

A STUDY OF IMPACT OF BAD DEBTS ON SMALL BUSINESS

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**ABSTRACT**

The term bad debts are a major problem across the globe which affects small business, the present study discovers the impact of bad debts on small business and how its affect finance and sales of a company. Business enterprises today use credit as a prominent strategy in the area of marketing and financial management as it is necessary for growth in business. However, trade credit is highly vulnerable to bad debts and losses. The present study also aims at analyzing how bad debts harmful to small businesses and how individuals/proprietors deal with bad debt customers. Due to bad debts, a small business cannot survive in the market. The result of the study shows that the majority of small businesses sell on credit (54%) despite the efforts they put into managing their debtors. 26% of the default. The result further shows that small businesses incur relatively high costs when managing debtors. The study highlights the main challenges faced by the small business while managing debtors. Bad debts put pressure on small business cash flow thereby limiting the growth of business.

*Keywords: Bad debt, Debtors, Finance, Sales, Impact of bad debts on small business*

**INTRODUCTION:**

Bad debts can have a detrimental impact on a business, putting its survival at serious risk. One of the more obvious impacts of experiencing a bad debt is on a business's cash flow, affecting profitability and for an estimated 5% of business that has been victim to bad debt, plans for further investment are delayed small business enterprise /business are an important part of nation's economic and social structure, as they play a very important role in creating employment opportunities for the growing labour force. Small businesses exert a strong influence on the economies of all countries particularly in Developing countries Bad debt expense is one of the several noncash expenses in the income statement.

The concept of bad debt expense is relevant to companies that use the accrual basis of accounting and are heavy on credit sales. An uncollectible account or a bad debt reduces revenue. Improper valuation of this expense may either overstate or understate the revenue of a company. Recognition of bad debts is crucial in presenting the correct revenue of the company.

Bad debt is money owed that cannot be collected. A debt becomes "bad" or uncollectible when surrounding facts and circumstances indicate that there is no longer any chance that the amount owed will be paid, Recognizing Bad debts for income statement presentation.

Bad debt is written off as a loss to the business. there is a difference in recognizing bad debts for income statement presentation and the purpose of taxation. The income statement follows the accrual basis of accounting and should follow the allowance method in the presentation of bad debts. On the other hand, the direct write-off method is also allowed in the income statement for taxation purposes. The United States Internal Revenue Service (IRS) no longer allows businesses to use the allowance method in accounting for bad debts. The direct write-off method is required in computing their taxable income.

Matching concepts is a generally accepted accounting principle (GAAP). The matching rule dictates those revenues must be assigned to the accounting period in which the goods are sold or the services performed, and expenses must be assigned to the accounting period in which they are used to produce revenue. Under the allowance method, losses from bad debts are matched against the sales they help produce. Under direct write-off, bad debts are usually recorded in a different accounting period from the one in which the sale takes place; the method, therefore, does not conform to the matching rule (Needles, Powers, & Cresson, 2007).

**REVIEW OF LITERATURE:**

Amiri A (2003). Bad debt is an amount owed to a creditor that is unlikely to be paid and, or which the creditor is not willing to take action to collect because of various reasons, for example, due to a company going into liquidation or insolvency. There are various technical definitions of what constitutes a bad debt, depending on accounting conventions, regulatory treatment, and institution provisioning. In the USA, bank loans with more than ninety days' arrears become "problem loans". Accounting sources advise that the full amount of a bad debt be written off to the profit and loss account or a provision for bad debts as soon as it is foreseen.

Bakhtiari P. and Pasban F (2004). Doubtful debts are those debts which a business or individual is unlikely to be able to collect. The reasons for potential non-payment can include disputes oversupply, delivery, and the



condition of the item, or the appearance of financial stress within a customer's operations. When such a dispute occurs, it is prudent to add this debt or portion thereof to the doubtful debt reserve. This is done to avoid overstating the assets of the business as trade debtors are reported net of Doubtful debt. When there is no longer any doubt that a debt is uncollectible, the debt becomes bad. An example of a debt becoming uncollectible would be: - once final payments have been made from the liquidation of a customer's limited liability company, no further action can be taken.

Allowance for bad debts are amounts expected to be uncollected, but still with possibilities of being collected (when there is no other possibility for collection, they are considered uncollectible accounts). For example, if gross receivables are US\$100,000 and the amount that is expected to remain uncollected is \$5,000, the net current asset section of the balance sheet will be

Gross accounts receivable: \$100,000 Less: Allowance for bad debts: \$5,000 Net receivables: \$95,000 In financial accounting and finance, bad debt is the portion of receivables that can no longer be collected, typically from accounts receivable or loans. Bad debt in accounting is considered an expense.

#### OBJECTIVES:

- To study and understand the balance off debtors' accounts to allow for bad debts.
- To evaluate different reasons for bad debts in the business.
- To recommend suitable strategies on how minimizes the debt in small businesses.

#### RESEARCH METHODOLOGY:

Sources of data collection

Primary data was collected to target respondent through circulated Google form, and secondary data was collected from various websites and journals. This study has a sample of 75 respondents, which is selected at convenience to discover the impact of bad debts on small businesses. Data has been collected using the primary and secondary methods of data collection. Primary data was collected through the structured questionnaire of Google forms and secondary data was collected from various journals, articles, newspapers, magazines, and websites. The collected data were further analyzed by using a simple statistical tool like a percentage. For this study questionnaire was prepared to satisfy the objective of a research paper.

#### SCOPE:

The present study aims at discovering the impact of bad debts on small business and the relationship between debtors and bad debts .it also aims to analyze the various classes of bad debt, the possible causes of bad debt, the impact on business operation, and the measures to the managing bad debt.

#### LIMITATIONS:

Primary data relevant to the study may be much dependent upon the cooperation of the respondents.

Respondents' opinions cab is biased which cannot be ruled out.

The primary data collected may influence by the behavior and mood of the respondents of whom the survey is conducted.

#### HYPOTHESIS:

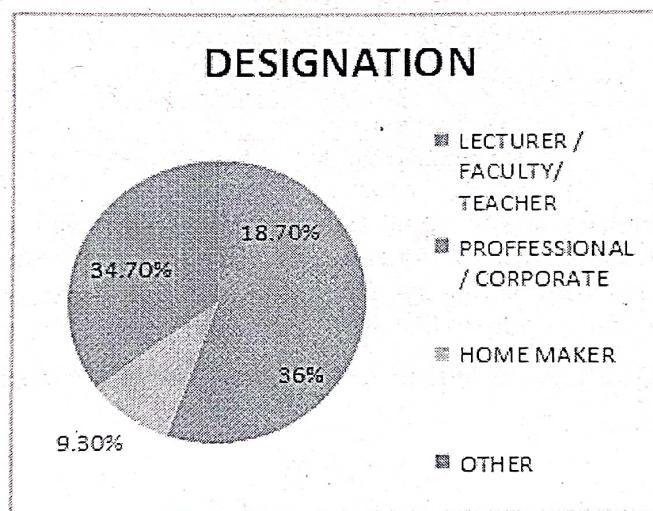
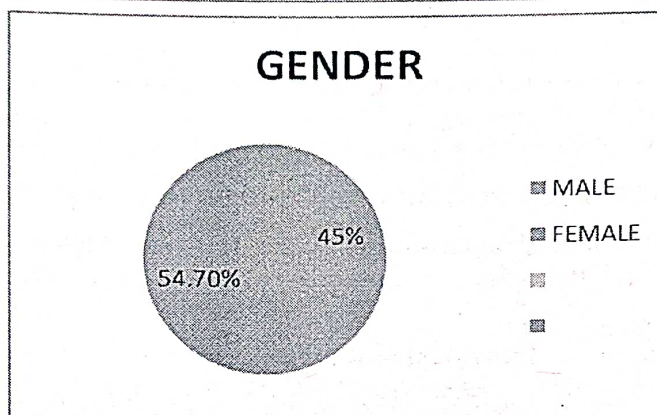
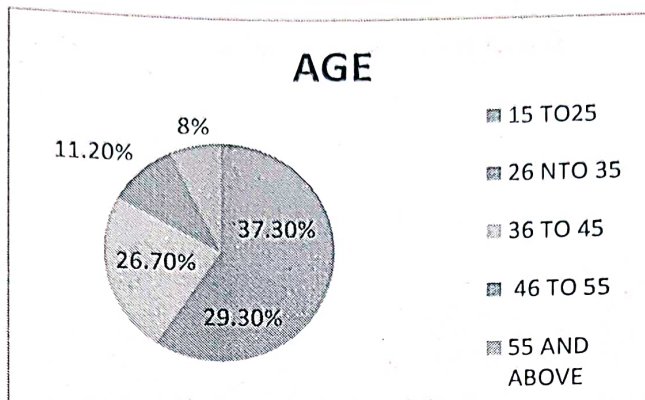
$H_1$ : There is a relation between Bad debts and Debtors

$H_0$ : There is no relation between Bad debts and Debtors

#### DATA ANALYSIS AND INTERPRETATION

##### A) DEMOGARHIC PROFILR OF RESPONDENTS:

The following pie chart represents demographic profile of respondents



**GENDER:** Among all the respondents there was 54.70% was females and 45.3% of males

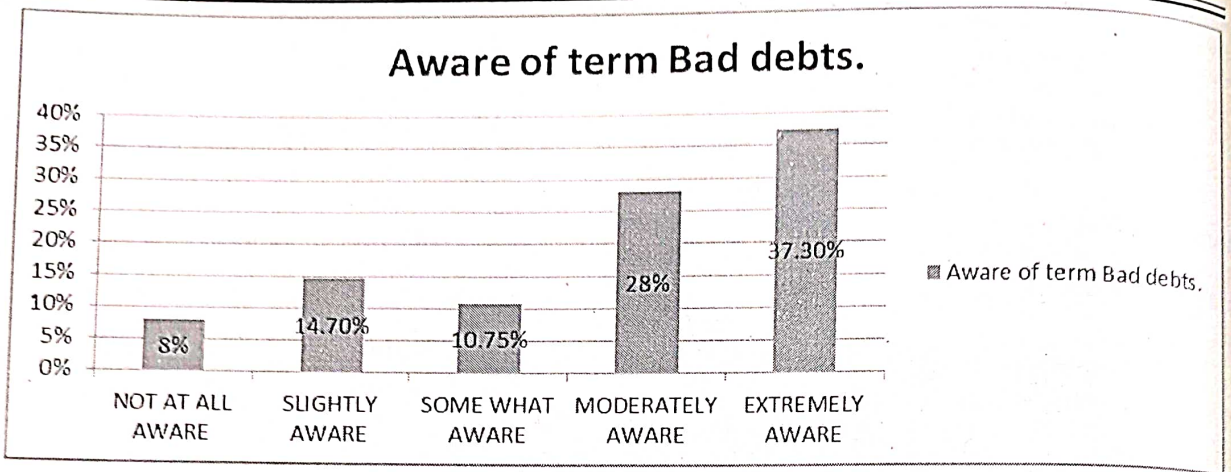
**AGE PROFILE:** The majority of respondents are between the ages of 15 to 25 that is 37.30%. The 29.30% of respondents were between 26 to 35. The 26.70% were age of 36 to 45. The respondents above age of 55 were 8% and respondents between age of 46 to 55 are 11.20%

**DESIGNATION:** In case of designation 18.70% were Faculty/ Lecturer/ Teacher, 36% were professional /corporate field, 9.30% were home maker, and 34.70% respondents were other designation.

**A) AWARE OF IMPACT OF BAD DEBTS:**

The following graph presents % of respondents who aware of term Bad debts.





**Findings:** Respondents were asked whether they are aware of the term bad debt. 8% of respondents said Not at all aware, 14.7% of respondents slightly aware, 10.7% of respondents somewhat aware, 28% of respondents moderately aware, and 37.3% of respondents extremely aware of the term Bad debts.

**B) HOW INDIVIDUAL/ PROPRIETOR DEAL WITH BAD DEBT CUSTOMER**

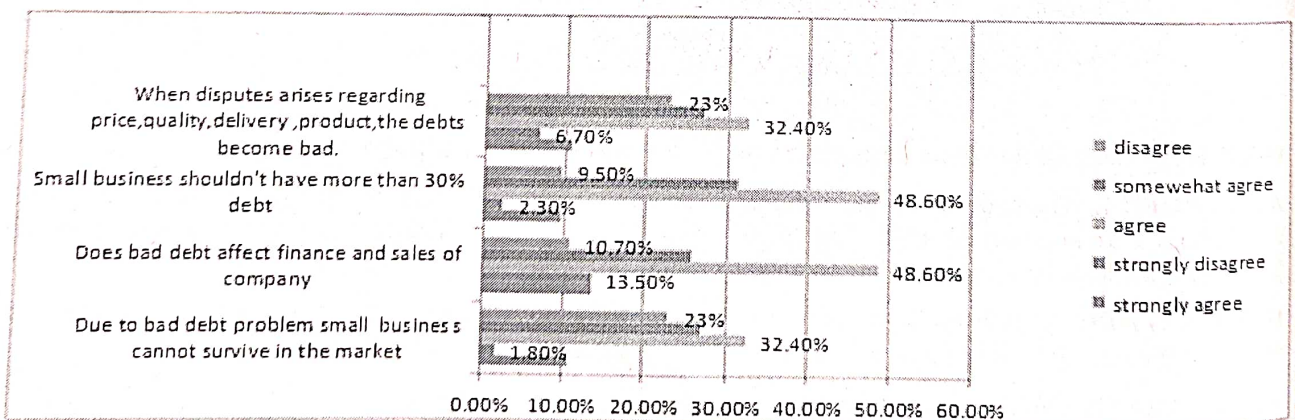
The following table presents how proprietor/individual deal with bad debts customer like motivated mindset, reduced financial liabilities, payment reminders, understand the problem and taking action on unpaid debts.

| Sr. no | Individual deal with bad debt customer | %   |
|--------|--|-----|
| 1.     | Motivated mindset—                     | 16% |
| 2.     | Reduce financial liability             | 12% |
| 3.     | payment reminders                      | 16% |
| 4.     | Understand problem                     | 16% |
| 5.     | Taking action on unpaid debts          | 40% |

**FINDINGS:** Respondents were asked about how they deal with bad debt customers. Among all respondents 16% were dealing with a motivated mindset, 12% of respondents deal with reduces liabilities, 16% respondents deal with payment reminders, 16% were deal with the understanding problem, and the majority of respondents like 40% deal with taking action with unpaid debts.

**C. THE FOLLOWING QUESTIONS WERE ASKED TO THE RESPONDENT.**

The Likert style was followed



**FINDINGS**

The respondents were asked when disputes arise price, quality, delivery, product the debts become bad. 10.8% of respondent strongly agreed, 23% disagreed 27% somewhat agreed and 32.4% agreed with the above

statement. 2nd question asked, small business shouldn't have more than 30% debt, 48.6% of respondent agreed, 31.1% somewhat agreed, 9.5% strongly agreed and 2.3% were strongly disagree. 3rd question asked, does bad debt affect finance and sales of the company, 48.6% of respondents agreed, 25.7% somewhat agree, 13.5% strongly agreed, 10.8% disagreed. 4th questions were asked due to bad debt problem, a small business cannot survive in the market, 47.3% of respondent agreed, 17.6% strongly agree, 21.6% somewhat agreed.

#### CONCLUSION:

Findings from this study show that management of Bad debt is critically important for small business survival because it affects their performance.

Most small businesses rely on trust while a few uses collateral to screen customers before selling credit. They keep on following them while monitoring them. To control, Bad debt, a few stop completely selling

On credit. while others charge interest on delayed payments.

#### RECOMMENDATIONS:

The following recommendations are therefore put forward in line with findings and conclusion from this study:

The study recommends that small business should regularly review their control on creditors to ensure they are ideal. this can be done by decreasing their day's account receivable cycle and adequate control and credit policies minimize the risk of bad debt. To reduce the percentage of bad debt allows cash discount to the respective customer.

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