CHAPTER : IV

CREDIT POLICY OF THE MATCH INDUSTRY IN SIVAKASI

The previous chapter has dealt with the sales management of the match industry in Sivakasi and explained the various functions involved in sales. It is found that credit sales is a developed trade practice followed by a majority of the match units in Sivakasi. Extending trade credit to customers results in receivables or book debts. Now-a-days the management of receivables is being considered as a crucial area in financial management. The overall management of receivables consists of three different activities namely,

a) Determination of credit policy
b) Evaluation of prospective customers, and
c) Formulation of collection policy

This chapter is devoted to study the credit policy of the match industry in Sivakasi.

TRADE CREDIT

The fundamental nature of credit is that element of trust exists between the buyer and seller. The very word credit derives from the Latin word "credere" which
means "to trust". "Buy now – Pay later" is the abiding practice of credit; only the techniques change to match the demands or needs of the society. Traders in every period have been using credit as fully as they need [1].

The fundamental purpose of all business is to make surplus. Usually, the introduction of carefully developed credit facilities can achieve an increase in turnover for the following reasons [2]:

- More new customers are attracted 'through the door and onto the floor'. This increase in floor traffic is, itself, a morale booster to any sales force.

- Sales can be made to those customers who can't immediately pay cash and impulse buying is encouraged, and

- Special credit terms can be arranged during the period of slack season, to assist in the promotion of 'slow moving line'.

The main lesson to be derived from the history of credit is that the purpose of granting credit is to promote sales. When a match unit sells its products on credit, the unit is to have granted trade credit.
Trade credit is a credit which is allowed by a seller to customer on the basis of some established credit terms i.e. conditions of sale and credit standards.

RECEIVABLES

Bills receivables or Debtors may arise only when a firm extends trade credit to its customers. The book debt or receivable arising out of credit has the following three characteristics [3]:

- Firstly, it involves an element of risk which should be carefully analysed.
- Secondly, it is based on economic value. The buyer receives the economic value immediately at the time of sale, while the seller can expect an equivalent value on the latter period, and
- It implies futurity.

Receivables constitute a substantial portion of current assets. In Indian industries, after inventories, trade debtor is the major component of current assets. They form nearly about one-third of current assets [4]. Receivables may be termed as "Accounts Receivables".
Conversion of receivables into cash is a prominent function among all the other functions involved in a operating cycle of working capital. It involves risk since it is primarily concerned with the outsiders and it requires a stream of effort and time for smooth flow of operating cycle of a firm.

The duration of time needed to complete the following chain of events in case of manufacturing firm is called operating cycle [5].

a. Conversion of cash into raw-materials
b. Conversion of raw-materials into work-in-progress
c. Conversion of work-in-progress into finished stock
d. Conversion of finished stock into accounts receivables through credit sales, and
e. Conversion of accounts receivables into cash.

This cycle will continue throughout the life of the business. The operating cycle of a match manufacturing firm is shown in Fig. 4.1.
Fig. 4.1 OPERATING CYCLE OF A MATCH MANUFACTURING FIRM
PURPOSE OF RECEIVABLES

Accounts receivables represent a significant portion of current assets that is financed on a continuing basis. The commitment of funds to accounts receivables is expected to maximise the sales as well as profit.

The three main purposes of financing receivables are: to achieve growth in sales, to increase profits and to meet competition [6]. The present study has attempted to find out the purpose of extending credit in match industry of Sivakasi. The opinions of the sample units under study are disclosed in table 4.1.

TABLE 4.1
PURPOSE OF RECEIVABLES

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Purpose</th>
<th>No. of units</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>To increase the sales and profit</td>
<td>15</td>
<td>57.69</td>
</tr>
<tr>
<td>2.</td>
<td>To meet market competition</td>
<td>5</td>
<td>19.23</td>
</tr>
<tr>
<td>3.</td>
<td>For growth and development</td>
<td>6</td>
<td>23.08</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>26</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Sample Survey
The scanning of the table 4.1 reveals that out of 26 units, 15 units (57.69 per cent) extend credit for increasing the sales and profit, 5 units (19.23 per cent) for meeting competition and 6 units (23.08 per cent) for growth and development of business.

It is inferred that the overall aim of committing funds in accounts receivables is to generate high sales and profit.

DETERMINATION OF CREDIT POLICY

The success or failure of a business depends primarily on the demand for its products - as a rule, the higher the sales, the greater the profits and it improves the wealth of the business. Sales depends on a number of factor, some exogenous but others controllable which affect demand are, sales prices, product quality, advertising and the firm's credit policy [7].

Credit policy is an important strategy of a firm to market its products. The factors which shape the credit policy are tradition of the trade, approach of the competitors, general market competition - sellers's market and buyer's market, availability of extra production capacity, excessive inventory and the status of the firm.
In simple, credit policy refers to those decision variables that influence the amount of credit i.e. investment in receivables [8]. It mainly involves decisions regarding the period of credit and cash discount to be allowed for making payment within a stipulated period [9].

TYPES OF CREDIT POLICY

The majority of the firms in all the industries except wholesale trade formulate and follow their own independent credit policy. The credit policy of any firm may be broadly classified as lenient (loose or expansive) credit policy and stringent (tight or restrictive) credit policy.

Firms following lenient credit policy tend to sell on credit to customers liberally. Credit is granted to the customers whose credit worthiness is not known or is doubtful. On the other hand, firms following stringent credit policy are very selective and alert in extending credit. A firm confronted with a competitive market adopts normal credit policy.

The match industry is associated with competitive market. It has to formulate credit policy which is normal in nature. An analysis over the credit policy adopted
by the sample units are clearly explained in table 4.2 and in diagram 4.1.

TABLE 4.2
TYPES OF CREDIT POLICY ADOPTED

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Types of credit policy</th>
<th>No. of units</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Lenient</td>
<td>5</td>
<td>19.23</td>
</tr>
<tr>
<td>2.</td>
<td>Normal</td>
<td>13</td>
<td>50.00</td>
</tr>
<tr>
<td>3.</td>
<td>Stringent</td>
<td>8</td>
<td>30.77</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>26</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Sample Survey

The Table 4.2 has highlighted the fact that out of 26 sample units half of them are adopting 'Normal credit policy' 5 units (19.23 per cent) are allowing credit liberally and the rest of 8 units (30.77 per cent) are following the 'Stringent Credit Policy'. It has brought to light that 50% of the units are following credit policy which is in between the two extremes i.e. lenient and stringent credit policies.
Dig. 4.1 CREDIT POLICY OF SAMPLE UNITS

Stringent Credit Policy (30.3%)

Normal Credit Policy (50.0%)

Lanient Credit Policy (19.2%)
During the survey, the units adopting lenient credit policy are asked to give their reasons for adopting the same. The reasons expressed by them are given in table 4.3.

**TABLE 4.3**
REASONS OR ADOPTING LENIENT CREDIT POLICY

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Reasons</th>
<th>No. of units</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Market fluctuations</td>
<td>3</td>
<td>60.00</td>
</tr>
<tr>
<td>2.</td>
<td>Customer's reliability</td>
<td>2</td>
<td>40.00</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>5</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Sample Survey

It is evident from the table 4.3 that market fluctuations and the customer's reliability are the two reasons for adopting the lenient credit policy by the match units in Sivakasi.

**VARIABLES OF CREDIT POLICY**

Accounts Receivables are equal to the product of sales per day and the collection period [10]. Both of these factors are influenced by a set of controllable
factors which are called as variables of credit policy. The four major credit policy variables are credit period, credit standard, collection policy and Discount [11]. The variables of credit policy are discussed below.

CREDIT STANDARDS: A credit policy of a firm should answer the question about the credit standard to be applied in accepting or rejecting an account for credit granting. Credit standard refers to the minimum financial strength of acceptable credit customers [12].

The credit standard followed by a firm has an impact on sales and receivables. The sales and receivables are likely to be high if the credit standard of the firm is relaxed. In contrast, if the firm has relatively tight credit standard, the sales and receivables are expected to be relatively low [13].

In general, liberal credit standard tends to increase the sales and attracts more number of customers. This is, however, accompanied by a higher incidence of bad debt losses, a larger investment in receivables and a high cost of collection. It is the reverse case when a firm applies strict credit standards [14].
Determining the optimal credit standard involves equating the incremental costs of credit to the incremental profits on the increased sales. Incremental costs include production and selling costs plus those costs associated with the quality of new customers which is called as credit quality costs [15]. The credit quality cost consists of bad debt or default losses, increase in collection cost and increase in cost of capital tied up in the additional receivables. This approach is called "trade-off between benefit and cost".

The factors to be considered while deciding the credit standard are the collection cost, the average collection period, level of bad debt losses and the level of sales. During the slack season, a firm may opt for liberal credit standard in order to boost up the sales. In simple, credit standard evaluates the credit worthiness of the customers.

The sample units of Sivakasi evaluate the credit worthiness of the customers who approached for fresh credit. The strength of a customer is determined by observing the reliability of the customers for first six months of cash sales transaction. During the slack season, the
match units may liberalise the credit standard adopted by them.

But, it is interesting to note that the firms are not applying any developed approach to fix or relax credit standard. Match units design the credit standard arbitrarily. The present study has found that even large sized units have not developed any mathematical approach to analyse the trade off between the proposed change in the sales and in the costs.

CREDIT TERMS: The situations under the firm sells goods on credit to its customers are called credit terms. Two important components of credit terms are credit period, and cash discount.

The second decision in accounts receivables management is the credit terms [16]. After establishing the credit standard and assessing the credit worthiness of the customers, the firm determines the terms and conditions on which the trade credit is available. Thus, credit terms refer to those terms and conditions on which the firm extends credit to its customers [17].

a) Credit period: Credit period refers to the length of time allowed to the customers to pay their purchases.
In other words, the time duration for which the credit is extended to the customer, is called credit period.

The decision regarding the length of the credit period directly affects the volume of investment in receivables and indirectly the net worth of the concern. Lengthening the credit period pushes sales up by inducing existing customers to purchase more and attracting additional customers [18].

However, it is accompanied by a larger investment in receivables and a higher incidence of bad debt losses. Shortening credit period would have opposite effects. It tends to lower sales, decrease in investment of receivables and reduce the incidence of bad debt losses [19]. The credit period varies from industry to industry.

An analysis over the credit period allowed by the sample match units clearly brings to light that credit periods fixed by the sample units vary from one unit to another. The credit periods allowed by the sample units to their customers are summarised in the table 4.4.
TABLE 4.4

CREDIT PERIOD ALLOWED TO THE CUSTOMERS

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Credit period (in days)</th>
<th>No. of units</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>7 - 15</td>
<td>2</td>
<td>7.69</td>
</tr>
<tr>
<td>2.</td>
<td>15 - 21</td>
<td>3</td>
<td>11.54</td>
</tr>
<tr>
<td>3.</td>
<td>21 - 30</td>
<td>2</td>
<td>7.69</td>
</tr>
<tr>
<td>4.</td>
<td>30 - 45</td>
<td>15</td>
<td>57.69</td>
</tr>
<tr>
<td>5.</td>
<td>45 - 60</td>
<td>4</td>
<td>15.30</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>26</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Sample survey

A scanning of the table 4.4 reveals that out of 26 units, a vast majority of the units i.e. 15 units (57.69 per cent) allow 30-45 days as credit period to their customers to pay the amount on credit sales transactions. The credit period enjoyed by the customers of other 7 and 4 units (26.92 and 15.39 percent) is 7-30 days and 45-60 days respectively.

It is inferred that the match units of Sivakasi normally allow 30-45 days as credit period to their
Dig. 4.2 CREDIT PERIOD ALLOWED BY
SAMPLE UNITS

43 - 50 Days (18.4%)
7 - 15 Days (7.7%)
15 - 21 Days (11.3%)
21 - 30 Days (7.7%)
30 - 45 Days (37.7%)
customers to make payment on credit sales. It is evident from Diagram 4.2.

The various factors influence the sample units for deciding the credit period are summarised in table 4.5.

**TABLE 4.5**

**FACTORS INFLUENCING THE CREDIT PERIOD DECISION**

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Factors</th>
<th>Rank I-4</th>
<th>II-3</th>
<th>III-2</th>
<th>IV-1</th>
<th>Total W.A. mean</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Market condition</td>
<td>12 (3)</td>
<td>6 (2)</td>
<td>16 (8)</td>
<td>9 (9)</td>
<td>43</td>
<td>4.3</td>
</tr>
<tr>
<td>2.</td>
<td>Repayment capacity</td>
<td>24 (6)</td>
<td>24 (8)</td>
<td>14 (7)</td>
<td>-</td>
<td>62</td>
<td>6.2</td>
</tr>
<tr>
<td>3.</td>
<td>Establishment of customers</td>
<td>28 (7)</td>
<td>18 (6)</td>
<td>10 (5)</td>
<td>4</td>
<td>60</td>
<td>6.0</td>
</tr>
<tr>
<td>4.</td>
<td>Bank's norms</td>
<td>36 (9)</td>
<td>12 (4)</td>
<td>-</td>
<td>8</td>
<td>56</td>
<td>5.6</td>
</tr>
</tbody>
</table>

Source: Sample Survey

Note: Figures in brackets indicate number of sample units; I-4, II-3, III-2 and IV-1 represent ranks and weights.

W.A. mean = Weighed Arithmetic Mean.
It is learnt from the table 4.5 that 'Repayment capacity' ranked first by the sample units in deciding the credit period. The other factors in the order of importance given by the units are establishment of customers, bank's norms and market competition.

It is noted that repayment capacity of the customers is being considered as the primary factor while deciding the credit period allowed to the customers.

b) Cash Discount: There are two kinds of discount namely cash and trade discount. Cash discount, is virtually, an aspect of credit terms. Many firms offer cash discount to their customers in order to induce them to pay their debts before the date and not a compensation for the so-called prompt payment [20].

The changes in the discount rate, would have both positive effects and negative effects like increase in sales, and reduction in prices [21].

In fact, cash discount, if availed of, besides being profitable to a debtor, is beneficial to the firm who extends credit. It increases the turnover rate of working capital and enables the credit firm to operate a higher volume of business with less investment in working capital [22].
The present study has observed that the sample units are providing both kinds of discount viz. trade and cash discount. It is seen in the table 4.6.

TABLE 4.6
KINDS OF DISCOUNT OFFERED

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Kinds of discount</th>
<th>No. of units</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Trade</td>
<td>8</td>
<td>30.77</td>
</tr>
<tr>
<td>2.</td>
<td>Cash</td>
<td>1</td>
<td>3.85</td>
</tr>
<tr>
<td>3.</td>
<td>Both</td>
<td>1</td>
<td>3.85</td>
</tr>
<tr>
<td>4.</td>
<td>No discount</td>
<td>16</td>
<td>61.53</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>26</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Sample Survey

As could be seen from the table 4.6 that 8 units (30.77 per cent) offer trade discount; 1 unit (3.85 per cent) offers cash discount and another one unit offers both trade and cash discount. It is also understood that 16 units (61.53 per cent) out of 26 units do not offer any discount to the customers.
In order to find out the most influencing factor for providing discount among the three factors identified, the respondents who offer discount are asked to give ranks on the basis of their importance. The opinions are processed with the help of Weighted Arithmetic Mean and presented in table 4.7.

**TABLE 4.7**

**FACTORS INFLUENCING THE DISCOUNT OFFERING**

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Rank</th>
<th>Total scores</th>
<th>W.A. Mean</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I-3</td>
<td>II-2</td>
<td>III-1</td>
<td></td>
</tr>
<tr>
<td>1. Market slackness</td>
<td>15 (5)</td>
<td>8 (4)</td>
<td>1 (1)</td>
<td>24</td>
</tr>
<tr>
<td>2. Dealers' wish</td>
<td>9 (3)</td>
<td>8 (4)</td>
<td>3 (3)</td>
<td>20</td>
</tr>
<tr>
<td>3. Policy of the firm</td>
<td>6 (2)</td>
<td>4 (2)</td>
<td>6 (6)</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: Sample Survey

Note: Figures in brackets indicate number of sample units.

I-3, II-2 and III-1 represent ranks and weights.

W.A. Mean - Weighted Arithmetic Mean.
It is crystal clear from the table 4.7 that the market slackness is the most influencing factor to decide the discount offerings. The other factors in the order of importance are dealers' wish and policy of the firm.

The present study has found the fact that nine units are providing trade discount to the customers. Hence it becomes necessary to analyse and discuss the trade discount offering.

Out of the nine units offer trade discount, only one unit has the practice of offering a different rate of discount i.e. unstable rate of discount. This unit is extending a minimum of one per cent and a maximum of four per cent as trade discount. The remaining eight units are providing a standard rate of discount i.e. stable discount policy. It is clearly shown in table 4.8.

**TABLE 4.8**
TRADE DISCOUNT OFFERING

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Rate of discount</th>
<th>No. of units</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>1%</td>
<td>3</td>
<td>37.50</td>
</tr>
<tr>
<td>2.</td>
<td>1.5%</td>
<td>4</td>
<td>50.00</td>
</tr>
<tr>
<td>3.</td>
<td>Re.1/- per bundle</td>
<td>1</td>
<td>12.50</td>
</tr>
</tbody>
</table>

Source: Sample Survey
The table 4.8 brings the various rates of trade discount offered by the sample units. 4 units (50 per cent) provide trade discount at the rate of 1.5% and 3 units (37.50 per cent) offering 1% as trade discount and the remaining one unit has offered Re.1/- per bundle, as trade discount.

SUMMARY

Trade credit is a credit allowed by a seller to a customer on the basis some established credit terms. When a firm extends trade credit to its customers, it will create bills receivables or trade debtors which are termed as 'Accounts Receivables'. Technically speaking, Accounts Receivables amount to the product of sales per day and the collection period. Thus the management of bills and debtors is collectively called as Receivables or Accounts Receivables management.

Accounts receivables represent a significant portion of current assets and that is financed on a continuing basis. The main purposes of financing of receivables are to increase the sales and profit and meet competition.

The overall management of Accounts receivables consists of three different aspects namely, determination
of credit policy, evaluation of prospective customers and formulation of collection policy.

Nearly half of the match units are following credit policy, which is in between the two extremes i.e. Lenient credit policy and Stringent credit policy, it is commonly described as 'Normal credit policy'. The credit period, credit standard, collection policy and discount (cash) are the four major variables of credit policy.

Credit standard refers to the minimum financial strength of acceptable credit customers. The match units in Sivakasi, normally determine the strength of the customers through the transactions held on cash basis during the first six months or any stipulated period. Such period is called as 'Credit Evaluation Period'.

The two components of the credit terms are credit period and the cash discount. Credit period denotes the length of time permitted to the customers to pay their dues. The credit period allowed is varying from one match unit to another. The match units of Sivakasi normally allow 30-45 days as credit period to the customers.
The factors influencing the match units to fix the credit period are repayment capacity, establishment of customers, bank's norms and market conditions.

Cash discount indicates the rate of discount offered to encourage the customers to settle their dues before the actual due date of maturity. The match units of Sivakasi are not interested in offering cash discount. The survey reveals that out of 26 units, only two units have offered cash discount to the customers.
REFERENCES


[2] Ibid., P.300.


