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Are Poor Accounting Receivable Management Practices Are Responsible for Dairy Plant Failure?: A Case Analysis of Muktai Dairy Pvt. Ltd.

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Abstract:

This paper aim at understanding the failure of the private milk dairy plants on the basis of case analysis with the help of financial tools like ratio, percentage cost of sale and common size statement analysis. The researcher critically analyzed the causes of failure on the on the basis of annual financial statement analysis and the subsequent structured interview of the director's. The researcher finds that poor selection of customers, liberal credit policy, delayed payment and debt ridden capital structure besides lack of financial acumen and professionalism in handing dairy operations are the major reasons of dairy plant failure. The researcher concluded that financial knowledge and skills is essential for implementing the sound financial management practices especially with reference to accounting receivable management so that short term survival, profitability and growth of dairy plant

Keywords: Account receivable management practices, financial knowledge and skills, milk processing, financial viability

1. Introduction

The dairy sector in India is highly fragmented and unorganized. Around 80 per cent of the milk produced in the country is handled by the organized sector whereas remaining 20 per cent of the milk is handled by the government, co-operative and private sectors in India. Around 35 per cent of the milk is processed wherein share of private and co-operative milk processing plants is substantial. Before liberalization and de-licensing government supported co-operative supported dairy development. The plans and policies were framed to protect the dairy industry in co-operative sectors. The aim was to generate employment and source of income for the rural population constituting around 60 per cent population in India which is based on agriculture and allied activities. Milk processing capacity has grown at a compound annual growth rate of 4 per cent over the past six years in India (Gupta, 2007). After delicensing of the dairy sector in 1991, many private and multinational companies entered into dairy industry and created tough competition through their professional management. The 'productivity' becomes key word as it ensures the efficient allocation and deployment of resources. Past research explored the constraints of private and co-operative plants in improving their efficiency (Nirmala and Muthuraman, 2009). Under capacity utilization, low productivity of capital and labour, lack of professionalism, poor assessment of economic & financial viability of plants, poor cost and financial management sighted as a major reason for poor performance of milk processing plants.

Rising health consciousness, changing life styles, rising income created huge opportunities in dairy sector. India continues to be the largest milk producer in world with milk production of 137.7 MT with an average growth rate of 4.7 % per year from 1980-81 to 2013-14. The output value of milk exceeds over 1,00,000 lakh crores. Considering the significance of dairy industry in terms of its contribution to Gross Net Product, income and employment generating potential and source of livelihood of rural population, it become important to make this dairy industry productive, cost competitive, economically viable and sustainable. This can be achievable if management decisions especially financial decisions are taken on the sound financial management practices as every management decision have financial implications.

The milk processing sector act as link between the milk producers and consumers. The more efficient the milk processing sector in its management particularly the financial management, the more benefits it can pass on to all the stakeholders. On the contrary weak financial management of the milk processing plants led to failure of milk plant and economic drainage of resources. Hence it is important that milk processing industry to be healthy, it should keep on increasing its profitability as it is crucial and significant factor for survival, growth and long term sustainability of milk processing plant.

The dairy is a high turnover low margin industry. Monsoon plays significant role on milk production. The raw milk constitutes around 70 to purchase cost. It affects demand and supply situations in market and influence price. The cash inflow and outflow is highly volatile and its proper management become essential for the successful operations of milk processing plants in short term. It is observed that milk processing plants started with lot of enthusiasm but within a year or two face financial difficulty. If cash not managed and utilized properly, the milk processing plant fails. Considering the above background, the researcher has identified the case of a small milk processing plants which faced financial difficulty owing to cash inflow problems. The researcher prepared the case and tried to identify the various reasons.

2. Literature Review

Regarding accounts receivable management practices, Grablowsky (1976) and Grablowsky and Rowell (1980) found generally low standards. Approximately 95 percent of businesses that sold on credit tended to sell to anyone who wished to buy. Only 30 percent of respondents subscribed to a regular credit reporting service. Most had no credit checking procedures and guidelines, and only 52 percent enforced a late-payment charge. Thirty-four percent of businesses had no formal procedure for aging accounts receivable. Bad debts averaged 1.75 percent of sales, with a high of 10 percent in some concerns. Peel, M.J. Wilson, N and Howorth C.A. (2000) in their article entitled "Late payment and credit management in the small sector: some empirical evidence," suggested that small firm tend to have relatively high proportion of current assets, less liquidity. They also opined that small firm exhibit volatile cash lows. They found that small firms are highly reliance on short term credit. DeloofM. (2003) studied influence of working capital management on profitability of Belgian firms and observed that the negative relationship exists between account payable and profitability which is consistent within the view that less profitable firm wait longer to pay their bill. Howorth C and Westhead P.P. (2003) in their published article on "The focus of working capital management in U.K. Small Firms", showed that small companies stressed on working capital management to improve marginal returns. Eljelly, A(2004) in his article empirically investigated "Liquidity and profitability tradeoff in an emerging market" has elucidated that efficient liquidity management involves planning and controlling current assets and current liabilities in such a manner that eliminates the risk of inability to meet short term obligation and avoid excessive investments in these assets. Jeng-Ren,et al. (2006) Chiou, Cheng and Wu(2006),Nazir and Afza(2008) as well as Palombini and Nakamura (2011) in their research studies found a significant correlation between the level of debt and company's working capital. Schroeder,et al.(2011) revealed that the ability of an enterprise to generate cash from operations is an important indication of financial health.

Literature reviewed signifies the importance of efficient management of the account receivable practices to generate sufficient cash from operations to ensure the short term survival and growth of business. Small firm needs to managed their working capital in an efficient way as it significantly decides the business success or failure.

3. Objectives of the Study

1. To analyze the financial performance of the Muktai Dairy with the help of ratios and common size statement analysis especially with reference to account receivable practices
2. To analyze the marketing cost in the context of account receivable management practices
3. To find out the reasons for failure of milk processing plants on the basis of financial statement analysis
4. To suggest appropriate financial strategies (short term as well as long term) to prevent failure of milk processing plant

4. Brief Profile of Milk Processing Plant

Muktai Dairy Private Ltd, a small scale dairy registered under Company Act 1956 started its operations in Rahuri Taluka of Ahmednagar district (Maharashtra) in 2011. The six persons comes together and contributed capital to start this dairy venture. His background was graduate in Art discipline with milk collection and procurement experience of around 15 years. The another person designated as a Director was having around 25 years of marketing experience in milk and milk products manufacturing units with a Dairy Diploma. He was assigned the responsibility of Plant Manager. The remaining our persons were from agriculture field. These six persons were the Directors of the Plant out of which one was the Managing Director. The installed capacity of the plant was 30,000 Liters per day. Initially, with the 15 workers and staff members, the milk processing operations take off. In finance and account department, the Director appointed one cashiers, one accountant who look after receipt and payment of cash on regular basis with the help of computer operated software like Tally and MS Excel. The accountant and cashier both were a post graduate in commerce discipline. The director body was responsible for making final decisions regarding production and processing, finance, marketing and milk procurement.

5. Research Design and Methodology

5.1. Data Sources and Data Collection Methods

Primary data collected through structured interview which is based on the questions designed after the annual statements analysis of the concerned Milk Processing Plant. Secondary data collected through the Annual statements (2011-12,2012-13) collected from the dairy plants. Websites, research journals, government published reports, newspapers, referred. Case study prepared and data analyzed with the help of ratio analysis techniques and MS Excel sheet used for further data processing.

5.2. Data Analysis

Annual statement of the dairy analyzed with the help of ratio analysis tool and common size statement analysis to diagnose the problems. The important ratios identified which influence contribute substantially in dairy plant failure. The decisions taken and reasons thereof analyzed. The table no. 1 shows major ratios calculated to diagnose the health of milk dairy plant.

Particulars	2012	2013
Net Profit Ratio	-3.125334	-6.59565601
Current Ratio	1.4686746	1.886927539
Liquid Ratio	1.463282	1.875158587
Stock to Current Assets	0.0036717	0.006237098
Advances to current assets	0.1614726	0.102760721
Cash and Bank to Current Asset	0.0187336	0.01266233
Stock Turnover ratio	2691.3093	654.9731705
Stock Turnover in Days (365 Days)	7.3734502	1.794447043
Debtors Turnover Ratio	12.27378	5.34677285
Debtors Turnover in days	29.738189	68.26547718
Creditor Turnover Ratio	15.109669	10.72071812
Creditor Turnover in Days	24.156718	34.04622675
Debt to equity ratio=LTD/SE+R&SUR	2.2666248	2.586054396
Total Debt ratio=Debt/TA	0.7763299	0.799279513
Interest coverage ratio=PBIT/Interest	-1.84	-1.80

Table 1

The financing structure of the dairy plant indicated through Debt to equity ratio. In the year 2012, it's observed that the debt to equity ratio was 2.27 which increased to 2.57 in 2013. It means that the debt of the dairy plant is around 2.42 times of share capital and reserve and surplus. The total debt ratios in the year 2012 and 2013 was 0.78 & 0.8 respectively. It indicates that the debt component is around 79% of the total assets. The interest coverage ratios vary from -1.84 to -1.80 in during the year 2012 to 2013. It means that dairy plant's profit before interest and tax is not sufficient enough to pay the bank interest. The current ratios increased from 1.47 to 1.89 in the year 2012 to 2013. But if we look at debtor turnover in days, it's observed that it increased from 29.74 to 68.27 days in 2012 to 2013. It indicates that the payment from the customer is delayed from 29.74 days to 68.27 days or dairy plant fails to recover the money from the debtors. At the same time, if we take a look at creditor turnover in days, the payment of the supplier delayed by the plant from 24.15 to 34.05 days. It is an indication that the dairy plant doesn't have adequate money to pay the creditors. Hence the payment is delayed. The dairy plants net profit ratios show negative net profit from -3.12 to -6.6 in the year 2012 & 2013 respectively. It is an indication that dairy plant fails to keep its cost under control. The table no. 2 shows that procurement cost constitute around 91 per cent of milk sale. Gross profit margin is only around 9 per cent to cover all other overheads. The selling and distribution overheads constitute around 5.6 per cent of the total milk sale. It means that dairy plant focusses on aggressive marketing. This cost has substantial effect on the profitability of the dairy operations.

Particulars	2013	Cost % of Sales	2014	Cost % of Sales
Sales	58354583	100	36023524	100
Procurement cost	53062999	90.93201534	30291608	90.93201534
processing cost	1071871	1.836824088	1276533	1.836824088
employee cost	1752568	3.003308233	1782500	3.003308233
Selling and Distribution cost	3272251	5.607530417	3707333	5.607530417
administration cost	26681	0.045722201	27634	0.045722201
financial cost	991989	1.699933315	1313904	1.699933315
PBIT	-1823775	-3.125333593	-2375988	-3.125333593

Table 2

6. Observations and findings

6.1 Dairy plants account receivable practices are poor. The plant has either offered a liberal credit to customers or failed to select a right customer on their credit worthiness. Though the current ratio seems good but if we look at the debtors the payment collection is very poor. This is bad sign especially for the high turnover low margin industry wherein the procurement cost constitutes around 91% of the total milk sale. The reason sighted by the director to continue the supply of milk sale to those customers with an anticipation that customers will not pay if milk supply stopped to them. The sounds like lack of professionalism in following the sound debtor management practices like selecting proper customers on the basis of credit worthiness, setting formal debtor and creditor policies, ensuring prompt recovery from the customers or taking business decisions on the basis of debtor aging schedule and daily

cash inflow and outflow. The plant authorities might be lacking in financial aspects of management. The poor financial knowledge and skills might have affected the financial decisions and financial discipline in the plant.

6.2. Through the cost analysis, it is observed that dairy plant focus on marketing and substantial portion of the money was spend on selling and distribution. The poor marketing especially in identifying and selecting the wrong customers without verifying their credit worthiness or financial standings. This is clear from the slower or almost non recovery of payments from the customer even after six months' period. The poor cash inflow brings the dairy plant in financial difficulty as it fails to fulfill the current obligations on the basis of current operations of dairy plants.

6.3. If we look at the dairy plants capital structure, it is debt ridden. It is 2.4 times of shareholder's equity or 78 per cent of the total assets. Debts brings financial obligations of paying interest along with principal and that is risk to the dairy plant. It significantly influences profit and risk. The plan failed to earn sufficient profit which is at least enough to pay bank interests and principal. Hence capital structure decisions substantially affect the working capital performance if finance not allocated and utilized properly.

7. Conclusions

Financial knowledge and skills matters in any business or non-business activities as each and every decision have financial implications. Healthy of the business depends upon the sound financial management practices and their proper implementation, monitoring and control. The business short term survival depends upon the effective management of the current assets and current liabilities. If any business has to thrive or prosper, then they need to make their cash position healthy and ensure that cash inflow and cash outflow properly managed so that short term failure can be avoided. Hence dairy plant especially need to refine their account receivable management practices on the basis of sound financial management practices which ensure timely, regular and healthy cash inflow by selecting the right customer, ensuring strict recovery, eliminating poor customers and implementing formal credit policy.

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