understand the nature and scope of receivable management.
* Know the importance of accounts receivables and its framework.
* Identify the different levels of credit policies and their effects
* Explain the determinants of a sound credit policy
* Explain the steps in designing the credit policy.

STRUCTURE

12.1. Introduction

Accounts receivables refer to the dues owed by the customers for goods purchased from the firm or services rendered by the firm in the ordinary course of business. Accounts receivable implies futurity, i.e., cash will be received future though uncertain. Sales cannot be done for cash alone and credit is inevitable in the modern business units, which is the basis for receivables. Thus, the receivables arise when a firm sells its products or services on credit and does not receive cash immediately. It is a marketing technique by granting trade credit to protect its sales from the competitors and attract the potential customers to buy its products at favourable terms. The customers from whom receivables have to be collected in the future are known as debtors. These debtors constitute about one-third of current assets in Indian industrial units. Since, a substantial amount is tied-up in this segment of current assets, a careful analysis and proper management is very much essential. In cash sales there will not be any risk, whereas in credit sales risk is there, as the seller receives payment later for delivery of goods affected today. In the credit business, it is not only the uncertainty element but also depreciated value of the money, which will receive, in the later date.

Credit management is risky and it is known as riding on a double-edged sword. If credit is not given sales will not increase, which is allowed as a chance of bad debts. Hence, every firm has to be careful in credit sales and credit extension. As such a prudential financial manager has to be optimum in deciding the quantum of credit, standards and procedures as well as terms of credit. The impact of credit business on the wealth of the firm is shown in figure 12.1.

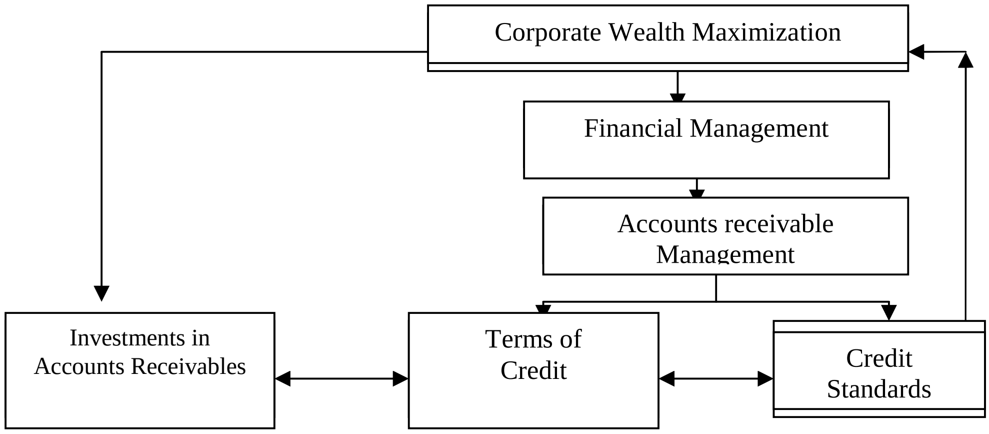

Figure 12.1 Credit impact on wealth Maximization of shareholders

12.2 Objectives of Receivables Management:

The main aim of credit management is not to maximize the sales, nor to minimize risk of bad debts, but it is to manage its credit in such a way that sales are expanded to such an extent to which risk remains within an acceptable limit. In order to attain the maximize the value of the firm, it should manage its trade credit to:

(i) obtain the optimum volumes of sales for which the efficient and effective credit management helps the firm to retain the old customers and attract new customer.

(ii) Control the cost of credit and keep it at minimum, which are associated with trade credit in the form of administrative expenses, bad debts losses and opportunity cost of funds tied up in receivables.

(iii) Maintain investment in debtors at an optimum level, by extending liberal credit, sales and profits increase but increased investment in debtors also result in increased cost and therefore, make a trade off between costs and benefits.

12.3 Issues of Receivable Management:

The management of receivables is a very critical area in the total working capital management as it can be very costly and time-consuming activity. The efficient receivables management results ample opportunities for a firm to achieve advantages through improvements in customer service, cash management and reductions in costs. The management of receivables can be divided into:

(i) Credit Policy
(ii) Credit Analysis
(iii) Collection Policy

12.3.1. Credit policy: It covers the questions concerning terms of credit, credit limits, cash discounts, etc. A business firm is not required to accept the credit policies employed by its competitors, but the optimal credit policy cannot be determined without considering competitors' credit policies. A firm's credit policy has an important influence on its volume of sales, and thus on its profitability. Therefore, a firm should have a well expressed and written credit policy for the purpose of attaining the efficiency in cash flow, clarity of objectives, good customers' relations, employee empowerment, etc.

(i) Goals of Credit policy: The following are the goals of a firm's credit policy:

(a) Marketing Tool: Firms use credit policy as a marketing tool for increasing its sales or to retain old customers in a competitive environment. In a growing market situation, it is used as a marketing strategy to increase the firm's market share.

(b) Sales Maximization: The credit policy of a firm also used for maximization of sales by following a very lenient credit policy and would sell on credit to everyone. But in practice the firms do not follow very loose credit policy just to maximize sales, because this raising of sales further increases the costs. Therefore, the firm has to analyze its credit policy in terms of both return and costs of additional sales.

(c) Pride of Relationships with Customers: The credit policy is used for sometimes as a pride to build long-term relationships with its dealers/customers or to reward them for their loyalty. In some occasions, the customers are not able to operate without sanctioning the credit. Sometimes firms continue by giving credit because of past practice rather than industry practice.

(ii) Types of Credit Policies:

The credit policy will never be balanced unless managed with all precautions. A rider on horse if not careful will get slipped. Similarly, if the credit policy is not carefully designed, it will end- up in losses. The credit policies are different types.

a) Liberal credit policy

b) Stringent credit policy

c) Optimum credit policy

(a) **Liberal credit policy:** Under this policy, the firm is ready to sell more on credit so as to maximize the sales. Profits will increase in liberal credit policy as a result of increased sales. More sales by way of liberal credit policy would also give rise to bad debts and losses there upon.

(b) **Stringent credit policy:** The firm is highly careful in extending credit to customers. The financial manager through rigid standards often sacrifices profitable sales opportunities and profits in the name of rigid and cautious credit norms. Therefore, the objective of profit maximization is partially fulfilled.

(c) **Optimum Credit Policy**: Optimum Credit policy is one, which maximizes the firm's value. To achieve this goal the evaluation of investment in receivables should involve the estimation of incremental operating profit; investment in receivables; estimation of the rate of return of investment; comparison of the rate of return with the required rate of return Sales increase by credit extension is associated with bad debt costs, because of defaulting accounts. Though return on credit sales increases firm's returns, simultaneously firm's liquidity is affected because of slow recovery of debts and at times no recovery of some of the debts

The analysis of the determination of optimum credit policy involves analysis of opportunity cost of lost contribution and credit administration costs and bad debt losses. These two costs behave contrary to each other. Figure 15.1 depicts the trade off between stringent and lenient credit policy. It can be seen from the figure that as the firm moves from tight to loose credit policy; the opportunity cost declines, but the credit administration costs and bad-debt-losses increase. The optimum credit policy lies at a point where these two lines intersect with each other, at which the costs of credit policy are minimum.

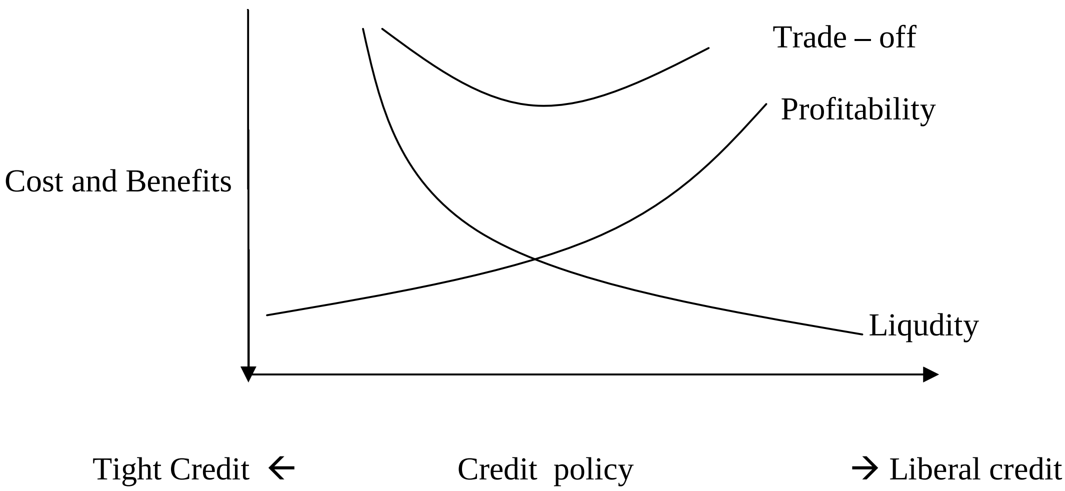

Figure 12.2 Optimum level of credit

Thus, the ultimate objective of a business firm is wealth maximization of shareholders, which is possible only when financial management is executed on sound lines. Accounts receivables management is one of the critical functional areas of financial management. A business firm may be so good in many other areas, like production, finance, marketing, etc. But, the firm will be a failure if it fails to collect cash and it does not matter even if does not sell on cash, provided its credit policy is sound."

Thus, an optimum credit policy covers the following aspects:

i) Investment in receivables

ii) Terms of credit

iii) Credit Standards

(i) Investment in receivables: Financial manager has to offer certain sales on credit, which means the credit sales is financed by the firm. Firms if rich in cash, credit extension is desirable. If firms are not strong financially, finance has to be obtained from outside which means inviting interest burden that goes to reduce profitability of the firm. So, financial manager has to reduce the capital tied up on credit sales.

(ii) Terms of credit: If credit terms are not competitive it will affect sales and consequently the shareholders' wealth. Here terms refers to what is the price if sold for cash, otherwise, what is the credit period and cash discount, how much percentage for how many days are the issues. Like wise the financial manager has to decide as and when situation arises.

(iii) Credit standard

Credit standards have a bearing on sales of the firm. These standards refer to minimum requirements for the evaluation of credit worthiness of a customer. The company may be liberal or strict in defining the requirement in getting credit. The standards imposed by the company are to assess the credit worthiness of customers. As long as company's profitability is higher, it can lower credit standards, which it would adversely, affect the sales.

Following are the effects of lowering the credit standards.

a) Rise in sales
b) Rise in collection period
c) Rise in accounts receivables
d) Rise in bad debts

e) Increase in servicing costs of accounts receivables

Illustration 12.1

Quality Ribbons limited is engaged in the manufacturing of nylon ribbons each price total at Rs. 100/-. Variable cost per unit is Rs. 60/-, fixed cost of the company are Rs. 16 lakhs (annually). Last year sales are 8000 units. The company is contemplating to relax credit standards as a result expecting 10 per cent increase in sales, collection period is likely to go up from 30 to 45 days and bad debts are expected to be 2% and collection expenses to go up by Rs. 50,000/-. Company pays a commission of 10% (not included in variable cost). After the tax the rate of return is expected as 15% while corporate tax is 50%. Now you have to recommend, should company relax credit standards. ?

Solution

Additional sales (Rs)	8000 X 100	=	800000
Variable cost (Rs)	8000 X 60	=	480000
Gross margin (Rs)		=	320000

Other costs

Bad debts expenses	800000 X 2% = Rs. 16000	
Commission	800000 X 10% = Rs. 80000	
Collection expenses	Rs. 50000	146000
Profit before tax		174000
Tax 50%		87,000
Profit after tax		87,000

Effects of changes

A/R collection X sales per day

A/R before changes = 30 X 80,00,000 ÷ 360 = 666667

A/R after change 45 X 4,00,000 Ó 360 = 11,00,000

Increase in investment of A/R = 4,33,333

Required return of additional investment = 4,33,333 X 15% = 65,000

But profit estimated above ----> 87,000

Hence, the proposal is acceptable

(iv) Determinants of Credit Policy

The following are the factors deciding the credit.

a) Competition

b) Producers capacity

c) Buyers condition

d) Marketing techniques

e) Trade practice.

a) Competition: Competition is the important factor why seller makes credit sales. Producers always wish, to leave the goods from the factory premises as early as possible.

b) Producers' capacity: The more the producers' financial capacity the more credit they allow to customers.

c) Buyers' needs: Buyers do wish to get on credit even if the prices are slightly high. It has become common habit to buy more if credit is easily available.

d) Buyers' status: Buyers feel credit as if it a status. They buy more even though the price is slightly higher.

e) Marketing technique: Companies use credit as a technique to maximize its sales and push the sales, to make more turnover and thereby more profit.

f) Trade practice: Credit has become a tradition both for production and buyers. So the practice is continued.

The following are the various steps for designing a sound credit policy.

i) evolve well-defined credit plan and program.
ii) conduct periodical trade enquiries from other customers
iii) analyze the financial statements of customers to know their financial position.
iv) conduct periodical review and up- date ratings of the existing customers.
vi) apply the tools and techniques to weed out the bad ones in letter and spirit
vii) make a credit policy with clear and unambiguous to all the concerned.
viii) keep and maintain personal contacts with the existing customers.
x) maintain the collection departments occasionally.
xi) seriously look into accounts of the long pending debtors.
xiii) train- up sales force to pay an eye on collections.
xiv) send invoices and remainders periodically.
xvii) set and re-set credit limits from time to time to customers
xviii) optimize investment in accounts receivables.
xix) establish and maintain the credit standards.

xx) minimize the cost of credit with selective customers

12.3.2 **Credit Analysis:** After establishing the credit policy, the firm should conduct the credit analysis for evaluating the capabilities of the customers. The credit analysis would broadly divided into two steps, i.e., obtaining credit information, and analysis of credit information. It is on the basis of credit analysis that the decision to grant credit to a customer as well as the quantum of credit would be taken. The credit information may provide some insights about the creditworthiness of the customer with respect to the character, capacity, capital, condition, cost and collateral.

Besides establishing a credit policy, a firm should develop procedures for evaluating credit applicants. The first step in the credit analysis is obtaining the credit information. The sources of information broadly divided into internal and external. The internal source of information is derived from the records of the firms contemplating an extension of credit. On the other hand the information available from external sources are financial statements of the customer, bank references, trade references credit bureau reports, etc.

In nutshell, the following are the various steps involved the credit analysis of the customers.

i) Get the financial data and analyze them
ii) obtain the bank and trade references
iii) refer the past records of the business
iv) Take the opinion of sales personnel
v) Get the credit assessment of the CRISIL, ICRA, etc.
vi) Ask customers to supply information substantiating his credit worthiness
vii) determine the credit worthiness of the customers
viii) take a decision to grant or not to grant credit to them
x) Send goods on trial basis before establishing market relations

The company willing to grant credit would enquire about the ‘prospective debtor’ in the market and know about the inventions and plans from the speeches of the Chairman. With the help of the credit analysis, the customers are selected

The following are the 5 elements that go into credit analysis in identifying a sound customer:

a) Capital
b) Character
c) Collateral
d) Capacity
e) Conditions
f) Past experience

a) Capital: The customers’ repayment capacity depends upon his capital adequacy. In business one’s financial position can be assessed by checking several ratios, especially liquidity and turnover ratios and also funds flow analysis These exercises will help to reveal the customer’s capital sufficiency and financial position of the business.

b) Character: The customers should cooperate and have to pay the debts timely. Many a firm do not cooperate even though they have funds. Some firms even though they have 'will' to pay quickly are unable to meet due to lack of funds. Here character also plays role in deciding the repayment capacity. Hence, the character of a customer shall be enquired and investigated by collecting information about his earlier performance of payments or

c) **Collateral:** The term collateral refers to the funds obtained by showing the assets as security if the customers failed to pay the creditors recover the credit amounts from the proceeds of the collateral assets. If a firm has more secured financing it implies that the firm is less creditworthy.

d) Capacity: Capacity refers to the personnel, technology and entrepreneurial abilities of a firm. The firm's ability and willing to pay the debts depends upon capacity. This capacity can be understood from the recognition of the customer in the market or industry.

e) Past experience: While choosing a customer one has to look into not only the above aspects but also his history. How he has made payments previously. There fore it is better to verify old records, particularly when the customer asks for credit extension. Also it is desirable to know how he has made payment to others has he involved in legal issues previously? Has he caused troubles to others? Such enquiries and credit investigation will help in letter serving the customers.

12.3.3 **Collection Policy:** The third area involved in the receivable management is collection policies**.** The firm should follow a well laid down collection policy and procedure to collect dues from its customers. The collection policies cover two aspects, i.e., the degree of effort to collect the over dues, and type of collection efforts. The collection policies may be classified into strict and liberal. The effects of tightening the collection policy would be to decline in sales, debts, collection period, interest costs and increase in collection costs and whereas, the effects of a lenient policy would be exactly the opposite.

Firms should be practical in their approach in collecting credit sales through regular correspondence, personal calls, telephone contacts, etc. The sudden reminders will not make the collection programs effective unless they take a follow up action and maintain personal relations. If the collection policy is not effective the company will incur large expenses and fail to be 'fund - rich'. So firms should trade –off between cost of collection and bad debt losses. A stitch in right time will save lot. The following diagram shows the relationship between losses due to bad debts and collection expenses.

Illustration: 12.2

From the earlier example - quality ribbons are proposing 2/10 net 3 - and company expects collection period would fall to 18 days from 10 days.

Solution:

Loss of revenue	30,00,000 X 60/100 X 2/100	=	96,000	
A/R before discount	30 X 80,00,000 / 360	=	6,66,667	
A/R after discount	18 X 80,00,000 / 360	=	4,00,000	
Release of investment		=	2,66,667	
Return on funds released	= 2,66,667 X 15%	=	4,00,000	(approx)
Loss of revenue (96,000) is more than				
Return on such funds i.e.,	= 2,66,667 X 15 %	=	40,000	

Since, revenue loss (96,000) is more than return on such funds Rs. 40.000/-, the Proposal is not desirable.

12.4 Costs of Credit:

When credit is sanctioned, funds get tied up in it. The main costs associated with trade credit are:

a) Default costs: All the debts will not be recovered; some of the debts are likely to become bad debts if the credit management is in effective.

b) Delinquency cost: The firms during the recovery of bills incur costs such as legal expenses, reminder costs, travel, recovery charges, etc. All these will cause additional burden to the firms.

c) Collection costs: The collection department of the organization will incur expenses such as telephone, fax, e-mail, correspondence, net charges, stationary, postage, etc. These costs will be high and they depend upon the amount of debts.

d) Opportunity costs: The debtors delayed will not yield returns and remain as idle investment, and thereby the firm looses profitable opportunities of re-investment in business activities.

12.5 Credit Terms:

Another noteworthy aspect of accounts receivables management is deciding credit terms, which include:

a) Credit period
b) Credit discount
c) Credit limit
d) Collection policy
e) Credit investigation
f) Credit insurance

(a) Credit period: It is the period allowed by the seller to the customer to pay the bills. The customer can take advantage and pay conveniently his bills. Here the customers are interested in getting more credit period. But the firm has to decide optimally the period even if sales increases proportionately, the relaxation would cost nearly the firm, as the funds will be blocked.

Illustration: 12.3.

Suppose M/s Quality ribbons limited is interested in increasing credit period from 30 to 45 days, expecting 5% rise in sales. The bad debts will be 2.5 per cent of increased sales. The company would also incur Rs.20, 000 for collection.

Solution :			**Rs**
Increase in sales	4,000 X 100	=	4,00,000
Increase in variable cost		=	2,40,000
Increase in gross profit		=	1,60,00
Less: bad debts	10,000		
Collection charges	20,000		
Commission	40,000	=	-70,000
Profit before tax		=	90,000
Tax (50%)		=	-45,000
Profit after tax		=	45,000
Return investment of A/R		=	x 100
		=	10.38 %

This is less than expected return hence this proposal is rejected

(b) Cash discount: Cash discounts are in the form of discount rate and discount period. It is an incentive to the customer who pays early which many customers take advantage of cash discounts. Rarely some firms do not utilize the opportunity due to their funds tied up and not able to take advantage of as they have no cash balance. Of course this policy would result in loss of revenue of it. Therefore the management has to balance the benefits and costs before arriving a decision on cash discount.

c) Credit limits: Credit sales decision cannot easily be made. While taking credit decision, besides character and capacity of the customer, the supplier has to decide several other things such as extent of credit and credit period. Some times, the supplier is asked to extend credit amount or credit period, for which the customer will not oblige either extra price or interest rate. Under such circumstances, the supplier has to weigh the profit out of extra sales against costs on account of such deal. As long as he makes reasonable gain in the deal he will say yes to extend extra credit period or credit extension.

(d) Collection procedure: Procedure to collect bills from the customers should be such that the firm has to expedite collection, so that, they have enough funds to meet its creditors. The firms have to adopt such collection procedures by giving cash discounts for quick payments and price discounts for cash sales.

(e) Credit investigation: Always the accounts receivables management has to make credit investigation by approaching personally the prospective customers and also the existing customers. He has to collect their financial data and do the credit analysis. The firms should not hesitate to enquirer the customers paying capacity and practices from time to time, which is of course expensive. Every firm has to investigate about its creditors before going credit; otherwise the firm has to face lot of difficulties.

(f) Credit Insurance: The debts are covered by credit insurance. Nationalized industries, government departments and local authorities are considered to be risk free , hence not included. Another method prevailing is special account policy, in this any business and any amount is covered.

12.6 Credit control:

The following actions are more helpful to bring the management of accounts receivables under control.

i) **Prompt invoicing: Even** after delivery, invoicing is made slowly. This will give impression to the customers that invoice has not yet reached. After receiving the invoice, he starts calculating the credit period from the day he has received the invoice. So to quicken the collection, the suppliers should dispatch invoice immediately.

ii) **Open item accounts:** In many firms, ways of collections are very slow and many invoices are turning to be bad debts due to lack of information such as which invoice in which stage. All the amount of each invoice is not collected at one time. Practically amounts are made partially and the payment is computed over a period of time. So for effective control the financial manager should have information invoice-wise, product-wise, division-wise, etc. and all these particulars be collected month-wise so that follow-up action can be initiated.

iii) Personal touch: A credit manager has to be in touch with the customer personally if possible. Otherwise contact them over-phone at-least, so that the customer will be serious and clear the pending dues. This kind of follow-up will bring the accounts receivables under control rather than regular reminders, where the customers act mechanically.

12.7 Credit Monitoring: Accounts receivables are monitored through the following techniques:

i) Aging schedule

ii) Balance of payments pattern

i) Aging Schedule: Aging schedule is a technique to check and regulate the accounts receivables. According to this method, bills are listed on the basis of due dates. Then the total sum due from debtors is divided into different age groups. The following illustration on a hypothetical basis gives further information.

Illustration: 12.4

Comparative statement of aging schedules of account receivables for firm A and B during 2005 - 06

	Firm A		**Firm B**	
Age	Amount Rs.	%	Amount Rs.	%
Billing pending 30 days	10	50	2	10
Bills pending Above 30 days And below 3	5	25	3	15
Bills pending Above 3 months Below 6 months	3	15	5	25
Bills pending Above 6 months and below 1 year	2	10	10	50
Total	20	100	20	100

From the above illustration both A and B firms appear to be equally strong since both firms claim that their A/R are same. But when their bills are wise categorized on age basis, it is evident that 50 % of the total A/R of firm B are kept not collected for reasons beyond the imagination (only 25 % of the bills are 3 months only) Thus firm B, is weak and A is strong (75 % of the bills are 3 months old) in liquidity.

ii) Balance of payments pattern: In this method out of the total sales made in month wise payments received will be shown separately. It will reveal the extent of bills pending and yet to be received. This will help collection departments to know how it has received so far and how much is pending so, far and further measures can be taken for the delay in payment if delay is made. The following hypothetical illustration will explain the method.

Illustration: 12.5 Payment conversion matrix

For analyzing the payments pattern for several months the following matrix is helpful.

Month	**Sale**	**Jan**	**Feb**	**Mar**	**April**	**May**	**Jun**	**July**	**Aug**	**Sept**	**Oct**
Jan	1,00,000		10,000	40,000	30,000	20,000					
Feb	80,000		21,000	28,000	22,000	9,000					
Mar	1,20,000				18,000	48,000	25,000	29,000			
April	1,60,000					19,500	72,500	38,000	30,000		
May	2,00,000						20,000	72,000	60,000	48,000	
June	1,60,000							14,500	56,000	49,000	40,500
Total	10,000		61,000	76,000	1,09,500	1,26,500		1,53,500	46,000	97,000	40,500

Looking at the conversion matrix one can judge whether the collection is improving, stable or deteriorating. Customers are identified as:

i) Reliable customers,
ii) Highly reliable customers,
iii) Risky customers,
iv) Highly risky customers,

12.8 Evaluating the collection department:

Evaluating collection department is a part of accounts receivables management. In this process, evaluation may be strict or liberal the management will assess the department and it's functioning by using several ratios. If management is rigid, collection department will also be strict in sanctioning credit facilities thereby firm looses futures sales. Otherwise the firm would involve in bad debts and problems of funds shortage. As such, the experts of the financial management that every management should be optimum in its evaluation of credit management and be not foolish feel it.

12.9 Factoring Services:

Customers' credit is sold to factors that take the responsibility of collecting and charge for the service rendered. This is called Factoring. The service charges vary from firm to firm and the extent of undertaking risk of bad debts. Factoring is not same as financial management and controlling the accounts receivables. In UK Factors not only advance money against the invoices, but also undertake the responsibility of collecting the debts and also provide services to their clients.

12.9.1 Functions of Factoring

a) Finance: The supplier sends the bills to the 'Factor' and takes finance by paying an extra of 2 % over bank rate of interest for the period, only from the date of advance to the date of payments by the customer. The firm will not show such finance as borrowings in their balance sheet, as this would reduce their borrowing ability from financial institutions. Hence, they show as if the bills are collected.

b) Risk: Factors by making finance available to their clients are taking credit risk. Factors collect from customers according to the normal terms of the suppliers. They are not hard –faced some popular companies do not take the services of Factors.

c) Charges of Factoring: Factoring charges 1 to 2 % for the service they extend on the invoice value. And it varies from company to company. Factors also refuse some sectors that they do not know about the inside knowledge of the business. In such cases they only assist in getting the bills collected.

12.10 Summary

In this lesson, it has been discussed that receivables management is a very important area of total working capital management. It means that an effective and efficient management of receivables can contribute a lot for the improvement of the profitability and liquidity of a business firm. The important dimensions of credit policy are credit terms, credit standards and collection efforts. In general, liberal credit standards tend to push up sales accompanied by a higher incidence of bad debt loss, a larger investment of receivables and a higher cost of collection. On the other hand, a stiff credit policy has opposite effects. In judging the credit worthiness of an applicant for credit, the basic factors are character, capacity and conditions. This lesson also covers the discussion on various aspects like credit analysis, credit collection, credit control, credit monitoring, factoring, etc. The concept of optimal credit policy is also thoroughly discussed with illustrations. Besides, the evaluation of the credit collection department is also presented.

12.11 Key words

1. **Accounts Receivable** money owed by debtors or customers

2. **Collection Policy** it describes the procedures a firm follows in attempting to collect its accounts receivables**.**

3. **Credit Analysis** estimation probability of default for individual customers to determine who receives credit

4. **Credit Period** the time given to a buyer to make full payment for credit purchases

5. **Credit Policy** Norms and guidelines to determine whether and how much credit is to be extended to a customer.

6. **Credit Standards** The minimum criterion for the extension of a credit to a customer.

7. **Credit Terms** The repayment terms extended by a firm to its debtors.

12.12. Self Assessment Questions

1. What are the objectives of Receivables Management? Discuss the importance of credit policy
2. How do you manage credit policy in an enterprise? Discuss the effects of tight credit policy
3. Discuss the factors that determine the credit policy of an enterprise? What are the financial implications of liberalized credit policy?
4. Explain the cost benefit trade-off in Receivable Management
5 Define Factoring. Explain the salient features of factoring.

6. A company sells a product at Rs.40 per unit with the variable cost of Rs.20 per unit. The total fixed costs amount to Rs.16, 25,000 per annum and the total sales are Rs 1,75,00,000. It is estimated that if the present credit facility of two months were Rs.60, 00,000 could increase double sales The company expects a return on investment of at least 75 % prior to taxation. Should the company release the credit period?

7. A firm is considering an increase in its credit period from 40 to 60 days. It currently sells 5,00,000 units at Rs.2 per unit. The average age of receivables is 50 days; the variable costs per unit is Rs.15.70 and the average cost per unit is Rs.18.70.The change in the credit period is expected to increase the sales by 3,15,000 units and the average collection period to 80 days. Assume the required return on investment as 20%, should the firm carryout the proposal. (Assume 360 days year).

8. A company has a 15% required rate of return. It is currently selling on terms of 'net 10'. The credit sales of the company are Rs. 12,00,000 a year. The company's collection period currently is 60 days. If company offered terms of '2/10, net 30' 60% of its customers will take the

discount and the collection period will be reduced to 40 days. Should the company follow the changed credit terms?

9.A firm sells 1,40,000 units of a product per annum at Rs.155 per unit. The average cost per unit is Rs.21.and the variable cost per unit is Rs.38. The average collection period is 65 days and bad debt losses are 2.3% of sales and the collection charges amount to Rs.65, 000. The firm is considering the proposal to follow a strict collection policy, which would reduce bad debt losses to 1 % of sales, average collection period to 45 days. It would however reduce sales volume by 10,000 units and increases the collection expenses to Rs.125; 000.The firm's required rate of return is 20%. Would you recommend the adoption of new collection policy? (Assume 360 days in a year)

12.13 Further Readings:

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