PalArch's Journal of Archaeology of Egypt / Egyptology

THE IMPACT OF ACCOUNT RECEIVABLE IN COMPANIES' VALUE: A STUDY OF SAUDI COMPANIES (RADWA TRADING COMPANY)

Ahlam Alalami[1], Shabir Hakim[2]

[1,2] Effat College of Business, Effat University Qasr Khuzam St.,Kilo. 2, Old Mecca Road.

P.O.BOX 34689 Jeddah 21478 Saudi Arabia

Email: [1]ahalalami@effatuniversity.edu.sa, [2]shhakim@effatuniversity.edu.sa

Ahlam Alalami, Shabir Hakim. The Impact of Account Receivable in Companies' Value: A Study of Saudi Companies (Radwa Trading Company) -- Palarch's Journal of Archaeology of Egypt/Egyptology 18(13), 1234-1242. ISSN 1567-214x

Keywords: Account Receivable, Credit Policy, Trade Credit, Liquidity, Firm Value, Profitability, Ar Aging

ABSTRACT

This paper has analyzed the impact of accounts receivable in Saudi companies' value. There is a negative impact on the value of the company when the company has a huge amount in the Account receivables aging system. This problem faced many profitability companies and they failed at the end due to lack of management of Account Receivables (AR). Additionally, this study has used AR aging of Radwa Trading Company as a case study. The results that the company sets credit policy based on the customer category and there is no credit department. The maximum days for wholesalers to pay are 30 days, and for retailers (regional chain and local chain) are 60 days. The company is taking two types of provision: Over one year they take provision over 50% and over two years they take 100% of the total amount as a provision. Economic recession is an external factor that causes an increase in the AR aging days. The company reaches optimal AR management when they increase the average days of payment from 30 to 60 days.

INTRODUCTION

Trade credit is selling products to customers and giving those customers a certain amount of time to make payments. Interest in debt claims is a significant aspect of a company's monetary records [1]. These significant degrees of exchange credit conceded by firms to clients can have significant ramifications for firm worth and benefit. Moreover, the presence of market defect suggests that exchange credit choices may influence the estimation of the firm. There are numerous reasons that lead providers to expand credit. Mainly, giving exchange credit improves association's deals and therefore may bring about higher productivity [2].

An essential capacity of exchange credit is to moderate clients' money related grindings, along these lines encouraging expanded deals and piece of the overall industry growth [3]. In expansion to settling financing gratings, exchange credit can help deals by lightening educational asymmetry among providers and purchasers as far as item quality. In this sense, the vender's interest in exchange credit encourages trade by lessening vulnerability about item quality [4]. Exchange credit likewise empowers value segregation, by changing the time of credit or the markdown for brief installment, firms can sell their items at various costs relying upon the interest flexibility of clients. In a drawn-out point of view, exchange credit may give future benefits by setting up and keeping up lasting business relations [4].

Notwithstanding expanding deals, exchange credit may build incomes through understood loan costs or then again it might decrease working and exchange costs. In any case, the arrangement of exchange credit involves negative impacts, for example, default hazard or late installment, which may harm firm benefit [5]. Additionally, expanding provider financing includes authoritative expenses related with the conceding and checking measure, just as exchange costs for changing over receivables into money. Besides, conveying receivables on the accounting report suggests direct financing and opportunity costs, so decreasing the assets accessible for extension ventures [6].

Hypothetical models contend that there is an ideal exchange credit strategy [7]. Exchange credit can be utilized to build firm esteem when money related business sectors are defective, so suggesting an ideal exchange credit strategy [7]. What's more, the ideal degree of records receivable happens when the peripheral income of exchange credit is equivalent to the minimal expense [8]. Thusly, one may expect a non-monotonic (curved) connection between exchange credit and firm worth controlled by a tradeoff between the expenses and advantages of providing exchange credit, where there is a degree of exchange credit conceded which expands firm worth [9].

This straight impact between exchange credit strategy and firm worth might be clearer for the instance of SMEs [10]. Firms working in serious business sectors are compelled to offer industry credit terms. Also, SMEs for the most part have less haggling force and need to ensure the nature of the items they sell. In this sense, SMEs could be compelled to concede exchange credit regardless of the expenses related, since not to do so would prompt loss of deals, and lower benefit [11]. Besides, firms may utilize exchange credit approaches that are identified with their objective development rates; a firm ready to develop may pick a methodology of broadening more exchange than its rivals. Since SMEs as a rule are high development firms, they can utilize exchange acknowledge terms as a serious apparatus to keep on expanding deals [12].

The management of Account Receivables (AR) is also an important element in trade credit for companies and SMEs. Management of AR is the process of making sure that the customer makes the payment on the required due date [12]. Additionally, optimal management of AR prevents customers to delay or default on a payment as well as optimal receivable management helps to maximize the firm profitability by reducing the risk of customers default [13]. All sizes of business must take into consideration AR and they have to make sure that all business revenues are entered in the company as cash flow not just stay as credit [14]. Additionally, setting policies for both customers and staffs about credit obligation, tracking and monitoring of customer ARs, differentiating between types of customers; who buy more and not pay and who buy less and pay in timely manner, and training to credit management team are considering as enhancement ways in managing AR department [15].

This paper studies the impact of AR on firm value. There is a negative impact on the value of the company when the company has a huge amount in the account receivables aging system. This problem faced many profitability companies' and they failed at the end due to lack of management of Account Receivables. This problem needs to be solved by applying new techniques in Saudi companies to achieve efficient account receivable management.

METHODOLOGY

This study has utilized quantitative comparison approach of a case study. This study used Radwa Trading Company as a case study. Radwa Trading Company is a Distribution Company that distributes perfumes and beauty products to wholesalers and retailers in KSA. The company shareholders are Farouk Trading and Contracting Co (FTC) and JAMJOOM family. They use the Account Receivable Aging system to manage their trade credit. The case study includes a comparison between total AR outstanding amounts provided by the company to its customers during the last four years. Additionally, the comparison between AR Aging done in the last four years.

RESULT AND DISCUSSION

Case Study

The case study has included a comparison between total AR outstanding amounts provided by the company to its customers during the last four years. Additionally, include a comparison between AR Aging during the last four years (2019-2016). Therefore, the company uses its method to calculate the time value of money which affects directly the cash conversion cycle of the company and then this affects the firm value.

Figure 1 shows the amount of AR outstanding for 2016 and 2017. Total AR Outstanding Amount in 2016 was SR 36,817,409 and in 2017 was SR 57,232,255. We can see that trade credit is increased by 55% from 2016 to 2017. The company adopts the provision method as a way to calculate the time value of money. If the time of customer payment exceeds 360 days, they take half of the amount as provision and if the time of customer payment exceeds 720 days, they take the whole amount as a provision. The minus amount in the provision part is conceder as the amount that the company has to pay to the customer for returns and something like that. The positive amount is the amount that the customers have to pay to the company so we can see in 2016 the company lost SR 528,786 and in 2017 the company lost SR 10,036,272.

	2016			2017		
	amount	%	Provision	amount	%	Provision
Total AR Outstanding Amount (LC)	36,817,409	100.00%		57,232,255	100.00%	
AR Aging 1-30 Amount (LC)	9,791,779	26.60%		8,321,451	14.54%	
AR Aging 31-60 Amount (LC)	10,614,628	28.83%		6,075,065	10.61%	
AR Aging 61-90 Amount (LC)	7,066,473	19.19%		10,548,486	18.43%	
AR Aging 91-120 Amount (LC)	5,503,898	14.95%		21,562,785	37.68%	
AR Aging 121-150 Amount (LC)	1,219,547	3.31%		5,882,749	10.28%	
AR Aging 151-360 Amount (LC)	2,591,864	7.04%		(14,694,446)	-25.68%	
AR Aging 361-720 Amount (LC)	(499,566)	-1.36%	(249,783)	20,072,545	35.07%	10,036,272
AR Aging 720+ Amount (LC)	528,786	1.44%	528,786	(536,380)	-0.94%	(536,380)

Figure 1. AR Outstanding For 2016 And 2017

Figure 2 shows the amount of AR outstanding for 2018 and 2019. Total AR Outstanding Amount in 2018 was SR 79,791,566 and in 2019 was SR 133,098,748. It is can see that the trade credit is increased by 117% from 2016 to 2018 as well it can be seen that the trade credit is increased by 262% from 2016 to 2019. In 2018, the company didn't lose any amount and we can see that the company goes on the right track on payment collection. Even though, we can see that the company has to pay back the customer SR 2,167,333 (491,347+ 1,675,986) and it refers there is a huge number of items is returned due to many reasons; the product did not satisfy the customer requirement, product damages, etc. In 2019, the company loss SR 828,460 as a provision.

	2018			2019		
	amount	%	Provision	amount	%	Provision
Total AR Outstanding Amount (LC)	79,791,566	100.00%		133,098,748	100.00%	
AR Aging 1-30 Amount (LC)	35,206,424	44.12%		35,023,139	26.31%	
AR Aging 31-60 Amount (LC)	14,086,778	17.65%		25,594,087	19.23%	
AR Aging 61-90 Amount (LC)	12,014,064	15.06%		36,492,681	27.42%	
AR Aging 91-120 Amount (LC)	1,170,171	1.47%		14,216,467	10.68%	
AR Aging 121-150 Amount (LC)	8,771,488	10.99%		7,211,348	5.42%	
AR Aging 151-360 Amount (LC)	10,709,974	13.42%		12,947,734	9.73%	
AR Aging 361-720 Amount (LC)	(491,347)	-0.62%	(245,674)	1,656,921	1.24%	828,460
AR Aging 720+ Amount (LC)	(1,675,986)	-2.10%	(1,675,986)	(43,628)	-0.03%	(43,628)

Figure 2. AR Outstanding For 2018 And 2019

Figure 3 shows the losses relative to AR outstanding. The AR outstanding amount is increasing each year as well as we can see that the amount of losses variable; on 2016 SR 528,786, on 2017 SR 10,036,272, on 2018 SR -2,167,333 (returns), and in 2019 SR 828,460. The company started to increase on trade credit and it lost money on 2017, faced returns issue on 2018, and then they go in the right track on 2019 even they loss but the loss is too much less than the losses on 2016 and 2017 at the same time they offer more trade credit relative to 2016 and 2017.

year	AR amount			%
2016	$36,817,409.20	$	528,786	1.44%
2017	$57,232,255.33	$	10,036,272	17.54%
2018	$79,791,566.27	$	(2,167,333)	-2.72%
2019	$133,098,748.32	$	828,460	0.62%
total	$306,939,979.12	$	9,471,858	16.88%

Figure 3. Losses Relative to AR Outstanding

Figure 4 shows the AR Aging from 2016 to 2019. The AR Aging is classified into 5 sections; 60 days, 90 days, 120 days, 150 days, and 360 days. The average days of AR Aging are 60 days. With every increase in days, the risk of default in payment is increase. Additionally, from the table, with the offering of more trade credit, the aging amount is increasing. When the amount is greater than 360 days, it's the highest risk of defaults on payment; in 2016 the amount was SR 29,220, in 2017 the amount was SR 19,536,165, on 2018 SR -2,167,333(returns), and on 2019 the amount was SR 1,613,292.

	2016	2017	2018	2019	Highest Risk
	amount	amount	amount	amount	Rank
>60 Days	16,411,002	42,835,739	30,498,365	72,481,522	5
>90 Days	9,344,530	32,287,253	18,484,300	35,988,842	4
>120 Days	3,840,631	10,724,468	17,314,129	21,772,374	3
> 150 days	2,621,084	4,841,718	8,542,641	14,561,026	2
>360 days	29,220	19,536,165	(2,167,333)	1,613,292	1

Figure 4. AR Aging From 2016 To 2019.

Based on Figure 5, it is seen that in 2016(blue line) they provide the lowest credit trade, as well as they, have customers defaulted on payment. Additionally, the amount that in 2017(red line) the customers have to pay is the highest amount greater than in other years. In 2018(green line) they offer trade credit higher than in 2016 and 2017 and they have a huge amount as returns. In 2019(purple line) the company offers the highest amount of trade credit relative to the previous year and at the same time they have customers default on payment amount conceder as low amount relative to the AR outstanding Amount and it's higher than the deflated amount on 2016. Based on Figure 6, it is seen that AR outstanding amount is increasing with each year comparing to the total amount offered in these 4 years.

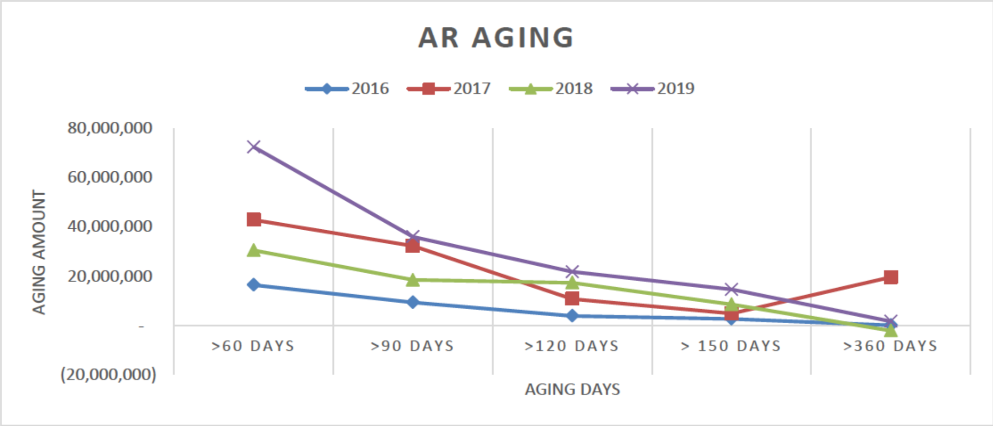

Figure 5. Ar Aging Chart

year	AR amount	%
2016	$ 36,817,409.20	11.99%
2017	$ 57,232,255.33	18.65%
2018	$ 79,791,566.27	26.00%
2019	$ 133,098,748.32	43.36%
total	$ 306,939,979.12	100.00%

Figure 6. AR Amount Relative to Total Amount During 4 Years

In addition, based on Figure 7 and Figure 8, it is seen that investing in trade credit is increase more than doubled in each year comparing to the based the year 2016. Therefore, this represents that the company becomes more focusing on trade credit on these periods.

year	AR amount	%
2016	$ 36,817,409.20	0%
2017	$ 57,232,255.33	55%
2018	$ 79,791,566.27	117%
2019	$ 133,098,748.32	262%

Figure 7. Vertical Analysis of AR Outstanding by Taking 2016 As Based Year

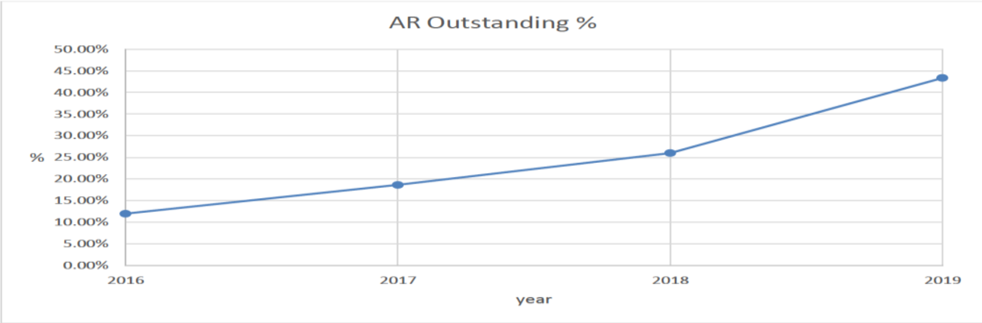

Figure 8. Vertical Analysis Chart

OVERALL DISCUSSION

Based on AR management, credit policy sets based on the customer category and there is no credit department. The aging followed by the finance department and the collection followed by sales teams. The maximum days for wholesalers to pay are 30 days, and for retailers (regional chain and local chain) are 60 days. The reasons for using different policies with different categories are that the wholesalers get an extra discount because a huge number of orders and the company used low margin with those customers. With retailers, the company uses a regular discount with more time to pay. Indicators of delay on payment are after 30 days for wholesalers, after 60 days for retailers and after 90 days with three specific customers having cash issues. The company put two norms to classify receivables by taking a provision: Over one year they take provision over 50% and over two years they take 100%.

If the customer delay payment the company will hold his account of sales, if he continues delaying the whole group will hold delivering to him, and if there is no response the company will go legally. The company takes power in putting policy from strong brands especially from *Chanel* because it's a leader in the market.

In the company, they agree that there is no need to have a credit department arguing about having different brands need of collecting the receivables by each brand sales team. Economic recession is an external factor that causes an increase in the AR aging average days from 30 to 60 days as well as an increase in trade credit to encourage customers to buy. The sales team and people who are in charge of following the collection are internal factors that they have to keep monitoring receivables. In 2017-2018, the internal factor that affects negatively on the AR aging due to internal restructuring of the company and fired some employees who control the customer payment. AR and company liquidity from 2016 to 2018, the company faced an increase in trade credit and this affects negatively their liquidity. In 2019, they provide the highest trade credit compare to the last three years as well as at this year they have the lowest amount of money greater than 360 days comparing to the last three years. This referred that they improve the collection and fewer liquidity issues. When the customers delay payments, the company takes loans or overdrafts from the bank. In this case, the interest amount increases with any amount they use it from overdrafts so their expenses increase which affect negatively the firm value. Aged receivables increase in the provision and then decrease on the company profitability. Make a balance between liquidity and customer service through financing their receivables from their suppliers. In the case of delaying occur from customers, the company forced to take a loan or over-drafted to make a balance between liquidity and customer service. Receivables have a direct relationship with the cash flow in the company. In the previous three years, the company has a poor collection of cash so they go to bank loans as an alternative to run their business. While in 2019, they improve their receivables and they can run their business through receivables.

AR and company profitability, the company faced both: customers' default in 2018 and return the product in 2017. This affected negatively on the firm value. Investing in receivables to increase the number of customers, so sales will increase but they have to make sure that this increase in sales inters the company as cash/ profit. If the cash increases it's mean that investing in trade credit maximizes the company profitability if not the company's profitability will decrease. They rich optimal AR management when they increase the average days of payment from 30 to 60 days. For a brand that there is no substitute for it like Chanel, so they are in a better position and they can consider that any policy they put is optimal. In the company, they agree that there is no need for the credit department and it does not affect the firm value. In the previous 3 years, increasing trade credit was having a negative impact on the firm value due to increasing the risk of high aging over 360 days. However, in 2019, they solve this issue and the AR become going positively with firm value. They want to improve the AR aging method by improving the reconciliation process, trying to build a strong relationship with customers through contacting customers, dealing with the right customers with right credit terms, increasing the awareness of sales teams about the importance of AR aging.

The company can improve the AR aging system and management by putting the credit department. Even though, having different brands, they can divide the collection based on the brand name within the credit department. Additionally, they can set collectors for each brand. By taking into consideration Vision 2030 the economic condition will improve, so the company has two ways to improve the profitability through trade credit either increasing in trade credit with the objective of increasing the cash not sales only or being on the safe side by decrease the trade credit because the customer will be more able to pay cash, both ways will help to increase the company profitability.

CONCLUSION

This paper has analyzed the impact of AR on firm value in Saudi Arabia, whereby Radwa Trading Company was analyzed as a case study. The target of the study is to understand the account receivables management practice used by the company. The study compared the account receivables of the company done in the last four years. Finding were that the AR outstanding amount was an increase in each year as well as the amount of losses variable; on 2016 SR 528,786, on 2017 SR 10,036,272, on 2018 SR -2,167,333 (returns), and on 2019 SR 828,460. The company starts to increase on trade credit and it lost money on 2017, faced returns issue on 2018, and then it goes in the right track on 2019 even it losses but the loss is too much less than the losses on 2016 and 2017 at the same time they offer more trade credit relative to 2016 and 2017.

REFERENCES

Yang, S. A., & Birge, J. R. (2018). Trade credit, risk sharing, and inventory financing portfolios. *Management Science*, *64*(8), 3667-3689.

Chod, J., Lyandres, E., & Yang, S. A. (2019). Trade credit and supplier competition. *Journal of Financial Economics*, *131*(2), 484-505.

Cole, R. A. (2018). Bank credit, trade credit or no credit: Evidence from the Surveys of Small Business Finances. *Trade Credit or No Credit: Evidence from the Surveys of Small Business Finances (July 31, 2018)*.

Fabbri, D., & Klapper, L. F. (2016). Bargaining power and trade credit. *Journal of corporate finance*, *41*, 66-80.

Chen, S., Ma, H., & Wu, Q. (2019). Bank credit and trade credit: Evidence from natural experiments. *Journal of Banking & Finance*, *108*, 105616.

Carbo-Valverde, S., Rodriguez-Fernandez, F., & Udell, G. F. (2016). Trade credit, the financial crisis, and SME access to finance. *Journal of Money, Credit and Banking*, *48*(1), 113-143.

Wu, D., Zhang, B., & Baron, O. (2019). A trade credit model with asymmetric competing retailers. *Production and Operations Management*, *28*(1), 206-231.

El Ghoul, S., & Zheng, X. (2016). Trade credit provision and national culture. *Journal of Corporate Finance*, *41*, 475-501.

Chod, J. (2017). Inventory, risk shifting, and trade credit. *Management Science*, *63*(10), 3207-3225.

McGuinness, G., Hogan, T., & Powell, R. (2018). European trade credit use and SME survival. *Journal of Corporate Finance*, *49*, 81-103.

McGuinness, G., & Hogan, T. (2016). Bank credit and trade credit: Evidence from SMEs over the financial crisis. *International Small Business Journal*, *34*(4), 412-445.

Lee, H. H., Zhou, J., & Wang, J. (2018). Trade credit financing under competition and its impact on firm performance in supply chains. *Manufacturing & Service Operations Management*, *20*(1), 36-52.

Norden, L., Udell, G. F., & Wang, T. (2020). Do bank bailouts affect the provision of trade credit? *Journal of Corporate Finance*, *60*, 101522.

Shenoy, J., & Williams, R. (2017). Trade credit and the joint effects of supplier and customer financial characteristics. *Journal of Financial Intermediation*, *29*, 68-80.

Tu, T. T. T., Huong, T. T. D., & Beason, D. (2019). Determinants of Account Receivable and Its Optimal Level: An Empirical Test on Vietnamese Companies. *Journal of Applied Economic Sciences*, *14*(2).