Management of Receivables

The term receivable includes the amount of credit sales which are generally made during the period and which could not be collected by the end of accounting year .It is generally found in the form of book debts and bills receivable .A certain amount of working capital is permanently involved in the form of receivables which comprises cost and benefit .If there is change in credit policies such as credit terms and conditions .For example, if credit period is increased ,it goes to increase the sales which goes to increase the profit but at the same time collection will be delayed and this goes to increase the cost too hence, receivables management goes to justify the thing where the amount of the benefit is more than the cost but there is a limit, hence, optimum level of receivable needs to be identified by the financial manager which is known as receivable management. Thus, the size of the receivable should not be very high and it should not be very low, because in both of the situation, profit cannot be maximized. In this way a financial manager has to see the level of the receivables by analysing so many factors which may fix the equilibrium between the profitability and the liquidity of any corporate concern . The management of receivables mainly covers the study of the Credit Policy, credit analysis ,credit control, management of investment in debtor's balances, increase in efficiency of short term fund management. A firm should strike a balance of accounts receivable. Liberal Credit Policy increases the sales as well as the profitability of the firm but simultaneously ,it should consider the cost involved in liberal credit policy which leads to increase in the investment in receivables, risk of bad debts, cost of administration of receivables, the problems of liquidity etc. Hence, a firm should adopt the policy on accounts receivable to minimize the cost and risk and maximize the firm's profitability and return.

The purpose of receivable management is to ensure the trade-off between the cost and benefits. There are so many factors which affect the size of receivable such as credit policy, size of credit sales, Terms of trade, Attitude of getting profit, credit collection policies, size of market etc.

So far the steps involved in the management of receivables are concerned ,we find that these are five:

(1)Credit analysis

(2)credit standards

(3) credit terms

(4) collection policies

(5)control and monitoring

(1)Credit analysis is done for keeping the customers under different categories .Under credit analysis Mainly Two factors are considered- one is average collection period where the time taken by the customer to repay the credit obligation is taken into consideration. Secondly ,the default risk where the failure in meeting the credit obligation by the customer is taken into consideration. It is generally measured in terms of bad debts losses. In order to determine the default risk, the credit manager should consider the following three factors:

(1)Character which refers to the customer's willingness to pay (2)capacity which refers to the customers ability to pay and (3)conditions which refers to the economic condition that affect the customers ability to pay.

After credit analysis the customers may be classified in various categories such as :

i)category of customers

ii)average collection period and

iii)Default risk

category of customers may be good, marginal and bad. Average collection period may be within credit period, moderate collection period and very large collection period. Default risk may be zero ,moderate and high level.

(2) credit standard: Credit standards are criteria to decide to whom credit sales can be made and to what extent. The firm may have soft credit standard and tight credit standards .Under soft credit standard ,credit sales are increased which increases bad debts and credit administration cost .Under tight credit standard credit sales is decreased and sale is made mostly on cash basis. The firm May extend credit only to the most reliable and financially strong customers. Such standards will result in no bad debts losses and less cost of credit administration. In such a situation the profit sacrificed on Lost sales may be more than the costs saved by the firm.

(3)Credit terms: It refers to the stipulations under which the firm sells goods on credit to the customers. These include credit period and cash discount .

(a)Credit period refers to the length of the time for which credit is generally granted to the customers. It is usually stated in terms of net days, For example, if credit terms are "net 60 "it means (customers are required to pay within 60 days.

(b) A cash discount: It is a reduction in payment offered to customers to induce them to pay within a specified period of time which will be less than the normal credit period. It is generally expressed as a percentage of sales .Cash discount goes to represent the period for which it is available at certain rate, if a customer wants to avail cash discount, he must make the payment in a specific credit period otherwise he may make the payment within normal credit period, For example, credit terms of 2/20 net 60 implies 2% cash discount ,if payment is made within 20 days and no cash discount if payment is made within 60 days.

(4)Collection efforts : This initiative is generally taken to speed up the collection from slow payers and to reduce bad losses. The collection policy needs to be designed in such manner where collection must be ensured at the right time as well as cost and bad losses may be minimum. The following steps need to be taken when the customer has failed to make the payment on the due date:

(i)Send first reminder in polite wordings,

(ii)If customer does not respond send second reminders in some strong wordings.

(iii) If the customer still does not respond, send third reminder in a strong wordings and follow up by email, fax, telephone, personal visit etc.

(iv)If the customer still fails to make the payment and his financial position appears to be weak,personal visit should be made with intention to settle the payment with compromise. On the other hand, if the financial position appears to be a strong, initiate a legal action .

However, individual cases should be dealt with on the merits of each individual case.

(5)Control and monitoring: Afirm needs to monitor and control its receivables on continuous basis to ensure the success of collection efforts.Average collection period and aging schedule are two important methods which are followed for evaluating the effectiveness of receivables management in any concern. However, aging schedule seems to be more beneficial as it provides more information about the collection experience. It helps to spot out the slow paying debtors . However, it also suffers from the problem of aggregation and does not relate receivable to sales of the same period.