

Application controlling of claims in the logistics company

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Abstract

In the condition of the increasing complexity of the business systems and their environment is the controlling an essential basic of the success of each company. It is a phenomenon which integrates the information processing, the analysis processes, the preparation of the business plans and the control processes. Controlling is implemented into the company system by the broad range of the activities that are influencing all the sectors, departments and the levels of the management. This article is focused on the financial controlling and on the keeping the financial balance over the year. Each company knows that to be competitive and has high sales, ordinary needs to offer some kind of the trade credit to the customers. By the sales of the credit arises the difference between the cash and the bookkeeping sales. These sales are until the date of the payment from the financial aspect unfinished, thus resulting to the assets that need to be financed in a way but there is always the risk that supplier won't pay on the time or at all. The aim of this paper is to present and to verify the complex model of the asset evaluation in the condition of the logistic company and its financial and economic consequences..

Keywords: financial controlling, controlling of claims, claims, working capital, logistics company.

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1. Introduction

All aspects of the business and the business environment come from the time of its inception, ongoing process of developing, improving, expanding and learning. The most substantial task for them is to face the continuous competitive fight. Therefore to be able that each of companies can exploit these developments and successfully apply it in their strategies and targets, it is necessary to adapt to the continuous changing conditions of business and the business environment and to adopt new methods for the effective management of the business and its continuous development. Recently, in the management of businesses, more and more occurs a concept named controlling as a governance function. Controlling is a management concept aimed at a result which goes beyond the functions and coordinates the planning, control and information flows.

Controlling is a very huge system and within the contribution we will focus on a specific area of financial controlling - controlling of claims. Currently, claims are becoming increasingly risky components of assets of the company, which has in many cases negative impact on the solvency of the company. In the business conditions the activity associated with the management of the claims is problematic. It often happens that the value committed in the claims overdue may cause a secondary insolvency of the company. In a competitive environment it is almost impossible to avoid the provision of trade credits, while increasing the number of problematic claims. With grant credits it relates also credit risk, which is from view of successful operation necessary to constantly monitor and evaluate. This is the want which is secure by controlling of claims which is an important factor in reducing the risk of secondary insolvency of the company.

2. Theoretical background

The most important prerequisite for ensuring the existence of the company is permanent solvency, i.e. the ability of the company at any moment to pay the due payment obligations. The company is solvent if there are at every moment more immediate financial resources (cash in hand, sources held at banks, or long-term commercial paper) as the outstanding obligations (Ponisciakova, 2014)

The main task of financial controlling is to ensure the financial balance. Further, timely detection of company's financial strengths and weaknesses, timely forecasts of financial limits, a clear statement of the principle of financing, as well as preventive measures for ensuring solvency. The main functions of financial controlling are shown in figure 1 (Ponisciakova & Sukalova, 2013)

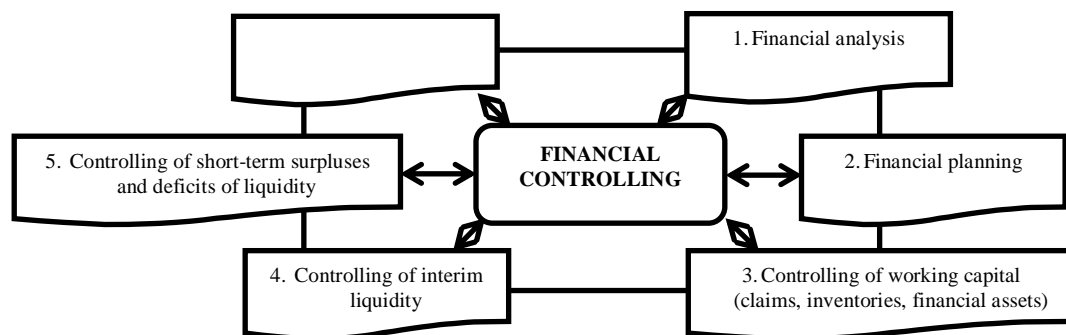


Figure 1. The tasks of financial controlling.

Source: edited from source Freiberg (1996)

Controlling of claims is a separate area of financial controlling, which can ensure timely and effective prevention to avoid the serious problems with solvency in the company. The main activity of controlling of claims is:

- Rating of financial-economic impacts of the credit policy
- A different approach to customers
- Monitoring of claims

2.1. Rating of financial-economic impact of the credit policy

The first phase in management process of claims is the decision to grant, or not grant credit to customers, while the objective is to evaluate the information about customers and follow them to determine payment conditions and limits of granting credit. The value of corporate performance depends from too many internal and external factors and the time available depends from the undertaking of its customers to pay for their performances.

Continuous progress of business relationship is just wished vision in our business environment. It is described by all liabilities between businessmen, which are filled on time and in required amount for the supply of the products, services or goods. Unless the customer is not paying for the goods, the sales are in progress from the view of the cash, i.e. unfinished. By granting credit leads to increase in claims, leading to the growth of cost and risks. In the case of contractual obligations is not reached in the required limits and amount become implications. The part of controlling procedures should be estimate of positive and negative implication of credit policy (Siekelova, 2015).

2.2. A different approach to customers

Until the creating of the payment terms for their own customers, company should have a differentiated approach. Sometimes the companies, which are longer on the market have feeling that they know divide their customers to responsible customers, i.e. granting credit without much risk and to customers, where the risk of not paid of claims is higher. But the financial situation of the customer is continuously changing and because of this reason it is necessary to monitor the financial health and solvency of customers. The company must set the limits for the customers, while the credit of the best customer should not be more than 20 % from average state of claims of the company. In other case unexpected shortfall in the payment should make secondary insolvency of the company or in the worst case also bankruptcy of the company.

2.3. Monitoring of claims

The main tasks in monitoring and managing claims by the controlling department can be the following activities Bragg (2004):

- evidence and control of claims,
- setting credit limits and their control,
- estimation of credibility of customers,
- control of the claims overdue and realization following measures,

- ensuring the collection, using the reminders and sanctions,
- monitoring the claims (turnover period, average daily sales, age of claims, etc.),
- analyses, plans and control the credit relationship and claims.

3. Objective and Methodology

The objective of this paper is to present and to verify the complex model of the asset evaluation in the condition of the logistic company and its financial and economic consequences. The methodology is closely related with the tasks of this paper. When we choose it, we considerate the fact, that from the point of set the objectives there doesn't exist any credit policy in every time, which can be optimal from the view of company. From these reason is necessary that the credit policy should be regularly revised through the following steps (Figure 2)

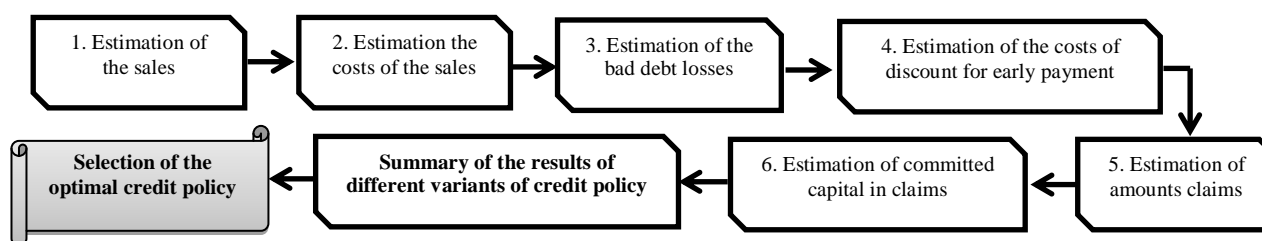


Figure 2. The steps of determining optimal credit policy

Source: edited from source Freiberg (1996)

When the company is deciding on an optimal alternative credit policy, the company can use the following methodology for calculating of individual steps:

Estimation of the sales (income) - set as a percentage of revenues based on quantified estimate from documentation of the past and development of the commodity market.

Estimation the costs of the sales - because the stability of the fixed costs (production capacities will remain unchanged), the costs are not proportionally increasing to the sales, but digressing. The estimation of costs is determined by the basement in the quantified estimation, what means - the estimation of the sales that is adjusted to the effect of fixed costs (Freiberg, 1996)

Estimation of the bad debt losses - are based on the creditworthiness of the customer, which was established on the basis of past experience.

Estimation of the costs of discount for early payment - for determining the total amount of the discounts is necessary to estimate the response of the customer, if he prefers to use the discount (paying a lower amount, but he will pay earlier), or he waits with the payment and he uses the granting credit. The quantified estimation is based on the past experience of the company, the creditworthiness of a customer and the price of the money. Estimation costs of discount for early payment (EDEP) are calculated by Baran (2006) from the formula:

$$EDEP = \text{estimated \% customers, who use the discount} \times \% \text{ discount} \times \text{sales for the year} \quad (1)$$

Estimation of the amounts claims - is based on turnover of the claims in the different variants, while is respecting the ratio, which is showing % customers, who will use and not use the discount for early payment. The average duration of the claims payments (ADCP) are calculated from the formula:

$$A_{DCP} = \% \text{ customers, who use the discount} \times \text{days discounts} + \% \text{ customers, who not use the discount} \times \text{duration of the claims payments without use the discount} \quad (2)$$

The average amount of claims ($\emptyset C$) is calculated from the formula

$$\emptyset C = (\text{sales}/360) \times \text{ADCP} \quad (3)$$

Estimation of committed capital in claims - granting credit have to be committed by financial resources, that we propose to calculate as the costs using the weighted average cost of capital (WACC). In the case of loan it is cost of debt (interest rate from the debt in that year). In the case of equity it is rate of the costs of lost opportunities, which is reflected by the return on equity (ROE) in year "n". The weighted average cost of capital by Lehutova, Krizanova and Kliestikpon(2013) is calculated from the formula:

$$\text{WACC} = i \times (1 - T_c) \times D/V + \text{ROE} \times E/V \quad (4)$$

i - interest rate; T_c - corporate tax rate; D - market value of the firm's debt; V - total market value of the firm's financing (equity and debt); ROE - cost of equity; E - market value of the firm's equity.

In the next part of the article is proposing application a specific application of controlling methodology of claims management, which is focuses on the evaluation of the financial-economic implications of the credit policy in the selected company. We selected permanent customer for the model proposal of positive and negative effects of the credit policy, who receives 2 % of annual production. To the customer is applying a policy of delivery of goods against payment, i.e. cash on hand. The customer was chosen, because this kind of customers requires reconsidering their approach creating the payment terms.

In the proposed methodology is compare profitability of the existing variant of payment on hand, with simulated four variants, which are based on the propose principles of the payment of the analysed logistics company, which is not the subject of this paper. The proposed variants of liberal credit policy, i.e. to provide the customer a certain time for payment after the goods was delivered or cash discount enable the company to increase sales. The criterion for evaluating the variant's credit policy is maximizing the profit.

4. Empirical research

The annual sales of the analyzed logistics company to selected customer are 214 900, - € and the total annual cost of the sales are 195 600, - €.

Variant I: According to the client's rating is analyzed customer added among the most creditworthy, and company can give him 30 days payment term and if the customer pay to 15 days, the customer would get the 4 % discount. The above conditions are expected to grow by 60 % of sales. Company to increase this sale has available spare capacity.

Variant II: change is in do not offering the discount and thereby a change in the anticipated increase in sales by 50 % to the current situation and other conditions are unchanged from I. variant.

Variant III: If the customer has some problems in the creditworthiness, the company will give him tighten the terms of payment and it on 14 days. The customer will be able to use discount of 4 %, if he pay to 5 days. The above conditions are expected to grow by 45 % of sales compared with the current situation.

Variant IV: The change in the compare with previous variant III is only in not providing the discount, thereby increasing sales by 30 % in compared with the current situation.

In evaluating the advantages of individual variants of company's credit policy, we set the standard to amount of profit that can be achieved with the selected variants. In the current state (policy

delivery of goods against payment) is profit 19 300, - € and after tax (22 %) is 15 024, - €. Obtaining further solutions is also possible with recalculation of variant's costs and sales to be established profit of selected variants.

1. Estimation of the sales (income)

- Variant I: an increase of 60%, i.e. to 343 840, - €
- Variant II: an increase of 50%, i.e. to 322 350, - €
- Variant III: an increase of 45%, i.e. to 311 605, - €
- Variant IV: an increase of 30%, i.e. to 279 370, -

2. Estimation the costs of the sales

- Variant I: an increase of 53%, i.e. to 299 268, - €
- Variant II: an increase of 44%, i.e. to 281 664, - €
- Variant III: an increase of 40%, i.e. to 273 840, - €
- Variant IV: an increase of 26%, i.e. to 246 456, - €

3. Estimation of the bad debt losses

Based on experience, these losses were estimated at 0.5% of sales.

- Variant I: 0.5% from 343 840 € = 1 719, - €
- Variant II: 0.5% from 322 350 € = 1 612, - €
- Variant III: 0.5% from 311 605 € = 1 558, - €
- Variant IV: 0.5% from 279 370 € = 1 397

4. Estimation costs of discount for early payment

For individual variants the estimated percentages of customers who use the discount.

- Variant I: $0.60 \times 0.04 \times 343\,840 \text{ €} = 8\,252, - \text{ €}$
- Variant II: discount not provided = 0, - €
- Variant III: $0.50 \times 0.04 \times 311\,605 \text{ €} = 6\,232, - \text{ €}$
- Variant IV: discount not provided = 0, - €

5. Estimation of amounts claims

In the compare with the current situation, where is not any claims (customer pays at the time of delivery), in variants I – IV will be some volume of claims.

- Variant I: $\text{ADCP} = 0.60 \times 15 + 0.40 \times 30 = 21 \text{ days } \emptyset C = (343\,840/360) \times 21 = 20\,057, - \text{ €}$
- Variant II: $\text{ADCP} = 0 + 1 \times 30 = 30 \text{ days } \emptyset C = (322\,350/360) \times 30 = 26\,863, - \text{ €}$
- Variant III: $\text{ADCP} = 0.50 \times 5 + 0.50 \times 14 = 10 \text{ days } \emptyset C = (311\,605/360) \times 10 = 8\,656, - \text{ €}$
- Variant IV: $\text{ADCP} = 0 + 1 \times 14 = 14 \text{ days } \emptyset C = (279\,370/360) \times 14 = 10\,864, - \text{ €}$

6. Estimation of committed capital in claims

$$\text{WACC} = 7\% \times (1 - 0.22) \times 16\,444\,694/18\,798\,623 + 17.41\% \times 2\,353\,929/18\,798\,623 = 6.96\%$$

- Variant I: 6.96% from 20 057 = 1 395, - €
- Variant II: 6.96% from 26 863 = 1 869, - €
- Variant III: 6.96% from 8 656 = 602, - €
- Variant IV: 6.96% from 10 864 = 756, - €

Table 1. Summary of the results of different variants of credit policy

The indicator of credit policy	Current status	Variant I	Variant II	Variant III	Variant IV
Estimation of the sales in €	214 900	343 840	322 350	311 605	279 370
Estimation the costs of the sales in €	195 600	299 268	281 664	273 840	246 456
Estimation of the bad debt losses in €	0	1 719	1 612	1 558	1 397
Estimation cost of discount for early payment in €	0	8 252	0	6 232	0
Estimation of committed capital in claims in €	0	1 395	1 869	602	756
Earnings before Taxes in €	19 300	33 206	37 205	29 373	30 761
Tax 22% in €	4 246	7 305	8 185	6 462	6 767
Earnings after Taxes in €	15 054	25 901	29 020	22 911	23 994

Table 2. Summary of the advantages of individual variants of the company's credit policy

Variant	Current status	Variant III	Variant IV	Variant I	Variant II
Earnings after Taxes	15 054	22 911	23 994	25 901	29 020
Chronological order of benefit	5.	4.	3.	2.	1.

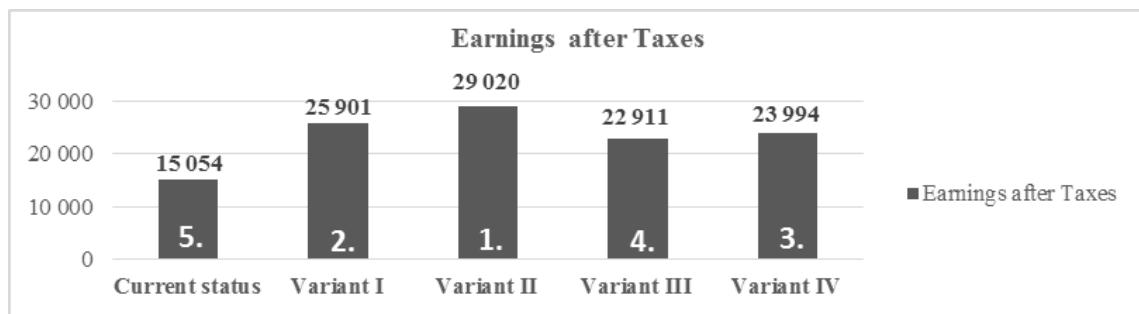


Figure 3. Summary of the advantages of individual variants of the company's credit policy

The results show that with the selected criteria, profit maximization is the best to realize second variant for the company, i.e. granting credit in 30 days without offering the discount for prompt payment. With II. variant company to achieve the highest profit, i.e. 29 020, - €, which represents about 92.77% increase in sales like in current status, which is the supply of goods against payment. The second most preferred variant is I, i.e. granting credit with a duration of 30 days and a discount (4/15, net 30). Profit at variant I is by 72.05% higher than the profit for the current state, i.e. 25 901, - €.

Order of benefit credit variants clearly shows that all variants company's commercial policy is more favorable than the current one. At the same time, these variants can ensure the company to increase market share, increase sales and maximize capacity utilization. But on the other hand, the company must consider whether it has sufficient additional capital in order to allow bind the amount of money in accounts claims. Furthermore, the company should consider how he can prevent the occurrence of non-recovered losses on claims, to assess the risk of delay or non-payment of claims, which leads the company to produce high additional costs which the company must use a recovery of claims. These

costs substantially worsen the financial and economic situation of the company. However, there are some solutions that the company can to avoid the growth of non-recovered claims:

- Motivation of customer to granting a period to pay the shipping performance, i.e. grant credit. In the interest of preventive measures, the company should provide discount for the customers, but the company waives certain percentage of revenues, however, prevents the emergence of bad debts.
- Estimating the creditworthiness of a business partner - past experience, the method of liability, seriousness behaviour, size of property, and so on.
- Increasing pressure on business partners whose creditworthiness is not on high level. Business parties may agree about sanctions for non-compliance with contractual terms before the delivery of the goods. In case when the customer fails to pay the claim till the prescribed period ends, the company will be able to penalize him, and penalties shall be credited to the invoice amount.
- Ensure the collection of claims using an accepted bill, i.e. a written undertaking by the purchaser. Exhibitor of accepted bill (purchaser) shall be guaranteed within a certain time to pay an amount of money, which is listed on the bill. Although the bill provides legal security, is tradable and it accelerate judicial process but from the customer side it is a certain pressure and he may not agree with it.
- The sale of claims before end of payment term, specialized organizations that take care of its collection - Factoring. Although the company will lose a certain part of the money from income claim, but can solve temporary problems with their own liquidity.
- Control of overdue claims and initiation of the following measures, for example create a relationship with customer. It is easier to collect money from someone we know. The best manner to build up this kind of relationship is to take a few extra times on the phone to chat with the customer and we should try to avoid any confrontations discussions.

Company by selecting different parameters (term of commercial loan, discount for early payment, etc.) influences the positive also negative effects which are change of the volume of revenue and cost of sales, the bad debt losses, the cost of committed capital in claims, costs to provide the discount. Research suggests that it is necessary to applicate the claims controlling for all customers. For simplify and accelerate the presented calculations is suitable for the company to create this methodology in the Excel spreadsheet in Microsoft Office. The program allows generating dozens of possible variants the credit company policy in few seconds and then selects the optimal variant according to the selected criteria.

5. Conclusion

The presented solutions, got and checked from the proposed complex methodological approach evaluation of financial-economics implications of credit policy of the company, expressly confirmed the need for controlling of claims in the company. Controlling is oriented on the monitoring of simply activity indicators, bookkeeping claims and also it must be a complete system of monitoring, analyzes and claim controls. The proposed model of evaluation of financial-economics implications in the selected logistics company simply shows the practical application of the controlling methods in the management of claims. Currently, the companies approach into the credit policy towards their customers is based on their experience from previous years, on their intuition and assumptions. By application of the controlling to the business management, the company will not make the decisions

based on the historical data which may be not accurate but based on the current and planned data with a focus on the future.

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