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# EFFECT OF ACCOUNTS RECEIVABLE MANAGEMENT ON PSV INSURANCE COMPANIES PERFORMANCE IN KENYA

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**Abstract**

*This research assessed the impact of accounts receivable management practices on the performance of PSVs insurance companies. Accounts receivable management plays a key role in the organisation performance The general objective of this study was to assess the impact of accounts receivable management on PSV insurance companies performance. A causal research ,design was used. The study was carried out in Nairobi at Amaco, Invesco, Direct line and Explico insurance companies head offices respectively. The target population was 62 respondents comprising 4 Finance managers, 32 Cashiers, 17 Accountants and 9 Internal Auditors of PSV insurance companies. The researcher adopted stratified random sampling technique with a sample size of 51 respondents, which was determined using Yamane's (2009).Both Primary data and secondary data was collected using questionnaires and data collection schedules and presented by tables . Descriptive statistics and inferential statistics were adopted. Inferential statistic was adopted where regression and correlation analysis were used to test the research hypothesis. Correlation findings showed that there was a positive relationship between the accounts receivable management and performance of PSVs insurance companies' performance. From the regression model, (R2 = .829) shows that accounts receivable predictor account for (82.9%) variation in performance of PSVs insurance companies. The study showed a positive relationship between accounts receivable* *management and performance of the PSV insurance companies. The study thus recommends that for PSVs insurance companies to improve performance they should adopt a cash and carry model for premium payments to reduce premium debts. Further studies are also required to establish if the findings of this research is the case of other insurance companies.*

*Keywords: Accounts receivable, Organizational performance, Public Service Vehicle, PSV, Kenya*

## INTRODUCTION

Insurance companies manage the risks transferred to them by policy holders. This policy holders pay premiums for the policies. Unfortunately not all policy holders pay their premiums some end up not paying the premiums resulting in PSV companies having huge debts. This premium debts are the accounts receivables. According to Amaya and Memba (2015) insurance firms manage risks transferred to them by other persons after agreeing to compensate the persons in the event of financial losses. They further assert that insurance provides protection to persons against an insured event by paying a predetermined sum of money in case that event happens. The main aim of accounts' receivable management is to minimize the loss due to bad debtors. For effective debt management, the Finance manager should analyse credit policy, carry out credit analysis and evaluate collection Policy of PSV.

Performance is the result of the whole organization's systems in relation to its objective. There are many ways of measuring performance of a firm. This study focused on profitability as a measure of performance of the PSV insurance companies. Every organization exists to achieve a goal. According to Yusuf, Gunasekaran, and Dan (2007) organizational performance is the final achievement of an organization and comprises the existence of certain specified targets, a time for achieving those specified targets and realization of efficiency and effectiveness. Providing cover for PSVs therefore has destroyed the whole essence of insurance, where individuals contribute money to a common pool to assist in case of a problem, since the claims exceeded the money contributed in the pool (Kimani, 2004). This has made several insurance companies in Kenya unwilling to provide cover for PSVs.

According to Filbeck and Krueger (2005) insurance companies do not have stock but have cash, accounts receivables and payables which they need to manage well.

### Statement of the Problem

Kenyan has witnessed the collapse of eight insurance companies. The companies include: United insurance company limited, Blue shield insurance company limited, Standard insurance company limited, Lakester insurance company limited, Concord insurance company, Invesco insurance company, Stallion insurance and Kenya national insurance corporation. This has mainly been attributed to mismanagement of funds and lack of proper management of accounts receivables. Collapse of these companies has led to loss of employment opportunities' and sufferings of policy holders who in most circumstances are forced to settle claims on their own when the insurance companies go under. Apart from the policy holders, the government has also been affected adversely by going under of the insurance companies which has meant loss of revenue to the government through payment of taxes. This study sought answers on how accounts receivables are managed. Waweru (2011) conducted a study to assess the relationship between working capital management and profitability of insurance companies in Kenya. The study covered a sample of eighteen (18) insurance companies in Kenya. The data covered a period of five years from 2005 to 2009 and used secondary data obtained from the insurance companies' websites. The data collected was analysed using descriptive and quantitative techniques. The study findings indicated that there was a positive relationship between accounts receivable management and profitability in the insurance industry in Kenya. .

### Objective of the study

To determine the effect of Accounts Receivable Management on PSV Insurance Companies Performance in Kenya

## LITERATURE REVIEW

### Accounts Receivable management

Many scholars have researched on accounts receivable and performance of organisations. According to Aminu and Zainudin (2015) receivables represent unpaid credit extended to customers by the business. Firms should employ policies that enable them to closely monitor their receivables. A combination of shortened creditor's collection period, low levels of bad debts and a sound credit policy improves the performance of a firm. Though it is healthy for a business to have receivables. Nyamao, Ojera, Lumumba, Odondo, and Otieno (2012) advise Small Micro Enterprises to maintain an optimal level of debtors lest they suffer from costs associated with bad debts, managing credit among others. Moles, Parrino and Kidwell (2011) advise that it is very important for firms to consider the credit rating of a customer before granting credit to avoid bad debts.

Credit policy affects debtor's management because it guides management about how to control debtors and how to make balance between liberal and strict credit. If company does not restrict to sell the products on credit after a given limit of sale, this liberated credit policy will increase the amount of sale and profitability, but risk will also increase with increasing of sale. If we sell the goods to those debtors whose capability to pay is not good, then it is possible that some amount will become bad debts. The Company can increase the time limit for paying by such debtors.

According to Kontus (2012), the management of accounts receivables should entail establishing credit collection policy. Normally a good credit policy should have four variables, this includes credit period, discount provided for early credit settlement, credit principles and collection policy. Therefore, in the management of accounts receivable the policy makers should focus on customer's terms of credit. If the terms of credit are tight less investment will be taken in account receivables and few bad debts issues.

Waweru (2011) conducted a study to assess the relationship between working capital management and profitability of insurance companies in Kenya. The study covered a sample of eighteen insurance companies in Kenya. The data covered a period of five years from 2005 to 2009 and used secondary data obtained from the insurance companies' websites. The data collected was analysed using descriptive and quantitative techniques. The study findings indicated that there was a positive relationship between working capital management and profitability in the insurance industry in Kenya. The study also found out that when the account receivable increases, it will have a positive impact on profitability. It further indicated that if debt ratio is increased, then profitability will increase. This study focused on all insurance companies in Kenya, the current study limited itself on PSV insurance companies.

Baveld (2012) carried out a study on the relationship between profitability and accounts receivables during current global crisis period. The study aimed at investigating how public listed firms in the Netherlands manage their working capital. The study compared two periods; the non-crisis period and the financial crisis period. The findings reflected significant negative relationship between accounts receivables and gross operating profit during non-crisis period. The study presented a contextual gap since it was conducted in Netherlands while the current study was carried out in Kenya. The study investigated the relationship between profitability and accounts receivables.

A study was conducted by Makori and Jagonga (2013) to establish the effect of working capital management on firm Profitability. The results of the study revealed that there is a negative relationship between profitability and number of day's accounts receivable and CCC, but a positive relationship between profitability and number of days of inventory and number of day's payable. Higher amount of working capital enables a firm to meet its short-term obligations easily. This results to increased borrowing capability and decrease in default risk and consequential decrease in cost of capital and increase in firm value. Therefore, efficiency in working capital management affects not only short term financial performance in terms of revenue, but also long-term financial performance.

Teklit and Jasmindeep (2017) in their study while examining Ethiopian insurance Companies also found out that Capital adequacy and liquidity ratio are major factors that significantly affect the profitability of insurance companies. Indeed, the two are working capital components. Efficient management of working capital ensures a company has sufficient cash flow to meet its short-term debt obligations and operating

Waweru (2011) conducted a study to assess the relationship between working capital management and profitability of insurance companies in Kenya. These study findings showed a positive relationship between working capital management and profitability of the insurance companies. Accounts receivables are part of working capital management in insurance companies.

**Operating Cycle Theory**

This theory paves the way to understand working capital management as a field. The operating Cycle Theory Forms a foundation for most studies in working capital management. According to Aminu and Zainudin (2015) Operating Cycle Theory provides a framework to understand the flow in the working capital management from the time raw materials are secured to the time receivables are collected.

The operating cycle theory looks explicitly at one side of working capital that of current assets and therefore gives income statement measures of firms operating activities that is about production, distribution and collection. Receivables, for instance are directly affected by the credit collection policy of the firm and the frequency of converting these receivables into cash matters in the working capital management. By granting the customers more liberal credit policy, the profitability will be increased but at the same time liquidity will be sacrificed. The same analysis goes for other components of current assets account. However, the operating cycle theory tends to be deceptive in that it suggests that current liabilities are not important during the firm’s operations. Our understanding of payables as the source of financing the firm’s activities can be assailed thus. Given this inadequacy of the operating cycle theory, it was essential to infuse current liabilities in the picture to enhance analysis and understanding. Although the operating cycle considers financial flows come from receivables and inventory, it ignores the financial flow coming from accounts payables in this regard. This theory was relevant to the researcher who looked at accounts receivable which are part of the working capital cycle in the PSV insurance companies.

 

## METHODOLOGY

### Research Design

The researcher adopted a causal research design. The study was carried out in Nairobi at Amaco, Direct line, Explico and Invesco insurance companies head office. The researcher administered questionnaires to Finance Managers, Accountants, Cashiers and Internal Auditors. The target population of study was 62 respondents, comprising of 4 senior management staff and 58 employees from finance and accounting department for the four insurance companies

### Sample size determination

The sample size was calculated using Yamane's (2009) formula below, since the target population was 62.

$n=N/1+N\ (e)^{2} = 62/1+62(0.05)^{2} = 51$

Where, n= corrected sample size, N = population size, and e = Margin of error (MoE), e = 0.05 based on the research condition.

The proportion=51/62 =0.822

### Sampling technique

Stratified random sampling method was used to arrive at a sample size that was used in the study. This sampling technique involved stratifying the population in to strata based on the unique characteristics (Habib, 2014). Senior managers and employees from the Accounts and finance department were targeted. The researcher stratified them into two major groups one of senior management and the other of employees of accounts and finance department. The researcher sampled 4 Finance Managers, 32 Cashiers, 17 Accountants and 9 internal auditors.

## ANALYSIS AND FINDINGS

### Response Rate

Table 1 Response Rate

| Sample Size | **Number** | **Percentage (%)** |
|---|---|---|
| Total sample size | 51 | 100 |
| Total responses | 48 | 94 |
| Unusable | 3 | 6 |
| Total usable responses | 48 | 94 |

Out of a targeted population of 62 employees, a sample of 51 was drawn. Consequently, 51 questionnaires were distributed. A total of 48 questionnaires were returned from which, 3 questionnaires were discarded as were incomplete. The 48 Questionnaires' were dully filled meaning all sections of the questionnaires' were answered. The researcher ended up with 48 usable questionnaires which represented a response rate of 94%. This response rate was deemed adequate for external validity.

**Demographic characteristics**

Table 2 Respondents Demographic characteristics

| | | Number of respondents | Percentage (%) |
|---|---|---|---|
| Gender | Male | 41 | 85.7 |
| | Female | 07 | 14.3 |
| Respondents Position | Managers | 04 | 08 |
| | Auditors | 07 | 15 |
| | Accountants | 12 | 25 |
| | Cashiers | 25 | 52 |
| Period in Employment | 0 -5 yrs. | 10 | 21.4 |
| | 5 -10 yrs. | 31 | 64.3 |
| | 10 - above | 07 | 14.3 |

Respondents were asked to provide information regarding their demographic profile/organization which included gender, positions they hold and period in employment. This information was deemed relevant in assessing the impact of working capital management on the performance of PSV insurance companies. The respondents' position gave them a better understanding of how accounts receivable affects performance of PSV insurance companies.

Results presented in Table 2 depict that respondents were majorly male at (85.7%); that most of the respondents were Cashier (52%); that a majority of them had been in employment for over 5 years (64.3%). These results clearly show that the employees who have been in the companies for more than 5 years gave a good basis to study since they understood the working capital management practices of the companies better.

**Descriptive statistics of accounts receivable management practices**

Table 3 Descriptive Statistics of accounts receivable management practices

| | Mean | Std. Deviation |
|---|---|---|
| The company applies stringent credit policy | 3.89 | .907 |
| The company maintains optimum debtors level | 3.67 | .923 |
| The company has debtors ledgers and control accounts | 3.63 | .956 |
| The company extends debtors payment period and observes average collection period | 3.49 | .906 |

Objective of the study was to establish the effect of accounts receivable management practices on PSV insurance companies' performance. The study conceptualized that accounts receivable management practices have a direct effect on PSVs performance.

Five items were used to measure the accounts receivable management practices, respondents were asked to indicate their agreement or disagreement on the items. Responses were elicited on a 5 point scale ranging from 1- strongly disagree to 5- strongly agree. Generally the analysis of the responses reveals that respondents mainly agreed with the suggested credit practices. Table above reveals results of this analysis. In particular, respondents tended to agree that the firm applies stringed credit policy (M = 3.89, SD = 0.907), that the firm maintains optimum debtors level (M = 3.67 SD = 0.923), and that the firm keeps debtors ledgers and control accounts (M =3.63, SD =0.956). However, respondents were not sure whether the companies allow for debtors payment beyond agreed period and observe the average collection period (M = 3.49 SD = 0.906).

The mean scores indicate that the credit practices were well managed in the PSV insurance companies with an average deviation of 0.9 on either side of the normal curve. This therefore had a potential to impact positively on overall performance and hence the need to investigate the nature of the impact.

## Regression Analysis

Table 4 Regression Coefficients[a]

| Model | Unstandardized Coefficients | | Standardized Coefficients | | | Collinearity Statistics | |
|---|---|---|---|---|---|---|---|
| | B | Std. Error | Beta | t | Sig. | Tolerance | VIF |
| 1 (Constant) | .255 | .205 | | 1.248 | .214 | | |
| Accounts receivable Management | .187 | .026 | .281 | 7.122 | .000 | .658 | 1.520 |

a. Dependent Variable: PSV Performance β

### *The effect of accounts receivable management on PSVs insurance companies' performance*

Research hypothesis $H_{02}$ postulated that accounts receivable management practices have no impact on PSV insurance companies' performance. Results indicate that the accounts receivable management practice is a significant predictor of PSVs insurance companies performance (=0.281, p<0.01).

The standardized coefficient =0.281 β implies that an increase of 1 standard deviation in the accounts receivable management is likely to result in 0.281 standard deviations increase in PSV performance. The t-value of 7.122 shows that accounts receivable management practice is an important predictor of PSVs insurance companies' performance. The study supports the findings by Gakure, Cheluget, Onyango and Keraro (2012) whose study revealed that there is a strong relationship between accounts payables and performance, Boadi, Antwi and Lartey (2013) who conducted a study to find out the determinants of the profitability of insurance firms in Ghana. The study discovered that, there was a positive relationship between leverage, liquidity and profitability of insurance firms in Ghana. Therefore the findings rejects the null Hypothesis that $_{HO2}$: There is no significant relationship between accounts receivable management and performance of PSV insurance companies and adapts an alternative hypothesis $_{HO2A}$: that there is a significant relationship between accounts receivable management and performance of PSV insurance companies.

## SUMMARY, CONCLUSION AND RECOMMENDATION

In view of the findings summarized above the following conclusions were drawn based on the research objective. Stringent accounts receivable management policies have a positive impact on PSVs insurance companies' performance and help in guiding the management in terms of balancing and controlling PSVs insurance companies debtors, this is necessary in ensuring sustained performance of PSVs.PSVs insurance companies performance can be regarded as a function of capital management practices particularly those emphasizing on cash management, accounts receivable management and accounts payable management

The PSVs insurance companies need to encourage stringent debtors' management policies that would oversee maximization of profits and more so adopt the cash and carry system of payments on its policies to reduce debtors. The study recommends close monitoring of accounts receivables average rates to monitor the debts of the PSV insurance companies

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