UNIT 18 RECEIVABLES MANAGEMENT

18.1 INTRODUCTION

To achieve the growth in sales and to meet competition in the industry a firm may resort to a sale on credit, companies offer credit to customers to attract more business, and the increased turnover will result in increased profit to the firm. Sales on credit depends upon the nature of the business, to increase the sales volume, generally the credit facility will be offered to the customers which results in investment in receivables to maximise return on capital invested.

Many firms offer "Buy now and pay later" to their customers the ability to take advantage of goods and services, putting efforts to offer their customers the ability to take advantage of goods and services now and pay further down the road. The term for keeping track of what customers buy on credit from a company is called receivables management. It takes a special role in many modern businesses & Financial Management.

A business can lose everything with poor receivables management during the last phase of the sales process (payment). Over half of all bankruptcies can be attributed to poor receivables management, which demonstrates its importance. Receivables management involves much more than reminding customers to pay. It is also about identifying the reason for non-payment. Perhaps a product or service was not delivered? Error in Invoice, delay in dispatching Invoice, is there any product default? etc

18.2 OBJECTIVES

After studying this unit, you will be able to understand the following;

- Explain the Nature of Receivable Management
- Understand the objective, benefits and Costs of Receivable management.
- Discuss the aspects of Credit Policy, collection policy, credit evaluation process.
- Understand the credit policy variables.
- Concept of Credit scoring and Credit scoring factors

18.3 CONCEPT OF RECEIVABLES MANAGEMENT

The word receivable stands for the amount of payment not received, it’s money that a company has a right to receive because it has provided a product or service. However, the company has not received the money yet. Usually, the company sells its goods and a service both in cash as well as on credit, Receivables arises from sale of goods and services on credit basis. Example: State Electricity Company that bills its clients after the clients received the electricity, the electric company records an account receivable for unpaid invoices as it waits for its customers to pay their bills.

Receivables Management refers to the set of policies, procedures, and practices employed by a company with respect to managing sales offered on credit. It encompasses the evaluation of client credit worthiness and risk, establishing sales terms and credit policies, and designing an appropriate receivables collection process.

18.3.1 OBJECTIVES OF RECEIVABLE MANAGEMENT

Credit is the soul of business, Credit facilities are important for attracting and retaining customers and this makes management of credit facilities by business crucial. Objectives of receivable management are as follows:

a) **Boost up sales volume**
By extending the credit facilities to their customers business are able to boost up their sales volume. More and more customers are able to do transactions with the business by purchasing products on a credit basis. Receivable management helps business in managing and deciding their investment in credit sales. This leads to increase in the number of sales and profit level.

b) **Monitor and Improve Cash Flow**
Receivable management helps business in deciding appropriate investment in trade debtors. It aims that a sufficient amount of cash needed for day-to-day activities is maintained at business. Credit facilities are extended by doing proper analysis and planning to ensure optimum cash flow in a business organisation.

c) To Minimises bad debt losses

Receivable management takes all necessary steps to avoid bad debts in business transactions. It designs and implement schedules for collection of outstanding amount timely and informs the collection department on due dates. Customers are notified for amount standing against them and charges interest on delay in payments.

d) Avoids invoice disputes

Disputes adversely affect the relationship between customers and business organisations. Complete and fair record of all transactions with customers is maintained on a daily basis. There is no chance of confusion and dispute arising as all sales transactions are accurately maintained. Automated receivable management systems present full evidence in a short time in case of dispute arising for resolving them. Receivable management has an efficient role in avoiding any disputes arising in business.

e) Improve customer satisfaction

Customer satisfaction and retention are key goals of every business. By lending credit, it supports financially weaken customers who can’t purchase business products fully on a cash basis. This strengthens the relationship between customer and organisation. Customers are happy with the services of their business partners. Receivable management help in organising better credit facilities for their customers.

f) Helps in facing competition

Receivable management is very important for facing stiff competition in the domestic and global market. Most of the competitors existing in market offer different credit options to attract more and more customers and customers are provided better services by extending credit at convenient rates. Receivable management process include analysis all information about market and helps the business in framing its credit lending policies. Appropriate amount and rates of credit transactions can be easily decided through receivable management process. All credit and payment terms are decided for every customer as per their needs. Example: Credit card credit, EMI credit, Cash credit, Loans and advance, Zero Interest Credit etc.

Receivables management involves much more than reminding customers to pay. It is also about identifying the reason for non-payment.

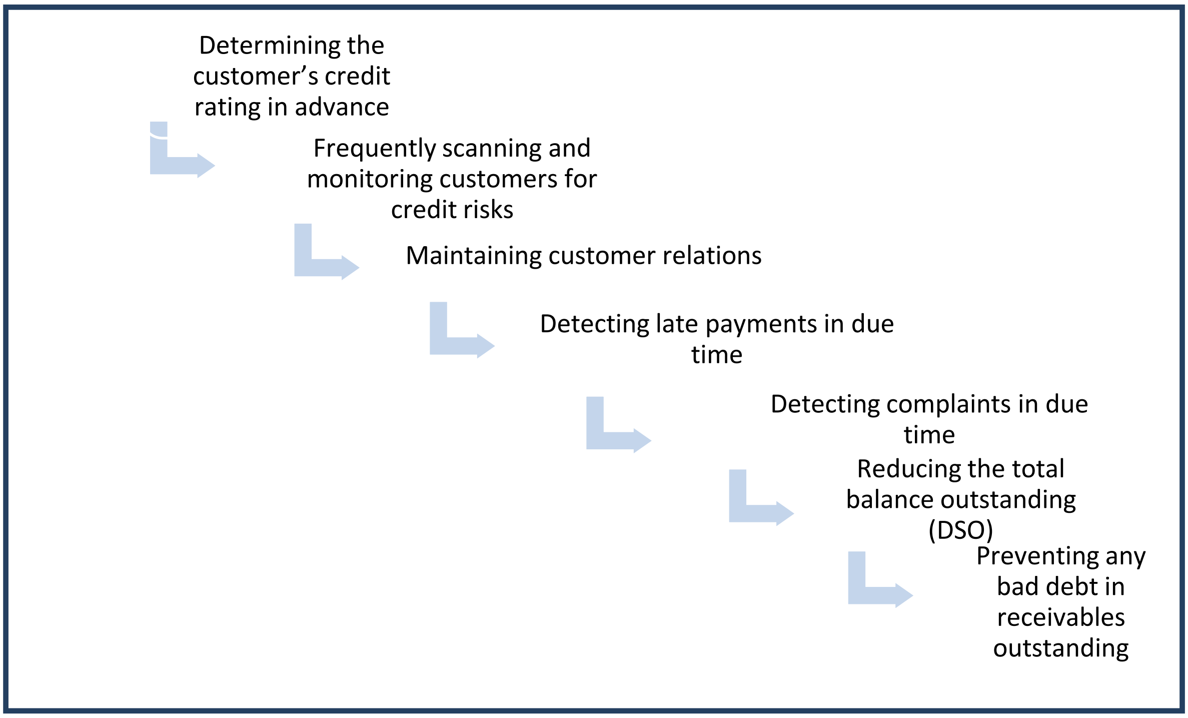


Fig 18.1 Process of Good receivables management

18.3.2 FACTORS INFLUENCING THE SIZE OF INVESTMENT IN RECEIVABLES

a) Level of Sales:

The primary factor in determining the volume of receivables is the level of credit sales. Increase in credit sales means a corresponding increase in debtors, and vice versa. No doubt the level of sales can be used to forecast changes in receivables, i.e., if a firm predicts an increase of 50% in its credit sales for the next period, it will probably experience also an increase of 50% in receivables.

b) Firms Credit Policy

The firm can adopt two types of policies such as lenient and stringent credit policy. A firm that is following lenient credit policy tends to sell on credit to customers very liberally, which will increase the size of receivables, and the firm which follows the stringent credit policy will have a low size of receivables.

c) Terms of trade

The period for which the credit is allowed will decide the extent of receivables. Longer the period of credit more would be the receivables. Again, cash purchases followed up with credit sale is the main reason for increasing receivables.

d) Paying practices of customers

The paying habits of customers also have bearing on the size of receivables. The customers may be in the habit of delaying payments even though they are financially sound. The concern should remain in touch with such customers and should make them realise the urgency of their needs.

e) Development and expansion plans

When the firms want to expand or to enter new markets and to attract new customers it becomes necessary for the enterprise to provide incentives in terms of credit. Once the firm gets the permanent customers it may start reducing the period for which credit was allowed.

f) Credit collection efforts

A firm must have strong and well equipped credit collection system and process. Periodical reminders should be sent to customers in order to reduce the size of outstanding. Delayed collection will increase receivables and will impose serious financial troubles for the company.

g) Endorsing & Bills Discounting

Bill discounting and endorsing the bill to the third party will reduce the size of investments in receivables. If the bills are dishonoured on the due date, investments in receivables will increase because the discounted bills or endorsed bills have to be paid by the firm.

18.4 CREDIT & COLLECTION POLICIES,

18.4.1 CREDIT POLICY

Credit policy is an important part of the overall strategy of a firm to market its products. It refers to those decision variables that influence the amount of trade credit. A firm’s credit policy comprises regarding its credit standards, credit period, cash discounts, and collection procedures.

Types of Credit Policy

a. Lenient Credit policy

This is also called as an Expansive Credit Policy , Under this policy seller sells goods and services on very liberal credit terms, conditions and standards or goods sold to the customers whose credit worthiness in not up to standards or whose financial position is doubtful.

Advantages of Lenient Credit policy

i. Increase in Sales: Lenient Credit policy helps to increase the sales because of the liberal credit terms and conditions & favourable incentives granted customers.

ii. Higher Profits: Increase in sales leads to increase in profits, because higher level of production and sales will reduce the fixed cost

Disadvantages of Lenient Credit policy

i. Liquidity : Lenient credit policy creates the liquidity problem, because if the firm is not able collect the payment or received the payment on time, it may create a problem for future or current maturing obligations

ii. Bad debt Loss: A firm that follows a lenient credit policy may suffer from Bad debt losses that arise due the non-payment on credit sales.

b. Stringent Credit Policy

Under this policy firms pay strict attention to rules, procedure, and detail, related to credit. A firm offers a credit to the customers who have proven creditworthiness and financially sound.

Advantages of Stringent Credit Policy

i. Less Bad Debts: A Firm which adopts the stringent credit policy will have minimum bad debts losses, because it has granted credit to only the customers who are creditworthy.

ii. Sound Liquidity: A firm will have sound liquidity position due to the receipt of all payments from customers on due date, so the firm can easily meet the future obligations.

Disadvantages of Stringent Credit Policy

i. Less Sales: Stringent Credit Policy restricts the sales, because it is not extended credit to the average credit worthiness of customers.

ii. Less Profit: Less will automatically reduce the profits, because firm may not be able to use the resources efficiently that leads in increase in production and sales.

18.4.2 CREDIT POLICY VARIABLES

Optimum credit policy is one which maximise the firms operating profit, for optimum credit policy the firm must consider the important decision variables like credit standards, credit terms and collection policy and procedure, credit evaluation Process.

a) Credit Standards:

The firm's credit standards would be applied to determine which customers qualified for the regular credit terms, and how much credit each should receive. The major factors considered when setting credit standards relate to the likelihood that a given customer will pay slowly or perhaps end up as a bad debt loss.

Credit standards refer to the financial strength and creditworthiness a customer must exhibit in order to qualify for credit. If a customer does not qualify for the regular credit terms, it can still purchase from the firm, but under more restrictive terms. For example, a firm's "regular" credit terms might call for payment after 30 days, and these terms might be offered to all qualified customers.

b) Credit terms

The second decision criteria in receivables management is credit terms, it means the stipulation under which good and services are sold on credit to the customers, one the credit terms has been finalised and established the creditworthiness of the customers can be assessed. Need to decide the terms and conditions also for the same. It must include the credit period, cash discount and the cash discount period.

c) Collection Policy

Collection policy defined as" A collection policy is the set of procedures a company uses to ensure payment of overdue accounts receivables". Generally, a collection policy systemizes the steps taken to recover amounts due prior to litigation.

This includes when a customer should be contacted, how they should be contacted, how disputes are resolved, when internal or external "collectors" are used to step-up collection efforts, and ultimately when and whether to turn the account over to litigation or write-off the debt. Each individual business will likely want to treat the collection policy in a different way – some are much quicker to send a sternly worded letter or firm phone call upon late payment, and some will let the account simmer for a short period of time.

The collection process can be expensive in terms of both out-of-pocket expenditures and lost goodwill—customers dislike being turned over to a collection agency. Collection policy refers to the procedures the firm follows to collect past-due accounts. For example, a letter might be sent to customers when a bill is 10 days past due; a more severe letter, followed by a telephone call, would be sent if payment is not received within 30 days; and the account would be turned over to a collection agency after 90 days. However, at least some firmness is needed to prevent an undue lengthening of the collection period and to minimize outright losses.

A balance must be struck between the costs and benefits of different collection policies. Changes in collection policy influence sales, the collection period, and the bad debt loss percentage. All of this should be taken into account when setting the credit policy.

Collection policy goals can take a liberal or conservative approach to collections, allowing that to define their collections procedures. A business that takes a more liberal approach will be more flexible and willing to work with a delinquent account while a more conservative approach will require strict adherence to credit guidelines.

Age past Due	Action
45 days	Collection call /Letter #1- seek a commitment for payment and a time frame for when it will be sent
60 Days	Letter #2 – It questions the reasons behind their lack of communication and informs them that to keep the account in good standing payment must be made immediately.
75 Days	Collection call – Trying to negotiate some type of payment arrangement that will keep it from being necessary to place the account on credit hold.
90 Days	Collection Call/ demand letter – It makes it clear our intent to take alternative action if full payment is not sent immediately.

Table 18.2 Time line for collection policy

The collection process can be expensive in terms of both out-of-pocket expenditures and lost goodwill—customers dislike being turned over to a collection agency. Collection policy refers to the procedures the firm follows to collect past-due accounts. For example, a letter might be sent to customers when a bill is 10 days past due; a more severe letter, followed by a telephone call, would be sent if payment is not received within 30 days; and the account would be turned over to a collection agency after 90 days. However, at least some firmness is needed to prevent an undue lengthening of the collection period and to minimize outright losses.

A balance must be struck between the costs and benefits of different collection policies. Changes in collection policy influence sales, the collection period, and the bad debt loss percentage. All of this should be taken into account when setting the credit policy.

A firm should finalise the decision relating to credit period only after Cost Benefit Analysis. If the change in net profit is positive it is better to go with proposed credit period and *vice versa.*

Illustration 1: Trimurti Pvt Ltd currently provides 20 days to its customers. Its current sales level is Rs 5, 00,000. The Cost of capital is 12% and the tax rate is 40%. The ratio of variable cost to sales is 75%. Trimurti ltd is considering extending its credit period by 40 days, such an extensions expected to increase by Rs 1, 00,000 and also increase the bad debts portion on new sales would be 5%. Determine the residual income and suggest whether the company should consider the relaxation of credit period or not.

Solution

Particulars	**Amount(RS)**
Increased sales	1,00,000
Less Variable Cost(1,00,000 X 0.75)	75,000
Contribution	**25,000**
Less: Bad Debts loss on new sale(1,00,000 X0.05)	5,000
Earnings before Interest and Tax	20,000
Less Tax at 40%	8,000
Earning After Tax	12,000
Less opportunity cost	6750
Residual income	5,260

Working Notes

Calculation of opportunity cost

Opportunity cost = Increase in investment X Cost of capital

Calculation of increase in Investment (DOS X NACP) + DVCIS X ACPn)

= (1369.86 *40) + (205.48*60) = Rs 67,123.2

DOS = RS 5,00,000/356 = Rs 1369.86

NACP = 60 -20 =40 days

DVCIS = (RS 1,00,000 X 0.75) / 365 = Rs 205.48

Opportunity cost = Rs 67,123.2 X 0.12 = Rs 8054.78

Where

DOS = Daily old Sales

NACP = Net average collection period = New Average collation period – Old average collection period

DVCIS = Daily variable cost of incremental sales =(incremental sales X variable cost PU)/365

ACPn = New average collection period

Interpretation: Trimurti Ltd can extend the credit period, since the residual income is positive.

d) Credit Evaluation Process

Credit Evalution Process is one of the most essential parts of the entire credit collection plan and how detailed firm get will depend on the size of the firm and its credit philosophy. Something general could be: "The Credit and Collections Department will evaluate and determine appropriate terms and credit limits for all accounts. Decisions will be based on references, payment histories and alerts obtained through The Credit Collective and Financials submitted by the customer. No credit scoring methods will be used. Should the account go beyond terms, the credit and collections department will utilize its best judgment and industry accepted practices to collect the debt." A more formal approach to this process could actually spell out procedures for credit limit ranges e.g., limits between Rs500 – Rs 5,000 is a no-score method, limits between Rs 5,000 - Rs10,000 utilizes both the no-score method and a D&B or Experian report, orders above Rs.10,000 require all of the preceding plus current customer financials.

18.5 ANALYZING CREDIT-WORTHINESS

Credit Analysis is the process of studying the credit worthiness of customers. Takes into account a range of information related to the buyer or customers, its environment and commercial stakes for your company. This analysis leads to a specific strategy with each customer and will have some effects on trade negotiations and commercial terms (payment terms, warranties, contract ... etc..)

a) **Creditworthiness of the buyer:** Creditworthiness of the buyer with the completion of a financial analysis of its balance sheet and its income statement. Behavioural references of the buyer: does he meet with its commitments? What is his payment behaviour? Commercial references of the buyer. Is he a business with great potential? Does he have a favourable market positioning? What is his age? In case of organisation need to consider legal form of the company. Is it a private or public company?

b) About the environment of the buyer:
Sector risk: the customer is his part of a sector in crisis or supporting? Country risk: does the country of the buyer have a significant political risk that could affect the progress of the business case? Currency risk for export to a country which has another currency and if the contract is signed with the buyer's currency.

c) **Locate the credit analyst in the Organisation**

Depending on the size of the firm, the credit analysis is performed by a qualified analyst, Credit Manager or a person trained belonging to the financial department (Chief Financial Officer, Accounting ... etc..). He is responsible for credit granted to customers and must be attached to the Finance Department.

In large firms or organisations, he defers to the Credit Manager who negotiates with trade customers and sales managers and then ratifies decisions based on credit analyses performed.

d) Financial Analysis

The financial analysis is the cornerstone of the valuation of the solvency of customers, suppliers, B2B Clients. The most important is: the understanding of the balance sheet and of the profit and loss account, their analysis with key indicators.

The profit and loss account highlights the turnover accomplished over period given (usually one year) from which it subtracts expenses supported by the business during the same period. The result of this subtraction shows the benefit or the loss made by the company at the end of the financial year. The following are the important indicators financial position.

Gross Revenue	Gross Revenue gives information about size of the business and evaluation of it financial activity which is link with balance sheet: what financial resources the company owns to support the evaluation of its gross revue.
Earnings Before Interest and Tax	EBIT shows the profitability of the activity of the firm by comparing the operation revenue with the operation expenses.
Net Income	The net income is the result of the revenue generated during the financial year less the total expenses supported by the company.

Table 18.3 Important indicators financial position.

Most of the time comparing the evolution of the turnover and the profitability on last 3 financial years (5 so possible) to determine the medium-term viability of client or customer will help to understand the credit worthiness in excellent way.

Following indicators help to determine if the company is profitable and to understand what are the main factors contributing to the net result (positive or negative).

Sr. No.	Interpretation	Calculation	Intermediate balance
1	The net income represents the	Result before tax +	Net income(profit or

	profit or loss at the end of the year (the difference between total revenue and total expenditure). It is increasing (if positive) or decreasing (if negative) the equity. If positive, it can remain invested in the company or be partially distributed to shareholders as dividends.	exceptional result - income tax	loss)
2	This result relates to unusual activity. For example, a capital structure transaction can create an exceptional result. Be careful because it can distort the true profitability of the business and distort an analysis that would be based solely on net income.	Exceptional income - Exceptional expenses	Exceptional result
3	Final result calculated from operating income and expenses. It is independent of taxation and exceptional income and expenses.	Operating profit + financial result	Result before tax
4	This purely financial result is often negative because firms are generally consumers of financial products (lines of bank overdrafts, bank loans, factoring etc ...). A significant negative financial result often reflects a weak financial structure and an excessive recourse to banks. Warning!	Financial income - financial charges	Financial result
5	Operating profit includes the amortization of fixed assets and provisions for risk (eg accrual of bad debts).	EBITDA - depreciations and provisions	Operating profit
6	Remaining amount after deduction of operating expenses to value added. It is a key indicator of profitability and business performance as it is independent of the financial policy of the	Value added - tax - wages and salaries - payroll taxes	Operating profit before depreciation and amortization (EBITDA)

	company. EBITDA should maintain and develop the means of production and pay the capital invested.		
7	Represents the creation of value that the company provides to goods and services purchased from third parties. The value added must be sufficiently high to absorb all other expenses of the company.	Trade margin + Production - purchases of raw material - other purchases and external charges	Value added
8	Relevant indicator to determine the gross margin of an activity of reselling such distribution or trading.	Sales of goods - purchases of goods + Goods inventory change	Trade margin

Table 18.4 : Factors contributing to the Net results (Profit or Loss)

The most important is to determine what are the main part in the P&L contributing to the net income (positive or negative) and to understand what is the size of the company, what are its strengths and weakness, the evolution in its turnover and profitability...etc. These indicators allow to refine understanding of the business by zooming into some key points generating income or losses. A detailed analysis will also help to check if there are some manipulations in the financial statements

e) Cash flow analysis

The cash flow is a key indicator in many aspects. It is very important for shareholders because it is strongly linked to their earnings. It gives confidence to creditors about the company's ability to repay the debts and allows managers to invest in the development of their business. The cash flow represents the excess cash generated by the activity of the company during the year. It allows:

i. To repay loans,
ii. To pay shareholders,
iii. To invest,
iv. To strengthen the financial structure of the company.

f) Balance Sheet Analysis

Analysis of the financial structure as a whole is a dynamic process. Each case is particular and the evaluation of the assessment depends intrinsically on the company business sector and of the financial need.

Assets, liabilities and ownership equity are listed as of a specific date, such as the end of its financial year. The balance sheet shows if company's activity is mainly financed by:

Owner's Equity: capital stock, retained earnings, reserve,

Liabilities: accounts payable, loans payable, tax payable.

The higher the part of **Owner's Equity** is high in comparison with debts, the more the company is financially autonomous, therefore solvent. In the opposite way, more debts part is high more the company depends on them to finance her/his activity, which can continue only if suppliers and banks credit lines are maintained and raised proportionately with company growth.

If we look to the company's financial resources (owners' equity + liabilities) and the assets, we can determine the part of the owner's equity which finances the current assets; in other words the business activity of the business. If working capital (**Working capital = Equity - Fixed assets)** is weak, working capital requirements is financed by the liabilities (negative treasury). The Working Capital (WC) must be positive and large enough to cover the Working capital requirement WCR.

If the Working Capital (WC) is negative, that means that equity is not sufficient to finance fixed assets and the company has recourse to the short-term bank loan (whose renewal is not guaranteed) to finance it.

Working capital requirement: Operating assets (inventories + accounts receivables) - operating liabilities (payables).

The Working Capital Requirement (WCR) represents the need to finance the operation. It depends strongly on the sector of activity. For example, industrial companies generally have a higher WCR while the major retailers have a negative working capital (they are paid by their customers before they pay their suppliers).

Companies having an unbalanced financial structure with an even negative WC and a high WCR is highly dangerous. This is a consequence of a bad management or a too light financing. These situations make these companies very risky whatever is the good will of the leaders to respect their commitments.

Net Cash

Net cash is the difference between Working Capital – Working Capital Requirements. The Net cash is the remaining of WC after absorption of WCR. If the WC covers WCR, the net cash is positive. This amount is reflected in cash (excess cash on a bank account).

g) Credit notation

The credit notation is based on behavioural information, legal and financial information following are the methods of Credit notation

i. Payment behaviour,
ii. Age of the company,
iii. Legal form of the company,
iv. Age of the business relationship and evolution of orders,
v. Evolution of the turnover,
vi. EBIT and net income,
vii. Financial structure with the level of equity in relation to total assets,
viii. Indebtedness, working capital and cash ... etc.

A total of 15 criteria are used to build up this "credit score", each criteria has a defined weight in the final calculation. Following Four notes are possible:

A: Company olid,

B: Company stable,

C: Company fragile,

D: Company close to failure.

Use the simplified credit rating with clients who refuse to disclose their balance sheet and income statement, which is common in several countries. In some countries (notably the Middle East) commercial culture is that these documents are confidential and are only internal management tools for managers. In this case, the solvency assessment will be based on others criteria like compliance and payment behaviour, which is of course reflected in the tool.

18.6 CREDIT RATING INFORMATION SERVICES OF INDIA LIMITED (CRISIL)

Credit Rating Information Services of India Limited (CRISIL) is one such global analytical company that provides ratings, research, along with risk and policy advisory services. It is India’s first credit rating agency, which has pioneered the concept of credit rating in the nation. It was launched in the country in 1987 with the Securities and Exchange Board of India (“SEBI”). With a tradition of independence, analytical rigour and innovation, CRISIL sets the standards in the credit rating business. CRISIL launched India's first index to benchmark performance of investments of foreign portfolio investors (FPI) in the fixed-income market, in the rupee as well as dollar version in 2018, which includes, mutual funds ranking, Unit Linked Insurance Plans (ULIP) rankings, CRISIL coalition index and so on. CRISIL went public in 1993, Headquartered in Mumbai, CRISIL ventured into infrastructure rating in 2016. CRISIL acquired 8.9% stake in CARE credit rating agency in 2017. CRISIL is registered in India as a credit rating agency.

The majority shareholder of CRISIL is Standard & Poor’s, one of the biggest credit rating agencies of the world, expanded its business operation to USA, UK, Poland, Argentina, Hong Kong, China and Singapore apart from India.

In India CRISIL rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage backed securities, partial guarantees and other structured debt instruments, Mid-scale corporations and financial organisations. CRISIL has also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and microfinance institutions, also pioneered a globally unique rating service for Micro, Small and Medium Enterprises (MSMEs) and significantly extended the accessibility to rating services to a wider market.

CRISIL Rating Criteria

CRISIL works towards managing and controlling credit and market risks at a portfolio level, and analyses the management’s attitude towards risk and growth. Hence, CRISIL’s ratings bridge the gap between the financier and the borrower or investors, enabling them to take the right decisions. These ratings act as an assurance that indicates the highest degree of safety for a fund. The ratings are made, based on information gathering, analysis and meetings with the Management.

CRISIL assigns credit ratings under the following six categories:

1) Long-term: Long-term ratings are assigned on a 20-point scale, from ‘CRISIL AAA’ to ‘CRISIL D. The term ‘long-term instruments’ includes bonds, debentures, other debt securities, bank loans and other fund-based facilities with an original maturity of more than one year.’
2) Short-term: Short-term ratings are assigned on a 9-point scale, from ‘CRISIL A1’ to ‘CRISIL A4’ and ‘CRISIL D’ denoting default. The term ‘short-term instruments’ refers to commercial paper, short-term debentures, certificates of deposit, inter-corporate deposits, working capital borrowings, and other fund-based and non-fund based facilities with an original maturity of one year or less.
3) Dual Ratings: CRISIL assigns dual ratings (i.e., ratings on both long-term and short-term scale) to debt instruments that have an original maturity of more than one year, and also have a put option exercisable within one year from the date of issue. The first component of the rating, i.e., the long-term rating, addresses the likelihood of timely payment of principal and interest over the life of the instrument.
4) Structured finance ratings: The structured finance rating categories range from ‘CRISIL AAA (SO)’ to ‘CRISIL D (SO)’ on the long-term scale and ‘CRISIL A1 (SO)’ to ‘CRISIL D (SO)’ on the short-term rating scale. CRISIL assigns ratings to long-term and short-term structured finance instruments by using a suffix ‘SO’. Instruments with an original maturity of more than one year are rated on long term scale whereas instruments with an original maturity of one year or less are rated on short term scale. Fixed Deposit (FD): CRISIL assigns ratings to the FD programmes of corporates, banks and financial institutions with the prefix, ‘F’. FD ratings are assigned on a 14-point scale, from ‘FAAA’ to ‘FD’
5) Financial strength ratings: CRISIL assigns financial strength ratings to insurance companies on a scale ranging from ‘AAA’ to ‘D’.
6) Corporate credit ratings: CRISIL assigns corporate credit ratings to issuers on a scale ranging from ‘CCR AAA’ to ‘CCR D’ and ‘CCR SD’ (indicating selective default)

Check Your Progress-A

Fill in the Blanks

1. Debt owed to the firm by customer arising from sale of goods or services in the ordinary course of business is known as__________________
2. ______________Involvement is one of the characteristic features of the Receivables.
3. __________ represents a percentage of reduction in sales or purchase price allowed for early payment of invoices.
4. Credit evaluation process involved three steps Viz, _______,__________&________
5. Receivable constitute a significant potential of _________________
6. Optimum credit policy occurs where there is tradeoff between ________&______

18.7 CREDIT SCORE FACTORS AND CREDIT SCORE

Credit Score Factors

There are three major credit reporting agencies in India, Credit Rating Information Services of India Limited (CRISIL), Credit Analysis and Research limited (CARE), Investment Information and Credit Rating Agency of India Limited. (ICRA) which report, update and store consumers' credit histories. While there can be differences in the information collected by the three credit bureaus, there are five main factors evaluated when calculating a credit score:

a) Payment history
b) Total amount owed
c) Length of credit history
d) Types of credit
e) New credit

Validity of ratings

CRISIL's ratings are under continuous surveillance over the life of the rated facility. In principle, all ratings assigned by CRISIL address the credit risk associated with the rated facility till such time as the entire facility is redeemed in full. Ratings are subject to change at any point in time, based on changes in the business profile or financial profile of the issuer, or the prospects for the industry in which the issuer operates. Therefore, CRISIL does not mention a fixed validity date in its rating communications, including rating letters, rating rationales and credit rating reports.

Credit Score

The credit score model was created by the Fair Isaac Corporation, also known as FICO, and it is used by financial institutions. A credit score is a statistical number that evaluates a consumer's creditworthiness based on credit history. Lenders use credit scores to evaluate the probability that an individual will repay his or her debts. A person's credit score ranges from 300 to 850 and the higher the score, the more financially trustworthy a person is considered to be. While every creditor defines its own ranges for credit scores (for instance, many lenders think anything over 800 is excellent), here is the average FICO score range:

a) Excellent: 800 to 850

b) Very Good: 740 to 799

c) Good: 670 to 739

d) Fair: 580 to 669

e) Poor: 300 to 579

18.8 SUMMARY

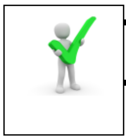
Receivable occupy an important position in the structure of current assets in financial statements of the organisation, which shows the rapid growth of credit sales approved by the firm for their customers. Objective of the receivable management are: Boost up sales volume, Monitor and Improve Cash Flow, To Minimises bad debt losses, Avoids invoice disputes, Improve customer satisfaction. Receivable management involves decision areas Credit standards, Credit period, and cash discount and collection procedure. A firm should follow an optimum credit policy that lies between lenient and stringent credit policy.

18.9 GLOSSARY

Day's sales outstanding(DSO): Average Collection period.

Credit standard: The minimum criteria for the extension of credit to a customer.

Collection cost: The Cost that are involved in collecting the debts from the customer.



18.10 ANSWERS TO CHECK YOUR PROGRESS

Check your Progress-A

1. Bills Receivable
2. Risk
3. Cash Discount
4. Obtaining Credit information, Analyzing the information and making the credit decision.
5. Current Assets
6. Liquidity and Profitability.

18.11 REFERENCES

Online sources:

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- https://www.crisil.com/en/home/our-businesses/ratings/understanding-rating.html
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Offline sources

Book on Financial Management Principle and practice by G Sudarsana Reddy.

18.12 SUGGESTED READINGS

1. Financial Management: G Sudarsana Reddy .
2. Basic Financial Management: M.Y. Khan and P.K. Jain, 2000.
3. Financial Management: I.M. Pandey.
4. Financial Management: Theory and Practices- Prasanna Chandra.
5. Corporate Financial Management: Arnold Alen, London, Pitman 1998.
6. Indian corporate financial management: Vijay Gopalan E., Bombay: Himalaya, 1997

18.13 TERMINAL QUESTIONS

Q1. What is credit policy? Discuss the different types of Credit policy.

Q2.Explain the importance of Receivable Management

Q3. Explain the Credit score factors and Credit scoring.

Q4. What is Receivable management? Discuss in detail the objective, benefits and Cost of Receivable management.

Q5. What is the role of credit policy variables in the credit policy of a firm? Discuss

Q6. Briefly explain the techniques available for Receivable Management.

Q7. What is Credit evaluation? Discuss the steps involved in it.

Q8. What is CRISL

Practical Applications

Q1. Identify the credit policy of a company of your choice from any sector.

Q2. Evaluate the performance of Receivable management of any company by collecting 5 years financial statements.

Q3. Take a company/ Bank/NBFC of your choice and find the procedure for evaluating individual accounts.