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Effect of Accounts Receivable on Financial Performance of Firms Funded By Government Venture Capital in Kenya.

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Abstract: *This study sought to establish the effect of accounts receivable management on financial performance of firms funded by Government venture capital in Kenya. The study's objective was to determine the effect of accounts receivable management on firms' financial performance and explore the moderating effect of political environment on a firm's financial performance. The target population comprised all firms (24) funded by government venture capital in Kenya. The study adopted a census approach because of the small number of firms. The study reviewed both theoretical and empirical literature on accounts receivable management. From the review of related literature, a comprehensive conceptual framework of argument of the relationship between accounts receivable management and firm financial performance was formulated. Based on the conceptual framework, a questionnaire was formulated and used to collect primary data for the independent variables while a record survey sheet was used to collect secondary data for the dependent variable. Out of 72 respondents, 51 responded, being 71%. Both descriptive and inferential analyses were done. Statistical package for social sciences (SPSS) version 20.0 was used as the statistical tool for analysis of the study. Analysis for variant (ANOVA) and regression analysis were used to test the hypothesis. The results show there is a positive relationship between accounts receivables and financial performance of firms funded by government venture capital in Kenya (0.038). Accounts receivable explain 25.7% of the financial performance of firms funded by government venture capital in Kenya while the variation of 74.3% is explained by other factors. The study recommend that managers in the firms funded by government venture capital should put in place good credit policies to enhance efficient management of accounts receivable thereby improve on their financial performance.*
Key Words*: Cash conversion cycle, accounts receivable period, financial performance*

I. Introduction

Public venture capital is one of the source of non-bank financing which is prevalent in developed financial market. Credit facilities remain the most important and powerful engine for economic growth. Credit facilities transforms the economic structure of countries from simple slow growing activities to more vibrant and industrializes economies. Business must ensure proper management of their accounts receivable to avoid to finding their liquidity under considerable strain and to remain profitable (Foulks, 2005). Effective accounts receivable management is important and strategic, it affects the financial performance of a firm and a firm's value. A firm's competency to synchronize cash inflows with cash outflows in formulating a cash flow management strategy is important to a firm's financial performance. The goal of accounts receivable management is to maximize shareholder wealth. Receivables are large investments in firm assets which are like capital budgeting projects measured in terms of their net present value (Emery et al 2004). Receivables stimulate sales because it allows customers to assess product quality before paying but on the other hand, debtors involve funds which an opportunity costs. Based on the characteristic of accounts receivable; the element of risk, economic value and futurity explains the basis and need for efficient management of receivables. Berry and Jarvis (2006) assert that a firm setting up a policy for determining the optimal amount of accounts receivable have to take into account the trade-off between the securing of sales and profits and the amount of opportunity cost and administrative costs of the increasing accounts receivable; the level of risk the firm is prepared to take when extending credit to the customer because the customer could default when payment is due and the investment in debt collection management.

Gill (2011) assert that the main objective of accounts receivable is to reach an optimal balance between cash flow management components. Cash flow management is the process of planning and controlling cash flow both into and out of a business, that is, cash flows within the business and cash balances held by a business at a point in time (Samilogu, 2008). Efficient accounts receivable management affords a firm improve on its profitability by reducing the transaction costs of raising funds in case of liquidity crisis (Ahmet, 2012).

Accounts receivable as a component of cash flow has a direct effect on the profitability of a business. Cash flow management refers to the management of movement of funds into and out of a business and involves the management of accounts payable, accounts receivables, inventory as well as the cash flow planning (Joshi,

2007). Efficient firms maintain an optimal level of cash flow that maximizes their value. Large inventories and generous credit policy may lead to high sales as well as reduce the risk of stock-out while at the same time stimulating sales (Lazaridis, 2005). Delaying payment of accounts payable to suppliers allow firms to access products or services and can be an inexpensive and flexible source of financing, but on the other hand, (Kaur, 2010) state that it can be expensive if a firm is offering discount for early payment while on the same token, uncollected accounts receivable can lead to cash inflow crisis.

Accounts receivable managmeent is a dynamic financial management process and its effectiveness is directly correlated with a firm's ability to realize its mission, goals and objectives (Sherman, 2010). Despite the role cash flow management plays, many firms have not implemented effective cash flow management practices and the results can be dire, Ahmet (2012). Even profitable firms can go backrupt if they fail to manage their accounts receivable effectively, partularly, if they operate in rapid-growth or seasonal industries (Prere, 2010). For a credit policy to be effective it should not be static but requires review periodically to incorporate changes in a firms strategic direction and risk tolerance as well as to ensure that the firm operate in line with competition to ensure sales and credit departments are benefiting (Eliots 2009). Szabo (2012) note that due to the speed in which technology is changing and the dynamics in business caused by changes in the internal and external environment, the ways in which businesses are conducted today differ significantly from yester years. The competitive nature of the business environment require firms to adjust their policies and strategies frequently for survival and growth (Kathleen, 2010). Although a credit policy ensures decision making process is logical and simplified it is based on pre-determined parameters at a historical period in time which may not hold at the current time (Venancio 2013). Filbeck and Krueger, (2005) argue that a credit policy being the most important medium of managing and regulating accounts receivables requires frequent reviewing to ensure a firm maintains optimal investment in accounts receivable while minimizing costs associated with credit and at the same time maximizing the benefits from accounts receivable.

Extending credit to customers is a decision based on the credit management and policy of a firm. Granting credit exists to facilitate sales. On the other hand, Al-Mwala (2012) state that sales are pointless without due payment and therefore the sales and accounts receivable functions must work together to achieve the objective of sales maximization within minimum length of time. Owalabi and Obida (2012) note that credit sales are a sign that firm is able to maximize its sales and improve its financial performance. According to Sushma (2007), an increase in the level of accounts receivables in a firm increases both the net working capital and the cost of holding and managing accounts receivable and both lead to a decrease in the value of the firm. Firms who pursue an increase in the accounts receivable to an optimal level increase their profitability resulting from the increased sales and market share.

Extension of Credit as stated by Gill, et al (2010) should only be on the basis of customer creditworthiness in order to minimize the level of default and bad debts. Weston & Copeland (205) state there are six C's of credit which credit managers should consider when extending credit: character, capacity capital, collateral, condition and contribution. They further assert that the six C's helps firms to decrease their default rate as they get to know their customers. Information on the C's can be obtained several sources including the firm's prior experience with the customers, financial statements for previous years, credit reporting agencies and even the customers financial institutions (Kalunda, 2012). As stated by Gitau et al. (2014), the purpose of credit control is to ensure that trade debts are recovered early enough before they become uncollectible and a loss to the business. According to Pandey (2008), average collection period determines the speed of payment by customers and delayed payment is a potential ground for bad debts which have a negative effect on a firm's financial performance. Many firms establish a credit period for their customers and offer discounts to encourage early payments. Gitau et al (2014) citing Chee and Smith (1999) assert that there are two forms of credit periods: the net terms which specifies that full payment is due within a certain period after delivery, for example, "net 30" means full payment is due 30 days after invoice and after that the buyer is in default; the two part terms which has three basic elements, discount percentage, discount period and effective due date, for example "2/10 net 30" would mean 2% discount for payment within 10 days and a net period ending on day 30 and thereafter if payment not received the buyer is in default. Longer credit periods are likely to stimulate sales while at the same time a firm forgoes the use of its funds for longer length of time and increases the potential for bad debts and losses. Gitau et al (2014) state that unless transactions occur instantaneously, payment arrangement is credit terms. As stated by Pandey (2008), a firm can shorten its credit period if customers are defaulting too frequently and bad debts are building up. However, through expanded sales, a firm will length credit period to increase its operating profit.

A centralized credit department enables a firm have well defined procedures to ensure a standard way of granting credit. Credit procedures are specific ways in which top management requires the credit department to achieve the best financial results for the firm (Dunn, 2009). Pandey (2008) state that credit procedures are the criteria used by a firm to decide on the type of customers to whom sales can be made on credit. Atkinson et al (2007) posit that credit procedures should include instructions on what data to be used for credit investigation and analysis process, provide information for data approval process, account relationships and instances for

management notification. Weston & Copeland (2009) state there are six C's of credit which credit managers should consider when extending credit: character, capacity capital, collateral, condition and contribution. They further assert that the six C's helps firms to decrease their default rate as they get to know their customers. Information on the C's can be obtained several sources including the firm's prior experience with the customers, financial statements for previous years, credit reporting agencies and even the customers financial institutions (Kalunda, 2012). Dunn (2009) assert that credit managers must apply the techniques of credit selection and standard for determining which customers should receive credit by applying the six C's propagated by Weston and Copeland (2009).

Dedication of debt collection resources ensure better and timely collection and few instances of bad debts. When sales are on credit, a monitoring system is important to avoid the potential build up to excessive levels of accounts receivable which would erode set profits (Maria 2014). Meyer et al (2006) advocate that firms should have rational and dedicated collection resource to categorize customers for future credit depending on their credit worthiness. Atkinson et al (2007) posit that credit procedures should include instructions on what data to be used for credit investigation and analysis process, provide information for data approval process, account relationships and instances for management notification. Maria (2014) relates dedication of debt collection to human factors establishing that dedicated resources ensured better collection and fewer instances of bad debts. Owonde (2013) provide that customer relationship officers in most firms act as the link between the firm and customers. They maintain close links which help in monitoring business activities of the customers and raising the red flag for management to take action before a debt can go bad and effect the firm's profits. Padachi (2006) state that a collection resource is a control process which ensures that trade debts are recovered early enough before they become un-collectable and therefore a loss to an organization.

Overdue accounts receivable is delayed payment by customers and is a potential ground for bad debts and subsequent low profitability. Although extension of Credit as stated by Gill, et al (2010) should only be on the basis of customers creditworthiness in order to minimize the level of default and bad debts, firms that use a lenient credit policy tend to give credit to customers on very liberal terms and standards that credit is granted for longer periods even to those customers whose credit worthiness is not well known (Krueger, 2005). Gitau et al. (2014), state that the purpose of credit control is to ensure that trade debts are recovered early enough before they become uncollectible and a loss to the business. In an attempt to pursue customers who do not pay on due dates, a firm may follow different procedures. Dunn (2009) state that a firm seeking to pursue overdue accounts may remind the debtor through a politely worded letter, a strongly worded letter, send a representative and eventually contemplate a legal action or writing off the debt altogether. Collection efforts may involve reminding the debtor through a demand note and if no response is received, progressive steps using tighter measures are taken (Pandey, 2008). Gitau et al (2014) assert that a creditor should use litigation as a last resort to collect a debt that is bad and when there is a major breakdown in the repayment agreement resulting in undue delays and legal action is required to effect collection. Finally a debt may be written off when the creditor feels that it is uncollectable. It is honorable to write off a bad debt from the books of accounts to give a true and fair view of the firm's financial position.

The purpose of this study was to determine the effect of accounts receivable on the financial performance of firms funded by government venture capital in Kenya. Both null and alternative hypothesis were tested:

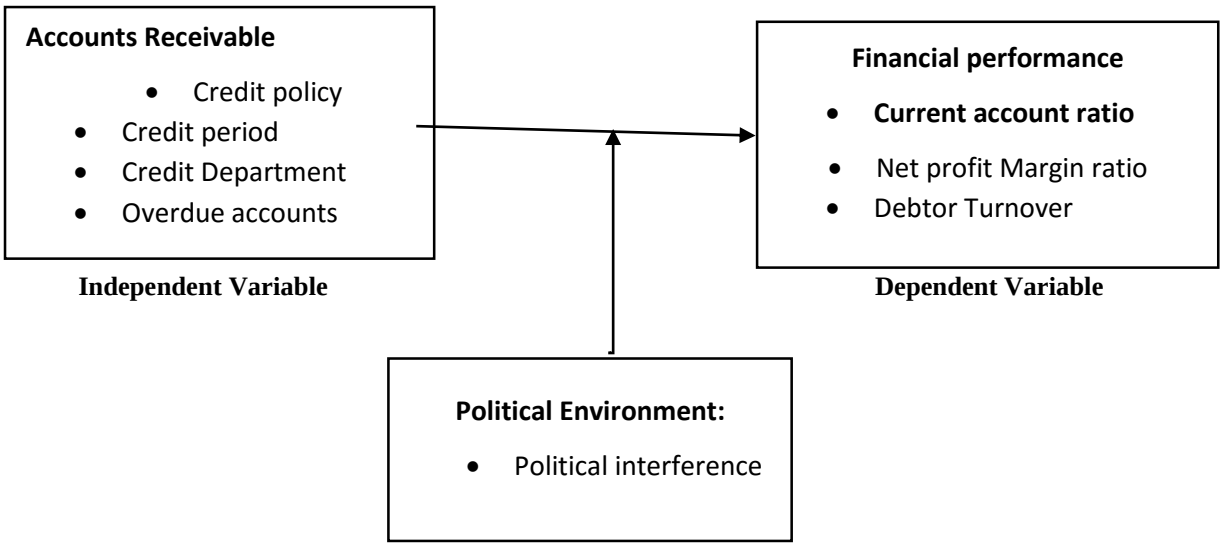
H_{o1}: There is no significant relationship between accounts receivable and financial performance of firm's funded by government venture capital in Kenya.

H_{11}:There is significant relationship between accounts receivable and financial performance of firm's funded by government venture capital in Kenya.

II. Conceptual Framework and Literature Review

Conceptual framework

A conceptual framework refers to a group of concepts which are systematically organized to provide a focus, a tool and rational for interpretation and integration of information and is usually achieved in pictorial illustrations (Njeru, 2015). The variables indicate the statistics that were related to this study



Literature Review

While a large number of studies examined working capital management on profitability of organization, less number directly examined the effect of cash flow management on the financial performance of an organization. Gill et al. (2010) state that managers can create profits for their firms if they maintain accounts receivables at optimal levels. Padachi (2006) in his study on relationship between working capital management and corporate profitability investigated a sample of 58 manufacturing firms, using panel data analysis for the period 1998-2003, using key variables of accounts receivable, inventories turnover, accounts payable days and cash conversion cycle, the regression result indicated that high investment in accounts receivable and inventories was associated with lower profitability. Lazaridis and Tryfonidis (2006) investigated the relationship between corporate profitability and working capital management using listed companies on the Athens Stock Exchange. They discovered a statistically significant relationship existed between profitability and the cash conversion cycle and concluded that business create profits for their companies by handling correctly and keeping each component of the cash conversion cycle (accounts receivable, accounts payable and inventory) to an optimal level. Deloof (2003) as cited by (Abuzayed, 2012) in his study of 1009 large Belgian non-financial firms for the period 1992-1996 found that the way working capital is managed had a significant impact on the profitability of businesses. Deloof (2003) study used accounts receivable, accounts payable, inventories and the cash conversion cycle as a comprehensive measure of working capital management and found a significant negative relation between operating income and the number of days accounts receivable, inventories and accounts payable. Deloof (2003) based on the study findings recommended that managers can increase corporate profitability by reducing the number of days accounts receivable and inventories turnover. The credit risk theory state that investors risk of loss, financial or otherwise, arise from a borrower who does not pay his or her dues as agreed in the contractual terms. Accounts receivable are credit in the provision of goods or services to a person or entity on agreed terms and conditions where payments are to be made later with or without interest. When the debtor does not pay on due date, the lender is exposed to credit risk which may in turn lead to default and bad debts (Nyunja, 2011). Mathuva (2009) examined the influence of working capital management components on corporate profitability by using a sample of 30 listed firms on the Nairobi Stock Exchange for the period 1993-2008. The findings of the study were that there exists a highly significant negative relationship between the time it takes for firms to collect cash from their customers and a highly significant positive relationship between the period taken to convert inventories into sales. Falope and Ajilore (2009) study using a sample of 50 Nigerian quoted non-financial firms for the period 1996-2005 found a significant negative relationship between net operating profitability and the average collection period, inventory turnover days, average payment period and cash conversion cycle. Falope and Ajilore (2009) findings were supported by the study by Raheman and Nasr (2007) on the effect of variables of working capital management on the net profitability of Pakistan firms listed on Karachi Stock Exchange for the period 1999-2004. The study by Baveld (2012) on 37 large firms in the Netherlands during the non-crisis period of 2004 to 2006 and during the financial crisis of 2008 to 2009 found a significant negative relation of accounts receivable on profitability, Gill et al (2010) study of 88 American firms listed on New York Exchange for the period 2005 to 2007 found a significant negative relation on accounts receivables and profitability, Laziridis and Tryfonidis (2006) study on 131 companies listed in the Athens Stock Exchange for the period 2001

– 2004 found a significant negative relation on accounts receivables on profitability, Garcia-Teruel and Martinez-Solano (2007) study on 8,872 Spanish SME's for the period 1996 to 2002 found a negative relation on accounts receivable on profitability, Mathuva (2010) study of 30 firms listed in the Nairobi stock Exchange for the period 1993 to 2008 found a negative relation on accounts receivable on profitability. Contradicting evidence is found in this study and the study by Sharma and Kumar (2011) on 263 non-financial BSE 500 firms listed at the Bombay Stock Exchange from 2000 to 2008 which found a significant positive relation of accounts receivable on profitability.

III. Methodology

The study used descriptive research design to establish the relationship between accounts receivables and financial performance. A census was used and all the 24 firms funded by government venture capital in Kenya through ICDC were studied. A structured questionnaire was used to collect data. Data was analyzed by use of the SPSS program. For reliability purposes of the tool, a reliability test was done. A Cronbach' alpha of 0.75 was established which was more than the 0.7 threshold advocated by Nunnaly and Berstein (1994). Factor analysis was done to ensure that all questions were relevant and made sense, a load of 0.4 was used as a benchmark. All the questions had a factor load of between 0.67 and 0.427. Descriptive analysis showed the percentages, means and standard deviation of different items in the study while quantitative analysis showed the Pearson correlation, ANOVA and regression analysis. Pearson correlation showed the degree of association between accounts receivable and financial performance.

IV. Analysis of Results

Table 1: Rate of Response

	Respondents	Percentage
Returned	51	71.9
Not returned	20	28.1
Total distributed	71	100

Table 1 shows that 71 questionnaires were administered to the Finance officers, operation officers and human resource officers of firms funded by government venture capital in Kenya. 51 questionnaires were returned which represented 71.9%. 20 questionnaires, representing 28.1% of the total number of questionnaires were not returned.

Table 2: Whether The Firm Has A Credit Policy

	Yes	No
Does the firm have a credit policy in place?	97.9%	2.1%

Table 2 shows that 97.9% of the respondents indicated yes to the question whether their firms had a credit policy in place, while only 2.1% of the respondents indicated no. Majority of the respondents were of the opinion that a credit policy has an influence on the financial performance of a firm

Table 3: Review of Credit polity

	Percentage (%)	No. of Respondents
Monthly	3.9	2
Quarterly	47	24
Half Yearly	19.6	10
Yearly	29.5	15
Total	100	51

Table 3 shows that 3.9% of the respondents indicated that that their firms reviewed their credit policy monthly, 47% indicated quarterly, 19.6% indicated half yearly while 29.5% indicated yearly. Majority of the firms acknowledged that the competitive nature of the business environment required them to adjust their strategies and policies frequently for survival and better financial performance.

Table 4: Credit to customers

	Yes	No
Does the firm give credit to customers?	93.3%	6.7%

Table 4 shows that 93.3% of the respondents indicated yes to the question whether their firm gave credit to their customers while only 6.7% indicated no. The study findings support credit extension by stating that credit period

whether from suppliers or granted to customers in most cases have a positive impact on profitability since the firms are able to maximize sales and profits.

Table 5: Credit period given to customers

	Percentage (%)	No of respondents
7 days	11.8	6
21 days	13.7	7
30 days	35.3	18
Over 31 days	39.2	20

Table 5 shows that 11.8% of the respondents indicated 7 days as the period their firms gave credit to its customers, while 13.7% indicated 21 day, 35.3% indicated 30 days while 39.2% indicated over 31 days. The findings imply that majority of the firms extended long credit period to have larger sales which would result in higher profitability.

Table 6: The firm has a credit department

	Frequency	Percent (%)	Valid Percent (%)	Cumulative Percent (%)
Yes	46	90.2	90.2	90.2
No	5	9.8	9.8	100.0
Total	51	100.0	100.0	

Table 6 shows that 46 of the respondents (90.2%) said yes to the statement that the firms has a credit department while only 5 ((9.8%) said no. This means that majority of the firms funded by government venture fund in Kenya have a credit department.

Table 7: the firm has a dedicated Debt Collection Resource

	Frequency	Percent (%)	Valid Percent (%)	Cumulative Percent (%)
Yes	32	62.7	62.7	62.7
No	19	37.3	37.3	37.3
Total	51	100.0	100.0	100.0

Table 7 shows that 62.7% of the respondents agreed to the statement that their firm had a dedicated debt collection resource while 37.3% said their firm did not have a dedicated debt collection resource.

Table 8: How the firm deals with overdue accounts

	Frequency	Percent	Valid Percent	Cumulative Percent
Sue the customer for recovery	23	45.1	45.1	45.1
Write-off	14	27.5	27.5	72.6
Engage auctioneers to recover debt	11	21.6	21.6	94.2
Other	3	5.8	5.8	100.0
Total	51	100.0	100.0	

Table 8 shows that 45.1% or 23 of the respondents rated customer suing as the most prevalent action taken by their firms on overdue accounts, 27.5% indicated write-off, 21.6% indicated engage auctioneers while 5.8% indicated other. Studies by Jack and Mathew (1994) cited by Duru (2014) advocated for active steps to avoid the entire process by employing good efficient working capital management which tries to minimize accounts receivables as much as possible. This study established that most of the firms funded by government venture capital in Kenya extend credit to their customers. Managers should take precautions to ensure these risks are mitigated and at the same time increase their credit sales which have a positive impact on profitability.

Correlation Analysis

Table 9: Correlation between Accounts Receivable and Financial Performance

		Financial Performance	Accounts Receivable
Financial performance	Pearson Correlation	1	.507
	Sig. (2-tailed)		.038

	N	17	17
Accounts Receivable	Pearson Correlation	.507	1
	Sig. (2-tailed)	.038	

Table 9 indicates that there is a positive significant linear relationship between accounts receivable and financial performance of firms funded by government venture capital in Kenya which relationship is illustrated by correlation coefficient of 0.507 at 0.05 significant level. Previous studies by Gill (2010), Huang (2007), Mathuva (2010) established that firms that maintain accounts payable at optimal levels are able to create and maximize their profits.

Regression Analysis

Table 10: Model summary for Accounts receivables

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.507	.257	.208	628.49040

a. Predictors: (Constant), Accounts Receivable

Table 10 provides the R and R^2 values which represent the sample correlation. R^2 indicate that accounts receivable explain 25.7% of the variation in financial performance of firms funded by government venture capital in Kenya while the other 74.3% of the variation is explained by other factors.

Table 11: ANOVA for Accounts receivable and financial performance

	Sum of squares	DF	Mean Square	F	Sig.
Regression	2053209.144	1	2053209.144	5.198	.038
Residual	5925002.765	15	395000.184		
Total	7978211.909	16			

Table 11, the regression model applied predicts the financial performance significantly well. An F statistic of 5.198 indicate that the model is significant and is supported by p Value of 0.038 < 0.05 meaning that the overall model is significant in the prediction of financial performance in firms funded by Government venture capital in Kenya.

Table 12: Prediction of Financial Performance from Accounts Receivable

	Coefficients				
	B	Std. Error	Beta	T	Sig.
(Constant)	635.156	279.630		2.271	.038
Accounts receivable	.699	.307	.507	2.280	.038

For the regression line to be significant, as shown by Table 12, the following alternative hypothesis has to be true: $H_0: \beta_1 = 0$: $H_1: \beta_1 \neq 0$,

Therefore the null hypothesis was rejected and the study concluded that the alternative hypothesis, $H_1 \neq 0$ which implies that accounts receivable has a significant relation on financial performance of firms funded by government venture capital in Kenya.

Table 12 show analysis of the regression model coefficients and established a positive beta co-efficient of 0.699 with a p-value =0.038 and a constant of 635.156 with a p-value = 0.038. Therefore both the constant and accounts receivable contribute significant to the model. To predict financial performance from accounts receivable, the model can provide the information. The regression equation is presented as: Financial performance = $635.156 + 0.699X_1 + \mathcal{E}$;

V Conclusion and recommendation

Majority of the firms funded by government venture capital in Kenya have sound accounts receivable management practices. However, there is more to be done in Kenya on the management of accounts receivables and especially in the area of management of overdue accounts as well as review and adherence to sound credit management policies. Managers can create value for their shareholders by reducing the number of days on accounts receivable to reasonable minimum Mathuva (2010). It is recommended that further studies be conducted

on other firms with an extended firm size. The scope can also be extended to other components of working capital management like accounts payable, inventory management and working capital levels.

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