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DEBTORS MANAGEMENT WITH RESPECT TO AHRIHANT LED LIGHTS PVT. LTD.

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Abstract:-Management of trade credit is commonly known as Management of Debtors. Debtors are one of the three primary components of working capital, the other being inventory and cash, theother being inventory and cash. Debtors occupy second important place after inventories andthereby constitute a substantial portion of current assets in several firms. The capital investedin Debtors is almost of the same amount as that invested in cash and inventories. Debtorsthus, form about one third of current assets in India. Trade credit is an important market tool.

Keywords: Debtors Management , working capital, substantial portion ,cash and inventories.

INTRODUCTION

As, it acts like a bridge for mobilization of goods from production to distribution stages in thefield of marketing. Debtors provide protection to sales from competitions. It acts no less Thana magnet in attracting potential customers to buy the product at terms and conditionsfavorable to them as well as to the firm. Debtors management demands due consideration notfinancial executive not only because cost and risk are associated with this investment but alsofor the reason that each rupee can contribute to firm's net worth.

Debtors represent amounts owed to the firm as a result of sale of goods or services in theordinary course of business. These are claims of the firm against its customers and form parto its current assets. Debtors are also known as accounts Debtors, trade Debtors customersDebtors or book debts. The Debtors are carried for the customers. The period of credit andextent of Debtors depends upon the credit policy followed by the firm. The purpose ofmaintaining or investing in Debtors is to meet competition, and to increase the sales andprofits.

DEFINITION:

"Debt owed to the firm by customers arising from sale of goods or services in ordinary course Ofbusiness."
"Accounts Debtors are amounts owed to the business enterprise, usually by its customers.Sometimes it is broken down into trade accounts Debtors; the former refers to amounts owed
by customers, and the latter refers to amounts owed by employees and others."

OBJECTIVES OF THE RESEARCH

1.To study of credit policy and procedure of Arihant Led Lights.
2.To analyze the average collection period and calculate effective collection period.
3.To study the impact of Debtors Management in financial liquidity

SCOPE OF STUDY

1.Understand the techniques used to find collection of debtors.

2.To suggest the organization which technique is best.

Theoretical Background

A] Credit Analysis:

Even through the intension of the company will be to increase the profit by increasing thesales, the company will not like to sale its product to any customer who comes its way forthe purposes the company has to decide the customer to whom it should sale its product oncredit. The credit should be extended only to those customers whose credit worthiness isestablished for deciding the credit worthiness of customers the company may considervarious factors Viz, Analysis of financial status of the customers, reputation of customers,record of previous dealing of the customer with the company.

Credit standards refers to the minimum criteria adopted by a firm for the purpose of shortlisting its customers for extension of credit during a period of time. Credit rating, creditreference, average payments periods a quantitative basis for establishing and enforcing creditstandards. The nature of credit standard followed by a firm can be directly linked to changesin sales and Debtors. In the opinion of Van Home, "There is the cost of additional investmentin Debtors, resulting from increased sales and a slower average collection period. A liberalcredit standard always tends to push up the sales by luring customers into dealings. The firm,as a consequence would have to expand Debtors investment along with sustaining costs ofadministering credit and bad-debt losses. As a more liberal extension of credit may causecertain customers to the less conscientious in paying their bills on time. Contrary, to thesestrict credit standards would mean extending credit to financially sound customers only. Thissaves the firm from bad debt losses and the firm has to spend lesser by a way ofadministrative credit cost. But, this reduces investment in Debtors besides depressing sales.

In this way profit sacrificed by the firm on account of losing sales amounts more than the cost saved by the firm.Prudently, a firm should opt for lowering its credit standard only up to that level whereprofitability arising through expansion in sales exceeds the various costs associated 184 withit. That way, optimum credit standards can be determined and maintained by inducingtradeoff between incremental returns and incremental costs.

B] Credit Terms:

Credit terms refer to the stipulations recognized by the firms for making credit sale of thegoods to its buyers. In other words, credit terms literally mean the terms of payments of theDebtors. A firm is required to consider various aspects of credit customers, approval of creditperiod, acceptance of sales discounts, provisions regarding the instruments of security forcredit to be accepted are a few considerations which need due care and attention like theselection of credit customers can be made on the basis of firms, capacity to absorb the baddebt losses during a given period of time. However, a firm may opt for determining the creditterms in accordance with the established practices in the light of its needs. The amount offunds tied up in the Debtors is directly related to the limits of credit granted to customers.

These limits should never be ascertained on the basis of the subjects own requirements, theyshould be based upon the debt paying power of customers and his ledger, record of the ordersand payments. There are two important components of credit terms which are detailed below.

1.Credit period
2.Cash discount

1) Credit Period:

The time duration for which credit is extended to the customers is referred to as credit period.It is the length of time for customers under which they are allowed to pay for their purchases.It is generally varies between 15-60 days. When a firm does not extend any credit the creditperiod would obviously be zero. It is generally stated in terms of a net date, for example, iffirm allows 30 days of credit with no discount to induce early payments credit then its creditterms are stated at 'net 30'. Usually the credit period of the firm is governed by industrynorms, but firms can extend credit for longer duration to stimulate sales. If the firm's baddebts build up, it may tighten up its credit policy as against the industry norms. According toMartin H. Seidhen, "Credit period is the duration of time for which trade credit is extended.During this period the overdue amount must be paid by the customer. The length of creditperiod directly affects the volume of investment in Debtors and indirectly the net worth of thecompany.

2) Cash Discounts:

The cash discount is granted by the firm to its debtors, in order to induce them to make thepayment earlier

than the expiry of credit period allowed to them. Granting discount meansreduction in prices entitled to the debtors so as to encourage them for early payment beforethe time stipulated to the i.e. the credit period. According to Theodore N. Beckman, Cashdiscount is a premium on payment of debts before due date and not a compensation for the socalled prompt payment; Grant of cash discount beneficial to the debtor is profitable to thecreditor as well. A customer of the firm i.e. debtor would be realized from his obligation topay Soon that too at discounted prices. On the other hand, it increases the turnover rate ofworking capital and enables the creditor firm to operate a greater volume of working capital.It also prevents debtors from using trade credit as a source of working capital. Cash discountis expressed is a percentage of sales. A cash discount term is accompanied by (a) the rate ofcash discount, (b) the cash discount period, and (c) the net credit period. Change in cashdiscount can either have positive or negative implication and at times both. Any increase incash discount would directly increase the volume of credits sale. As the cash discount reducesthe price of commodity for sale. So, the demandfor the product ultimately increase leadingtomore sales. On the other hand, cash discount lures the debtors for prompt payment so thatthey can relish the discount facility available to them. This in turn reduces the averagecollection period and bad debt expenses thereby, bringing about a decline in the level ofinvestment in Debtors. Ultimately the profits would increase. Increase in discount rate cannegatively affect the profit margin per unit of sale due to reduction of prices. A situationexactly reverse of the one stated above will occur in case of decline in cash discount.

C] Credit collection:

This indicates step taken by company to collect the dues from the customer. For this purposethe company may fallow the standard prices of reminding the customer just before the duedate. This can be done by sending the reminder letters, or making telephone calls or payingthe personal visits.

The customers who slow paying one should be handled properly. If they are permanentcustomers, they may object too harsh collection procedure and the company may loseultimately. If the slow paying customers are facing some temporary fund problems, thecompany understands the same. If there is some defaulting customers decided a how manyreminders should sent and how each of them should be drafted. If this measure fails, the nextstep taken may be the company representatives. It is very regular practices to offer cashdiscounts to the customers in order to speed up the credit collection process.

D] Financing of Debtors:

Which sourceare available to the company for financing the working capital requirement, areequally the source available for financing the Debtors. This due is to the fact that Debtors area part of working capital. However following source may be identify as a source available for financing the Debtors particularly.

a) Bill discounting
b) In the recent past, factoring has been become one of the source available financing theDebtors.
c) Factoring indicate the relation between a financial institution and(called as factor) andbusiness organization (called as client) who is turn sell goods or services to its customer(called as customer) whereby the factor purchase book debt of the client, either resource orwithout resource, and relation there to control the credit the extended to the customers andadministrators the sales ledger of the client in non-technical language, the financial services is the forms of factoring tries to provide the services which marketing department of aorganization will be undertaking.

E] Control of Accounts Debtors:

Some of the important techniques for controlling accounts Debtors are ratio analysis,discriminate analysis, decision tree approach, and electronic data processing. Informationsystem with regard to Debtors turnover, age of each account, progress of collection size ofbad debt losses, and number of delinquent accounts is also used as one of the controlmeasures.Ratio analysis is widely used in the control of accounts Debtors. Some of the important ratios used for this purpose are discussed below:

1) Average collection Period

The average collection period indicates the average time it takes to convert Debtors into cash.

Too low an average collection period may reflect an excessively restrictive credit policy andsuggest the need for relaxing credit standards for an acceptable account. On the other handtoo high an average collection period may indicate an excessively liberal credit policy leadingto a large number of Debtors being past due and some being not collectable.

2) Ageing Schedule:

The gaining schedule classifies outstanding accounts Debtors at the given point of time intodifferent age brackets. In other words, it breaks the down Debtors according to length of timefor which they have been outstanding.

Now if the normal credit period offered by the company to the customers in the 30 Days, anyamount which is outstanding for than 30 days is definitely indicating inefficiency on the partof collection department of the company in collecting the Debtors. Thus age wise analysis ofthe Debtors and the company can concentrate in collection efforts on those Debtors which areoutstanding for a longer period of time.

3) Debtors Turnover (Annual Credit Sales/Debtors):

This ratio also indicates the slowness of Debtors. Both the average collection period ratio andDebtors ratio must be analyzed in relation to the billing terms given on the sales. If theturnover rates are not satisfactory when compared with prior experience, average industryturnover and turnover ratios of comparable companies in the same industry, an analysisshould be made to determine whether there is any laxity in the credit policy or whether theproblem is in collection policy.

4) Debtors to Sales (Debtors/Annual Credit Sales x 100)

Debtors can be expected to fluctuate in direct relation to the volume of sales, provided that sales terms and collection practices do not change. The tendency towards more lenient credit extensionas would be suggested by slackening of collections and increase in the number of slow paying accounts needs to be detected by carefully watching the relationship of Debtors tosales. When credit sales figures for a period are not available, total sales figures may be used. The Debtors figures in the calculation ordinarily represent year-end Debtors. In the case of firms with seasonal sales, year-end Debtors figures may be deceptive. Therefore, an average of the monthly closing balances figures may be more reliable.

OUTLINE OF THE PROBLEM

In the current situation handling the Debtors is very important the need for this research was to understand how much interest cost was lost due to delay in payment by the customers this analysis can help the company to understand its Debtors collection rates. It is also required by the company to set a proper procedure for future. Debtors management should intended to improve the Debtors management situation and to find the loop holes in the collection procedure; it should also intend to improve their credit control activities.

RESEARCH METHODOLOGIES

OBJECTIVES OF THE RESEARCH

1. To study of credit policy and procedure of Arihant Led Lights.
2. To analyze the average collection period and calculate effective collection period.
3. To study the impact Debtors management in financial liquidity.

SCOPE

1. Understand the techniques used to find collection of debtors.
2. To suggest the organization which technique is best.

RESEARCH DESIGN AND METHODOLOGY

There are two types of data:

A] Primary Data

A] PRIMARY DATA:

The primary data are those which are collected a fresh & for the first time. Primary data isalso called basic data or original data. Following the method of collection of primary Data,these are called sources of primary data collection.

•Observation method
•Interview method
•Schedules & Questionnaire
•Case studies
•Survey

B] SECONDARY DATA:

The secondary data means data are already in various reports, diaries, letters, books,periodically, etc., The secondary data are those which been used previously for any research & now used for second time. In short the data presented in research report when used againfor further research the data are to be said as "Secondary Data."

SOURCES OF SECONDARY DATA:

• Books
• Magazines
• Historical Data
• Company Reports
• Internet

Ratio Analysis: - Ratio Analysis is the process of determining and presenting therelationship of items and group of items in the statements. According to Batty J.Management accounting "Ratio can assist management in its basic functions offorecasting, planning coordination con troll & communication".It is helpful to know about the liquidity, solvency, capital structure & profitability of anorganization. It is helpful tool to aid in applying judgment, otherwise complex situations.Ratio analysis is such a significant technique for financial analysis. It indicates relation oftwo mathematical expressions and the relationship between two or more things.Financial ratio is a ratio of selected values on an enterprise's financial statement. There aremany standard ratios used to evaluate the overall financial condition of a corporation or otherorganization. Financial ratios are used by managers within a firm, by current and potential Stockholders of a firm, and by a firm's creditor. Financial analysts use financial ratios tocompare the strengths and weaknesses in various companies. Values used in calculatingfinancial ratios are taken from balance sheet; income statement and the cash flow ofcompany, besides Ratios are always expressed as decimal values, such as 0.10, or theequivalent percent value, such as 10%.

1) Current ratio:

Current ratio indicates how the expected current claims are covered by current assets. A veryhigh current ratio may not indicate a very favorable position because it means that excessiveinvestments in current assets are made. The current ratio 2:1 shows highly solvent position.

Current ratio = Current Assets.
Current Liabilities

2) Inventory turnover ratio:

It establishes relationship between cost of goods sold during a given period and the averageamount of inventory held during that period. It indicates the number of times finished stock isturned over during a given accounting period. High ratio shows rapid turnover & low ratioshows slow moving stock.

Inventory turnover ratio = Cost of Goods Sold OR Sales
Average Inventory

3) Debtor's turnover ratio:

This ratio indicates the credit policy followed by a business firm. The higher the ratio loweris the collection period while low ratio indicates higher collection period. An averagecollection period, which is shorter, needs to be analyzed carefully.

Debtors turnover ratio = Credit Sales
Average Debtors

4) Working capital turnover ratio:

This ratio compares the net sales with net working capital. The indication given by this ratiois the number of times working capital is turned around in a particular period. The higher theratio the better the utilization of working capital and lower is the investment in workingcapital. However, a very high working capital turnover ratio is a sign of overtrading and afirm may face shortage of working capital.

Working capital turnover ratio = Net Sales.
Net Working Capital

LIMITATIONS:

1.The time limit factor was major constraint as the research was to be completed within two months.
2.The financial analysis will be based only on the figures provided by the financial statements of company. So if the financial statement figures are wrong then ratio will misguide to us.
3.If there is window dressing the ratio calculated will fail to give the correct picture and will prove to be misleading.
4.Change in the prices due to inflation effect will misguide while comparing the figures of different financial years.
5.During this the research doesn't net profits that are why doing calculate market based ratio because this ratio are necessary to net profit.
6.Due to confidentiality sum important information, which are important for the research, could not be collected.
7.The research is based on theoretical guidelines and as per situation prevalent at the timeofpractical training. Hence, it may not be apply to different situation.

FINDINGS:

1.The procedures used in the company.
2.The importance of the planning of the cash so that their business should not face anyhurdles.
3.It is found that collection of debtors in the year 2013-2014 is good comparing to last years.

CONCLUSION

The suggestions given above if implemented will improve the Debtors management and cashflow position of the company, thereby contributing for future growth of the company withbetter funds position. Increase the sales volume automatically increase the debtors, companyalways try to collecting the money minimum time it help to maintain the working capital aswell as liquidity of ARIHANT LED LIGHTS PVT. LTD.

LEARNING THROUGH RESEARCH

1.Maximum Credit period for any customer is 30 days for all categories of customers. Any extension to the above would require prior approval. Credit Period (Days) would begin from the date of our Invoice.

2.Companies sell its products mostly to government sectors.
3.It is found that collection of Debtors in the year 2013-2014 is good comparing to other years.
4.The company mostly does their business on credit basis more than on cash basis
5.The importance of the planning of the cash so that their business should not face any hurdles.

CONTRIBUTION TO THE HOST ORGANIZATION

1.After analyzing of the financial statement, I suggest the technique ofcredit insurance so that the company may recover their debtor's amount safely without any losses.
2.Further I suggested dividing the aging dates in 30 days so as to classifyeasily and making out for a solution on every failure of recovery was suggested to the company.

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