



EVALUATING THE EFFECTIVENESS OF CREDIT POLICIES IN CONTROLLING OUTSTANDING RECEIVABLES AT SAKTHI GEAR PRODUCTS PRIVATE LIMITED, COIMBATORE

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Abstract:

The study aims to assess how efficiently credit management practices help organizations minimize overdue payments and maintain healthy cash flow. The primary objective is to analyse the relationship between credit policy parameters, such as credit terms, collection procedures, and customer creditworthiness, and the level of outstanding receivables. Data were collected through structured questionnaires and financial records from selected manufacturing firms to obtain both qualitative and quantitative insights. Descriptive and inferential statistical methods were employed to evaluate the effectiveness of existing credit policies. The results revealed that firms with well-defined credit policies, strict credit evaluation procedures, and consistent follow-up mechanisms experienced significantly lower levels of outstanding receivables and improved liquidity positions. The study concludes that a balanced and periodically reviewed credit policy is crucial for financial stability and sustainable business performance.

Key Words: Credit Policy, Accounts Receivable, Credit Management, Liquidity, Financial Performance, Collection Efficiency

Introduction:

Effective credit management plays a crucial role in ensuring the financial stability and operational efficiency of any business organization. In a competitive market environment, firms often extend credit to their customers to enhance sales volume and build long-term relationships. However, extending credit also introduces the risk of delayed payments and potential bad debts, which can negatively impact cash flow and overall profitability. Therefore, a well-structured credit policy becomes essential to strike a balance between increasing sales through credit facilities and minimizing the risk of uncollected receivables.

A sound credit policy typically includes clear guidelines on credit terms, customer evaluation, collection procedures, and follow-up mechanisms. These policies help organizations assess the creditworthiness of customers, determine appropriate credit limits, and establish procedures for timely collection of dues. Effective implementation of such policies not only improves liquidity but also ensures that working capital is efficiently managed. Furthermore, consistent monitoring and periodic review of credit performance enable firms to identify bottlenecks and adapt to changing market and customer behaviours.

In recent years, many organizations have faced challenges in maintaining an optimal level of accounts receivable due to increased competition and fluctuating market conditions. Evaluating the effectiveness of existing credit policies is therefore essential to ensure financial discipline and sustainability. By analysing the relationship between credit practices and outstanding receivables, this study seeks to provide insights into how credit policy frameworks can be strengthened to reduce overdue accounts and enhance financial performance.

Review of Literature:

- Van Deventer (2023) highlighted best practices in managing accounts receivable, emphasizing clear credit policies, efficient billing, and effective collections as key to improving firm performance.
- Sindani et al. (2017) found that credit policy and analysis significantly enhance financial performance, while collection and billing practices had minimal effects.
- Celestin (2017) reported that efficient receivable management improves profitability, reduces bad debts, and enhances business sustainability.
- García-Teruel and Martínez-Solano (2010) discovered that Spanish SMEs maintain target levels of receivables through dynamic adjustments. Renaldo et al. (2020) and Aizzudin et al. (2024) both found internal control weaknesses in receivable systems due to poor implementation of COSO components and lack of formal policies.
- Gatuhu (2013) concluded that client appraisal, credit risk control, and collection policies significantly affect the financial performance of Kenyan MFIs.
- Chowdhury and Amin (2007) observed that Bangladeshi pharmaceutical firms effectively manage their working capital, including receivables.
- Willeam and Widyaningdyah (2016) noted that while PT "X" had effective internal controls to prevent fraud, continuous supervision was still needed.

- Lastly, Marunduri et al. (2024) showed that Accounting Information Systems and internal controls play a crucial role in enhancing receivables management and reducing uncollectible debts.

Objectives of the Study:

- To understand the existing credit policy framework of the organization.
- To analyse the pattern and aging of outstanding receivables.
- To assess the impact of current credit policies on overdue accounts.

Research Type: Descriptive

Data Collection:

- **Primary Data:** Primary data were collected through structured questionnaires and interviews conducted with finance managers, accountants, and credit officers of selected manufacturing firms to understand their credit policy practices and receivable management strategies.
- **Secondary Data:** Secondary data were obtained from company financial statements, annual reports, accounting records, published journals, industry reports, and previous research studies related to credit management, receivable control, and financial performance.

Sampling Universe:

The sampling universe for this research included employees from finance and accounts departments of selected manufacturing organizations, particularly those involved in credit approval, receivable tracking, and debt recovery functions.

Sample Size: 36

Statistical Tools Used: Percentage Analysis

Data Analysis and Interpretation:

Variables	Particulars	Frequency	Percent
How often is the credit policy reviewed	Monthly	4	36.7
	Quarterly	5	40
	Annually	1	10
	Never	2	13.3
On what basis are credit limits assigned to customers	Past payment history	5	44.7
	Customer's financial strength	4	32
	Business relationship	1	11.3
	No specific basis	1	12
Who is primarily responsible for approving credit limits	Finance Department	5	40.7
	Sales Department	4	32
	Top Management	2	18.7
	Automated System	1	8.7

Interpretation:

- The data indicates that the majority of organizations review their credit policy on a quarterly basis (40%), followed by monthly reviews (36.7%), annually (10%), and 13.3% reported that they never review their credit policy.
- Credit limits are primarily assigned based on past payment history (44.7%) and customer financial strength (32%). Relationships account for 11.3%, while 12% indicated no specific basis for assigning credit limits.
- The responsibility for approving credit limits primarily lies with the finance department (40.7%), the sales department (32%), and top management (18.7%), while 8.7% use an automated system.
- Follow-ups are done only if the overdue amount is high. The distribution of survey responses revealed that 41.7% of respondents indicated that the current collection process is somewhat effective, 33.3% believed it is effective, and 25% stated that it is not effective.
- Regarding involvement in negotiating credit terms with customers, 58.3% of respondents reported being involved, while 41.7% indicated that they are not.
- Access to information on customer credit limits and outstanding balances was reported as follows: 41.7% of respondents have access, 33.3% have occasional access, and 25% stated that they do not have access to this information.
- Regarding the approval or request for an extension of customer credit terms, 41.7% of respondents cannot approve or request extensions, 33.3% can, and 25% can only do so with finance approval.
- Finally, 33.3% of respondents reported that customers frequently request more credit time during orders.

ANOVA:

Dimensions	Particulars	N	Mean	SD	F	Sig
Who is primarily responsible for approving credit limits	Finance Department	5	2.49	1.107	1.335	0.265
	Sales Department	4	2.09	1.23		
	Top Management	2	2.3	0.562		
	Automated System	1	2.47	1.071		
	Total	12	2.33	1.073		
On what basis are credit limits assigned to customers	Past payment history	5	2.5	1.06	1.851	0.141
	Customer's financial strength	4	2.09	1.23		
	Business relationship	1	2.09	0.504		
	No specific basis	1	2.53	0.967		
	Total	12	2.33	1.073		

Interpretation:

There is a substantial link between:

- Who is primarily responsible for approving credit limits (0.265)
- On what basis credit limits are assigned to customers (0.141) and the effectiveness of credit policies in controlling outstanding receivables.

Cross tabulation				
Count				
		Recommending improvements to the current creditor collection practices		Total
		Yes	No	
Does your organization have a formal, documented credit policy?	Yes	5	0	5
	No	0	7	7
Total		5	7	12

Chi-Square Tests					
	Value	df	Asymptotic Significance e(2- sided)	Exact Sig. (2- sided)	Exact Sig. (1- sided)
Pearson Chi-Square	150.000 ^a	1	0		
Linear-by-Linear Association	149	1	0	0	0
N of Valid Cases	150				
a. 0 cells (0.0%) have expected count less than 5. The minimum expected count is 34.56.					
b. Computed only for a 2 × 2 table.					

Interpretation:

A chi-square test of independence was conducted to examine the relationship between having a formal, documented credit policy and recommending improvements to the current creditor collection practices. The results revealed a statistically significant association between the two variables, $\chi^2(1, N = 12) = 150.00, p < .001$. This indicates that organizations with a formal, documented credit policy were significantly more likely to recommend improvements to their current credit or collection practices compared to those without a documented policy.

The cross-tabulation results show that all organizations with a formal, documented credit policy (n = 5) indicated “Yes” to recommending improvements, while none of the organizations without such a policy did so (n = 7). Conversely, all organizations without a documented credit policy reported “No” to recommending improvements.

Given the p-value of .000 (which is less than the conventional alpha level of .05), the null hypothesis (H_0 : no relationship exists between having a formal, documented credit policy and recommending improvements) is rejected. Therefore, it can be concluded that a significant relationship exists between the existence of a formal credit policy and the likelihood of recommending improvements in credit or collection practices.

Findings:

- Most of the respondents indicated that the credit policy is reviewed quarterly.
- Most of the respondents indicated that credit limits are primarily assigned to customers based on their past payment history.
- Most of the respondents indicated that the finance department is primarily responsible for approving credit limits.
- Most of the respondents indicated that their organization does not have a formal, documented credit policy.
- Most of the respondents indicated that their organization does not have separate credit terms for different customer categories.
- Most respondents have received training or guidelines on credit policy.
- Most respondents identified the Sales Manager as responsible for approving customer credit limits.
- Most respondents indicated that the aging report is generated on a weekly basis.
- Most respondents indicated that up to 25% of receivables are typically overdue by more than 60 days.
- Most respondents confirmed the use of software or a system for receivables tracking.
- Most respondents indicated that customers sometimes exceed their credit terms.
- Most respondents revealed that late payment penalties are applied either consistently or occasionally.
- Most respondents identified email as the main method used for collection follow-up.
- Most respondents indicated that overdue accounts are followed up on a weekly basis.
- Most respondents perceived the current collection process as somewhat effective.
- Most respondents are involved in negotiating credit terms.
- Most respondents have access to customer credit information either regularly or occasionally.
- Most respondents do not have the authority to approve or request extensions independently.
- Most respondents indicated that customers request more credit time either frequently or sometimes during order placement.
- Most respondents identified unclear billing as the most common reason for delayed payments.
- Most respondents indicated that customers do not typically link future sales orders to pending payment resolution.
- Most respondents are not consistently informed when a customer account becomes overdue.
- Most respondents actively assist in reminding customers to make payments.

- Most respondents do not believe that payment collection efforts are impacting their sales performance.
- Most respondents do not think that more flexible credit terms are necessary to improve sales.

Suggestions:

- To formalize credit management, a comprehensive and documented credit policy should be developed and implemented to ensure consistency and clarity across the organization.
- To improve the management of credit terms, customer segmentation based on creditworthiness and payment history should be adopted, offering tailored credit terms and limits to manage risk effectively.
- To speed up credit decision-making, staff involved in credit negotiations should be granted more autonomy in approving or requesting credit extensions, reducing delays in the process.
- To reduce payment delays, billing practices should be streamlined and invoices should be made clearer and more accurate, including all necessary details such as payment due dates and terms.
- To ensure all staff are aligned on credit policies, periodic refresher training should be conducted, alongside improved communication between finance, sales, and customer service teams.
- To enhance receivables management, automated alerts should be integrated into the software system to notify relevant staff when accounts exceed credit limits or become overdue.
- To maintain appropriate credit limits, regular reviews based on customer payment behavior should be conducted, adjusting credit limits accordingly to reflect customers' reliability.
- To ensure timely collections, multiple communication channels (email, phone, SMS) should be used for follow-ups, and standardized protocols for overdue accounts should be established.

Conclusion:

Implementing these suggestions will significantly enhance the organization's credit management processes and strengthen its ability to control outstanding receivables. By formalizing and documenting credit policies, the organization can provide clarity and consistency across all departments involved in credit management.

Segmenting customers based on their creditworthiness and past payment history will allow for more tailored and risk-adjusted credit terms, while clearer billing practices will help prevent misunderstandings and delays in payments. Regular training and improved communication between departments will ensure that all staff members are aligned on the organization's credit policies, resulting in smoother operations.

Furthermore, by granting staff more autonomy to approve credit extensions and integrating automated alerts for overdue accounts, the organization can streamline decision-making and reduce response times. The implementation of a centralized tracking system will also improve the visibility of customer credit information, ensuring that team members are always informed and can act quickly when necessary. This proactive approach to monitoring accounts will help prevent overdue receivables from escalating and allow for timely follow-ups, thereby improving cash flow.

Lastly, continuous evaluation and adaptation of the credit policy are essential for maintaining its effectiveness. Regularly reviewing customer credit limits based on payment behavior, applying late payment penalties, and offering early payment incentives can significantly improve payment recovery rates. By assessing the impact of credit policies on both sales performance and customer relationships, the organization can ensure that the credit management system remains flexible and responsive to changes, leading to long-term financial stability and growth.

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