MANAGEMENT OF RECEIVABLES

Policies for Managing Accounts Receivables

Accounts receivable consist of the credit a business grants its customers when selling goods or services. They take the form of either trade credit, which the company extends to other companies, or consumer credit, which the company extends to its ultimate consumers. The effectiveness of a company’s credit policies can have a significant impact on its total performance.

For a business to grant credit to its customers, it has to do the following:

- Establish credit and collection policies.
- Evaluate individual credit applicants.

Receivables management involves the following aspects:

1. **Forming of credit policy:**

Every company must adopt a credit policy. Credit policy relates to

(a) Quality of Trade accounts or credit standards:

- Volume of sales will be influenced by the credit policy of a concern.
- By liberalizing credit policy, the sales will be increased,
- The increased volume of sales will be increased the cost and risk of bad debts
- Credit to only creditworthy customers will save costs like bad debt losses, collection costs and investigation costs etc
- Quality of trade accounts should be decided so that credit facilities are extended only up to the optimum level.

(b) Length of credit period:

- It means the period allowed to the customers for making the payment
- Customers paying well in time also be allowed certain cash discount.
- Concern fixes its own terms of credit depending upon its customers and volume of sales.

(c) Cash discount:

- Cash discount is allowed to immediate payment of customers
- Discount allowed involves cost
- Financial manager compare the cost of discount and the amount of fund realized
- Discount should be allowed only if its cost is less than the earnings.

(d) Discount period:

- Collection of receivables influenced by the period allowed for availing discount
- Additional period allowed for this facility may prompt some more customers to avail discount and make payments.

2. Executing credit policy:

- After formulating credit policy proper execution is important.
- Evaluation of credit applications and finding out the credit worthiness of customers should be undertaken

(a) Collecting credit information:

- Collecting credit information about the customers is the first step in implementing credit policy.
- Information should be adequate and proper analysis about the financial position of the customers is possible.

(b) Credit analysis:

- After gathering information, analyze the creditworthiness of the customer
- Credit analysis will determine the degree of risk associated the capacity of the customer to borrow and his ability and willingness to pay.

(c) Credit decision:

- After analyzing the creditworthiness of the customer, decision has to take whether the credit is to be extended and then up to what level.
- Match the creditworthiness of the customer with the credit standard of the company.
- If customers creditworthiness is above the credit standards then the credit is allowed.

3. Formulating and executing collection policy:

- Collection policy be termed as Strict and Lenient.
- Strict policy of collection will involve more efforts on collection
- Such policy will enable early collection of dues and will reduce bad debts losses.
- It may also reduce the volume of sales.
- Some customers may not appreciate the efforts of the concern and may shift to another concern thus causing reduced sales and profits.

- A lenient policy may increase the debt collection period and more bad debt losses.
- Collection policy should devise the following steps:

a) Sending a reminder for payments

b) Personal request through telephone etc.

c) Personal visits to the customers