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ACCOUNT RECEIVABLE MANAGEMENT PRACTICES OF SMEs IN TANZANIA: A QUALITATIVE APPROACH

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ABSTRACT

This paper focused on establishing how micro, small and medium enterprises (MSMEs) operating in Tanzania manage debtors. The study used an exploratory approach and was informed by the asymmetric information theory. Saturation point was reached in the fifteenth case. A content analysis was used for the data analysis. The findings show that MSMEs are aware of the importance of managing debtors; they use different means to screen prospective debtors and follow them so that they get paid on time.The same methods are used to monitor and control bad debts. Informal networking, calling debtors, and visiting their residencesor workplaces are mostly used to reduce asymmetric information problems. The paper contributes to the theory by stressing the importance of searching for relevant information while managing debtors.The results further depict the formal credit risk management process and contribute to the literature on the actual methods used by MSMEs while managing debtors. Results suggest that less costly methods of monitoring debtors should be sought and used.

Key Words: *Debtors; Credit Risk Management Practices; MSMEs; Tanzania*

INTRODUCTION

Working capital, which includes all current assets and liabilities,is key to the survival of organizations. Its management is vital for all organizations as not only is it estimated to account for more than 80 percent of daily business (Peel, Wilson & Howorth, 2012), but it is also the most important aspect of the overall financial management practices of any organization as it is directly linkedto cash flow. Current assets include cash, debtors, inventory, pre-payments, and short-term investments whereas current liabilities include creditors, short-term loans, and accruals. The principle of financial management advocates that there should be enough current assets to cover current liabilities. Therefore, the management of current assets is crucial for the prosperity of organizations. It is more crucial for SMEs as empirical studies indicate that they are less liquid and experience more volatile cash flows and profits than large firms.SMEs are also more prone to being credit rationed by FIs because, among other things, their riskscannot be evaluated, thereby making them more cash constrained. Evidence suggests that firms fail because of insufficient liquidity, although they experience sales growth (Ben, 2012).

Kahinde (2011) explained that one of the biggest components of cash flow management is managing debtors. Debtors are among the major components of current assets (Madishetti & Kibona, 2013) and account for 30% to 35% of total assets. According to Peel, Wilson, and Howorth (2012), 43.1%

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of manufacturing SMEs complain that bad debts pose a very important problem to their businesses, and 59.5% of them complain that late payment by debtors creates a significant problem for their businesses. CIMA (1994) showed that 20% of failed firms in the UK were caused by the poor management of debtors. Peel and Wilson (1996) said that, "if the financial/working capital management practices in the small firm sector could be improved significantly, then fewer firms would fail and economic welfare would be increased substantially". Thus, the good management of debtors is pivotal to the health of SMEs.The effective management of debtors means that firms have enough liquidity not only to meet short-term obligations when they come due, but also to conduct normal day-to-day operations andeventually create value for shareholders (Raheman & Nasr, 2007).

A good number of studies have indicated the importance of managing debtors to businesses' performance (Gill, Biger & Mathur, 2010; Deloof, 2003; Ben, 2012; Kahinde, 2011; Rafuse, 1996; Jindrichovska, 2013; Peel et al., 2012; Gamze, Ahmet & Emin, 2012; Al-Mwalla, 2012; Richard & Mori, 2016). However, little is known about how micro, small, and medium enterprises (MSMEs) manage their debtors in terms of screening, monitoring, and controlling. This study fills this gap by establishing debtor-management practices from the credit risk management perspective. Specifically, the paper asks: i) how do MSMEs screen prospective debtors? ii) how do MSMEs monitor debtors? iii) how do MSMEs control their debtors?

Klaras (2014) explained that businesses that do not have a risk management system in place have a tougher time recovering debts than those in which the business owners have taken steps to manage risk prudently.Therefore, managing credit risk arising from debtors cannot be underestimated because customers are important for generating cash for businesses.

This study is informed by the asymmetrical information theory, which explains that giving trade credit provides solutions to the problem of information asymmetry between buyers and sellers. The credit period permits buyers to reduce uncertainty concerning product quality prior to payment, while the seller can reduce uncertainty concerning buyers' intention to repay by prescribing payment beforedelivery or other mechanisms. This act by the seller can be regarded as a component of credit risk management.

The paper proceeds as follows. Section 2 presents the literature review, including the context of SMEs in the country. Section 3 presents the methodology. Section 4 presents the findings of the study, and Section 5 discusses the findings.Finally, Section 6 concludes the paper.

LITERATURE REVIEW

Theoretical Perspective

Asymmetric Information Theory

The information asymmetry theory is based on the basic argument that, in many markets, buyers and sellers do not hold the same information at the same time (Akerlof, 1970). The theory explains that it is equally important to be able to identify the quality of inputs and to certify the quality of outputs (Akerlof, 1970),implying that it is critical for sellers to strive to know the quality of the buyers and make the right choice in order to avoid bad output/loss. Auronen (2003) explained that, empirically, people possess different information that affects their behavior in many situations. Whereas sellers normally adjust the price of items based on their knowledge of prices of similar items on the market and the condition of said items among other factors, buyers can have information about the prices of similar items on the market but probably do not have the same depth of information about the quality of the items as the sellers do. Thus, information is not symmetrical between sellers and buyers.

Information asymmetry normally creates adverse selection and moral hazard problems (Auronen, 2003).

The adverse selection problem is created by ex-ante asymmetric information, whereby the seller may select a potentially defaulting buyer/debtor as a result of insufficient information concerning the debtor. Moral hazard, which is created by ex-post asymmetric information, refers to the situation whereby the debtor decides not to repay the seller on time but instead use the money to meet his/her other interests. The literature explains that good firms sell on credit (creating debtors in their books of accounts) as a result of asymmetric information, thereby enabling the buyer to verify the quality of products before they make a payment. Selling on credit, mostly by SMEs, is one of the strategic tools for attracting new customers, building the supplier–customer relationship and signaling product quality and reputation (Peel et al., 2012). However, selling on credit causes cash flow or financing difficulties. Organizations are therefore compelled to finance their receivables through short-term borrowing, among other possibilities, which is costly for organizations (Gill et al., 2010).

The literature suggests that the information asymmetry challenge between parties can be reduced through intermediary market institutions called counteracting institutions (Auronen, 2003). One of these institutions is a guarantee provided by sellers for goods/services (Auronen, 2003). A guarantee allows the buyer sufficient time to reach the same level of information about the good as the seller before the buyer assumes full risk for the good being bad.

According to Stiglitz (1975), the quality of individuals in economies with perfect information is significantly different from economies with imperfect information, thereby implying that individual screening practices in developing economies differ from those in developed economies. Screening assists in identifying individuals who are betteroff than others (Stiglitz, 1975). The crucial part of managing working capital is in maintaining the liquidity in day-to-day operations to ensure the smooth running of the business and meeting its obligation. The successful management of working capital enables a firm to react quickly as well as appropriately anticipate changes in market variables, such as interest rates and raw material prices, gaining competitive advantages over its rivals.

Wembe (2013) explained that firm performance is affected by working capital management (WCM). Significant evidence suggests that managing WC components can increase the NPV of firms' cash flows, thereby adding to shareholders' value. Yet in Wembe's (2013) study, strategies used to manage the WC were not covered. Our study addresses this gap. Bandaraand Rathnasiri (2016) studied the working capital management practices of SMEs in Sri Lanka, examining debtor management in terms of the extent of reasonability of debtors' credit period as well as bad and doubtful debts. They measured these factors through the level of credit sales, disclosure of credit policies to customers, and percentage of bad debts as compared with sales. Tesfaand Chawla (2018) conducted a comparative study of working capital management practices between Ethiopian manufacturing firms and the United States, Australia, Canada, and Pakistan. Using a survey method of data collection, they identified some similarities and differences in the managerial methods and techniques employed among the manufacturing firms in the studied countries. The differences in the practices could be attributable to, among other issues, the size of the firms as well as cultural differences across international boundaries.

Reddy and Reddy (2005), as quoted in Kaur, Laveena, and Jindal et al. (2017), attempted to evaluate the receivables management practices in the selected small-scale industries at the Peenya industrial estate in Bangalore. They established that credit sales are used as sales promotion

techniques whereas debtors' credit worthiness is judged based on the companies' association with their customers. SMEs collect their dues from the customers either directly or through representatives, and they do not prefer to go to court to deal with defaulting customers.

Gaskill and Van Auken (1993) reported that the most internal problems identified by small American firms relate to inadequate capital, cash flow management, and inventory control. Berryman (1983) indicated that "poor" or "careless" financial management is a major cause of small business failure. In addition, a major survey by the Insolvency Practitioner Society (CIMA, 1994) indicated that 20% of UK corporate failures (the vast majority of which are small firms) were due to bad debts or poor credit management.

MSMEs' Context in Tanzania

The 2003 Small and Medium Enterprise Development Policy of the Government of Tanzania defined SMEs nomenclature to mean micro, small, and medium enterprises (MSMEs). The size of small businesses is defined by the number of employees and amount of capital invested. If an enterprise falls under more than one category (for instance, one employee but capital investment is greater than TZS 5 million), the level of capital investment becomes the deciding factor in determining the size (URT, 2003). Moreover, Olomi (2006) defined "micro enterprises as those employing up to 4 people or with capital of up to US$ 5,000; small enterprises as those employing between 5 and 49 employees or with capital between US$ 5,000 and US$ 200,000; medium enterprises as those that employ between 50 and 99 people or with capital from US$ 200,000 to US$ 800,000". For the purpose of this study, micro and SME[3]are defined according to the 2003 Small and Medium Enterprise Development Policy of the Government of Tanzania, as summarized in Table 1.

Table 1: Categories of MSMEs in Tanzania

Category	**Employees**	**Capital Investment in Machinery (Tshs)**
Micro enterprise	1 – 4	Up to 5 mil.
Small enterprise	5 – 49	Above 5 mil. to 200 mil.
Medium enterprise	50 – 99	Above 200mil.to 800 mil.
Large enterprise	100+	Above 800 mil.

Source**:** Small and Medium Enterprise Development Policy of the URT (2003)

The importance of MSMEs in any economy cannot be overemphasized. The literature clearly indicates thatMSMEs generate at least 60% of the gross domestic product (GDP) in the US (Ovia, 2001) and create about a third of industrial jobs in the US and the UK (Smit &Watkins, 2012; Yazdanfar & Öhman, 2014). Meanwhile, in developing countries, MSMEs generate greater economic benefits than large firms as they not only create employment for a large population but also utilize more of what the respective country possesses and less of what it lacks (Mbura, 2014). In Tanzania, SMEs play a critical role in the economy through the generation of income (more than 20% of the GDP originates from MSMEs) and its equitable distribution, thereby contributing to poverty alleviation (Mori, 2014; MIT, 2012; Hamisi, 2011; Ubabuko et al., 2010; SME Policy, 2003). Despite their importance, MSMEs in Tanzania still face several challenges, including bad debts, insufficient working capital, lack of access to credit at a reasonable cost, high taxes, high cost of inputs, lack of trustworthy workers, lack of proper workplaces, harassment by the authorities, and

[3] Also referred to as micro, small, and medium enterprises (MSMEs)

lack of access to utilities like electricity and water, (MIT, 2012). The literature further indicates that several MSMEs survive for a short time after being established. Most of them fail due to poor working capital management (debtors, cash, account payable/creditors, and inventory/stock; Kahinde, 2011; Padachi & Howorth, 2013). Kahinde (2011) observed that most MSMEs focus on cash receipts and what their bank account position is while ignoring the other components of working capital, which in most cases leads to their downfall.

The theory and empirical literature reviewed herein have suggested that it is difficult for the seller to detect and punish the opportunistic behavior of the buyer, although they stress the importance of screening, monitoring, and controlling debtors, which is the main objective of this study. We thus argue that understanding how MSMEs manage their debtors is critical for finding appropriate solutions for overcoming the adverse and moral hazard problems.

Debtor Risk Management

A debtor is a person or entity that owes money. In other words, the debtor has a debt or legal obligation to pay an amount to another person or entity. The debtor is given a chance to repay thedebt at a later date, according to the agreement. Debtor management is a strategy that involves designing and monitoring the policies that govern how a company extends credit to its customer base (Kaur et al., 2017). The idea behind debtor management is to minimize the amount of bad debt the company will eventually incur due to customers failing to honor their commitment to repay the full amount (Harris, 2014). Common goals of debtor management include ensuring that debts are collected within specified credit terms (Pike & Cheng, 2001, cited in Leitch & Lamminmaki, 2009),identifying delinquent accounts, and reducing the total trade credit written off as a bad debt (Peacock et al., 2003, cited in Leitch &Lamminmaki, 2009).

The process of debtor management begins by evaluating potential customers in terms of their creditworthiness, identifying the credit limit that carries a level of risk that the company is willing to assume, and then monitoring how well the customer makes use of that available credit, including making regular payments within the terms and provisions associated with the credit account (Harris, 2014). This process is elaborated on further in the risk management literature.

A formal risk management process involves risk identification, assessment, monitoring, and control. Gao, Sung, and Zhang (2013) and Poba-Nzaou, Raymond and Fab (2014b) suggest that risk management practices in SMEs may be very informal, which inhibits their being shared. Yet Brustbauer (2014) found a number of examples of SMEs adopting a proactive approach to risk management. Peel and Wilson (1996) observed that 16% of SMEs with debtors in the UK do not keep debtors' records. Other studies indicated almost similar results in other developed (EU) countries (Widbong, 1997).Ben (2012), using a sample of 800 cross-sectoral SMEs from Ghana, found that 80% of the studied SMEs sell their products on credit, 47% set up a credit policy for customers, and 10% sell on credit to anyone who wants to buy; in addition, the majority of SMEs review their debtors' levels on a quarterly basis and 67% of them experience bad debts whereas only 10% of SMEsemployed credit officers.

Falkner and Hiebl (2014) used the systematic literature review method used by Transfield, Denyer and Smart (2003) to identify ambiguities, gaps, and contradictions in the SMEs risk management literature. They analyzed 27 papers and determined that SMEs' risk management in the context of developing economies has not been seriously studied. Indeed, they found only two papers by Acarand Goc (2011) and Gaoet al. (2013), conducted in Turkey and China, respectively. They found that SMEs use informal personal networks to manage any risk situation as well as create and

maintain a close relationship with both suppliers and buyers to ensure repeat business. Furthermore, SMEs frequently use networking as a risk mitigation strategy and even more so for coping with technology, financial, and market risks. The researchers identified several gaps in risk management by SMEs,including the lack of empirical evidence on the control of risk management.They thus recommended, among other things, that research into risk management by SMEs in developing economies is critical given its effect of enabling SMEs to survive, which may also influence the economy.

It has been further observed that many organizations focus more on collection rather than the front-end activities of negotiating, screening for risk, using credit information, and establishing clear credit policies. Empirical evidence indicates that debtors' age has a negative relationship with gross operating income (Deloof, 2003; Raheman & Nasr, 2007; Garcia-Teruel & Martinez-Solano, 2007; Falope & Ajilore, 2009; Mathuva, 2009),and the slow collection of debts is correlated with low profitability (Gill et al., 2010)

Peel et al. (2012) found that most SMEs in the UK concentrate more on stocks and creditors and less on debtors (as measured by their review frequency). Orobia et al. (2013) conducted a qualitative study of 10 business organizations, interviewing their owner-managers. The researchers observed that owner-managers give credit based on their relationship with customers and that debtors are intuitively selected. Furthermore, SMEs orally agree on the payment terms and call their debtors to remind them of the due dates. They concluded that bundling SMEs and large corporations when it comes to working capital management is not appropriate given the differences in the task environment.

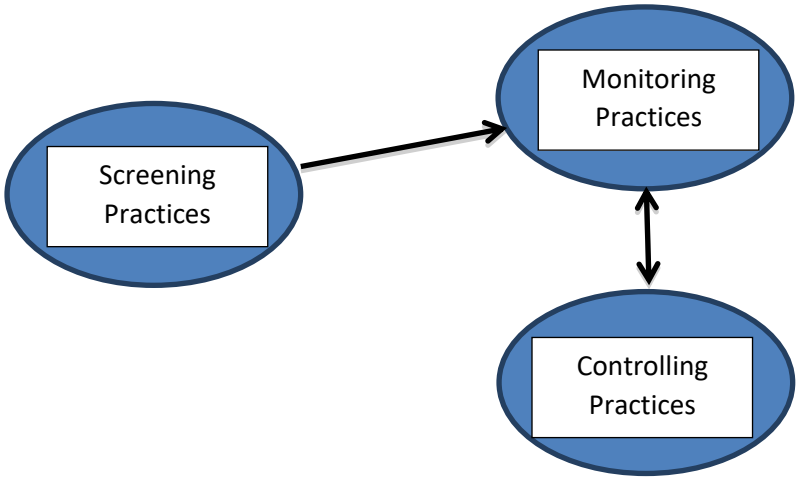
Understanding SMEs' management practices related to debtors is important given the different results observed in the different studies reviewed. Wilson et al. (1995) found that poor credit management is one of the underlying causes of late payment, as well as the ad-hoc credit management behavior of many organizations. Alrill (2006), quoted in Ben (2012), asserted that SMEs often lack resources to manage their debtors effectively,as both the expertise and information required to make sound decisions may be missing. Furthermore, SMEs lack proper debt collection procedures,such as sending out regular statements and invoicing promptly, which tend to increase the risk of late payment by defaulting debtors.The literature argues that the majority of overdue debtscould be reduced by improved credit management (Richard & Nam, 2001). Rafuse (1996) observed that a very close supplier–customer partnership has been identified as one of the successful strategiesfor managing debtors. However, the author arguedthat proper measures need to be established to prevent non-repayment.

Research Gap and Conceptual Framework

Several studies in the area have been conducted in relation to the influence of WCM to firms' performance but leave out how firms manage the working capital. Agyei-Mensah (2011) observed that no research (apart from his) had examined the working capital management practices of small firms, especially in Ghana. His research, which focused on understanding how SMEs make working capital and capital budgeting decisions, was limited by few identified strategies used by SMEs in, among other decisions, managing debtors and cash flows. Few studies have indicated the need to examine working capital management practices or used a survey method while collecting data, thereby limiting results to only a few pre-identified methods used in managing debtors. Such studies further suggest that there are differences in working capital management practices that could be attributed to, among other issues, the size of the firms as well as cultural differences across

international boundaries. Thus, our study used a qualitative approach in establishing MSMEs' practices in managing debtors in Dar es Salaam, Tanzania, following the conceptual framework indicated in Figure 1.

Figure 1: Conceptual Framework



METHODOLOGY

This exploratory research used MSMEs conducting business in Dar es Salaam, Tanzania. Qualitative research is considered a more appropriate approach instudying and understanding the "how" questions (Veal, 2005, as cited in Kusumawardhani, 2013). It provides a rich description of the subject being investigated (Miles & Huberman, 1984). The Dar es Salaam region was selected because it is the major commercial city in Tanzania and has one of the highest business densities, with 45% being MSMEs (National Base line Survey report, 2012). According to this report, the highest general business density (percentage of households with a small business) was found in Mbeya (46%) and Dar es Salaam (45%), while the lowest was in Kagera (14%) and Manyara (17%). The difference in percentages between Mbeya and Dar es Salaam was insignificant.

The current study involved 15 MSMEs. The researchers picked a case and kept on adding cases until, upon analysis, nothing new came from the data (i.e. the saturation point was reached). MSMEs were selected to include those from different business sectors: manufacturing firms (three), commerce and trading (nine), and service enterprises (three). The respondents were chosen based on a prior question asked of them, which cross-checked whether or not they sell on credit. Only those that sold on credit were included.

The information collected was MSME owners'/owner-managers' knowledge, views, opinions, and practices concerning debtor risk management in their work context. An unstructured interview guide with open-ended questions was used to guide the data collection exercise. This gave participants the freedom to give more information on the subject matter. The interview questions were divided into three parts. Part A covered general information about particular MSME businesses; part B covered the profile of the respondents (owners/owner-managers); and part C involved questions on debtor risk management, particularly in terms of screening, monitoring, and controlling prospective debtors.The interview questions were prepared in English and translated into

Swahili to enable those MSME owners/owner-managers who were not conversant in English to respond in Swahili. Most MSMEs in Tanzania use Swahili as the medium of communication.

The researchers introduced themselves and explained the essence of the research to respondents, explaining that they should be free but very honest when replying to the questions (Moorefield-Lang, 2010). The researchers interviewed, recorded, described, interpreted, and appraised the settings as they were (Eisner, 1991). Researchers were very attentive when listening to the responses and used a tape recorder to store the conversations so they did not lose anything while analyzing and presenting the results. Permission from respondents to record the interviews was sought prior to the recording. Moorefield-Lang (2010) argued that it is important for the researcher to present respondents' voices in their true delivery.

A content analysis was used to analyze the data by reading and re-reading transcripts, listening to the recorded tapes, and looking for similarities and differences so as to develop themes and categories. The researchers marked the text containing coded paragraphs, arranged the data, cut the transcripts, and put them in the Microsoft Word format (Miles & Huberman, 1994). Furthermore, the information was organized and reduced through summarization and categorization so that patterns and themes could be identified and linked using pattern matching as proposed by the respective literature reviewed as well as the proposed conceptual model (Patton, 1987; Kulindwa et al., 2016). All the interviews were transcribed, which allowed the researchers to become acquainted with the data. This process is very important because, in qualitative studies, data collection and analysis must be done simultaneously (Marshall & Rossman, 1989, as cited in Moorefield-Lang, 2010). To ensure the reliability and validity of the information, multiple sources of information were used. Furthermore, all transcribed materials from the interviews were shared with the interviewees, which reduced the possibility of the researchers using their own interpretations of the data.

FINDINGS

General information about the Studied MSMEs, their products, and respondents' profile

Fifteen MSMEs were studied: 11 sole proprietors and 4limited companies. Eight of 15 studied MSMEs' businesses had operated for fewer than 5 years, and 7 had been in operation for more than 5 years. In addition, 7 MSMEs were small enterprises, with investment between TZS 5 mil and 200 mil, whereas 8 MSMEs were micro enterprises with investment of less than TZS 5 mil. Eight of the MSMEs had more than three employees. Nine engaged in commerce and trading, three in manufacturing soap and soya products, and three in services (mostly catering services).

Eight of the interviewees were owners while seven were owner-managers; nine were female and six were male. Their education qualifications range froma certificate to a master's degree. Most respondents had more than three years of experience selling on credit.

Debtor Risk Management

Practices of Screening Prospective Debtors

Respondents were asked about howthey decide which customers should be offered goods or services on credit. Their responses are indicated as follows:

> *'I ask and use customer's salary or wage level'*
>
> *'I actually favor customers who I know very well'*
>
> *'I give goods on credits to customers who I know where they reside and that their residences are permanent in nature'*

'I offer credit to customers who had purchased with cash before buying goods or services on credit'
'I must know the customer well before I sell to him/her on credit'

When asked how they reach the final assessment decision and sell on credit, they responded as follows:

'I make a decision based on a customer's self-expression'
'I have to confirm if the customer is a tenant or landlord. If he/she is a tenant, thenI use the rent amount to make my final decision'

The respondents were further required to explain how they verify the ability of new customers to pay before they offer them goods/services on credit. This is how they responded:

'The customer must have paid in cash for some prior purchases; otherwise, I don't sell on credit'
'I have to satisfy myself whether he/she is employed somewhere or not and, if not employed, what is she/he doing for a living?'
'I find a way to verify either through the use of a third party, like his/her relative, friend, co-worker, or neighbors'
'I sometimes just rely on trust'

In summary, the studied MSMEs understand the importance of having relevant information before selling on credit and mostly focus on obtaining information concerning the ability to pay.

Monitoring of Debtors
The respondents were asked to explain how they monitor their debtors and ensure that they make good on their debts. The following responses were provided:

'I normally call them as most of them have mobile phones'
'I sometimes use their friends to remind them if they are taking long to pay their debts'
'I tell their spouses to remind them'
'If my customer is a worker, I sometimes tell his/her employer'

The respondents were further asked to provide information on who is responsible for monitoring debtors. They responded as follows:

'Myself, the owner who also manages the business, [I] follow up on debtors'
'Very rarely I ask the accountant to follow up'
'On some occasions I ask my employees to call and remind those who take a long time to pay their debts'

When asked about how frequently they review their debtors' ability to pay, they indicated the number of times they review debtors' records.

'I cross-check every month'
'I do a check-up after either two or three months'

'I do a review every week'

Respondents were further asked to explain what methods they use when making these periodic reviews of debtors' ability to pay. They responded as follows:

'I always check his/her outstanding balance'
'I check in my computerized system, which tracks when he/she is supposed to pay'
'I calculate the amount paid compared to the total debt'
'I call them and remind them and observe their responses'
'I sometimes go to their premises or offices and see what they have to tell me about paying my debts'

The respondents were asked to indicate how long it takes, on average, for debtors to pay for goods and services bought on credit. The following are their responses:

'It takes them an average of one month'
'They take an average of two to three weeks'
'They sometimes take two to four weeks'
'Many customers pay in a month's time'
'Many customers pay between one and two months'
'Some customers take even six months to pay their debts'

In summary, MSMEs monitor their debtors to avoid them turning into bad debt. They have different means of reassessing their debtors' ability to repay. However, the time they use to reassess their debtors as well as the time it takes for debtors to repay the debts varies.

Controlling Debtors
Respondents were asked to indicate how they follow up with defaulting customers and what they do to debtors who do not pay on time or do not pay at all. They said:

'I always call them almost every day'
'I visit their premises more frequently as they are not very far from here'
'I use polite language to persuade them, like I need the money you owe me so that my family can also survive'
'I sometimes go and report them to their respective local leaders'
'I report them to the police'
'I sometimes just let it go'
'If the customer does not pay, I stop selling goods to him on credit'
'I stop selling on credit and require them to pay cash'

The respondents were alsoasked to indicate at what point they decide to stop offering credit to bad customers in order to avoid losing money. They said:

'I assess my business to see if I can still manage to sell on credit'
'I normally check my books and stock to know if I should sell more on credit or stop'
'I stop selling on credit when I realize that fifty percent of my debtors are not paying on time'
'Selling on credit is inevitable'

In summary, MSMEs institute some control mechanisms that assist them in reducing money losses resulting from credit sales.

DISCUSSION

This study aimed to understand the management practices MSMEs operating in Dar es Salaam, Tanzania, used with debtorsby adopting the credit risk management context. The goal was to explore how MSMEs ensure that their customers to whom they sell on credit do not default and cause losses to their businesses. The study further explored how MSMEs monitor and control their customers throughout the process so that they make good on their debts.

Most (nine) of the studied businesses were in commerce and trading, and a few were in manufacturing. This was expected as the businesses in commerce and trading do require less capital than manufacturing businesses. Joshua (2007) found that industry effect is important for explaining the capital structure of SMEs, as wholesale and retail trade sectors are more likely to use short-term credit than the manufacturing sector.

The study results indicate that more females engage in SMEs than men. These results are in line with those of ILO (2015). Their education qualifications range from certificates to master's degrees, implying that there is a shift from having uneducated SME owners to educated ones. This finding is supported by existing literature demonstrating that the majority of new entrants into the job market in Tanzania are absorbed by SMEs. Most respondents had more than three years of experience selling on credit, which is a good indication of having relevant experience on the subject matter.

Debtor Credit Risk Management

Screening Prospective Debtors

Respondents were asked about how they make decisions on which customers should be offered goods or services on credit. They said they used customers' salary or wage levels and favored customers who were well known to them, those with a permanent residence, and those who had purchased with cash before buying goods or services on credit. These results imply that SMEs understand the importance of having relevant information before selling on credit; such information primarily concerns the ability to pay.

Responses on how they verify the ability of new customers to pay before they offer them goods/services on credit revealed that SMEs do have different ways of verification and mostly rely on informal networks. The major means of verification include determining whether the customers are employed or are businesspeople. Few of them verify through the use of a third party, like a respective relative, friend, co-worker, or neighbors. Very few rely on trust. These results match those of Gao et al. (2013), who observed that SMEs use informal networks to manage risks. Orobia et al. (2013) also observed that most SMEs grant credit to customers known to them.

Monitoring of Debtors

The study results indicate that SMEs in the process of managing debtors' credit risk do monitor their customers, either by calling them or using informal networks (e.g., relatives, friends, and/or employers) to remind them of their payments due. Part of these findings concurred with those of Orobia et al. (2013).The predominant practice is for owners/owner-managers to follow up on the debtors themselves. This is surprising given that most of the studied MSMEs had a minimum of

three employees. A possible explanation could be owners' level of education makes them comfortable performing such tasks themselves. The study revealed that SMEs review their debtors' ability to pay by either calling the debtors or going to their premises/offices. The latter was observed to be costly for most SMEs. Few of the MSMEs track their debtors' outstanding balances; this practice occurs over a period lasting between one week and a month. These results imply that few MSMEs keep proper formal records of their debtors, which is supported by Orobia et al.'s (2013) findings.

The study further observed that it takes a period of one to two monthsfor debtors to pay for goods and services bought on credit. These results indicate that debtors take a longer time to pay MSMEs in a developing economy than those in a developed economy. The FSB (2011) report shows that 69% of SMEs in the UK give credit for up to one month and only a few give credits for more than a month. Therefore, it might not be surprising to learn that SMEs operating in Tanzania experience cash flow problems. Ben (2012) observed that credit sales are positively correlated with the level of sales but negatively correlated with cash flows.

Controlling Debtors

The studied MSMEs do call defaulting customers frequently and also pay them visits. A few of the MSMEs eventually stop selling to such customers,although mostly when they observe their capital being depleted.The MSMEs assess the performance of their businesses to determine whether or not they should continue selling on credit. They keep on giving credit if their businesses are performing well and stop selling on credit when otherwise.

CONCLUSION AND IMPLICATIONS

Conclusion

The findings of this study indicate the existence of an asymmetrical information problem: It is not easy for sellers (i.e., MSMEs) to assess buyers. However, MSMEs are aware of the importance of managing theirdebtors. They use different means to screen prospective debtors in order to deal with the asymmetrical information problem and ensure that they satisfy themselves before selling on credit. They further closely followup on debtors to ensure that they make good on their debts. Networking informally, calling debtors, and visiting/following up on them where they reside or work are mostly used to reducethe asymmetric information problems. Almost the same methods are used to control bad debts.In other words, MSMEs do not have completely different practices when monitoring and controlling their debtors.

Implications

This study has theoretical as well as practical implications. It contributes to the asymmetrical information theory by stressing the importance of searching for relevant information concerning debtors while managing them. In addition, the results depict the formal risk management process that MSMEs use.The study contributes to the literature by discussing the actual methods MSMEs use in practice to manage debtors. However, the results suggest that less costly methods of monitoring debtors should be sought and used. Our study also made a methodological contribution as it was conducted qualitatively, which enabled a more detailed investigation into how MSMEs operating in Dar es Salaam, Tanzania, actually manage their debtors. Further studies to establish the extent of the influence of the identified practices on the level of debtors' risk need to be done. The study used 15 SMEs, so the generalization of the findings is limited.

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