International Journal of Science and Research (IJSR)
ISSN (Online): 2319-7064
Index Copernicus Value (2015): 78.96 | Impact Factor (2015): 6.391

Effect of Receivable Management Practices on Financial Performance; A Case Study of Deloitte East Africa Limited Authors

Chris Jared Odondi[1], Dr. Kennedy K. Nteere[2], Agnes Njeru[3]

[1]Jomo Kenyatta University of Agriculture and Technology, P.O. Box 620000-00200, Nairobi, Kenya

[2]Co-operative University College of Kenya

[3]Jomo Kenyatta University of Agriculture and Technology, P.O. Box 620000-00200, Nairobi, Kenya

Abstract: ***Financial distress has been a serious challenge to the existence of not only small firms but also The general objective was to investigate effect of Receivable management practices on financial performance of an organization, with particular emphasis on Deloitte East Africa Limited. The study specifically aimed at establishing the effect of preparation of credit sales on financial performance and to assess the effect of Credit guidelines on financial performance and to assess the effect of reviewing level of receivables on financial performance. The study area was Deloitte East Africa Limited headquarters situated in Nairobi, Wayaki way, Waruku in Westlands. A descriptive research design was adopted. Judgmental sampling was a technique applied in identifying respondents who have the information that was required for this study, meaning, all the management employees working in the case company was included in the sample. The study used a sample size of 82 respondents. The choice and identification of key informants was purposive as they were having key information of the company's business information. Questionnaire was the main instrument for data collection. Analysis and interpretation of the data was done using both qualitative and quantitative methods according to research objectives and research questions. The data collected was summarized, classified, tabulated and analyzed qualitatively. Data was then presented using tables, charts and percentages the findings was to help the organization achieve the financial minimums and ensure smooth improvement in the staff performance of Deloitte east Africa. And that proper operating capital management practices in the organization for the effective utilization of the resources for the organizations to enhance their financial performance.***

Keywords: Receivables management practices, Credit sales, creation of credit guidelines, Reviewing level of receivables, financial performance, Deloitte East Africa

1. Introduction

Fund management practice is a managerial accounting strategy focusing on maintaining efficient levels of both components of fund, current assets and current liabilities, in respect to each other. Fund management ensures a project has sufficient cash flow in order to meet its short-term debt obligations and operating expenses. Fund management is an aspect of corporate finance and directly affects the liquidity, profitability and growth of a business. It is important to the financial health of businesses of all sizes as the amounts invested in Operating Capital are often high in proportion to the total assets employed (Atrill, 2006). It involves the planning and controlling of current assets and liabilities in a manner that eliminates the risk of inability to meet short-term obligations and avoid excessive investments in these assets (Lamberson, 2005). This management of short-term assets is as important as the management of long-term financial assets, since it directly contributes to the maximization of projects' profitability, liquidity and total financial performance. Consequently, projects can minimize risk and improve the overall financial performance by understanding the role and drivers of funds (Lamberson, 2005). In addition, as argued by Peel and Wilson (2000) and Padachi (2006) efficient management of Operating Capital is pivotal to the health and performance of firms hence the view that firms should employ the use of efficient practices of fund management as a strategy of improving their value. The literature on Operating Capital management practices identifies efficiency of cash management, efficiency of receivables management and efficiency of inventory management as determinants of financial performance model. Financial performance can be improved if efficiency levels of cash, receivables and inventory management practices are increased.

Management of Operating Capital which aims at maintaining an optimal balance between each of the Operating Capital components, that is, cash, receivables, inventory and payables is a fundamental part of the overall corporate strategy to create value and is an important source of competitive advantage in businesses (Deloof, 2003). In practice, it has become one of the most important issues in organizations with many financial executives struggling to identify the basic Operating Capital drivers and the appropriate level of Operating Capital to hold so as to minimize risk, effectively prepare for uncertainty and improve the overall performance of their businesses (Lamberson, 1995). The existence of efficient Operating Capital management practices can make a substantial difference between the success and failure of an enterprise and it is of particular importance to the managers of small scale enterprises, because it is they who strive for finances and the opportunity cost of finances, for them is usually on the higher side (Kwame, 2007). As established by Padachi (2006), efficient management of Operating Capital is vital for the success and survival of an organization that needs to be embraced to enhance performance and contribution to economic growth

Liquidity is affected by cash, credit, inventory, and accounts payable that form part of the overall cash flow of a business (Maness, 1994). A business that considers decreasing its levels of cash by carrying too many inventories or providing too much credit endangers its liquidity, Madura and Veit, (1988). Declining levels of liquidity, unless remedied, may result in insolvency and eventually bankruptcy as the business's liabilities exceed its assets (Cooper, et al. 1998). From the perspective of efficiency, the business that demonstrates the least operating capital per dollar of sales can be considered as managing their operating capital efficiently (Tully, 1994).

As a result of expansions and contractions in the business cycle the investment in operating capital will fluctuate in aggregate, and the composition of the constituent components of the investment in operating capital can be subject to a considerable degree of volatility (Richards & Laughlin, 1980). The needs for operating capital increase during periods of economic growth, and should decrease as economic growth contracts (Weston and Brigham, 1992). For example when the economy is robust and in an expansionary phase, debtors and inventory may increase notably, whereas with the onset of a recession a prudent business may apply more restrictive credit policies thereby reducing credit sales, and hence debtors. Moreover production may be reduced because of a slackening in consumer demand. This will in all probability result in a reduction of inventory. Some businesses tend to build up operating capital when the economy is strong, but then sell off inventories and have net reductions of receivables when the economy slacks off (Brigham, et al. 1999). During recession consumption may decline, which may result in debtors declining, doubtful and bad debts may increase, and stocks of unsold or unprocessed inventory may rise as production contracts, during an expansion, consumption may increase, and debtors may increase as sales increases (Nawrocki, 1997). Since the direction and the duration of the business cycle cannot be forecast with any degree of certainty, and since the term structure of interest rate, which has a considerable impact on the costs of various forms and sources of finance as well as their associated yield spreads, cannot be forecast with any degree of accuracy, the management of the financing of current assets is an ongoing challenge. The literature provides guidelines in this respect (Peel & Wilson, 1996).

According to Ferreira and Vilela (2004), corporations hold about 15% of their total assets in cash or cash equivalents. Some of the theories underpinning this study are Keynesian liquidity preference theory, agency cost of free cash flow theory and the risk- return trade off model to be discussed later. Deloitte East Africa is one of the longest established professional firm of accountants in Kenya. Its history begins in 1907 with the formation of Ramsay & Gill. In 1915, this firm became Gill & Johnson and today, with 16 partners and 340 employees in office in Nairobi with a total of eighty two (82) managers, Deloitte HR manual (2015), Deloitte East Africa is among the largest accounting firms in Kenya. Deloitte clients range from the largest and most prestigious organizations in the country, including nearly 30% of the companies quoted on the Nairobi Stock Exchange, to sole traders. Deloitte clients come from a wide variety of local and international organizations, including manufacturing, financial, distribution, service, agricultural, governmental and charitable bodies, representing the complete spectrum of the private sector, development agencies, non-governmental organizations and parastatals.

2. Statement the Problem

The optimal level of Operating Capital is determined to a large extent by the approaches adopted for the management of current assets and liabilities. Indeed, Operating Capital starvation has generally been credited as a major cause of business failure in many developed and developing countries (Rafuse, 1996). The strategic importance of Operating Capital management has ignited many researchers to focus on evaluating the Operating Capital management and profitability relationships in business enterprises all over the world (Uyar, 2009). Regrettably, most studies have largely focus on developed markets (Peel and Wilson, 1996; Shin and Soenon, 1998; Deloof, 2003). Similar investigations could provide useful insights on the impacts Operating Capital management approaches in emerging capital markets like Kenya. Most organization in Kenya are in great crisis when it comes to managing finances in the firm to reduce the liquidity level of funds in the organization, the liquidity of funds have been a major problem causing most organization to close up viable projects that can lead to the maximization of shareholders wealth and it is against this background that the study is seeking to investigate effect of Operating Capital management practices on financial performance of an organization to enable the organization make short term investments and reducing the liquidity of funds within the firm. Many studies have been conducted on the effect of Operating Capital management on financial performance in Kenya and especially on banks. However, few have been conducted on service delivery firms that aim to offer financial consultancy and protect small-scale enterprises. It is this industry that has the potential to help Kenyan in the reduction of poverty through employing the operating capital in the organization. Therefore, the study deem it right to investigate the effect of Operating Capital management practices.

General objective of the Study

To assess the effect of receivable management practices on financial performance of Deloitte east Africa limited

Specific objectives of the Study

1) To establishing the effect of preparation of credit sales on financial performance at Deloitte East Africa Limited
2) To assess the effect of Credit guidelines on financial performance at Deloitte East Africa Limited
3) To assess the effect of reviewing level of receivables on financial performance at Deloitte East Africa Limited

International Journal of Science and Research (IJSR)
ISSN (Online): 2319-7064
Index Copernicus Value (2015): 78.96 | Impact Factor (2015): 6.391

3. Theoretical Framework

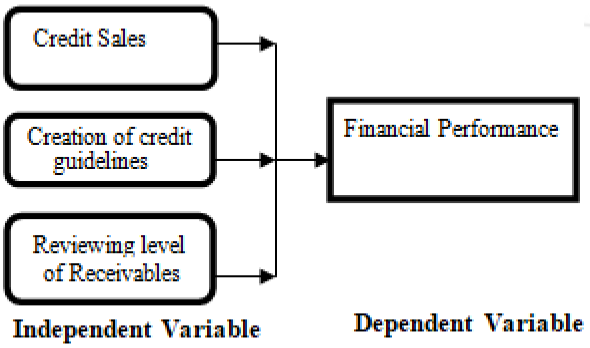
Trade-off Model Theory

Trade-off model demonstrates that firms decide their optimal level of cash holding by comparing the marginal cost and benefits of holding cash. Large investment in current assets under certainty would mean low rate of return on assets (ROA) of the firm, as excess investments in current assets will not earn enough return. A smaller investment in current assets, on the other hand, would mean interrupted production and sales, because of frequent stock-outs and inability to pay to its creditors in time due to restrictive policy. Various studies attempted to examine the relationship between Operating Capital management and financial performance which embodied liquidity as a component and profitability (Deloof, 2003; Raheman and Nasr, 2007). The ultimate objective of any firm is to maximize profit. At the same time, preserving liquidity of the firm is an important objective too. The problem is that increasing profits at the cost of liquidity can bring serious problems to the firm (Shin and Soenen, 1998).

Therefore, there must be a trade-off between these two objectives of firms. One objective should not be fulfilled at the cost of the other since both are important. If we do not care about profit, we cannot survive for a longer period. On the other hand, if we do not care about liquidity, we may face the problem of insolvency or bankruptcy. The firm must decide about the levels of current assets to be carried for which a firm's technology and production policy, sales and demand condition, operating efficiency is taken into consideration in the policy decision. It may follow a conservative risk-return trade-off. The rank correlation of liquidity and profitability are said to be inversely related to each other. It implies that as the liquidity increases and profitability decreases (Pandey, 2010). More aggressive Operating Capital approaches are associated with higher return and higher risk while conservative Operating Capital approaches are concerned with lower risk and lower return (Carpenter and Johnson, 1983).

4. Conceptual Framework

The study adopted the following conceptual framework:



Source: Author 2017
Conceptual framework

Receivable management practices

Provision of trade credit is normally used by businesses as a marketing strategy to expand or maintain sales (Pandey, 2004). Efficient receivables management practices augmented by a shortened creditor's collection period, low levels of bad debts and a sound credit policy often improves the businesses' ability to attract new customers and accordingly increase financial performance hence the need for a sound credit policy that will ensure that organizationals' value is optimized (Ross et al., 2008). Costs of cash discounts, losses of bad debts and costs of managing credit and credit collections constitute the carrying costs associated with granting a credit which increase when the amount of receivables granted are increased. Lost sales resulting from not granting credit constitute the opportunity cost which decrease when the amounts of receivables are increased. Firms that are efficient in receivables management should determine their optimal credit which minimizes the total costs of granting credit (Ross et al., 2008).

While there are numerous ways to free up working capital, this series focuses on four core strategies: accounts receivable, accounts payable, cash management and inventory. This first installment looks at accounts receivable, (Ross et al., 2008). Most businesses have formal accounts receivable policies that dictate when to bill, how much to bill and when to collect. Unfortunately, not all businesses enforce those policies effectively – or even adopt the right processes at all. In many cases, it comes down to culture. Businesses that prioritize sales often fall into the trap of extending credit to customers, offering discounts or ignoring payment terms if it means winning new sales. However, if management does not have a focus on working capital, no one will, you end up unintentionally providing customers with free financing, (Pandey, 2004). Some may argue this is no big deal, but the truth isn't so simple. If a company needs to borrow money to meet its obligations because customers are paying late, it could incur losses on the financing charges alone. Even if that's not the case, carrying overdue accounts receivable still has a cost. It puts you on a cash flow tightrope. Rather than having free capital to invest in growth opportunities, increase shareholder payouts, buy new equipment or introduce new products, your money is tied up on your balance sheet (Loftus, 1941)

According to Anderson A. and Company, (1996) it can be complicated if the company accepts many different forms of payment, such as pre-authorized debit, cheques, wire transactions, electronic funds transfer or even payment over the phone. In these cases, it may make sense to limit the payment methods customers can use Post journal entries well before system cut-off dates, Reconcile accounts on a timely basis by quickly and consistently following up on unidentified cash receipts rather than dumping them into suspense accounts and letting them languish. While every business enjoys collecting revenues, not all organizations take a proactive approach to ensure receivables are collected on a timely basis. This is often due to weak processes. For instance, a lack of reporting can make it difficult – or impossible – to determine which amounts are collectible and which may be in danger of default. Similarly, failure to adhere to the company's credit or collection policies makes it harder to determine which payments are late and which will never arrive. Loftus, (1941). Of course, before they can follow up on late payments, your staff members also need assurance that the accounts receivable reports are accurate as of today and that there aren't days, or even weeks, worth of cash receipts that have not yet been applied to customer accounts. This requires a robust accounting process. Other ways to maximize collection of receivables include: Engaging in frequent and consistent collection efforts. This includes bolstering staff skills if they lack knowledge on how to collect amounts owing from recalcitrant customers.

5. Research Methodology

A case study research design was selected because this brought a researcher to an understanding of a complex issue and extended experience or add strength to what is already known through previous research. Case studies emphasizes detailed analysis of a limited number of events or conditions and their relationships, (Yin,1997). Time and availability of data are also important considerations in the determination of the case study . The target population for the study was all 82 management personnel from Deloitte East Africa limited. In order to meet the objective of the study, open and closed ended questionnaires were used to collect the primary data developed by the researcher. The questionnaires were used to obtain primary data from the sampled population, who were the partners, middle level managers and entry level managers. All the respondents were asked the same questions in the same order. The questionnaires provide both qualitative and quantitative data. Secondary data were also used, extracted from previous research reports and bank documents review. A descriptive study was analyzed based on secondary data obtained from available financial statements derived from the website of Deloitte East Africa Limited.

Qualitative analysis was done on the information collected from the results of the questionnaires; quantitative analysis was included, both descriptive and inferential statistical techniques were used. Descriptive statistics was used to analyze the quantitative data. The findings were presented using tables, graphs and pie charts.

6. Results and discussions of the findings

The study sought to find out the levels of agreement with the statement related to receivable management Practice on financial performance of the organization and found that:

Table 4.2: Extend with agreement with the statement relating to Receivable Management Practice on the financial performance

Statement	5	4	3	2	1
When the company limits its credit sales the default rates will reduce	65%	30%%	1.25%	3.75%	0%
Proper credit guidelines created by the organization will prevents the danger of over lending and enable the organization to invest more of its cash	57.5%	37.5%	1.25%	3.75%	0%
Continues review of level of receivable usually enable the organization to detect and gauge the borrower's ability to borrow and payback on time.	65%	32.5%	2.5%	0%	0%
Review of bad debts sets the organization to be ready for the risk of defaults.	78.75%	20%	1.25%	0%	0%
Organization when have the proper records of the receivables they will easily makes the follow up..	82.5%	17.5%	0%	0%	0%

This study sought to find the levels of agreement with the sentence that when the company limits its credit Sales then the default rates will reduce. 52% strongly agreed, 24% agreeing while just 3% in the contrary opinion. It is natural that when many customers buy from an organization on credit, this will accumulate and therefore the rate of payment becoming difficult thereby increasing the rate of default it concurs with the findings of Maness (1994) Liquidity is affected by cash, credit, inventory, and accounts payable that form part of the overall cash flow of a business. A business that considers decreasing its levels of cash by carrying too many inventories or providing too much credit endangers its liquidity, Madura and Veit, (1988).

Proper credit guidelines created by the organization will prevents the danger of over lending and enable the organization to invest more of its cash. 57.5% of the respondents strongly agreed, 32.5% of the respondents agreed, 1.25% not sure while a paltry 3.75 % disagreed. This means that the rules and regulation pertaining to lending are properly observed. This enables re-investment of the profit realized back into the business.

Continues review of level of receivable usually enable the organization to detect and gauge the borrower's ability to borrow and payback on time. Nearly all the respondents were in agreement with this statement while only 2.5% of the respondents were not sure with it. They claimed that this enables the organization to check the borrowing tread of the costumers and his ability to pay back in time. This will boost the confidence of the two parties when doing business.

The extent of agreement of the respondents on the review of bad debts sets the organization to be ready for the risk of defaults, 98.75% of the respondents either strongly agreed or just agreed claiming that the provisions of bad debts within the organization enables the organization to be cushioned against the shocks of non-payments. Only 1.25% of the respondents were in the contrary opinion saying that in business, no one should anticipate for a loss.

Organizations, when they have the proper records of the receivables, they will easily makes the follow up. This was confirmed by the 100% of the respondents who unanimously agreed that records enable an organization to keep records of their customers, their loan amount and their payment trends. The company is able to now make a follow up to recover the funds. This study also enquired if the management involves the debt collectors in decision making concerning the lending activities of their organization. 32.5% of the respondents agreed, 38% were not sure while 37.5% disagreed. The bigger number of the respondents who were not sure or disagreed was attributed to the fact that they are not stakeholders of the organization as they work on contract and for a specific period of time therefore they should not be involved in any decision makings.

International Journal of Science and Research (IJSR)
ISSN (Online): 2319-7064
Index Copernicus Value (2015): 78.96 | Impact Factor (2015): 6.391

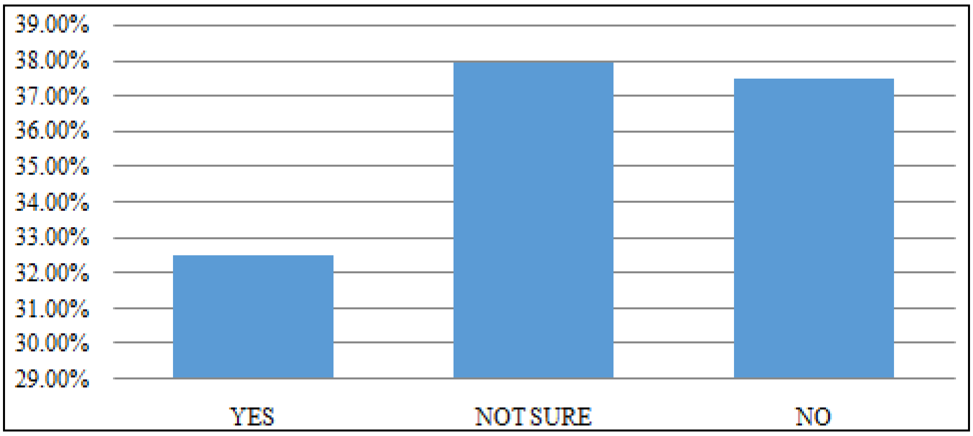


Figure 4.7: Debt collectors involved in decision making

7. Summary of the Findings

The study established that Receivables have significance effect of the financial performance of an organization. This study sought to find the levels of agreement with the sentence that when the company limits its credit Sales then the default rates will reduce and this was supported by majority of the respondents and further affirms that proper credit guidelines created by the organization will prevents the danger of over lending and enable the organization to invest more of its cash. This means that the rules and regulation pertaining to lending are properly observed. This enables re-investment of the profit realized back into the business.

Organizations, when they have the proper records of the receivables, they will easily makes the follow up. This was confirmed by the 100% of the respondents who unanimously agreed that records enable an organization to keep records of their customers, their loan amount and their payment trends. The company is able to now make a follow up to recover the funds.

This study also enquired if the management involves the debt collectors in decision making concerning the lending activities of their organization. The bigger number of the respondents who were not sure or disagreed was attributed to the fact that they are not stakeholders of the organization as they work on contract and for a specific period of time therefore they should not be involved in any decision makings the study is in agreement with Michalski (2007) who observed in his study that an increase in the level of accounts receivables in a firm increases both the net working capital and the costs of holding and managing accounts receivables and both lead to a decrease in the financial performance of an organization.

8. Conclusions

Receivable management practice is a very important aspect in finance department in all the organization when the organization is projecting to start up a project then they must put in place the best way of managing operating capital in the organization. Proper receivable management determines the position of an organization in terms of financial performance. Whenever an organization wants to improve in its financial performance, the organization has to plan and provide necessary resources beforehand. And this cannot be done without proper management of account receivables as suggested from the findings of this research hence it is important for the organization to work on its liquidity level.

9. Recommendations

The company should such for ways of reducing its credit Sales then the default rates will reduce. If they don't then it will accumulate and therefore the rate of payment becoming difficult thereby increasing the rate of default and these will reduce the rate of receivables in the organization which will impart greatly to poor financial performance.

References

[1] Anderson A. and Company, (1996) Fund Management: *An International Legal Guide*
[2] Appleby, Spurling & Kempe, (Bermuda) (1992)Fund Management: *A Legal Guide to the World's Investment Fund Markets*, Euromoney Publications.
[3] Bates G. E, (1959) Investment Management: *A Casebook*, McGraw-Hill.
[4] Benz C., Kinnel R., Phillips D., & Peter Di Teresa, (2002), Morningstar Guide to Mutual Funds:*5-Star Strategies for Success*. John Wiley and Sons publishers.
[5] Bernstein M., Bernstein P. L.,Damodaran A., (1998), *Investment Management*, John Wiley and Sons.
[6] Bogle J. C., (1993) Bogleon Mutual Funds: *New Perspectives for the Intelligent Investor*
[7] Bogle J. C., (1999) Common Sense on Mutual Funds: *New Imperatives for the Intelligent Investor*, John Wiley and Sons.
[8] Committee on Business Strategies for Public Capital Investment, National Research Council (U.S.), (2004) Investments in Federal Facilities: *Asset Management Strategies for the 21st Century*, National Academies Press.
[9] DunisC.(2000)*Advances in Quantitative Asset Management*, Published by Springer.
[10] Euro money Publications PLC., (1992), *Fund Management*, Euro money Publications PLC.
[11] Euromoney Publications.
[12] Fabozzi F. J., (1997) *Pension Fund Investment Management*, John Wiley and Sons incorporated.
[13] Faerber E., (1999) All About Bonds and Bond Mutual Funds: *The Easy Way to Get Started*, McGraw-Hill Professional.

[14] Great Britain Office of Government Commerce, (2003), *Software Asset Management*, Stationery Office publications.
[15] Hagin R., (2003), Investment Management: Portfolio *Diversification, Risk, and Timing-- fact and Fiction*, John Wiley and Sons.
[16] Haslem J. A., (2003) Mutual Funds: *Risk and Performance Analysis for Decision Making*, Blackwell Publishing.
[17] Investment Company Institute, *Mutual Fund Fact Book*, (1995), McGraw-Hill inc.
[18] Kelly K. S., (1997)*Effective Fund-Raising Management*, Lawrence Erlbaum Associates.
[19] Krogh P., (2005), The DAM Book: *Digital Asset Management for Photographers* O'Reilly Publishers.
[20] Lacasse, M. A., & Vanier, D. J. (1999). *Durability of Building Materials and Components 8: Service life and durability of materials and components* (Vol. 1). NRC Research Press.
[21] Litterman B, Quantitative Resources Group,(2004) Modern Investment Management*: An Equilibrium Approach*, John Wiley and Sons publishers.
[22] Loftus J. A., (1941) Investment Management: *An Analysis of the Experiences of American Management Investment Trusts*, Johns Hopkins Press.
[23] Musalem A. R., Palacios R. J., (2004) Public Pension Fund Management: *Governance, Accountability, and Investment Policies*: Proceedings of the Second Public Pension Fund Management Conference May 2003, World Bank Publications.
[24] Programme on Educational Building, (1999), *Strategic Asset Management for Tertiary Institutions: Pep Papers*, OECD Publishing. Published by McGraw-Hill Professional.
[25] Sauvain H. C., (1967) *Investment Management*, Prentice-Hall publications.
[26] Sheimo M. D., (1999), Mutual Fund Rules: *50 Essential Axioms to Explain and Examine Mutual Fund Investing*, McGraw-Hill.