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Debtors Management and Financial Performance of Firms. A Critical Review

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Abstract
Globally, a debt is an obligation or duty to pay, deliver goods or render services under express or implied contract. From the review of Literature, debtors' management plays a critical role in improving financial performance in firms. The regulation of the size and handling of the structure of public debts, Actions taken to manage the debt have significant effect on the financial markets because government securities compete with private securities for the limited funds in the capital markets. Debt set in when a firm sale its products or services on credit and does not collect cash instantly. It is an essential marketing tool, acting as a bridge for the movement of goods and services through the production and distribution stages to customers. Debtors constitute a substantial po1tion of current assets of several firms. The present paper aimed at reviewing empirical literature drawn across past studies in Kenya and beyond on debtors' management and financial performance of firms. Specifically, the study reviewed literature on debt consolidation, liquidity levels and security of debts. The financial performance indicators reviewed were profitability and reduction in bad debts. Theoretical framework guiding the studies was reviewed as well. The reviewed literature highlights the importance of debt management on financial performance. It's hoped that this paper informs academicians and interested parties in future on matters debt management and financial performance of firms.
Key words: *Debtors management, financial performance, Firms.*

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I. Introduction

A debt is an obligation or duty to pay, deliver goods or render services under express or implied contract. One who owes is a debtor and the one to whom it is owed is a debtee, or creditor or lender, (businessdictionary.com). Debt refers to both short term and long-term loan. Debt management is the regulation of the size and handling of the structure of the public debts. In other words, it's the act taken to manage debts (Ferlex 2012).

According to Charitou, Elfani and Lois (2010), the term debtor's management refers to a procedure of coming up with policies that are aimed at controlling how the firm gives credit to its clients as well as monitoring the same credit process. It goes beyond giving out credit and ensuring that the same s collected back in the appropriate time by the organization. The process is important to minimize the number of bad amount outstanding to the firm which in turn will lead to losses and ultimately be out of business.

According to Fer lex (2012), debt management is the strategies which help the debtor to repay or handle their debts better. It involves working with creditors to restructure debts and enabling the debtor manages payments effectively. CIMA (2015) argues that credit and debt are directly related to each other. The amount of debt that you have affects your credit score, and the way you handle your debt and make payments affects your credit score. You need to understand that your credit history and credit score are two different things. (Keown & Petty 2014). Therefore, when one thinks about credit or debt management, it is important to realize that these two things are linked together (CIMA, 2015)

Kariuki (2010) found that for a firm to ensure that credit management is done various policies should be put in place, one of these policies is a collection policy that is needed since all customers do not pay the firms bills in time. Some clients take long to make payments while some do not pay at all. The aim of collection effort should be to accelerate collections from slow payers and reducing bad debt losses.

Senyonga (2000) stipulates that, whereas it would not be prudent for the business to sell on credit, because of the problems of bad debts and getting money from customers, most business finds themselves at crossroads because if they refuse to give credit to their customers, others will do so.

Models proposed by Straka (2009) and Wheaton et al, (2010) have expressed default as the end result of some trigger event, which makes it no longer economically possible for a borrower to continue offsetting a

credit obligation. Though there are various definitions of debt/credit risk, one outstanding concept portrayed by almost every definition is the probability of loss due to default. However, a lot of divergences emerge on defining what default is, as this is mainly dependent on the philosophy and/or data available to each model builder. Liquidation, bankruptcy filing, loan loss (or charge off), nonperforming loans (NPLs) or loan delayed in payment obligation, are mainly used at banks as proxies of default risk. This research paper has proxy credit risk by the ratio of Nonperforming loans to total loans advanced (Beck and Hesse, 2012).

Statement of the Research Problem

Firms use highly effective and efficient debt management strategies like debt consolidation loan, debt cycle strategy budgeting strategy among others such firms are protected from bad amount outstanding and legal penalties. Soke and Yusoff (2009), in their study on debt management strategies of selected financial institutions in Malaysia found that majority of financial institution's losses stem from outright default due to inability of customers to meet obligations in relation to borrowing. Debt is the oldest and biggest risk that a bank, by virtue of its very nature of business inherits. To most of the transition economies lending activities have been controversial and a difficult matter.

According to debt management frame work in commercial banks by GTZ (released in 2000) debt is an integral part of financial services. When commercial banks issue loans, there is a risk of borrower default. When commercial banks collect deposits and on-lend them to other clients (i.e. conduct financial intermediation), they put clients' savings at risk. According to GTZ frame work any institution that conducts cash transactions or makes investments risks the loss of those funds.

Nancy et al. (2001) also noted that managing debt is a complex task for any financial organization, and increasingly important in a world where economic events and financial systems are linked. Global financial institutions have emphasized debt management as an essential element of long-term success. Rather than focusing on current or historical financial performance, management and regulators now focus on an organization's ability to identify and manage future risks as the best predictor of long-term success.

The present review showcased past empirical studies to ascertain relationship between debtors' management and financial performance of firms.

II. Literature Review

Moranga Getii Kevin and Job Omagwa (2017) did a study on debtors Management and Financial Performance of Selected Microfinance Institutions at Nairobi City County in Kenya. The specific objectives of this study were: to establish the effect of debt collection policy on financial performance of selected MFIs at Nairobi County in Kenya, to determine the effect of the internal control system on financial performance of selected MFIs at Nairobi County in Kenya, to establish the effect of Client Appraisal on financial performance of selected MFIs at Nairobi County in Kenya and to determine the effect of legal framework on financial performance of Selected MFIs at Nairobi County in Kenya. Primary data was collected by the aid of self-administered questionnaires and analyzed using multiple regression analysis. Both descriptive statistics and inferential statistics were determined. The nine licensed MFIs in Nairobi City, Kenya by the CBK as at 31st December 2014 were the target population of the Study. In each of the 9 MFIs, four individuals were purposively selected to participate in the study as respondents; these were the Branch Manager, Credit Officer, Debt Recovery Officer, and Finance Officer and hence the sample size was 36 Officers in the 9 MFIs.

Kevin and Omagwa (2017), assessed the effect of debtors' management on the financial performance of selected microfinance institutions (MFIs) at Nairobi County in Kenya. The independent variables for debtors' management were: debt collection policy, internal control systems, client appraisal and legal framework. On the other hand, the dependent variable was financial performance of selected MFIs at Nairobi County in Kenya. Primary data was collected by the aid of self-administered questionnaires and analyzed using multiple regression analysis. Both descriptive statistics and inferential statistics were determined. The nine licensed MFIs in Nairobi City, Kenya by the CBK as at 31st December 2014 were the target population of the Study. In each of the 9 MFIs, four individuals were purposively selected to participate in the study as respondents; these were the Branch Manager, Credit Officer, Debt Recovery Officer, and Finance Officer and hence the sample size was 36 Officers in the 9 MFIs. With the aid of SPSS version 21.0 and Excel software, quantitative results were tabulated and presented in the form of charts, bar graphs, and narratives. The study found out that debt collection policy, legal framework and internal control systems are statistically significant in influencing financial performance of selected MFIs at Nairobi City in Kenya. The study further established client appraisal had no statistically significant effect on financial performance of MFIs at Nairobi city in Kenya. The study found out that internal control systems had a significant effect on financial performance of MFIs in Nairobi city Kenya. The research recommends that all MFIs should have established debt collection Policy, adopt internal control system, closely monitor implementation of internal control systems and that the MFI Managers and the regulators should put more emphasis on compliance procedures.

In a separate study Kiplimo and Kalio (2014), established the Influence of Credit Risk Management Practices on Loan Performance of Microfinance Institutions in Baringo County. The objective of the study was to determine the client appraisal on loan performance of microfinance institutions in Baringo County. The descriptive research design methodology was employed based on a survey of Microfinance institutions in Baringo County. Since all branch managers and credit officers, were directly targeted in the study Census sampling technique was appropriate. Inferential and descriptive statistics was used in data analysis. The study findings indicated that there was a strong relationship between client appraisals and loan performance in Microfinance institutions. The study showed that an increase in client appraisal led to a rise in the performance of loans in MFIs in Baringo County.

Critique of Literature reviewed

In the study by Moranga Getii Kevin and Job Omagwa (2017), the nature of sampling procedures used by the researchers was not clear. We expected the researchers to highlight sampling procedures clearly. In addition, given that the researchers used descriptive design as their methodology as well as regression modelling, we expected hypothetical guidance right from the beginning. The study would have therefore been better understood by the readers.

In the study by Kevin and Omagwa (2017), the researcher could have used secondary data. Given that the variables of debt management were; debt collection policy, internal control systems, client appraisal and legal framework. The information could have been sourced from documentary analysis of the already existing data on debt policy, internal control mechanism, client appraisal and existing legal framework.

Separately, Kiplimo and Kalio (2014), used primary data collection instruments. The study variable was client appraisal. There was need to do documentary analysis to establish the existing client appraisal process as opposed to the use of questionnaires.

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