

A Study on the Role of Credit Policy on Working Capital Performance in Garment Retail Business.

Vinit M. Varlani

Research Scholar

Department of Business Administration (MBA) SIPNA College of Engineering & Technology, Amravati

varlanivinit@gmail.com

Dr.M.D.Jadhav

Professor and Head MBA Department.

Sipna College of Engineering and Technology,

Amravati 444607

Amravati (MS.), India

manish_pari78@rediffmail.com

ABSTRACT

Working capital management plays a crucial role in the smooth functioning and profitability of retail businesses, especially in the garment retail sector where inventory turnover, credit sales, and seasonal demand are significant. Credit policy is one of the most important components of working capital management, as it directly affects cash flows, liquidity, and overall financial performance of a business.

This study aims to analyze the role of credit policy on working capital performance in garment retail businesses. The research focuses on understanding how credit terms, credit period, collection policies, and debtor management influence working capital efficiency. The study uses both primary data collected through structured questionnaires from garment retailers and secondary data obtained from books, journals, and financial reports.

The findings of the study indicate that an effective and well-structured credit policy improves liquidity, reduces bad debts, and enhances working capital performance. However, overly liberal credit policies may lead to cash flow problems and increased credit risk. The study provides useful insights for garment retailers to design balanced credit policies that support

sales growth while maintaining healthy working capital levels.

Keywords: Credit Policy, Working Capital Management, Garment Retail Business, Retail Finance, Liquidity Management, Accounts Receivable, Inventory Management, Cash Conversion Cycle, Financial Performance, Apparel Industry.

INTRODUCTION

Working capital refers to the funds required for day-to-day operations of a business, including the management of cash, inventory, receivables, and payables. Efficient working capital management is essential for the survival and growth of retail businesses, particularly in the garment retail sector where high inventory levels, changing fashion trends, and credit sales are common.

The garment retail business operates in a highly competitive environment with fluctuating consumer demand and seasonal sales patterns. To increase sales and retain customers, garment retailers often extend credit to wholesalers, distributors, and institutional buyers. This makes credit policy a critical factor influencing working capital performance.

Credit policy determines the terms and conditions under which credit is offered to customers. It includes decisions related to credit period, credit standards, cash discounts, and collection procedures. A liberal credit

policy may increase sales but can adversely affect liquidity, whereas a strict credit policy may improve cash flow but reduce sales volume. Therefore, maintaining an optimal credit policy is essential for balancing profitability and liquidity.

Poor credit management can result in delayed collections, higher bad debts, and increased working capital requirements. On the other hand, an effective credit policy improves cash inflows, reduces financial risk, and strengthens the overall financial health of the business.

This study attempts to examine the role of credit policy in influencing the working capital performance of garment retail businesses and to identify best practices for effective credit management in the retail sector.

In the present dynamic and competitive business environment, effective financial management has become a critical requirement for the survival and growth of retail businesses. Among the various financial management functions, working capital management occupies a central position as it ensures the smooth conduct of day-to-day operations. Working capital represents the difference between current assets and current liabilities and includes key components such as cash, inventory, accounts receivable, and accounts payable. Efficient management of these components is essential for maintaining liquidity, profitability, and operational efficiency.

Credit policy is one of the most significant determinants of working capital performance in retail businesses. It refers to the guidelines and procedures adopted by a firm for granting credit to customers and collecting outstanding dues. Credit policy includes decisions related to credit standards, credit period, cash discounts, credit limits, and collection policies. These decisions directly influence the level of accounts receivable, cash inflows, and the firm's liquidity position.

A liberal credit policy may boost sales and improve customer relationships, but it also increases the risk of delayed payments, bad debts, and higher working capital requirements. On the other hand, a strict credit policy improves cash flow and reduces credit risk but may lead to loss of customers and reduced sales. Therefore, maintaining a balanced and well-designed credit policy is essential to achieve the dual objectives of sales growth and financial stability.

In this context, studying the role of credit policy on working capital performance in garment retail businesses becomes highly relevant. Understanding how credit terms, collection practices, and receivables

management affect working capital can help retailers make informed financial decisions. This study attempts to examine the relationship between credit policy and working capital performance and to identify best practices that can help garment retailers achieve sustainable growth and financial stability.

RESEARCH OBJECTIVES

The main objectives of the study are as follows:

1. To understand the concept of credit policy and working capital management in garment retail businesses.
2. To analyze the impact of credit policy on working capital performance.
3. To examine the relationship between credit period, debtor turnover, and liquidity position.
4. To identify problems faced by garment retailers in managing credit sales and receivables.
5. To suggest measures for improving credit policy for better working capital efficiency.

REVIEW OF LITERATURE

Efficient working capital management has been widely recognized as a key determinant of business performance, particularly in retail and trading firms. According to **Gitman (2018)**, working capital management focuses on maintaining an optimal balance between liquidity and profitability, where credit policy plays a significant role in managing accounts receivable.

Smith (2019) emphasized that credit policy decisions directly influence a firm's cash conversion cycle. Liberal credit terms may increase sales volume but also extend the collection

period, thereby increasing working capital requirements. Conversely, strict credit policies improve liquidity but may negatively affect customer relationships and sales growth.

Padachi (2006) found that inefficient credit management leads to higher levels of receivables and poor cash flow management, especially in small and medium-sized retail businesses. The study concluded that firms with structured credit policies show better working capital performance and lower default risk.

In the context of retail businesses, **Narware (2017)** observed that garment retailers often face challenges such as delayed payments, seasonal inventory accumulation, and fluctuating demand. The study

highlighted that proper credit evaluation and timely collection practices significantly improve working capital efficiency.

RESEARCH METHODOLOGY

Research methodology refers to the systematic approach adopted to collect, analyze, and interpret data in order to achieve the objectives of the study.

i. Research Design

The study adopts a descriptive and analytical research design to examine the impact of credit policy on working capital performance in garment retail businesses.

ii. Data Sources Primary Data:

The study adopts a descriptive and analytical research design to examine the impact of credit policy on working capital performance in garment retail businesses.

Secondary Data:

Secondary data is collected from textbooks, research journals, published articles, company reports, and websites related to finance and retail management.

iii. Tools of Data Collection

A structured questionnaire is used as the main tool for collecting primary data.

iv. Sample Design

The sample consists of selected garment retail businesses, and the sample size is limited to a manageable number of respondents as per the scope of the study.

v. Sampling Technique

Convenience sampling is used to select respondents based on accessibility and willingness to participate.

HYPOTHESIS OF THE STUDY

Null Hypothesis (H₀):

There is no significant impact of credit policy on the working capital performance of garment retail businesses.

Alternative Hypothesis (H₁):

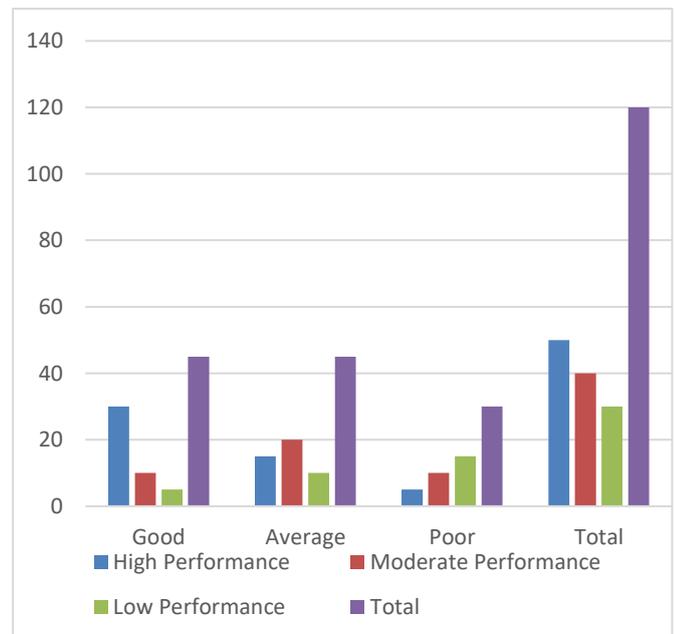
There is a significant impact of credit policy on the working capital performance of garment retail businesses.

DATA ANALYSIS AND INTERPRETATION

Table 1. Observed Data (Survey Responses from 120 Garment Retailers)

Credit Policy Effectiveness	High Performance	Moderate Performance	Low Performance	Total
Good	30	10	5	45
Average	15	20	10	45
Poor	5	10	15	30
Total	50	40	30	120

Graph 1. Observed Data (Survey Responses from 120 Garment Retailers)



Findings

Out of the total 120 respondents, 45 retailers (37.5%) follow a good credit policy, 45 retailers (37.5%) follow an average credit policy, and 30 retailers (25%) follow a poor credit policy.

Interpretation

The table reveals a significant and direct relationship between credit policy effectiveness and working capital performance in garment retail businesses. Retailers with good credit policies demonstrate higher levels of working capital efficiency, mainly due to better control over receivables, timely cash inflows, and effective liquidity management.

HYPOTHESIS TESTING

Chi-Square Test for Testing the Hypothesis

Table 1: Observed Frequency Distribution

Credit Policy Effectiveness	High Performance	Moderate Performance	Low Performance	Total
Good	30	10	5	45
Average	15	20	10	45
Poor	5	10	15	30
Total	50	40	30	120

Table 2: Expected Frequency Distribution

Credit Policy Effectiveness	High	Moderate	Low
Good	18.75	15.00	11.25
Average	18.75	15.00	11.25
Poor	12.50	10.00	7.50

Formula Used:

$$\chi^2 = \sum (O - E)^2 / E$$

Where:

O = Observed Frequency

E = Expected Frequency

Chi-Square Calculation Summary:

$$\chi^2 = 23.43 \Rightarrow \chi^2 = 23.43$$

Degree of Freedom:

$$df = (r - 1)(c - 1) = (3 - 1)(3 - 1) = 4$$

Table Value (At 5% Level of Significance):

$$\chi_{0.05, 4}^2 = 9.488$$

Decision Rule:

Since the calculated Chi-square value (23.43) is greater than the table value (9.488), the null hypothesis (H_0) is rejected.

Conclusion:

There is a significant impact of credit policy on the working capital performance of garment retail businesses. Effective credit policies lead to better

liquidity management, efficient working capital utilization, and improved operational performance.

Interpretation:

The analysis reveals that garment retail firms with well-structured credit policies demonstrate higher working capital efficiency and improved financial performance. Therefore, credit policy plays a vital role in maintaining liquidity and sustaining business growth in the garment retail sector.

FINDINGS

The study revealed that credit policy has a significant impact on the working capital performance of garment retail businesses. Retailers offering longer credit periods were able to increase sales, but they often faced delays in cash collections, which affected their liquidity position. It was also observed that businesses with well-defined credit and collection policies maintained better debtor turnover and cash flow efficiency. Poor management of credit sales resulted in higher outstanding receivables and blocked working capital.

CONCLUSION

The study concludes that credit policy plays a vital role in influencing the working capital performance of garment retail businesses. An effective and well-structured credit policy helps in improving liquidity, managing receivables efficiently, and ensuring smooth business operations. However, improper or liberal credit practices can lead to delayed collections and financial strain. Therefore, garment retailers should maintain a balanced credit policy to achieve better working capital efficiency and long-term financial stability.

SUGGESTIONS

- Garment retailers should adopt a well-defined and formal credit policy.
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- Regular follow-up should be done for timely recovery of outstanding receivables.
- Creditworthiness of customers should be evaluated before granting credit.
- Use of discounts for early payment can help improve cash flow and liquidity.

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