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A Study on Impact of Accounts Receivable on Working Capital and Profitability at S. H. Kelkar Ltd Company, Mumbai

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Abstract: *Accounts receivable (AR) refers to money owed by customers (individuals or corporations) to another entity in exchange for goods or services that have been delivered or used, but not yet paid for Receivables usually come in the form of operating lines of credit and are usually due within a relatively short time period, ranging from a few days to a year. The objective of the debtor management is to minimize the time-lapse between completion of sales and receipts of payment. The management of accounts receivable is largely influenced by the credit policy and collection procedure of a firm. Accounts receivable represents the rate at which the firms collects payments from its customers. Excessive level of accounts receivable ratio on profitability may lead to negative effect. The paper is based on Receivables Management. The main objective of the project was to find out the efficiency of receivables management. The other objectives were to assess the impact of receivables management on working capital and profitability of the organization.*

1. Introduction

AR is one such type of a business transaction. It refers to the way of dealing with amounts of money that are owed to a business by its customer. An AR's transaction is generally carried out by means of an invoice which is sent to the customer with the aim of informing him of the duration within which the debt amount must be paid off. The term within which the debt has to be paid may be thirty days, forty-five days, sixty days, or even as much as ninety days. However, the duration of the debt depends entirely on the debtor and the creditor. Various payment practices may be followed.

These practices may be determined by the various industry standards. They may also be colored by the financial status of the debtor, or affected by the company's corporate policy. Larger business organizations usually have to resort to the development of an entire accounts receivables department to look into the various kinds and amounts of debts that its customers owe it. A sales ledger is usually used to record transactions that pertain to accounts receivables.

The objective of the debtor management is to minimize the time-lapse between completion of sales and receipts of payment. The management of accounts receivable is largely influenced by the credit policy and collection procedure of a firm. Accounts receivable represents the rate at which the firms collects payments from its customers. Excessive level of accounts receivable ratio on profitability may lead to negative effect. This is because if a firm has so many Debtors to pay, they may become short of cash which may lead to difficulty in settling their short-term financial obligations. Profit may be called real profit after receivables are turned into cash. The management of accounts receivable is largely influenced by the credit policy and collection of a firm. A credit policy specifies requirements to value the worth of customers and a collection procedure which provides guidelines to collect unpaid invoice that will reduce delays for customers who have not yet made payment for goods and services and outstanding receivables.

2. Review of Literature

- N. Venkataramana (2013)in their study of impact of receivables management on working capital and profitability, collected their data from annual reports of the companies from 2001-2010, the ratios which highlight the efficiency of receivables management have been computed using ANOVA technique to know the impact on working capital and profitability.. The investigation revealed that the receivables management across cement industry is efficient and showed significant impact on working capital and profitability.

- Okpe Innocent Ikechukwu and Duru Anastesia Nwakaego (2015) in their "The Effect of Receivable Management on the Profitability of Building Materials/ Chemical and Paint manufacturing firms in Nigeria." Tried to examine the effect of the management of accounts receivable on the profitability of building materials/chemical and paint companies in Nigeria. At the end of the study, the results showed that accounts receivable had positive and significant effects with the profitability ratio at 1% levels of significance. Both Debt ratio and

sales growth rate had negative and non-significant effect on these companies.

- Singh and Pandey (2008) made an attempt to study the working capital components and its impact on profitability of Hidalco industries limited.

3. Objectives

- To find out the efficiency of Receivables Management.
- To assess the impact of Receivables Management on Working Capital Management.
- To assess the impact of Receivables Management on Profitablity.

4. Research Design and Methodology

Research design

Data collection – The study is based on secondary data pertaining to the period 2011-15. The secondary data pertaining to companies was sourced from annual reports of companies, prospectus of S. H. Kelkar etc. Data has been obtained for all companies for which information was available.

Sampling design

A Universe

Universe includes organizations in Fragrance and Flavours Industry.

B Sampling unit

S. H. Kelkar and its two competitors Symrise and IFF.

C Sampling frame

The data analyzed is between the financial years 2011-2015.

D Sampling technique used

The data is collected and analyzed in a systematic manner using tables, graphs & diagrams.

Data Collection

A Sources of Data Collection

Data is gathered from the secondary sources to achieve the aforesaid objectives. Secondary data: Annual reports, Prospectus and research papers.

B Analytical tools of data analysis

Ratio Analysis
Ratio Analysis is a form of Financial Statement Analysis that is used to obtain a quick indication of a firm's financial performance in several key areas. The ratios are categorized as Short-term Solvency Ratios, Debt Management Ratios, Asset Management Ratios, Profitability Ratios, and Market Value Ratios.

Statistical tools for data analysis
Use of tables and column charts was done to compare the ratios of organizations for period of five years & interpret the analysis of the same.

5. Data Analysis and Interpretation

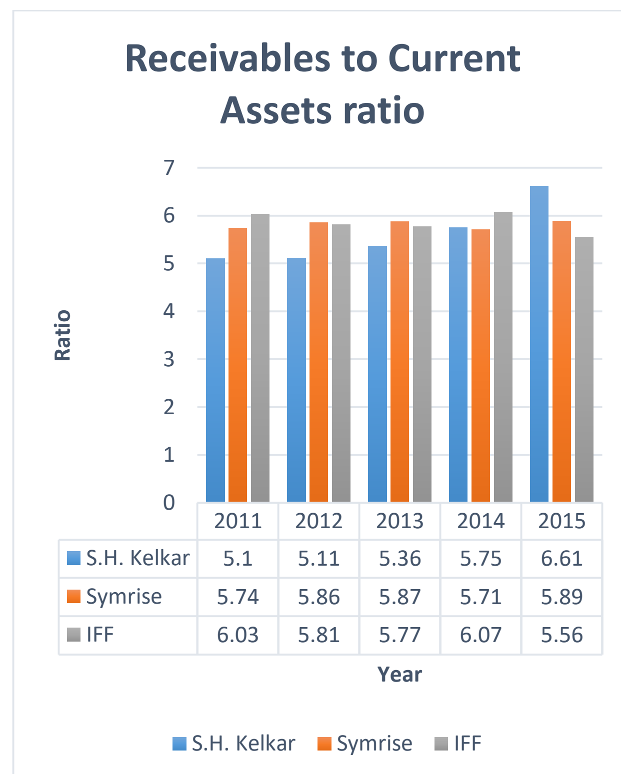
Introduction to Ratio Analysis

A ratio analysis is a quantitative analysis of information contained in a organization's financial statements. Ratio analysis is based on line items in financial statements like the balance sheet, income statement and cash flow statement; the ratios of one item – or a combination of items - to another item or combination are then calculated. Ratio analysis is used to evaluate various aspects of a organization's operating and financial performance such as its efficiency, liquidity, profitability and solvency.

An attempt is made to study the impact of Receivables Management on Working Capital and Profitability. Various ratios are computed to check the performance of organization with that of its selective competitors.

RATIO ANALYSIS

1. $Receivables\ to\ Current\ Asset\ ratio = \frac{Receivables}{Current\ Asset} \times 100$

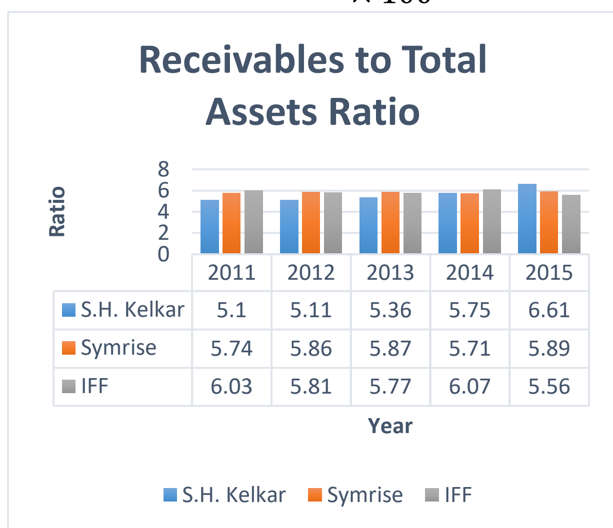


	2011	2012	2013	2014	2015
S.H. Kelkar	5.1	5.11	5.36	5.75	6.61
Symrise	5.74	5.86	5.87	5.71	5.89
IFF	6.03	5.81	5.77	6.07	5.56

Interpretation:
This ratio reveals the size of receivables in current assets and the opportunity cost associated with it, higher the percentage and higher is the cost of carrying the receivables. It is therefore desired that a firm needs to carry the least percentage of receivables as possible without affecting the sales volume. The ratio of S. H. Kelkar is much less than that of its competitors which means less funds of S. H. Kelkar are locked up in current asset than of its competitors. This gives them an advantage of using these funds for further investment or repay its loans if working capital is borrowed.

2. Receivables to Current Assets =

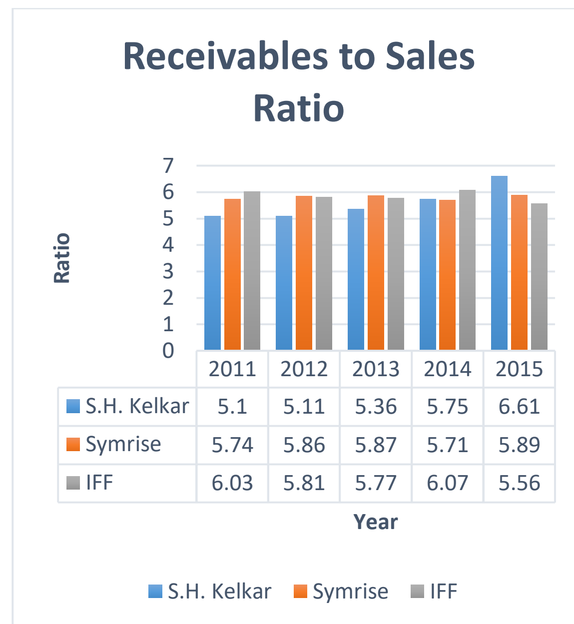
$$\text{Receivables to Total Assets Ratio} = \frac{Receivables}{Total\ Assets} \times 100$$



Interpretation:
The receivables to total assets ratio show the size of Receivables in Total assets. The less the size of receivables, better is the position of the organization to invest the amount caught in receivables and earn revenue. Also this reduces the chances of Bad debts in the organization. The average Ratio of Symrise is much less than S. H. Kelkar and IFF. This means that S. H. Kelkar can still improve its position in the Fragrance and Flavour Industry.

3. Receivables to Sales Ratio=

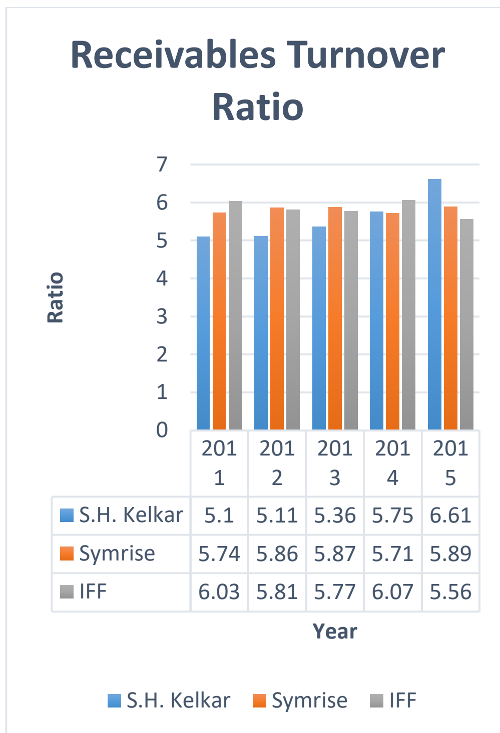
$$\text{Receivables to Sales Ratio} = \frac{Receivables}{Sales} \times 100$$



Interpretation:
This ratio shows amount of cash tied up with slow paying customers. The data shows that IFF has less cash tied up, whereas S. H. Kelkar has highest amount of cash tied up with slow paying customers. Therefore, IFF is more efficient by holding less investment in receivables as percentage of sales when compared to the aggregate of the industry. Whereas S. H. Kelkar and Symrise were inefficient because they had the percentage of receivables to sales more than the industry average.

4. Receivables Turnover Ratio

$$Receivables\ Turnover\ Ratio = \frac{Sales}{Average\ Receivables}$$

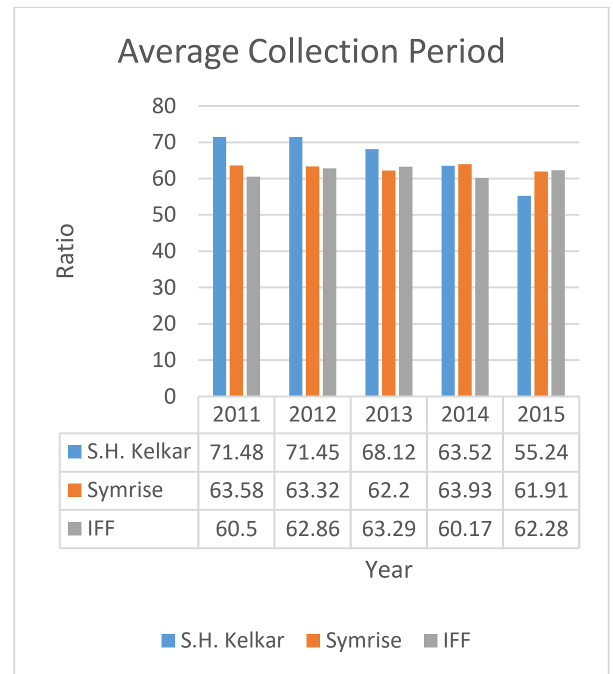


	2011	2012	2013	2014	2015
S.H. Kelkar	5.1	5.11	5.36	5.75	6.61
Symrise	5.74	5.86	5.87	5.71	5.89
IFF	6.03	5.81	5.77	6.07	5.56

Interpretation:
A high receivables turnover ratio implies either that the organization operates on a cash basis or that its extension of credit and collection of accounts receivable are efficient. Also, a high ratio reflects a short lapse of time between sales and the collection of cash, while a low number means collection takes longer. The lower the ratio is the longer receivables are being held and the risk to not be collected increases. A low receivables turnover ratio implies that the organization should re-assess its credit policies in order to ensure the timely collection of credit sales that is not earning interest for the firm. This means that S. H. Kelkar needs to work on its credit policies and increase its turnover ratio match the industry standard and its competitors.

5. Average Collection Period:

$$\textit{Average Collection Period} = \frac{365}{\textit{Receivables Turnover Ratio}}$$



	2011	2012	2013	2014	2015
S.H. Kelkar	71.48	71.45	68.12	63.52	55.24
Symrise	63.58	63.32	62.2	63.93	61.91
IFF	60.5	62.86	63.29	60.17	62.28

Interpretation:
Average Collection period gives the average days a firm takes to recover its accounts receivable. A lower collection period means that an organization takes less days to collects its receivables from the customers. Which means that companies funds are tied up with its customers for less days and the organization can use it to invest and earn revenue on those funds. S. H. Kelkar takes the longest amongst its competitors to collect its funds from customers, while IFF is most efficient amongst the three in collection of funds.

6. Findings and Conclusions

Findings :

1. The study reveals that less funds of S. H. Kelkar are blocked in Receivables in current assets. Its position is better than that of its competitors, when it comes to Receivables to current Assets ratio.
2. From 2011-2015 the Receivables to Total Assets ratio showed an increasing trend, which was not good for the organization. But it did decrease to a large extent in 2015 which shows its improvement.
3. S. H. Kelkar seems to be inefficient in receiving timely payments from its customers as most of its cash is tied up with slow paying customers. S. H. Kelkar is less efficient by holding more investment in receivables as percentage of sales when compared to the aggregate of the industry.
4. The Receivables Turnover ratio of S. H. Kelkar is below the industry average which means it is not efficient in collecting timely cash from its customers. The risk of these receivables turning into bad debts is more, which is not good for the organization.
5. The Average Receivables collection Period is highest of S. H. Kelkar is highest amongst its

competitors as it takes 65.96 days to collect cash from customers, which is longest amongst its competitors.

6. The Working capital ratio of S. H. Kelkar is less than the standard ratio which is 2:1.This shows that Working capital management of S.H. Kelkar is not efficient.

7. The return on capital employed is much better of S. H. Kelkar. Its average return for period of five years from 2011-2015 is 23.19 which is highest among the competitors in this industry.

8. The Working Capital ratio of S. H. Kelkar is well above the industry average. Which means it is utilizing its working capital well.

9. All the ratios computed point towards the huge impact of receivables management on the working capital and profitability of the firm. When the size of receivables will decrease cash will increase, which will increase revenue for the organization as those funds can be invested.

Suggestions :

1. S. H. Kelkar needs to concentrate more on its receivables management as when it comes to total assets most of its funds are blocked in accounts receivables.

2. The credit policies of the organization needs to be reviewed, so that there is less risk of receivables turning into bad debts. The credit policies should be such that payment should be received from customers in least time.

3. More focus should be given on the collection period of the organization, as it takes the maximum amount of days to collect its receivables which can prove to be harmful as more time it takes to collect cash from customers, the more is the risk of it turning into bad debts.

4. Co-ordination between all departments like Receivables department, Payables department, and sales department should be increased. This will ensure speedy recovery of cash and payment to suppliers.

5. The organization can match its due date for payments to suppliers with its probable date of receiving payment from customers. This ensure optimum efficiency in managing the working capital.

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