Chapter-6 Debtors Management

Question 1. Calculate the Average Collection Period in each of the following cases:

Credit Policy	Customers avails cash discount
2/10, net 30 days	25%
3/15, net 40 days	20%
1/20, net 50 days	30%

Question2. Calculate Debtors turnover ratio in each of the following cases:

(a) Credit sales 50 lakhs p.a., Current level of receivables(debtors) is 5 lakhs.
(b) Average collection period is 45 days.
(c) Average collection period is 2 months.

Question3. Calculate average collection period in each of the following alternative cases: (assume 360 days in year)

Case A: Debtors turnover ratio is 6.
Case B: Current level of receivables Rs.60 crores, current annual credit sales Rs. 600 crores.
Case C: Average level of receivables Rs. 1,00,000, Average net credit sales per day Rs. 2,500.
Case D: Credit terms are 2/10, net 30, 25% of the credit customers avails cash discount facility.

Question4. Calculate the opportunity cost of investment in receivable in each of the following alternative cases: (assume 360 days in a year)

Case A: Total sales Rs. 62,50,000, cas sales 20% of the total sales, variable cost 85% of sales, fixed cost Rs. 3,12,500, bad debts 5 %, Average collection period 90 days, required rate of return 12%.

Case B: Total sales Rs. 125 lakhs, cash sales 25% of credit sales, bad debts 5%, selling price per unit Rs. 500, average cost per unit Rs. 450, Debtors turnover ratio 4, required rate of return 12%.

Question5. Unani Cosmetics, manufacturer of herbal cosmetic products, has an annual sale of Rs.50 lakhs. It offers 30 days credit on sales. The fixed costs are Rs.5 lakhs and the variable costs are 80% of sales.

The company is considering a change in its credit policy. Based upon its knowledge of market response, it has estimated likely sales figures against each of the proposed collection period as follows:-

Policy	Collection Period	Projected Sales (in lakhs)
A	45 days	56
B	60 days	60
C	75 days	62
D	90 days	63

If expected rate of return is 20%, which policy should be adopted and why ?

Question.6 A trader whose current sales are in the region of Rs. 6 lakhs per annum and an average collection period of 30 days want pursue a more liberal policy to improve sales. A study made by a management consultant reveals the following information :-

Credit Policy	Increase in collection period	Increase in sales	Present default anticipation
A	10 days	Rs. 30,000	1.5%
B	20 days	Rs. 48,000	2%
C	30 days	Rs. 75,000	3%
D	45 day	Rs. 90,000	4%

The selling price per unit is Rs. 3. Average cost per unit is Rs. 2.25 and variable cost per unit is Rs.2.
The current bad debts los is 1%. Required return on additional investment is 20%. Assume a 360 days year.

Which of the above policies would you recommend for adoption ?

Question 7. Sales manager of a company proposes to sell goods to a group of new customers with 10% risk of non-payment. This group would require one & half month's credit and likely to increase sales by Rs. 1,00,000 per annum. Production and selling expenses amount to 80% of sales and income tax rate is 30%. The company's minimum required rate of return after tax is 25%,.

Should the sales manager's proposal be accepted ?

Find the degree of risk of non- payment that the company should be willing to assume, if required rate of return (after tax) is (i) 30% ; (ii) 40%; or (iii) 60%.

Question 8. The present credit terms of Creation Ltd. are 1/10, net 30. Its annual sales are Rs.80 lakhs, its average collection period is 20 days, its variable cost and average total costs to sales are 0.85 and 0.95 respectively and its cost of capital is 10%. The proportion of sales on which customers currently take discount is 0.5. Creation Ltd. is considering relaxing its discount terms to 2/10,net 30. Such relaxation is expected to increase sales by Rs.5 lakhs, reduce the average collection period to 14 days and increase the proportion of discount sale to 0.8. What will be the effect of relaxing the discount policy on company's profit? Take an year as of 360 days.

Question 9. Gel Corporation presently gives credit terms of 'net 30 days'. It has Rs.600 lakhs in credit sales and its average collection period is 45 days. To stimulate sales, the company may give credit terms of 'net 60 days' with sales expected to increase by 15%. After the change, the average collection period is expected to be 75 days with no difference in payment habits between old and net of customers. Variable costs are Rs.0.8 for every Re.1 of sales; and the company's before tax required rate of return on investment in receivable is 20%. Assume 360 days in a year. Should the company extend its credit period?

Question 10. Peacock Ltd. has been engaged in manufacturing of textiles. It has a current sale of Rs.30 lakhs p.a. The cost of sale is 75% of sales and bad debts are 1% of sales. The cost of sales comprises 80% variable and 20% fixed cost, while the company's required rate of return is 12%. The company currently allows customers 30 days credit, but is now considering increasing this to 60 days credit in order to attract more customers.

It has been estimated that this change in policy will increase sales by 15%, while bad debts will increase from 1% to 4%. It is expected that the policy change will not result in any increase fixed cost, creditors and stock level.

Should Peacock Ltd. introduce proposed policy?

Question 11. ABC Ltd. currently has sales of Rs.30,00,000 with an average collection period of two months. At present, no discounts are offered to the customers. The management of the company is thinking to allow a discount of 2% on cash sales which will result as under:

(i) The average collection period would reduce to one month.
(ii) 50% of customers would take advantage of 2% discount.

The company would normally require a 25% return on its investment.
Advise the management whether to extend the discount on cash sales.

Question 12. Ash Ltd. follows collection policy as detailed below:

(i) 10% of the sale is collected in the same month.
(ii) 20% of the sale is collected in the 2nd month.
(iii) 40% of the sale is collected in the 3rdmonth.
(iv) 30% of the sale is collected in the 4thmonth.

Sales of the company for the first three quarters of the year are as follows:

Month of the quarter	Quarter –I	Quarter-II	Quarter-III
1	15,000	7,500	22,500
2	15,000	15,000	15,000
3	15,000	22,500	7,500
	45,000	**45,000**	**45,000**
No. of working days	90	90	90

You are required to work out average age of receivables.