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Shenzhen JIT Technology: Accounts Receivable Management Issues

Dazhi Chu and Li Wang wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On March 5, 2012, Feng Li, the president of Shenzhen JIT Technology Co., Ltd. (JIT Technology), was sitting in his office in Longhua District, Shenzhen, China. He was reading the company’s 2011 statement of financial position, which the director of finance had given to Li. The company had a high level of accounts receivables (AR) in 2010: a total of ¥20,637,946[[1]](#footnote-1) accounted for 60 per cent of the company’s working capital. In 2011, the AR figure had risen to ¥27,977,006, accounting for 63 per cent of working capital. Meanwhile, profit after tax for the years 2010 and 2011 were ¥4,654,176 and ¥4,748,265, respectively. Moreover, the number of turnover days for AR, a very important index, was not promising. As the AR figure increased, the time it took to settle them was also increasing—from 45–60 days to 90 and sometimes even 120 days or more. (The average AR turnover rate for the manufacturing industry was about 4.08 and the average AR turnover days overall was about 90 days.)[[2]](#footnote-2) These factors made the company’s operation and management of funds difficult. The company was a small sole proprietorship, and Li had recently had to borrow money for the company using his own property as collateral in order to solve the cash-flow shortage. At that time, the one-year loan rate was about 6.5 per cent.[[3]](#footnote-3) What should Li do to solve these problems?

Background

JIT Technology was established in 1999. The company provided a range of electronics, chemical materials, ancillary equipment, and precision adhesive products for the electrical and electronics industries. The core products included insulating materials, glue, coating equipment, adhesives, and organic silicon materials.

JIT Technology was a small private company established solely by Li, who was Singaporean. The company had only ¥1 million in registered capital and fewer than 100 employees, some of whom were Li’s relatives or friends. Its organizational structure included four main departments under the general manager’s office: finance, human resources, marketing, and inventory (see Exhibit 1).

Evolution of AR Policy at JIt Technology

The sales and financial staff explained that there had been fewer than ten staff members when the company was first established. As was the practice in most Chinese companies, sales staff at JIT Technology who were authorized to extend credit to customers were also responsible for collecting accounts receivable. However, there were no rewards or penalties associated with collecting these receivables.

JIT Technology management staff were unaware of the serious problem of high AR until 2002, when the collection period for AR became longer and longer with increasing sales volumes and an increasing number of sales personnel. A new regulation was established that kept salespeople responsible for collecting AR but asked senior leaders to urge the marketing staff to collect AR as soon as possible. However, at that time, there were still no specific quantitative terms that associated the AR collection period with any reward or penalty.

General Rules

When the problem of AR became more serious, JIT Technology finally formulated a written reward and penalty policy for the marketing staff, based on its own situation and the methods of other companies in the same industry, and introduced this to the marketing staff at the end of 2009. This policy was developed by the company and the marketing staff, and was intended to provide incentives and motivation to the marketing staff and eliminate their concerns about the future. The policy was formalized in writing and applied to all staff members involved with marketing.

The policy included the salary system (a basic salary plus commission), the assessment system, the payment collection requirements, and the relevant rules, and used the following formulas:

*Note*: Costs included material costs, customs duties, and freight costs for delivery to Hong Kong and outside the province.

*Note*: Miscellaneous costs included entertainment costs and commissions; delivery costs included delivery to Hong Kong and outside the province.

The maximum commission was 2 per cent for transactions under ¥5,000, regardless of the gross profit margin. Salespeople would be paid a fixed salary of ¥1,500 if sales were less than ¥100,000 per month, and this base salary would increase as monthly sales volumes and profit rates increased (see Exhibit 2).

Here are some examples of how JIT Technology’s sales commission policy was applied:

* If salesperson A’s monthly sales volume was ¥150,000 and the corresponding gross profit margin was 30 per cent, the sales commission would be (¥150,000 × 30% × 2.2%) = ¥990.
* If salesperson B’s monthly sales volume was ¥210,000 and the corresponding gross profit margin was 35 per cent, the sales commission would be ¥1,764.
* If salesperson C’s monthly sales volume was ¥260,000 and the corresponding gross profit margin was 50 per cent, the sales commission would be ¥3,510.
* If salesperson D’s monthly sales volume was ¥500,000 and the corresponding gross profit margin was 22 per cent, the sales commission would be ¥2,200.
* If salesperson E’s monthly sales volume was ¥920,000 and the corresponding gross profit margin was 77 per cent, the sales commission would be ¥35,420.

The commission structure would be revised yearly or whenever the managing staff thought that it was necessary to do so. The board of directors of JIT Technology reserved the right of final explanation.

Performance Assessment and Calculation

The probationary period for new sales staff was three months. For those who sold few orders or none (that is, those whose sales revenue was less than ¥50,000), the basic salary ranged from ¥500 to ¥1,000, depending on the individual’s marketing experience and the company’s needs at the time. New sales staff who achieved monthly sales over ¥50,000 received the same basic salary and commission rate as established salespeople.

New staff members were not assessed in the first month, but their performance was assessed each month beginning in the second month. The company paid commission bonuses month-by-month. Travel expenses were claimed at cost.

Rules for Payment Collection

The confirmation of clients was an essential step in the sales and payment process. When they concluded their first deal with the client, salespeople asked each client to fill in an application form outlining company profile details. These details were entered into the client information system. Salespeople needed to ensure that all basic client information was documented, including the exact address, the amount of registered capital, the legal representatives, the business scope, the size of the manufacturing field, the relationship of JIT Technology’s products to the client, and the potential amount of business that could be expected from the client. The final steps in the procedure for client confirmation included obtaining approval from the marketing manager and the executive manager. After these approvals, the client would be entered into the salesperson’s business client list, and the salesperson would receive the total commission from managing all of the client’s sales activity with the company.

Payments for goods delivered were to be collected as specified in the sales agreement, excluding the month when the goods were delivered. For example, if the payment term was 30 days, the payment for goods delivered in January had to be collected before March 2, with postponement possible if the due date fell during a holiday.

Sales staff would still receive their commission when payment collection was delayed due to product quality problems, but the staff member needed to submit a written application to delay collecting the payment. This application had to include the date the problem would be solved, confirmation from quality control (QC), and permission from the manager and executive manager.

The responsibility of the sales staff to collect payments was established and emphasized in the policy previously mentioned, and in the following rules, which were also intended to strengthen the capital turnover rate and protect the company from bad debts.

Sales staff would receive 90 per cent of their commission if they collected payment for goods within one month after the payment collection date. They would receive 80 per cent of the commission if they collected payment within two months after the payment collection date, but this commission payment would be postponed until the payment date for the next month’s commission. Sales staff would receive 70 per cent of the commission if they collected payment within three months; this commission payment would also be postponed until the payment date for the next month’s commission. For payments that were not collected within three months, the sales staff would receive only 50 per cent of the commission, which would be released the month following the collection of the final payment for goods. For payments that were not collected after three months, the relevant supervisors and managers would take action to solve the problem and would decide who would take responsibility for managing the payment collection. These rules were listed separately.

Rewards and Penalties

The general rules for rewards and penalties applied to the sales staff. Every salesperson had to collect payments for goods on time and would receive feedback about the payment collection from the financial staff. Rewards such as promotions went to sales staff with remarkable performances. Sales staff could also be downgraded and would have to take responsibility for the consequences caused by poor business performance—especially for not collecting payments for goods, for causing bad debts, and for losses to the company because of fraud.

The marketing staff had to claim responsibility for any outstanding payments still uncollected two months over the AR recovery date. They would be penalized by being required to return 20 per cent of the sales commission awarded to them. If their supervisors succeeded in collecting their overdue AR, then that 20 per cent sales commission would be paid to the supervisors.

In the case of bad debt, 30 per cent of the bad debt, based on the company’s basic cost, would be deducted from the salesperson’s earnings; another 10 per cent would be deducted from the supervisor’s earnings; and 5 per cent would be deducted from the earnings of the manager, the finance manager, and the executive director, respectively. The company would assume 45 per cent of the bad debt.

The commission for each salesperson for the previous month had to be accurately calculated before the 12th day of each month. Each salesperson’s commission from two months prior would be released on the 15th day of each month (for example, the commission for July would be released on October 15). The financial staff would inform the sales manager and salesperson in advance if the commission could not be released on that date. If this was not done, a penalty of ¥300 would be issued to the involved financial staff member and managing staff member.

Members of the sales staff could enjoy the same remuneration package as other staff members by submitting applications to become regular staff members within the probationary period if they met one of three criteria: (1) they had achieved remarkable marketing performance by doubling the basic marketing performance target in any of the first three months; (2) they had exhibited excellent marketing performance and contributed constructive ideas and advice to the management of the company; or (3) they had exhibited high-quality talents and skills and employed these in special circumstances to benefit the company.

The response of the Sales Staff

The new rules did not improve the problems of AR. As a result, Li decided to ask a consulting company to investigate the situation and the implementation of the marketing policy. Only through careful investigation could the next steps for improvement be developed.

results

Sales Staffs’ Attitudes toward Marketing

The investigation determined that the sales staff came mainly from two groups of people. The first group included individuals from companies in the same field as JIT Technology; they had related work experience in the area and business relationships that were based on those experiences. They were familiar with the clients’ internal operations and had established social networks in the area. Some of them also had prior management experience. These people quickly adapted to their jobs and easily achieved their goals. For example, Li, the manager of one department, came from the client company ZTE Corporation, and he sold JIT Technology’s products to his former company. This group of salespeople were usually well educated and had related expertise and social networks in the field. Thus, they performed better and achieved higher commissions; their average salary was over ¥10,000 per month.

The second group of sales staff were individuals who had been promoted or transferred from other staff positions in the company by the executive staff. They included former drivers, clerks, secretaries, and warehouse staff. Members of this group had no previous systematic training, an average educational background (a high school diploma), inadequate professional knowledge, and no established relationships with related industries. Thus, these people usually achieved an average business performance, at best, and had lower incomes as a result. It was very difficult for these salespeople to locate clients, particularly large ones, or to sign them to contracts. For example, Luo—who, as the driver for the chief executive officer had received an average salary between ¥2,500 and ¥3,000—was encouraged by the chief executive officer to enter sales and became a professional salesperson for the company. He was very depressed because he could only earn a salary of ¥1,500 as a salesperson, which was much lower than his former salary as a driver.

Satisfaction with Salaries

The investigation found that the salaries of the sales staff fell into two extremes. The difference between the lowest and highest incomes was substantial, with the highest being as much as 10 times more than the lowest and the average gap representing a difference of from 5 to 7 times. There were two distinctly different groups with contrasting feelings. High-income salespeople thought that their salaries were reasonable and they had higher expectations, while low-income salespeople were generally depressed, had lower spirits, and saw no promising prospects in their futures. They had no passion for their work and thought there was an unfairness in the salaries of the high-income salespeople. The low-income salespeople believed they worked just as hard as the high-income salespeople and had poorer business performance simply because they had less information and fewer network advantages.

Conclusion

Li sank into deep contemplation after hearing the investigation report. His mind was awash with questions. Where did these problems come from? Did they come from the oversight of the rewards and punishments policy or from something else? He knew that the causes needed to be found or the situation would become worse and possibly cause the ultimate collapse of the company.

Li summoned the company management to find a solution. At the meeting, the marketing director, Lin, suggested that the problem lay in the marketing incentive policy. There were only rewards and no fines, and this was the reason why the number of AR had become larger and larger. The financial director, Ding, suggested that the company should use a quantitative approach to determine the penalty. He wondered if the aging analysis method or the days sales outstanding (DSO, also known as “days receivable”) could be taken into account.

Of the two methods, he preferred DSO because the DSO index was calculated based on a single person’s business. If the marketing staff were to be penalized by having to return some of their sales commission for overdue AR collection, the amount of the penalty would depend on a calculation of the salesperson’s DSO, the uncollected AR, and the opportunity cost (based on the treasury bill rate or a one-year loan rate, depending on whether the funds belonged to the company or were borrowed). Even if the amount of the deduction greatly exceeded the sales commission, the policy would still be executed in order to maintain a strict reward or penalty.

Exhibit 1: SHENZHEN JIT’s Current Organizational Structure

President/General Manager

General Manager’s Office

Inventory Department

Marketing Department

Human Resources Department Department

Finance Department

Marketing Department 1

Marketing Department 4

Marketing Department 3

Marketing Department 2

Source: Created by the authors based on observation.

exhibit 2: commission plan for the sales and marketing staff

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| Grade | Monthly Sales Volume | Gross Profit Rate | Commission Rate | Monthly Salary |
| A) | ¥100,000−¥150,000 | 0%−5% | 0.10% | ¥1,000 |
| 5%−10% | 0.25% |
| 10%−15% | 0.50% |
| 15%−20% | 1.30% | ¥1,100 |
| 20%−25% | 1.70% |
| 25%−30% | 2.20% |
| 30%−35% | 2.30% |
| 35%−40% | 2.40% | ¥1,200 |
| 40%−50% | 2.50% |
| 50%−75% | 3.20% |
| 75%−100% | 4.20% |
| B) | ¥160,000−¥300,000 | 5%−10% | 0.35% | ¥1,200 |
| 10%−15% | 0.60% |
| 15%−20% | 1.40% |
| 20%−25% | 1.80% | ¥1,400 |
| 25%−30% | 2.30% |
| 30%−35% | 2.40% |
| 35%−40% | 2.50% | ¥1,600 |
| 40%−50% | 2.60% |
| 50%−75% | 3.40% |
| 75%−100% | 4.40% |
| C) | ¥310,000−¥500,000 | 10%−15% | 0.70% | ¥1,800 |
| 15%−20% | 1.50% |
| 20%−25% | 1.90% |
| 25%−30% | 2.40% | ¥2,000 |
| 30%−35% | 2.50% |
| 35%−40% | 2.60% |
| 40%−50% | 2.70% | ¥2,200 |
| 50%−75% | 3.60% |
| 75%−100% | 4.60% |
| D) | ¥510,000−¥700,000 | 10%−15% | 0.80% | ¥2,400 |
| 15%−20% | 1.60% |
| 20%−25% | 2.00% |
| 25%−30% | 2.50% | ¥2,600 |
| 30%−35% | 2.60% |
| 35%−40% | 2.70% |
| 40%−50% | 2.80% | ¥2,800 |
| 50%−75% | 3.80% |
| 75%−100% | 4.80% |
| E) | ¥710,000–¥1,000,000 | 10%−15% | 0.90% | ¥3,000 |
| 15%−20% | 1.70% |
| 20%−25% | 2.10% |
| 25%−30% | 2.60% | ¥3,200 |
| 30%−35% | 2.70% |
| 35%−40% | 2.80% |
| 40%−50% | 2.90% | ¥3,400 |
| 50%–75% | 4.00% |
| 75%−100% | 5.00% |

Note: The market value for die-cutting processing products = Cost (1 + 55％).

Source: Company documents.

1. ¥ = CNY = Chinese yuan renminbi; all currency amounts are in ¥ unless otherwise specified; US$1.00 = ¥6.29 in March 2012. [↑](#footnote-ref-1)
2. “The Industrial and Commercial Financial Index of Listed Companies,” 2012, accessed March 3, 3017, https://wenku.baidu.com/view/0cbe98da856a561252d36fc9.html. [↑](#footnote-ref-2)
3. For comparison, the one-year Chinese treasury bill rate at the time—for those who had spare capital to invest—was 3.85 per cent. [↑](#footnote-ref-3)