

Working Capital Management
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Lecture-57
Other Accruals and Overtrading

Welcome students, so this is how find the lecture know about the management of payables and after that we will move to the other sources of finance short term finance. This is the first source of spontaneous as a short term finance of the working capital, that was a spontaneous finance we talked about we learn about, that first of all that finish which comes from the suppliers and from the expense creditors.

That is the first naturally the first source of finance which is generally free of cost which is only free of cost. So there is nothing to worry about it, it is free of cost which means we should resort to this first as much as possible and was just source is fully exhausted that will look for the look forward for the other sources of finance like the short term sources of the finance and ones that short term sources of finance is over then we should we go for the long term sources of the place to meet the short-term requirements.

So this is the last part of discussion on the spontaneous finance or the tables management that is the management of the current liabilities in the form of the creditors and the expense creditors. So we discussed at length that how we can manage the sundry creditors all the accounts payables, apart from the creditors and accounts payable they are the other sources of the spontaneous finance.

And these are the other sources of spontaneous finance which we call them as other accruals are the expense credit. Other accruals are the expense credit for employees salaries and wages of employees and workers variable and the fixed expenses taxes and dividend like debits. So we all do that bought in any company so there we work for 1 month and 4 month and we get the salary after 1 month.

So what we are doing there, we are providing the spontaneous finance as an company of that organization, we are providing them the spontaneous finance we are not asking the selling in the beginning of the month, we are expecting the salary at end of the month, we are not

asking the salary of everyday evening, we are asking the salaries after 30 days and what are the term payment or payment period is and normally the terms of payment or the payment period is 30 days that is normally 1 month right.

So it is for example any company 1000 employees are working and they are being paid on a already 5000 rupees purpose the average salary was 50000 rupees per person, so please you can make out that how much rupees of the finance is required if you have to pay them in the beginning of the month or if you have to make the payment to them on daily basis that in the every evening you have to make the payment to them.

And tomorrow they will come for the work was there paid for the previous day's work, it means you can see that is 1000×50000 . So that amount will be how much you can find out that that amount will be some where I can find out that is how much that is 5 crores you have to arrange. But when they are not asking for the salary it means that salaries and wages which we are paying at the end of the month that 5 crore rupee we are paying at the end of the month it means that what is that.

That is spontaneous streaming that is coming to us nobody is asking for that money and you are automatically getting it. Similarly you talk about these input companies you can say the power companies are you can say that water companies or maybe some other small a suppliers maybe some lubricants or some other kind of not very significant material, but any significant material but useful material.

So they are also asking for the payment normally the electricity companies in India the payment period was 2 months 60 days. Now it has been in the most of the states it has been brought down to 30 days 1 month, water supplying entities also charged their price, after 30 days of some time it may be 2 months also. So it means you are getting the virtual credit of the spontaneous finance on account of the salaries and wages that dissolve supplies inputs without asking for it.

It is a natural agreement is a long term agreement once you get the power connection is assumed that you will make the payment to the power company when the bill will come and bill will come after 1 month or maybe in some cases it may be 2 months also right. So this is

in another source of the spontaneous finance or the say you can call it as a self adjusting source of finance means we know that we have to pay the power bill.

So automatically make the provision of the day of the funds to be paid nobody ask power company does not enter into an agreement every month that condition is that we will send you the bill after 30 days and you have to make the payment accordingly. So we know it this apply the keep on supplying the electricity be keep on paying them and it is a long term say on written agreement or maybe the agreement forms we have applied for the power connection.

That time I think there must be some terms and conditions we have signed on, so that might be at that time and that once for all goes on. So these are very very important qualities source of the finance. Then variable in the fixed expenses for example your telephone expenses must be use the postpaid telephone landline and only postpaid connections was used the telephone their partly the rent is fixed and the call charges are variable.

There also be not make the once we make the payment at the end of the month variable and fixed expenses they are also to be paid at that some period of time and what they are paid or we have incurred them we not need to look for these expenses to be incurred again right. So this is other self adjusting source of finance. Then we talk about taxes, taxes cases another important source of sometime spontaneous finesse.

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$$\begin{aligned} & \text{Advance Tax Payment system} \\ & 10000 \times 4 = 40000 \\ & = \boxed{80,000} \end{aligned}$$

Normally people say it is not it is not the source of fiancé that is say how the taxes are there in India why it is not because when you talk about the taxes in India we have that was the tax payment system in India the tax payment system is advance tax payment system, we have advance tax payment system, we pay taxes in advance, normally prepare the quarterly taxes to the government.

Our company's, our corporate pay the quarterly taxes to the government and that is paid in advance in the beginning of the quarter on the basis of the estimated sales estimated profit estimated revenue and estimated profit the firm has to pay the text to the government right. But sometimes what happen that estimated tax which works out as here is that is 10000 rupees per quarter, so into 10000×4 so that will be how much total tax the company will be depositing over the ear is that is 40000 rupees.

Advance tax and then the first quarter 10000 in the second quarter 10000 third and 10,000 in the 4th quarter to total tax will be deposit for 40000 rupees, but this is on the estimation basis, sometimes what happened your sales go up very high unexpectedly the sales god very high and actual may be possible the text word in all the text component was not 30,000, but it was 40000 sorry it was not 40000.

But it became 80000 but we are you expecting that sales will be as there was a sales in the previous year have a revenue say profit will be accordingly and will be paying almost this much amount of the tax to be asking that quarterly in equal for instruments but in the sales have exponentially gone up which was not expect when it is trophy unexpected. So it means your tax component which was expected to be 40,000 it has become 80000.

So which means how much we paid in advance we have paid in advance is only 40000 and remaining 40000 will be paid at the end of the year. So that amount you are using for the period of one full year that is the 12 months period, when it will be possible that the actual tax this much that is 40000 rupees. We have paid advance tax is 80000 rupees. So the firm will get back is the balances 40,000.

Firm will get back when the total final adjustment of the tax will be made at the end of the year when the form with file the return and they will show that this much of the tax was to do tax was 40, we have deposited 80 and we have deposited 40000 extra so it means the 40 will

get back. So in both the case if the view was more deposited is less than the firm deals and that difference from uses for meeting is too short term requirements.

If reverse is there then which founds loss that firm has deposited more due was less so firm will have to get the say refund of that, but that to after the say one year when the adjustment will be done tax adjustment will be done and the returned by the form will be filed right. But tax can be one source of spontaneous finance if the due is more and deposited is less it may be possible but not always.

Now we talk about the other company other important components debit, debit is a very important source of the spontaneous finance for which firm does not arrange or firm does not look for any other way or you can call it as source to look for but it provides the spontaneous automatic source of the finance spontaneous source of the finance and in this case how to works it works out as dividend.

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The image shows two T-accounts side-by-side. The left T-account represents the Profit and Loss Appropriation account, and the right T-account represents the Dividend Distribution account.

Profit and Loss Appropriation Account		Dividend Distribution Account	
To N.P.A.T	1,00,000	By Dec. Dividend	50,000
To Dividend	50,000	By N.P.A.T	1,00,000
To Retained Earnings	50,000		
	1,00,000		1,00,000

Additional notes in the diagram include "For Appropriation etc" written below the first T-account and "31st Dec. Dividend - Rs. 50,000" written above the second T-account.

You see when the dividend is paid what we do if we prepare the profit and loss account. For example this is a profit and loss account and here we calculate the net profit to net profit after tax, net providing say no but not operating profit or sometime we finally when we calculate the profit we say that it is the net profit after tax and their net profit after tax is here for example it is say 1 lakh rupees.

We have calculated this is 100000, 100000 rupees this is a net profit after tax this the profit and loss account right. After this we prepare profit and loss appropriation account. When you

pay the profit and loss appropriation account but you do it by NPAT net profit after tax this becomes 100000 rupees here and now you have to distribute this profit. For example this profit is distributed as a 2 dividend 2 to the shareholders.

We talk about that 50% will be distributed as dividend. So this will be the dividend 50,000 will be dividend and to retainer means will be the remaining will go to the balance sheet will be added in the capital and that is 50000 rupees. So your 100000=100000. This 100000=100000, 100000=100000 right. This is the this is how we apportion, this is called as profit and loss appropriation account.

So we are debating it to dividend this is our 2 dividend 50,000 dividend to the shareholders 500000 retained earnings is 50000 rupees. So with this 50000 rupees of dividend we have provided we have calculate we shown in the profit and loss appropriation account, but this dividend the last day of the operating period or that accounting period. For example last day of the accounting period is we can say that is 31st December of any.

Because accounting period of the firm ends up on is secondary year that is a January to December should there accounting period ends on 31st December. So it mean 31st December can we prepare the profit and loss account, they decided that this year the dividend will be how much that will be given to be paid to the shareholders is rupees 50000 rupees right this si 50000 rupees.

But that 50000 rupees dividend is not immediately transferred to the account of the shareholders, that is not required to be transferred to the accounts of the shareholders immediately, fund can transfer this amount or can pass on this amount to the shareholders within a period of 3 months next 3 months. So this on the 90th day total all the tax of the dividend must be sent must be reaching to the shareholders and they cannot to retain it beyond that.

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B/S	
- Proposed Dividend	50,000

But they can pay it within a period of 3 months, so they do not in firms normally but they do they normally delete the payment of the dividend and use this amount of the dividend declared for their short term purposes, has a spontaneous finish, so how it happens that no this is a balance sheet. In the balance sheet this is the shown as proposed dividend, this is shown as a liability.

This is the proposed dividend 50000 rupees, we have taken this amount out of the profit through profit and loss appropriation account and it is shown in the balance sheet is a liability and unless it is paid actually to the shareholders it is transferred to the shareholders account. So this is 50000 rupees remaining in the balance sheet. So this is taken out through profit and loss account from the profit.

The firm has earned during the year it is the shareholders share it has to go to the shareholders versus there is a time period allowed under the Indian companies act 3 months. So within 3 months at the end of the third month is this amount should be reaching. So here this amount is available for the firm to use for a period of 3 months. Not entire amount this start sending that cheques maybe in the third month may be in the mid of the third month.

So they have clear we use this 50000 rupees for 2 and half months and even that because of the disbursement float and all that if you work out this can sometimes can see make this this funds available for the complete period of 3 months amount. So this amount is available at this amount can be used at this amount becomes a spontaneous source of energy. So firm is using after 3 months it has to be transferred to shareholders.

So it cost them is it safe and its money which free of cost available to the firm and every firm using this money every firm using this funds for the short-term purposes for the working capital requirements in the firms you look at when which are of very large size this dividend amount is runs into crores that runs into millions. So when it is into billions you can make out that how much is that amount and without looking for any external source of short term finance within firm they have generated sufficient amount.

And this is easily available to the firm, so dividend is also the one source which provides a spontaneous finance to the firm. So we have seen here that apart from the creditors suppliers we have the expense creditors and these are salaries and wages than your utility supplying company that variable and the fixed expenses taxes and dividends. But here in case of the taxes flexibility is also limited.

In case of the dividend flexibilities limited you cannot use it and ending, in case of the dividend you can do you can use it maximum for a period of 90 days. So limitless there is the possibility that but with unlimited flexibility what the forms who want to make proper use of these firms, they are free to do that they can do this. But in case of the taxes if you delay the payment of taxes, want of liquidity then say to you have to pay the penalty.

Similarly in case of the dividend if you delay the payment of the dividend beyond 3 months you will lose many things may not be directly but indirectly in terms of the credibility, in terms of the repetition, in terms of the financial you can call it as rating or reputation or credibility you have to lose. So we can use these sources taxes and dividends especially will limited extent.

But still these are the important sources of the spontaneous finish right, then before we close the discussion on this accounts payable and the expense credits we will discuss something about which is abode of caution about overtrading in sometime what happens that things are available free of cost means no free of cost currently we are not paying anything and they are available on the current, they are available on credit.

So we think that ok if the material is available on the credit goods and services are available on the credit we are not to pay today we have to pay after 2 months or maybe sometime 3

months or in certain companies case after 6 months. So keep on purchasing placing the order is buying it at sometime we buy on credit to that much extent which is much more than buying capacity of selling capacity of the buying firm selling capacity of the buying firm.

That is really I was a very disastrous thing for the firm who is buying on credit, if example of the buying on credit but they are not able to convert that material into sales in the market or for example therefore the sold in the market and to on the credit and their credit got stuck in the market but you have to make the payment to supplier. So in that case it creates are very very often called as a picture which is not acceptable to normal traitor.

So we should be very very careful, here things are available on credit they are not available on free, we have to make the payment one or the other day if you do not make the payment you become a defaulter, for you talk about we talk about electronics industry, electronic segment, if you talk about the company for manufacturing the world class products like Samsung, LG, Sony, there might not be any credit period available from them or they are giving the minimum credit period of 10 days, 15 days not more than that.

So you even very careful, very very obedient, very very disciplined with these companies but says these companies have the good reputation, good standing in the market. So you are compensated that you buy the product and immediately their product goes out of your store and that is sold in the market. But there are the companies like Videocon, Onida whose products has less acceptability in the market these days less acceptability in the market these days.

When these companies interact with some of the distributors and dealers they say that ok you are normally not interested to sell our product and you also feel that there is more easily available market for our products and our company's product in the market, people are not intending to buy it, but we will give you some incentives, number 1 keep the product in the store, provide as the shelf space and in return to that will give you a credit period of 6 months.

You keep the product on the shelf, try to sell it, Samsung is giving you 10% profit I will give you 30% profit number one, second thing is sensing is giving you 15 days of the credit period I will give you 6 months of the credit period, you sell the product in the market and pay me

after 6 months. They are giving you 10%, I will give you 30%. So you will be load in that case, that is very good.

If I am getting extra margin, if I am getting extra credit period then what is the harm in keeping the product, but sometimes you rather than ordering and keeping a few items of this kind of the products you say order too much and store too much of the products without keeping in your mind that this supply is only on credit and the profit will be available to me if I sell the product in the market.

Therefore that selling of this product in the market how much efforts have to make that you also must be aware about that, the dealer must be aware of about those effects, customer is very very smart, he would not be easily convinced that I should buy this company's product no he will not be he has come up with a mind makeup that I would like to buy a colour TV Samsung, LG or Sony.

So you if you want to change his mind set on the Samsung to Videocon you have to make numerous efforts, is it possible to make that much of the efforts and convince the customer number 1, second thing is this then only 30% will be available to you, second thing is that you have to keep the product and for example this product is 6 months old there is a risk of the option is also, product coming today from the company, product coming 6 months back from the company, you are keeping in your warehouse in your gudown.

That loses the quality, that loses the prices, that loses the say and their source, so it cannot be possible for us to sell that product ultimately after 6 month Videocon will send you the reminder, that our payment is due please make a supplement, Onida will send you the reminder our payment is due please make a supplement. If you have sold the product in the mark the product list is stuck with you, you cannot do anything.

At that time you have 2 options to do, you need to return the product back to the company or to make the payment to them, returning the pack product back to the company is also not a good practice and not making the payment is also not a good practice and if you make the payment from your own account then what you are expecting is a profit of 30% or you are thinking of selling this product in the market.

I think if 10% of this kind of the product becomes unsalable on the normal market price, I think entire your profit of 30% will be wiped out, entire profit will be wiped out you had got say 25 colour TVs, you could sell only 15 and 5 are not sellable, still not sellable, the normal market price, you have to say those products at 50% price. So how much is your profit 30% and you are selling it at 50% it means already you are paying 20% from your pocket.

So the profit you are getting for the 15 sets and profit your losing the entire 50% you are losing of the five sets, if you see the net gain is not 30%, if you lose somewhere 5, 10%. So be careful that when we are thinking that product is available on the credit number one if there is unlimited credit and you credit and an expected credit then there must be something fishy about.

The product is not easily saleable in the market as compared to the one where there is even or credit or the very limited credit of 10, 15 or 12 days. So here the point of caution is to maintain your credibility to maintain the reputation in the market you have to avoid something which is called as overtrading, do not buy too much, do not store too much, do not be say greedy too much that I will get a profit of 30%.

So buy and number one is not to make the payment now I have to make the payment after 6 months. So we will see after 6 months you ultimately have to make the payment of 6 months to be careful about that. So here the 3 important points are there, validation to avoid overtrading, validation when any back load of materials comes to you, you compare with your orders, whether this order was place by us right.

And this is value not acceptable order then only accept order otherwise sometime what happens we have place the order for 20 quality which company sells 40 quality piece, so return immediately the additional 20 colour TV that I am not ordered for this 40, I have ordered for 20 I will return only 20 and 20 should go back. So your only answerable for the payment of 20 CTVs not 40 CTVs.

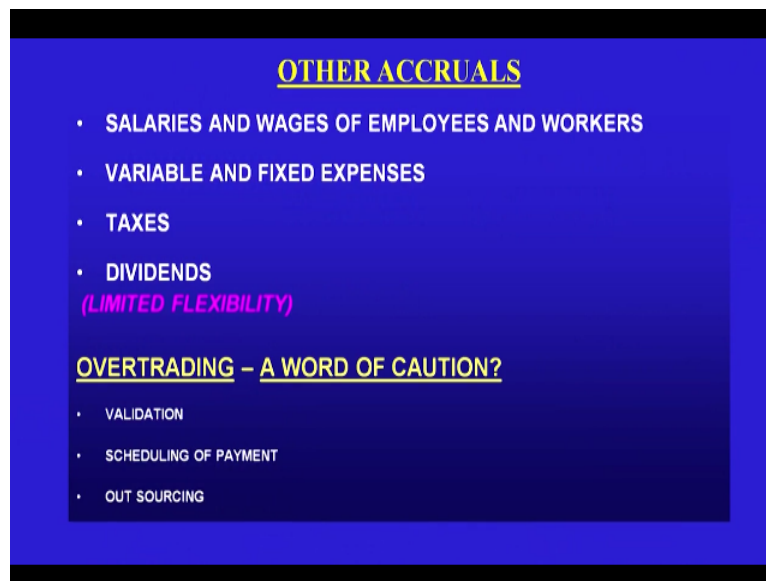
So validation of that receipt of the material is very very important if we have ordered receive it if we have not ordered then you simply return back. It is sometime the tendency of the companies were not able to sell their product in the market that they normally supply more

than what we have ordered but ultimately we have to make the payment at the end of the credit period. So validation is the one important point.

Then scheduling of the payment is very important we can use the cash budget approach I told you many times and if you are very efficient company you use the cash budget for one week or 15 days or maximum 1 month. So that in that 1 months period you know how much I am going to have how much famous I have to make what is the net difference.

If you have scheduled all your payments you want me at any point of time under pressure that my payment is do I have to make the payment but I do not have the liquid for so how to meet this commitment. So scheduling is very important that as and when the payment is due you think of from where the funds will come, I need to have the liquid funds and I will arrange for that and third is outsourcing.

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So during sometimes becomes expensive, preparing the budgets and keeping a proper track of the receipt of the material and then the due date of making the payments and then same sending the payments all these things in sometime cause a huge cost and large amount of the prophets which we are expecting from the sub standard companies that may be offset by spending on maintaining the say the payment ledges.

So we can use here the concept of outsourcing of our payment ledger, outsourcing of our payment ledger means there are the different companies different say export companies who deal in managing your credit sale bill and one such company or one such say agency is called

as factor that is a very important source of short term finance also and factor is very important source to manage the credit sale ledger also. What the company can do rather than maintaining your own credit sales management department.

You have to have the employees, you have to have space, you have to have stationery, you have to have a computers you have to have so many expenses only maintaining your sales ledger. So that when material was received when the payment is due to be made, when the payment is to be received all these things. So you outsource all these things to the company called as factor.

This agency which is called as vector, the day we receive the material we accept the voice our copy of invoice, you keep the Xerox, the company should keep the xerox and other copy should go to the factor, you hire the factor or factor will maintain all your payment record this company's payment records with them and as and then the payments are due to the different suppliers maybe after 2 month, 3 month, 6 months.

They will automatically keep on sending the text you have the authority to write the cheques, on at least if they have not authority to write the text that they can inform the company that is this is famous add you in the next one week please prepare the cheques and maintain the liquidity or in the next 15 days or next 1 month, maintain the liquidity prepare the cheques and send it to them.

So they keep on maintaining the credit sales ledger and reminding the company and helping them that to make the payment as and when it is due. So factor is a very important agency it was not there in India, but now has come after 1991 once we have a liberalise this economy factoring is very much possible and it has come to India also many companies are there who are providing the factoring services.

So we can take the help of the factors, this is this is save the cost of maintaining the credit sales ledger and that will help us to have the efficiency also show that any payment which is due on any particular date that can be made as and when it becomes due. So as a point of caution overtrading should be avoided and to avoid copper trading we should validate the order when we received anything any order you should check whether we are placed order or not, second thing is scheduling of the payment is important.

So that we never default in making the payment and to say schedule the payment properly all the payments properly and regularly and make the payment on the due date without any kind of default. We can compare whether it is advisable to have in house credit sales department or this service or this particular activity can be outsourced to agency which is called as factor right. So this is all about the spontaneous finance or the management of accounts payables.

They will discuss the management of creditors and the expense creditors and something you learnt about the overtrading because things are available on the credit. So keep on buying it but mind it is not is only on credit not free. We have to make the payment will be after any length of the credit period, apart from these 3 important sources of the spontaneous finished we will discuss some other important sources of the short term finance and that I will discuss with you in the next class, thank you very much.