



## Analysis of Receivables Practices in Manufacturing Companies: A Case of Nepalese Pharmaceuticals Companies

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### Abstract

*This paper presents the results of the survey and analysis of receivable practices in Nepalese pharmaceuticals companies. The survey is based on the structured questionnaire completed by 209 pharmaceuticals executives of which 44 were under corporate level, 98 under business level and 67 at operational level. The major issues dealt in the survey are concerned with the application of credit control policy, application of credit customer grading form, application techniques used to grant credit, application of “best practice” tips for effective credit control and opinion on practice of credit limit. Survey results showed that pharmaceuticals companies have desired to establish credit control policy with continuous practice of using credit application to screen new customer and renew them yearly. However, the practice of average collection period was not satisfactory in the companies. The choice of “references” for grading credit customer and ratio analysis were evident to grant credit.*

**Keywords:** Account receivable, credit control, pharmaceuticals, average collection

### Introduction

Management of the receivables is a challenging assignment and it can be argued that revenue generation is the most critical function of a company. Zetocha et al. (1984) stated that accounts receivable has been singled out as an important area that deserves close management attention because these accounts affect the day-to-day cash flow of a business. Receivable represents a prominent force of modern business (Pradhan, 2006). Accounts receivable is money owed to a firm when it sells its products or services on credit and it does not receive cash immediately (Pandey, 2004).

## **Review of Empirical Works**

Ricci (1999) carried out a survey and analysis of receivables practices in American corporations. The paper reported the results of a survey of the receivables practices of 200 large American corporations. The survey focused in three areas of receivable management: presales, post sales issues and ongoing issues. The major findings of the study showed that majority of the respondents used ratio analysis and credit scoring method to decide to whom to grant credit. Similarly, majority of respondents received information on the credit applicant from more than one source and majority of respondents used the percent of sales method to forecast their receivables. The survey also asked respondents whether they used aging schedules, bad debts percentages, exception reports, ratio analysis, trends analysis or another measure to measure to monitor their receivables. Results showed 97.4% respondents used at least an aging schedule to review their receivables (Prahdan, 2006, p. 365).

The researches that have shown the relationship between account receivables and profitability have presented mixed findings. Lazaridis and Tryfonidis (2006) investigated relationship between accounts receivables management and corporate profitability for the firms listed in Athens stock exchange for a sample of 131 listed companies over the period 2001-2004. Results showed that there is statistical evidence for a strong relationship between the firm's profitability and receivables management efficiency. Similarly, Haitham and Maryam (2009), Chawla et al. (2010), Kofi et al. (2013), Emmanuel and Nti (2017), Anwar (2018) and Dhar (2018) study results showed that there is a significant inverse relationship between receivables collection period and company's profitability. On the same ground, Kieschnick et al. (2013) analyzed the relationship between corporate working capital management and shareholders' wealth 3786 US corporations from 1990 through 2006. The study result showed that investment in AR has more impact on shareholders' value.

However, Jakpar et al. (2017) found significant positive relationship between profitability and average collection period of 164 manufacturing firms of Malaysia for the period of 2007-11. But, Ullah et al. (2017) reported no significant relationship of account receivables with profitability.

The general conclusion that emerges from the above-mentioned studies is that controversy arises in the findings to those studies showing the relationship between account receivables and profitability. Since the surveys relevant to account receivables

management practices in Nepalese pharmaceuticals companies have not yet been evident in the Nepalese literatures, this study is directed towards analyzing the account receivables management practices of Nepalese pharmaceuticals companies based on survey method.

### **Sources of Data and Nature of Study**

In the Nepalese context, the data problem is more discriminating in private enterprises since most of the private enterprises are non-listed and the information relating with the account receivable management is not rightly being understood and needs additional explanation for the clear understanding.

This study has employed a survey research design to deal with the fundamental issues associated with the account receivable management and attempted to collect data from randomly selected respondents from executives of Nepalese pharmaceuticals companies who have been involved in the field of pharmaceuticals production, manufacturing, finance and corporate management. The questionnaire reference is based on Zetocha et al. (1984) and author's personal academic and professional experience working in pharmaceuticals companies. Among the administered questionnaire to the respondents of all industry categories, 209 usable responses were received from pharmaceuticals companies relevant to account receivable practices. The questionnaire mainly contained questions on background information on respondents, credit policy, credit customer grading and account receivables management practices. The response to the questions are presented in tables 1 A to 1 F. As is evident from Table 1 A, the majority of persons responding to the survey (47 percent) hold the position of manager but there are also good number holding the position of officer (32 percent) and general manager / director (21 percent). The initial background survey result shows the respondents' key interest in the survey is evident from the key positions held by respondents.

Male respondents are dictating the large numbers in the top level of pharmaceuticals companies. As is evident from Table 1B, the majority of respondents (86 percent) are males whereas female's respondents are 14 percent. As regard of respondents' age, majority 47 percent respondents are above 35 years, 37 percent are between 25 to 35 years of age and 16 percent are below 25 years of age (Table 1C).

Table 1 Background information of the respondents

A. Respondents' position in the company

Position	Number	Percentage
General Manager / Director	44	21
Manager	98	47
Officer	67	32
<b>Total</b>	<b>209</b>	<b>100</b>

B. Respondents' gender

Gender	Number	Percentage
Male	180	86
Female	29	14
<b>Total</b>	<b>209</b>	<b>100</b>

C. Respondents' age

Age	Number	Percentage
Below 25	33	16
25 to 35	78	37
Above 35	98	47
<b>Total</b>	<b>209</b>	<b>100</b>

D. Respondents' academic qualifications

Academic qualifications	Number	Percentage
Bachelor's Degree	165	79
Master's Degree	36	17
Above Master's Degree	8	4
<b>Total</b>	<b>209</b>	<b>100</b>

E. Age of company establishment (Years)

Age	Number	Percentage
6 to 10	8	4
11 to 15	116	55.5
16 to 20	70	34.5
Above 20	15	7
Total	209	100

F. Years of research and development activities

Years	Number	Percentage
0 to 5	10	5
6 to 10	166	79
11 to 15	33	16
Total	209	100

Concerning respondents' academic qualifications, majority (79 percent) have qualifications of bachelor's degree, 17 percent master's degree and 4 percent have above master's degree (Table 1D). Regarding age of the pharmaceuticals companies, 4 percent of the companies covered by this study are of 6 to 10 years old, 55.5 percent are of 11 to 15 years old, 34.5 percent are of 15 to 20 years of old and rest are above 20 years old (Table 1E). Table 5 F shows the years of research and development activities. Majority (79 percent) of the companies have experience of R & D activities of 6 to 10 years, 16 percent of companies have R & D experience of 11 to 15 years and only 5 percent of the companies have R & D experience of less than 5 years.

## **Results**

Under account receivable management, credit standards and credit evaluation are a necessary part of the management decision framework. Questions which must be raised concern: to whom should credit; be extended, how much and on what terms? The checklist on the following was used (Zetocha et al., 1984, p.4) to evaluate the credit control procedures.

Majority of the firms have no standard operating procedures (SOP) of credit control policy. However, they do have regular practice of using credit application to screen new customer and renew yearly. The most surprising part under this checklist showed that almost all (204 out 209) respondents opined that credit terms are not clearly stated in the invoice. Similarly, special instructions are not found followed carefully.

*Table 2* Application of credit control policy checklist in Nepalese pharmaceuticals companies

<b>Credit control policy</b>	<b>Yes</b>	<b>No</b>	<b>Not Applicable</b>	<b>Total</b>
Do you have SOP of credit control policy	65	74	70	209
Do you regularly use a credit application to screen new customers?	45	81	83	209
Application renew customers yearly	11	103	95	209
Is there credit terms clearly stated in the invoice?	5	85	119	209
Are invoices prepared after evaluation of credit practices ?	11	105	93	209
Are customers' special instructions followed carefully?	5	106	98	209
Do you determine your average collection period on a regular basis?	67	80	62	209
Do you compare your collection period with industry averages?	45	82	82	209
Do you compare your current collection period with your previous experience ?	8	96	105	209
Do you compare your collection period with your payment terms?	10	82	117	209
Do you have a monthly aging of all outstanding accounts?	7	100	102	209
When a problem is identified, is corrective action prompt and firm?	4	95	110	209
Do you periodically review your credit policy?	5	74	130	209

There exists a strong relationship between a firm's profitability and receivables management efficiency (Lazaridis and Tryfonidis, 2006). Out of 209, only 67 were found using average collection period on a regular basis and only 45 out of 209 opined to compare with industry average. Similarly, very few (6 out of 209) were found comparing collection period with previous experience. These all showed that application of credit control policy was poorly followed in Nepalese pharmaceuticals companies.

According to Zetocha et al. (1984), the credit applicant is the first and most important source of information. If applicants are willing and able to provide the necessary basic personal information, the remainder of the investigation and evaluation can go much more quickly and smoothly. In order to identify the assessment of the credit customer through grading form, the following pattern were asked to the respondents and majority of the customers ranked references at the most followed by payment record, residence, net worth, reputation, size of the operation and cash flow or income.

*Table 3* Application of credit customer grading form in Nepalese pharmaceuticals companies

<b>Credit qualities</b>	<b>Good 3</b>	<b>Fair 2</b>	<b>Poor 1</b>	<b>Grade</b>	<b>Rank</b>
Cash Flow or Income					<b>V</b>
Size of Operation					<b>IV</b>
Residence					<b>III</b>
References					<b>I</b>
Net Worth					<b>III</b>
Payment Record					<b>II</b>
Reputation					<b>III</b>

Table 4 presents the respondents opinion on use of the sources obtaining information of the credit applicants. Majority of the respondents (106 out of 209) replied single source where 103 out 209 respondents pointed out multiple source of information about the credit applicant.

*Table 4* Obtaining information of the credit applicant in Nepalese pharmaceuticals companies

<b>Information the credit applicant</b>	
Single source	106
More than one source	103

The survey asked the respondents whether they used 5C's credit scoring, financial statement, ratio analysis or any others technique to grant credit to the customers. In fact, 36% of the respondents used ratio analysis to grant credit. Interestingly, only 8 of the respondent said that they apply 5 C's credit scoring technique to grant credit.

*Table 5* Application techniques used to grant credit in Nepalese pharmaceuticals companies

Techniques used to grant credit (1= 5 C's Credit Scoring, 2= Financial statement, 3= ratio analysis, 4 = others)	
5 C's credit scoring	8
Financial statement	55
Ratio analysis	75
Others	71

The survey asked the respondents to rank the best practice tips for effective credit control in their company. Results in Table 6 showed that highest weighted value opined on the issue monthly statements of account showing invoices paid and still outstanding followed by set a “minimum order” level for credit sales, use fully documented terms of trade, conduct regular credit checks on your main customers, obtain a personal guarantee from “doubtful” customers, set a credit limit for each new customer, make a credit check on each new customer (bank references –v/s- trade references), decide which customers will receive credit – credit is not an automatic entitlement and ensure sales staff are familiar with company’s credit policy.

*Table 6* Application of “best practice” tips for effective credit control in Nepalese pharmaceuticals companies

“Best practice” tips for effective credit control (1 to 5)	Rank					Total	WV	Mean	SD
	1	2	3	4	5				
Ensure sales staff are familiar with company’s credit policy	26	37	60	43	43	209	667	3.19	1.29
Make a credit check on each new customer (bank references –v/s- trade references).	10	20	71	77	31	209	726	3.47	1.01
Obtain a personal guarantee from “doubtful” customers	5	18	62	78	46	209	769	3.68	0.99
Set a “minimum order” level for credit sales	3	12	55	90	49	209	797	3.81	0.91
Decide which customers will receive credit – credit is not an automatic entitlement		53	70	53	33	209	693	3.32	1.02
Set a credit limit for each new customer	7	34	67	45	56	209	736	3.52	1.15
Conduct regular credit checks on your main customers	7	10	58	83	51	209	788	3.77	0.98
Use fully documented Terms of Trade	8	16	50	71	64	209	794	3.80	1.08
Issue monthly statements of account showing invoices paid and still outstanding	4	16	38	81	70	209	824	3.94	1.00
Divide your customers into Good, Average and Bad, and set a Collection Policy for each category	9	14	48	65	73	209	806	3.86	1.10
Properly allocate payments against specific unpaid invoices	18	101	88	2		209	492	2.35	0.65
Phone major accounts before the due date of payment to ensure there are no disputes and that the way is clear for payment to be made on time	7	26	89	65	22	209	696	3.33	0.94
Conduct an aged debt analysis each week	9	23	59	64	54	209	758	3.63	1.11

The survey also asked the respondents to rank the practices of credit limit in their companies. Table 7 showed that highest weight of the respondent opinion is on the credit limit decreases sales followed by credit limit discourages customers relations, credit limit does not motivate marketing people and credit limit decrease risk of non-payment.

Table 7 Opinion on practice of credit limit in Nepalese pharmaceuticals companies

Opinion on practice of credit limit (1 to 5)	Rank					Total	WV	Mean	SD
	1	2	3	4	5				
Credit limit decreases sales	-	4	53	76	76	209	851	4.07	0.83
Credit limit decrease risk of non-payment	-	16	110	77	6	209	700	3.35	0.66
Credit limit does not motivate marketing people	-	23	87	70	29	209	732	3.50	0.87
Credit limit discourages customers relations	-	17	76	67	49	209	775	3.71	0.92

### Conclusions

Several conclusions were drawn from the results of the survey on the topic account receivable management practice of Nepalese pharmaceuticals companies. First, in the account receivable area which is called pre-sale area, pharmaceuticals companies may want to establish credit control policy under which there is regular practice of using credit application to screen new customer and renew yearly. Second, analysis of average collection period was not perfectly in practice by all the companies. Third, respondents appeared to prefer “references” for grading credit customer and mostly choice ratio analysis to grant credit. Finally, respondents highlighted the issue of monthly statements of account showing invoices paid and still outstanding followed by set a “minimum order” level for credit sales and gave highest weightage for the credit statement on “credit limit decreases sales”.

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