

# Management of Receivables: A Study of Selected Micro and Small Enterprises

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## ARTICLE DETAILS

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## ABSTRACT

When an enterprise makes an ordinary sale of goods and services and does not receive payment, the enterprise grants credit and creates accounts receivable, which would be collected in future. The problem of managing the accounts receivable required special attention as micro and small enterprises face many problems in monitoring the accounts receivable relating to collection problems, bad debts problems etc. The only alternative with the seller is to have restrain and control on the problems of accounts receivable. It was under this background that it was felt desirable to conduct an exhaustive study of the prospects and problems of management of receivables in the micro and small enterprises and suggest measures for overcoming the problems.

## 1. Introduction

The small-scale industrial (SSI) sector has acquired a place of prominence in the economy of the country. It has contributed significantly to the growth of the Gross Domestic Product (GDP), employment generation and exports. The sector is contributing significantly towards the economic growth of the country with over 1/3 of the industrial production and nearly 1/3 of direct taxes. The sector has emerged as an engine of growth in the new millennium. Consequent of the enactment of Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, the small and medium sector has been defined as micro, small and medium enterprises with effect from October, 2006 as:

### 1. In the case of Manufacturing Enterprises

- (i) A micro enterprise, where the investment in plant and machinery does not exceed Rs. 25 lakh;
- (ii) A small enterprise, where the investment in plant and machinery is more than Rs. 25 lakh but does not exceed Rs. 5 crore; and
- (iii) A medium enterprise, where the investment in plant and machinery is more than Rs. 5 crore but does not exceed Rs. 10 crore.

### 2. In the case of Service Enterprises

- (i) A micro enterprise, where the investment in equipment does not exceed Rs. 10 lakh;
- (ii) A small enterprise, where the investment in equipment is more than Rs. 10 lakh but does not exceed Rs. 2 crore; and
- (iii) A medium enterprise, where the investment in equipment is more than Rs. 2 crore but does not exceed Rs. 5 crore.

The problem of management of receivables arises when merchandise is sold on credit. When an enterprise makes an ordinary sale of goods and services and does not receive payment, the enterprise grants credit and creates accounts receivable, which would be collected in future. Though commercial banks provide a significant part of requirements for working capital, receivables continues to be a major source of funds for micro and small enterprises and accounts receivable

that result from granting credit are major investment for the micro and small enterprises. The investment in accounts receivable is an important aspect, which requires careful management.

## 2. Rationale and Objectives of the Study

In most of the micro and small enterprises, working capital management is inadequate and ineffective. This situation is often marked when the fund in accounts receivable is blocked up. Increase in the sales on credit results into blockade of funds in accounts receivable. As a consequence a considerable portion of working capital is not available in the form of cash, raw material or inventory; and thus this blockade of funds aggravates the problems of working capital employed. Therefore, for minimizing the problem, the level of accounts receivable should be reduced to a feasible extent. But complete aversion to the accounts receivable is not possible in this age of credit, because there is another side of credit sales as credit sale is a sort of invisible concession, which induces sales. These two aspects of accounts receivable, i.e., the blockade of working capital and the increase in sales, are to some extent contradictory. Hence the problem of managing the accounts receivable required special attention as micro and small enterprises face many problems in monitoring the accounts receivable relating to collection problems, bad debts problems etc. The only alternative with the seller is to have restrain and control on the problems of accounts receivable. And thus the present study tries:

- (i) to explore the prospects and problems of managing the receivables in micro and small enterprises, and
- (ii) to suggest the measures for overcoming the difficulties stemming from the problems.

## 3. Study Area – Jaunpur : The Industrial Scenario

The district of Jaunpur is situated in the North-West part of Varanasi Division in the state of Uttar Pradesh, India. It lies in eastern part of the state. Jaunpur City is situated on the bank of the Gomti River. Its attitude varies from 261 feet to 290 feet above sea level. As per official census of 2011, the district of Jaunpur recorded a population of 4,476,072 of which 2,258,437 were female and 2,217,635 male. Jaunpur district has population density of 1,113 persons per km<sup>2</sup>. Jaunpur ranks 7th

in terms of population in the state and ranks 1st in terms of sex ratio (1,024).

District's main economical activity is agriculture and allied sector. Jaunpur is fastest developing area in eastern Uttar Pradesh with skill development, quality education and good infrastructure. About 29% of Jaunpur's population is employed. There is little heavy industry in Jaunpur. National highway number 56 between Lucknow and Varanasi cross from Jaunpur allows for some industrial economic development. Manufacturing Enterprises include perfume (jasmine oil and attar) and incense, furniture, carpets, chemical fertilizer, cement etc. And Service Enterprises include repair workshops, print shops, internet cafes etc. There is a special economical zone located at Allahabad road near Mungra Badshahpur - the Sathariya Industrial Area. Although all units of the Sathariya Industrial Area are not in function but maximum are doing work. Jaunpur have problem of infrastructure development. Like many other districts of eastern uttar pradesh Jaunpur have poor road quality and lack of electricity supply.

#### 4. Scope of the Study

As observed in the foregoing paragraphs that the management of receivables in micro and small enterprises need be enquired into so that the problems faced by this sector in managing the receivables may be analysed and investigated and remedial measures may be suggested, the present study has the following scope:

- The study relates to the management of receivables in micro and small enterprises situated in the District of Jaunpur.
- The present study is restricted to the micro and small enterprises, which are registered with District Industries Centre (D.I.C.), Jaunpur, up to March 2016.
- The management of receivables in micro and small enterprises is observed and analysed for three years (2013-2016), in particular.

#### 5. Hypothesis for the Study

The hypothesis formulated for the purpose of this study is that the "effective management of receivables is essential for the growth of micro and small enterprises." In other words, the large-scale failure of micro and small enterprises is pre-

dominantly due to the ineffective and inefficient management of receivables.

#### 6. Methodology for the Study

For the purpose of studying the management of receivables in the micro and small enterprises the stratified random sample method has been adopted. One hundred enterprises coming under micro and small-scale sector have been selected out of a universe of 7,269 enterprises registered, up to March 2016, as micro and small enterprises at District Industries Centre (D.I.C.), Jaunpur, in as much as the various categories of micro and small enterprises have been selected on the basis of their nature as manufacturing enterprises, which include perfume (jasmine oil and attar) and incense, furniture, carpets, chemical fertilizer, cement etc. And service enterprises which include repair workshops, print shops, internet cafes etc.

The study is design to look forward to the prospects of such enterprises based on their historical performance restricted to their positions obtained during the three years. Since a period of three financial years (i.e., from 2013-14 to 2015-16) has been decided for the comparative evaluation of management of receivables, the universe has been remodeled accordingly. The micro and small enterprises, which were either abandoned at any time during this period or started after the financial year 1913-14, have ceased to form the part of the universe.

During the course of this study, sophisticated statistical tools of analysis and interpretation have been used for the data collected through primary sources and also obtained from secondary sources. To obtain the primary data a structured questionnaire has been circulated to the suppliers of credit. The secondary data gathered for the purpose of this study are from the published records of the District Industries Centre (D.I.C.), Jaunpur. However, the analysis and interpretation of the present study seeks to focus mainly on the primary data.

#### 7. Data Analysis and Observation of the Study

The management of receivables is studied with the help of growth pattern and trend of credit sales, ageing of accounts receivable, receivables turnover and average collection period and bad debts' analysis.

Growth Pattern and Trend of Credit Sales (Approximate)				
	2013-14	2014-15	2015-16	Average
(a) Total Sales (Lakh Rs.)	5,666	6,878	8,018	6,854
(b) Credit Sales (Lakh Rs.)	4,300	5,421	6,328	5,350
Rate of Annual Growth of 'a'	---	21%	17%	19%
Rate of Annual Growth of 'b'	---	26%	17%	21%
Credit Sales as % of Total Sales	75%	78%	79%	78%

Appraising the overall performance of micro and small enterprises in the sample it has been observed that a substantial part of the total sales available with the sample enterprises is blocked in the credit sales during the whole

period (2013-16). It is revealed that the credit sales constitute as much as about 78 percent of the total sales. The credit sales have caused the problems of collection as well as bad debts.

Credit Period	Receivables as % of Credit Sales			
	2013-14	2014-15	2015-16	Average
0 - 30	38	37	40	38
31 - 60	32	34	30	32
61 - 90	13	13	14	13
91 – 180	2	2	6	3
181 - 360	1	1	1	1
> 360	12	13	14	13

The analysis of ageing schedule of all enterprises in the sample shows that about 13 percent of the total credit sales could not be realised even within a period of one year. And thus it is found that a substantial part of the total credit sales available with the sample enterprises is blocked in accounts receivable at the end of the year. It is also observed that the highest amount of credit sales is realised within 30 days of the

date of credit sales, whereas the second highest is between 31 to 60 days and the third highest is in the next period, i.e., 61 to 90 days. The observation coins the contention that collection problems are quite acute in the case of sample enterprises and thus the collection percentage decreases as time passes. In other words, early attempts for collection are easily responded and the problems become acute as time elapses.

	2013-14	2014-15	2015-16	Average
Accounts Receivable (Lakh Rs.)	572	698	824	698
Receivables Turnover in times	7	8	7	7
Average Collection Period in days	51	45	51	49

The average collection period for the sample is 49 days. Thus, the accounts receivable has blocked up a substantial part of the total credit sales available with the sample units for 49 days. The enterprises, which have collected their dues

within the average collection period, have higher receivables turnover, i.e., low investment of receivables to credit sales and thus have high liquidity position and vice-versa.

	2013-14	2014-15	2015-16	Average
Bad debts (Lakh Rs.)	72	81	91	81
Bad debts as % of Credit Sales	1.67%	1.49%	1.43%	1.51%

An analysis of bad debts as a percentage of total credit sales over time shows that it is about 1.67 percent in first year. But this percentage went down to about 1.49 percent in second year and 1.43 percent in third year. It seems that bad debts as percentage of total credit sales are declining. On an average the incidence of bad debts is to the tune of about 1.51 percent of the total credit sales.

## 8. Hypothesis Testing

As the hypothesis formulated for the purpose of this study is that the "effective management of receivables is essential for the growth of micro and small enterprises", Chi-Square test have been applied for the purpose of testing the hypothesis. The null hypothesis,  $H_0$ , taken for the testing is that the two attributes, effective management of receivables and growth of micro and small enterprises, are independent.

The average bad debts of all micro and small enterprises collectively are about 1.51 percent of the credit sales. Therefore, here, we assume that the micro and small enterprises, which are showing bad debts of 1.51 percent or less, are with effective management of receivables. Hence, those micro and small enterprises, which have average bad debts of more than 1.51 percent, are the enterprises with non-effective management of receivables. In the same way, the average rate of annual growth in the total sales of the all micro and small enterprises is about 19 percent. So, the micro and small enterprises with average annual growth rate of about 19 percent or more are growth enterprises and other than these enterprises, are non-growth (decline) enterprises.

The Critical Value of Chi-Square for one degree of freedom at 5% level of significance is 3.841. It has been observed that the Calculated Value of Chi-Square being 14.401 is more than the tabular value; hence the difference is significant. The observed frequencies and the expected

frequencies do differ significantly. The null hypothesis is rejected. The effective management of receivables and growth of micro and small enterprises are not independent. Thus, the effective management of receivables is essential for the growth of micro and small enterprises.

### 9. Conclusion and Suggestions

The foregoing observations' regarding the management of receivables in micro and small enterprises reveals that:

- Very few micro and small enterprises have attempted a systematic articulation and formalization of their credit and collection policies. Generally credit and collection policies have emerged as unstated conventions.
- Monitoring and controlling of accounts receivable is often neither very thorough nor systematic in these micro and small enterprises. Very few micro and small enterprises have well-defined systems for monitoring and controlling of accounts receivable.
- The measures commonly employed, in these micro and small enterprises, for judging whether accounts

receivable are 'in control' are: Ageing schedule, Average collection period and Bad debts losses.

- The effective management of receivables is essential for the growth of micro and small enterprises.

To make the role of effective management of receivables in the growth of micro and small enterprises more meaningful, action on the line of following suggestions should be initiated:

- Management of receivables must be accorded the importance it deserves. A senior executive should shoulder this responsibility.
- Credit policies need to be articulated in explicit terms and revised periodically as per need.
- Debtors should be divided according to their payment habits and should be approached accordingly.
- Micro and small enterprises granting credit should examine the published statements of prospective customers with greater rigour.
- References provided by the prospective customers should be consulted and necessary follow-up action should be taken.

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