
Didace Nzitaira¹, Dr. Patrick Mulyungi²
¹, ²Jomo Kenyatta University of Agriculture and Technology

Abstract: Financial distress has been a serious challenge to the existence of not only small firms but also to large firms. The objective of this study was to determine the effect of account receivable management practices on performances of SMEs In Rwanda. Specifically, the study sought to address the following specific objectives, that is, to establish the influence of Accounts receivable collection practices on performance of SMEs in Kicukiro District, to assess the effect of Accounts receivable management practices on performance of SMEs in Kicukiro District, to evaluate the effect of Accounts receivable management practices on performance of SMEs in Kicukiro District and to determine the effect of Accounts receivable management practices on performance of SMEs in Kicukiro District and lastly to assess the moderating effect of financial literacy on the effect of Accounts receivable management practices on performance of SMEs in Kicukiro District. The study adopted a cross-sectional survey research design and in-depth interviews which allowed the collection of primary quantitative data through structured questionnaires. Target populations of 300 finance managers/ accountants of SMEs comprising 164 trading 26 manufacturing, 10 hairstyling, 62 dressmaking, and 38 carpentry enterprises. Stratified random sampling technique was used to obtain a sample of 172 SMEs both primary data and secondary data was used for the study. Primary data was collected using a well-structured questionnaire. The study utilized questionnaires as an instrument for data collection. Data was analyzed for descriptive and inferential statistics using SPSS version 21. Descriptive statistics such as tables, graphs, charts and percentages analysis were used for presentation of data. Also, a linear regression model was used to analyze quantitative data and was developed and tested to explain the relationship between various proxies of accounts receivable management practices and financial performance of SMEs in Rwanda. Descriptive statistics such as mean, standard deviation and homoscedasticity were used to test for normality of data. Ordinary Least Square method was utilized to establish the cause-effect relationship between variables while hypotheses were tested at 5% significance level. The overall model was statistically significant at F=11.298 and p-value (0.000< 0.05). The findings revealed that efficient Accounts receivable management practices, when adopted by SMEs lead to growth. The study recommended that owners and managers should be trained and made to understand the various techniques of managing Accounts receivable levels. The findings would form a basis for government and policy makers in management decision making, to formulate Accounts receivable management strategies that would help minimize bad and delinquent debt. The study also forms a basis for further research and adds to the existing body of knowledge.

Keywords: Accounts receivable collection practices, Financial performance, SMEs, Kicukiro District

1. Introduction

Accounts Receivable is one of the largest and most liquid of corporate assets Ongore & Kusa, (2013) which are very important in facilitating business transactions. Berk and Demarzo (2016) consider accounts receivable as both a source and use of finance in that it can be obtained and extended. However, it can be unproductive unless it generates additional business since it ties up scarce financial resources and exposes organizations to risk of default in situations whereby the credit period is lengthy (Jindal, Jain &Vartika, 2017). Huge amounts of accounts receivable is likely to reduce the firm value and as such the need to have best Accounts Receivable best practices. Pandey, (2010) assert that Accounts receivable is a current asset and a component of working capital.

Jian, Yang & Tsung (2011), posits that an invoice has to be converted into cash in a timely manner; otherwise it becomes meaningless to raise it in the first place, the scholar further emphasizes that as long as an invoice hasn’t been paid there is no sale, and if there is no sale there is no money. Accounts receivable management is the facilitation of the completion of the collection process or better still put the completion of the sale. It is crucial that a firm keeps its current customers and strive to maintain repeat sales through good practices. Accounts Receivables are large investments which appear on a firm's balance sheet, just like capital budgeting projects, they are measured in terms of their net present values (Molina & Preve, 2009). They are therefore an important component of firm assets. Accounts receivable are monies the customers owe a business and are comprised of a huge number of invoiced amounts. They are the amounts a firm has the right to collect from their clients for providing them with goods or services on credit

Oware, Samanhyia and Ampong (2015), demonstrated that when a firm does not invest well in the collection of account receivable then the probability that a firm will stagnate as a result of very poor account receivables levels and debt accumulation would be high. This is clearly shown on how the operations of Ghana Water Company Ltd (GWCL) were affected. When accounts receivable take a long time to be collected; it becomes impossible investing in production for your next order. Uncollected amounts tie up working capital unreasonably and may lead to long business cycles. It is therefore important for a business to collect all owed amounts in a timely manner to avoid liquidity problems.

Volume 7 Issue 11, November 2018

www.ijsr.net
Licensed Under Creative Commons Attribution CC BY

Paper ID: ART20192519 DOI: 10.21275/ART20192519 569
Accounts receivable is an important 3 source of funds for both small and medium enterprises around the world (Petersen & Rajan, 1997; Demirguc-Kunt & Maksimovic, 2002). Most firms use Accounts receivable both to finance their input purchases (accounts payable) and offer financing to their clients. Pandey (2010) explains that, a limited capital base and poor cash flow levels as a result of uncollected monies deters financial performance of an entity. Connolly (2013) observed that many enterprises rarely maintained customer details and credit information; appropriate credit terms and billing cycle which affected timely collection of payments from the customers.

Several studies have analyzed the effect of Accounts receivable management on performance of firms. For instance, Teruel and Solano (2014) studied a sample of non-financial companies in the UK and established that there existed a relationship between working capital management and corporate performance; the study amplified the fact that there is an existence of an optimal level of investment in working capital which maximizes a firm's value. However accounts receivable was just one of the components of working capital. This study looked at Accounts Receivable management practices as a standalone process. Angahar and Alematu (2014) examined the impact of WCM on profitability of cement companies quoted on the Nigerian Stock Exchange (NSE), one of the independent variable was accounts receivable. The findings showed that Accounts receivable measured by number of days Accounts Receivable outstanding did not impact on the profitability. Sharma and Kumar (2011) undertook a study on 263 non-financial BSE 500 firms listed on the Bombay Stock (BSE) from 2000 to 2008. The study concluded that there is a significant positive relationship between accounts receivable turnover and profitability. When customers pay the amounts they owe promptly then profits increase as these amounts are ploughed back.

World over, various studies have been carried out on the financial performance of SMEs, illustrating the role SMEs play in the Economy. SMEs are very important economic wheels for financial performance and development in any country as indicated by recent publication by the 2016 Economic Survey (Kenya), they employees less than 99 workers. Studies indicate that in both developed and emerging economies (Mole & Namusonge, 2017), and contribute 60 percent of total formal employment in the manufacturing sector (Ayyagari et al., 2007). OECD, (2010) states that SMEs play a significant role towards overall enterprise growth, real GDP growth, new job creation and reduction of poverty, however, this units have limited resources due to the inability to have enough cash flows to meet their day to day obligations. SMEs dominate the informal sector in Kenya and they have a potential to grow into large companies that support the Gross Domestic Product (GDP) financial performance and check unemployment if encouraged by Government policy or public procurement authority, (Njeru, Namusonge & Kihoro, 2012).

The starting point for accounts receivable management practices is to understand the policies and procedures for sales. Two critical questions to answer are, how and when a firm should evaluate a customer for credit, and whether there exist a credit policy. Myers (2003) describes AR management as methods and strategies adopted by a firm to ensure that they maintain the best optimal level of credit and its effective management. It is a component of financial management which involves Accounts Receivable analysis, Accounts Receivable extension, Accounts Receivable collection and Accounts Receivable financing. Some of the other components of Accounts receivable management practices are policies, measurement and outsourcing options.

In Rwanda majority of the SMEs are micro enterprises with fewer than 10 employees, while 70 per cent of them are one-person, own account workers. This means that majority of SME entrepreneurs are operating at the bottom of the economy, with a significant percentage falling among the 53 percent of Rwandans living below the poverty line of USD 1 per day. The latter are largely for subsistence and engage in economically uncompetitive activities both in urban and rural areas (Kamunge, 2014).

Indeed, the failure rate of SMEs in Rwanda is reported to be one of the highest in the world as about 70% to 80% of these entities fail during their first three years of existence (Ngary, Smith, Bruwer & Ukphere, 2014). Although prior research in other countries has partly attributed a high failure rate of SMEs to ineffective cash management practices (Abanis et al. 2013), limited research has been conducted in Rwanda to investigate the cash management practices of SMEs in the country. Therefore, there is a gap in research on cash management practices of Rwanda SMEs. Given the importance of SMEs in creating employment opportunities that are desperately needed in Rwanda and bearing in mind the high failure rate of these entities in the country, it is imperative that their accounts receivable management practices be investigated.

2. Statement of the Problem

Accounts receivables management is important to the profitability of an organization. Although scholars are in agreement about the important role played by SMEs in a Country’s Economic growth, there is still a fundamental lack of knowledge as to why some of them manage to grow and transition to large firms, while others remain stagnant or fail altogether. The challenges that most SMEs face is striking a balance between liquidity and profitability. This challenge is enormous since SMEs have to wade through stiff competition by attracting and maintaining customers through credit sales and at the same time use aggressive methods of collecting accounts receivables to maintain optimal levels of working capital. Increasing credit sales to improve profitability may end up extending credit to risky customers who will default, such customers will be asked to pay cash as the goods are delivered to them. Inability to manage accounts receivables, made many SMEs in Rwanda to suffer financial distress resulting to their eventual collapse.

Of late SME segment is a very important vehicle for economic development, however, the failure of an SME never attracts the media attention that is usually associated with the collapse of bigger firms such as Enron in the USA, Kicomi and Dn International in Rwanda. The consequences of the failure of smaller firms are certainly a serious matter.
affecting several stakeholders that require attention, employees want to be assured of job security, government benefit from a constant flow of funds from SMEs in form of taxes, Communities need steady flow of goods and services. For these firms to survive, be self-sustaining and able to create the desirable impact, they have to be liquid. They need to make important financial decisions, among them being the liquidity decision and investment decisions.

Previous studies by Lobel (2013) found out that improper accounts preparation and inadequate cash management procedure were some of the major challenges facing organizations leading to close up of the enterprises. According to Abanis, et al. (2013), among the weaknesses that occur in micro enterprises in terms of cash management is that, most owners do not have bank account to record their sales. This problem occurred because they do not have experience in managing enterprise. In Rwanda, an example may be taken referring to one manufacturing company, CHALOM PAINTS that collapsed because of mismanagement and their liabilities were far outweigh their assets (Hagenimana, 2015).

Literature reviewed therefore showed need for efficient management of account receivable through proper practices, which provides sufficient cash from operations that guarantee short term survival and financial performance of business. Small firm needs to manage their working capital in an efficient way as it significantly determines whether a business succeeds or fails. It was evident no research had been conducted on the effects of ARM practices on the financial performance of SMEs in Kicukiro District. This study fills this gap.

3. Objectives of the Study

3.1 General objective

The general objective of this study was to determine the effects of accounts receivable management practices on financial performance of SMEs in Rwanda.

3.2 Specific objectives

The specific objectives were:

1) To establish the effect of Accounts receivable collection practices on financial performance of SMEs in Kicukiro District.

4. Conceptual Framework

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Dependent variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable collection management practices</td>
<td>Financial performance</td>
</tr>
<tr>
<td>• Collection policy,</td>
<td>• Return on capital employed</td>
</tr>
<tr>
<td>• Communication</td>
<td>• Profitability</td>
</tr>
<tr>
<td></td>
<td>• Sales</td>
</tr>
</tbody>
</table>

**Figure 2.1:** Conceptual framework

**Target population**

Target population in statistics is the specific population about which information is desired. According to Ngechu (2014), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. This definition ensures that the population of interest is homogeneous. And by population the researcher means the complete census of the sampling frames. According to Mugenda and Mugenda (2008), target population in statistics is the specific population about which information is desired. The population of the study was 300 SMEs operating in Kicukiro District were subdivided into five mutually exclusive subpopulations or strata herein referred to as business classes as shown in Table 3.1. These included comprising 164 trading, 26 manufacturing, 10 hairstyling, 62 dressmaking, and 38 carpentry enterprises.

The finance manager/Accountant from respective targeted organization were selected to answer the questionnaire.

<table>
<thead>
<tr>
<th>Table 3.1: Target population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Area of operation</td>
</tr>
<tr>
<td>Traders</td>
</tr>
<tr>
<td>Manufacturing</td>
</tr>
<tr>
<td>Hairstyling</td>
</tr>
<tr>
<td>Dress making</td>
</tr>
<tr>
<td>Carpentry</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

5. Research Findings and Discussion

5.1 Accounts Receivable Collection Practices

The study sought to establish the effect of customer collection practices on financial performance of SMEs in Kicukiro District. The study specifically investigated the following elements of customer collection practices; credit collection policy, prompt invoice and regular sending of statements, contact overdue accounts, use of ageing sheet, keeping accurate and timely records, use of collection agencies and use of average collection period technique.

<table>
<thead>
<tr>
<th>Table 4.2: Relationship between Accounts AR Practices and Financial performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement</td>
</tr>
<tr>
<td>----------</td>
</tr>
<tr>
<td>How often do you refer to a defined credit collection policy?</td>
</tr>
<tr>
<td>How often do you Invoice and send statement?</td>
</tr>
<tr>
<td>Do you Contact overdue accounts holders?</td>
</tr>
<tr>
<td>How often do you review collection timelines?</td>
</tr>
<tr>
<td>How often do you use ageing sheet and make constant follow up?</td>
</tr>
<tr>
<td>How often do you call customers prior to due date?</td>
</tr>
<tr>
<td>How often do you use collection agencies?</td>
</tr>
<tr>
<td>Do you use average collection period technique</td>
</tr>
</tbody>
</table>
Results in Table 4.2 show that 58.1% of the respondents indicated that there is a defined credit collection policy, 43.1% of the respondents also agreed that they invoice promptly and send statement regularly while 61.8% of the respondents agreed that they contact overdue accounts more frequently. Results also revealed that 75.4% of the respondents agreed that they review set collection timelines and penalize those who pay late, 48.5% of the respondents agreed that they used ageing sheet and make constant follow up 58.7% of the respondents agreed that they call customers prior to due date while 78.8% of the respondents agreed that they review and kept timely records.

Further, results in Table 4.2 reveal disagreed that they used collection agencies while 44.4% of the respondents agreed that they used average collection period technique. The results show good practice of the AR collection practices. This can be supported by the mean of the responses (3.29) which means that majority of the respondents were agreeing to the statements in the questionnaire. Table 4.10 demonstrates 5.10 % percent of respondents never review set collection timelines, while 10.30 % do it annually, 9.20 % semiannually while 58.50 % monthly while 16.90 % always carried out the practice. Table 4.17 demonstrates 6.60 % percent of respondents never use ageing sheets showing, while 17.60 % only once a year 27.20 % twice a year, 38.20 % use them monthly while 10.30 % always. This finding suggests that having an ageing sheet is not often practiced by SMEs in Kicukiro District, only about 48% of SMEs studied had ageing sheet. Many seem not to have information about ageing sheet.

The study determined that SMEs have a defined debt collection policy. The findings concurred with those in Gitau (2014) who explains that it is important to set credit terms and payment arrangement, the period of repayments. The findings implied that the SMEs under study have a defined credit collection policy. The existence of a defined credit collection policy creates a good platform for the SMEs owners to follow up on the customers’ in-case of default. This further indicated that the SMEs in Kicukiro District have put in place effective credit collection practices which may have an implication on the financial performance of the SMEs.

The study showed that not all SMEs invoice promptly and sends statement regularly. Results in Table 4.2 reveal that less than 43.1% of the respondents agreed that they invoice promptly and send statement regularly while 32.6% of the respondents disagreed that they invoice promptly and send statement regularly. Another 24.3% of the respondents were sent only twice a year. The findings agreed with Connolly (2013), who found that firms use collection agencies (73.7%). The findings implied that only a few SMEs under study use collection agencies. Use of collection agencies helps the SMEs owners to follow up on customers who have declined to pay back their debts even after reminding them constantly and giving them ample time to repay back even after their credit is long overdue.

5.1.1 Regression Showing Relationship between Accounts Receivable Collection Practices and Performances

Regression analysis was used to find out if there is a relationship between credit collection practices and SMEs financial performance by evaluating the contribution of the credit collection practices in explaining SMEs growth, when the other variables are controlled; the R Square value was obtained in this case. From the results in Table 4.3, credit collection practices were found to have an R Square value of 0.312 or to contribute to 31.2% SME growth. The R square value is an important indicator of the predictive accuracy of the equation. The remaining 68.8% can be explained by other factors. The implication of these finding is that credit collection practices plays a significant role enhancing SME financial performance.

Table 4.3: Model summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.442</td>
<td>.301</td>
<td>.312</td>
<td>.65724</td>
</tr>
</tbody>
</table>

Table 4.4: Analysis of Variance

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>12.14</td>
<td>1</td>
<td>12.14</td>
<td>5.020</td>
<td>.000*</td>
</tr>
<tr>
<td>Residual</td>
<td>28.684</td>
<td>49</td>
<td>.476</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>40.824</td>
<td>50</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Dependent Variable: Financial Performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Predictors: (Constant), Accounts Receivable Collection Practices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Regression of coefficients results in Table 4.4 shows that there is a positive and significant relationship between credit collection practices and SMEs financial performance as supported by a p value of 0.000 and a beta coefficient of 0.342. This was also supported by the t values whereby t cal=50.75> t critical =12.706 at 95 percent confidence level which depicts that we reject the null hypothesis and accept the alternative. The findings concurred with those of Pandey (2008), an indication that collection practice adopted influences financial performance of SMEs. This implies that an increase in credit collection practices by 1 unit would
results to increase in SMEs financial performance by 0.342 units. This result concurs with Owure, Samanhyia and Ampong (2015), who demonstrated that when a firm does not invest well in the collection of account receivable then the debt accumulation will decrease profits.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>2.487</td>
<td>.270</td>
<td>7.169</td>
<td>.000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>.342</td>
<td>.062</td>
<td>.444</td>
<td>2.241</td>
</tr>
<tr>
<td>Collection Practices</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SMEs Financial performance = 2.487 + 0.342 Credit Collection Practices

6. Conclusions

The study concluded that Accounts Receivable Collection Practices influence the financial performance of SMEs in Kicukiro District. This can be explained by the regression results which revealed that the influence was positive and significant.

7. Recommendations

Based on the findings and the conclusions drawn above, this study makes the following recommendations. As evidenced by the study findings, credit collection practices play a key role in the financial performance of SMEs in Kicukiro District. Thus, it is imperative that SMEs owners should continue in the practice of Accounts Receivable Collection Practice for consistent growth. Additionally, the SMEs owners should endeavor to use other credit collection practices that are not outlined in this study.

References


[59] Muya, T. W., & Gathogo, G. (2016). Effect of working capital management on the profitability of


[71] Indonesia: OECD Publishing.


