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EFFECT OF CREDIT APPROVAL PROCESS ON ACCOUNT RECEIVABLES IN KENYA LITERATURE BUREAU (KLB)

[1*]Benard Odhiambo Obura, [2]Mr. John M. G. Kabiru and [3]Mr. Kennedy Nyabuto Ocharo
[1]Post Graduate Student,
Jomo Kenyatta University of Agriculture and Technology

[2]Lecturer,
Jomo Kenyatta University of Agriculture and Technology

[3]Lecturer,
Jomo Kenyatta University of Agriculture and Technology

***Corresponding author's Email: boobura@gmail.com**

ABSTRACT

Purpose of the study: Over the years the Kenya Literature Bureau (KLB) has experienced continued increase in uncollectible debts. This has forced KLB to write off huge debts every end year thus leaving very little or no surplus for expansion or improvement of her facility. In year 2007 and 2008 alone, KLB wrote off Kshs 125 million as uncollectible debts while in 2010/2011 financial year, KLB wrote off a total of Kshs 80 million as uncollectable debts. The purpose of this study was to determine the effect of credit approval process on Account Receivables in KLB.

Methodology: The research design was descriptive in nature and employed the survey method. Purposive sampling technique was adopted and a sample size of 90 employees of Kenya Literature Bureau was selected to participate in the case study by completing the questionnaire. Data collected was analyzed through cross tabulation of data variables coded on the study's questionnaire responses using SPSS computer package.

Results of the study: The study revealed that credit approval process plays an important role toward proper management of accounts receivables in KLB.

Conclusion and policy recommendation: The study recommends that Credit Approval Policies be reviewed regularly to ensure that approval levels are as dynamic as the business world is. To be relevant and worthwhile, a credit approval policy must be current, not out of date. A written

policy can be reviewed by senior management and either accepted or modified helping ensure that the credit department focuses on what the company considers vital.

Keywords: *Credit approval process, Account Receivables and Kenya Literature Bureau*

INTRODUCTION

Management of the Receivables asset is a complex task. It addresses the ramifications of practices and processes usually outside the span of control of the responsible manager. It requires balancing of opposing priorities. It involves business process, technological tools, staff skills, motivation, organizational culture, changing behavior of both customers and coworkers and flexibility to deal with changing external influences. The Receivables asset reflects the quality of the entire revenue cycle operation. If an error is made in taking an order, fulfilling it, invoicing it, applying customer payment, or if the customer is dissatisfied with the service, it will manifest itself as a past due Receivables (Greet, 1999).

Receivables represent the largest single liquid asset of most companies. On a good day, efficiently turning these Accounts into cash flow is a tough job. In the current business climate – with reduced sales potential and the threat of recession – Credit professionals are under increased pressure to productively manage this key responsibility. Effectively managing Account receivable is all about well-ordered processes from beginning to end. Yet, surveys have shown that only about half of all Credit departments have a written Credit policy in place and only one-quarter of those regularly review that policy (Ritz, 2008).

In the UK corporate sector more than 80% of daily business transactions are on Credit terms and Account Receivables constitute one of the main assets on corporate balance sheets (35% of total assets) (Summers & Wilson, 1997). As soon as trade debtors settle their accounts, cash flows into the company. At the same time, however, new sales generate new Account Receivables. Usually, the level of debtors thus remains constant when sales figures are stable, while it grows as sales figures increase (Grass, 1972). Although firms extending trade Credit heavily invest in Account Receivables, the resulting financial need is not the only reason why trade Credit decisions merit more careful attention.

A well organized Account Receivables financing management function is significant to the cash in-flow of any business. To have an effective Account Receivables financing function requires an investment of time, talent, reliance and business resources. Converting Receivables to cash is a challenging task. In many instances, businesses have not defined a procedure for expediting Receivables. Continuous investment in cutting edge technologies enables an organization to provide professional Account Receivables financing. For a company that sells on Credit, the Account Receivables financing portfolio is one of the largest assets. However, often Account Receivables management area of asset is not given due importance or care. It will be found that most of those companies do not have enough work forces to focus on this issue.

East African Literature Bureau (EALB's) mandate was mainly to promote a reading culture and eliminate illiteracy and ignorance, to promote local authorship in mother tongue, Kiswahili and English to publish and market books at affordable prices and to encourage academic writing of books and journals for higher learning. On the attainment of independence by the three East African states (namely Kenya, Uganda and Tanzania), EALB was passed into the hands of the East African Community, serving all the three countries alike. However, with the collapse of EAC in 1977, Kenya Literature Bureau (KLB) was re-constituted through an Act of Parliament in 1980, as a purely Kenyan parastatal (Kenya Literature Bureau, 2008/2011).

KLB's mandate has remained the same as originally mooted for EALB. However, with the introduction of the 8.4.4. Education system in 1985, KLB's activities have been skewed more towards responding to the huge demand for textbooks in both primary and secondary schools. In addition, the withdrawal of government subsidies in education from 1985 – 2002 thrust KLB into a commercial regime in order to survive. Furthermore, the liberalization of the textbook industry in the late 1990's thrust KLB into the fierce world of competition with the private sector (KLB, 2008/2011).

In spite of all these changes, KLB has managed to transform itself into a competitive, market-driven and customer-focused outfit. This is despite various statutory and structural limitations which its private sector competitors are free from. Currently, KLB is estimated to be amongst the top 3 publishers in Kenya (Strategic management research paper, 2010). With an increased number of companies running into financial difficulties, Credit management within a sales

organization is an important tool to manage the risk of loss of Receivables. Additionally offering unique Credit terms may be the only way to win a buyer from the competition. Therefore a company should not eliminate the Credit risk, but rather manage the risk. To make fast and efficient Credit decisions, a Credit manager needs internal and external Credit information, coming from different systems throughout the whole company (Edwards, 2004).

STATEMENT OF THE PROBLEM

The KLB's mission is to publish Quality Educational and knowledge materials at affordable prices, promote local authorship and provide shareholder value. KLB has entrenched itself in the printing segment to become one of the leading publishers and printers in the region. Over the years the KLB has experienced continued increase in uncollectible debts. This has forced KLB to write off huge debts every end year thus leaving very little or no surplus for expansion or improvement of her facility. In year 2007 and 2008 alone, KLB wrote off KES 125 million as uncollectible debts while in 2010/2011 financial year, KLB wrote off a total of KES80 million as uncollectable debts.

To address this problem, in 2007 KLB developed and implemented a Credit policy whose purpose was to put in place standards of offering Credit facilities to customers by setting up proper Credit management processes and practices implicit throughout KLB. The purpose of this study therefore, is to investigate the effect of credit approval process policy on the management of Account Receivables at KLB given no study has been conducted since then to prove whether there is any improvement in the management of Account Receivables as a result of the implementation of the credit approval process policy.

OBJECTIVE OF THE STUDY

To establish the effect of Credit approval Process on Account Receivables in Kenya Literature Bureau (KLB)

LITERATURE REVIEW

Constant Market Assessment and Innovation

About the only thing in business that is a constant, is change. As the world transforms at an unprecedented pace so have to the components that propel its engines. Thus a Credit policy that is written without an understanding of the market and ample room for change in it and the one that is not frequently revisited could become obsolete in matter of days. With the information-age revolution, knowledge-based activities are becoming increasingly important for existence. Hence, enhancing skill-sets and knowledge is an intangible component of a Credit policy (Martin, 2000).

Maintaining good Cash Inflows

Wells (2004) opines that for any business to be successful the most important factor is availability of ready cash and maintenance of a healthy cash flow. However, during day-to-day operation of business it is often found to be the most difficult task and every year a big percentage of the small businesses close down for lack of ready cash. Over time, the company's profits are of little value if they are not accompanied by a positive net cash flow. Sound Credit policies firmly administered can help increase cash inflow through timely collection of due Account (Wells, 2004).

Improves Overall Organizational Efficiency, Acts as a reference guide and creates Improved Credit Department Focus on Objectives and Goals

Credit strategy can promote administrative efficiency. The granting of Credit may be motivated by a desire to capture certain administrative efficiencies and thus reduce operating costs. Efficiencies available include: reducing number of invoices, reducing cash handling, reducing

numbers of shipments, reducing storage costs, and increasing sales volumes (Wells, 2004). New Credit department associates can quickly familiarize themselves with department procedures, expectations and visions (Martin, 2000). When initiating an employee into a corporation, it's ideal for the new hire to begin contributing as soon as possible. Start off by sharing the company's mission statement and core values. A Credit policy talks about the organization's structure, the industry and its competitors and outlines job and performance expectations.

Current Ratio

The current ratio is a simple but effective tool that is often used to get an accurate picture of the financial stability of a company. Essentially, the calculation of a current ratio only requires that access to two accurate pieces of information is present, that is, the total of current liabilities held by the company, as well as the value of current assets. By comparing the two figures and arriving at the current ratio for the company, it is possible to plan for future operations and determine ways to improve the overall condition of the business (Allott, 2008).

One of the most important facts that a current ratio will reveal is the current status of a company to honor short-term debt obligations. Generally, a company that is in good financial condition will have a high ratio of assets to liabilities. This means that the company will not anticipate any problems in being able to honor short-term debt that may have been acquired to enhance some portion of the production process or replace equipment. Companies tend to employ the current ratio strategy on a regular basis (Salek, 2005. In more volatile industries, organizations may choose to calculate a current ratio each billing period or at least every calendar quarter. For companies that are engaged in a relatively stable industry, they may find that a semi-annual current ratio works well. Of course, a current ratio can be calculated at any time, as long as a specific date for evaluating the status of both assets and liabilities is identified (Allott, 2008).

Effective training guide for new staff

The case for proactive decision making regarding credit strategy at the highest level in an organization is clear. Credit is potentially a powerful tool available to executives crafting an effective marketing strategy. If its potential is understood and used wisely, credit will promote

success in the most competitive circumstances. Conversely, those business leaders who accept credit passively, as a necessary chore, and leave it to meander through the enterprise without strategic direction, will ensure that credit adds little and will risk a credit-related disaster arising without warning (Wells, 2004).

All debt customers are pursued for overdue invoices although it is important to establish a contact/name/link with the customer to provide a one-stop customer service whether for debt collection or related enquiries. A good credit policy would stipulate that on a monthly basis statements are dispatched to all customers with outstanding invoices. By delivering a monthly statement the organization can promote the benefits of good customer care since Customers find it helpful in controlling and reconciling their client accounts. Monthly statements also bring to our customers attention any "misplaced" invoices that may have been overlooked and Enables the customer to make one single payment based on the Statement of Account rather than individual cheques for each invoice, thus cost saving to the customer.

Minimizes the Costs of Granting Credit

Credit approval is something that a business is likely to provide for its customers, whether those customers are primarily individual consumers or other businesses. Experts recommend that small businesses develop credit policies that are consistent with overall company goals. In other words, a company's approach toward extending credit should be as conservative as its approach toward other business activities (Wells, 2004). When developing credit policies, small businesses must consider the cost involved in granting credit and the impact allowing credit purchases will have on cash flow.

The decision about whether to grant credit to a certain customer must be evaluated on a case-by-case basis. Each small business that grapples with this issue needs to gather and evaluate financial information, decide whether to grant credit and if so how much, and communicate the decision to the customer in a timely manner. The goal is to form an assessment of the character, reputation, financial situation, and collateral circumstances of the applicant (Martin, 2000).

Strict Enforcement of Credit Limits

Cash is not given. It is not the passive, inevitable outcome of business endeavors. It does not arrive in the bank account willingly. Rather it has to be tracked, chased and captured. The Organization needs to control the process and there is always scope for improvement (Wells, 2004). According to Mason (2004), very few customers will pay to terms, whatever they are. Quite a large number of customers will take a fixed time beyond the nominal date to settle their account. They have for example, a cynical policy of taking an extra 30 days. If you specify seven days you will be paid after 37 days. If you say 30 days, you will be paid after 60 days. You will most certainly face the problem of some customers being unable or unwilling to make payments in a time acceptable to you. Normal collection procedures will fail and very firm action will have to be taken. Some of the possibilities are one or more of the following: cut off further supplies until payment has been made, use a collection agency, threaten legal action and then take it, close the account and refuse further business and write off the debt.

Mason (2004) further asserts that there is need to have a policy on who will decide to freeze customer Account and at what stage. He poses the question, Is the Credit controller authorized to make the decisions alone or should others be involved? Cutting off supplies may be devastating or it may not concern the buyer at all. Legal actions and the cutting off of supplies are the most common sanctions and they usually work. But there are others, such as publicity or reporting a late payer to their trade association or professional body. Very often the threat is all that is needed.

CONCEPTUAL FRAMEWORK

Independent variable **Dependent variable**

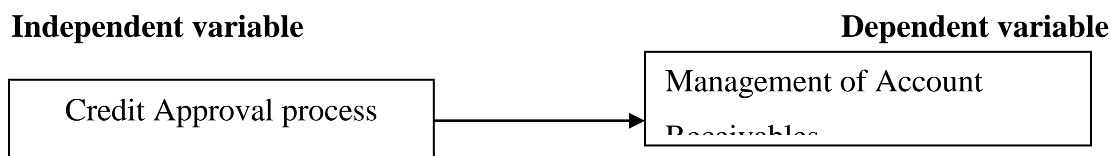

Figure 1: Conceptual Framework

Source: (Researcher, 2012)

RESEARCH METHODOLOGY

The research design was descriptive in nature and employed the survey method. Purposive sampling technique was adopted and a sample size of 90 employees of Kenya Literature Bureau was selected to participate in the case study by completing the questionnaire. Data collected was analyzed through cross tabulation of data variables coded on the study's questionnaire responses using SPSS.

RESULTS AND FINDINGS

Helps in Constant Market Assessment and Innovation

Findings in table 1 show that, 33% of the respondents agreed that Credit Approval Process helps in continuous market assessment and innovation, 39% were of a neutral view while 11% disagreed. Only 17% of the respondents were in strong agreement that The Credit Approval Process helps in Continuous Market Assessment and Innovation. This factor had an average rating 3.59 with a medium of 4 and a mode of 3 against a scale of 5 (strongly agree).

Table 1: Distribution of Respondents who felt that the Credit Approval Process helps in Continuous Market Assessment and Innovation

Response	Distribution Frequency	Percentage
Strongly Agree	14	17
Agree	28	33
Neutral	33	39
Disagree	9	11
Strongly disagree	0	0
Total	**84**	**100**

Aids in Strict enforcement of credit limits

Table 2, shows that 33% strongly agreed with this notion, 43% agreed, 20% were of a neutral view while only 4% disagreed. Majority of the Respondents (76%) agreed that Credit Approval Process is instrumental in strict enforcement of Credit Limits. This factor had an average rating of 4.07 with a medium and a mode of 4 respectively against a scale of 5 (strongly agree)

Table 2: Distribution of Respondents who felt that Credit Approval Process facilitates strict enforcement of credit limits

	Distribution	
Response	**Frequency**	**Percentage**
Strongly Agree	28	33
Agree	36	43
Neutral	17	20
Disagree	3	4
Strongly disagree	0	0
Total	**84**	**100**

Assists in maintaining good Cash inflows

Majority of the respondents agreed that Credit Approval Processes assist in maintaining good cash inflows. The factor had an average rating of 4.59 and a mean and a mode of 5 each against the scale of 5 (strongly agree). From the findings in table 3, majority of the respondents; 62% indicated that they strongly agreed with the opinion that Credit Policies assist in maintaining good cash inflows while 34% agreed with this opinion. Only 3% of the respondents were unsure on the effect of Credit Policies on cash inflows.

Table 3: Distribution of Respondents who felt Credit Policies assist in maintain good cash inflows

Response	Distribution Frequency	Percentage
Strongly Agree	18	62
Agree	10	34
Neutral	1	3
Disagree	0	0
Strongly disagree	0	0
Total	**29**	**100**

Improves overall Organization's efficiency

Findings in table 4 indicate that an overwhelming majority of respondents (96%) agreed that Credit Approval Processes helps improve overall organization's efficiency as follows: 62% of the respondents strongly agreed that Credit Approval Processes can improve overall organization's efficiency while another 34% agreed. On the contrary, no one disagreed and only 3% were neutral towards this notion. The average rating for this factor was 3.14 with a median of 3 and a mode of 4 against the scale of 5 (strongly agree)

Table 4: Distribution of Respondents who felt Credit Policies improved overall organization's efficiency

Response	Distribution Frequency	Percentage
Strongly Agree	41	49
Agree	38	45
Neutral	5	6
Disagree	0	0
Strongly disagree	0	0
Total	**84**	**100**

FINDINGS AND DISCUSSION

The study showed that sound credit policies firmly administered can assist in maintaining good cash inflows. This finding is in line with the literature review. Nearly all the respondents were in agreement that credit policies can help maintain good cash inflows. Over time, the company's profits are of little value if they are not accompanied by a positive net cash flow. Sound credit policies firmly administered can help increase cash inflow through timely collection of due accounts (Wells, 2004).

Further findings showed that there were mixed feelings on whether credit policies can improve overall organizational efficiency. This finding was somewhat in contradiction with literature by Ron Wells (2004) which states that Credit strategy can promote administrative efficiency. The granting of credit may be motivated by a desire to capture certain administrative efficiencies and thus reduce operating costs. Efficiencies available include: reducing number of invoices, reducing cash handling, reducing numbers of shipments, reducing storage costs, and increasing sales volumes (Wells, 2004).

CONCLUSION

The major challenge of a credit policy is the practical process of credit approval. Most organizations have dedicated sales order; manufacturing, accounting and ordering systems but very little around credit approvals and credit management. Attempting to implement a credit approval policy without systems to support it is a brave choice of decision but the fact is many credit approval policies are not implemented fully because the level of administration to effectively manage the Approval processes is too high.

RECOMMENDATIONS

The study recommends that Credit Approval Policies be reviewed regularly to ensure that approval levels are as dynamic as the business world is. To be relevant and worthwhile, a credit approval policy must be current, not out of date. A written policy can be reviewed by senior management and either accepted or modified helping ensure that the credit department focuses on what the company considers vital. Future research needs to be directed to Striking the right balance between higher sales and rational credit decision.

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