UNIT 19 RECEIVABLES MANAGEMENT

Structure

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19.0 OBJECTIVES

After studying this unit, you should be able to:

- discuss the nature and goals of credit policy;
- examine the credit worthiness of individuals and monitor receivables; and
- discuss factoring and securitisation,

19.1 INTRODUCTION

The most common form of short-term debt is trade or mercantile credit. It is short-term credit extended by a supplier to a buyer in conjunction with the purchase of goods for ultimate resale. Consumer credit, on the other hand is a credit of a retailer to a consumer so that he may purchase goods. .

The installment purchase typically provide for an extension of credit over some period of time. Here we are concerned with credit extended in connection with purchase of goods. Thus the direct loans from the supplier to his customer or any loan from one business to another are not termed as trade credit. So consumer credit, installment sale and direct loans are excluded from trade credit since such credits are not in connection with purchase of goods and services for ultimate resale.

There are two problems regarding credit. First, the decision to extend credit is a capital budgeting decision. The management may assume that outlay is equal to cost of credit (collectionfacilities) or additional investment will be needed for collection facilities as well as in working'capital or investment in working capital but not in credit facilities will be needed. The second problem is the question of financing. The permanent addition to working capital consists of: (a) increase in funds needed to finance current assets, and (b) precautionary balance i.e., additional capital needed for additional risk. The management may need short term loans for a longer period assuming that permanent capital structure will remain the same. In this unit you will learn about the nature and goals of credit policy, credit policy variables, credit evaluation, credit decision. You will also learn how receivables are monitored, meaning of factoring and meanings, process and merits and demerits of securitisation.

19.2 NATURE AND GOALS OF CREDIT POLICY

The term 'Credit Policy' refers to those decision variables that influence tlie amount of trade credit i.e., the investment in receivables. A firm's credit policy determines tlie amount of risk a firm is willing to undertake in its sales activities. If the credit policy is liberal and lenient, receivables will be at a higher level as compared lo in case of a rigid policy. The objective of credit policy i.e., receivables management is three fold:

a) To maintain optimum level of investment in receivables;

b) To keep down tlie average collection period;

c) To obtain the optimum level of sales.

There are three steps in credit policy. First, the credit policy is to be formulated by deciding credit conditions, terms and standards. Secondly, the credit policy is to be executed. Thirdly, the credit policy is to be evaluated by collecting and analyzing information.

Goals of Credit Policy

The goals of credit policy are:

1) Achieving growth in sales,
2) Increasing profits,
3) Maintaining liquidity,
4) Meeting competition.

The main purpose of granting credit is to increase sales. Some customers who are not in a position to pay cash are attracted due to credit facilities. When sales increase, tlie profit will also increase. A higher margin of profit is charged on credit sales. Since accounts receivables can be converted into cash so they help to maintain liquidity as compared to inventories. Sometimes in situation of intense competition in the market with other, firms may be able to meet competition through credit sales. It may offer discounts if the customers pay in time.

When a firm adopts more liberal credit policy, no doubt sales and profit increase, but there is a risk of more bad-debts. A stringent credit policy, on the other hand, reduces profitability but increases liquidity of the firm. The following figure shows how the credit policy effects its profitability and liquidity.

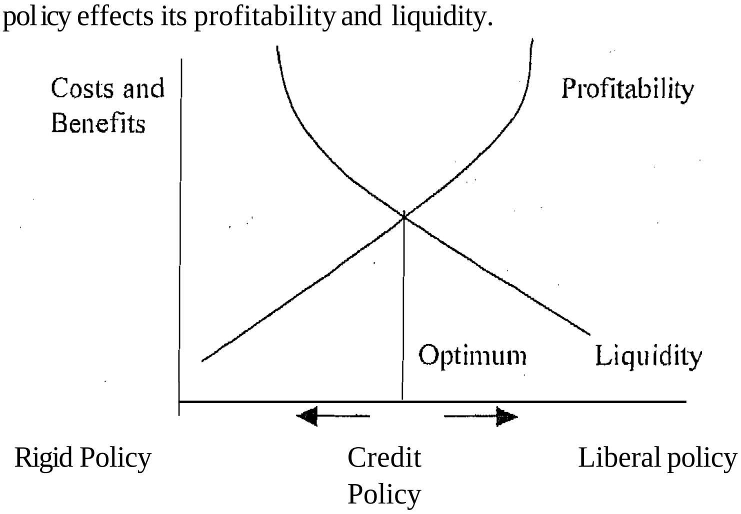

Figure 19.1: Credit Policy: Profitability and Liquidity

A more liberal policy shows that liquidity decreases and profitability increases. In case of rigid and stringent policy, liquidity increases and profitability decreases. So a firm's credit policy should be such that can maintain balance between liquidity and profitability.

However, credit policy depends upon many factors. They are: (1) percentage of credit sales to total sales, (2) the nature of business and conventions prevailing in tlie trade, (3) tlie level of sales i.e., higher the sales high will be receivables and *vice-versa,* (4) tlie collection policy, (5) tlie quality of customers; and (6) the terms of sales.

19.3 CREDIT POLICY VARIABLES

The financial manager must consider the variables that influence the credit policy of a firm.

The following are important variables of credit policy:

1) Credit Standard;
2) Credit Period;
3) Cash Discount; and
4) Collection Efforts.

Let's discuss them one by one

1) Credit Standard

Credit standard is the basic criterion for granting credit to customers. On the basis of such standards, it is decided to whom the goods or services be sold or not. They should neither be loose nor strict. There are five "C"s that are considered for determining these standards. These are character, capacity, capital, collateral and condition. Character is concerned with the probability that a customer will honour his obligations. Capacity refers to customer's ability to pay along with his past record. Capital is measured by firm's general financial position. Collateral is represented by the security that a customer can pledge. Condition is the impact of the firm on the economy.

When a firm plans to liberalise its credit standard, the profits arising due to increased sales have to be examined, along with costs of collection, taxes and bad debts, etc. the comparison of costs and profits may be done by two methods : -

(a) total profit under different proposals;

(b) incremental profit under different proposals.

Let us see the following examples:

Illustration **1:** Standard Sports Company dealing in sports goods, has an annual sales of Rs.50 lakh and are currently extending 30 days credit to tlie dealers. It is felt that sales can pick up considerably if the dealers are willing to carry increased stocks, but the company is, therefore, considering shifts in credit policy. The following information is available:

The average collection period is 30 days.

Fixed Costs : Rs. 6 lakh per annum.

Costs : Variable costs : 80% on sales,
Required (pre-tax) return on investment : 20%.

Credit Policy	*Average Collection*	*Annual Sales (Rs. Lakh)*
A	45 days	56
B	60 days	60
C	75 clays	62
D	90 days	**63**

Determine which policy tlie company should adopt?

Solution: The salient features of the various credit policies are summarised below:

Credit Policy	*Present*	*A*	*B*	*C*	*D*
The average collection period (days)	—	45	60	75	90
credit allowed (days)	30	—	—	—	—
Annual Sales (Rs. Lakhs)	50	56	60	62	63
	—	—	—	—	—
Cost of Sales (Rs. Lakhs)					
Variable Cost : 80% of sales	40.0	44.8	48.0	49.6	50.4
Fixed Cost	6.0	6.0	6.0	6.0	6.0
	—	—	—	—	—
Total cost	46.0	50.8	54.0	55.6	56.4
	—	—	—	—	—
Contribution (Rs. Lakhs)					
(Annual Sales – Cost of Sales)	4.0	5.2	6.0	6.4	6.6
Incremental Contribution (i)	—	1.2	2.0	2.4	2.6
Investment in Debtors (Rs. Lakh)		—			
(Cost of sales/360 x Credit Period)	3.8	6.3	9.0	11.6	14.1
Incremental Investment in Debtors					
Over present level (Rs. Lakhs)	—	2.5	5.2	7.8	10.3
Required Return on Investment on					
Account of Incremental Debtors					
x 20% (Rs. Laklis) (ii)	—	0.5	1.0	1.6	2.1
Excess of incremental contribution					
under the alternative credit policies					
over corresponding required return					
on incremental investment					
(i) – (ii) (Rs. Lakhs)	—	0.7	1.0	0.8	0.5

On the basis of the above incremental contribution under the various alternative credit policies over the present level, policy B should be adopted.

Illustration 2: **A** trader whose current sales are Rs.15 lakhs per annum and average collection period is 30 days wants to pursue a more liberal credit policy to improve sales. A study made by a consultant firm reveals the following information:

Credit Policy period	*Increase in collection period*	*Increase in sale (Rs.)*
A	15 days	60,000
B	30 days	90,000
C	45 days	1,50,000
D	60 days	1,80,000
E	90 days	2,00,000

The selling price per unit is Rs.5. Average cost per unit is Rs.4 and variable cosl per unit is Rs.2.75 paise. The required rate of return on additional investment is 20%. Assume a 360 days in a year and also assume that there are no bad debts. Which of the above policies would you recommend for adoption?

Solution:

Statement showing evaluation of different credit policies :

Average collection period (days)	Present 30	A 45	B 60	C 75	D 90	E 120
Sales (Rs.)	15.00.000	15,60,000	15,90,000	16,50,000	16.80.000	17,00,000
Less : Variable cost @ Rs.2.75 per unit	8,25,000	8,58,000	8,74,500	9,07,500	9,24,000	9,35,000
Marginal cost (Rs.)	6,75,000	7,02,000	7,15,500	7,42,500	7,56,000	7,65,000
Less: fixed cost (3,00,000 x 1.25) = 3,75,000	3.75.000	3,75,000	3,75,000	3,75,000	3,75,000	3,75,000
Profit (Rs.)	3.00.000	3.27.000	3.40.500	3,67,500	3,81,000	3,90,000
Increase in Profit (Rs.) (A)	—	27,000	40,500	67.500	81,000	90,000
Investment in Debtors Total cost (VC+FC) (Rs.)	12,00,000	12,33,000	12,49,500	12,82,500	12,99,000	13,10,000
Debtors Turnover Ratio = 360/Average Collection Period	360/30 =12	360/45 = 8	360160 = 6	360/75 = 4.8	360/90 =4	360/120 =3
Average Investment Required (Rs.) = Total Cost/ Debtors Turnover Ratio	1,00,000	1,54,125	2,08,250	2,67,187	3,24,750	4,36,667
Additional Investment needed		54,125	1,08,250	1,67,187	2,24,750	3,36,667
Cost of additional investment 20% (B)		10.825	21,650	33.437	44,950	67,333
Incremental Profit (A – B)		16,175	18,550	34,065	36,050	22,667

Proposal D is accepted because it shows highest profits.

Selection of such alternative credit policies are based on certain assumptions e.g., prices are same and existing capacity is sufficient to cope with increased production and sales.

Credit Period

Credit period is tlie length of time allowed to customers to pay for their purchases. Such period directly affects the volume of investment in receivables. Longer credit period may increase sales, but it also increases investment in receivables and lower the quality of trade credit. The credit period differs from industry to industry and within firms in tlie same industry. The firm usually talces into consideration tlie buyer's rate of stoclc turnover, competitors' approacli, nature of commodity, margin of profit and availability of funds.

The lengthening of credit period involves the costs. Such costs are involved in tying up investment in receivables. The firm may also experience bad debts and increase in collection costs. The credit policy can be Iiberalised if the cost associated with lengthening the credit period is less than increased earnings. In case the costs are more, the credit period should not be extended. The finance manager has to find an optimal credit period for tlie firm. The extension of credit period is useful and to what extent is also explained by incremental approacli, as shown in above two examples, i.e., 60 days in first and 90 days in second example.

Cash Discount

A creditor grants cash discount to a debtor if lie makes payment in or before credit period. It is not a compensation but a premium on payment of clebts. The cash discount term indicates the rate of discount and the period for which the discount has been offered. Cash discount is beneficial lo both creditor and clebtor. It increases the turnover rate of working capital and the firm can do higher volume of business with less investment in working capital. Cash discount prevents clebtors from using trade credit as a source of working capital.

Illustration 3 : If the trader offers a cash discount @ 2% if payment is made within 10 days of the date of invoice. If tlie collection period is reduced from 60 clays to 30 days, it is hoped 50% of customers will take the discount benefit.

Assume Rs. 25,00,000 average investment in receivables and net profit in 30 days is Rs. 54,000 and in 60 days. Additional investment needed is Rs. 2,33,334 and profit will be Rs. 80,500. Should the company give this discount?

Cost of Cash discount	=	Rs. 25,00,000 x 0.50 x 0.02
2,33,334 / 2	=	Rs. 1,16,667

The amount of Rs.1,16,667 is freed up and suppose trader wants 14% rate of return, additional earnings will be Rs.1,16,667 x 0.14 = Rs.16,333. The cost of discount is higher than tlie additional earnings. So the discount should not be offered.

Collection Efforts

The collection policy should be such that speeds up collection of dues. If the speed is slow, additional finance will be needed to sustain the production and sales. The objective should be to collect dues and not to offend the customer. The firm may take efforts like sending a reminder or personal request on phone or personal visits to customer or through collection agencies. The aging schedule of debtors should be prepared. Some of the firms in big cities employ 'muscle' men to recover payments, which is a wrong policy. Court case of recovery should be avoided as far as possible because of court delays and mounting litigation expenses in India.

Check Your Progress A

1) What are the basic elements of credit policy'?

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2) What are the objectives of credit policy?

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11.9.4 CREDIT EVALUATION OF INDIVIDUAL ACCOUNTS

Aftel-credit policy is formulated, the next step is to execute it, Execution of credit policy involves two steps: (a) evaluation of credit applicants, and (b) financing of investments in receivables. Financing of investment in receivable we have already explained.

Evaluation of Credit Applicants

The first step in credit policy implementation is to find the credit worthiness of the applicants. This is to ensure that they conform to the firm's credit standards. The credit worthiness of customers involves :

a) Collecting Credit Information;

b) Credit Investigation; and

c) Credit Granting Decision.

19.4.1 Collecting Credit Information

To collection credit information about customers involve cost and time. Some firms can not spend much money. But spending more money to collect credit information is necessary, upto a certain point, because more information will help to make a better judgment of the credit worthiness of customers.

In case of new customers, more time is spent to collect such information. But a customer will not wait for more time and may turn to other source of supply.

The sources of information may be banks, other firms, credit bureau reports and financial statements.

19.4.2 Credit Investigation

Credit investigation can be held in the following areas :-

a) Type of customer: to find whether new or existing

b) Business line of customer: background and trade related risk with the business,

c) Kind of product dealing in: whether it is perishable, seasonal, durable, etc,

d) **Size** of order placed along with volume of business expected from customer: and

e) Credit policies and practices of the company.

Two approaches can be followed for credit investigation :

1) Traditional Approach

2) Statistical Approach

Traditional approach relates to analysis of five "C"s of credit - Capital, Character, Collateral, Capacity and Condition, which have discussed earlier.

The traditional approach suffers from drawbacks like that it is not easy to judge these **five "C"s.** There is no consistency in analysis or no link to shareholders' wealth maximisation.

Modern approach consists of (a) Heuristic approach, (b) discriminate analysis, (c) Sequential decision analysis.

According to Heuristic or Rating Index approach, the factors to be considered are credit requirements, pay habits, year of business, profit turnover, and qualitative factor (i.e., discretion of the manager). Each factor is given a weight. Then contribution of each factor to credit limits is expressed as percentage of net worth. Discriminate analysis is computer based technique. It considers current ratio and return on net worth ratio. These ratios are plotted on a graph. A line is drawn between the plotted points dividing them in equal parts, Sequential decision analysis follows three steps (a) consulting credit files, i.e. past payment record (b) examining credit agency rating, i.e., internal **analysis.** (c) interchange of bank report, i.e., external credit analysis,

19.4.3 Credit Granting Decision

Credit investigation can be held in the following areas:

After credit investigation is complete, the decision to grant or refuse or seek more inforination is taken. The customers may be divided into two classes (1) old customers and (2) new customers. The old customers are to be further classified into sub-groups like (i) very good, (ii) good, (iii) medium, (iv) poor. It is very difficult to decide about customers who are marginally credit worthy. This can be shown as follows like a decision tree.

Customers	Old	High	Grant credit
		Medium	Compare potential loss
		Low	Refuse credit
	New	High	Grant credit
		Medium	Compare potential loss
		Low	Refuse credit

It is necessary to compare cost of goods sold and revenue From sale. The present value of revenues from sale to customers who have been granted credit should be compared with cost of goods sold plus cost of investigation. If there is a possibility of repeat order from customer who pays in time, then the expected profits should be considered after considering the probability of payment and repeat order. In such a case time value of money be ignored.

Suppose a firm has an incremental cash flows of Rs. 300 as a result of change in credit policy. The required rate of return is 5%. The cost of producing additional units due to increase in credit sales of Rs. 35,000 is Rs.10,000. Then NPV will be = P.V. of benefit — Cost.

$$(3000/.05) - (35{,}000 + 10{,}000)$$

$$\text{Rs.}60{,}000 - \text{Rs. } 45{,}000$$

$$NPV = \text{Rs. } 15{,}000$$

The credit policy be followed because NPV is positive.

19.5 MONITORING RECEIVABLES

For control or monitoring accounts receivables, two methods are used. (a) Ratio Analysis; (b) Aging Scliedule. The ratio analysis employs daily sales outstanding ratio (DOS) which is calculated by formula:

$$DOS = \frac{\text{Accounts Receivables at Time t}}{\text{Average Daily Sales}}$$

The four weekly receivables are Rs.800, Rs.720, Rs.640, Rs.620 and weekly sales are Rs.300, Rs.312 and Rs.316 respectively. The DOS for six weeks will be as follows:

$$\frac{\text{Rs.}620}{(300+312+316)/30} = 20 \text{ days approximately}$$

The DOS should be below 4 pre-determined period. A better method is to show the pattern of collections associated with credit sales by matrix method. If we divicle credit sales by average debtors it will give us, average collection period. The average collection period be shown as follows:

Week of Sales		I week	II week	III week	IV week
Percentage of Receivables					
Collected during	I week	20%	15%	10%	35%
	II week	45%	25%	15%	10%
	III week	10%	25%	35%	50%
	IV week	20%	50%	15%	10%

This method helps to remove the drawback of DOS payment behaviour. The matrix method helps to know when collection is improved, same ordeclining.

Aging Schedule

This method is also a traclitional method. It also suffers from the same defect as the DOS. The quality of receivables is determined by their age. It is compared with pre-determined credit period. For example, if the normal credit period is 30 days and their age is as follows:

Age (number of days)	% of total outstanding receivables
Less than 30 days	80%
31 to 60 days	20%
61 to 90 days	10%

From the above, the aging shows that creclit policy is good.

Check Your Progress B

1) What do you mean by credit analysis?

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2) List the five C's of credit.

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19.6 FACTORING

Factoring is an increasingly utilized financial tool that speeds a firm's cash flow and helps to avoid the problems that slow-paying customers can create. It involves an outright sale of a company's receivables to a financial institution known as a factor. When receivables are factored, title passes on to the factor and tlie receivables no longer appear on the company's balance sheet.

Factoring provides quick and convenient funding to growing companies who need capital to expand their business. To do this, factors purchase credit-worthy accounts receivable at a small discount and fund the company with immediate cash. Normally it is without recourse to the supplier who raised the bill. Hence, factoring turns your receivables into cash today, instead ofwaiting to be paid at a future date.

The factor enters into an agreement with the company for factoring receivables and the terms under which it is ready to advance funds. The firms sends the customer purchase order to the factor to do a credit verification and approval. Factor confirms willingness to advance funds based on the credit risk evaluation. Based on this confirmation, the customer is informed that the receivables have been sold and that the payment must be made directly to the factor.

There is no debt repayment, no compromise to the firm's balance sheet, no long-term agreements or delays associated with other methods of raising capital. Factoring allows the firm to use its own hard earned assets to create cash for the growth needs of the business today.

19.7 SECURITISATION

Securitisation means the conversion of existing or future cash inflows into tradable security which then may be sold in the market. The cash inflow from financial assets such as mortgage loans, automobile loans, trade receivables, credit card receivables, fare collections become the security against which borrowings are raised. In fact, even individuals can take the help of securitisation instruments for better economic efficiency. e.g, an individual having regular inflows by way of rent from property can raise a loan by offering his rent receivables as security i.e. the rent receipts will first be used to pay the loan and then for other purposes. Since the lender is assured of regular cash inflows, there is an enhanced element of credit. Corporate securitisation deals involving crores of rupees arc much more complicated. The importance of securitisation lies in the fact that it helps to convert illiquid assets or future receivables into current cash inflows and that too at a low cost. The company may sell the receivahlcs in the market and raise loans.

Securitisation therefore, is a process by which tlie future cash inflows of an entity (originator) are converted and sold as debt instruments called **"pay through or pass through"** certificates with a fixed rate of return Io the holders of beneficial interest. The originator of a typical sccuritisation transfers a portfolio of financial assets to a Special Purpose Vehicle (SPV), commonly a trust. The SPV is basically funded by investors. In return for the transfer, the originator gets cash up-front on the basis of a mutually agreed valuation of the receivables. The transfer value of tlie receivables is done in such a manner so as to give tlie lenders a reasonable rate of return. In 'pass-through' ancl 'pay-through' securitisations, rcccivahles arc transferred to the SPV at the inception of the securitisation, and no further transfers arc made. All cash collections arc paid to the holders of beneficial interests in tlie SPV.

Special Purpose Vehicle (SPV)

An SPV is an entity specially created for doing the securitisation deal. It invites investment from investors, uses the invested funds to acquire to receivables of the originator and then uses the realizations from the receivnhlcs transferred to it to pay the investors, thereby giving them a reasonable return An SPV may be a trust, corporation. or any other legal entity. Its activities are :

- Holding title to transferred financial assets
- Issuing beneficial interest (if the beneficial interests are in tlie form of debt securities or equity securities, the transfer of assets is a securitisation)
- Collecting cash proceeds from assets held, reinvesting proceecls in financial instruments pending distribution to the holders of beneficial interests and otherwise servicing the assets held
- Distributing proceeds to the holders of the beneficial interests.

Beneficial interests in the qualifying SPV are sold to investors and the proceeds are used to pay the transferor for the assets transferred. Those beneficial interests may comprise either a single class having equity characteristics or multiple classes of interests, some having debt characteristics and others having equity characteristics. The cash collected from the portfolio is clistributed to the investors and others as specified by tlie legal documents that establishes the SPV. Normally, transfer to the SPV of receivables involves stamp duty payments. However, these costs may be offset by benefits such as the PTCs being fairly tradable and liquid, higher credit rating, etc. In India, the stamp ditty on secondary market transactions is waived, if the PTCs are issued in dematerialized form. A Pass Through Certificate is an instrument which signifies transfer of interest in the receivable in favour of the holder of the Pass Through Certificate. The investors in a pass through transaction acquire the receivables subject to all their fluctuations, prepayment etc. The material risks and rewards in the asset portfolio, such as the risk of interest rate variations, risk of prepayments, etc. are transferred to the investors.

Merits

Securitisation can help raise funds at a rating higher than what is the actual rating of the originator. The added advantage of a securitisation deal is that the securitised assets (receivables) go off the balance sheet of the originator. This is especial ly helpful in the banking industry which has to adhere to capital adequacy norms. Besides, the asset portfolio (receivables) is liquidated releasing cash which in turn reduces the need for demand and time liabilities that are subject to statutory reserves in case of banks. Another advantage is that small investors can profit from such deals since they can invest small sums in the SPV and acquire beneficial interest. In fact there may be issues whereby the SPV is funded mainly by small investors. Securitisation keeps the other traditional lines of credit undisturbed. Hence, it increases the total financial resources available to the firm.

Demerits

Since securitisation is off-balance sheet funding, the true picture of the, originators' financial position is not clear merely from the balance sheet The best assets of the company may be transferred to the SPV and the company may be left with sub-standard assets on its books. The greatest demerit of securitisation is its opagueness. A company may have taken huge liabilities but that may not be apparent from the balance sheet or conventional financial statements of the company. This is especially true where the securitisation is with recourse i.e. if the receivables which have been securitised to the SPV become bad the SPV will have the right to recover the dues from the originator. The originator may have a lot of contingent liabilities without anyone being aware of it.

The process **of securitisation of** receivables

A securitisation deal normally has the following stages : i) The originator determines which assets he wants to securitise for raising funds. ii) The SPV is formed, iii) The SPV is funded by investors and issues securities to the investors, iv) The SPV acquires the receivables under an agreement at their discounted value, v) The servicer for the transaction is appointed, normally the originator, vi) The debtors are fare not notified depending on the legal requirements. vii) The servicer collects the receivables, usually in an escrow mechanism, and pays off the collection to the SPV, viii) The SPV either passes the collection to the investors, or reinvests the same to pay off to investors at stated intervals, ix) In case of default, the servicer takes action against the debtors as the SPV's agent, x) When only a small amount ofoutstanding receivables are left to be collected, the originator may clean up the transaction by buying back the outstanding receivables, and xi) At the end of the transaction, the originator's profit, if retained and subject to any losses to the extent agreed by the originator, in the transaction is paid off.

Check Your Progress C

1) What is factoring?

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2) How does SPV work?

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3) Why factoring is not loan?

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19.8 LET US SUM UP

Tlie most common form of credit is trade credit. These are two problems relating to trade credit. Firstly it is a capital budgeting decision and secondly it is tlie question of financing. Credit policy refers to those decision variables that influence the extent of trade credit i.e. investment in receivables. Cedit policy includes credit standards, credit period and collection efforts and cash discount. Credit standard are the criteria for granting credit to customer, credit period is the length of time allowed to customer. Cash discount is the discount given to customer and collection efforts are concerned with the speed up of collecting dues. After credit policy next step is execution of credit policy which involve credit evaluation of individual account. It includes: collecting credit information, credit investigation and credit decision. Receiveables are monitored by ratio analysis and aging schedule. Factoring involves sale of receivables to specialised firms. These firms are called factors. They collect receivables and advance cash against receivables to firm. Securitisation is conversion of casli into trade securities. SPV is especially created to deal in securitisation process.

19.9 KEYWORDS

Aging Schedule : A compilation of accounts receivable by the age of each account.

Credit Analysis : The process of determining the probability that customers will not pay.

Collection Policy : The procedure followed by a firm in collecting accounts receivables.

Credit Period : The length of time for which credit is granted.

Credit Standard : The standard applied in accepting or rejecting an account.

Cash Discount : Reduction in payment given to customer to induce promt payment.

Credit Evaluation : Judging the credit worthness of the customers.

Factor : Specialised firm involve in the collection of receiables.

Pass Through Certificate : Instrument signifies transfer of interest in receivables.

Terms of Sale : The conditions under which a firm sells its good and services for cash or credit.

19.10 TERMINAL QUESTIONS/EXERCISES

1) What is credit policy? Discuss its objectives and variables?

2) How are the receivables monitored?

3) Discuss the role of credit terms and credit standards in a credit policy of a firm.

4) What is factoring? What are its function's.

5) What is securitisation? What are the functions of SPV?

SOME USEFUL BOOKS

1. Smith, Keith V (1973) "*State of the art of working capital management*", Financial Management, *Autumn*.

2. James C. Van Horne, *Financial Management and Policy,* Edition 2002. Prentice Hall of India, New Delhi.

3. I. M. Pandey. *Financial Management,* Ninth ed., Vikas Publishing House, New Delhi.