PRINCIPLES AND PRACTICE OF EFFECTIVE ACCOUNTS RECEIVABLE MANAGEMENT IN KENYA: A CASE OF SELECTED MANUFACTURING FIRMS IN THIKA MUNICIPALITY

BY
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SEPTEMBER 2013
DECLARATION

This research project is my original work and has not been presented in any other University or for any other award.

Sign _________________________________ Date ______________________

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D53/CE/21200/2010

Supervisors’ Approval

This research project has been submitted for examination with my approval as the University Supervisor.

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This research project has been submitted for examination with my approval as the Chairman of the department.

Sign _________________________________ Date ______________________

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Chairman
Department of Accounting and Finance.
DEDICATION

This research project is dedicated to my beloved wife Ruth and children and to my Mum Monica for their encouragement and invaluable support throughout my study period.
ACKNOWLEDGEMENT

I am sincerely grateful to the Almighty God who enabled me to get the opportunity and granted me His grace to accomplish this work. My sincere gratitude to my wife and children for always being there for me at all times, good and bad, for their prayers, time and support. Sincere appreciation to my mum and late dad, who taught me the value of investing in education. I am also grateful to my dear brothers and sisters for their encouragement and setting a perfect academic trend. I wish to thank my University supervisor, Mr. J. Theuri for his encouragement and professional guidance throughout the course of this project. To all those whose names are not mentioned above, I say a big thank you for your contribution in whichever way.
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ABSTRACT

Accounts receivable constitute a significant portion of current assets in manufacturing firms. Management therefore has to formulate strategies of effectively managing this important yet sensitive asset. This study aimed at investigating the principles and practices adopted by manufacturing firms in the management of accounts receivable in Kenya with specific reference to manufacturing firms in Thika municipality within Kiambu County. The study further aimed at examining the strengths and weaknesses of the various strategies used by the firms and advice on the best strategies and practices for effective and efficient accounts receivable management in the sector. The study was descriptive in nature and targeted a population of 52 manufacturing firms licensed to operate within Thika Municipality. Data was collected using semi-structured questionnaire administered to the chief finance officers and key credit control department personnel in the selected firms to collect both qualitative and quantitative information. Where necessary, personal interviews and documentary analysis were conducted to enhance validity of information gathered using questionnaires. Data was analyzed using descriptive statistics where measures of central tendency and measures of dispersion were computed to give results. Charts, tables and graphs were used to report findings. The results from the study revealed several factors that affected the management of accounts receivable such as lack of a formal credit policy, delayed or non review of the credit policy manual, inconsistency on credit risk analysis procedures and haphazard variation of credit terms. The study revealed erratic fluctuation in the average collection period and significant amounts of bad debts written off. A large number of firms did not have a credit control function at all. A sizeable number of firms were still using manual invoicing system and others took a considerable time to present invoices to their customers. The study recommends that firms should create a credit extension policy which should be adhered to always and periodically reviewed to see when it should be changed to match with economic conditions. Firms should create a credit collection policy setting out the procedures and practices to be used by the company to collect overdue or delinquent accounts receivable. Management should approve the formation of a well-run autonomous credit department that will allow the imposition of a comprehensive set of operating policies and procedures. Credit monitoring should be enhanced to evaluate the quality of accounts receivables to reduce over-investment in accounts receivable. Firms should automate their invoicing system to cut down on the time taken to present invoices to customers. The study was undertaken despite a number of limitations such as lack of co-operation by some potential respondents, lack of financial data for some firms for some time periods, and its scope which was limited to manufacturing firms within Thika municipality.
CHAPTER ONE
INTRODUCTION

1.1 Background of the Study
Accounts receivable is money owed to a firm when it sells its products or services on credit and it does not receive cash immediately (Pandey, 2004). The primary goal of accounts receivables management is to maximize the value of the enterprise by striking a balance between liquidity, risk and profitability (Hrishikes, 2002). The purpose of any commercial enterprise is the earning of profit, credit in itself is utilized to increase sales but sales must return a profit (Wood, 1953). ‘The primary objective of management of accounts receivables should not be limited to expansion of sales but should involve maximization of overall returns on investment’ (Wood, 1953). A significant part of receivables management involves the proper selection of customers because every credit sale involves the risk of delayed payment or non-payment of the value involved (Hrishikes, 2002).

The major preoccupation for most of today’s organizations’ management is to remain relevant in the market by striving to cope with the ever increasing brutal competition in the market brought about by production of very close substitutes to the firms’ own products by competitors. At the same time, managers are faced with the challenges of achieving optimal profits, improving the company’s performance and maximizing the shareholders wealth which can only be achieved through increase in revenue obtained from sales and cost cutting on expenses. This has seen many firms employ all forms of tactics and strategies to woo new customers to their products or to maintain their existing market share. One such strategy is selling their products on credit.

In this kind of competitiveness, there exists a real incentive for managers in the manufacturing industry to adopt product pushing strategies to offload their stocks to the market with the hope that this will culminate to a successful sales transaction and that it will retain the customer for a future sales transaction. Selling on credit is one of the company’s approaches in enhancing sales and it has turned up to be an enticement for customers in retaining the business relationship with the company and in time increase the company’s profit (Barad, 2010), eventually optimizing the company’s profit. The purpose of offering credit is to maximize profit (Damilola, 2005).
However, this is where most organizations start landing into problem since not all such goods sold on credit will be paid for in good time, or ever at all. Managers are always working for ways of maximizing returns so that they spend much of their effort watching costs and managing the day to day operations of the business often ignoring crucial assets such as accounts receivables which arise from credit sales transactions (Nealon 2003). Selling on credit is almost a universal practice especially for manufacturing firms who sell primarily to other firms. Almost all the sales are entirely on credit terms making accounts receivable to account for a significant proportion of the firms current assets as can be seen below from balance sheet extracts of published accounts of a selected companies.

**Table 1.1: EAST AFRICAN BREWERIES LIMITED**

<table>
<thead>
<tr>
<th>Current Assets</th>
<th>2011 Sh. ‘000’</th>
<th>2011 % of total current assets</th>
<th>2010 Sh. ‘000’</th>
<th>2010 % of total current assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventories</td>
<td>4,399,365</td>
<td>32</td>
<td>3,465,054</td>
<td>20</td>
</tr>
<tr>
<td>Accounts receivables</td>
<td>7,066,073</td>
<td>51</td>
<td>5,593,453</td>
<td>32</td>
</tr>
<tr>
<td>Tax recoverable</td>
<td>740,353</td>
<td>5</td>
<td>405,251</td>
<td>2</td>
</tr>
<tr>
<td>Term deposits</td>
<td>-</td>
<td>-</td>
<td>6,570,036</td>
<td>38</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>1,649,453</td>
<td>12</td>
<td>1,325,079</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>13,855,244</td>
<td>100</td>
<td>17,358,873</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: Published financial statements)

**Table 1.2: KENYA ORCHARDS LIMITED**

<table>
<thead>
<tr>
<th>Current Assets</th>
<th>2011 KSh.</th>
<th>2011 % of total current assets</th>
<th>2010 KSh.</th>
<th>2010 % of total current assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventories</td>
<td>11,875,122</td>
<td>54</td>
<td>13,316,555</td>
<td>54</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>9,589,967</td>
<td>44</td>
<td>10,664,328</td>
<td>44</td>
</tr>
<tr>
<td>Cash and cash Equivalents</td>
<td>402,186</td>
<td>2</td>
<td>484,974</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>21,867,275</td>
<td>100</td>
<td>24,465,857</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: Published financial statements)
Table 1.3: MUMIAS SUGAR COMPANY LIMITED

<table>
<thead>
<tr>
<th>Current Assets</th>
<th>2011 Sh. ‘000’</th>
<th>2011 % of total current assets</th>
<th>2010 Sh. ‘000’</th>
<th>2010 % of total current assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventories</td>
<td>1,191,114</td>
<td>18</td>
<td>955,078</td>
<td>15</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>3,863,595</td>
<td>59</td>
<td>3,327,244</td>
<td>51</td>
</tr>
<tr>
<td>Biological assets</td>
<td>210,615</td>
<td>3</td>
<td>179,375</td>
<td>3</td>
</tr>
<tr>
<td>Tax recoverable</td>
<td>250,109</td>
<td>4</td>
<td>401,301</td>
<td>6</td>
</tr>
<tr>
<td>Collateral deposit</td>
<td>314,524</td>
<td>5</td>
<td>286,709</td>
<td>4</td>
</tr>
<tr>
<td>Short term deposit</td>
<td>14,345</td>
<td>0.2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Quoted investment</td>
<td>25,267</td>
<td>0.4</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>642,090</td>
<td>10</td>
<td>525,751</td>
<td>8</td>
</tr>
<tr>
<td>Deposit with other financial institutions</td>
<td>-</td>
<td>-</td>
<td>820,376</td>
<td>13</td>
</tr>
<tr>
<td>Total</td>
<td>6,511,659</td>
<td>100</td>
<td>6,495,834</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: published financial statements)

As can be deduced from above, accounts receivable, as are forms of investment in any enterprise manufacturing and selling goods on credit basis, represent large sums of funds that are tied up in trade debtors. Hence, a great deal of careful analysis and proper management need to be exercised for effective and efficient management of receivables to ensure a positive contribution towards increase in sales and profitability. Accounts receivable is one of the firms’ investments in working capital; hence its control, effective and efficient management is critical for the success of the firm.

Management of accounts receivable is made complex because it forms an integral part of the marketing function as the granting of credit attracts customer thus resulting to increased sales and sales revenue (Cooper, 1985). Management of the accounts receivables asset is a complex task as it addresses the ramifications of practices and processes usually outside the span of the responsible manager, thus it requires balancing of opposing priorities of the sales, marketing and finance functions (Salek, 2005).
Management of trade debtors is not as easy to be treated in an analytical way as is the case with inventories as they are not physical in nature (Brockington, 1987). In principle, every business wants to be paid for the goods that it supplies as soon as possible. In accounting, using the revenue realization concept, once a sale has been made, revenue is recognized and hence the profit making process is completed. However the resources employed in this process cannot be utilized on another operating cycle until cash has been received, hence the need for effective and efficient management of the credit sales and the asset of accounts receivable arising there from by the firms’ management.

1.1.1: Consequences of Ineffective Accounts Receivable Management

Poor management and control of accounts receivable often results to disruption of the firms daily operations caused by cash flow problems which results to non-payment of suppliers of goods and services, non-payments of employees and inability to meet statutory obligations. The overall effect is non-supply of materials and services leading to disruption in production, a demotivated workforce and penalties from authorities. Hence J. Salek (2005) opines that cash is the “life blood” of any company and every dollar of a company’s revenue that becomes a receivable must be management and collected.

Poor management of accounts receivable impacts negatively on profits in two ways; first, bad debts written off reduce the firms’ profits directly in the profit and loss account; Secondly, when a lot of funds are tied up in accounts receivable, the company may find itself borrowing funds to finance operations; these borrowed funds attracts interest which also reduces profit. Other than the bad debt and interest expense, there are legal expenses associated with collecting debts.

Ineffective management of accounts receivable may result to poor credit rating from financial institutions. This makes it difficult to obtain financing from the institutions to finance the firms’ working capital and if it does then it is at a high interest rate since it is unable to negotiate for better terms. Severe liquidity problems caused by so much funds held in accounts receivable may lead to total collapse in production since the firm can no longer meet its financial obligations, which is extreme cases may lead to the firm becoming insolvent and consequently being placed under receivership. Ultimately, the firm may be wound up.
1.2: Statement of the Problem

Many businesses do not have the time, expertise, or resources to appropriately administer the accounts receivable and the closely related business functions (Voi, 1999). Effective management of the credit and accounts receivable process involves cooperation among sales, credit control, marketing, finance, and accounting function staff (Megginson, 2008). Management of accounts receivable is made complex by the fact that it involves credit control, sales, marketing, and finance functions of the business (Cooper, 1985). These four functions must therefore strike a balance against their conflicting interests for the management of this important asset to be effective. If these important functions are not effectively managed, the company can be exposed to potentially fatal long-term losses.

It is therefore crucial that management formulate principles and practices that result to effective and efficient management of this sensitive yet important asset of accounts receivable so as to ensure that high turnover resulting from credit sales actually result to improved cash flows and higher profitability.

1.3: Objectives of the study

The main objective of the study was to investigate the principles and practices adopted by manufacturing firms in Kenya for effective management of accounts receivables.

1.3.1: Specific objectives

This study specifically sought to:

(i) Investigate the effects of the principle of credit extension on management of accounts receivable.

(ii) Investigate the effects of the principle of credit collection on management of accounts receivable.

(iii) Investigate the role of principle of credit control and monitoring on management of accounts receivable.

(iv) Investigate the role of principle of pricing administration, order processing, and invoicing on management of accounts receivable.

1.4: Research Questions

(i) What are the effects of a credit extension policy on management of accounts receivable?

(ii) What are the effects of a credit collection policy on management of accounts receivable?

(iii) What is the role of credit control and monitoring on management of accounts receivable?
(iv) What is the role of pricing administration, order processing and invoicing procedures on the management of accounts receivable?

1.4: Significance of the Study
The study will have the following significance:

Financial Managers
It will give an insight to management especially the chief finance officers in identifying critical areas in accounts receivable management and the best practices to employ to effectively manage the company’s accounts receivable.

Credit Control department personnel
It will point out areas of weaknesses in the existing credit practices that inhibit effective control of accounts receivable and give recommendations on the best practices to employ in order to achieve optimal efficiency.

Researchers
It will be of importance to other researchers who may want to carry out further research on management of accounts receivable since it will provide a report on current practices in management of accounts receivable in the manufacturing industry and give recommendation on areas that need further research.

1.5: Scope of The Study
The study specifically focused on investigating the principles and practices of effective accounts receivable management in manufacturing firms in Thika municipality within Kiambu County, Kenya. To this end the target population was all the manufacturing firms operating within Thika municipality, a sample that was obtained from the Municipal Council of Thika.

1.7: Limitations of the study
Lack of co-operation by some potential respondents. Some potential respondents did not complete the questionnaire arguing that their corporate policy does not allow release of such information to third parties. Though all effort was made to assure them that the information was for academic purpose only and was going to be treated with utmost confidentiality, this did not change their position.
Lack of financial data for some firms for some time periods. Some firms were not in operation for some periods of the study. Others claimed the period of study was long, thus some data could not be retrieved.

The study focused only on management of accounts receivable in manufacturing firms within Thika municipality. Generalization of the findings to other regions and/or sectors of the economy may not be readily applicable.
CHAPTER TWO
LITERATURE REVIEW

2.1: Introduction
This chapter deals with review of both theoretical and empirical literature of previous research conducted on management of working capital and specifically management of accounts receivable. It will provide a framework for establishing the importance of the study, to highlight the gaps in existing studies and to provide a benchmark for comparing the findings with the previous findings.

2.2: Theoretical literature
2.2.1: Meaning and Definition
Accounts receivables are debts owed to the firm by customers arising from sale of goods or services in ordinary course of business (Joy, 1978). Hence accounts receivables are asset accounts representing amounts owed to the firm as a result of the credit sale of goods and services in the ordinary course of business. There have been many theories proposed for trade credit. The Financial theory (Emery, 1984; Mian and Smith, 1974) argues that firms able to obtain funds at low costs will offer trade credit to firms facing higher financing costs. Thus, for sellers, trade credit is a more profitable short term investment than marketable securities.

The Operational theory stresses the role of trade credit in smoothing demand and reducing uncertainty in the payments. Emery (1987) and Feris(1981) argue that trade credit can reduce cash flow uncertainty by separating the payment cycle from the delivery cycle so that both the buyer and can save on cost of handling liquidity. According to the Commercial theory, trade credit improves product marketability by making it easier for firms to sell (Nandiri, 1969). Also, trade credit can be used to maximize profits through price discrimination (Bannan,Makismovrc and Zenchar, 1998) that is selling the same product at different prices to different customers. Potential buyers with difficulties to obtain credit of the banking system constitute new opportunities; giving easier terms to this segment through trade credit sellers market can be extended. Proponents of the Product quality theory argue that firms extend trade credit to guarantee product quality by alleviating information asymmetry between buyers and sellers (Smith, 1987). This study will lean more closely towards the Commercial theory of trade credit.
According to International Financial and Reporting Standards (IFRS) and International Accounting Standards (IAS), accounts receivable are recognized and measured according to IAS(39) and are disclosed in accordance with IFRS(7). According to IAS (39) on Financial Instruments Recognition and Measurement, trade debtors are measured at their fair value. IFSR(7) set out disclosure requirements that are intended to enable users to evaluate the significance of financial instruments for an entity’s financial position and performance, and to understand the nature and extent of risks arising from those financial instruments to which the entity is exposed. These risks include credit risks, liquidity risks and market risks. This study partly seeks to establish the extent to which firms carry out credit analysis and evaluation on their potential customers and the procedures employed in credit monitoring to establish the health status of the accounts receivables held by the firm at any given time.

Trade credit creates receivables or book debts which the firm is expected to collect in the near future. Accounts receivable is money owed to a firm when it sells its products or services on credit and does not receive cash immediately (Pandey, 2004). Selling on credit is one of the company’s approaches in enhancing sales and it has turned up to be an enticement for customers in retaining the business relationship with the company and in time increase the company’s sales volume and eventually optimizing the company’s profit (Barad, 2010). Selling on credit is almost a universal practice especially for manufacturing firms who sell primarily to other firms. Almost all sales are on credit terms making accounts receivable to account for a significant proportion of the firms current assets.

2.2.2: Characteristics of Accounts Receivable

Since Accounts receivable arise when a firm sells goods or services to another without receiving immediate payment for the goods, this asset have two common salient characteristics. Firstly, the existence of credit risk element. Credit risk is the potential loss that may arise out of failure by the credit customers to honour their obligations as and when they fall due (Kalunda et al., 2012).

When a firm sells goods on credit to another, it assumes a risk since it is not certain as to whether the customer will pay for them in good time or ever at all. Typical examples in Kenya are two local banks namely; Rural Urban Credit Finance Limited and Trade Bank which collapsed in the 1980s’. The major causes of failures of local banks during the period
were accumulation of bad debts because of fraudulent or imprudent lending. Rural urban credit finance which collapsed in 1984 is said to have for instance, given out thousands of largely unsecured loans to residents of a slum area in Nairobi to buy matatus, plots and houses. As it turned out, nearly all of the loans were non-performing loans and the bank had to close its doors. In the case of Trade Bank Ltd, it is said that the bank was coerced into lending a company by the name LZ Company Limited four hundred million shillings, an amount way above the banks’ capital base. The money was utilized to put up a business Centre. On suing for recovery, LZ Co. Ltd called a valuer who “valued” the building at nine hundred million shillings meaning that, even if Trade Bank was to acquire the asset it still would have to pay an additional five hundred million. Inevitably this bank too had to go under (Oyuke, J. 2011).

A credit customer may fail to honour its obligation for a number of reasons including; stiff competition, inferior quality of products, poor pricing policies, but most importantly, poor management among other reasons. The second common characteristic of account receivable is the time value of money. The value of the money received later for goods supplied now is lower due to factors such as inflation and loss of investments opportunities for the money held by the trade debtors in form of accounts receivable.

2.2.3: Objectives of selling on credit
There are many reasons for offering credit including increasing or facilitating sales, meeting terms offered by competitors, attracting new customers or providing general convenience (Meggison, et al 2008). As accounts receivables will increase the sales volume, the sales expansion would favourably raise the marginal contribution proportionately more than the additional costs associated with such an increase. This in turn would ultimately enhance the level of profit of the concern.

A firm offering sale of goods on credit basis always falls in the top priority list of customers willing to buy those goods. Therefore a firm may resort to granting of credit facility to its customers in order to protect sales from losing it to competitors. Accounts receivable acts to attract potential customers and retaining the existing ones at the same time by weaning them off from the competitors (Meggison and Scott 2008).
Accounts receivable are valuable to the customers on the ground that it augments their resources. It is favoured particularly by those customers who find it expensive and cumbersome to borrow from other sources. In a typical business to business environment, a company may have to offer trade credit just to generate sales. This is especially the case for a large company selling to smaller companies where the smaller company literally needs the credit period to sell merchandise so that it can pay its supplier. To this end, not only the present customers but also the potential customers are attracted to buy the firm’s products at terms and conditions favourable to them (Meggison and Scott 2008).

As a usual practice companies may resort to credit granting for various other reasons which include industrial practice, dealers’ relationship, status of the customers, customers’ requirements, and transit delays among others. In a nutshell the overall objective of making such commitment of funds in the name of accounts receivable aims at generating a large flow of operating revenue and earning more than what could be possible in the absence of such commitment (Barad, 2010).

2.2.4: Ways of Executing Trade Credit
There are four ways through which trade credit may be executed. These are categorized into two broad groups as corporate credit and consumer credit (Hunt, 1996). This study will limit itself to the corporate credit. In corporate credit, the bulk of credit sales are made on open account, meaning the seller only keeps a single account that records obligations arising out of a sales transaction with the buyer. In this case there is no contractual undertaking in terms of formal acknowledgement of the debts arising or signed promissory notes. In the event of disputes the company can only fall back on documents generated during the transaction such as customers’ orders, delivery notes, invoices and shipping documents in case of foreign trade to prove the validity of a debt in a court of law. In the open account system, there is no collateral security and the firm does not charge interest and enjoys no special rights to recover the goods sold even if the account or debt is not paid (Pinson and Jinnett, 2006).

The second way of executing a trade credit is the documentary credit commonly used in foreign trade. In this case, the firm may place additional requirements such as bank guarantees on the buyer before authorizing shipment of goods. The buyer is required to draw a letter of credit in favour of the selling firm or open a bank guarantee in favour of the selling firm (Belay, 2000).
Trade credit may also be in form of installment credit where payment is made as a series of regular installments for the principal amount and interest. This form of credit is common for one-off purchase of expensive goods such as motor vehicles, aeroplanes and equipments (Belay 2000).

Trade credit can also be a revolving credit where the buyer has the flexibility of paying differing amounts ranging from settling the entire balance to paying the minimum installment required to remain current (Pinson and Jinnet, 2006).

2.2.5: Factors Affecting the Size of Receivables

The size of accounts receivable is defined by a number of factors given that accounts receivables is a major compound of current assets. Most of these factors vary from business to business in accordance with the nature and type of business.

If the sales are seasonal, the seasonal nature of sales will violate the continuity of sales in between the year. So the sale of such a business in a particular season would be large requiring a large size of accounts receivable (Barad 2010).

A firm may effect its sales either on cash basis or on deferred payment basis. The larger the volume of sales made on credit the higher the volume of receivables will be and vice versa.

Establishments of credit department and its function of operating efficiency in filing, record keeping, inspecting the credit worthiness of customers, reminder or follow-up later etc are important aspects in determination of the size of receivables (Barad, 2010).

A firm practicing lenient or relatively liberal credit policy will have a comparatively larger size of receivables than a firm with a more stringent or restrictive credit policy. This is because of two prominent reasons; Firstly, a lenient credit policy leads to greater defaults in payments by financing weak customers resulting in bigger volume of receivable and secondly a lenient credit policy tends to encourage even financially sound customers to delay payments again resulting in the increase in the size of receivable (Periasamy, 2009).

Firms may offer cash discounts to debtors to encourage them to pay their dues early, this helps in reduction of investment in accounts receivable (Periasamy, 2009). Also, the impact of
cash discount offered when accepted by the customers, is immediately felt by the quickening of cash inflows and reduction in the size of accounts receivables. Thus a firm that offers competitive discount rates will have a comparatively smaller size in receivables (Hrishikes, 2002).

Credit period is the period for which credit is extended to customers. If the credit period is extended, the possibility of increasing sales associated with increases in both its collection costs and bad debts loss may occur. Thus a firm with long or extended credit periods will tend to have a large size of receivables (Periasamy, 2009).

A firm with a weak or lax collection policy will tend to have high levels of investment in accounts receivables. ‘The second major factor affecting receivable management is the collection and monitoring policies because all customers do not pay bills on time. These delayed payments affect investment in receivables (Ramesh, 1987).

2.2.6: Accounts Receivable Management
Having accounts receivables is both good and bad. It is good because it means that you have sales and customers. It is bad because it is cash that you don’t have now, and there is always a possibility that you won’t collect. When you offer credit terms to your customers, it is extremely important to have a system in place to manage your accounts receivable.

The function of accounts receivable management emanate from its goals which is stated simply as setting out credit terms, selecting the customers, installing appropriate collection and monitoring system and financing receivables for maximizing the value of the firm (Hrishikes 2002).

The first issue for the management of trade debtors is to decide whether to grant credit at all. (Arnold, 2005). However credit is inevitable. The global market runs on credit, goods and services are routinely delivered with the expectation that payment will be made according to the agreed payment terms (Salek, 2005). If a firm decides that it is in its best interest to allow delayed payment then it needs to set up a system of rules and guidelines which will amount to a debtor policy (Arnold, 2005).
Although accounts receivable are short term in nature the policy decisions that create them often have a long-term impact on the organization and its financial structure because, once a receivables policy is determined it is difficult to come out of it except at the cost of adverse market reactions. Credit policy decisions are part of an integrated approach, and interface actively with production, marketing and finance functions of an enterprise (Hrishikes, 2002).

‘The process of accounts receivable management is truly a misnomer; that in a perfect word, accounts receivable would require nothing more than collection not management or process. With growing complexity, payment ambiguity and other factors that drive up costs in service delivery, the management of accounts receivable process continues to demand more attention’ (John, 2007).

Management of the receivables asset is a demanding task. The vast majority of companies expect that over 99.9% of all billings will be collected. Companies will tolerate bad debt expense of several tenths of a percent of revenue, but not much more. Which other departments are expected to perform at 99 plus percent effectiveness? It is generally expected that a high percentage of invoices will be paid on time and over 90% within thirty days of the due date (Salek 2005).

Management expects that the asset of accounts receivable will be managed to promote sales and that all customers will be served promptly, courteously and professionally. Astoundingly, most firms also expect this all to be accomplished for a cost equal to about two to three tenths of a percent of revenue. Management of the receivables asset is a complex task, it addresses the ramification of practices and processes usually outside the span of the responsible manager. It requires balancing of opposing priorities from the sales, marketing and finance functions (Salek 2005).

2.2.7: Objectives of Accounts Receivables Management

The primary objective of accounts receivable management is to maximize the value of the enterprise by striking a balance between liquidity, risk and profitability. A significant part of accounts receivables management involves the proper selection of customers, because every credit sale involves the risk of delayed payment or non-payment of the value involved (Hrishikes, 2007).
The main purpose of maintaining receivables is not, sales maximization nor is it for minimization of risks involved by way of bad debts. Had the main objective been growth of sales, the concern would have opened credit sales to all sorts of customers. Contrary to this, if the aim had been minimization of risk of bad debts, the firm would not have made any credit sale at all. That means a firm should indulge in sales expansion by way of receivables only until the extent to which the risk remain within an acceptably manageable limit. The basic target of management of receivables is to enhance the overall return on the optimum level of investment made by the firm in accounts receivables. This optimum investment is determined by comparing the benefits to be derived from a particular level of investment with the cost of maintaining that level (Periasamy, 2009). Thus the objectives of management of accounts receivable may be viewed as to; attain not maximum but optimum volume of sales, exercise control over the cost of credit and maintain it on a minimum possible level and to keep investment at an optimum level in the form of accounts receivables.

Granting of credit and its proper and effective management is not possible without involvement of any cost. These costs include administration costs, capital costs, production and selling costs, delinquency costs, default costs and opportunity cost (Periasamy, 2009). These costs cannot be possibly eliminated altogether but should essentially be regulated and controlled. 'Elimination of such costs simply mean reducing the cost to zero i.e. no credit grant is permitted to the debtors In that case a firm would no doubt escape from incurring these costs yet the other face of the coin would reflect that the profits foregone on account of expected rise in sales volume made on credit amounts much more than the costs eliminated (Barad, 2010). Thus a firm would fail to materialize the objective of increasing overall return on investment.

**Capital costs**

The increased level of accounts receivables as an investment in current assets results in blocking of the firms’ capital, since there is a time tag between the sale of goods and the payment for them. Meanwhile, the firm has to arrange for additional fund either from outside or out of retained profits or share capital to pay employees, and suppliers of raw materials among other financial obligations as they fall due, while wanting for payment from its customers. The firm incurs a cost on account of raising additional capital to support credit sales, the capital which alternatively could be earned profitably if employed elsewhere (Periasamy, 2009).
**Administration cost**

This is another cost that comes from an enlarged credit department as a result of increased accounts receivables. This cost is involved in form of clerical work involved in checking additional accounts, serving the added volume of receivables, maintaining accounting records and cost of conducting investigation to assess the credit worthiness of the customers (Periasamy, 2009).

**Collection costs**

Some costs are to be incurred by the firm for collecting the amounts from the customers on account of credit sales. Sometimes, additional expenses involves sending frequent follow up letters, cost of collection of exchange or cost of discounting bills, expenses on stringent action against default customers among others (Periasamy, 2009).

**Delinquency costs**

These costs are incurred by the firm while extending credit to the defaulting customers (Periasamy, 2009). This type of cost arises on account of delay in payment on the customers’ part or the failure by the customers to make payment of the receivable as and when they fall due after the expiry of the credit period. Such debts are treated as doubtful debts and involve the following; Tying of firms fund for an extended period of time, costs involved in putting extra effort to recover the overdues from the customers, costs associated with frequent reminders and costs incurred on account of legal charges where legal actions is sought to collect the debt.

**Default costs**

This cost comes from the probability of bad debt losses (Periasamy, 2009). The cost of bad debt arises when the firm despite all efforts is not able to recover the dues from the defaulting customers. The firm treats such dues as bad debts, which are to be written off as expenses against the revenues.

**Production and selling costs**

Expansion of sales volume arising from credit sales will see an increase in the production and selling costs. In this respect, a firm confronts two situations; firstly when the sales expansion is within the range of existing production capacity, in this case only variable costs relating to production and selling will increase. Secondly, when the production capacity requires to be added due to expansion of sales in excess of the existing production capacity. In this situation
the incremental production and selling costs will increase both variable and fixed costs of the firm (Barad, 2010).

**Opportunity cost**

This is the cost of lost sales by not extending credit. By not granting credit, the firm would escape incurring all the other costs of maintaining accounts receivable but on the same token, the profit foregone on account of expected rise in sales volume made on credit amounts much more than the costs eliminated by not granting credit.

**2.2.8: Principles and Practice of Accounts Receivable Management**

There are three factors that affect accounts receivable and that should be the main focus in account receivable management. These are credit extension policy, credit collection policy and monitoring receivables investment (Ramesh, 1987). In order to add profitability, soundness and effectiveness to receivables management an enterprise must make it a point to follow certain well established and dully recognized principles of credit.

The first of these principles relate to the allocation of authority pertaining to credit extension and collection to a specific management. The second principle puts stress on the credit extension policy. The third principle emphasizes a thorough credit investigation and analysis before a decision on granting a credit is taken. And the last principle touches upon the establishment of sound collection policies and procedures (Mishra, 2012). In the light of these quotations the principles of accounts receivables management are discussed below.

**Credit Extension Policy**

A credit policy is the blueprint used by a business in making its decision to extend credit to a customer. The primary goal of a credit policy is to avoid extending credit to customers who are unable to pay their accounts. The credit policy for larger businesses can be quite formal while that of a small business tends to be quite informal with a number of small business owners relying on their instincts (miller 2002).

A good credit policy should help attract and retain good customers without having a negative impact on the cash flow. Miller (2002) advocates at least four reasons to have a written credit policy and that they add to the productivity of the entire organization. These reasons are
seriousness of this undertaking, need for consistency among departments, need for consistent treatment towards customers and finally it provides recognition to the credit departments as a separate entity.

A firm’s credit policy is the primary determinant of accounts receivable and it is under the administrative control of the chief finance officer. Moreover credit policy is a key determinant of sales so sales and marketing executives are concerned by this policy (Houston, 2009).

Determination of credit policy involves a trade-off between the profit and additional sales that arise due to credit being extended on the one hand and the cost of carrying those debtors and losses suffered on account of bad debts on the other hand.

A credit extension policy has the following important variables:-

**Credit standard**

Credit standard refers to the required financial strength of acceptable credit customer (Brigham, Houston, Eugene, 2009). Also, credit standard refers to the minimum quality of credit worthiness of a credit applicant that is acceptable to the firm (Periasamy, 2009). A firm’s credit standard can either be liberal or restrictive.

In a liberal or lenient credit standard the firm relaxes its minimum conditions to be met by the credit applicant. A firm with a liberal credit standard may likely portray the following indicators: The firm stimulates sales and attracts more customers; increased sales may be accompanied by added costs such as clerical expenses involved in investigating additional accounts; It involves a larger working capital investment in receivables; There is a higher rate of default because of the inability of the customer to pay their accounts and extension of credit facility to less credit worthy customers; The average collection period may be long and lastly increased profit due to increased sales (Periasamy, 2009).

In a Restrictive or strict credit standard, the firm raises the minimum required condition for the credit applicant. A firm adopting a stricter credit standard is likely to be faced by the following effects: Decrease in sales as few customers are attracted; Reduced incidences of bad debt loss; decrease in the amount of working capital requirement to finance receivables; credit standards of the firm are normally high; Low costs of maintaining accounts receivable;
Extension of credit facilities to more credit worthy customers only; Decrease in profit due to decreased sales (Periasamy, 2009).

From these dimensions, it is observed that if credits standards are relaxed, the volume of sales are expected to increase. On the other hand, if credit standards are tightened, the expected volume of sales will decline. The effect of liberalizing the credit standard on profit may be estimated on the basis of matching between the profits or incremental earnings resulting from increased sales and the costs to be incurred or associated with relaxation of the credit standards. Accordingly, with the help of analysis of profitability versus required return in evaluating a credit standard change, then the financial manager should strive to determine the appropriate credit standard for the firm (Periasamy, 2009).

Credit Terms

Credit terms refer to the stipulations under which the firm sells on credit to customers. Thus the size of the accounts receivable is also affected by the terms of credit (Periasamy, 2009). Credit period is the length of time buyers are given to pay for their purchase. Naturally customers prefer longer credit periods; so lengthening the period will stimulate sales. However a longer period lengthens the cash conversion cycle, hence it ties up more capital in receivables which is costly (Brigham, Houston 2009). Moreover, the longer a receivable is outstanding the higher the probability that the customer will default and that the account will end up as a bad debt. To maintain the tradeoff between costs and profitability the financial manager should formulate an optimal credit period for the firm.

Discounts are price reduction given for early payment. The discount specifies what the percentage reduction is and how rapidly payment must be made to be eligible for the discount. A discount term of 2/10 net 30 means that 2% discount will be offered if payment is made within ten days, and the maximum period of credit is thirty days (Periasamy, 2009). Offering discounts has two benefits; first, the discount amounts to price reduction which stimulates sales. Secondly, discounts encourage customers to pay earlier than they otherwise would, which shortens the cash conversion cycle (Houston 2009). However, discounts mean lower prices and lower revenue unless the quantities sold increases by enough magnitude to offset the price reduction. The benefits and costs of discount must be balanced when establishing the credit policy (Periasamy 2009).
Credit Risk Analysis and Evaluation

The chief aim of debtors’ management is to ensure minimum or optimum investment in accounts receivable and considerable reduction in bad debt losses. To achieve this, the financial manager should follow clear cut principles and procedures to evaluate the credit worthiness of the applicants regarding how much credit can be extended and for how long (Periasamy 2009).

Granting credit is a journey, the success of which depends on the methodology applied to evaluate and to grant credit. The journey starts from the application for credit through acquisition of credit sales and ends at the time the debt is fully paid (Clerke, 1999). Credit granting exist to facilitate sales but credit sales are pointless without due payment (Morgan, 2002).

Credit analysis seeks to determine who will receive credit and under what conditions. For a continuing customer it is much easier because experience provides considerable information. For new customer credit analysis is obviously a tougher problem (Weaver and Weston, 2008). As alternative sources of funds become costly and unavailable due to increasing lending rates, customers start to look at trade credit as a source of working capital. Current customers will request for extension of terms to stretch out their payments. New customers may request very liberal open account terms. Thus, a firm must beware and cautious in its credit decision makings. It should treat every credit sale as if it could become a potential collection issue. When dealing with new customers, a firm might require making the following considerations when asked to extend credit to a troubled company.

There can be a number of reasons why a formerly profitable company becomes unprofitable; insufficient sales, shrinking profit margins, excess costs or even poor credit and collection management. Determining what is going wrong is important in deciding whether or not to extend credit to such a company. Taking the following steps will help to get to the bottom of things; Ask the customer face-to-face; if possible perform a site visit and speak to the owners and managers why the company is in difficulty.
Review the financials; It is helpful to focus on the following areas; Are they building inventory and not able to sell it? Do they have a negative cash position? Have they maxed out their borrowing base, is their working capital strong enough to support short-term liabilities even though they are losing money?

Check on the recent trade payment history; the financial ratios may be “text book perfect” yet trade payments are found to be substantially beyond terms. Examining the promptness of recent trade payments therefore may provide a more accurate picture of the financial strength of the business.

Take the whole picture; it might be helpful to view the company as if you were considering acquiring it. Make objective considerations (such as found in the ratios and elsewhere) as well as more subjective areas like the attitude of employees and managers.

Finding out what is the company doing to turn itself around is an important point to consider because it indicates the company’s commitment to itself, its customers and its suppliers. You might need to perform a site visit or have a personal conservation with management to identify what changes the company is making to improve its situation. If there haven’t been significant efforts to improve cash flow, profitability or late payment issues, it is a pretty good indicator that the company is either incapable of constructively dealing with its problems or is in denial. In either case, it is not a good risk.

The management of a firm will need to weigh the difference between losing the customer by refusing open account terms against the lost revenues if the customer fails to pay. It should also factor in the long-term benefits of customer loyalty, should it opt to support the company through a difficult period.

Once the firm has made the decision that it wants to keep and work with this customer, it is time to consider potential means of securing the sale. The firm might ask for a personal guarantee or letter of credit.

With current customers, the firm should not assume they are okay now because they were okay last year. It is important to review the credit worthiness of all important customers. Today’s business climate is erratic, to say the least. Companies that appeared secure six
months ago may now be on the verge of collapse. Management should set up regular reviews to monitor each customer’s credit worthiness to keep a step ahead of bad debts write-off.

In particular, credit applications, financial statements and participation in industry credit groups can help a firm develop the information necessary to making a reasonable decision about extending credit to both new and existing customers (Richard C, Oct 2008).

The afore-mentioned issues may be summed up by the Five C’s of credit evaluation. To evaluate the credit risk, credit managers in any industry should consider the Five C’s of credit which are character, capacity, capital, collateral and conditions (Weston and Coperland, 1995).

The Five C’s can help manufacturing firms to reduce the risk of default as they get to know their customers. The five C’s of credit represent the factors by which credit risk is judged and are defined as follows:

Character; which refers to the applicants record of meeting past obligations. The lender would consider the applicants payment history, as well as any pending or unresolved legal judgments against the applicant. The question addressed here is whether the applicant will pay his account, if able, within the specified credit terms (Megginson and Scott 2008).

Capacity is the applicants’ ability to repay the requested credit. The lender typically assesses the applicant capacity by using financial statements analysis focused on cash flow available to service debt obligation. (Megginson and Scott 2008).

Capital refers to the financial strength of the applicant as reflected by its capital structure. The lender frequently uses analysis of the applicants’ debts relative to equity and profitability ratios to assess its capital. The analysis of capital determines whether the applicant has sufficient equity to survive a business down turn (Megginson and Scott 2008).

Collateral is the asset the applicant has available for securing the credit. In general, the more valuable and more marketable these assets are the more credit lenders will extend. However, trade creditors are rarely secured loans as mostly are open account in nature (Megginson and Scott 2008).
Conditions have to do with the impact of general economic trends on the firm or special developments in certain areas of the economy that may affect the customers’ ability to meet the debt obligation (Weaver and Weston, 2008).

Credit application document serves as an information gathering tool that can also function as an enforceable document if litigation becomes necessary; secondly, financial statements; though difficult to obtain, they are important since their analysis is critical to determining whether a customer is worth the risk of unsecured credit facility and thirdly, Industry credit groups; Credit managers routinely use credit bureau reports as a source of data for determining credit worthiness of a customer. These reports may include general and undated information on a company’s financial position and credit history from various unidentified source. However, these one-size-fits-all credit information fall short however, when it comes to providing industry specific information. Credit managers need to roundout a customer’s financial profile and payment history (Richard C, Oct 2008)

In analyzing credit requests and determining the level of credit to be offered, the company can gather information from both internal and external sources usual internal source of credit information are the credit application and agreement submitted by the applicant and if available, the company’s own records of that applicant payment history. External sources typically include the financial statements, trade references, banks or other creditors and credit reporting agencies (Megginsen and Scott 2008).

Each of these sources of information involve a cost; internal sources incur costs of analyzing the data while some external sources such as credit reporting agencies also have explicit costs charged for obtaining data. The management should therefore weigh the benefit of the information sought against the cost of obtaining such information.

The credit policy should be endorsed by the executive officer of the company and should be based on the risk assessment of the company and its customers, which must be explicitly stated in the policy. The credit policy must also explain the nature of debts and debtors in terms of value of debts and the maximum credit limit for each category of debts. The company’s rights and duties with debtors and legal consequences must be clearly stated in the
policy so that all debtors are aware of the implications and consequences that will face them if they do not pay in time. The policy must enumerate in details the terms of trade and circumstances under which a company may change them. This will ensure that all the trading conditions are clear and all misunderstandings are eliminated at an early stage.

The credit policy must indicate the various modes of payments accepted and under what conditions. Also, it should identify the mechanism for reviewing requests from customers. The credit policy must state the procedure of giving customers discounts and who has the authority to do so and give directions on the provision of reviewing the policy and procedures for reviewing it i.e. when and by whom.

Credit policy is important for three main reasons. First, it has a major effect on sales, secondly it influences the amount of funds tied up in receivables and lastly it affects bad debt losses (Brigham et al., 2009).

Because of the importance of the policy the firms’ executive committee which normally consists of the chief executive officer in addition to the heads of finance, sales and marketing has the final say on setting the credit policy once the policy has been established, the credit manager, who typically works under the chief finance officer, must carry it out and monitor its effects (Brigham et al., 2009).

To ensure that the credit policy is being followed and it is achieving the desired objective, a firms’ credit policy should be monitored. More over when customers’ payment patterns change significantly, the firm should consider changing its credit policy. Proposed credit policy changes should be evaluated using Net present value approach to ensure the firm is maximizing its value (Brigham et al., 2012).

**Credit Collection Policy**

A credit collection policy are the procedures used by a company to collect overdue or delinquent accounts receivables (Megginson and Scott 2008). A credit collection policy manual are the procedures used to collect past due accounts including the toughness or laxity used in the process. At one extreme, the firm might write a series of polite letters after a fairly
long delay; at the other extreme, delinquent accounts may be turned over to a collection agency relatively quickly (Brigham et al., 2012).

Businesses today cannot afford excessive write-offs or large numbers of delinquent accounts. Lack of operating cash was the primary “cause of death” for many U.S “dot-coms” in the early 2000’s. Poor cash flow management continues to result in the collapse of business enterprises, large and small worldwide. One of the most common cash-traps is uncollected sales, i.e. accounts receivables (Richard 2008).

A company can improve its cash flow by reducing its Days Sales Outstanding (DSO) which is attained by training customers to pay on time. This requires constant attention and follow up. Firms should be somewhat firm, but excessive pressure can lead customers whose business is profitable to take their business elsewhere. Thus a balance must be struck between the costs and benefits of different collection policies (Brigham et al., 2009).

A company must determine what its collection policy will be and how it will be implemented. As is the case of credit standards and credit terms, the approach may be a function of the industry and the competitive environment (Megginson and Scott, 2008).

For any overdue or delinquent accounts, a reminder form, letter, telephone call or visit may facilitate customer payment. At minimum, the company should generally suspend further sales until the delinquent account is brought current. Should these actions fail to generate customer payment, it may be necessary to negotiate with the customer for past-due amounts (Megginson and Scott, 2008).

A firm should have invoices printed and mailed as quickly as possible and look for ways to improve invoice accuracy without delaying the presentation date. The sooner you can get the accurate invoice to the customer, the sooner they will pay you; offer financial inducements to customers who agree to pay your invoices electronically; with customers, who have a history of paying late, begin collection efforts before the due date. Call to inquire whether they have the invoice and if everything is in order, resolve any problems quickly at this point and if a customer indicates it has a problem with part of the invoice, authorize partial payments.
When a firm identifies a customer whose account is overdue it may take the following sequence of steps: The firm mails a delinquency letter notifying the customer of the past due account. Frequent follow up of delinquent accounts greatly increases chances of collecting them. People will often prioritize payment based on how much of a hassle they expect to receive. The firm may send a polite friendly reminder to those customers who are just a few days late with their payment. Letters with a more serious tone may follow as the receivables remain outstanding for longer periods (Kent et al., 2005).

The firm calls the delinquent customer to discuss payment. The firm may agree to extend payment period if the customer has a reasonable excuse. The firm may also send a representative to meet with the delinquent customer. Again the firm may decide to grant a credit extension to customer with a reasonable excuse for the delinquency (Kent et al., 2005).

Penalize the delinquent accounts. Penalizing delinquent accounts can be an effective way to ensure timely payments. This can be done by levying interest on overdue balances (Richard 2008). Where goods were sold with a lien attached, collateral was pledged against the account or additional corporate or personal guarantees were given, the company should utilize these options for obtaining payment (Meggison and Scott 2008).

The firm employs a collection agency. If despite all efforts the company is unable to collect, it should submit the account to a collection agency. Through this is not ideal, but collection agencies tend to be quite aggressive in their collection efforts. Also they usually charge based on amounts collected so there is no upfront cash outlay required. If the company had written off the amounts, then the amounts collected are somewhat of a bonus.

The firm takes legal action against the delinquent customer. The firm may seek legal judgment against the debtor. However, because of the substantial expense involved this action is appropriate only for the larger outstanding amounts. In addition, legal action could force the delinquent customer into bankruptcy, without securing the guarantee of eventual payment. Obviously a cost-benefit analysis should be made at each stage to compare the cost of further collection actions against the cost of simply writing off the account as a bad debt.
Credit Control and Monitoring

The efficiency of accounts receivable in formulation and execution of credit and collection policies largely depends upon the location of the credit department in the organizational structure of the firm. The aspect of authority allocation can be viewed from two perspectives. Firstly, it should be placed under the direct responsibility of the chief finance officer for it being a function primarily of finance in nature. Further, credit and collection policies lay direct influence on the solvency of the firm and therefore should be placed under the direct supervision of the individuals who are responsible for the firms’ financial position. Secondly, business firms should strictly enforce upon their sales departments that sales are insolate until the value thereof is realized (Curtis, 1959). Those favouring this perspective plead to place the allocation of authority under the direct charge of the marketing executive or the sales department. The responsibility to administer credit and collection policies may be assigned either to a financial executive or to a marketing executive to both of them jointly depending upon the organizational structure and the objectives of the firm (Chambers, 1969).

From the above arguments concerning the allocation of authority for management of accounts receivable, it is evident that as Salek (2005) puts it, management of the receivables assets is a complex task. It addresses the ramifications of practices and processes usually outside the span of the responsible manager and thus requires balancing of opposing priorities of the finance, marketing and sales functions.

A written credit policy provides recognition to the credit department as a separate entity (Miler, 2002). It is therefore important for an organization to set up an autonomous credit department equipped with modern technology and run by personnel qualified in credit management who are capable of addressing the needs of the various interrelated functions professionally. This will ensure that there is adequate coordination that will lead to synergy in the three departments.

The core functions of a credit department depicted by many scholars include: Establishment of credit terms and limits, taking into account the risk involved and liaising closely with the sales department; Assessment of credit risk, this involves trying to find a way of accepting and controlling all businesses including high risk opportunities; Monitoring and control of debt, this entails ensuring that agreed terms are adhered to, all high risk customers are kept
under control and action is taken promptly to resolve any queries or dispute; Maintenance of the sales ledger, by ensuring that the customer master file is up to date and accurate and that payments and other adjustments have been applied promptly and accurately and finally; Collection of payment in a manner which creates the optimum cash inflow while at the same time ensuring continuity of business (Kalunda et al., 2012).

A company sells on credit in order to increase sales and credit sales create the need for a credit department to investigate credit ratings, approve extension of credit and attempt to collect delinquent accounts (Nikolai and Bazley, 2010). If a company decides to sell on credit and establishes a credit department, it must install an effective internal control system for processing credit sales and cash collections. These controls features include firstly, pre-numbered sales invoices so that all invoices are accounted for and secondly the separation of the sales function from the cash collection responsibilities so that theft should not occur unless there is collusion between employees (Nikolai and Bazley, 2010).

Credit monitoring involves the ongoing review of a firms’ accounts receivable to determine if customers are paying according to the stated credit terms. If they are not paying on time, credit monitoring will alert the firm to the problem (Meggnison and Scott, 2008).

Companies must monitor credit on both an individual and on aggregate basis. Individual monitoring is necessary to determine if each customer is paying in a timely manner and to assess if the customer is within its credit limits. Customer screening should be continuous, not just a once-and-for-all assessment (Fleming, 1991). Companies which were once prosperous can quickly become very risky and if the seller is unaware of this, excessive credit may be being granted (Fleming, 1991).

Today’s business climate is erratic to say the least, companies that appeared secure six months ago may now be at the verge of collapse. A firm should set up regular reviews to monitor each customer’s credit worthiness to keep a step ahead of bad debts write-off. (Richard C, 2008). With current customers, the firm should not assume that they are okay now because they were okay last year. It should review the credit worthiness of all its important customers.
Credit monitoring on aggregate basis is important because it indicates the overall quality of the company’s accounts receivables. Slow payments are costly to a firm because they increase the average collection period and thus the firm’s investment in accounts receivable. If a company is also using its accounts receivable as collateral for a loan, the lending institution will generally exclude any past due accounts from those used as back up for the credit line.

Changes in accounts receivable over time could impact the company’s overall liquidity and the need for additional financing therefore, analysis of accounts receivable payment patterns can be essential for forecasting future cash receipts in the cash budgets (Megginson and Scott, 2008).

Techniques for Monitoring Quality of Accounts Receivable.

There are three most frequently cited techniques for monitoring the overall quality of accounts receivables namely: Average-collection-period (Days Sales Outstanding), Aging of accounts receivables and payment pattern monitoring. These techniques are discussed below.

**Average Collection Period**

The Average Collection Period (ACP) also known as Days Sales Outstanding (DSO) represents the average number of days that credit sales are outstanding. According to Graham, Scott (2010), the Average collection period has two components; first the time from sales until the customer places the payment in the mail and secondly, the time to receive, process and collect payment once it has been mailed by the customer. Average Collection Period is computed as follows:-

\[
ACP = \frac{\text{Average accounts receivable} \times 365}{\text{Credit sales}}
\]

If it may be assumed that the receipt, processing and collection time is constant, then the Average Collection Period tells the firm how many days (on average) it takes customers to pay their accounts (Graham et al, 2010).

The computed average collection period may be used by the firm for trend analysis to compare the collection period over time. Secondly, it may be used to compare with the set target by the firm and lastly it may be used in comparison with the industry average.
Aging of Accounts Receivable

This is a method used to monitor accounts receivable where an aging schedule classifies the firms’ receivables by the number of days outstanding (age of the receivable). It provides useful information about the quality of a firm’s accounts receivable. Table 2.1 below provides an example of an aging schedule.

Table 2.1: Aging schedule for Accounts Receivable.

<table>
<thead>
<tr>
<th>Age of account</th>
<th>Receivable amount ($)</th>
<th>Percentage of Total Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 10 days</td>
<td>130,000</td>
<td>43.3</td>
</tr>
<tr>
<td>11 – 30 days</td>
<td>100,000</td>
<td>33.3</td>
</tr>
<tr>
<td>31 – 60 days</td>
<td>50,000</td>
<td>16.7</td>
</tr>
<tr>
<td>61 – 90 days</td>
<td>15,000</td>
<td>5.0</td>
</tr>
<tr>
<td>More than 90 days</td>
<td>5,000</td>
<td>0.017</td>
</tr>
<tr>
<td>Total Value</td>
<td>300,000</td>
<td>100.0</td>
</tr>
</tbody>
</table>

(Source: Kent. H, and Baker, 2005)

Table 2.1 shows that 76.6% of the firm’s accounts receivable have been outstanding for 30 days or less. If the firm allows 30 days for payment of credit sales, 23.4% of the receivables are past due.

The firm would probably need to discover why so many of its outstanding receivables are past due; are customers experiencing temporally financial difficulties? Are customers delaying payment because they are unhappy with the firm’s product? Which of the customers will eventually pay and which receivables will the company have to write off as bad debt expense (Kent et al., 2005).

The payment pattern Technique

The payment pattern is the normal timing in which firms’ customers pay their accounts; it is expressed as the percentage of monthly sales collected in each month following the sale. One approach to determine the payment pattern is to analyze the company’s sales and resulting collections on a monthly basis. That is, for each month’s sales, the firm computes the amount collected in the month of sale and each of the following months. Every firm has a pattern in which its credit sales are paid, if the payment pattern changes, the firm should consider
reviewing its credit policies. By tracking these patterns over a period of time, the company can determine the average pattern of its collection using either spreadsheet or regression analysis. For most companies, these patterns tend to be fairly stable over time even as sales volumes fluctuates (Megginson, 2010).

**Pricing Administration, order processing and invoicing**

Pricing accuracy is possibly the most important determinant of management success (Salek, 2005). There are some fundamental practices that promote pricing and invoicing accuracy. They include: Keeping the pricing scheme as simple as it can be; complex pricing structure complicates receivable management; for example, a large firm selling numerous different products whose prices change sporadically. If this firm maintains individual cost plus pricing schedule for each of its many customers, each time prices changes on a product, it potentially requires a price change in all the individual customers’ price schedules. This will amount to a very difficult price administration challenge (Salek, 2005). However maintaining a simple pricing scheme may not be possible if the competitor offer complex pricing incentives.

Incorrect invoices resulting from price discrepancies will cause customer to refuse to pay, frequently demanding corrected invoices. This will increase days sales outstanding and delinquency.

As stated in the ‘quotation’ and ‘contract administration’ sections ensure the multiple elements of the price are clearly articulated to both the customer and the company’s internal staff (Salek, 2005). The various elements of price include List or base price for the stock keeping unit, Applicable discounts, Freight terms, Payment terms (including prompt payment discounts and billing timing, Applicable sales tax, Late payment fees /financial charges); Ensuring all elements of the pricing master and individual customer price are up to date and in force and ensuring promotional pricing is adequately controlled, that is, all promotions are authorized and communicated internally.

Before an order can be routed to fulfillment it must be reviewed to ensure it meets the conditions of an acceptable order. Such conditions are elements such as; price, freight terms (which party pays freight changes), payment terms, delivery date, clear description of the product ordered, quantities of product or service ordered and a purchase order number (most
companies will not pay an invoice unless it references a valid purchase order number). The purchase order must be filled correctly and promptly, it should also be billed accurately. The purpose of presenting an invoice to a customer is to secure payment for having provided a product or service; it may also be as a deposit on the future provision of a product or service. The invoicing function in many companies is highly automated; it requires little manual intervention and is often overlooked. However, invoicing accuracy is the single most important determinant of effective and efficient receivable management. Accurate invoicing leads to: Lower receivables delinquency and increased cash flow; Reduced exposure to bad debt loss; Lower cost of administering the entire revenue cycle; Fewer concession of disputed items and also enhanced customer service and satisfaction (Salek, 2005).

The two key objectives of invoicing are accuracy and speed. Accuracy is defined as meeting the customers’ requirements for timely payment of an invoice. On the other hand, speed is defined as presenting an invoice to the customer as soon as permissible under the terms of the business agreement; usually after shipping a product or rendering a service (Salek 2005). Invoice presentation can be accelerated by electronic presentation. Many companies begin the countdown to the due date on receipt of the vendor’s invoice; hence speed of invoicing is critical to maximizing receivable asset turnover. Speed however, is less important than accuracy as an inaccurate invoice will typically delay payment by several weeks. Thus, a delay of a few days to ensure accuracy is worth the avoidance of weeks of delay caused by a disputed invoice.

2.3: Empirical Literature
Quite a number of studies have been done on the area of working capital management and a few specifically on accounts receivable management.

In a research on the Accounts receivable, Strategies, Experiences and Intentions, the findings were that lack of efficiency within contemporary accounts receivable departments remain the norm as; cheques are still almost twice as common as electronic forms of payments; the Average Days Sales Outstanding (DSO) for enterprises surveyed exceed 45 days and 87% take more than a day to clear payment through their accounts receivable ledger and 45% of invoices are created manually (Andrew, 2008).
A study on effect of working capital management practices on financial performance of small scale enterprises in Kisii Kenya revealed that only 29% of all small scale enterprises set up credit guidelines for their credit customers. The study further revealed that the low use of credit sales was attributable to the lack of sound credit policies (Nyabwanga 2012).

In a study on ‘Determinants of accounts receivable and accounts payable management policies: A case of Pakistan textile sector’ the researcher found that accounts receivable are affected by the firms incentive to use credit as a means of price discrimination and a level of internal financing. The study also observed that the size of the firm also affects the level of accounts receivable that a firm maintains (Mubashir, 2012).

In the research titled “Empirical analysis of working capital and its impact on the profitability of listed manufacturing firms in Ghana” the findings revealed that working capital cycle (used as proxy for working capital management) is statistically significant but negatively associated with the firms’ profitability. Also, the findings revealed that accounts receivable collection period (used as proxy for accounts receivable management) is negatively correlated with profitability (Thomas, 2013).

In the study carried out Kenya titled “Factors affecting management of accounts receivable among Agro-manufacturing companies in Kenya” the study concludes that although the management of accounts receivable fall under the umbrella of the finance department, it is a complicated field that needs special attention as it affects both the sales and marketing and the finance departments (Onami, 2008).

The study on the effects of receivable management on the financial performance of Technical, Industrial, Vocational, and Entrepreneurship Training (TIVET) institutions in Kenya established that there is a positive relationship between receivable management and the financial performance of TIVET institutions. The study also established that a majority of the institutions (77%) had adopted formal receivables management procedures (Nyaga, 2011).
2.4: Gap to be filled by the Study
In most of the studies carried out, the focus has been on a single industry or sector which means that the findings may not be readily generalized to other industries or sectors of the economy. Onami (2008) contends that further studies need to be carried out on other sectors of the economy to determine their similarity to his study, since the scope of the study was limited only to agro-manufacturing companies.

It is therefore critical that a study be carried out in a cross-section of several manufacturing industries to establish whether the principles and practice of accounts receivable management are firm-specific or industry-specific. In the studies that have been carried out on working capital management, the asset of accounts receivable has been given only a very shallow or one sided attention; that of Average Collection Period, which has been used as proxy for the accounts receivable management. There is therefore a need to carry out a study that will deeply focus on the other elements or factors that influence the asset of accounts receivable as a function of working capital.

2.5: Conceptual Framework
A conceptual framework is a model of presentation where the researcher conceptualizes or represents the relationship between diagrammatically. The purpose of the conceptual framework is to help the reader to quickly see the proposed relationship. Figure 1 shows the relationship between the independent variables and the dependent variable of the study.
Credit Extension Policy
A sound credit extension policy with optimal credit standards and credit terms will result to higher sales that will lead to improved profitability for the firm. Thorough vetting of credit applications before credit is granted will ensure that a firm only extends credit to credit worthy customers. This will in turn reduce the firms’ exposure to risks of delayed payments and defaults. Credit risk analysis will therefore save the firms credit collection teams the agony of putting in additional efforts to make collections and hence saving on the administration cost related to collection of receivables.

Credit collection policy
A credit collection policy that facilitates low average collection period will ensure the firms’ healthy cash flows and improved liquidity position. Improved liquidity will enable the firm to meet its financial obligations as and when they fall due and also be in a position to seize opportunities that may arise in the market.
Credit Control and Monitoring
Establishment of an autonomous credit control department with its functions of establishment of credit terms and limits, assessment of credit risk, monitoring and controlling of debts, maintenance of the sales ledger and collection of payments will lead to improved operational efficiency in terms of high receivables turnover, lower average collection period and improved customer satisfaction. Managing accounts receivables is a unique discipline that involves a combination of accounts, sales and marketing skills. Thus department should have personnel who are trained on credit control as opposed to having personnel only trained accountancy.

The ongoing or continuous review of a firm’s accounts receivable to determine if customers are paying according to the stated credit terms will help the management to identify customers who have difficulty in paying and those who have surpassed their credit limits. This will help in mitigating the likelihood of delinquency and default in good time and thus take the appropriate action. Credit monitoring will also enable a firm to establish the overall guide in making important credit decisions such as credit terms and credit limits.

Pricing Administration, Order Processing and Invoicing
Price discrepancies are the leading cause of invoice disputes. However, a well-structured price scheme allows a firm to offer pricing incentives and promotions which gives it a competitive advantage. It also enables the firm to influence customer buying behaviour, which in turn increases the sales turnover and hence improved profitability.

Accurate order processing reduces the occurrence of invoice disputes which cause delayed payments hence a shortened average collection period and improved cash-flow. Accurate and speedy invoice presentation ensures timely payments by customers since the customers will start making payment arrangement on receipt of invoice from the vendor. This timely payment reduces the average collection period and hence an improved cash flow and healthy liquidity position of the firm.
Intervening variables

**Inflation:** The changes in prices may affect the value of the accounts receivable held by the firm since when the customers finally pay their accounts; the purchasing power of the money will be weaker.

**Information asymmetry:** when evaluating the credit status of potential customers, the firm may overlook or lack adequate information regarding the customer. This may lead to an otherwise good customer being denied credit and/or a wrong customer being granted credit.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1: Introduction

This chapter deals with the description of the methods and procedures used to carry out the study, sampling procedures and data collection and analysis methods.

3.2: Research Design

The study used descriptive research design where data was collected in order to establish the current status of the population. This research design was appropriate because the study sought to investigate the principles and practices adopted by manufacturing firms in managing their accounts receivable.

3.3: Target Population

The population under study was manufacturing firms located and operating within Thika municipal council. The target population was made up of 52 (fifty two) manufacturing companies registered with the Municipal Council of Thika in the year 2012 as shown in the table 3.1 below and in appendix (iv).

Table 3.1: Manufacturing firms within Thika municipality

<table>
<thead>
<tr>
<th>Category of firm</th>
<th>Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large industrial plants</td>
<td>12</td>
</tr>
<tr>
<td>Medium industrial plants</td>
<td>12</td>
</tr>
<tr>
<td>Small industrial plants</td>
<td>28</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
</tr>
</tbody>
</table>

(Source: Municipal Council of Thika)

3.4: Sample size and Sampling Technique

A census was carried out and hence all the fifty two manufacturing firms in Thika Municipality were used in the study.
3.5: Data Collection Procedure
Primary data was collected using semi-structured questionnaire administered to the chief finance officer and key credit control department personnel in the selected companies to collect both qualitative and quantitative information. The drop-and-pick later approach was used in this study and was considered an appropriate method because it gave the respondents time to complete the questionnaire and also gave the researcher an opportunity to review the questionnaire before picking to ensure completeness of the responses. Where necessary, personal interviews and documentary analysis was conducted to enhance validity. Secondary data was obtained from financial statements maintained by the companies

3.6: Data Analysis and Interpretation Procedures
Data collected from the primary and secondary sources was analyzed by way descriptive statistics where measures of central tendency such as mean, mode and weighted averages were computed to give result, which was then compared with the findings from literature review. Charts, graphs and tables were used to present the findings.
CHAPTER FOUR
DATA ANALYSIS, PRESENTATION AND FINDINGS

4.1: Introduction
This chapter presents the analysis of data collected and discusses the findings of the study. It consists of an overview of data collected and analyzed guided by the general objective of the study which was to investigate the principles and practices adopted by manufacturing firms in Kenya for effective management of accounts receivables.

4.1.1: Response Rate
This was a census study targeting all manufacturing firms located and operating within Thika municipality. Out of 52 questionnaires administered, 34 respondents filled and returned the questionnaires. The response rate was therefore 65% which is considered significant enough to give reliable findings for this study. According to McBurney (2001), an above 50% response rate is acceptable for the study because low response rate could have a potentially biasing effect on the study results.

4.2: Credit Extension Policy
4.2.1: Credit Policy Objectives
The respondents were required to rate their firms credit policy objective on a rating of 1- for “very important” 2- for “important”,3- for “necessary” and 4- for “not important” from among the listed objectives. The responses are presented in the table 4.1 below.

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>AVERAGE RATING</th>
<th>FREQUENCY</th>
<th>PERCENTAGE OF RESPONDENTS(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elimination of bad customers</td>
<td>1</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Minimize credit costs</td>
<td>2</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Tool to gain competitive advantage</td>
<td>2</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Earn interest on overdue accounts</td>
<td>4</td>
<td>34</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: Author)
The study found that on average, elimination of bad customers is considered the most important objective of having a credit policy. Minimization of credit costs and credit as a tool to gain competitive advantage are considered as important credit policy objectives. On the other hand, earning interest on overdue accounts is not considered an important objective of having a credit policy.

4.2.2 Credit Risk Analysis

The respondents were required to rate the requirements that a credit customer should meet for credit appraisal on a rating of 1- for “very important” 2- for “important”, 3- for “necessary” and 4- for “not important” from among the listed requirements.

The responses are presented in the table 4.2 below

<table>
<thead>
<tr>
<th>REQUIREMENT FOR CREDIT APPRAISAL</th>
<th>AVERAGE RATING</th>
<th>FREQUENCY</th>
<th>PERCENTAGE OF RESPONDENTS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Character</td>
<td>1</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Capacity</td>
<td>1</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Capital</td>
<td>1</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Collateral</td>
<td>2</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Condition</td>
<td>3</td>
<td>34</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: Author)

The study found that on average, capacity; that is the customers’ ability to pay the requested credit, character, that is, the applicants record of meeting past obligations and capital, which is the financial strength of the applicant as being the most important requirements for credit appraisal. Collateral, which is the asset the applicant has available for securing credit is considered as an important requirement for credit appraisal. Condition, which is the impact of general economic conditions, is considered as only necessary requirement for credit appraisal.
4.2.3 Variation of Credit Terms

The respondents were required to indicate whether their firms’ normally vary its credit terms for particular customers, particular products, or particular season.

The responses are presented in the table 4.3 below.

Table 4.3: Variation of Credit Terms

<table>
<thead>
<tr>
<th>TARGET</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FREQUENCY</td>
<td>PERCENTAGE OF RESPONDENTS (%)</td>
</tr>
<tr>
<td>Particular customers</td>
<td>32</td>
<td>94</td>
</tr>
<tr>
<td>Particular products</td>
<td>19</td>
<td>56</td>
</tr>
<tr>
<td>Particular season</td>
<td>18</td>
<td>53</td>
</tr>
</tbody>
</table>

(Source: Author)

Credit terms are the stipulations under which the firm sells on credit which may have an impact of stimulating sales for different customers, different products and different seasons. More than fifty percent of the respondents vary their credit terms for different customers, different products and also different seasons. The study found that credit terms for customers are varied depending on the ability of the customer to pay, the length of time the customer has traded with the firm and the amount of credit being sought. Credit terms for products are varied depending on whether the product is fast or slow moving and its perishability or obsolescence. Credit terms are varied depending on the demand in different seasons.

4.3 Credit Collection Policy

4.3.1 Strategies of Dealing with Overdue Accounts

The respondents were required to rate the various strategies adopted by their firms in dealing with overdue accountson a rating of 1- “for mostly used”, 2- for “averagely used”,3- for “rarely used” and 4- for “never used”. The responses are presented in the table 4.4 below.
Table 4.4: Strategies of Dealing with Overdue Accounts

<table>
<thead>
<tr>
<th>STRATEGY</th>
<th>AVERAGE RATING</th>
<th>NUMBER OF RESPONDENTS</th>
<th>PERCENTAGE OF RESPONDENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sending reminder notes</td>
<td>1</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Making telephone calls</td>
<td>1</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Use of debt collection agencies</td>
<td>3</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Institute legal proceedings</td>
<td>3</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Leave customer alone to decide when to pay</td>
<td>4</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Put the accounts on hold and stop further sales</td>
<td>2</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Factor the account</td>
<td>4</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Write off the accounts as bad debt</td>
<td>3</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Charge interest on overdue accounts</td>
<td>3</td>
<td>34</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: Author)

The study found that on average, sending reminder notes and making telephone calls were the mostly used strategies in dealing with overdue accounts whereas putting the account on hold and stop further sales is averagely used. The least used strategies are leaving the customer alone to decide when to pay and factoring the accounts.

4.3.2 Incentives Used To Encourage Prompt Payment

The respondents were required to indicate the incentive they give their customers to encourage prompt payment. The responses are presented in the figure 4.1 below.

![Figure 4.1: Incentives Used To Encourage Prompt Payment](Source: Author)
Cash discount which is the price reduction given for early payment is the mostly used incentive to encourage prompt payment with thirty one of the respondents which represent ninety one of the respondents indicating its use as compared to trade discount and promotional gifts with nine percent and zero percent of the respondents respectively. The study also found out that cash discounts and trade discounts are being used simultaneously by some firms to encourage large sales and prompt payment.

### 4.3.3 Level of Bad Debts Written Off

The respondents were required to indicate the level of bad debts written off for each of the five years under study. The figure 4.2 shows average number of respondents for the different levels of bad debts written off.

![Figure 4.2: Level of Bad Debts Written Off](image)

(Source: Author)

On average, twenty nine of the respondents which represent eighty five percent of the respondents indicated to have written off less than five percent of their accounts receivable as bad debts while none had written off more than twenty percent of their accounts receivable as bad debts.
4.3.4 Average Collection Period (ACP)

The respondents were required to give the values of credit sales and accounts receivables for each of the five years under study. This information was used to compute the average collection period (ACP) for each of the years. The figure 4.3 below gives the mean of the number of respondents for different levels of average collection period.

![Figure 4.3: Average collection period.](Source: Author)

It can be observed that a majority, eighteen of the respondents which represent fifty three percent of the respondents had an average collection period of between thirty and forty five days and only two of the respondents which represent six percent of the respondents had an average collection period of above sixty days.
4.4 Credit Control and Monitoring

4.4.1 Existence of Autonomous Credit Control Department

The respondents were required indicate whether their firms had autonomous credit control department. The responses are presented in the figure 4.4 below.

![Figure 4.4: Existence of Autonomous Credit Control Department](Source: Author)

This question intended to establish the number of firms that have an independent credit department to exclusively deal with management of accounts receivable. As can be depicted from the table above, thirteen of the respondents which represent thirty eight percent of the respondents had an established autonomous credit control department. The study found out that those firms with autonomous credit departments had shorter average collection period and low incidences of bad debt write off.

4.4.2 Professional Qualification of Head of Credit Control Department

The respondents were required to give the relationship between professional training in credit management and the level of efficiency in the management of accounts receivable in those firms with an independent credit control department. The responses are presented in the table 4.5 below.
Table 4.5: Professional Qualification of Head of Credit Control Department

<table>
<thead>
<tr>
<th>QUALIFICATION</th>
<th>LEVEL OF EFFICIENCY</th>
<th>NUMBER OF RESPONDENTS</th>
<th>PERCENTAGE OF RESPONDENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree and above</td>
<td>Very good</td>
<td>13</td>
<td>38</td>
</tr>
<tr>
<td>Diploma in credit management</td>
<td>Good</td>
<td>7</td>
<td>21</td>
</tr>
<tr>
<td>Certificate in credit management</td>
<td>Average</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>Certified accountant</td>
<td>Good</td>
<td>9</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>34</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

(Source: Author)

Thirty eight percent of the respondents indicated that personnel with a degree and above were very good in the management of accounts receivable. Twenty one percent of the respondents indicated that personnel with a Diploma in credit management were good and fifteen percent of the respondents indicated that personnel with a certificate in credit management were average in credit management. However, even without a professional training on credit management, the level of efficiency of a certified accountant was as good as that of one with a Diploma in credit management.

4.4.3 Techniques for Managing Credit Risk Exposure

The respondents were required to rate the various techniques for managing credit risk exposure on a rating of 1- for “very important”, 2- for “important”, 3- for “necessary” and 4- for “not important”. The responses are presented in the table 4.6 below.

Table 4.6: Techniques for Managing Credit Risk Exposure

<table>
<thead>
<tr>
<th>TECHNIQUE</th>
<th>AVERAGE RATING</th>
<th>FREQUENCY</th>
<th>PERCENTAGE OF RESPONDENTS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt collection services</td>
<td>2</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Credit insurance</td>
<td>2</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Letters of credit</td>
<td>1</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Factoring</td>
<td>2</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Instituting legal proceedings</td>
<td>3</td>
<td>34</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: Author)
The study found that on average, letters of credit is a very important technique for managing credit risk exposure. Use of debt collection services, credit insurance and factoring of accounts were found to be important techniques for managing credit risk exposure. The least important technique was found to be instituting legal proceedings against defaulters.

4.4.4 Techniques for Monitoring the Quality of Accounts Receivable

The respondents were required to indicate the method commonly used to monitor the quality of their accounts receivable from among the three listed. The responses are presented in the figure 4.5 below.

![Figure 4.5: Techniques for monitoring the quality of accounts receivables](Image)

(Source: Author)

Fifteen of the respondents which represent forty four percent of the respondents indicated that they used Payment pattern monitoring, which is the normal timing in which a firm’s customers pay their accounts. Eleven of the respondents which represent thirty twopercent of the respondents indicated that they used aging of accounts receivable where the accounts receivables are classified by the number of days outstanding. Eight of the respondents which
represent twenty four percent of the respondents indicated that they used ratio analysis. The most commonly used ratios were rate of debtors turnover ratio and average collection period.

### 4.4.5 Value of Accounts Receivables on Total Current Assets

The respondents were required to indicate the percentage of current assets represented by accounts receivables for each of the five years under study. The table 4.7 below shows average number of respondents for the different ranges of the percentage of current assets represented by accounts receivables.

#### Table 4.7: Value of Accounts Receivables on Total Current Assets

<table>
<thead>
<tr>
<th>% OF CURRENT ASSETS REPRESENTED BY ACCOUNTS RECEIVABLES</th>
<th>FREQUENCY</th>
<th>PERCENTAGE OF RESPONDENTS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 25%</td>
<td>7</td>
<td>21</td>
</tr>
<tr>
<td>Between 25% - 50%</td>
<td>23</td>
<td>68</td>
</tr>
<tr>
<td>Between 50% - 75%</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>Above 75%</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>34</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

(Source: Author)

On average, twenty three of the respondents which represent sixty eight percent of the respondents indicated to having between twenty five and fifty percent of their current assets in form of accounts receivable. Seven of the respondents which represent twenty one percent of the respondents indicated to having below twenty five percent of their current assets in form of accounts receivable.

### 4.5 Invoicing

#### 4.5.1 Invoicing System

The respondents were required to indicate the invoicing system in use in their firms. The responses are presented in the table 4.8 below.

#### Table 4.8: Invoicing System

<table>
<thead>
<tr>
<th>INVOICING SYSTEM</th>
<th>FREQUENCY</th>
<th>PERCENTAGE OF RESPONDENTS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manual</td>
<td>12</td>
<td>35</td>
</tr>
<tr>
<td>Automated</td>
<td>22</td>
<td>65</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>34</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

(Source: Author)
Invoicing system to a large extent influences the accuracy and speed of processing invoices. Twenty two of the respondents which represent sixty five percent of the respondents indicated to have automated invoicing system whereas twelve of the respondents which represent thirty five percent of the respondents indicated to be using the manual system of invoicing. The study found that the firms with automated invoicing system had fewer cases of disputed invoices.

4.5.2 Timing of Invoicing after a Sales Transaction

The respondents were asked to indicate the time when they present invoices to their customers. The responses are presented in the figure 4.6 below.

![Figure 4.6: Timing of Invoicing After a Sales Transaction](chart)

(Source: Author)

The speed of invoicing is critical to maximizing accounts receivable turnover. Seventeen of the respondents which represent fifty percent of the respondents indicated that they invoice their customers immediately a sales transaction is made, that is, on delivery of the goods. Ten of the respondents which represent twenty nine percent of the respondents indicated that they invoice their customers one day after a sales transaction is made. Six of the respondents which represent eighteen percent of the respondents indicated that they invoice their customers within one week of a sales transaction. One of the respondents which represent three percent of the respondents indicated that they invoice their customers within one month of a sales transaction. The study found out that speedy presentation of invoices reduces the average collection period.
4.5.3 Techniques of Dealing with Disputed Invoice

The respondents were required to indicate the technique they mostly used in dealing with a disputed invoice. The responses are presented in the table 4.9 below.

Table 4.9: Techniques of Dealing with Disputed Invoice

<table>
<thead>
<tr>
<th>TECHNIQUE</th>
<th>FREQUENCY</th>
<th>PERCENTAGE OF RESPONDENTS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Making concession</td>
<td>12</td>
<td>35</td>
</tr>
<tr>
<td>Drawing a new invoice with</td>
<td>13</td>
<td>38</td>
</tr>
<tr>
<td>corrected amounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sending a debit note</td>
<td>9</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>34</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

(Source: Author).

How a disputed invoice is dealt with will determine how much longer the firm will have to wait before receiving payment from the customer. Thirteen of the respondents which represent thirty eightpercent of the respondents indicated that they draw new invoices showing the correct amounts which they send to the customer. This means that the firm will have to wait longer by the length of time the invoice was in dispute. The reason given for this was accountability on the part of the book keepers. Twelve of the respondents which represent thirty fivepercent of the respondents indicated that they make concession on the disputed invoice and simply receive the lesser payment. This technique ensures speedy settlement of the receivables. Nine of the respondents which represent twenty sevenpercent of the respondents indicated that they send a debit note to the customer correcting the over-invoicing.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS.

5.1: Introduction
This chapter discusses the summary and conclusions of the research findings in relation to the objectives as stated in chapter one. It also discusses the recommendations of the study, its limitations as well as the suggested areas of further research.

5.2: Summary
The study aimed at investigating the principles and practices adopted by manufacturing firms in Kenya for effective management of accounts receivables. The results from the study revealed several factors that affect the management of accounts receivable.

With regard to credit extension policy, the study revealed factors such as lack of a formal credit policy, delayed or non review of the credit policy manual, inconsistency on credit risk analysis procedures, lack of clear credit policy objectives and haphazard variation of credit terms which pose a real challenge to the effective management of accounts receivables.

On credit collection, the study revealed erratic fluctuation in the average collection period through the five years under study. There were also significant amounts of bad debts written off in the same period, which is an indication of either lack of, or inconsistent application of credit collection policy procedures and weak follow up strategies on overdue accounts.

A surprisingly large number of firms did not have a credit control function at all. Instead, the standard practice was to invoice all credit customers and hope that they pay approximately on time. Its only when the company accumulated a few large bad debt losses did the management take action to institute credit risk analysis for its customers. The firms with autonomous credit control departments reported shorter average collection periods and fewer bad debt write offs. Credit monitoring was weak in those firms without autonomous credit control departments as evidenced by their holding of large accounts receivable in their current assets portfolio.

A sizeable number of firms were still using manual invoicing system and others took a considerable time to present invoices to their customers. This goes to explain the existence of
delayed payments by customers as evidenced by the long average collection period of these firms. Use of manual invoicing system may also be attributed to the high frequency of disputed invoices in these firms.

5.3: Conclusion

The study concludes that although there exists some practices guiding extension of credit to customers, their weak implementation as evidenced by lack of formal credit extension policy, delayed or non-review of the policy manual, inconsistency on credit risk analysis pose a challenge to effective management of accounts receivables. The study also concludes that there is either lack of or inconsistent application of credit collection policy procedures and or weak follow up strategies on overdue accounts which hampers effective accounts receivables management. The study further concludes that due to weak or inadequate credit control and monitoring procedures, manufacturing firms continue to face a challenge ineffectively managing their accounts receivables. Finally, the study concludes that timely and accurate invoicing procedures are an important component in the effective management of accounts receivable that would ensure a reduction in bad debts and improved liquidity for manufacturing firms.

5.4: Recommendations

From the findings of the study the researcher makes the following recommendations:

The firms should create a credit extension policy which should be adhered to always and periodically reviewed to see when it should be changed to match with economic conditions. The policy should be able to attract new customers as well as protect the firm from potential bad customers.

Firms should create a credit collection policy setting out the procedures and practices to be used by the company to collect overdue or delinquent accounts receivable. This policy should allow for simultaneous use of a combination of several collection strategies that ensures that the firm not only improves its cash flow by shortened average collection period but also does not suffer bad debt losses.

It is of importance that management approves the formation of a well-run autonomous credit department that will allow the imposition of a comprehensive set of operating policies and procedures so as to achieve a reduction in bad debt losses and an improvement in liquidity
through shortened average collection periods. Credit monitoring should be enhanced to evaluate the quality of accounts receivables to reduce over-investment in accounts receivable as currently witnessed by a sizeable number of firms.

Firms should automate their invoicing system to cut down on the time taken to present invoices to customers. This will reduce the average collection period. Automated invoicing will also serve to reduce the errors in invoices thus reducing the number of those disputed.

5.5 **Suggestion for further research**

The study focused only on manufacturing firms. It is therefore recommended that similar research be extended to other sectors of the economy such as service industry and retail business.

The study was limited to accounts receivable management. Further studies should be done on other elements of working capital such as cash flow management, accounts payable management and inventory management.
REFERENCES


Nyabwanga O; *Effect of working capital management practices on financial performance of small scale enterprises in Kisii Kenya*; African journal of business management Vol 6 No. 18


Voi, H. D. (1990).*Managing accounts Receivables and inventory*; Cantho University press, Thailand


APPENDIX 1
QUESTIONNAIRE

Principles and Practices of Effective Accounts Receivable Management

1. i. Name of the company ________________________________________
    ii. Year the company started operating ____________________________
    iii. Nature of main business activity ______________________________

2. What percentage of your total current assets is represented by accounts receivables?
   Answer using a tick (√ )
   a) Below 25% (   )
   b) Between 25% - 50% (   )
   c) Between 50% - 75% (   )
   d) Above 75% (   )

3. In your opinion, how would you generally rate your company’s account receivable management policy. Answer by putting a tick ( √ ) as appropriate.
   a) Excellent (   )
   b) Good (   )
   c) Average (   )
   d) Below average(   )

4. Does your company have a credit policy manual? Yes (   ) No (   )
   If yes, then answer the following
   i. Which of the following are the components of your company credit policy manual?
      Tick (√ ) as appropriate
      a) The credit period (   )
      b) The credit limits (   )
      c) Discount rate and period (   )
      d) Any other, (Please specify) ______________________________________
   ii. How often is the credit policy manual used by the management
      a) Always (   ) b) Sometimes (   ) c) Never (   )
   iii. Who of the following personnel in your company is in charge of implementing the credit policy?
      a) Managing director (   )
b) Chief finance officer (   )
c) Credit controller (   )
d) Any other, Please specify _________________________________

iv. Rank the credit policy objectives in your company use (1) for very important (2) for important (3) for necessary and (4) for not important.
   a) Minimizing credit cost (   )
   b) Elimination of bad customers (   )
   c) Tool to gain competitive advantage (   )
   d) Earn interest on an overdue account (   )

v. Do you review the company credit policy Yes (   ) No (   )

vi. If yes how often? yearly, quarterly, never etc. Please state ________________________________

vii. In order of importance, which of the following requirements does your company consider when appraising credit application by customers? Use: 1 for very important, 2 for important, 3 for necessary and 4 for not important.
   a) Character of the customer i.e. customers willingness to pay (   )
   b) Capacity of the customer, i.e. customers ability to pay (   )
   c) Capital i.e. financial strength of the customer (   )
   d) Collateral i.e. the asset the customer has for securing the credit (   )
   e) Condition of the customer i.e. the impact of general economic environment (   )

viii. What is the level of involvement of the following personnel in credit risk assessment? Use 1 for most involved, 2 for averagely involved, 3 for rarely and 4 for never involved

Personnel
Chairman (   )
Managing Director / General manager (   )
Departmental head (   )
Credit manager (   )
Finance manager (   )
Any other Please specify ________________________________
5. i. What action(s) does your company take in dealing with overdue accounts. Use 1 for mostly used, 2 for averagely used, 3 for rarely used and 4 for never used.

a) Sending reminder notes
b) Making telephone calls
c) Use of collection agencies
d) Institute legal proceedings
e) Leave the customer alone to decide when to pay
f) Put the Accounts on hold and stop further sales
g) Write off the account as bad debt
h) Charge interest on overdue amounts

ii. Which of the following is the incentive mostly offered by your company to encourage customers to pay promptly?

a) Cash discounts
b) Trade (volume) discounts
c) Giving promotional gifts
d) None of the above
e) Any other, please specify______________________________________

iii. Have your company ever written off debts as bad? yes ( ) No ( )

If yes, please answer the following.

iv. What percentage was the bad debts written off to the total debts for that period?

a) Below 5%
b) Between 5% - 10%
c) Between 10% - 20%
d) Above 20%

v. Briefly state the factors that led to the situation above.

____________________________________

6. i. Does your company have an independent credit control department

Yes ( ) No ( )

ii. If No, briefly explain why ____________________________________________________________

iii. Is there a credit committee Yes ( ) No ( )

a) If yes, what is the composition of the credit committee (e.g managing director, finance manager etc.)
b) How frequent does the credit committee meet?
   i. Monthly
   ii. Weekly
   iii. Any other, please specify ________________________________

c) Briefly state the role played by the credit committee in managing your company’s accounts receivable
   ______________________________________________________
   _______________________________________________________

d) What are the qualifications and experience of the head of the credit control department?
   _________________________________________________________
   _________________________________________________________

e) To whom is the head of the credit control department directly answerable to?
   i. Managing director ( )
   ii. Chief Finance Officer ( )
   iii. Marketing manager ( )
   iv. Sales Manager ( )
   v. Any other, please specify ________________________________

f) i) Who of the following officers in your organization is in charge of approving the customer credit application?
   a) Managing director ( )
   b) Finance control ( )
   c) Credit controller ( )
   d) Sales manager ( )
   e) Marketing manager ( )
   f) Any other, please specify ________________________________
ii. In order of importance which practices has your company used to manage credit risk exposure? Use 1 for very important 2 for important, 3 for necessary and 4 for not important
   a) Debt collection services (   )
   b) Instituting legal proceedings (   )
   c) Using letters of credit (   )
   d) Credit insurance (   )
   e) Write off debts as bad (   )
   f) Wait and see (leave customer to decide when to pay )

iii. Does your company review its accounts receivable? Yes ( ) No ( ),
     If yes, answer the following

iv. How often does the company review its accounts receivable?
   a) Weekly
   b) Monthly
   c) Quarterly
   d) Any other, please specify ____________________

v. Which technique does your company use to monitor the quality of its accounts receivable?
   a) Ratio analysis (   )
   b) Aging of accounts Receivable (   )
   c) Payment pattern monitoring (   )
   d) Any other, please specify ____________________

vi. If your company uses ratio analysis technique, please state the ratios used
   a)
   b)
   c)

7. i) Does your company vary its credit terms and/or for
   a) Particular customers Yes ( ) No ( )
   b) Particular products Yes ( ) No ( )
   c) Particular season Yes ( ) No ( )

ii. If your answer to (i) above is yes, please briefly explain
iii) How does your company process invoices?
   a. Manual system ( )
   b. Automated system ( )

iv) How long after a sales transaction does your company take to invoice a customer?
   a) One day
   b) One week
   c) One month
   d) Any other please specify _________________

v) How do you deal with a disputed invoice? Briefly explain
   a) Make concession to the disputed amount ( )
   b) Draw another invoice correcting the errors ( )
   c) Send the customer a debit note ( )
   d) Any other, please specify ________________________________

8. Please fill the table below for the period indicated

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Credit sales (sh)</th>
<th>Annual debtors Turnover (times)</th>
<th>Annual Profit / loss (sh)</th>
<th>Current assets at year end (sh)</th>
<th>Debtors balance at year end (sh)</th>
<th>Bad debts written off (if any) (sh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
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<tr>
<td>2009</td>
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<td>2010</td>
<td></td>
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<td></td>
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<td>2011</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>
9. How often has your company experienced the following situations? Mark with a tick (√) as appropriate

<table>
<thead>
<tr>
<th></th>
<th>Never</th>
<th>Rarely</th>
<th>Often</th>
<th>Very Often</th>
</tr>
</thead>
<tbody>
<tr>
<td>Writing off bad debts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Suing customers for non payment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Use of collection agencies to collect debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Factoring debtors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incorrect discount rates</td>
<td></td>
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<td></td>
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<tr>
<td>Incorrect credit period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disputed invoices</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incorrect credit limits</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Thank you so much for sparing your invaluable time for this noble course