AN INVESTIGATION INTO THE FACTORS AFFECTING MANAGEMENT OF ACCOUNTS RECEIVABLE. A CASE OF SELECTED AGRO-MANUFACTURING COMPANIES IN NAIROBI

BY:

RICHARD ONAMI OMWEGA

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Omwega,Richard Onami
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DECLARATION

This Project is my original work and has not been presented in any other university or for any other a ward.

.... 05/05/08 ....

Richard Onami Omwega

Date

This research Project has been submitted with my approval as the university supervisor.

.... 20/5/08 ....

Joseph Theuri

Date

Lecturer, Department of Accounting & Finance

This research Project has been submitted with my approval as the chairman of Department of Accounting & Finance.

.... 21-5-08 ....

Mr.J.M. Muturi

Date

Chairman, Department of Accounting & Finance

KENYATTA UNIVERSITY DEPARTMENT OF ACCOUNTING & FINANCE P.O. Box 43844, NAIROBI, KENYA

DEDICATION

This project is dedicated to my wife and children for their unconditional support, encouragement and love.

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My sincere thanks to almighty God who makes all things possible, he who gave me the ability that I cannot supply to my self or explain my worthiness.

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ABSTRACT

Accounts receivables account for a greater portion of current Assets. Management has to formulate strategies of managing this asset. The objective of this project was to understand the factors affecting management of accounts receivable with specific reference to agro-manufacturing companies in Kenya. It further explored various strategies used by companies to manage their accounts receivables. Also the project examined the weaknesses and strengths of the various strategies used by the companies under study and advised on the best strategies and best practices of accounts receivable management in the industry.

The data was collected through a structured questionnaire and a total of twenty responses were obtained out of the thirty questionnaires that were distributed.

From the analysis of the data it was found out that lack of trained credit control professionals contributed a high percentage to the poor management of accounts receivables followed by well established credit reference bureaus that can give companies information of the customers' credit worthiness without infringing on the customers' confidentiality.

The study also revealed that lack of proper constituted credit committees to vet the customers' credit applications is an important constituent of managing of accounts receivables. These committees evaluate applications of various customers before credit is granted hence properly constituted committees plays a vital role in managing of accounts receivable.

TABLE OF CONTENTS

1. Title..i
2. Declaration..ii
3. Dedication...iii
4. Acknowledgement..iv
5. Abstract...v
6. Table of Contents..vi

CHAPTER ONE 1

INTRODUCTION 1

1.1: Background to the Study. 1
1.2: Management of Accounts Receivable 5
1.3: Statement of the Problem..6
1.4: Objectives of the Study 7
1.5: Research Questions 7
1.6: Significance of the Study 8
1.7: Scope of the Study...9

CHAPTER TWO 10

LITERATURE REVIEW 10

2.1: The general importance of accounts receivable management 10
2.2: Characteristics of Accounts Receivables..11
2.3: Forms of Accounts Receivables..12
2.3: Objectives of accounts receivable managements 13
2.4: Reasons for companies granting credit 14
2.5: Accounts receivable policy formulation 15
2.7: Sources of credit information about customers: 22
2.8: Credit investigation and analysis 23
2.9: Conceptual Framework...28

CHAPTER THREE 30

RESEARCH METHODOLOGY 30

3.0: Introduction 30
3.1: Target Population 30
3.2: Sample size and sampling methods 30
3.3: Data Collection Procedures 30
3.4: Data Analysis and Interpretation Procedures 31
CHAPTER FOUR 32
DATA ANALYSIS 32
4.1: Overview of data collected and analyzed 32
4.2: Debt collection strategies used by Companies 33
4.3: Relationship between the professional course on credit management and the Management of Accounts receivable. 34
4.4: Incentives company offers to Customers to pay promptly 36
4.5: Financial performance of the firms and their ranking 37
4.6: Awarding of credit facilities in the years 2001-2005. 38
4.7: Sources of information organizations uses in assessing customer credit worthiness. 39
4.8: Factors a company considers before granting credit facility. 40
4.9: Reports used to manage Accounts Receivable 41
CHAPTER FIVE 42
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS 42
5.1: Summary and conclusions 42
5.2: Recommendation 43
5.3: Limitations of the Study 44
5.4: Suggestion for further study. 44
REFERENCES 46
APPENDIX1 48
APPENDIX 11 58
APPENDIX 111 59
APPENDIX IV 60

CHAPTER ONE

INTRODUCTION

1.1: Background to the Study.

The focus of attention of most companies' management is to increase the bottom line through cost cutting and more cost cutting, leaving more money on the table that would be available for maximization of shareholders wealth and even employee's compensation. According to Nealon (2003), managers are always looking to maximizing returns so they spend so much of their efforts watching costs and managing the day to day operations of the business ignoring the biggest asset they have which is accounts receivable.

Accounts receivable is one of the principal elements of a company's investment in working capital; hence it is management is vital to the success of a company. According to Copper (1985),management of accounts receivable is complex because it forms an integral part of the marketing function as the granting of credit terms attract customers resulting to increased sales .

Financial management functions such as accounts receivable have been traditionally viewed as transaction processing activities. According to ANAO (1996),it is indicated that up to 65 per cent of time was spent on non-value added activities across all government and industry sectors. The study suggested

that the elimination or reduction of non-value tasks could be effected through better work practices and automation of processes. This can be achieved by analyzing current processes and redesigning them to remove as much manual intervention as possible, reducing re-keying and appraisal activities and minimizing operator error. An important part of this analysis is a formal, structured risk assessment that identifies and measures exposures associated with the accounts receivable process.

According to Hunt (1966), trade credits gives rise to accounts receivables and any company cannot do without accounts receivables as this is a marketing tool. It is used as a tool of retaining the market and also to attract potential customers. Similarly, it adds an additional responsibility of converting the debtors into cash through effective collection mechanism.

According to Brockington, (1987) management of trade receivables is easy to be treated in an analytical way than is the case with inventories because they are not physical. In principle, every business wants to be paid for the goods or services that it supplies as soon as possible. In accounting using the accrual concept, once a sale has been made revenue is recognized hence the profit-making process is completed. However, the resources employed in this process cannot be set working on another cycle until the money has been received.

The conversion of accounts receivables into cash is very important as it determines the liquidity position of an organization hence affecting the daily operations of an organization. The giving of credit facilities is almost universal as there is no business that can survive only on cash transactions. Most manufacturing firms sell primarily to other firms and almost all sales are entirely in credit terms hence accounting to a greater proportion of the firm's current assets as shown below.

Table 1.1: Current assets of Limuru Tea Ltd and Unilever Tea Kenya

Description	Limuru Tea Ltd(Amount in shs'000"	% Of Debtors over total Current Assets	Unilever Tea Kenya (Amount in shs'000	% Of Debtors over total Current Assets
Receivables	26,837	86.4%	591,415	44%
Cash at Bank & in hand	562	1.8%	371,675	27.7%
Current Income Tax	3,657	11.8%	34675	25.8%
Inventories	0		345,754	25.7%
Total Current Assets	31,056	100%	1,343,610	100%

Source:(Extract of 2005 Audited Financial statements.)

As shown from above the largest percentage of current Assets is represented by the accounts receivable. Therefore it is one of the critical assets of any organization; hence effective management is a necessity.

It is the responsibility of the chief Finance officer with the assistance of the credit control department to manage the investment in accounts receivables. It is expected that the team formulates and implements the relevant policies and guidelines governing the accounts receivables management. The overall responsibility of the team will include ensuring compliance with company policies and guidelines on credit management, responsible for timely collection of debts from credit customers.

Similarly, ensure no further credit is extended to customers exceeding their credit limits or payments terms, assigning appropriate credit limits to customers and monitoring performance against these set limits. Also, the team is responsible for ensuring sufficient credit checks are carried out on new and existing customers on regular basis, taking appropriate debt recovery action against customers who do not pay and finally responsible for identifying and resolving customer queries and disputes in order to resolve them quickly.

Therefore the credit control department is expected to work closely with accounts, sales and marketing team and to receive unqualified support from the entire senior Company management of the organization.

1.2: Management of Accounts Receivable

Effective management of accounts receivables results in maximization of shareholders' wealth or return. This result to improved liquidity hence able to meet it is daily financial obligations and reduced bad debts write off. Poor management of accounts receivable will result to disruption of the organization in daily operations as it will result to the cash flow crisis resulting to non-payment of suppliers, employees and government departments. The overall effect of this will result to the non –supply of raw materials and services to the company, de-motivation of employees and also penalties from government bodies.

Another effect of poor accounts receivable management is increase in bad debts hence affecting company's profitability. The profit is increased by fewer bad debts and lower borrowings. With poor management of accounts receivable, bad debts increase resulting to higher borrowing to finance the operations of the organizations. Other than bad debts results to other expenses like increase in legal fees as recovering of these debts will result to litigations.

Poor management of accounts receivable can also result to poor rating from financial institutions as it becomes evident that the management is not able to manage its accounts receivable. Therefore, it becomes difficult to get short term loans to finance the firm's working capital as banks shy away from lending to the

company and if they agree then this will be at very high interest rates as the firm is viewed to be very risky.

Finally, poor management of accounts receivable can result into the company being placed under receivership. Since the entity cannot be able to generate enough funds to meet its daily operations, it is practically insolvent hence not a going concern. This results to a company being wound up or acquired by other investors.

1.3: Statement of the Problem

According to Voi (1999), many businesses do not have the time, expertise or resources to appropriately administer or manage the accounts receivable function and closely related business matters. If these important assets are not properly managed, the company can be exposed to potentially fatal long-term losses. Also management of account receivable is complex because, it involves sales and marketing team, Credit control and finance team, therefore the three teams must strike a balance, for the management of this current assets to be effective.

Higher turnover of a firm does not necessarily translate to improved cash flow nor does high profitability of a firm also imply good cash flow, therefore management should formulate strategies that should result to efficient credit control department equipped with modern technology and well trained

manpower so that to ensure that high turnover results to good cash flow and higher profitability.

From the factors stated in section 1.2 it is evident that management must put in place effective strategies of managing accounts receivable.

1.4: Objectives of the Study

The general objective of this study was to determine the factors that affect management of accounts receivable in the agro-manufacturing companies in Nairobi. The specific objectives were:

i. To investigate the role of credit agencies or bureau in the management of accounts receivable.
ii. To investigate the effect of trade discounts on the management of accounts receivable.
iii. To investigate the impact of credit management course on the management of Accounts receivable.
iv. To investigate the effect of management of accounts receivable on the firm's daily operations and profitability.

1.5: Research Questions

This study sought to answer the following questions:

i. What are the effects of management of accounts receivable on the firm's profitability?

ii. What role do the credit agencies or bureaus play in the management of accounts receivable?

iii. What value does the credit control management course add on the management of credit control?

iv. What is the effect of trade discounts on the management of accounts receivable?

1.6: Significance of the Study

The outcome of this study is important to the following groups of users:

Credit management students- The study will explore the practical skills of management of accounts receivable. As a result, students will have practical knowledge on this study.

Management: The study will assist the company management in identifying critical areas in the receivables management so as to establish best methods of safeguarding company assets.

Credit managers or controller: The study will identify weakness in the existing structures on the management of accounts receivable .As a result, new strategies of management of accounts receivable will be recommended and their suitability evaluated using actual data.

Other researchers: The study will provide researchers with detailed recommendation on new development on the management of accounts receivables. This study is prompted by the fact that as one component of working capital, most researchers have done research on the entire working

capital management, but not on accounts receivable as an element of working capital.

1.7: Scope of the Study

The study was designed to examine the factors that affect accounts receivable management in agro -manufacturing firms in Nairobi. To achieve this objective the target population was all the agro-manufacturing operating in Nairobi geographical area. The sampling frame was Nairobi Province geographical area from which a study sample of all listed Agro-Manufacturing companies in the 2004-2005 directory of Kenya Association of Manufacturers was systematically obtained.

CHAPTER TWO

LITERATURE REVIEW

This chapter contains the review of both theoretical and empirical literature.

2.1: **The general importance of accounts receivable management**

Accounts receivable arises out of the sale of goods and services by business firms on terms other than cash. Practically most business sales are made on credit terms; therefore, the investment in accounts receivables accounts for a greater portion of a firm's current Assets. Failure to provide proper management of accounts receivables, will inevitably lead to the collapse of a company.

According to Arnold (1998), good accounts receivable management will increase profitability by improving cash flow, reduce working capital requirement, and reduce bad and doubtful debts resulting to funds being reinvested in the business. This enables the optimization of sales on a controlled risk basis.

Thus, most manufacturing firms sell their goods on credit to wholesalers and distributors resulting to a big portion of their current assets being accounts receivables. This shows the need for the companies to put more resources in the management of accounts receivables.

2.2: **Characteristics of Accounts Receivables**

Account receivables arise when a company sales goods to another firm without receiving immediate payments. The characteristics of Accounts receivables include-

Credit risk that refers to the potential loss arising from any failure by customers to fulfill their obligations as and when they fall due. When a firm gives credit to another firm, the firm takes the risk, as it is not sure whether it will receive payment or not. For example when General Motors company sold vehicles to Kenya Bus company on credit, General Motors was taking a risk, as it is now evident Kenya Bus company is unable to pay .It is now the responsibility of General Motors to recover their money hence their action of impounding the Metro Minibuses of Kenya Bus.

Some of the reasons that can result to a company not being able to meet its obligation include competition, poor quality products resulting to lack of the market, high cost of productions, company being placed under receivership , poor management practices leading to poor strategies and finally change of management.

The other characteristic is the economic value that is passed immediately to the buyer while the seller expects to receive the economic value when payment is received. Finally, time value of money, the seller will receive payment in future

thus due to inflation, the value of the money might deteriorate, resulting to the seller losing in the long run.

2.3: **Forms of Accounts Receivables**

According to Hunt (1996), there are four forms of accounts receivables, the first two are generally applicable to corporate credit, and the latter two are principally for consumer credit. This research proposal is concerned with corporate credit.

The bulk of credit sales are made on open account, that is, the seller keeps a single book recording obligations arising out of sales .In this case the company does not ask its customers for formal acknowledgement of their debts or for a signed promises to pay. In case of disputes, the company uses the following documents to prove the case: customers' order, copies of sales invoices, delivery notes signed by the customer and shipping documents incase of export sales. All these documents are used to prove the validity of the debt and are acceptable in a court of law as a form of evidence of a debt. In the open account system there is no security and the company does not charge interest and enjoys no special rights to recover the goods he has sold even if the account is not paid.

The other form is documentary credit that covers mostly international credit whereby the company places additional requirements such as some type of bank support on the buyer before authorizing shipping of goods. The buyer must open

a letter of credit in favour of the seller or open a bank guarantee in favour of the seller.

Accounts receivables can also result in the form of Installment credit. This is a situation where payment is made by a series of regular installments for the interest and the principal amount. Mostly, this is common for one time purchase of expensive items like motor vehicles.

Finally, the other form of accounts receivable is a revolving credit. This where the debtor has the flexibility of paying off differing amount ranging from the entire balance to the minimum payment required to remain current.

2.3: **Objectives of accounts receivable managements**

Financial officers have the operating responsibilities for management of the accounts receivables. Reporting directly to the financial officers is the Head of Credit Department that carries out the work of granting credit and supervising the collection of receivables.

The main objective of accounts receivable management is maximization of shareholders' wealth; this is achieved through the improved cash flow due to increased revenue and prudent and prompt account receivables collection strategies. As a result, the firm is able to meet its daily obligation as and when

due. Another objective is improved profitability as a result of elimination of bad debts or less debts being written off translating to higher earnings per share. Finally, it results to minimization of risk that is the potential of a customer not paying his debtors as proper due diligence will have been done before giving credit to the customer.

2.4: **Reasons for companies granting credit**

According to Bosworth (2000), companies grant credit because; credit is regarded as a marketing tool. Through credit the company is able to attract its consumers particularly when it's re-launching its product or launching a new product or wants to push its products in the market.

A company can grant credit due to competition in the industry. There are limited customers in the market therefore customers will buy from companies that provide favourable terms like credit facilities.Another reason for granting credit is due to the requirement, tastes and preference of buyers. Buyers naturally will be more than willing to buy from suppliers who sale goods on credit than those that sell strictly on cash, therefore due this nature companies are forced to sale their goods on credit, resulting to accounts receivables.

A company can also give credit to its customers because of the status of its customer, relationship with its customers and finally industry practices. All these

are done so that the company can remain relevant in the market that is attract and retain customers.

Accounts receivable management focuses on the following four key areas namely; deciding what credit to give a customer, efficient credit control policy, chasing debts and coping with other companies' bad habits.

2.5: **Accounts receivable policy formulation**

High turnover of a company does not necessary imply improved cash flow neither does high profitability of a firm imply good cash flow. The company's management should formulate strategies that should result to efficient credit control department equipped with modern technology and well-trained manpower. This will ensure that high turnover results to good cash flow and also higher profitability. Hence, the need to employe more resources in formulating accounts receivable policy or also called credit policy.

According to the Society of Management Accountants of Canada (2000), accounts receivable policy development is subject to both internal and external business constraints. Similarly, it requires careful evaluation of the policy's potential impact on sales volume, cash management objectives and procedures, direct and indirect costs of receivables management and customers' relations.

The accounts receivable cycle begins with the enterprises decision to extend credit and ends when settlement is received in payment for the goods or services provided. It is critical that accounts receivable credit policy, collection, and financing policies complement marketing, sales, and production policies. Therefore, should be compatible with the enterprises overall objectives. To achieve this goal, the chief executive officer should involve senior managers from all appropriate departments in developing the accounts receivable policy.

The specific levels of accounts receivable responsibility and authority should be assigned throughout the enterprise. Various managers should have different levels of credit approval limit with senior managers approving high limits.

An enterprises credit policy is a major controllable element that has a significant influence on sales demand and profits. The many factors that comprise credit policy should be analyzed before the decision is made whether or not to offer credit or to make changes to current policy. Factors that could constrain or influence credit policy include ability to finance the credit policy. Costs of financing receivables by means of internal or external credit facilities should be estimated to determine which approach is feasible for the enterprise and industry credit terms that tend to be alike throughout an industry. However, if an enterprise has a superior product or service, it could consider applying more restrictive credit terms than those offered by the industry in general.

Competition can influence the initial credit policy and any subsequent changes made to it. Credit policy should take into account major high-risk customers and the weighting that should be given to them in relation to the total customer base and sales volume. If a new or revised credit policy is expected to increase sales volume, the ability to meet customer demand should be considered. As a firms credit policy is eased, late-payment and default risk usually increase.

The implementation of a promotional programme may require a target market base, which is provided by records of credit customers and sovereign risk and credit policy on export sales. Export sales credit policy should consider political, economic, and local practices as well as specific banking requirements.

The development of the enterprises credit policy requires that specific decisions be made regarding several variables that establish the terms of sale and the acceptable level of credit risk. These variables are credit quality standards, credit period, credit terms, cash discounts and surcharges, credit limits, credit instruments and payment methods.

According to Brockington (1987), management needs to establish a policy on its trade debtors and the major factors to be considered are:

Cash discount usually given to those customers who pay their debts promptly. However, the organization must compute the opportunity cost of providing cash

discount. Granting unstructured cash discounts can prove to be expensive in the long run hence the computation of opportunity is critical before the management decides on the percentage of cash discount to be awarded to various classes of customers.

Official period of normal credit being offered is a critical factor, that is how long will the organization do without being paid its funds and yet its working capital is not affected that is its daily operations are not disrupted at all. Therefore the organization must work out its cost of finances before deciding on the optimal credit period.

In formulating the credit policy, the management of the organization must also evaluate the credit worthiness of its customers. This will involve the organization getting all relevant information about the customer and assessing the riskness of the customers before awarding the credit facility. Some of the ways that the organization can get information about the customer include: Making trade references, analyzing the organization's audited financial statement, getting the references from the bank references amongst other sources.

Finally, the organization must make a decision regarding late payment because the action the organization takes will have an impact on the public image of the organization. If the organization is too lenient to customers who pay later, this will encourage other customers to pay later hence affecting the daily operations

of the organization as most of the working capital will be tied in debtors. Whereas if the organization is too strict, this will scare away potential customers resulting to lower sales and eventually reduced profitability. Therefore the management must strike a balance on the best action to take on customers who pay later.

Also according to Nealon (2003) similar observations have been made. In addition, it was observed that in extending credit to customers, the firm would ensure that receivables will be collected in full and on due date. Credit should be granted to those customers who have the ability to make payment on time. To ensure this, the firm should have credit information concerning each customer to whom the credit will be granted.

According to Canada's Audit General's Audit Report No.29 (1997) and Pearson (2003), a credit policy document is a key component of the accounts receivable control environment and needs to cover all aspects of revenue and debt collection practices. It needs to be written in plain English so that it is understandable by staff and customers, accessible to all staff that are required to administer it and made available to customers in summary form.

In addition, the policy should establish a financial threshold under which it is uneconomical to pursue recovery action. Also, it should set down criteria against which a debt might be considered for waiver. The credit policy should be kept up

todate, that is, it should be reviewed at regular intervals so that consideration can be given to incorporating new practices or initiatives and be endorsed by executive management. The company should be aware that the credit term set in a credit policy would have a direct impact on their terms of trade.

The credit policy should be endorsed by the Executive Officer of the company and be based on the risk assessment of the company and its customers, which must be explicitly stated in the policy and finally should have the following features:

The credit policy must explain the nature of debts and debtors. This involves value of debts and the maximum credit limits for each category of debts.

The company's rights and duties with debtors and legal consequences must be clearly stated in the credit policy so that all debtors are aware of the implication and consequences that will face them if they do not pay in time.

The credit policy must enumerate the details of terms of trade and circumstances under which a company may change the terms of trade. This will ensure that all the trading conditions are clear and all misunderstandings are eliminated at an earlier 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 debtors. The company must state who is responsible for debt collection and the various methods of communication to the customer about the

overdue accounts. The role of debt collecting agencies must be explained in the policy.

Finally, the credit policy must state the procedures of giving customers discounts e.g. cash and volume discount and who has authority to give the discounts and give direction on the avenues of reviewing the policy and procedures - when, by whom.

2.6: Factors hindering the availability of credit information on customers.

According to Crane (1983), all over the world it is becoming increasingly difficulty to get information about customers requesting credit facilities due to the following:One of the hindrance is customer confidentiality, thus a firm cannot release information about the credit worthiness of another firm without the authority of the firm itself because of the confidentiality clause. Therefore, it becomes difficult to get unbiased information as the customer can give names of firms that can give only favorable recommendation.

Another factor is costs, thus it is only prudent that the cost of collecting information should not supposed to be more than its profitability. As a result, for small accounts, credit decisions are made on the basis of the available information.

2.7: Sources of credit information about customers:

According to Cole (1980), unless the information is used and useful, it is not worth what it costs in either time or money. Thus, there are many types of information that the credit grantor has at its disposal to make credit decisions. According to Kallberg (1993), the cost (in terms of acquisitions or in terms of required analysis) differs greatly as does its value in making informed credit evaluation.

Financial statements are important sources of credit worth information for any customer as they provide information on credit application. Through analysis of financial statements, some of these ratios can be computed like current ratio which measures the ability of the company to meet its obligations when due, quick ratio (acid Test), receivables turnover which measures how quickly on average receivables are collected (converted into cash) by the business. Thus the quicker the process, the more quickly cash is available to support current liabilities, days' receivable which measures the average days the company takes to collect its receivables, day s' sales outstanding (DSO) which measures the firm's investment in receivables and finally the aging schedule analysis which shows the amounts or percentages of outstanding accounts receivable in specified categories frequently 30-day increments. Its main use is to identify the aggregate quality of accounts receivables. These ratios through use of financial statements are very important in evaluating the credit worthiness of a customer.

Another source is the financial institutions i.e. Bank References- Banks can provide valuable information about customer's financial condition, however, it is not detailed due to the customer confidentiality clause. Also, the trade references can reveal the firm's experience with the customer that would provide excellent indicator of when payment will be made, thus if references provided can be objective, this can form a very strong indicator of the credit worthiness of a customer.

In most countries, there are organizations specialized in credit rating of other customers for example the Credit Reference Bureau in Kenya. These agencies collect, evaluate and report information on credit history, including past payment history, financial information, high credit amounts, length of time credit has been available and other actions that have been necessary to achieve collection.

2.8: Credit investigation and analysis

According to Hedge (1990), the factors that affect the extent and nature of credit investigation of an individual customer include: The type of the customer, whether new or existing, more analysis and evaluation is required before a decision is made whether to grant credit or not. Whereas for existing customers, less documentation and investigation is required hence less time and costs are involved.

Other factors are the customer's business line, background and the related trade risks, the nature of the product –perishable or seasonal. Size of the customer's order and expected further volumes of business with him and finally company's credit policies and practices.

The basic goal of the credit granting process is to evaluate credit applicants with the objective of determining the appropriate risk return trade off, thus the problem can be viewed as that of forecasting that is what will be the applicant's future payment behaviour. As a result, the firm should do the following analysis of the customer, both qualitative and qualitative.

In qualitative analysis, the management should evaluate the 4 Cs of credit for the applicants. Credit investigation could get intricate and dense. The information that is being gathered could be getting strewn and scattered all over the place. The 4 Cs of credit helps in making the evaluation of credit risk systematic. They provide a framework within which the information could be gathered, segregated and analyzed. It binds the information collected into 4 broad categories namely character, capacity, capital and conditions. These Cs have been extended to 5 by adding 'Collateral', or extended to 6 by adding 'Competition' According to *Bobby Rozario*. No matter how many Cs we come up with, the fundamental question that remains to be answered by the framework of our analysis is: 'Will I get paid on time?'

One of the 4Cs of credit is character, JP Morgan (2003), a successful businessman, once said that 'I will do business with anyone as long as he/she is honest!'. In analyzing commercial credit, one must consider the size of operation, number of years in business, legal form of the business, number of employees, management record of the company, location of the company, any previous evidence of fraud, any previous insolvency record, any labour dispute, any recent media coverage of the company, any lay-off or resignation of key personalities, shareholders of the company.

Capacity is one of the 4Cs of credit; sometime a business that you are analyzing might not have the required capacity in kind but the same could be latent in some other form. For example a start-up business should have a good business blue-print of succeeding namely, a good business plan. A contractor might have a good media-advertising plan, say an ad in the local yellow pages. All this adds to the capacity of a business to carry on trade and perhaps be successful. Under this, one must evaluate capacity of the business to pay, in getting paid, receive/absorb and capacity of the credit grantor to expose.

Capital is one of the 4Cs of credit, thus capital refers to the financial resources obtained from financial records that a company may have in order to deal with its debts. Many a time's credit analysts would make this portion of the credit analysis the most important one. Weight is given on Balance Sheet items and components like Working Capital , Net Worth and Cash Flow.

One must know how to read financial statements and that too from the perspective of a creditor. Short-term liquidity is important if you are expecting to get paid in the short -term. You should be able to see whether this company has the ability to absorb more debt and then where does your loan (selling on credit is a loan) fit in the overall debt-framework of this business. You should also evaluate to see if you could depend on the numbers whether they are audited, un-audited or company prepared.

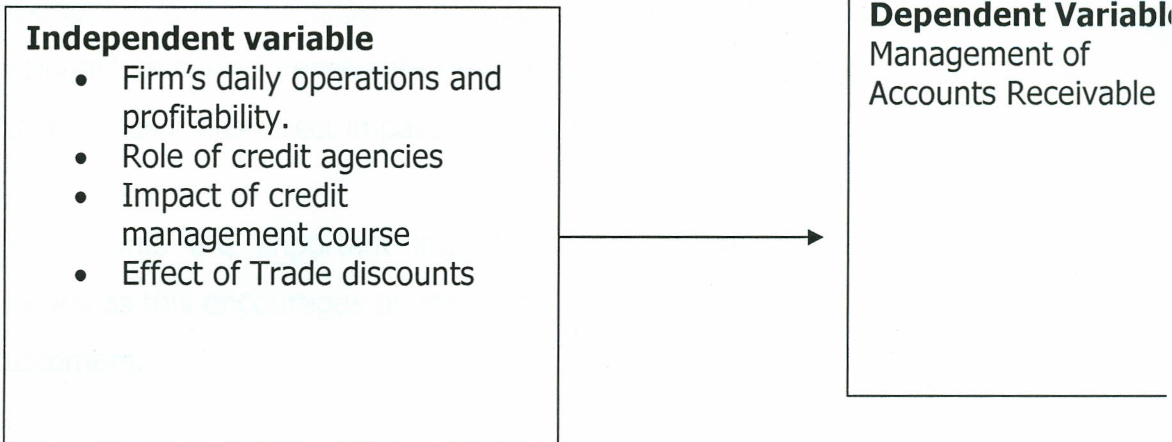
Leveraged borrowing depends on the equity/ net worth that a company has and it is a good idea to see if the company is committed to improve its borrowing-power by contributing to its Equity/Capital/Net Worth . One way of doing this is by retaining all or portions of its earnings. But all said, done and then undone cash and only cash pay bills. Thus, keep an eye of the company's cash flow and cash-position. But one must be cognizant of the fact that financial records are snapshots of the past and credit analysis is trying to figure out the future. Thus, all 4 Cs of credit are important in the overall analysis of a company where you combine elements of the past to make a futuristic prediction.

Conditions is the last of the 4Cs of credit; conditions refers to the external conditions surrounding the business that you are analyzing. For example, the construction industry might get influenced with the changes in the government's wide range of policies on immigration, interest rates and taxation.

Thus in evaluating the degree of risk of a customer, information revolving around the 4Cs of credit would be normally necessary. However, one of the weaknesses of the 4Cs is that it may not give an objective assessment of the customer's creditworthy as it cannot be proved scientifically, hence its outcome can be challenged.

The company can also use quantitative analysis techniques. The most involved technique in this analysis is the credit scoring model which refers to a procedure for weighting characteristics (relevant to payment behaviour) to obtain numerical score which can then be used to determine whether or not credit should be granted to the customer .The variables e.g. years in business, public rating, payment performance etc should be defined and then presented in a linear regression model. The higher the score, the more creditworthy is the customer. The quantitative approach is more cost-effective and objective in evaluating creditworthiness of the customer.

2.9: Conceptual Framework



Accounts receivable contribution to firm's profitability depends on the level of credit sales and several financial variables. These variables include the net profit margin, the cost of goods sold as a percent of sales, the level of credit sales, the percent of credit sales collected and the interest rate.

The firm's daily operations and profitability is affected by management of accounts receivable. Since accounts receivables are converted to cash which is needed for working capital and in turn results to less debts being written off and less legal costs being incurred for recovery of debts.

Credit reference bureaus provide information on the customer's credit worthiness before a credit facility is a warded to the customer. Therefore credit reference agencies play a vital role in the management of accounts receivable. With proper established credit reference agencies, managing of accounts receivables will be enhanced.

Managing of accounts receivable is a unique discipline as it involves combination of accounting and marketing skills, therefore credit management courses plays an important role in the managing of accounts receivables. Without credit control professionals, accounts receivable managing will result to disastrously effect on the company as it has direct impact on working capital.

Trade discounts are important ingredients on the management of accounts receivables as this encourages prompt settlement of debts and bulk purchases by the customers.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0: Introduction

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

3.1: Target Population

The population under study was agro –manufacturing companies as listed by Kenya Association of Manufacturers. The target population under study was made up of thirty agro-manufacturing companies listed in the Kenya Association of Manufactures (KAM) directory of 2004/2005 within Nairobi geographical area.

3.2: Sample size and sampling methods

Proportionate random sampling technique was used to select a representative sample of the population. Total of thirty firms were selected through the help of random numbers. Then each selected company was surveyed independently.

3.3: Data Collection Procedures

Both primary and secondary data was used in this study. Primary data was collected using a set of questionnaire containing both open and closed ended questions which was administered to the identified key credit control decision

makers in selected agro manufacturing companies to collect both qualitative and quantitative information required.

Data collection instruments were self- administered questionnaires and where necessary personal interviews and documentary analysis were conducted to enhance validity. Secondary data was sought from Credit Reference Bureau - Kenya Office, audited financial statements and other relevant registered credit agencies bodies in Kenya.

3.4: Data Analysis and Interpretation Procedures

Data collected from primary and secondary sources was processed and analyzed statistically. Standard statistical tools such as graphs, mean and the mode were used to summarize the data into descriptive statistics. Other measures of association among all the variables were also performed to establish the magnitudes and directions of the existing relationships. Only descriptive statistics were reported.

CHAPTER FOUR

DATA ANALYSIS

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, factors affecting the management of accounts receivable, a case study of agro-manufacturing companies in Nairobi.

The chapter is divided into six parts. Part one covers overview of data collected and analyzed. The second part covers the role of credit agencies in the management of accounts receivables .Part three covers impact of credit management course on the accounts receivable management. Part four covers an analysis of trade discount on the management of accounts receivable. Part five covers the effects of accounts receivable on the firm's daily operations and profitability. Finally sixth part covers summary and discussion of the findings respectively.

4.1: Overview of data collected and analyzed

Out of 30 questionnaires that were distributed, 20 were returned. This represents a response rate of 88.33% which is considered significant enough to provide a basis for a valid and reliable conclusion with regards with the factors affecting management of accounts receivables.

The management of accounts receivable in all companies are centralized that is all policies and decisions concerning accounts receivables are coordinated from the companies' headquarters.

4.2: Debt collection strategies used by Companies

Strategy	No. of Respondents	% of Respondents
Sending Reminder letters	18	90%
Making Telephone calls	18	90%
Hiring Collection agencies	5	25%
Suing the customers	5	25%
Settling for a reduced amount	1	5%
Writing off the bill as a loss	1	5%
Selling accounts receivable to factors	0	0%

This test was aimed at capturing the most effective strategies that companies use to collect their overdue debts and also the effect of credit reference agencies. It was found out that 90% prefer sending reminder letters and making telephone calls, while 25% use collection agencies and lawyers whereas when all the above have failed 5% will settle for a reduced amount and also in real instants writes off the debt as a loss. It was also found out that factoring

accounts receivable is not been practiced in Kenya as this is not well developed, therefore there no institutions that have specialized in this Kenya.

From the study, it was found out that credit references agencies are not well developed in Kenya and therefore most of the personel interviewed had limited knowledge on the operations of the Credit refences agencies in Kenya .In the whole country we have only one credit reference agency known as credit reference bureau. Accessing information from this agency sometimes is not easy because of client confidentiality.

4.3: Relationship between the professional course on credit management and the Management of Accounts receivable.

This section highlights the effects of the credit management course on the management of accounts receivable.

Level of Qualification	Level of efficiency	No. of respondents	Percentag
Diploma in credit management	Very good	12	60%
Certificate in credit management	Average	1	5%
Certified Accountant	Good	5	25%
Diploma in sales and marketing	Below average	2	10%
Total		20	100%

Source: Research data

The trend of the level of efficiency for the personnel manning the accounts receivables was evaluated and from the responses it was found out that 60% of the respondents were of the view that personnel with credit control professional qualification offered superior managing of accounts receivable where 5% felt that personnel with certificate in credit management were equally average in managing accounts receivables,25% felt that qualified Accountants were good in the management of accounts while 10% felt that diploma in sales and marketing holders were below average.The study focused on the level of qualification of the personnel managing credit control department in all the companies under study.

During the study it was found out that companies whose accounts receivable portofolio were managed by professional credit managing personnel , had well developed strategies and policies of managing accounts receivable.This was evidenced in debts being paid in time as the aging summary showed that were receivables were within the credit limits and also their receivables had recorded growth implying that they created good trading environment .Also the level of debtors written off had been reducing for the fives years under study despite the growth in the accounts receivables. Where as companies which were managed by non credit management professionals had poor credit strategies as manifested in number of cases that were pending in court relating non-payment of debts and also increase in amount of debtors written off yearly and even the

customers ageing summary showed that some customers had exceeded their credit limits and efforts were being made to follow them for payment.

4.4: Incentives company offers to Customers to pay promptly

Incentive	No. of Respondents	% of Respondents
Cash discounts	15	75%
Volume Discounts	4	20%
Giving promotional Gifts	1	5%
Annual awards	0	0%
Total	20	

The study found out that 75 %companies' use cash discounts as strategy to encourage customers pay promptly, 20% use volume discount, 5% giving promotional gifts while none of the companies give annual wards to the best paying customers.

During the study it was found out that companies have studied using both cash discount and volume discount as one strategy to encourage customers who buy in bulk and pay in cash, however for most of them , they had not developed a written policy on this.

4.5: Financial performance of the firms and their ranking

Trend: 2001-2005

Performance Trend	No. of respondents	Percentage of respondent
Increasing	12	60%
Decreasing	1	5%
Stable	5	25%
Fluctuating	2	10%
Total	20	100%

Source: Research data

The firm's performance gave a comparison of the firm's financial performance from the year of 2001-2005.The respondents were required to state their firm's performance from any of the four categories as shown in the above table. From the findings shown in the table 60% of the respondents reported an increase in financial performance from one year to the other over five years period,5% decreasing,25% stable ,10% fluctuating .

The test was carried at capturing the operating profit of the companies over the five years period under study .The performance of companies under study showed that majority of the companies had their financial performance increasing between 10%-30%.These findings are reinforced by the economic growth figures as released by the government over the last five years.

4.6: Awarding of credit facilities in the years 2001-2005.

Credit facility trend	**No. of Respondent**	**% of Respondents**
Increasing	11	55%
Decreasing	5	25%
Stable	3	15%
Fluctuating	1	5%
	20	100%

Source: Research data

The results presented in this section shows the trend of the firms in the awarding of credit facilities as derived from the ageing analysis of the firms under study for the years 2001-2005.The study makes comparison year to year aging analysis for the last five years.

The respondents were required to state their firm's financial performance from any of the four categories as shown in the above table.55% of the respondents reported that their level of warding credit to customer was on the increase, 25% decreasing, 15% stable and 5% fluctuating .These result reflect the increase in sales for the companies under study during the same period and also the prevailing monthly accounts receivable balance over the period under study.

4.7: Sources of information organizations uses in assessing customer credit worthiness.

Source of information	No. of Respondents	% of respondents
Bank References	12	**60%**
Trade References	15	**75%**
Financial Accounts	5	**25%**
Personal Contact	10	**50%**
Credit agencies	4	**20%**
Past experience	14	**70%**
Trade Journals	0	**0%**
Total	20	

Source: Research Data

The above data shows that 75% of the firms relies on trade references in a warding credit facility, while 70% relies on past experience,60% bank references,50% personal contact ,25% financial accounts,20% credit reference agencies while non of the firms interviewed uses trade journals. The results shows that firms uses a lot of networking when assessing the creditworthiness of their customers and financial accounts, credit agencies are not well developed methods in Kenya because for private companies is not easy to access their audited financial accounts while most companies do not allow credit reference agencies to access their debtors database .In kenya so far we don't have trade

journals which give all information about the firm and individual credit worthiness, therefore this is not applicable in Kenya, hence the reason why this method is not used in Kenya.

4.8: Factors a company considers before granting credit facility.

Factor	Ranking	No. of Respondents	% of Respondents
Character of customer	1	18	90%
Capacity of the customer	1	18	90%
Capital of the customer	2	15	75%
Collateral	3	16	80%
Conditions	4	18	90%

Source: Research data

90% of the companies interviewed consider character and capacity and Capacity of the customer, 75% consider capital while collateral and conditions are ranked 3rd and 4th respectively in granting credit facility. This explains why it is very difficult for new and small companies, partnership and sole proprietors are not able to access credit facilities from most of companies as it is not easy to evaluate their capacity and character.

4.9: Reports used to manage Accounts Receivable

Report	No. of Respondents	% of Respondents
Turnover Ratios	0	0%
Ageing Schedule	20	100%

Source; Research data

From this study, it was found out that all the firms' studied use ageing summary to manage their Accounts receivables. The Ageing summary shows the age of their customers' balances and this is compared with the agreed limit of their individual customers' credit limit period. It was also found that all Accounting software used by all the firms interviewed have this report in built, therefore it is easy to generate the reports and make decisions insantly.While it was found none of the firms studied uses turnover ratios, this is partially because management accounts are prepared once a month for other firms, quarterly for others and also companies are audited once a year. Therefore it is not easy to find reliable figures to compute ratios with.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter summarizes the findings of the study 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.

5.1: Summary and conclusions

The study aimed at investigating factors affecting the management of accounts receivables amongst the agro-manufacturing companies in Nairobi. It also focuses on highlighting the best and worst strategies of managing of accounts receivables and its implication on the overall performance of a company.

The result of the study indicated the factors that mostly affect the management of accounts receivables are :lack of trained credit control professionals to manage account receivables followed by lack of developed credit reference bureaus to provide companies with credit worthiness of customers before there are granted credit facility and lack of well constituted credit evaluation committees .The least important factors are Trade incentives such as trade discount where as the following factors have no impact on the management of the accounts receivable: use of debt collectors and factoring of debts.

From the above it was evident that although the management of accounts receivables falls under the umbrella of finance department, it is a complicated

field that needs special attention as it affects both sales and marketing and Finance Departments.

5.2: Recommendation

Further to the research findings and related discussions, the research makes the following recommendation:

i. Management of accounts receivable function: This Function should be managed by a professionally trained Credit manager/Controller. This will enable the section head to integrate the sales and marketing skills with accounting skills through a course of Credit management. During the research it was evident that most companies accounts receivable are managed by Professional accountants who lacks skills on Accounts receivables Management

ii. Adoption of credit Controller department. It has always been assumed that credit control is a function of finance alone, although it affects a lot sales and marketing, thus Companies should make credit controller a department. This will eliminate the conflicts between accounts receivable management and other related function that is finance, sales & marketing.

iii. Encouragement-This should be given to writing papers and thesis on accounts receivable within the present MBA programs to research more on this area.

5.3: Limitations of the Study

The study was undertaken despite several limitations that are worth noting. These were:

i. Lack of co-operation of the respondent. Some respondents did not complete the questionnaire arguing that their corporate policy does not allow release of such information to third parties. All efforts were made to explain that the information was only for academic purpose and was to be treated with utmost confidentiality did not change their perception.

ii. The study only covered agro-manufacturing companies in Nairobi, therefore generalization of the findings to other sectors of the economy must be done with caution.

iii. Lack of access of financial data for some firms.

5.4: Suggestion for further study.

The study focused on the factors affecting the management of accounts receivable, amongst the agro-manufacturing companies in Nairobi as listed in the 2004-2005 Directory of Association of manufactures. Further study is recommended on the following:

i. Further study should be done on the other sectors of the economy to determine their similarity to this study.

ii. Further study on the factors that affect the management of accounts receivables in all manufacturing companies in Kenya. Because the scope

of this study was limited to only gro-manufacturing Companies that were listed in the 2004-2005 directory of Association of manufactures.

iii. The study should done on the facts affecting management of accounts payable so as to compare and contrast with this study.

This chapter summarizes the findings of the study 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.

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APPENDIX 1

LETTER OF INTRODUCTION

Richard Omwega

P.O. Box 47773-00100,

Nairobi.

TO: The Respondent.

Dear Sir/Madam,

Re: Request for Your Participation in my Research Work.

I am a graduate student at Kenyatta University pursuing a master of Business Administration .In order to fulfill the degree requirements; I am currently undertaking a research study on factors affecting management of Accounts Receivable in the agro-manufacturing companies in Nairobi.

I would highly appreciate if you kindly spared some time to complete the attached questionnaire.

The information you provide is strictly for academic purposes and will be treated with utmost confidentiality.

Yours sincerely,

Richard Omwega

QUESTIONNAIRES

Factors affecting the management of Accounts Receivable. A case of Selected Agro –Manufacturing companies in Nairobi.

Q1) Name of the company:......................

Q2) Year the company started......................

Q3) Management and ownership of the Company (Tick one)

a) Wholly local []

b) Wholly foreign []

c) Both []

Q4.a) How many large customer accounts balances do you have? ______________

b) What is their total in Kenya Shillings per month? ....

Q5.What percentage of your total current Assets is represented by Accounts Receivables**?**

Tick using (√) for correct answer.

a) Between below 30%[]

b) Between 30%- 45%[]

c) Between 45%-60% []

d) Above 60% []

Q6. Based on your experience, on average how many traders do you give credit per month?...

Q7. In your opinion how would you generally describe your company's account receivable management policy?

a) Excellent []
b) Good []
c) Average []
d) Below Average []

Q8.In order of importance which of the following requirements does your company consider before granting credit facility to your customers.(use 1 = very important,2= Important,3=Necessary,4=Not important).

a) Character of the customer i.e borrower 's willingness to pay. []
b) Capacity of the customer i.e borrower's ability to pay. []
c) Capital of the customer i.e how much wealth a borrower is. []
d) Collateral []
e) Conditions []
f) Credit scoring []
g) Other requirements. Please specify []

Q9.Which of the following are the debts collection policies used by your organization in collecting overdue accounts.

a) Sending reminder letters []
b) Making telephone calls []

c) Hiring collection agencies []

d) Suing the customers []

e) Settling for a reduced a mount []

f) Writing off the bill as a loss []

g) Selling accounts receivable to factors []

h) Any other policy. Please specify []

Q10.Which of the following are the incentives your company offers your customers to encourage them to pay promptly.

a) Cash discounts []

b) Volume discounts []

c) Giving promotional gifts []

d) Annual awards for best paying customers []

e) Any other, please specify []

f) None of the above []

Q11. i) Does it have specific variations to its terms of trade for

Particular customers? □ Yes□ No

Particular product images? □ Yes□ No

ii) Explain your answer above...

Q12. (i) Does your Company have a credit control Department?

a) Yes []

b) No []

If yes then answer the following

ii) What are the qualification and experience of the head of credit control department?..

Q13. Which of the following are the reports you use in managing your accounts receivable?

a) Turnover ratios computation []

b) Ageing schedule analysis []

c) Any other Technique please specify []

Q14. If you organizations uses Turnover ratios, kindly state the ratios that you use.

....

....

....

Q15. (i) Does your company have a credit Committee?□ **YES** □ NO

If your answer is yes then answer the following.

ii) State the membership of the credit committee by stating their designation in their company (that is Managing Director, Finance Director etc)

....

....

....

....

....

iii) How frequent are the credit committee meeting held?

a) One a week.

b) Once A month

c) Any other, please specify.......................................

iv) Briefly state the role prepared by the credit committee in managing your Accounts receivables?

....

....

....

....

Q.16. (i) Does you company have a credit policy?□ YES □ NO

If yes, then answer the following

(ii) Which of the following are the components of your company's credit policy.

KENY

a) The credit period []

b) The credit standards []

c) Discount amount and period []

d) Any other. Please specify []

iii)How often is the credit policy used by the management.

a) Always. []

b) Sometimes. []

c) Usually []

d) Never []

e) Any other, please specify... []

Q.17.Who of the following in your organization officers approves the customers' credit application?

a) Managing Director []

b) Finance Manager []

c) Credit Controller []

d) Marketing Manager []

e) Sales Manager []

f) Any other. Please specify []..

Q.18. (i) Does your company ever written off debtors?□ YES □ NO

if your answer is yes , then answer the following.

ii) what percentage was the write off to the total debtors for that period?

a) Below 20% []

b) Above 20% but below 40% []

c) Above 40% but below 60% []

d) Above 60% []

iii) Briefly state the factors that led to this situation.

....

....

....

....

Q19.Please fill the table below for the last three years

Year	Annual turnover	Annual profit/Loss	Cash & cash equivalent balance at year end	Debtors balance at year end	Value of debtors written off if any
2003					
2004					
2005					

Note: Please indicate the currency used in the above table.

Q20.How often has your organization experienced the following? Please mark **X** appropriately.

VARIABLE	**Never**	**Rarely**	**Often**	**Very often**
Bad debts written off				
Incorrect customer statements				
Incorrect customer credit terms				
Incorrect customer discount rates				
Suing customers for non-payment				
Use of credit agencies to correct debts.				
Factoring of debtors				

Q21.Please fill in the details required in the table below.

Questions	**Answers**
1.Your business type	
2. How long has your company been in business?	
3. Is your company small, medium or Large?	
4. Is your Sole proprietor, partnership or a limited company?	

5. Your Gender? Male/ Female	
6. Your Academic Award?	
7. Your highest professional award?	
8. On average what is your monthly accounts receivables?	

Thank you for your cooperation.

APPENDIX 11

PLAN AND SCHEDULE OF ACTIVITIES

Plan of Activities

ACTIVITY	TIME
1.Pilot Study	One Week
2.Data collection & Coding	Three Weeks
3. Data Analysis	Three Weeks
4.Compilation of Report	Three Weeks
5.Submission of Report	1st Week of April 2008

APPENDIX 111

BUDGET

A) Cost of proposal Development

I) Printing 40 pages @Kshs 20.00	800.00
ii) Binding 6 copies @ 80	480.00
iii) Traveling Expenses	5000.00
Sub Total	6,280

B) Cost of Data Collection and Analysis

i) Traveling Expenses	10,000.00
ii) Data processing	3,000.00
Sub Total	**13,000**

C)Production of the final document

i) Printing 100 pages @Kshs 20	3,000.00
ii) Binding 5 copies @kshs 700	3,500.00
Sub Total	**6,500**
Grand Total	**25,780**

APPENDIX IV

LIST OF AGRO- MANUFACTURING COMPANIES IN NAIROBI

1	Alpha Fine Foods Ltd	Food & Beverages
2	Bidco Oil Refineries Ltd	Food & Beverages
3	Broadway Bakery Ltd	Food & Beverages
4	Brookside Dairy Ltd	Food & Beverages
5	Cadbury Kenya Ltd	Food & Beverages
6	Capwell Industries Ltd	Food & Beverages
7	Corn Products Kenya Ltd	Food & Beverages
8	Del Monte Kenya Ltd	Food & Beverages
9	Farmer's Choice Ltd	Food & Beverages
10	Global Beverages Ltd	Food & Beverages
11	Jambo Biscuits Ltd	Food & Beverages
12	Kapa Oil Refineries Ltd	Food & Beverages
13	Kenchic Ltd	Food & Beverages
14	Kenya Breweries Ltd	Food & Beverages
15	Nairobi Bottlers Ltd	Food & Beverages
16	Nairobi Flour Mills Ltd	Food & Beverages
17	NAS Airport Services Ltd	Food & Beverages
18	Nestle Foods Kenya Ltd	Food & Beverages
19	Nutro Manufacturing (EPZ) Ltd	Food & Beverages
20	Pembe Flour Mills Ltd	Food & Beverages
21	Premier Flour Mills Ltd	Food & Beverages
22	Premier Food Industries Ltd	Food & Beverages
23	Proctor & Allan (K) Ltd	Food & Beverages
24	Rafiki Millers Ltd	Food & Beverages
25	Softa Bottling Co. Ltd	Food & Beverages
26	Spice World Ltd	Food & Beverages
27	Spin Knit Dairy Ltd	Food & Beverages
28	Tetra Pak Converters Ltd	Food & Beverages
29	UDV Kenya Ltd	Food & Beverages
30	Unga Group Ltd	Food & Beverages