International journal of management and economics invention
||Volume||2||Issue||11||Pages-1116-1122||Nov-2016|| ISSN (e): 2395-7220
www.rajournals.in

Debtors Management: A comparative analysis of selected Power Distribution Companies in Andhra Pradesh

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Abstract: Debtor management is heart of every business. Making a sale is fine, but collecting the cash is ultimately what matters. Selling goods and services on credit, results in blocking of funds in accounts receivable. The interval between the date of sale and date of payment has been financed out of working capital. Additional funds are therefore required for the operational needs of the business which involves extra costs in term of interest.The present study is an attempt to analyze Debtors management with the help of debtors turnover ratio in APSPDCL and APEPDCL. For this study the statistical tools like percentage, averages and t-test are used. The study reveals that an efficient debtor's management process results in enhanced operating efficiencies, effective billing procedures and quick dispute resolution. It additionally requires less management time to be spent on administration and processing issues allowing senior management to focus on key strategic issues and on growth of business.

Keywords: Southern Power Distribution Company of AP Ltd., (APSPDCL), Eastern Power Distribution Company of AP Ltd., (APEPDCL), Debtors Turnover Ratio and working capital.

INTRODUCTION

Indian Power Sector has made substantial progress both in terms of enhancing power generation and in making available power to widely distributed geographical boundaries. The Installed generation capacity in the country is about 288005 MW as on 31st January 2016.The Indian power distribution sector is witnessing a lot of activity of late with positives like increased consumer demand on the back of GDP growth, increased urbanization, rural electrification and increased private sector participation.

The major preoccupation for most of today's organizations management is to remain relevant in the market by striving to cope with the ever increasing brutal competition in the market brought about by production of very close substitutes to the firm's own products by competitors. At the same time, managers are faced with the challenges of achieving optimal profits, improving the company's performance and maximizing the shareholders wealth which can only be achieved through increase in revenue obtained from sales and cost cutting on expenses. This has seen many firms employ all forms of tactics and strategies to woo new customers to their products or to maintain their existing market share. One such strategy is selling their products on credit.

According to Pandey (2004), Debtors constitute a substantial portion of current assets of several firms. For example in India, trade debtors, after inventories (Stock), are the major components of current assets. They form about one-third of current assets in India. Granting credit and creating debtors amount to the blocking of the firm's funds. The interval between the date of sale and the date of payment has to be financed out of working capital. This necessitates the firm to get funds from banks or other sources. Thus, trade debtors represent investment. As substantial amounts are tied-up in trade debtors, it needs careful analysis and proper management.

CONSEQUENCES OF INEFFECTIVE DEBTORS MANAGEMENT

Poor management and control of accounts receivable often results in disruption of the firms daily operations caused by cash flow problems which results in non-payment of suppliers of goods and services, non-payments to employees and inability to meet statutory obligations. The overall effect is non-supply of materials and services leading to disruption in production, a demotivated workforce and penalties from authorities. Hence J. Salek (2005) opines that cash is the "life blood" of any company and every rupee of a companies' revenue that becomes a receivable must be managed and collected. Poor management of accounts receivable impacts negatively on profits in two ways; first, bad debts written off reduce the firm's profits directly in the profit and loss account; Secondly, when a lot of funds are tied up in accounts receivable, the company may find itself borrowing funds to finance operations; these borrowed funds attracts interest which also reduces profit. Other than the bad debt and interest expense, there are legal expenses associated with collecting debts. Ineffective debtor's management may result to poor credit rating from financial institutions. This makes it difficult to obtain financing from the institutions to finance the firm's working capital and if it does then it is at a high interest rate since it is unable to negotiate for better terms. Severe liquidity problems caused by so much funds held in accounts receivable may lead to total collapse in production since the firm can no longer meet its financial obligations, which in extreme cases may lead to the firm becoming insolvent and consequently being placed under receivership. Ultimately, the firm may be wound up.

STEPS FOR BETTER DEBTOR MANAGEMENT

1. Credit Policy and terms of trade

Credit policies need to be routinely reviewed to ensure they are appropriate for the organisations risk profile. The credit policy should be clearly articulated in writing to all debtors and understood by all staff. Terms of trade should be documented and cover areas such as prepayments, down payments, terms and any discounts for early settlement.

2. Invoicing and estimates

All quotes, estimates, invoices, contracts, agreements, purchase orders, and related documentation should refer to your terms of trade and credit policy, and information on the nature of work/products supplied, quantities, timings and the structure and method of payment should be clearly articulated in order to minimise any misunderstandings. Ensuring that acceptance of terms in writing is recommended. And of course, invoice as early and as often as possible.

3. Accounts receivable processes

The process for collections should be clearly mapped out and understood by staff, with the timings of various communications (letters/emails/phone calls) articulated. In the event of debtor disputes, payment of the non-disputed amount should always be sought to maintain cash-flows.

4. Conduct Credit Checks to identify and mitigate risks

Credit checks for new and existing customers should be carried out routinely to identify issues which can influence credit limits. Credit data products such as ledger monitoring and alerts are increasingly available to identify deterioration in credit-worthiness and mitigate credit risk.

5. Review system and ledger monitoring

Scheduled reviews of credit limits are critical to ensure settings are appropriate for individual debtors. Routinely monitoring the days outstanding (DSO) is critical to identifying adverse trends in the debtor's ledger and ensuring prompt action.

6. Systems and data management

Good debtor management relies on well-maintained information. There are numerous software solutions available to assist owners in credit management, and increasingly more of them are cloud-based. Data integrity needs to be maintained to ensure credit limits are appropriate, and the organisation has good knowledge of the legal entities to which credit is extended.

7. Credit Management services

Close monitoring of the debtors ledger is the best way to minimising issues however there will be situations which are uncontrollable. Organisations should consider if the use of credit insurance products and debt recovery services is appropriate to manage the risk and effects of bad debts. Ensuring that terms of trade have been reviewed by solicitors and are legally compliant will ensure there will be no impediments to the recovery process. Some financing solutions such as factoring (also known as debtor finance) can provide a cost-effective and comprehensive credit management function in addition to a flexible line of credit which ensures that the debtor ledger is maintained and sufficient working capital exists to fund the business.

8. Bad debt provisioning

Research & Analysis Journals
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Credit management is about safeguarding profitability and provisions for bad debts should ideally be made in any annual or ongoing budgeting process to minimise the risk of impacting on profitability.

Objective of the Study

The objective of this paper is to analyze the efficiency of Debtor's Management in power sector. The main of the study is to investigate the practices adopted by Power sector for effective debtors Management and to estimate the Debtors turnover ratio for the period of five year during 2010 to 2015.

1. To estimate the debtors turnover ratio of APSPDCL during 2010-2015.
2. To estimate the debtors turnover ratio of APEPDCL during 2010-2015.
3. To compare the debtors turnover ratio of APSPDCL and APEPDCL during 2010-2015.
4. To test whether there is a significant difference between debtor's turnover ratio of APSPDCL and APEPDCL.

RESEARCH METHODOLOGY

The study is primarily based on secondary data. The sources of secondary data are web sites and annual reports of APSPDCL and APEPDCL 2010-2015. In addition to this a number of books, journals articles and text books referred in this regard. The analysis is mainly carried out through various statistical measures like percentage, Average, *t test* etc.

Analysis

Table -1: Debtors Turnover ratio and Collection Period of APSPDCL

Indices of Sales, Debtors and Current Assets Rs. In Crores							Average
Particulars		**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	
Sales	**Rs. In Crores**	4946	6039	6535	7327	10923	4978
	%	100	122.10	132.13	148.14	220.85	109.27
Debtors	**Rs. In Crores**	354	351	302	256	247	302
	%	100	99	85	72	69	85
Total CA	**Rs. In Crores**	5275	10552	7725	8002	11927	8696.20
	%	100	200	146	151	225	164
Size of Debtors							
%Debtors to Sales		7.16	5.81	4.62	3.49	2.26	4.67
%Debtors to Total CA		6.71	3.33	3.91	3.20	2.07	3.84
Turnover and Collection Period of Debtors							
Turnover (in Times)		14	18	22	29	44	25
Collection Period (days)		26	21	17	13	8	17

The above table reveal that the Debtors Turnover Ratio and Debtors collection period of APSPDCL for five year from 2010-11 to 2014-15. The average collection period is 26 days in 2010-11, 21days in 2011-12, 17days in 2013-2014, 13 days in 2013-2014 and 8 days in 2014-2015. It is observed that the collection period gets declined from 2010-11 to 2014 – 15 and an average Debtors Turnover Ratio and Debtors Collection period recorded as 25 times and 17 days respectively.

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Table – 2: Debtors Turnover Ratio and Collection Period of APEPDCL

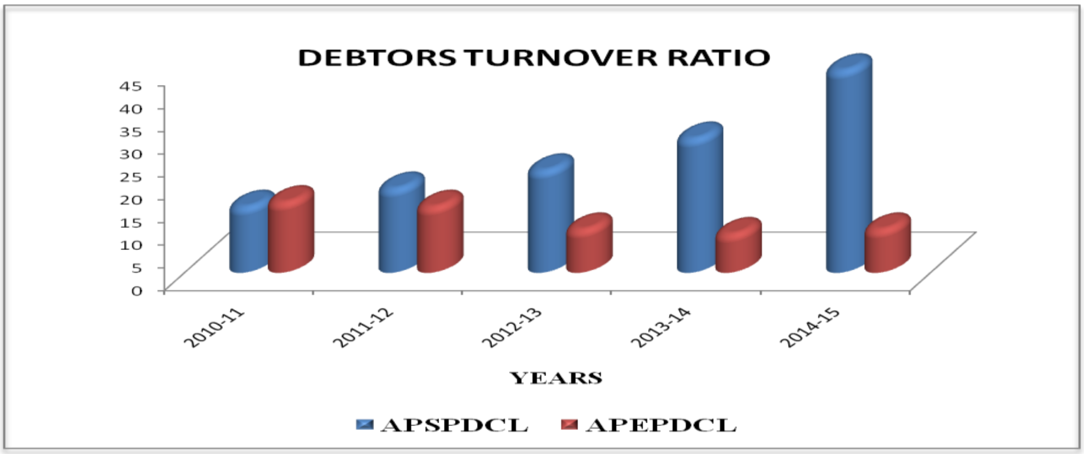
Indices of Sales, Debtors and Current Assets Rs. In Crores							Average
Particulars		**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	
Sales	Rs. In Crores	3472	5350	4871	6033	7617	3953.80
	%	100	154.09	140.29	173.76	219.38	122.43
Debtors	Rs. In Crores	231	383	556	726	890	557
	%	100	166	241	315	386	241.60
Total CA	Rs. In Crores	4119	6624	6340	6247	6789	6023.80
	%	100	161	154	152	165	146
Size of Debtors							
%Debtors to Sales		6.65	7.16	11.41	12.03	11.68	9.79
%Debtors to Total CA		5.61	5.78	8.77	11.62	13.11	8.98
Turnover and Collection Period of Debtors							
Turnover (in Times)		15	14	9	8	9	7
Collection Period (days)		24	26	41	46	41	36

The above table reveals the Debtors Turnover Ratio and Debtors collection period of APEPDCL for five years from 2010-11 to 2014-15. The average collection period in the year 2010 - 11 is 24 days, 2011-12 is 26 days, 2012-13 is 41 days, 2013-14 is 46 days and 2014- 15 is 41 days and an average Debtors Turnover Ratio and Debtors collection period recorded as 7 times and of 36 days respectively.

Table – 3: Debtors Turnover Ratio of APSPDCL and APEPDCL

YEAR	APSPDCL	APEPDCL
2010-11	**14**	**15**
2011-12	**18**	**14**
2012-13	**22**	**9**
2013-14	**29**	**8**
2014-15	**44**	**9**
Average	**25**	**7**

Fig – 1: Debtors Turnover Ratio of APSPDCL and APEPDCL



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International journal of management and economics invention
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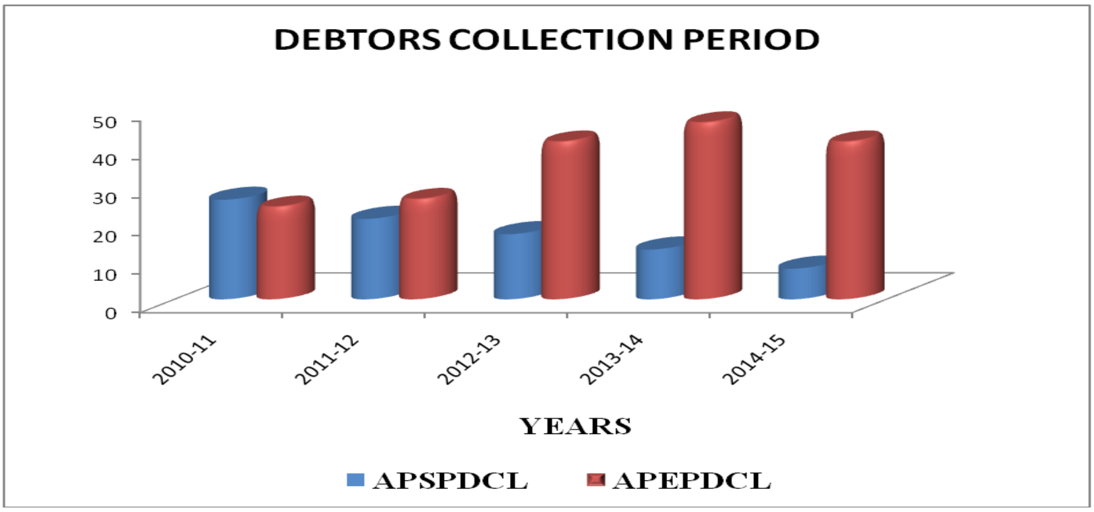
The above Table-3 and Fig-1 reveal that the Debtors Turnover ratio of the APSPDCL and APEPDCL for the period of five years. It shows that in the year 2010-11 the Debtors Turnover Ratio of APSPDCL is 14:1 and from there after in the year 2011-12 to 2014-15. The Debtors Turnover Ratio is increasing in trend recorded as 18:1, 22:1, 29:1 and 44:1 respectively. On the other hand the APEPDCL indicating a gradual decrease in the Debtors Turnover Ratio. In the year 2010-11 it shows 15:1 and from there after it decrease in trend recorded as 14:1, 9:1 8:1, 9:1 and 7:1 respectively. It states that a company with a higher ratio shows that credit sales are more likely to be collected than a company with a lower ratio. Ideally a higher debtor's turnover ratio and lower collection period are what a company would want. In other words higher debtor's turnover ratio indicates faster turnaround and reflects positively on the liquidity of the company.

Table – 4: Debtors collection period of APSPDECL and APEPDCL

YEAR	APSPDCL	APEPDCL
2010-11	26	24
2011-12	21	26
2012-13	17	41
2013-14	13	46
2014-15	8	41
Average	17	36

Fig – 2: Debtors collection period of APSPDECL and APEPDCL



The Table-4 and Fig-2 show that the Debtors collection period of the APSPDCL and APEPDCL. The APSPDCL shows that in the year 2010-11 to 2013-14 recorded as 26 days, 21 days 17 days, 13 days and least collection period recorded as 8 days in the year 2014-15. On the other hand the company APEPDCL shows more Debtors Collection period 24 days, 26 days, 41 days, the highest 46 days and then 41 days respectively. It states that a short collection period is prompt collection and better debtor's management. If the average collection period of a company is 50 days and the company allows credit terms of 40 days then the average collection period is worrisome. Hence the companies should work towards increasing its debtor's turnover ratio and reducing the average collection period to the minimum days.

Hypothesis testing on Debtors Turnover Ratio (APSPDCL and APEPDCL):

To test whether there is a significant difference between Debtors turnover ratio of APSPDCL and APEPDCL the following hypothesis is framed and tested through t-test at 95 % confidence level.

H_O: There is no significant difference between debtor's turnover ratio of APSPDCL and

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APEPDCL.

H_1: There is a significant difference between debtor's turnover ratio of APSPDCL and

APEPDCL.

T-test Two Sample Assuming Unequal Variance

PARAMETERS	Debtors Turnover Ratio of APSPDCL	Debtors Turnover Ratio of APEPDCL
Mean	25.13	7
Variance	144	10.5
Observations	5	5
Hypothesized Mean Difference	0	0
df	8	
T stat	3.26	
P(T<t) one tail	2.81E-02	
t critical one tail	2.31	
P(T<t) Two tail	5.61E-02	
t critical two tail	1.86	

Since the calculated value of t-two tail at .05 level of significance is more than the table value of t, null hypothesis is rejected and alternative hypothesis is accepted. It reveals that there is significant difference between Debtors turnover ratio of APSPDCL and APEPDCL.

CONCLUSION

Debtor management is a strategy that involves the process of designing and monitoring the policies that govern how a company extends credit to its customer base. The idea behind this process is to minimize the amount of bad debt that the power sector will eventually incur due to customers failing to honour their commitments to repay the total amount of the credit purchases. Apart from high financial losses and debt burden hampering the development of the Power distribution sector. In such circumstances effective debtor Management may help bridge the cash flow gap between invoicing and payment to ensure wages, tax and creditors are kept up to date. The overall analysis indicates the fact that the performance of the Power Distribution Companies in respect of debtors Management was satisfactory.

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