

Research Article

Assessment of Structure of Credit Policy and Sales Trend of Sarbottam Cement

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A B S T R A C T

The Number of brands in cement industry is growing and with increase in number of brands, it is essential to understand how the consumers are attracted to the respective cement brands. The overall objective of the research is to assess the structure of credit policy and sales trend of Sarbottam Cement. For the study, Sarbottam Cement has been selected for the assessment of credit policy of Sarbottam cement after assuring its quality.

The nature of the research is descriptive. For the credit policy Primary data were collected by the method of Key Informant Interview. The sales Trend of Sarbottam Cement showed growth from last year. There was increase in sales from September till April. The credit policy of Sarbottam Cement was found defensive as it aims to reduce bad debt rather than increasing the sales by providing credit period with more flexibility. Its credit term is found to be NRs 10 discount if payment is done within 10 days of the generation of invoice and overall payment to be made is within 30 for Cheque transaction. Similarly, for BG/LC the credit terms are NRs 10 discount if payment is done within 10 days of the generation of invoice and overall payment to be made is within 30 days for retailers and NRs 5 discount if payment is done within 15 days of the generation of invoice and overall payment to be made is within 60 days for Projects. For the Sarbottam Cement, in order to increase sales further it is recommended to increase the credit period and credit terms.

Keywords: Sales Trends, Dealership, Credit Manual

Introduction

Cement is most important material for construction industry. It is used almost in every construction. Although Nepal is not developed country and lots of development activities are going on and the demand of cement is growing day by day be it for buildings, bridge, road or hydropower project. Nepalese cement industries are continuously striving to meet the demand of cement. To succeed an industry or organization the product should be liked by the people. It

should attract consumer in order to get good market share but the immediate and serious question arises, is what attracts the customers is only the quality of cement or the credit policy. How is the credit policy and how dealers are granted the credit limit in the market of the cement industries is matter of intriguing study. Effective credit Policy is very much important for the organizational success because no matter what an organization manufactures, at the end of the day it eventually wants to earn the profit

by selling the product in the market. Standard quality of the cement produced by Sarbottam Cement was assured.² Though field test of cement showed some defects like lump formation and absence of manufacturing date, the production of cement can be considered consistent within the time frame of 6 months. About the strength of Sarbottam cement it can be concluded that it is higher compared to other cement when tested under the similar condition. The strength corresponds to 53 grades of cement as given by Indian Standard Institution.. The success of an organization or company depends upon its Credit Policy if quality is maintained. To the current scenario of the cement industries, this research has importance in order to find out the answerable questions regarding the credit policy after assuring quality variations of Sarbottam Cement.

Research Objective

The overall objective of the research is to assess the structure of credit policy and sales trend of Sarbottam Cement.

Literature Review

Credit

Credit is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest. Credit also refers to an accounting entry that either decreases assets or increases liabilities and equity on the company's balance sheet. Additionally, on the company's income statement, a debit reduces net income, while a credit increases net income¹⁰

Determinants of Length of Credit Period

According to Ross et al (2002), factors responsible for length of credit period are:

- a. Buyer's inventory and operating cycle
- b. Perishability and collateral value
- c. Consumer demand for the product
- d. Cost, profitability and standardization
- e. Credit risk of the buyer
- f. The size of the account
- g. Competition in the product market
- h. Customer type

Elements of Credit Policy

The elements of credit Policy are as follows:

Credit Standard

It refers to the required financial strength of acceptable credit customers. The tighter credit standards reduce bad debt losses but may reduce sales. Credit standard consists of evaluation of credit risks and to do so, credit managers consider the five C's of credit.

Credit Term

The Company should lower its credit terms if benefits are greater than costs of increased sales. Credit terms involve credit period, discount given, and discount period. Credit term may be stated as "2/10, net 30" It means that a 2 percent discount is given if the bill is paid before the tenth day after the date of invoice. The total credit period provided is for 30 days. The credit terms consist of the following elements:

- Credit Period:

Credit period refers to time provided to the customer for making payment. The shorter period reduces sales outstanding and average account receivable, but it may discourage sales. Credit period should be changed if additional benefits are greater than the costs.

- Cash Discount:

Cash discount refers to the discount given for early payment. It represents how rapidly payment must be made to qualify for the discount. The cash discount lowers the price. However, it attracts new customers and reduces Sales outstanding.

- Discount Period:

Length of discount period also affects average collection period but the effect is not as clear as before. Companies usually move slowly toward optimal credit policy.

Collection Policy and Procedures

Collection policy and procedures also affect the size of investment in receivables. If the collection policy and procedures are efficient it will reduce average collection period and bad debt losses. Collection procedures should involve such things as letter sent, phone calls, personal calls, turning the account to collection agency and legal actions or compromised settlements.⁷

Net 30 Credit Terms Calculation

For net 30, calculators are not necessary when one understands how the system works. If the buyer decides not to take advantage of the 2% discount by paying within ten days, the buyer is essentially paying 2% interest for the benefit of holding onto the cash for 20 more days. When considered in this way, the buyer's cost of foregoing the discount amounts to about 36.5% per year. This is because the buyer is essentially paying 2% interest on a 20 day loan; there are 18.25 twenty-day periods in a year; so 18.25 multiplied by 2% equals 36.5% per year ($36.5\% = 2\% \times (365/20)$). Likewise, by foregoing the 1% discount offered for payment within 10 days is costing the buyer 18.25% per year.

$$36.5\% = 2\% \times (365/20)$$

$$18.25\% = 1\% \times (365/20)$$

So, even if the customer doesn't have the cash on hand to pay the bill within the 10 day window, as long as the customer can obtain cash for a borrowing cost less than 36.5% (for a 2% discount) or 18.25% (for a 1% discount), that customer would be better off borrowing the money to pay the bill early so as to benefit from the discount offered by the credit terms.¹¹

Table 2.5. Relationship of Credit Terms and Effective Per Annum Interest Rates

Credit Terms	Effective Per Annum Interest Rates
½ % 10 Days Net 30 Days	9%
1 % 10 Days Net 30 Days	18%
2 % 10 Days Net 30 Days	36%
2 % 10 Days Net 60 Days	14%
2 % 30 Days Net 60 Days	24%
2 % 30 Days Net 120 Days	8%
3 % 10 Days Net 30 Days	54%
5 % 10 Days Net 120 Days	16%
6 % 10 Days Net 60 Days	43%
8 % 10 Days Net 120 Days	26%

Advantages of Trade Credit

Meet the competition: When competitors are making sales on credit to one's customers, one will need to do the same just to stay competitive. If one wants to offer more favorable terms, one might consider giving discounts for prompt payment. For example, instead of just providing 30-days terms, offer 2/10/30. This means that the customers can take a 2-percent discount if he pays within 10 days instead of waiting for the full 30 days to pay.

Increase in sales: An increase in sales may or may not happen when one start selling on credit. If competitors are not offering credit terms, then one will gain sales by offering credit terms, because one's customers will buy from one instead of having to pay cash from competitors.

Better customer loyalty: Offering credit to customers indicates that one respect and trust them to pay their bills before their due dates. Customers will reward these gestures of confidence by continuing to buy from the firm. They will feel a degree of loyalty, and they like to do business with someone who trusts them.

Disadvantages of Trade Credit

Negative impact on cash flow. When one begins selling to customers on credit, his/ her cash flow will be immediately affected. For example, if one begins to offer credit terms for

30 days, the cash that one would normally receive during this time will disappear. One will not have this cash to pay his/ her bills, employee and suppliers.

Need to fund accounts receivable: Since giving credit terms to customers will directly affect his/her cash flow, one must calculate how much his/her accounts receivable will increase and then figure out how one will finance this increase. One may need to use a line of credit with a bank or ask his/her suppliers to extend better credit terms to his/her company.

Taking a credit risk with customers: The creditworthiness of each customer must be investigated. This will require checking the customers' credit references and obtaining a business credit report, such as Dun & Bradstreet.

Keeping up with accounts receivable: Someone needs to keep up with the status of his/her accounts receivable. The reality is that customers don't always pay on time, and somebody needs to make calls or to send out past due notices. If there isn't already an employee in the office who can do this, one may need to hire a new employee.

Potential for bad debts: No matter how well one check a customer's credit rating and references, eventually, there will be someone who doesn't pay. When that happens, if one turns over the account to a collection agency, one will incur fees. If collection efforts don't work, then one will need to write off the receivable as a bad debt.

Offering credit to customers is a necessary evil to remain competitive in the marketplace. If his/her competitors are offering credit terms, one must do the same. Otherwise, his/her customers will abandon him/her.⁹

Currently, Quality is highly focused even Value management seems to be applied in Project Management.⁵ Quality of every component of construction including High Density Polyethylene Pipes to all is focused.³ Contractors are strong in terms human resource in Nepal.⁴ For big picture , it is time to go for zero defects by maintaining high quality during manufacturing. In case of cement even handling behavior is highly important¹. It is important for kaizen to know credit policy as the Sarbottam cement Manufacturing of Nepal is capable to produce quality cement with minimum variations in strength.

Methodology

Research design is descriptive as it is associated with observational studies with inductive approach as data are collected and theory is developed based on the analysis of data. Case study has been chosen as research strategy. Key Informant interview were conducted regarding the documentation of credit policy with the key personnel of Sarbottam Cement like Managing Director, General Managers, Techno Marketing Engineers, credit controllers,

Area Sales Manager and Sales Officers. Total 19 People were interviewed related with the field. For KII, snowball sampling method was selected. All the documents of company related to credit were collected and Content analysis was done. Sales record was analyzed based on trend line. Dealer selection criteria were collected and compared with industrial trends. Dealership process and manual was reviewed too.

Results and Discussion

Sales Trend analysis

The sales trend analysis of Sarbottam cement is presented in the graph. The sales of Sarbottam cement (consisting of both OPC and PSC) shows that sales of cement drastically decrease from Baisakh (April/May) to Asadh (June/July) and increasing upto bhadra (August/September) before declining again in Asoj (September/October). After Asoj sales has increased till baisakh. Upon discussing with sales team, the major reason of declining the sales during asadh was monsoon season. After Shrawan though sales increase it further falls because of festivals.

Sales of cement has increased from 2073 to 2074 BS. The most probable reason is because the Sarbottam cement was new during 2073 BS and many people didn't know about Sarbottam cement. From KII of informants of other cement industries, similar pattern of sales was confirmed. Though the idea was to obtain the sales data and compare, due to company policies sales data were kept confidential.

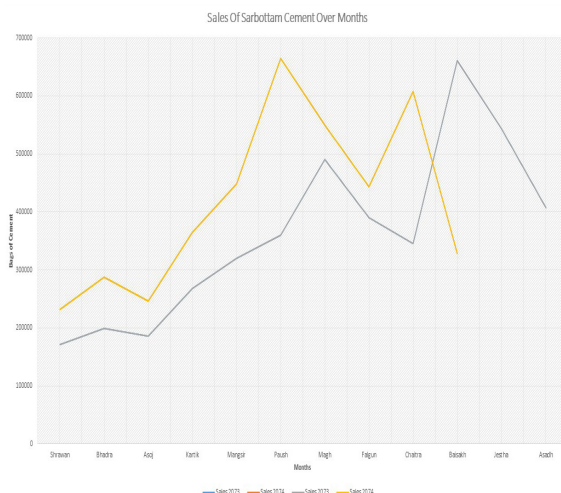


Figure 1. Sales Trend Graph

Credit Policy and Terms

Dealer selection criteria

Dealer selection criteria was not important when SC launched. Earlier target was to penetrate market. So, dealership was granted without any strict consideration. After two years business certain criteria need to be evaluated to grant dealership.

They are Financial situation of the dealer in which the credit history and timeliness of payments are studied. The next criteria are Sales History of dealers where Past sales history of similar products are examined. Information about market that a dealer has is also other criteria that are considered while selecting dealers. Similarly Types of Product that a dealer is dealing or selling and the ways with which the inventories are stored and handled are another criterion.

Dealership Process

First there is desire of a person or firm to be dealer of SC. With the desire firm establishes contact with the respective ASM or SO of the area. This is done by local enquiry or by contacting the head office.

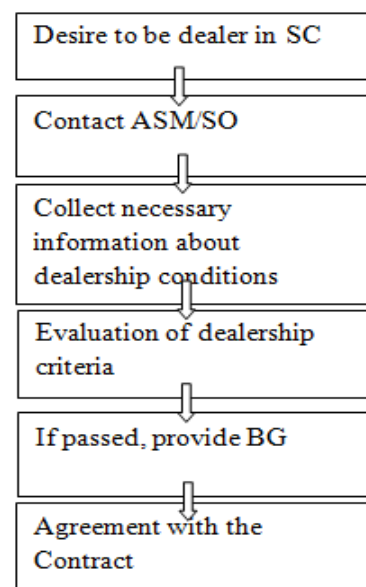


Figure 2. Dealer Selection Process

With the ASM or SO, necessary information is collected and if the firm find them suitable, then next step of dealership begins in which ASM and GM evaluates and approves the credit limit based on the mentioned criterion. Once credit limit is set then firm signs agreement contract with the company and dealership is granted.

Credit Policy Manual

Sarbottam cement has its own credit policy manual which contains guidelines regarding credit policies credit limit and credit durations.

Determination of Credit Worthiness of Dealers

Credit worthiness is determined by inquiring about the dealers in other companies. Some of them are members of its company like Jagdamba cements. SCPL inquiries about their transactions past histories and payment records and determine credit worthiness. For existing dealers, they have their own database regarding their transactions which help them to judge their credit worthiness.

According to the sales policy manual of Sarbottam cement credit worthiness of New and existing dealers are evaluated based on following factors like Establishment period of Dealers, since when the dealer is operating his business in the market? This is an important question regarding determination of credit limit. If there are two dealers A and B, A who has been in business for 10 years and other dealer B who has been in business for 3 years then the credit worthiness of A will be higher. Capacity of investment is another factor. The amount of money invested in the business helps to evaluate the credit worthiness as well. This can be determined by the observation of the shop, if the dealer is dealing with other goods like rebar, tools, wire net and other construction materials instead of selling cement solely then their credit worthiness will be higher. Dealership of number of brands are considered to be another criterion. larger the number of dealership of cement brands a firm has, greater will be the credit worthiness. Term larger means greater than three brands. Similarly, Financial Institutions used in transactions are also referred. The class and status of the financial institutions used for transactions has impact on credit worthiness. Finally, another factor is Past transaction record of Laxmi Steels.. Transactional Database of Laxmi steels private company which is one of the companies under Saurabh groups are used for the evaluation of credit worthiness. If any firm has or had transaction with Laxmi steels, then their payment mode, payment duration and other financial records are analyzed before granting credit.

Setting of Credit Limit to the Dealers

Generally, SCPL deal in bank guarantees (BG). SCPL does not provide credit to new parties without BG. It allows transactions for 40 % extra then BG amount but the firm should provide open dated cheque of such amount prior of receiving the goods. Letter of credit (LC) can also be used to determine credit limit. However, since the cement company is new and has not grasped the market properly it allows to grant credit limit of 3 lakhs by sales officer, 6 lakhs by Area Sales Manager and 10 Lakhs by General managers depending upon their references and intuition regarding clients. The credit limit of existing party for new business year is determined by doubling the total amount of the cement sold and dividing it by 12. Suppose any party X sells cement of 10 Lakh in the last year then his credit limit on cheque for this year will be 20 Lakh divided by 12 that would be 1.667 Lakh.

Modes of payment that are allowed by the dealers

Cash is most preferable way of payment. If a party agrees to pay from cash then the cheque provided by the party should be cashed within one week from date of receipt. BG and LC are other modes of payment.

For Credit analysis Character is evaluated by enquiring credit history, reputation in the market and bank relationships. This is done by SO by interviewing to various person of dealer's locality. If the BG is provided than capacity to repay is not generally evaluated. But if the transaction is made on cheque than it is considered. This is done by enquiry.

To understand how the business has handled previous dealings, SO ask to respective sales persons or clients. Capital is not measured directly as BG assures SC that their payment will be made. In case of cheque, interview regarding capacity and credit answers this factor. Generally collateral is not asked or evaluated. As in BG it is already considered by bank, whereas while trading in cheque, credit history and capacity are recorded.

Departments for Credit Control and Credit Recovery

SCPL has credit control department which exercises credit control. They continuously monitor the due amount of parties and call them. Before passing the order, department checks the credit limit (if it is within the limit, order is passed or else they are withheld) ensures payment status.

There is not any separate credit department. The sales team are provided ageing report weekly and they follow credit recovery procedure by calling and visiting the clients. In case of chronic party's regular calls and follow ups from SA and ASM are done. Chronic party means any party who has not paid any amount since last 90 days of their transactions or party having total outstanding amount greater than 50 % of their transaction which has crossed 120 days.

Credit Control Process

The general credit control process is once the invoice is released, the customers are not reminded to clear their credit within credit period. But 1 week prior to the termination of credit period, firms are informed via call or through direct visit. After credit period, until the party becomes chronic party, regular calls and spaced visits are performed by SO or ASM. No further order is entertained from such parties. Once the party becomes chronic then regular call and visit are performed. Based on their response and judging their financial condition via their neighbor and surrounding, if the company finds that the parties are going to default, then court procedure and litigations are used.

Policies to Encourage Creditors to Repay Credit

For the creditors to repay earlier there are certain provisions that are done. Dealer gets NRs 10 and NRs 5 cash discount in per bag of cement if the dealer pays within 10 days and 15 days respectively of the issuing of invoice.

Credit Period

Generally, the dealers are provided 30 days credit period

but when BG/LC are provided the credit period is extended to 60 days.

Default of Creditors

Generally, when it seems that firms are not willing or unable to pay, the cheques presented to Sarbottam cement are used for legal purpose as there is provision in banking regulations that if the cheque is bounced, the parties will be blacklisted and will be punished as per law.

Use of debt Collection Agency for debt Recovery

SCPL is not in tie with any debt recovery agency.

Limitations of Credit Policy

General and most important limitation of credit policy is the credit limit defined based upon the PDC transaction. The general credit limit of 3 lakhs (nearly one truck of OPC which is equivalent to 420 bags) by sales officer, 6 lakhs (Nearly two trucks of OPC) by Area Sales Manager and 10 Lakhs (Nearly 3 trucks of OPC) by General manager is very less and has least impact on the willingness of dealer to sell Sarbottam cement. If credit limit of sixty days is provided, then the allocated quantities of cement bags are not fruitful because they are easily sold and once they are sold dealers have to wait till they get paid so that they can pay back to the company for next order. Another limitation of credit policy is the requirement of BG, especially while selling to any contractor for any construction project. Most of the cement companies provide the flexibility of PDC for transactions while SCPL focuses on BG and LC. Since BG and LC require collateral for the bank, dealers are unwilling to grant BG or LC. These two major limitations have impacted the sales of Sarbottam Cement. Though the risk of losing money has been reduced, these conditions discourage dealers to sell the Sarbottam cement.

To improve the limitations first of all the credit duration should be extended to 60 days for cash and 90 to 120 days for BG. Similarly, since the banking regulations are continuously improved, cheque transaction should be given more priority.

Rationale behind the Credit Policy

The rationale behind credit policy is to reduce the chances of bad debt. Shorter duration of credit limit is provided to reduce the chance of bad debt. The main logic is if the dealers are given less credit limit then they would pay the credit and order next. Consider an example, if credit limit of 50 lakhs are given on cheque and they are unable to pay the amount then instead of ordering again from SC they would rather order from other cement as NRs 50 lakhs is huge amount to pay, but at the same time if the credit limit of 3 lakhs are provided then it is easier for the dealer to pay the amount and order next consignment. Instead of sales the credit policy aims to control bad debt.

Dealers of Sarbottam cement

Overall in Nepal there are 2164 dealer (as per 11 June 11, 2018) the highest being at Kathmandu with 585 Dealers. In other Categories, the dealers from any particular location or contractor for any particular project which do not fall in the categorized regions are included.

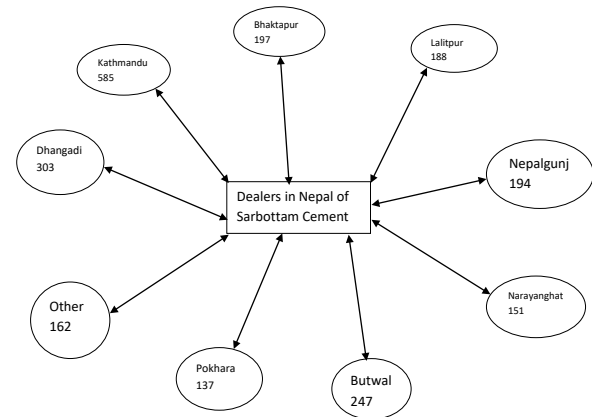


Figure 3. Dealers of Sarbottam Cement

Conclusion

Based on the findings of the research conducted, the sales trend of two year shows similar pattern but the sales has been growing which is good sign for the company. The documented credit policy shows the nature of credit services provided by SC to its customer. Credit policy of SC is defensive credit policy. It means policy aims to reduce bad debt or reduce the chance of not getting paid back rather than increasing the sales. The credit period provided to customers on the cash basis also seems to be not sufficient. Similarly, the requirement of BG/LC to provide credit period of 60 days also seem to be insufficient. The current credit term can be indicated as 10/10 Net 30 and 5/15 Net 30 for Cheque transaction and 10/10Net30, 5/15 Net 60 For BG/ LC

Recommendation

Credit Period should be increased from 30 days to 60 days and rather than being defensive credit policy it should give priority to cheque transaction instead of relying on the BG/ LC as this will increase the market share and will attract contractors to deal directly with the company.

The general limit of credit assigned to GM, ASM and SO should be removed and collective decision should be encouraged to grant limit regarding credit limit.

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