Receivable Management practices: the past and the future

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Abstract:

Any organization's ability to succeed depends on how its resources are allocated. As a result, when it comes to managing receivables, every firm must exercise extreme caution when giving customers credit. Credit sales will undoubtedly contribute to boosting sales volume while also boosting revenue. At the same time, we must be extremely cautious when it comes to the cost of extending the credit. If receivables are not collected on time and turn into bad debts, the cost of credit is quite significant. In this research, an effort has been made to examine the receivable management strategies that have been used for a long time and what potential future practises might be. This research paper explores the strengths and shortcomings of the various practises now in use as well as potential future trends in receivable management. For this, we gathered and contrasted the various approaches and procedures, which we then described in this paper.

Key words: Receivable management, profitability, credit sales, future trends

Introduction:

Trade credit is a common and well accepted practise worldwide that separates many businesses from their customers. The pursuit of this idea has numerous advantages for both providers and purchasers. Trade credit has many attainable benefits, but it also has a number of drawbacks. Although some clients absolutely abide by the terms and conditions, there are numerous instances where clients, particularly buyers, are in default and act in a way that contravenes and disobeys the agreed-upon terms and conditions, whether or not it is documented. Payment delays, payment defaults, and in the most extreme situations, willful nonpayment by people or companies, as well as winding up and leaving, could all be mentioned. This is a result of the informal trade credit chase that predominates in this concept's application. Petersen and Rajan (1997) divided the reasons for using trade credit into three categories: financial benefit theory, price discrimination theory (commercial reasons), and transaction costs theory (operational motives). The main factors that affect trade credit are macroeconomic factors and firm-specific ones. A strong credit control system reduces the amount of money held in debtors' hands and reduces bad and iffy debts. Optimizing cash flow is a crucial part of prudent credit management since it allows for improved potential growth and financial stability for the company. When a company does not immediately receive cash in exchange for goods sold or services rendered to a client, credit exists. It is a crucial marketing tool that facilitates the flow of merchandise along the supply chain. In other words, from production to final consumer. In order to maintain and protect its market share from outside competitors as well as to attract and invite new customers to its market and products at fair conditions, a business may offer credit sales. Credit sales activities result in account receivables that will be collected or received in the near future.

Literature Review

According to the Commercial Theory, trade credit makes things more marketable. Consequently, trade credit makes it rather simple for businesses to sell (Nandiri, 1969). Price discrimination can also boost profitability with credit sales (Bannan, Makismovrc and Zenchar, 1998). This describes the offering of the same goods to numerous customers at various costs. Accounts that are measured in accordance with IAS(39) and disclosed in accordance with IFRS are recognised by International Financial and Reporting Standards (IFRS) and International Accounting Standards (IAS) (7).

Trade debtors are valued at fair value in accordance with IAS (39) on the Recognition and Measurement of Financial Instruments. In addition, IFSR(7) outlines disclosure standards that are meant to help users understand the type and scope of risks associated with the financial instruments in issue and the impact of those risks to an entity's financial position. Credit, liquidity, and market risks are a few of these dangers.

Trade credit was suggested by Jain (2001) as a second layer of protection between users and financial intermediaries. To assess a client's creditworthiness and calculate their default risk rates, suppliers and banks need to be well-informed. Suppliers typically have fairly simple and inexpensive access to financial data about clients. As a result, banks are likely to favour lending money to suppliers in order to reduce expenses. In particular in a market where suppliers are more assertive, trade credit, in the opinion of Frank & Maksimovic (2004), helps suppliers and their customers by giving buyers the chance to lessen their reliance on outside sources of funding. According to Fisman & Love (2003), businesses that have access to credit facilities expand more quickly than those who don't. Wilson & Summers (2002) support the aforementioned claim by asserting that businesses in their stage of rapid growth but facing financial challenges frequently rely on trade credit.

There are a number of hypotheses that try to explain why vendors are prepared to extend credit to customers and why customers would want to use this pricey credit option. According to Frank & Maksimovic (2004), trade credit motive focuses on two aspects: the first is connected to actual operations. It explains the justifications for using trade credit. The other aspect is concerned with the financial role of trade credit, and it encompasses the theories of transaction cost reduction, price discrimination, and quality assurance. According to the authors, suppliers want to maintain long-term ties with their customers by offering trade credit to individuals who are struggling financially.

According to Emery (1984), suppliers need liquidity reserves in order to issue trade credit in order to generate profits in a financial market that is underdeveloped. Additionally, when there is no competition and the suppliers have significant market power, they try to sell as many products as they can, particularly when the profit is higher. According to Fisman & Love (2003), reliance on trade credit is a distinctive feature of the industrial sector.

Based on US industry characteristics, they have divided trade credit provisions into four categories: I industry liquidation, (ii) price discrimination, (iii) guarantee for product quality, and (iv) customised items. According to Biais& Gollier (1997), a different research source, businesses who rely on trade credit demonstrate that they have sufficient confidence in their suppliers' trustworthiness. As a result, outside investors may interpret this as permission to lend money to buyers.

The objective of the study

This paper has the following objectives
 To study the existing as well as the new trends of the receivable management and compare them.

Research methods

This paper is a exploratory and descriptive paper based on the previous literatures on the receivable management.

Existing Receivable Management Practices:

The underlining principles for managing account receivables are discussed further below.

- Credit Extension Policy

A credit policy is a guide that businesses use to decide whether or not to issue credit to a consumer. The credit policy's main objective is to prevent giving credit to clients who won't be able to pay their loans back. While smaller businesses tend to be more informal, with many small business owners depending on their instincts, more eminent corporations typically have a written credit strategy.
A sound credit strategy should aim to attract and retain loyal consumers while having no negative effects on cash flow. The policy should also have the ability to increase sales. The crucial elements of a good credit extension policy are as follows.
i. Credit standard
ii. Credit Terms

i. Credit standard
Credit standard can be defined as the degree of financial stability as well as any other minimal requirements and characteristics of a credit applicant's creditworthiness necessary to be taken into consideration for credits. A company's credit standard criteria could be either lax or stringent. The minimal requirements for clients to be considered for credit with a company that has liberal credit standards are fairly flexible and lax.

Businesses with lax credit standards often raise sales to draw in more clients; this often entails additional expenditures, such as clerical fees for reviewing more accounts; It necessitates significant capital expenditure for receivables; Due to the difficulty of businesses to pay their obligations and the likelihood of giving credit facilities to companies and people who are not creditworthy clients, default rates tend to be greater; Finally, as a result of higher sales, there can be a longer average collection period and an increase in profit (Persiamy, 2009).

The supplier corporations raise the minimal requirements for credit with rigorous credit standards. A company that pursues tight credit standards would therefore probably encounter the following: Low sales due to a lack of clients, fewer occurrences of bad and questionable debt loss, a reduction in the amount of working capital needed to finance receivables, the firm's credit criteria being usually strong, Low expenses of maintaining accounts receivable; the provision of credit to more creditworthy clients; Profit decline because to declining sales (Periasamy, 2009). The impact of easing credit standards on profit can be evaluated based on the correlation between the cost of doing so and the profit realised or to be realised as a result of the increase in sales via lax standards. This can be inferred from the discussions above that sales volumes are expected to increase with relaxed standards for trade credits, whereas volumes of sales are likely to decline with strict standards for credits. As a result, the credit manager and the credit team are now required to decide on a suitable credit standard for the company based on careful cost and benefit analysis.

ii. Credit Terms

Credit terms are the specific terms and circumstances that accompany a company's sale of credit to its clients. This suggests that credit terms have an effect on the size of the accounts receivable. The amount of days granted to a client to pay back a loan is referred to as the credit term. The majority of customers, with the exception of a small minority, frequently prefer longer credit terms, therefore extending the payment period is likely to boost sales but would negatively impact the cycle of cash conversion.

As a result, it locks up a large amount of capital in accounts receivable at a cost (Brigham, Houston 2009). Every time a receivable remains unpaid for a longer period of time, there is a considerable likelihood that a default payment may occur, creating bad debt. The management and the responsible department are responsible for creating the ideal credit payment period. To determine the trade-off between cost and profitability, the company should adhere to it. Trade discounts are price reductions made available to encourage early payments from creditors. The discount specifies the actual price reduction and the deadline for payment in order to qualify for it.

A discount of 5/14 net 30 indicates, for instance, that a price reduction of 5% will be permitted for payments paid within fourteen (14) days of the thirty (30) day credit period (Periasamy, 2009). The discount has two advantages, one of which is price reductions, which frequently increase sales. The speedier debtor payments is one of the additional advantages. This facilitates the cash flow of supply-side firms and shortens the cash conversion period. However, unless trade volumes significantly increase to accommodate a decrease in prices in the name of discounts, the discount tends to reduce prices, which results in lower income. Therefore, the costs and benefits of discount must be balanced in establishing the credit policy (Periasamy 2009).

b. Credit risk analysis and evaluation

Ensuring a minimal or optimal investment in accounts receivable and a significant decrease in bad debt losses are the main goals of receivables management. To do this, the financial manager must adhere to specific guidelines and processes when determining whether a customer is deserving of credit or not. This determination must take into account the credit limit to be issued as well as the credit period. Giving credit in trade is a way to encourage sales, but it is ineffective if prompt payment can't be ensured. Credit analysis determines which clients will receive credit as well as all the additional terms that make life easier for repeat customers, typically because experience has taught us a lot.

Credit analysis is a difficult task for new clients (Weaver and Weston, 2008). Customers frequently seek to trade credit as a source of funding as alternatives become expensive and unavailable due to rising loan rates. Customers who are already past due will probably ask for an extension of the payment deadline and possibly review other parameters to extend relief payments. New clients frequently ask for and haggle over credit accounts and terms. In this case, it is especially up to supply-side companies to be cautious when approving loans. Every credit transaction should be seen as a possible bad or dubious debt at first. It is vital to find out the real justifications behind credit requests from clients, especially if you speak with them one-on-one. If you can, visit the business location and ask the owners and managers if there are any problems.

c. Financial Review

Consider whether the company is accumulating shares at an alarming rate and struggling to sell it. What kind of cash position does the company in question have—positive or negative? Has the company used all of its borrowing capacity? Despite the possibility of losses, do they have excellent working capital to cover short-term debts? Assessing the credit volumes and payment trends of recent trade history is smart; doing so can help to provide a more accurate picture of the entity's financial situation. You might have a better perspective as if it were being considered for acquisition if you take the whole picture into account.

Make objective decisions and take into account other important subjective factors, such as examining the relationship between managers and subordinates. In order to benefit suppliers and customers, it is wise and crucial to identify the firm's dedication to and efforts in restructuring things. It can even be necessary to visit the company and speak with management face-to-face in order to learn about the efforts the management is making to improve the difficult condition the company is in. The lack of pertinent and important actions to restore and increase cash flow and profitability to address debt payment concerns and the overall health of the firm are sufficient indicators to draw the conclusion that the firm is unable to handle its challenges. And this makes it not worth risking.

It is the responsibility of a company's management to distinguish between revenue losses brought on by customer debt collection and customer losses brought on by refusal to extend credit. In the long run, a company's decision to persevere through difficult times or not should be based on the advantages of client loyalty. When the movie intends to keep and work with its valuable clients, it is appropriate to identify ways to protect sales. Since circumstances are always changing, it is appropriate to periodically review clients' creditworthiness, which is highly vital to the business.

d. Credit collection policy

A credit collection policy can be defined as a set of formally organised components and procedures that direct the recovery of past-due and unpaid debts (Megginson and Scott 2008). The techniques used to collect past-due debts are described in the credit collection policy document and show the amount of sternness displayed throughout the process. For instance, the business might send staff members to clients on a regular basis to facilitate payment during periods of delay or unwillingness to honour a payment commitment.

To ensure prompt and simple collection, other businesses could instantly turn over past-due and delinquent accounts to a factoring service (Brigham et al., 2012). Recent years have seen a rise in the difficulty for businesses to write off excessive amounts of bad and iffy debts. The early 2000s saw the demise of several American "dot-coms" primarily due to a lack of operational cash. The main factor in the demise of many organisations continues to be poor and incorrect cash flow management. By reducing the number of days that a credit line is outstanding, a business can significantly increase its cash flow.

These demand ongoing monitoring and attention. Firms must be strict without applying too much pressure, which could result in a loss of customers. The costs and benefits of various collection tactics must be balanced (Brigham et al., 2009). A business must decide the foundational principles of its collection policy and detail how to apply it. Megginson and Scott (2008) claim that the industry type and the business environment have always played a role in the criteria, terms, and strategy of credit.

Since there is a direct correlation between invoicing timings and payment periods, businesses are required to issue and/or fulfil bills right away and to continuously look for ways to improve invoicing accuracy over time. Customers who have a history of paying late are more likely to pay on time if an appropriate invoice is delivered early. Customers who receive financial incentives are more likely to accept paying invoices electronically. Follow up on unpaid invoices to make sure clients exist and are satisfied with the specifics as well. Address issues swiftly. If a client complains about a portion of an invoice, ask for partial payment while requesting approval right away.

Customers who have outstanding bills should be notified right away and frequently via phone calls, personal visits, or delinquent letters. The likelihood of recovering delinquent accounts is increased by routine follow-up. Many clients have a propensity to prioritise payments according to the anticipated pressure. Sending a kind and cordial reminder to customers who are a few days overdue with their payment is an excellent idea. As the bills are left unpaid for longer periods of time, a letter with a more serious tone can come next (Kent et al., 2005).

When consumers have valid and justifiable justifications, the business must contact the late client to discuss payment and get their consent to modify payment plans. Penalizing delinquent accounts is a good strategy to make sure payments are made on time. This can be accomplished by removing discounts and adding interest to past-due balances (Richard 2008).

It merely takes using the alternatives for getting paid in cases where the transaction was carried out with sureties or guarantees (Megginson and Scott 2008). The business may decide to use a factoring agency to handle debt collection if all other attempts are unsuccessful. Although this isn't the best way to handle clients, it does ensure payments—though at a price—typically a percentage of the sums involved and without requiring an upfront financial investment. The company is in a better financial position if the money in question has previously been written off as bad debt.

The business may potentially file a lawsuit against the noncompliant client and obtain a judgement against the debtor. It is suggested to choose this if there are significant financial stakes because it is expensive. Legal action may also result in the debtor's bankruptcy, with no assurance that the debt will be paid off anytime soon. At each level of the debt collection process, it would be wise to conduct a cost-benefit analysis to weigh the costs of taking more collection measures against the cost of just writing off the account as a bad debt.

e. Credit control and monitoring

The level of effectiveness in accounts receivable administration is determined by the relevancy and vested authority in the credit department of a company. This is a direct result of how credit and collection rules are created and implemented. Given the importance of the credit business to the finance department, it makes sense and is smart to name the chief financial officer if the officer in charge of finances is accountable and in constant communication with the credit department in all business interactions.

Since the issue of credit is related to the entity's solvency, all other departments and individuals in charge of the firm's solvency and cash flow should come together. According to Curtis (1959), the sales department should constantly push for the realisation of value for money before closing each sales deal. Given this, it makes sense and sense to combine the efforts of the finance and sales divisions to manage sales, especially when credits are involved.

A stated credit policy justifies the credit department's status as a distinct legal body (Miler, 2002). In order to effectively handle the needs in many interrelated activities, an organisation must have a self-contained credit department with cutting-edge technology and staff that are trained in credit administration. This aids in ensuring proper coordination, which creates a synergy between the aforementioned three departments. According to numerous academics, a credit department's primary duties include the following:

(i) Institution of credit terms and the ceiling.
(ii) Assessing credit risk from time to time and teaming with the marketing department in credit transactions.
(iii) Analyzing credit risk and ensuring compliance to credit terms by customers through monitoring and control.
(iv) Ensuring customer records update and accuracy to avoid trade disputes and doubts.
(v) Collection of payment in due time and ensuring
business continues, especially with loyal customers.

f. Techniques for monitoring quality of accounts receivable

This paper considers three primary techniques for monitoring the quality of accounts receivables, and they are (i) Average-collection-period, (ii) Aging of accounts receivables and (iii) Payment pattern monitoring. These techniques are further discussed below.

(i) Average Collection Period

The average number of days that accrued debt from sales remains unpaid is shown by the Average Collection Period (ACP). The first component, according to Graham, Scott (2010), is the delay between when sales are realised and when the consumer starts payment. The second part focuses on the customer's payment request's receipt, processing, and collection. If receipt, processing, and collection times are constant, the average collection period will predict to the company the average number of days it takes for customers to settle their bills (Graham et al., 2010). The business may compare the predicted average collection period over time using trend analysis. Secondly, it may be used to compare with the firm's set target and compare with the industry average. It is mathematically represented as shown below;

$$ACP = \frac{\text{Average accounts receivable}}{\text{Credit sales}} X365$$

(ii) Accounts Receivable Aging Schedule

By grouping receivables according to their maturities and calculating the number of days outstanding using an ageing schedule, this technique is used to keep track of accounts receivable. It offers useful details regarding the status of a company's accounts receivable.

(iii) Payment Pattern Technique

Customers typically settle their bills according to a routine of payments. It is stated as a percentage of the total amount of sales that were made during the month. Analyzing the company's sales and resulting collections each month is one method for figuring out the payment trend. The company calculates the amount collected throughout the period and subsequent months for each month's sales. Every company has a regular pattern for how its receivables are paid; if the pattern varies, the company should think about evaluating its credit policy. The business can use a spreadsheet or regression analysis to calculate the typical pattern of its collection by monitoring these trends over time. These patterns tend to be reasonably stable for most companies over time, even as sales volumes fluctuate (Megginson, 2010).

New trends/methods of Receivable management

Risk management will be front and centre.

We anticipate that businesses will focus on building an objective, data-driven perspective of likely to pay in 2021 because that is the only way for A/R teams to effectively detect and reduce risk. We also expect A/R to improve their present customer breakdown by utilising various segmentation strategies frequently used in marketing and sales to assist categorise clients and identify not just who is unlikely to pay but also how to approach them differently. If these steps are done properly, departments will have a greater awareness of their entire customer base, which will enable them to take more precise measures and increase their revenue.

Increased forecasting frequency

Forecasting needs to be more regular and more precise because the business environment is constantly changing and businesses' fortunes might occasionally change overnight. Since you never know what tomorrow will bring, there is no purpose in planning a month in advance. Instead, A/R departments need to be aware of their current situation, where they expect to be tomorrow, and what the potential implications are for the coming week.
Forecasting quality can be improved, but it takes effort and money. The good news is that most A/R departments already have the information required to provide more essential projections; all that is left to do is locate it, put it all together, and develop some repeatable procedures around it. For that reason, we fully expect to see significant investments in this area over the year.

Finally, mastering master data.

Not every shift has to be about wide-scale revolution. Additionally, A/R can take a few simpler measures to increase cash flow. Going back to the fundamentals and fixing all the minor, ineffective process components that can accumulate to have a measurable, detrimental effect on payment timelines is a great place to start.
Inaccurate information in master data can, in fact, cause a weeks-long payment delay. Additionally, any payment delay can have serious repercussions in the current economic climate. That means that all of these unpleasant and boring chores, including reconciling customer records, must be finished as soon as possible. And doing it calls for a certain amount of investment.
The good news is if A/R departments can dedicate the required resources to it, correcting master data d can have a significant impact on cash flow.

AR will enter the age of automation.

Every industry is currently discussing automation, which promises to boost productivity, save operational costs, and lessen human error. But you might wonder what there is to automate when calling customers to collect payments makes up such a large portion of accounts receivable.
The small, time-consuming chores that surround the main activity of gathering are the solution. One of these responsibilities can be updating and correcting the master data. It is also possible to automate data collection procedures, which sometimes include several systems, in order to create and distribute invoices.
We anticipate that adoption of automation will bring A/R departments two big benefits in the upcoming year. First, data accuracy will increase, virtually eliminating the possibility of errors resulting in late payments.
Second, staff won't have to spend their time on time-consuming simple activities like data entry, giving them more time to concentrate on what they do best, which is collecting money.

Parer less trasactions.

Even though it sounds incredible that we're still discussing paper bills in 2021, Accounts Receivable, as well as Accounts Payable, still primarily rely on paper-based procedures.

The digitization of these procedures has never been more important as a result of the decentralisation of workforces during the past year. Sending and shipping paper invoices, which require going into the office and hoping that someone else on the other end is also at the office to handle that paper, is unsustainable, as the past year has made abundantly evident. And doing so will bring about a number of important advantages.

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A rise in factoring

It can be frightening to not know when or from where the next payments will come, especially when margins are thin. Selling accounts receivable (A/R) can frequently feel like a last resort because you won't earn as much money as you would if everyone paid ahead. But given the particular circumstances of today, we believe that factoring has a number of important advantages that could surprise some people in 2021.

In particular, the possibility of non-payment is eliminated, forecasting is made much simpler, and the resources you are currently devoting to pursuing non-payments may all be put to better use inside the company.

All of this obviously has a cost. Because of this, many businesses may view factoring as a temporary fix while they take care of the other issues we discussed above. However, the devil you know might occasionally offer some comfort when uncertainty rules.

Conclusions:

We thoroughly looked over both procedures. We are aware of the current norms and anticipated trends. We are aware that the assistance offered by the current procedures is adequate to support the receivable management activities. But in order to boost the organization's profitability, we also need to adopt new approaches in addition to the current ones.

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