

**THE EFFECT OF CREDIT MANAGEMENT ON COMPANY PROFITABILITY  
CASE STUDY: SELECTED MANUFACTURING COMPANIES  
IN GAROWE PUNTLAND SOMALIA.**

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**A RESEARCH REPORT SUBMITTED TO THE SCHOOL OF BUSINES AND  
MANAGEMENT IN PARTIAL FULFILLMENT OF THE REQUIREMENT  
FOR THE AWARD OF A BACHELOR'S DEGREE OF  
BUSINESS ADMINISTRATION OF  
KAMPALA INTERNATIONAL  
UNIVERSITY**


**APRIL, 2011**

### **DECLARATION**

I, AHMED SHIRE AHMED declare that, this research report is my original academic work. It has not been submitted or presented for the award of Bachelor of Business Administration or any other award at any University or Other Institution of Higher Learning.

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### APPROVAL

I affirm that the approved has been given for this research report to be submitted to the school of business and management for the period fulfillment for the award of a bachelor's degree in Business Administration of Kampala International University.

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## **DEDICATION**

I dedicated my Bachelor Report to my Father Shire Ahmed, Mother Fatimo Ali, brothers & sisters, friends, and also to my uncle Hon. Mp Hasan Abshir, Brother Mahad Hasan and Aunt Mrs. Habiba Ahmed for their moral and financial support to my study in Uganda and encouraged me in all crucial situations. I am hearty thankful to all who helped in pursuing my education.

## **ACKNOWLEDGEMENT**

In the name of Allah, the Most Merciful the Most Gracious, I thank Allah the way he guided to me and give the ability, the knowledge and the wealth to write the full Thesis. Nonetheless this thesis was written for the help and the contribution of many people and I wish to put across my truthful appreciation for them for their magnificent help.

My heartfelt gratitude goes to my supervisor Mr. Ruteganda Michael whose support and advice enabled me accomplish this research successfully.

I also thank the management and staff of the AL – NACIIM and SAAFI for giving me a chance to carry out my research to their organizations, their parental support especially on giving me necessary information regarding this research is an unforgettable part that positively contributed to the success of this thesis.

A vote of thanks also goes to my family for their moral, spiritual and financial support during my period of study. Without their continued support, this may have not been achieved. My love for them endures for a life time.

I also appreciate to Mr. Abshir Mohamed Abshir, Abdullahi Ahmed, Eng Bashir Hussein, Abdirizak Qawle, Abdullahi Kabayare and other friends, colleagues who shared very attractive and unexpected time, which encouraged me and participated to complete my graduation thesis.

Allah blesses you all.

## **ABSTRACT**

The study investigated the relationship between the credit management and company profitability in selected manufacturing companies in Garowe Puntland, Somalia with the objectives of determining the level of credit management in selected manufacturing companies in Garowe Puntland Somalia, to determine the level of profitability in selected manufacturing companies in Garowe Puntland Somalia and to establish the a relationship between the level credit management and level of profitability in selected manufacturing companies in Garowe Puntland Somalia.

The study used a descriptive correlation quantitative design focused on two (2) manufacturing companies in Garowe Puntland Somalia consisting of a total population of 40 company staff consisting of finance managers and customers. A sample of 36 respondents was selected using simple random technique. The data collection method used was questionnaire. Data analysis techniques of frequency, percentages, mean and correlation analyses were used as found appropriate.

The study found that the companies controls credit management through proper procedure by applying effective credit policies, credit terms, credit limits, credit standards credit period, credit discounts, and collection procedure, The findings showed that the most respondents agreed that credit management process plays great role the collection of sales revenue and if this system is poor or weak, company will not be able to collect its overdue accounts effectively and efficiently and the study found that there is a significant relationship between credit management and profitability. The findings indicated the relationship between credit management and profitability is weak positive correlation which means there is a relationship between these two variables but it is not strong. Therefore the Null hypothesis was rejected.

The study recommended that the finance manager should maintain that accounts credit management model that the firm uses currently and also should improve the risk management model which is currently weak, The finance manager should supervise

whether credit terms, credit limits, credit period are clear stated both informally and formally. Because as Somalis, we are oral society, so, the finance manger should closely consider that, The finance managers should come up with other strategies to satisfy customers about model of managing accounts receivable because as table 4.5 reveals that the customers are dissatisfied how they accounts receivable handled, offered. But as accountants our concern is not that (customers satisfaction), our concern is level of profit being generated by the firm and The finance manager should main and update as environment changes the technique and tools of billing can collection procedure that the firm uses currently because they are strong as the respondents agreed.

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# **CHAPTER ONE**

## **INTRODUCTION**

### **1.0 Introduction**

This chapter present and describes the background of the study, statement of the problem, purpose of the study, research objectives, research questions, the scope of the study and the significance of the study.

### **1.1 Background of the Study**

Puntland is a region in northeastern Somalia, centered on Garowe in the Nugal province. Its leaders declared the territory an autonomous state in 1998. Puntland is bordered by Somaliland to its west, the Gulf of Aden in the north, the Indian Ocean in the southeast, the central Galmudug region of Somalia in the south, and Ethiopia in the southwest. A third of Somalia's population lives in the territory, which contains about a third of the nation's geographical area.

In addition to that, there are many manufacturing companies in Puntland which sell different products and services; Al-NACIIM and SAAFI manufacturing company, they are of those manufacturing companies in the region and they produce different fruit juices for instance Mango, Pineapple, and apple. They are of the leading pure fruit juice brands in the country; it was established around 2000 by a group of people.

However, these manufacturing company experiences credit problem nowadays, because around 60%-70% of their products are based on credit (survey of Puntland chamber of commerce, 2006).

Managing credit particularly accounts receivable effectively and efficiency way is one of the most difficulty tasks under the managers, because accounts

receivable is the second broadest part of company's assets after Cash. Managing these accounts effectively will contribute to the organization to gain high profitability. Secondly, managing these accounts need to set up effective credit policies, collection procedures, and effective way to recognize bad debt expenses.

Nowadays, markets for manufactured companies have become very competitive and many managers used credit grant as marketing strategy though they do not assess effectively the effect of this grant to the organizational profitability.

According to Weygandt, Kieso, and Kell(1996), defined the term "receivables" the amounts due from individuals and other companies. Receivables are claims that are expected to be collected in cash. Therefore, receivables are frequently classified as:

Accounts receivable are amounts owed by a customer on account. They are from the sale of goods and services. These receivables generally are expected to be collected within 30 to 60 days, and they are the most significant type of claim held by a company.

Notes receivable represent claims for which formal instrument of credit are issued as evidence of the debt. The credit instrument normally requires the debtor to pay interest and extend for time periods of 60 to 90 days or longer.

Trade receivables are notes and accounts receivables that result from sales transactions.

Other receivables include nontrade receivables such as interest receivable, loans to company officers, advances to employees, and income taxes refundable. These are unusual; therefore, they are generally classified and reported as separate items in the balance sheet.

However, the researcher will research on one of the receivables types mentioned above called "**Accounts receivable**" because these they represent one of the largest most liquid assets that a company may hold.

In addition, the overall goal of every business enterprise is to earn profit, and those businesses use measurement that indicates the profitability in the firm. The first one is profit margin which tells decision makers how much profit is generated or how much loss is incurred (Brock, Palmer, & price, 1990).

The second one is return on sales which indicates how much profit is being produced per dollar of sales. As with many ratios, it is best to compare a company's ROS (return on investment) over time to look for trends, and compare it to other companies in the industry. An increasing ROS indicates the company is growing more efficient, while a decreasing ROS could signal looming financial troubles. And the final one is return on equity which indicates the amount of net income returned as a percentage of shareholders equity (Finche, 2003). Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

On the other hand, whenever a business enterprise makes business transactions which have monetary value could be cash based or credit based, so accounts receivable plays a great role in the business and deserves to be managed effectively.

According to Roberto, Short, and Patricia (2001) credit management (Managing accounts receivable) is the process of establishing an effective system for credit policy, credit risk management, credit risk procedure, and recognition bad debt expense". Credit policy is the process of establishing and defining under what conditions you will extend credit, how much credit you'll extend, and to whom. Decide whether to accept checks and credit cards, how you will investigate new customers before extending credit, if you will require your customers to pay

deposits before delivering goods or services, and if you will charge interest on late accounts.

And like wise, credit risk management is a process to assess the credit worthiness of the buyer and then come up with possible alternatives to manage these risks.

Therefore, if there is no effective credit policy, and credit risk management, it means that the enterprise is not investigating the worthiness of the buyer, not credit limit, and this will add more risk sales of the enterprise which it was sold on credit, so, this risk will result in loss which will reduce the profit of the enterprise over particular period of time.

Secondly, if the credit collection procedure is weak, the period outstanding the amount of credit will increase and this means that there is no immediate cash collection, and if there is no immediate cash collection there is no purchase of goods.

## **1.2 Statement of the Problem**

Every manufacturing company needs to generate profit. To be able to generate this profit, they need to sell their products on both cash and credit bases so as to attract customers and get good market share from their rivals. Offering products on credit base to customers needs an effective credit system management that allows the firm to collect its accounts due on time and not inherit risk from the buyer. To get early payments, the seller needs to offer discount for his credit products, so, this is one of the credit costs which reduces the firm's profitability.

In Puntland, like many other regions, manufacturing companies experience tough competition from their rivals. Due to the tough competition in the market,



manufacturing companies need to sell their products both on cash bases and credit bases and these manufacturing company does not has an effective credit system that allows the firm to collect its accounts due on time and not inherit risk from the buyer. It is still using the traditional credit based system (Puntland chamber of commerce, 2009).

In view of this discrepancy, there is need to establish the kind of relationship that exists between the credit management and the firm's profitability.

Therefore, the researcher endeavored to determine the effects of accounts credit management on profitability in selected manufacturing companies.

### **1.3 Purpose of the Study**

The purpose of this study was to determine how accounts credit management affects the profitability in selected manufacturing companies in Garowe Puntland Somalia.

### **1.4 Research Objectives**

1. To determine the profile of the respondent in terms of: Age, Gender, and Education level.
2. To identify the level of credit management used in selected manufacturing companies in Garowe Puntland Somalia.
3. To determine the level of profitability in selected manufacturing companies in Garowe Puntland Somalia.
4. To establish a relationship between the level credit management and level of profitability in selected manufacturing companies in Garowe Puntland Somalia.

## **1.5 Research Questions**

1. What is the profile of the respondents is in terms of: Age, Gender, and Education?
2. What is the level of credit management in selected manufacturing companies in Garowe Puntland Somalia?
3. What is the level of profitability in selected manufacturing companies in Garowe Puntland Somalia?
4. Is there a significant relationship between the level of credit management and level of profitability in selected manufacturing companies in Garowe Puntland Somalia?

## **1.6 Scope of the Study**

### **1.6.1 Content scope**

The research study emphasized on credit management used in selected manufacturing companies in Garowe Puntland Somalia with considerations on credit policy, credit risk management and billing and collection procedure, and how they have influenced the company profitability.

### **1.6.2 Geographical Scope**

The study was carried out in selected manufacturing companies in Garowe Puntland Somalia. Al – NACIIM and SAAFI both located in Garowe City in Puntland State which is a semi autonomous state of Somalia.

### **1.6.3 Time scope**

The study was covered the period starting from January, 2011 to May, 2011.

## **1.7 Significance of the Study**

- This study benefits the managers of any manufacturing company who was experiencing nowadays credit system problem and improving their understanding towards the effects of credit management on firm's profitability.
- The study highlights how effective credit management will improve the profitability level and even the components of credit system.
- The study adds some knowledge to the already existing facts about effects of credit management on firm's profitability to those researchers who are interested in credit management for further research.
- The research will lead to the generation of ideas for better understanding of the relationship between accounts receivable management and profitability.

## **1.9 Operational definitions of Key terms**

### Credit management

It is characterizes by credit policy, credit risk management, billing and credit collection procedure.

### Credit Policy

Credit policy is guideline addressing how accompany evaluates potential customers who wish to buy on credit.

### Credit Risk Management

Credit risk management is a continuous process of creating transparency and risk mitigation that can face the firm, and assessing the credit worthiness of buyer.

### Billing and collection procedure

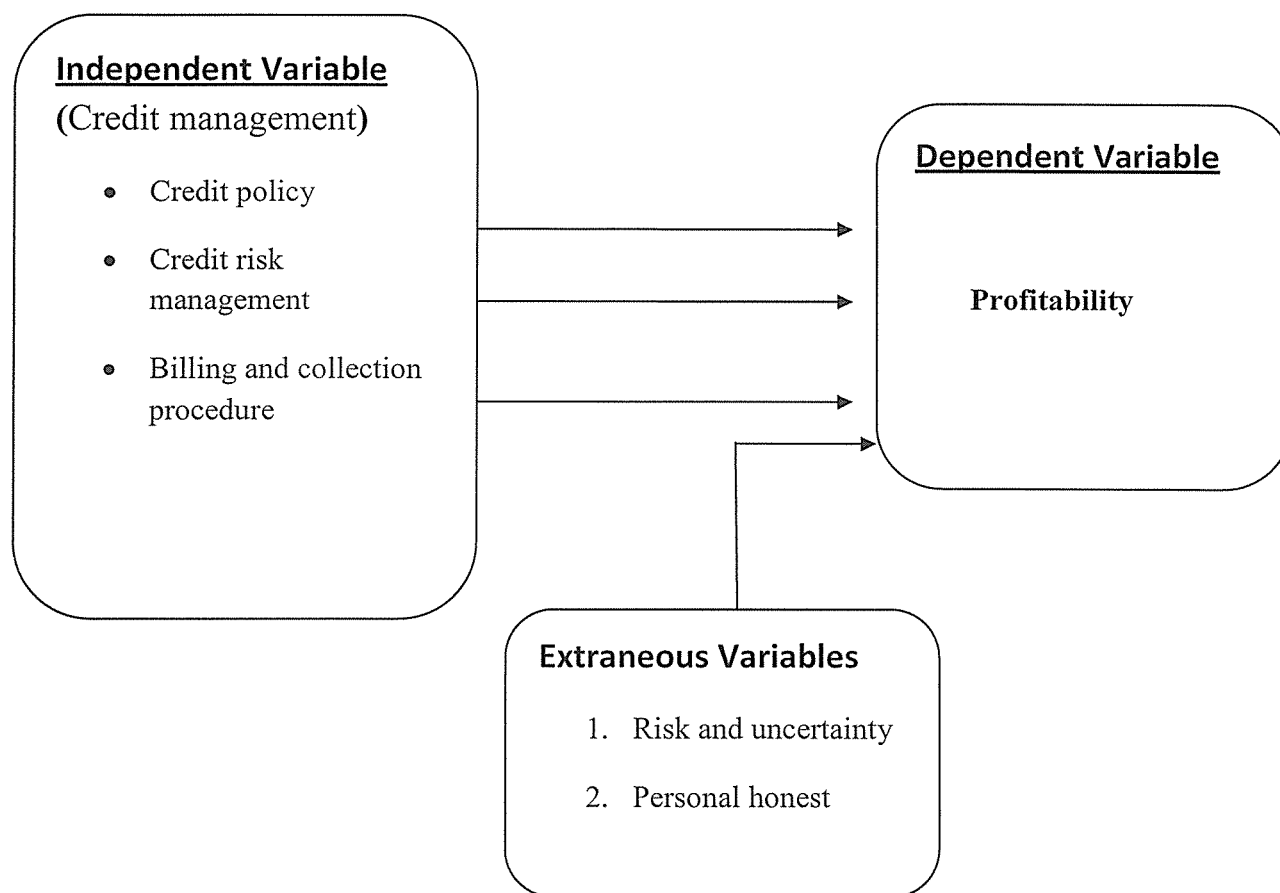
Collection procedure is a detailed statement of steps to be taken regarding when and how the past-due amounts are to be collected. Collection procedure is laid down usually in the credit policy.

### Profitability

It is the excess of revenue over expenses. Expenses can be simply broken down into many categories and the most well known ones are CGS (cost of goods sold), salaries and wages, allowances, tax, overheads, direct costs and indirect costs and etc, while revenue is from sales of goods, service fees and any other earnings.

**Fig. I**

**1.10 Conceptual Framework**



**Source: Developed by the researcher.**

## **CHAPTET TWO**

### **REVIEW OF RELATED LITERATURE**

#### **2.0 Introduction**

This chapter presents a review of related literature based on previous studies and what other authorities world over and in different industries have observed on the study variables. The literature review is done with a view of throwing more light on the study problem and identifying literature gaps. The first section presents related literature on accounts receivable management. This is followed by related literature on profitability, the relationship between accounts receivable management and profitability.

#### **2.1 Over view of Accounts receivable management**

Outstanding accounts represent a high proportion of capital employed. A company's debtors are an investment - you only earn the profit when the sale is paid for - and so, as with all investments, you must assess the risk before taking the plunge and accepting a new customer. In other words, is the new customer a good bet? People who do not pay you promptly are taking unauthorized interest-free credit at your expense (and very much so, if you are paying for overdraft facilities or loans that you would not otherwise need).

Correctly assessing the risk of doing business with someone on credit terms and making sure you are paid on time can make the difference between success and failure, particularly for a small business.

In addition to that, Accounts receivable are amounts owed by a customer on account. They are from the sale of goods and services. These receivables generally are expected to be collected with in agreed period of time, and they are the most significant type of claim held by a company.

To manage accounts receivable effectively, you need to analyze the credit worthiness of your buyer. The sources of information on credit worthiness of the buyer are Business references, Bank references, Credit agencies, Chambers of commerce, Employers and Credit application forms.

According to smith (1980), working capital management particularly cash and accounts receivable has great effect on the profitability of the firm and same time reduction of firm's risk.

## **2.2 Objectives of accounts receivable management**

Objectives of accounts receivable are creating, preserving, and collecting accounts receivable, establishing and communicating credit policies, Evaluation of customers and setting credit lines, Ensuring prompt and accurate billing, Maintaining up-to-date records of accounts receivables, and Initiating collection procedures on overdue accounts. Without these objectives, account receivable management model can not be implemented.

### Guidelines for managing accounts receivable

1. Establishing terms of sales
2. Conducting credit analysis
3. Lying down strong credit policy
4. Lying down effective and strong credit policies and procedure

## **2.3 Elements of effective accounts receivable management**

Every system in management has its own elements which assure its efficiencies and effectiveness, so, credit management also has its own elements which do that function and they are:

1. Credit policy
2. Credit risk management
3. Collection policy and procedure

## **2.4 Credit Policy**

Credit policy is guideline addressing how accompany evaluates potential customers who wish to buy on credit (Grove, 2000). Writing an effective Credit Policy begins with an understanding of the financial exposure that you or your business can endure and the amount of your working capital that you would be willing to risk, or call it 'invest' in your customers.

### **2.4.1 Components of Credit Policy**

Components of credit policy are those which guide establishing an effective credit system hat will allow the firm to collect its outstanding amounts in time. In addition the components of credit policy are as follows:

#### **2.4.1.1 Credit Limit**

A credit limit is one of the components of credit policy set by the authorities body for controlling the amount that a borrower could take as credit and it is the maximum amount of credit that a financial institution or other lender will extend to a debtor for a particular line of credit (Wikipedia, 2008). This limit is based on a variety of factors ranging from an individual's ability to make interest payments, an organization's cash flow and/or ability to repay the principal, to the



credit standards employed by the lender. A credit limit is also based on the borrower's recoverable assets in the event of default.

According to Grove (2005) "*Credit Limits* are threshold that a company (creditor) will allow its customers to owe at any one time without having to go back and review their credit file. Credit Limit is the maximum amount that a firm is willing to risk in an account.

Credit Limits helps the creditor in the following ways:

- a. It frees up valuable time for other credit management tasks
- b. It speeds up the sales process
- c. It reduces risk and improves collection activity and efforts.

#### **2.4.1.2 Credit Analysis**

Credit analysis is the process of determining the probability that customers will or will not pay his/her obligation (Bearly--). In credit analysis process, it is process to analyze the creditworthiness of the buyer by using the 5'C of credits as follows:

- Collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan. The collateral serves as protection for a lender against a borrower's risk of default - that is, any borrower failing to pay the principal and interest under the terms of a loan obligation. If a borrower does default on a loan (due to insolvency or other event), that borrower forfeits (gives up) the property pledged as collateral - and the lender then becomes the owner of the collateral (Riter, 2001).
- Condition is the relevant economic conditions which surround you when you are granting credit.
- Character is the applicant's willingness to pay the bill when they become due.

- Capital is the financial resources obtained from financial records that a company may have in order to deal with its debt. Many a time's credit analysts would make this portion of the credit analysis the most important one. Weight is given on Balance Sheet items and components like Working Capital, Net Worth and Cash Flow.
- Capacity is the ability that borrower can the pay the obligation.

#### **2.4.1.3 Price Discounts**

Price discounts are reductions to a basic price of goods or services. They can occur anywhere in the distribution channel, modifying either the manufacturer's list price (determined by the manufacturer and often printed on the package), the retail price (set by the retailer and often attached to the product with a sticker), or the list price (which is quoted to a potential buyer, usually in written form). The market price (also called effective price) is the amount actually paid. The purpose of discounts is to increase short-term sales, move out-of-date stock, reward valuable customers, and encourage distribution channel members to perform a function, or otherwise reward behaviors that benefit the discount issuer. Some discounts and allowances are forms of sales promotion (Wikipedia, 2008).

### **2.5 Credit Risk Management**

First, risk can be defined as the combination of the probability of an event and its consequences (ISO/IEC Guide 73). In all types of undertaking, there is the potential for events and consequences that constitute opportunities for benefit (upside) or threats to success (downside).

According to Pyle (1997) a risk may be defined as reduction in firm value due to changes in business environment.

Secondly, the major sources of risks are identified as follows:

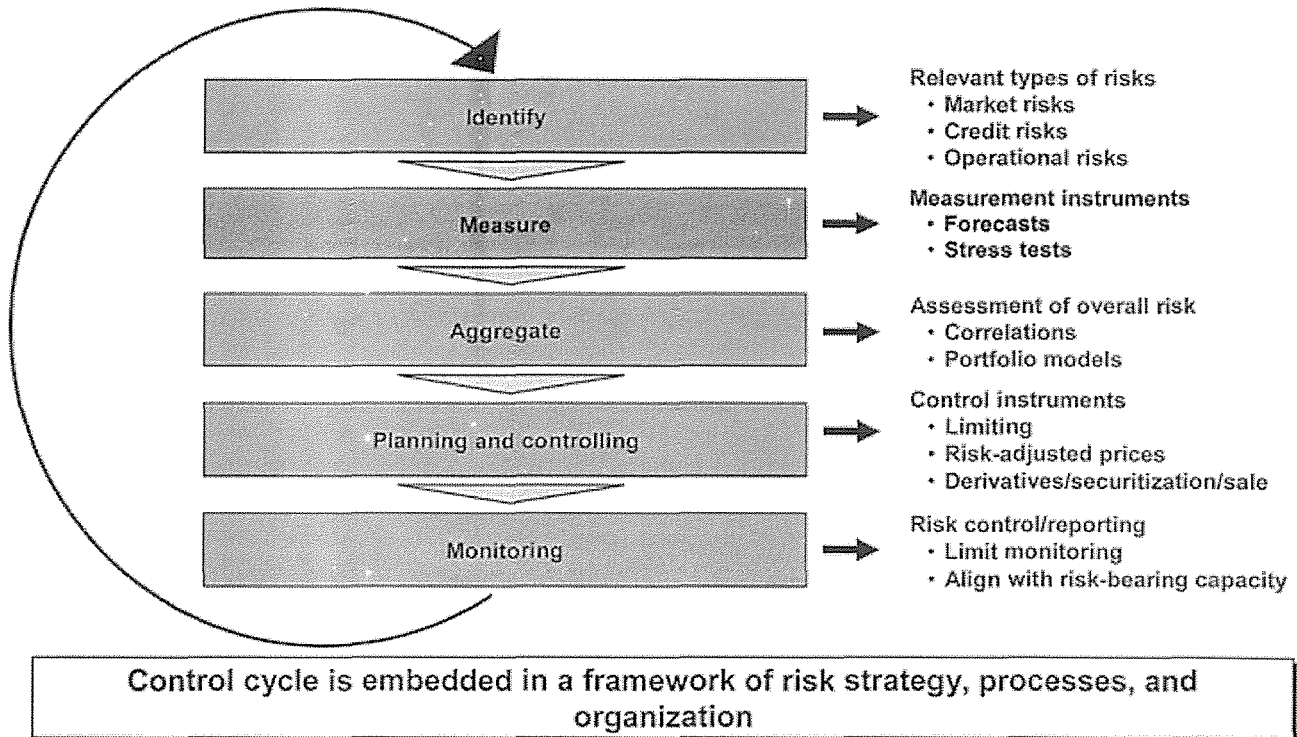
- Market risk: it is the change in net asset value due to changes in underlying economic factors such as interest rates, exchange rates, and equity and community prices.
- Credit risk: it is the change in net asset value due to changes the perceived of counterparties to meet their contractual agreements.
- Operation risk: it is the results from cost incurred through mistakes made in carrying out transactions such as settlement failures, failures to meet regulatory requirement, and untimely collections.
- Performance risk: it encompasses losses resulting from the failure to properly monitor employees or to use appropriate methods (including "model risk").

In addition to that, credit risk management as mentioned above is the change in net asset value due to changes the perceived of counterparties to meet their contractual agreements.

However, credit risk management is a continuous process of creating transparency and risk mitigation that can face the firm, and assessing the credit worthiness of buyer. Credit risk management has control cycle of risk management as mentioned below so as manage the risk and prevent the firm to inherit a risk from the third party.

## Risk Management Is a Continuous Process of Creating Transparency and Risk Mitigation

Control cycle of risk management



Source: (Bessis & Joel 2002).

Fig. II

As mentioned above, credit risk management has control cycle to be taken when ever the firm is granting credit to the third party so as to assess the potential risks that a firm can face. Accordig to Bessis and Joel (2002) credit risk control cycle has the following steps to be taken:

- The credit risk manager should identify the possible losses that the firm will encounter if it grants credit portfolio. Potential losses in the credit business can be divided into:
  - expected losses
  - un expected losses
- The credit risk manager measure and aggregate the potential risk by using forecast, stress tests and correlation and portfolio model respectively.

- The credit risk manager should plan and control the risks that will face if it grants credit portfolio by using risk adjusted prices.

## **2.6 Billing and Credit Collection Procedure**

Collection procedure is a detailed statement of steps to be taken regarding when and how the past-due amounts are to be collected. Collection procedure is laid down usually in the credit policy.

If there is a strong and effective system for collection of over due accounts, the amount of cash on hand and sales revenue will be increased and this will have a great impact on the profitability level and vice verse. Before you start to collect the over due accounts, you should know your self which means if you are not physically and mentally prepare to make that phone call, it will be waste of time and phone call. Emotions can be very easily read over the phone. So be eager to collect the money. After all it is your money (Grover, 2005)!

Secondly, ask questions to your customer because questions convey to your customer that you are concerned. Questions also provide you important information for leading the discussion and controlling it. Questions also yield information or reference material for future reference. Ask open ended questions and when the conversation requires it ask leading questions. If time is being wasted then perhaps start closing with close-ended questions. Keep control!

### **2.6.1 Collection Policy**

An effective collections policy requires some kind of formal system that ensures overdue accounts get paid. Letting late payments languish can disrupt cash flow and harm your company's chances of success.

- **Second collection phone call:** The account is now 30-40 days past due. Be polite yet firm, and ask for full immediate payment. Work to resolve payment problems. If the debtor cannot pay immediately, get him or her to commit to a payment date.
- **Second collection letter:** Now is the time to communicate the seriousness of the delinquency. This letter should demand immediate payment, and discuss the short-term consequences of failure to pay. Send this letter – and any correspondence that follows – via certified mail or overnight mail to give you a record that it was received.
- **Final collection letter:** The tone is now stern and demanding. Use this letter to confirm what was agreed upon in the last call and demand payment. State that if payment is not received by the agreed-upon date, you will turn the account over to a collection agency.

On the other hand, billing is the process of sending a bill (also called an invoice or accounts receivable) to customers for goods or services is called billing. The bill may be attached to the goods or forwarded separately (Wikipedia, 2009).

In addition to that, you can speed up receivables and avoid late payment problems by developing an effective billing plan and this plan increases or increments the level of profitability in the firm by increasing sales revenue.

### 2.6.3 Billing Process

1. **Create an effective invoice:** Make sure that your invoices are clear, accurate, detailed and easy to decipher. Each one should include the amount due; a purchase order number; customer name and address; and your business' name, address, and ID number. You should also include the name and phone number of a person in your company to contact if there are any questions. If possible, itemize the charges. It is harder to

contest a bill that is itemized, and if there is a dispute over one of the charges, you can legitimately ask to be paid for the uncontested, itemized charges. Invoices should also contain a clause instructing the customer to contact you if there are any problems with your services, and a clear outline of late charges (Grover, 2000).

2. **Mail invoices promptly:** the sooner you get invoices out; the sooner payments will come in. Some small businesses send invoices out monthly, but this is a mistake since it can delay some receivables by two to three weeks. Instead, try to send invoices within a day or two of delivery of your product or completion of a project.
3. **Bill the right person:** Sending a bill to the wrong person can push payment off as much as 30 or 60 days as it gets routed around a company. Talk directly with your client and ask to whom you should send your bill. If the bill is going to someone other than your day-to-day contact, call and introduce yourself before you put the bill in the mail. If you are sending a bill to your client's bookkeeper or accounting department, copy your client as well and follow with a phone call.
4. **Follow up:** It is easy for a bookkeeper to ignore an invoice if there are no follow up phone calls to check on its status. A quick check-in can confirm that your invoice was received & processed.

## 2.7 Profitability

The second variable of this study is Profitability. Profit is simply the excess of revenue over expenses. Expenses can be simply broken down into many categories and the most well known ones are CGS (cost of goods sold), salaries and wages, allowances, tax, overheads, direct costs and indirect costs and etc, while revenue is from sales of goods, service fees and any other earnings.

In accounting, profit is the difference between price and the costs of bringing to market whatever it is that is accounted as an enterprise (whether by harvest, extraction, manufacture, or purchase) in terms of the component costs of delivered goods and/or services and any operating or other expenses.

In addition to that, there are words which can be used as substitute to profit e.g. earnings, profit and income.

Gross profit equals sales revenue less Cost of Goods Sold (COGS), thus removing only the part of expenses that can be traced directly to the production of the goods. Gross profit still includes general (overhead) expenses like R&D, S&M, G&A, also interest expense, taxes and extraordinary items.

Operating profit equals gross profit less all operating expenses. This is the surplus generated by operations. It is also known as Earnings Before Interest and Taxes EBIT, Operating Profit Before Interest and Taxes OPBIT or simply Profit Before Interest and Taxes PBIT.

(Net) Profit Before Tax PBT equals operating profit less interest expense (but before taxes). It is also known as Earnings Before Tax EBT, Net operating income before taxes or simply Pretax Income.

Net profit equals Profit After Tax (unless some distinction about the treatment of extraordinary expenses is made). In the US the term Net Income is commonly used.

### **2.7.1 How to analyze profitability**

Profitability can be analyzed through ratio analysis.

Ratio analysis is a process that enables the analyst to compare items on a single financial statement or to examine the relationships between items on two financial statements. It also provides relative measures of the firm's conditions



and performance. After calculating ratios for each year's financial data, the analyst can then examine trends for the company across years. Since ratios adjust for size, using this analytical tool facilitates intercompany as well as intra company comparisons (business encyclopedia, 2009).

When using the financial ratios, a financial analyst makes two types of comparisons:

(1) *Industry comparison*. The ratios of a firm are compared with those of similar firms or with industry averages or norms to determine how the company is faring/managing relative to its competitors.

(2) *Trend analysis*. A firm's present ratio is compared with its past and expected future ratios to determine whether the company's financial condition is improving or deteriorating over time.

However, ratios that are used to analyze the profitability of the firm are as follows:

1. Profitability Ratios
2. Efficiency Ratios
3. Liquidity Ratios

Thought, ratios encompasses many different types of ratios but in profitability analyzes, we will use these above mentioned ratios.

### **2.7.2 Profitability ratios (Operating ratio)**

Profitability ratios are used to measure the firm's return on its investment (**Brealey, Myers, & Marcus, 2004**). Secondly, it measures the firm's use of its assets and control of its expenses to generate an acceptable rate of return.

There are many kinds of ratios under classification of ratios. The most well-known ones are as follows:

#### **2.7.2.1 Profit margin**

Profit margin measures the percentage of each sales dollar, on average, that represents profit. It is computed as follows:

$$\frac{\text{Operating Income}}{\text{Net Sales}}$$

#### **2.7.2.2 Return on Asset**

It measures the return on all the firm's assets. It is computed as follows:

$$\frac{\text{Net Income}}{\text{Total Assets}}$$

#### **2.7.2.3 Return on equity**

It measures the return on the shareholder's equity. The formula is :

$$\frac{\text{Net Income}}{\text{Average Shareholders Equity}}$$

#### **2.7.3 Efficiency Ratio**

Financial ratios that are typically use to analyze how well a company uses its assets and liabilities internally. Efficiency Ratios can calculate the turnover of receivables, the repayment of liabilities, the quantity and usage of equity and the general use of inventory and machinery.

There are number of types of ratios in this ratio but the most well-known ones are as follows:

### 2.7.3.1 Accounts receivable turnover

This is the ratio of the number of times that accounts receivable amount is collected throughout the year. A high *accounts receivable turnover ratio* indicates a tight credit policy. A low or declining *accounts receivable turnover ratio* indicates a collection problem, part of which may be due to bad debts. Formula:

$$\text{Accounts Receivable Turnover} = \frac{\text{Net Credit Sales}}{\text{Average Accounts Receivable}}$$

### 2.7.3.2 Asset turnover ratio

This ratio is useful to determine the amount of sales that are generated from each dollar of assets. It is calculated by dividing sales in dollars by assets in dollars.

$$\text{Asset Turnover} = \frac{\text{Revenue}}{\text{Assets}}$$

### 2.7.3.3 Inventory turnover ratio

A ratio showing how many times a company's inventory is sold and replaced over a period. the

Generally calculated as:

$$= \frac{\text{Sales}}{\text{Inventory}}$$

However, it may also be calculated as:

$$= \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

### 2.7.4 Liquidity Ratios

Liquidity ratios are used to measure how easily the firm can lay its hands on cash, or company's ability to meet its currently maturing debt (**Libby & Short,**

**2004**). There are many kinds of ratios under classification of ratios. The most well-known ones are as follows:

#### **2.7.4.1 Quick (or Acid Test) Ratio**

Which measures how current assets can quickly change into cash and it called liquidity? It is computed as follows:

$$\frac{\text{Current Assets} - (\text{Inventories} + \text{Prepayments})}{\text{Current Liabilities}}$$

#### **2.7.4.2 Operating Cash flow**

A measure of how well current liabilities are covered by the cash flow generated from a company's operations.

Formula:  $\text{OCF Ratio} = \frac{\text{Cash Flow from Operations}}{\text{Current Liabilities}}$

If the operating cash flow ratio is less than one, it means that the company has generated less cash over the year than it needs to pay off short term liabilities as at the year end. This may signal a need to raise money to meet liabilities.

In summary, cash and accounts receivable management affects the firm's profitability significantly. Because collection of cash and credit sales will play great the firm's profitability percentage, so, the managers need to manage those two effectively.

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.0 Introduction**

This chapter present and describes methods and techniques and it include research design, the area of the study, the study population, sampling procedures, data collection instruments, and research procedures and data analysis.

#### **3.1 Research Design**

The study used a descriptive correlation quantitative design to investigate the credit management and profitability in selected manufacturing companies in Garowe Puntland Somalia.

#### **3.2 Research population**

The population of the study was comprised of 40 people who will be selected from finance managers and customers of selected manufacturing companies in Garowe Puntland Somalia.

#### **3.3 Sample size**

Out of the population of 40 the study was selected a sample of 36 respondents using Sloven's formula. In slovin's formula,  $n = N / (1 + N*(e)^2)$ , where: n = number of samples, N = total population, and e = margin of error, 5% = 0.05.

### **3.3.1 Sampling Procedure**

The study was used a simple random technique of sampling to come up with the sample of 36 respondents. This technique was based on the assumption that each and every individual has same chance to be selected irrespective of gender, religion, age, marital status and education.

In this sampling procedure the respondents was randomly selected and they identified according to their willingness and availability to take part in the study.

### **3.4 Research Instrument**

This study was used questionnaires devise as the main tool for collecting data. The questionnaire consisted of a structured type for the collection of the required data in this study. A questionnaire is a formatted set of questions that was drawn up to meet objectives of the study (Mugenda, & Mugend 1989).

The reason of selecting this instrument is the researcher believes that the questionnaire was the most reliable instrument to get the necessary information from the respondents without fear or hesitancy. It is also less costly as compared to other instruments. Each respondent was provided a chance to express his or her ideas, options, views freely in a provided space without any undue influence of the researcher or his assistants.

### **3.5 Data Gathering Procedure**

The researcher was obtained a letter of introduction from the University and was used this letter as proof that he/she is a student of Kampala International University, main campus, Kansanga. The researcher was proceeded to the field, made preliminary introductions to the staff members and selected employee to participate in the study. The entry point was the top management of each organization and will hand over the introductory letter in order to get authorization from them. Thereafter, the questionnaire was personally delivered to the sampled respondents by the researcher; sufficient time was provided to the respondents which result to successful data collection. After receiving the questionnaire back, the researcher was analyzed the collected data by using SPSS package.

### **3.6 Data Analysis**

After the researcher receive the questionnaire filled by the respondents. The researcher will use cross tabulation for frequencies and percentages to analyze the profile of the respondents. Secondly, the researcher will use means to analyze the extent that the level of credit management implemented and the level of profitability in selected manufacturing companies in Garowe Puntland Somalia.

Thirdly, the researcher used Person correlation coefficient to analyze the relationship between level of credit management and profitability in selected manufacturing companies in Garowe Puntland Somalia.

## **CHAPTER FOUR**

### **THE PRESENTATION, ANALYSIS AND INTERPRETATION OF DATA**

#### **4.0 Introduction**

This chapter presents the presentation of data, analysis, and interpretation. The data analysis and interpretation was based on the research questions as well as research objectives, the presentation is divided in to two parts. The first part presents the respondents profile or demographic information, while the second part deals with presentation, interpretation, and analysis of the research questions and objectives. Below are the data presentations and analysis of research findings.

#### **4.1 Demographic information of the respondents**

This part presents the background information of the respondents who participated in the study. The purpose of this background information was to find out the characteristics of the respondents and show the distribution of the population in the study.

In addition to that, the first objective of this study was to determine the profile of respondents (finance managers and customers) as to Age, Gender, and level of education to view what category the majority of the respondents are belonging to. Data on this objective was analyzed under the question "What is the profile of the respondents (Finance managers and customers) as to Age, Gender, and Educational level?"



Their distribution is established as it follows in table 4.1.

## Profile of Respondents

**Table 4.1 Gender**

<b>Gender</b>	<b>Frequency</b>	<b>Percentage (%)</b>
Male	28	78.00
Female	8	22.00
<b>Total</b>	36	100.00

Source: primary data

In the above table 78% of the total respondents were male and 22% were female. This shows us the both finance managers and customers of those selected manufactured companies are dominated by male. This is inline with a research conducted by John philipez (2007) which states that the managerial positions and business activities are dominated by male workers.

**Table 4.2 Age Distribution**

<b>Age bracket</b>	<b>Frequency</b>	<b>Percentage (%)</b>
20-25 years	4	11.11
26-31 years	17	47.22
32-37 years	10	27.22
38-43 and above	3	8.33
44 and above	2	5.55
<b>Total</b>	36	100

Source: Primary data

According to the above table 4.2, the majority of the respondents that constitute 47.22% of the respondents are within the age bracket (26-35 years), 27.22% of the respondents are within the age bracket (32-37 years), 11% of the respondents are within the age bracket (20-25), 8% of the respondent old between 38 and 34 and last 5.55% of the respondents are 44years old and above.

This shows us that the age of the majority of the respondents lay between 26 and 31 which means that most of them are in youth age. One of the authors of Organizational behavior when he was discussing decision making process and its relationship with the oldness he said " youths takes the decision quickly with high risk" this means that when people are in this age, they just take decision in simple manner regardless of their consequences and risks associated with them.

**Table 4.3 Academic Qualification**

<b>Qualification</b>	<b>Frequency</b>	<b>Percentage (%)</b>
Primary Certificate	12	33.33
Secondary Certificate	17	47.22
Bachelor Degree	7	19.44
Master Degree	0	0
<b>Total</b>	36	100%

Source: Primary data

In the above table 4.3, indicates that the majority of the customers are Secondary certificate holders that makes up 47.22% of the respondents, second group of the customers are primary certificate holders which represents 17% of the respondents, third group of the respondents are Finance managers who have or holds bachelor degree and that one constitutes 19.44% of the respondents,

while the last group would have been master holders but unfortunately there is not master holders in my respondents.

With the respect of the above table, this indicates that the respondents particularly, finance managers are bachelor holders. So, conclusions, that finance managers in selected manufacturing companies in Garowe Puntland Somalia has the right skills, education, knowledge and competence to handle financial issues.

**RESEARCHES QUESTION TWO:**

This question was derived from the second objective of the study which was to determine the level of credit management in selected manufacturing companies in Garowe Puntland Somalia. In order to achieve this objective, the researcher asked a number of questions by the respondents to provide answers to research question two. The results are presented in the following table.

**Table 4.4 Level of Credit Management of Selected Manufactured companies (From Finance Managers)**

<b>Areas Rated</b>	<b>Mean</b>	<b>Interpretation</b>
<b>Credit Policy</b>		
1. The company has strong credit policy that allows the company to asses its potential buyers	4.00	Strongly agree with no doubt
2. Credit policy set by top managers	3.33	Agree with some doubt
3. the components of credit policy are: credit limit, credit discount and credit period	3.00	Agree with some doubt
4. Credit policy of the company allows the firm to generate more sales, and also to collect efficient its over due accounts	4.00	Strongly agree with no doubt
5. Your company credit policy has great effect on the firm's profitability	2.00	Disagree with some doubt
<b>Mean Index</b>	<b>3.26</b>	<b>Agree with some doubt</b>
<b>Credit Risk Management</b>		
6. The company investigates the creditworthiness of its potential customer through: banks, audited financial statements, credit history , and trade references	3.33	Agree with some doubt
7. The company uses credit identification analysis before granting trade credit to its customers	3.00	Agree with some doubt
8. The credit risk management reduces the credit default and the credit cost	2.66	Disagree with some doubt
<b>Mean Index</b>	<b>2.996</b>	<b>Agree with some doubt</b>
<b>Credit Collection and Billing Procedure</b>		
9. The company mails the invoices promptly	3.366	Agree with some doubt

10.The company have follow up phone calls to make sure whether invoices have received or not	3.00	Agree with Some doubt
11.Finance managers are the ones who approves, sets limit and time to the credit	3.66	Strongly agree with no doubt
12.Your collect your over due accounts through: tell phones, letters or credit agencies	3.00	Agree with some doubt
13.Your company assigns specific persons for billing and collection	4.00	Strongly agree with no doubt
<b>Mean Index</b>	<b>3.4</b>	<b>Agree with some doubt</b>
<b>Overall Mean</b>	<b>3.22</b>	<b>Agree with some doubt</b>

**Source: primary data**

The above table indicates that level of credit management in those selected manufactured is high with overall mean 3.22, which means a strong credit management system has been put in place that allows the firm to collect its overdue accounts on time. Please look at Appendix IV for the interpretation of the mean. The credit management has been operationalized: a system being put in place to control the goods and services being sold on credit and it gives emphasis on the following areas:

- Credit policy: as the above table indicates, the overall mean of the credit policy is 3.26 which means that level of managing accounts receivable is strong in those selected manufactured companies.
- Credit risk management: as the above table shows us, the overall mean of the credit risk management is 2.99 which states that the credit risk management in those selected manufactured companies is weak and it needs to be improved.

- Collection and billing procedure: as the table 4.4 indicates, the overall mean of the collection and billing collection procedure is 3.4 which states that collection and billing procedure of those selected manufactured companies is strong.

The findings also showed that accounts receivables period is high, which means the period which borrowers will pay back their debt. This means the period which the customers will pay back their debt normally take long, and as long as the accounts receivable period takes long, the less cash to be collected.

In my conclusion towards this question says that the level of credit management in those selected manufactured companies is high which means strong credit management system has been put in place which has tight credit policy, effective credit risk management model, and effective billing and collection procedure. Let me remind you that conclusion is based responses from finance managers which mean people from inside those manufactured companies.

**Table 4.5 Level of Credit Management of Selected Manufactured Companies (Questionnaire from Customers)**

<b>Areas Rated</b>	<b>Mean</b>	<b>Interpretation</b>
1. your vendor has good credit policy	3.25	Agree with some doubt
2. your vendor's collection procedure and billing system is systematic and well organized system which eases you to pay your debt on time	2.77	disagree with some doubt
3. your vendor's system for granting credit is highly developed	1.388	Strongly disagree with no doubt
4. your satisfaction towards your vendor's service according to credit is high	2.6	disagree with some doubt
5. your vendor's credit encompasses: Credit period, Credit limit, & Credit discounts	2.47	disagree with some doubt
<b>Overall Mean</b>	<b>2.5</b>	<b>disagree with some doubt</b>

**Source: primary data**

After having discussed the level of managing accounts receivable in the perspective of finance managers, now we will look it at the perspective of customers, because customers are real source of information that can determine whether level of credit management is strong or weak and its affect on profitability.

As the table 4.5 indicates the overall mean of level of credit management is 2.5 which means that the level of accounts receivable management is weak or poor. Please refer appendix IV for the interpretation of the mean. The customers of those manufactured companies do not satisfy how the credit are handled, offered and billed. Therefore, this is a contradictory what finance managers said

(3.26 of overall mean). Therefore, it needs that the credit system to be improved.

### RESEARCH QUESTION THREE:

This question was derived from the third objective of the study which was to determine the level of profitability in selected manufactured companies in Garowe Puntland Somalia. In order to achieve this objective, the researcher asked a number of questions by the respondents to provide answers to research question three. The results are presented in the following table.

**Table 4.6 Level of profitability in selected manufactured companies**

Areas Rated	Mean	Interpretation
1. Your company credit policy increases the firm's profitability	3.66	Strongly agree with no doubt
2. Credit analysis allows managers to increase firm's profitability	3.66	Strongly agree with no doubt
3. Assessing effectively and efficiency the risk associated with granting credit increases firm's profitability	3.00	Agree with some doubt
4. Analyzing the credit worthiness of the buyer through banks, audited financial statements and trade references plays great role on the firm's profitability	2.66	Disagree without doubt
5. Your company's collection procedure and billing system increases the firm's profitability	4.00	Strongly agree with no doubt
6. Your company's terms of sales, credit limit and time increase	3.66	Strongly agree with no doubt



firm's level of sales		
7. Your company's collection procedure increases the firm's collection amounts	3.33	Agree with some doubt
8. Your company' credit risk management model reduces the probability that the firm to inherit risk	3.00	Agree with some doubt
9. Your organization has strong credit risk identification model that reduces credit cost from the company	3.66	Strongly agree with no doubt
10. Your accounts receivable management model reduces the firm's credit cost	3.00	Agree with some doubt
<b>Overall Mean</b>	<b>3.36</b>	<b>Agree with some doubt</b>

**Source: primary data**

As the above table indicates, the overall mean of level of profitability is 3.36 (Agree with some doubt). This states that credit management has great effect the level of profitability that company earns or generates at a specific period of time. This means as long as credit management is effective, sales and collection of the firm will increases and this will have great effect to the firm's level of profitability.

Most respondents agreed that credit management process plays great role the collection of sales revenue and if this system is poor or weak, company will not be able to collect its overdue accounts effectively and efficiently, therefore, respondents agreed with the mean of 3.4 that profitability of every organization or company is determined by its credit management system. If good credit

system is not put in place, the company will have a sales revenue collection problem.

In addition to that, majority of the respondents agreed that the components of accounts receivable management: credit policy, credit risk management and collection procedure are key determinant factors of profitability.

However, these findings show us that the credit management system is strong tool which can be used to measure the level of profitability in those selected manufactured companies.

Having said that, the overall mean demonstrates the factors that have contribute the level of profitability to be high: strong credit policy which encompasses the credit limit, terms of sales, credit period, and credit discount, strong credit risk management system which encompasses whole the credit risk management process and lastly credit collection and billing procedure.

In addition to that, table 4.4 (level of credit management) shows us that the level of credit management in those selected manufactured companies is high and at the same time the above table (4.6) shows us the level of profitability is effected by level of credit management with the mean 3.36, therefore, as a researcher, I can conclude that: as level of credit management increases, the level of profitability also increases, so they have strong relationship.

#### RESEARCHES QUESTION FOUR:

This question was derived from the fourth objective of the study which was to determine the relationship between credit management and profitability in selected manufactured companies in Garowe. In order to achieve this objective, the researcher used means a basis of correlation between these variable. The results are presented in the following table.

**Table 4.7 determining the relationship between managing accounts receivable and profitability in selected manufactured companies**

Pearson's product moment correlation coefficient

Criteria	Mean	Computed r-value	Critical r-value	Decision	Interpretation
Managing accounts receivable	3.26	0.30	0.25	Rejected the null hypothesis	Weak significant correlation
profitability	3.4				

As the table 4.7 reveals, the computed r is 0.3 and according to Pearson's correlation coefficient, the relationship between credit management and profitability is weak at value of 0.3. This means that there is weak positive correlation between these two variables. The r-vale is computed a data from table 4.4 and 4.6.

The computed  $r$  value is generated from mean scores of credit management and profitability in selected manufactured companies in Garowe Puntland Somalia. The critical value was generated from statistical books.

The above table shows us that the both variables are going to same direction, as the level of credit management increases, the level of profitability increases. Therefore, company's level of profitability depends on how it manages its credit.

In addition to that, the relationship between these two variables is somehow weak due to: firstly, Puntland is a place where people life is guided by Islamic Shari'ah and one of fundamental principles of Islamic Shar'ah is the repayment of the credit. Many Islamic scholars talked about this principle and it plays great role the person's faith.

That is why these variables have weak relationship, regardless whether the credit system is strong or not, those debtors will pay their debt but the question is: will they pay the credit on time? Here is where we need to be put place a strong credit system.

Finally, using correlation does not measure cause: means which variable is causing the other variable, in here, we are looking for how these two variables are related not their causation. So, these two variables are positively correlated but their level of management may be caused other factors.

## **CHAPTER FIVE**

### **DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS**

This chapter discusses the findings, conclusion and recommendation of this study. Firstly, it will be discussed the major finding of each study as stated in the research objectives. Secondly, the conclusion will be draw form the findings of the study. Lastly, the researcher will bring recommendation for further research for this study.

#### **Discussions of the Research Findings**

The study focused on the effect of credit management on profitability in selected manufactured companies. The objectives of the study were to determine the profile of the respondents in terms of: gender, age, and academic qualification, to determine the level of managing accounts receivable in selected manufactured companies, to determine the level of profitability in selected manufactured companies and to establish the relationship between credit management and profitability in selected manufactured companies.

#### **Research Question one: profile of the respondents**

The first objective of this study was to determine the profile of respondents in terms of gender, age, ad academic qualification in selected manufactured companies. The study indicated the majority of the customers and finance managers of those selected manufactured companies were male. It also showed that majority of the respondents particularly customer were secondary certificate holders which means that these customers have the basic education to address their day to day activities and those selected manufactured companies will be easy for them to communicate their customers in formal way, meanwhile, the study also indicated that all finance managers of those selected manufactured companies are Bachelor holders. This indicates that the finance managers are

capable to handle effectively the financial matters in the company. Because of finance managers do a lot of activities which needs a person to be competent, knowledgeable, and skilled. In credit management: a finance manager minimally needs some basic knowledge about business administration, credit system of the companies and credit risk management model.

Finally, this study shows that the respondents fall within different age brackets from youth to elders who have more information in the field of study and can provide very useful information to the study.

It also shows that all finance managers their age fall around thirtyish (30<sup>th</sup>) and this indicates the finance behave responsible by the time their age is around 30<sup>th</sup>. Because people say always that a person's intelligence increases as he/she becomes older and older.

In addition to that, experience is something that plays great role the successfulness of a person, and as person becomes older and older, his/her experience level will also increase, and this person will be able to manage things in organized way than a teenager person.

## **Question Two: level of credit management**

The second objective of this study was to determine the nature of credit management in selected manufactured companies. Based on analysis of chapter four, most of the respondents agreed that the level of credit management has great impact the company's level of profitability in specific period of time. The researcher found the companies controls receivables through proper procedure by applying effective credit policies, credit terms, credit limits, credit standards credit period, credit discounts, and collection procedure. These findings are inline with Chittende (1948), who noted that the main aim of credit management (accounts receivable management) is to maximize profitability and to minimize risk costs. A business can afford to invest in its receivables unless the marginal cost and marginal profits are the same. Although the level of receivables is affected by various external factors like standards of industry, economic conditions, seasonal factors, rate of competition, Islamic Shari'ah and etc.

In addition tot that, the findings of this study with the respect of this objects, revealed that the strong credit policies, effective credit risk management and strong collection procedure are best way to manage credits and play great the level of profitability of selected manufactured companies.

This is also in line with Smith (1980) who noted that the managing accounts receivable is a credit managing tool which encompasses: credit policy, credit risk management and billing and collection procedure. He also noted that the accounts receivable is the second most valuable asset in the organization after cash, and cash can not be generated unless to collect accounts receivable effectively and efficiently. Within this analysis, I can say that accounts receivable is as a key metric that can drive the profit to be well improved.

However, the findings showed that proper credit risk management tool may reduce the risk of the borrower through: banks, audited financial statements,

credit history and trade references. The study also revealed that finance managers use different risk management tools like: they assess the Islamic-teachings this person possesses, as the person possesses more Islamic-teachings, the more he is willing to pay his debt.

In addition to that, the findings showed that credit policy has great effective to the level of profitability of the company, which means if the company's credit policy is weak; the level of profitability will also be low. It also revealed that credit policy allows the firm to generate more sales, and also to collect its overdue accounts on time. This is in line with Brelay (2002) who noted that firm's credit policy plays great the firm's level of sales, and overdue accounts.

Based on analysis of chapter four, the findings also revealed that the credit risk management reduces the credit default and the credit cost of potential buyer. This is really in line with Pyle (1997) who said "credit risk management is a continuous process of creating transparency and risk mitigation that can face the firm, and assessing the credit worthiness of buyer. Credit risk management has control cycle of risk management as so as manage the risk and prevent the firm to inherit a risk from its third party.

Moreover, the study showed those selected manufactured companies assign specific persons for billing and collection, companies have follow up phone calls to make sure whether invoices have received or not, The company mails the invoices promptly and

Finance managers are the ones who approves, sets limit and time to the credit. This is in line with Grover, (2005) who noted that collection and billing procedure is a detailed statement of steps to be taken regarding when and how the past-due amounts are to be collected. Collection procedure is laid down usually in the credit policy.



If there is a strong and effective system for collection of over due accounts, the amount of cash on hand and sales revenue will be increased and this will have a great impact on the profitability level and vice versa. Before you start to collect the over due accounts, you should know your self which means if you are not physically and mentally prepare to make that phone call, it will be waste of time and phone call. Emotions can be very easily read over the phone. So be eager to collect the money. After all it is your money

According to grover (2001), collection of accounts receivable will increase the total sales volume and sales revenue and also the same time will reduce cost of goods supplied, due to this, the profit and growth of organization will increase.

In addition to that, credit management can be used to increase the cash level, and also can be used to measure the liquidity and organizational valuation. However, the primary objective of credit management is to turn debtors into cash swiftly, but without upsetting the business relationship. This requires careful handling. It is a balancing act between the necessity to impress upon the customer the need for, and benefits of, prompt payment, without being so heavy handed that you put them off dealing with you ever again.

More over, credit management is the process of planning and controlling credit accounts and it plays great roll the profitability of the firm. Effective controlling is characterized to increase sales, to Reduces bad debts, to Increases profits, to build customer loyalty, to build confidence of financial industry, to Increase company capitalization and to Increase the customer relationship.

To manage accounts receivable effectively, you need to analyze the credit worthiness of your buyer. The sources of information on credit worthiness of the buyer are Business references, Bank references, Credit agencies, Chambers of commerce, Employers and Credit application forms.

These findings are also in line with Bhattachay, (2001), who said that from creation of receivables, the firm gets a few advantages and it has to bear bad debts, administrative expenses, financing costs and etc. in managing accounts receivable, financial managers should follow strong credit policy which causes out standing can be fully collected. Thus, the main of objective of management of accounting receivables is to maximize the returns on investment in accounting receivable and to minimize the risk of bad debts. The investment in accounting receivables affects liquidity and profitability: it is therefore, it is significant to maintain the management of accounts receivable. In other words, the basic of objective of managing accounts receivable is to maximize the profits. Efficient credit management helps the managers to increase the sales of the firm. Thus, the objectives of managing accounts receivable are: to optimize the amount of sales and amount of collection, to minimize the cost of credit and to increase the investment of accounting receivables.

Achieving excellence in credit management (managing accounts receivable) and collections are crucial in realizing and optimizing the profit and cash benefits of increased revenues.

### **Research Question Three: level of profitability**

The second objective was to determine the factors that affect the level of profitability in selected manufactured companies. Based on analysis of chapter four, the study revealed the level of credit management has great effect to the company's level of profitability.

The findings showed that the most respondents agreed that credit management process plays great role the collection of sales revenue and if this system is poor or weak, company will not be able to collect its overdue accounts effectively and efficiently. Profit is just subtraction of all revenues from expenses, so, if there is no revenue collected, it means there is no profit. Therefore, level of profitability always depends how company collects its overdue accounts.

This is in line with by Besses, Joel (2002) who noted that the prime objective of the company is to obtain maximum profit through the business. The amount of profit largely depends upon the magnitude of sales. However the sale does not convert into cash instantaneously. There is always a time gap between sale of goods and receipt of cash. Additional capital required to have uninterrupted business operations, and the amount will be locked up in the current assets. Regular availability of adequate working capital is inevitable for sustained business operations. If the proper fund is not provided for the purpose, the business operations will be effected.

He urged that the goal of working capital management (let me remind you that accounts receivable is one of the biggest items in working capital) is to ensure that a firm is able to continue its operation. And that is has sufficient ability to satisfy both maturing short term debt and upcoming operational expenses. The better a company manages its working capital, the less the company needs to borrow.

In addition to that, the findings showed that the period of accounts receivable affect firm profitability negatively. This is in line with a research carried out by a Benjaminc (2009) on the title of "effective of working capital management on profitability in HOZOPAC NIG. LIMITED. LAGOS. NIGERIA" who noted that the period of accounts receivable and profitability has negative relationship which means as one increase the other decreases; they are not going on same direction.

In addition to that, the overall goal of every business enterprise is to earn profit, and most businesses enterprises use measurements that indicate the profitability in the firm. The first one is profit margin which tells decision makers how much profit is generated or how much loss is incurred (Brock, Palmer, & price, 1990). The second one is return on sales which indicates how much profit is being produced per dollar of sales. The only way that this goal could be implemented is through putting effective credit management system.

Most scholars use profitability ratios to measure the level of profitability of a company within specific period of time. Most well known ones that scholars use are: profit margins--the percentage of each sales dollar, on average, that represents profit. It is computed operating income divided by net sales. As we see from this formula, operating income as numerator plays great role the measurement of firm's profitability. This means, income can not be generated unless we put in place effective credit system that allows us to collect the outstanding revenue.

Secondly, scholars use efficiency ratio to analyze how well a company uses its assets and liabilities internally. Efficiency Ratios can calculate the turnover of receivables, the repayment of liabilities, the quantity and usage of equity and the general use of inventory and machinery.

Accounts receivable turnover is one of the tools that can be used to measure the efficiency of the company. Accounts receivable turnover the ratio of the number of times that accounts receivable amount is collected throughout the year. A high accounts receivable turnover ratio indicates a tight credit policy. A low or declining accounts receivable turnover ratio indicates a collection problem, part of which may be due to bad debts. It can be calculated through net credit sales divided by average of accounts receivable. Again this shows us, the net credit sales play great the efficiency of the company.

#### **Research Question Four: relationship between credit management and profitability in selected manufactured companies.**

The fourth objective of this study was to establish the relationship between credit management and profitability in selected manufactured companies in Garowe Puntland Somalia. Data analysis and interpretations revealed that there is a significant relationship between credit management and profitability. The findings indicated the relationship between credit management and profitability is weak positive correlation which means there is a relationship between these two variables but it is not strong. Therefore the Null hypothesis was rejected.

The findings also showed the reason caused the relationship of credit management and profitability to be weak positive correlation is the presence of Islamic Shar'ah in Garowe Puntland. Islamic Shariah has principles, and credit principle is one of the fundamental principles of Islamic Shariah.

In addition to that, the findings showed that these two variables have positive correlation which means they are going on same direction, as one increases, the other increases, therefore, if the level of management in those selected manufactured companies increase, the level of profitability will increases given other factors constant.

On the other hand, the hypothesis was stating that “there is not significant relationship between managing accounts receivable and profitability in selected manufactured companies in Garowe Puntland, but the findings showed that there is a direct relationship between these two variables, therefore, the hypothesis has been rejected.

## CONCLUSIONS

The study investigated the relationship between credit management and profitability in selected manufactured companies in Garowe Puntland. The conclusions were made on objectively based as follows:

The second objective of this study was to determine level of credit management in selected manufactured companies: as the findings showed, the level of credit management of those selected manufactured companies was high because the average mean of this objective was **3.22 (table 4.4)** which most of the respondents agreed that the level of credit management is high. This means that the elements of credit management was applied to the business operation of those selected manufactured companies.

Credit management is the process of establishing an effective system for credit policy, credit risk management, credit risk procedure, and recognition bad debt expense". Credit policy is the process of establishing and defining under what conditions you will extend credit, how much credit you'll extend, and to whom. Decide whether to accept checks and credit cards, how you will investigate new customers before extending credit, if you will require your customers to pay deposits before delivering goods or services, and if you will charge interest on late accounts.

Results obtained from findings revealed that all the components of credit system have been applied to those selected manufactured companies. Therefore, the nature of credit management or managing accounts receivable in selected manufactured companies in Garowe, Puntland is strong.

Within this objective, the findings also showed credit risk management tool has not been applied effectively those selected manufactured companies because the average mean of credit risk management is **2.99 (table 4.4)** which most of the

respondents disagreed with some doubt the application of credit risk management tool.

Customer default is one of greatest risk the firms may come across or face, and the only way to be minimized is applying your business operation effective credit risk management tool.

The third objective of this was to determine the level of profitability of selected manufactured companies in Garowe Puntland. The findings revealed that the study revealed the credit management process plays great role the collection of sales revenue and if this system is poor or weak, company will not be able to collect its overdue accounts effectively and efficiently. Profit is just subtraction of all revenues from expenses, so, if there is no revenue collected, it means there is no profit. Therefore, level of profitability always depends how company collects its overdue accounts. This is in line with **table 4.6** which shows the mean average of level of profitability in those selected manufactured companies.

The fourth objective of this was to establish the relationship between managing accounts receivable and profitability. The finding showed there is a significant relationship between managing accounts receivable and profitability at value of 0.3 as the following table shows. But their relationship is weak not strong.

The findings also revealed that these two variables have positive correlation which means they are going on same direction, as one increases, the other increases, therefore, if the level of management in those selected manufactured companies increase, the level of profitability will increase given other factors constant.

In addition to that, the null hypothesis has been rejected because the computed  $r$  value (0.3) is greater than critical value (0.25).



## **RECOMMENDATIONS**

The study investigated the relationship between credit management and profitability in selected manufactured companies in Garowe Puntland. The recommendations were made on objectively based as follows:

The second objective of this study was to determine level of credit management in selected manufactured companies: Based on the findings, discussions and conclusions of the study, the level of credit management of those selected manufactured is high or strong except credit risk management which is weak. Therefore,

Firstly, the finance manager should maintain that accounts credit management model that the firm uses currently and also should improve the risk management model which is currently weak.

Secondly, the finance manager should supervise whether credit terms, credit limits, credit period are clear stated both informally and formally. Because as Somalis, we are oral society, so, the finance manger should closely consider that.

Thirdly, the finance manager should closely consider the Islamic Shar'ah particularly Islamic finance principles as long they concern credits.

Finally, Finance managers should come up with other strategies to satisfy customers about model of managing accounts receivable because as table 4.5 reveals that the customers are dissatisfied how they accounts receivable handled, offered. But as accountants our concern is not that (customers satisfaction), our concern is level of profit being generated by the firm.

The third objective of this was to determine the level of profitability of those selected manufactured companies: Based on the findings, discussions and conclusions that were drawn from this study revealed that the level of profitability always depends how company collects its overdue accounts. So,

The finance manager should main and update as environment changes the technique and tools of billing can collection procedure that the firm uses currently because they are strong as the respondents agreed.

The fourth objective of this was to establish the relationship between credit management and profitability in selected manufactured companies in Garowe, Puntland. : Based on the findings, discussions and conclusions of the study, it revealed that there is a weak positive significant relationship between credit management and profitability at value of 0.3.

As long as the relationship is weak, the finance managers should use other techniques to manage the accounts receivable other than credit management model.

### **Areas for Further Research**

On the basis of the knowledge that I gained during this study, I would recommend the following topics for further studies which are important in the field of credit management and help to may finance managers and owners of business enterprises to increase their level of profitability.

- Effect of working capital management on firm's profitability
- Impact of controlling accounts payable on firm's return on investment
- The relationship between credit management and firm's financial performance

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## **APPENDICES**

### **Appendix 1**

#### **The time frame of the study**

Proposal	January to February, 2011
Data collection	February to March, 2011
Dissertation writing	March to April, 2011
Submission	April, 2011

## Appendix II

### Budget for the study

No	Items	Quantity	Rate	Amount
1	Transporting services	8 weeks	20000@ week	160,000
2	Lunch	8 weeks	25000 per week	200,000
3	Typing and printing	48 pages	500 @ page	24,000
4	Internet service	8 weeks	50 hrs x 1000	50,000
5	Photocopying	48 pages	100 x 48	4,800
6	Stationary	1 ream	1 x 10,000	10,000
6	Miscellaneous			59,820
	Total			508,620

## APPENDIX III

### RESEACH INSTRUMENT

#### Questionnaire for Finance Manager

#### SECTION I: PROFILE OF RESPONDENT

Please kindly tick the provided space

1. Age of the respondent

A. 20-25

B. 26-31

C. 32-37

D. 38-43

E. 44 and above

2. Gender: Male [ ] Female [ ]

3. Educational level: Secondary [ ] Bachelor [ ] Masters [ ]

#### SECTION II: LEVEL OF Credit Management

Scale	Strongly Agree	Agree	Disagree	Strongly Disagree
1. The company has strong credit policy that allows the company to asses its potential buyers				
1. Credit policy set by top managers				
2. the components of credit policy are: credit limit, credit discount and credit period				
3. Credit policy of the company allows the firm to generate more sales, and also to collect efficient its over due accounts				



4. Your company credit policy has great effect on the firm's profitability				
5. The company investigates the creditworthiness of its potential customer through: banks, audited financial statements, credit history , and trade references				
6. The company uses credit identification analysis before granting trade credit to its customers				
7. The credit risk management reduces the credit default and the credit cost				
8. The company mails the invoices promptly				
9. The company have follow up phone calls to make sure whether invoices have received or not				
10. Finance managers are the ones who approves, sets limit and time to the credit				
11. Your collect your over due accounts through: tell phones, letters or credit agencies				
12. Your company assigns specific persons for billing and collection				

### SECTION III: LEVEL OF PROFITABILITY

Scale	Strongly Agree	Agree	Disagree	Strongly Disagree
1. Your company credit policy increases the firm's profitability				
2. Credit analysis allows managers to increase firm's profitability				
3. Assessing effectively and efficiently the risk associated with granting credit increases firm's profitability				
4. Analyzing the credit worthiness of the buyer through banks, audited financial statements and trade references plays great role on the firm's profitability				
5. Your company's collection procedure and billing system increases the firm's profitability				
6. Your company's terms of sales, credit limit and time increase firm's level of sales				
7. Your company's collection procedure increases the firm's collection amounts				
8. Your company's credit risk management model reduces the probability that the firm to inherit risk				
9. Your organization has strong credit risk identification model that reduces credit cost from the company				
10. Your accounts receivable management model reduces the firm's credit cost				