Research Paper | Accounting | E-ISSN No : 2454-9916 | Volume : 3 | Issue : 5 | May 2017

RECEIVABLES-PAYABLES MANAGEMENT AND LIQUIDITY TRAP- A CASE STUDY OF SELECTED COMPANIES OF INDIAN CEMENT INDUSTRY

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ABSTRACT

Receivables constitute a substantial portion of current assets and are mainly guided by credit policy decisions taken by the business enterprise. Extending credit would be a fruitful solution only if extra revenue generated from extending credit period exceeds the cost of credit. Accounts payable is basically a short term financial obligation for a business enterprise. The efficiency of the accounts payable management has a bearing on a company's cash flow, credit rating and operational costs. Proper Receivables and Payables Management is key to maintain a balance between liquidity and profitability. The Author in this paper has thrown light on actual scenes as is existed regarding Receivables and Payables in Indian Cement Industry, highlighted the importance of proper Receivables and Payables Management, discussed as to how the companies may improve their Receivables and Payables Management and may avoid the situation of liquidity trap.

KEY WORDS: Receivables, Payables, Liquidity, Credit, Cost of credit.

I. OBJECTIVES OF THE STUDY

1. To study the present position of Receivables and Payables and their management in selected companies in Indian Cement Industry.

2. To assess the impact of impact of improper management of Receivables and Payables on liquidity with the help of selected companies in Indian Cement Industry.

II. RESEARCH METHODOLOGY

Data is basically collected from secondary sources like annual reports of companies. To analyze the data both Financial and statistical tools have applied. Last five years financial statements of Shree Cements Limited, Ultra Tech Cement Limited, Birla Corporation Limited, ACC Limited and Dalmia Bharat Limited have been taken into consideration for the study.

III. HISTORICAL REVIEW

Panigrahi, A.K conducted study in year 2014 on Relationship of working capital with liquidity, Profitability and solvency: A case study of ACC limited. He concluded that Working capital management is the functional area of finance that covers all the current accounts of the firm. It is concerned with the adequacy of current assetsas well the level of risk posed by current liabilities. Efficient handling of company liquidity provides goodwill about the company as well as success of the company.

Mohan Kumar M.S, T Aswathanarayana in his study in 2015 on an impact of negative working capital on profitability – A case study of selected cement companies in India emphasized that companies can run their business without having sufficient working capital in the day to day activities. He added that it involves more risk, but it is very essential to maximise profit and survive in the competitive world.

Hassan Aftab Qazi, Syed Muhammad Amir Shah, Zaheer Abbas and TanzeelaNadeem in their research paper on Impact of working capital on firms' profitability in 2011 covered. This research paper was conducted for the association between working capital (WC) and value creation for share-holders and found that networking capital is positively correlated with profitability of the firms.

Mr. N. Suresh Babu and Prof. G. V. Chalam in their study on the Working Capital Management Efficiency in Indian Leather Industry- an Empirical Analysis observed that working capital management has significant impact on profitability of the firms. These results suggest that managers can create value for their shareholders by reducing the number of day's accounts receivable and increasing the account payment period and inventories to a reasonable maximum and also suggests that managers of these firms should spend more time to manage cash conversion cycle of their firms and make strategies of efficient management of working capital.

Gurmeet Singh in his research study on Negative Working Capital - A Case Study of Selected FMCG Companies in India concluded that a proper trade-off between liquidity and working capital requirement is needed in the long run.

IV. RECEIVABLES AND ITS MANAGEMENT

"Receivable" constitutes one of the core segments of working capital. It is originated due to goods and services provided to the customers on credit. The Black's Law Dictionary defines receivable as "the right to bring an action to recover a debt, money, or thing". Further, the Penguin Dictionary of accounting defines receivable as "the amount of money due to a business from customers".

Credit is cannot be avoided in modern business. Receivables constitute a significant portion of current assets in many business entities and hence investment in them should be managed to be maintained at an optimum level. Investment in receivables depends on two parameters, namely the volume of credit sales and the period taken to collect the credits. These both the parameters can be controlled through a change in firms' credit policy. Further credit policy depends on the entity's credit standards, credit terms and collection efforts. Credit standards requires fixation of criteria for selecting the customers for selling goods or providing services on credit basis. Credit standards should be neither be too strict nor too liberal..

Extending credit would be a fruitful solution only if extra additional benefit from extending credit exceeds the cost of credit. Cost of credit involves two types of costs, namely, carrying cost and opportunity cost.

An optimal amount of credit would be that point at which carrying cost equals the opportunity cost because at this point total cost of receivables would be minimum.

V. IMPACT OF RECEIVABLES ON LIQUIDITY

Investment in Receivables and liquidity are inversely related because capacity to pay short term debts decreases with every increase in the volume of trade receivables. Hence if trade receivables increase, the business enterprise relies on borrowings to finance its receivables so that proper liquidity could be maintained. However, since borrowings are never free of cost, any attempt to improve liquidity, adversely impacts its profitability. So as a better option, the Business Enterprises should try to control its receivables. Proper evaluation of customers, both financially and reputation check is necessary before extending credit. After once credit has been extended, proper monitoring and collection exercises should be duly carried out to avoid any blockage of funds in receivables.

VI. PAYABLES AND ITS MANAGEMENT

Accounts payable is basically a short term financial obligation for a business enterprise. It basically comprises off creditors for goods and outstanding expenses. In balance sheet it is represented under the head current liabilities. From the point of view of working capital accounts payable is considered as a source that originates without any specific arrangement for raising finance. This is the reason why accounts payable is also termed as spontaneously source of working capital and any working capital requirement is computed after deducting current liabilities from current assets.

In Indian context basically small business firms are good suppliers of raw materials to medium and large firms. This is against the features of developed countries where large business firms are the basic sources of supply of raw materials to medium and smaller firms.

Thus, accounts payable is a good source of working capital provided good relations are maintained with suppliers including their timely payment as per agreement.

Improper accounts payable management may bring severe problems to business enterprises including but not limited to shortage of raw materials, liquidity crunch, increased cost and delay in delivery of final products.

Thus, accounts payable management is an important area of consideration for finance manager. Particularly, in Indian scene proper attention is lacking in accounts payable. The Enterprises should develop criteria for evaluation and selection of suppliers. Suppliers should be evaluated on basically four grounds before selection. These parameters are operational, legal, financial and market reputation. The proportion of these parameters may vary from industry to industry and from one firm to another based on their supplier policies.

Exhibit-1: Supplier's evaluation criteria

It is clearly visible from above table that industry ranks equally the operational and market reputation criteria. Thus, good market reputation of supplier is as important as operational criteria. For improving the position and for efficient management of accounts payable proper care and attention is needed of higher management.

VII. THE IMPACT OF PAYABLES ON LIQUIDITY

There is direct relation between liquidity and accounts payable. The creditors being autonomous source of finance the longer the payment period, lesser will be the cost of funds. One strategy which is cropping up in Indian scene is delaying payment to suppliers and fast collection of receivables. But this term has been wrongly interpreted in Indian business operations. Better liquidity demands some more. Intention to delay suppliers may have adverse effect on viability of enterprise in the long run. It may not only force the organization to face scarcity of raw materials but also involve the enterprise in legal suits. Proper relationship with the suppliers is a key to success in the long run.

VIII. THE CONCEPT OF LIQUIDITY TRAP

Proper receivables and payables management is a key to strike a balance between liquidity and profitability. Proper receivables and payables management demands not only to think them individually but also to analyze their impact collectively. As a rule of thumb, the receivables collection period should be lesser than payables payment period. The more is the gap, better will be the profitability. Trade payables is the first and the autonomous source that is available to every business enterprises as per industry norms. However, excessive exploitation of creditors may badly hamper the reputation of business enterprise in long run. So every business enterprise is required to maintain a justifiable gap between receivables collection period and payables payment period. The situation of liquidity trap starts arising when the receivables collection period starts rising and payables payment starts decreasing over time period. Liquidity Trap is a situation where the Receivables Collection Period is more than Payables Payment Period. The situation becomes more trivial where this gap is increasing. If not controlled, this situation may bring serious liquidity crisis in the Company.

IX. DATA ANALYSIS

Table I: Receivables Collection Period (in days)

Year	2011-12	2012-13	2013-14	2014-15	2015-16	Average
Shree Cements Limited	11.21	20.54	18.39	26.94	21.54	19.724
Ultra Tech Cement Limited	40.61	47.5	52.05	55.5	56.19	50.37
Birla Corporation Limited	5.94	10.51	9.04	10.02	10.5	9.202
ACC Limited	7.01	10.11	9.71	14.81	10.17	10.362
Dalmia Bharat Limited	30.75	114.45	129.87	59.02	65.33	79.884
Average						33.9084

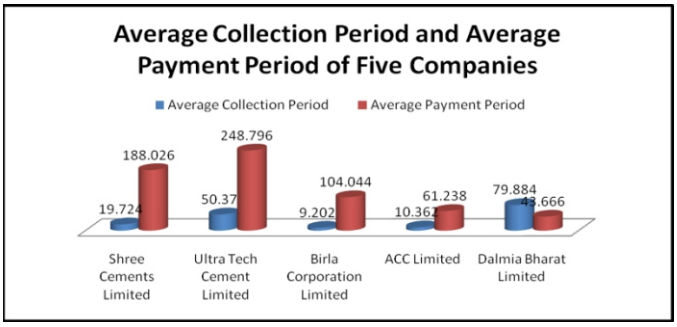
The Receivable collection period of Shree Cements Limited and Ultra Tech Cement Limited is showing somewhat increasing trend. However as far as Birla Corporation Limited and ACC Limited is concerned they are managing their receivables efficiently (Table I). Average collection period of all five companies is around one month.

Table II: Payables Payment Period (in days)

Year	2011-12	2012-13	2013-14	2014-15	2015-16	Average
Shree Cements Limited	380.47	53.25	142.53	162.03	201.85	188.026
Ultra Tech Cement	293.8	254.48	284.22	264.46	147.02	248.796
Birla Corporation Limited	114.38	65.77	123.99	124.24	91.84	104.044
ACC Limited	141.42	20.98	39.24	53.52	51.03	61.238
Dalmia Bharat Limited	49.38	65.07	44.04	23.97	35.87	43.666
Average						129.154

The scene of payable payment period is somewhat different in all five companies. On an average it comes out to four and half months. As far as Shree Cements Limited and Ultra Tech Cement Limited are concerned, they are maintaining average payable period of around seven months (Table II)

Exhibit 2: Trend of Average Collection Period and Average Payment Period of Five Selected Cement Companies



The gap between receivable collection period and average payment period is higher in Shree Cements Limited and Ultra Tech Cement Limited, moderate in cases of ACC Limited and Birla Corporation Limited, while lowest in case of Dalmia Bharat Limited (Exhibit 2).

Table III: Statement of Ranking based on Average Payment Period and Average Collection Period

Company	Average Collection Period	Average Payment Period	Average Payment Period/Average Collection Period	Ranking
Shree Cements Limited	19.724	188.026	9.533	II
Ultra Tech Cement Limited	50.37	248.796	4.939	IV
Birla Corporation Limited	9.202	104.044	11.307	I
ACC Limited	10.362	61.238	5.910	III
Dalmia Bharat Limited	79.884	43.666	0.547	V

When we rank the overall position of five companies, Birla Corporation Limited is the leader because it has maintained payables payment period around eleven times of receivables collection period (Table III).

Table IV: Excess of Payables Payment Period over Receivables Collection Period (in days)

Year	11-12	12-13	13-14	14-15	15-16	Standard Deviation	Mean	Coefficient of Variation
Shree Cements Limited	369.26	32.71	124.14	135.09	180.31	124.4657	168.32	73.9537
Ultra Tech Cement Limited	253.19	206.98	232.17	208.96	90.83	63.0452	198.46	31.7725
Birla Corporation Limited	108.44	55.26	114.95	114.22	81.34	26.04699	94.842	27.4636
ACC Limited	134.41	10.87	29.53	38.71	40.86	48.17259	50.876	94.6867
Dalmia Bharat Limited	18.63	-49.38	-85.83	-35.05	-29.46	37.7158	-36.218	-104.136

When we check consistency of excess of Payables Payment Period over Receivables Collection Period then again the Birla Corporation Limited stood first and Ultra Tech Cements Limited second (Table IV)

X. FINDINGS

- Cement companies in India are not able to maintain a consistent gap between receivables collection period and payables payment period.
- In some companies creditors payment period is 9 to 10 times of receivables collection period. However, the companies are not able to maintain this gap consistently.
- In some of the cases the receivables collection period is increasing while payables payment period is decreasing which in long run may endanger the liquidity position of company.
- There is no consistent trend of industry as far as the receivables collection period and payables payment period are concerned.
- Proper supplier's evaluation has not been done in many cases.
- Cement companies are dealing with a very large number of suppliers and not relying on fewer trusted numbers.

XI. RECOMMENDATIONS

- The manufacturer should maintain proper relationship with its suppliers and customers
- The number of Suppliers should not be too large. Fewer but trusted suppliers are the key to success.
- A proper gap between receivables collection period and payables payment period should be decided and this gap should be consistently maintained.
- Suppliers should be selected after proper evaluation on financial, technical and reputation grounds.
- Securitisation of Receivables is a good tool to recycle the funds in the business.
- Suitable discount policies should be framed out for attracting the debtors for making faster payments.
- Before extending credit to new customers, proper market verification is very necessary

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