# Effect of Debtors on Performance of Small and Medium Enterprises

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***Abstract***

*The paper assesses effect of credit sales on performance of small and medium enterprises (SMEs) in Tanzania using the credit risk management perspective. Asymmetric information and trade-off theory of liquidity guided the study whereby a dataset of 6,134 Tanzanian SMEs was used. Descriptive and regression methods were used as analyses techniques. Results confirm that majority of SMEs sell on credit (54%). Despite efforts they put into managing their debtors, 26 percent of them default. The results further showed that SMEs incur relatively high costs when managing debtors, an aspect, which hampers their performance. Costs incurred relate to financing, administration and moral hazards problems. The paper contributes to asymmetric information and trade-off of liquidity theories by showing how the relationship between SMEs and debtors can be hampered by ex-post asymmetric information whereby debtors decide to act in their own interests but against seller's interests, a pattern, which contravenes terms of their contracts. The study highlights main challenges faced by SMEs while managing debtors. Bad debts put pressure on SMEs' cash flow thereby limiting growth of their businesses. Education level was seen to be important when managing debtors.*

**Key Words:** Credit Sales; Performance; Credit Risk Management; SMEs

## Introduction

Debtors are one of components of working capital. Working capital refers to all current business assets and liabilities. Evidence from studies indicates that debtors are among major components of current assets (Madishetti and Kibona, 2013). According to Masoud and Mbega (2013), majority of Small and Medium Enterprises [SMEs (56.3% of their surveyed sample)] in Tanzania often sell on credit. Customers taking products on credit and failing to repay is among critical problems facing SMEs in Tanzania. The challenge of recovering their cash is also contextual. Some customers are untrustworthy, for they purchase on credit but before repaying they disappear, an aspect, which creates a problem in following them up (Masoud and Mbega, 2013). Absence of valid national identification for all Tanzanians as well as lack of proper addresses increase the challenge of managing debtors. Effective management of debtors facilitates an increasing number of business activities by increasing sales and consequently, increasing recycling of funds as well as generating greater profits (Madishetti and Kibona, 2013). Some studies indicate the importance of managing debtors in order to enhance business performance (Gamze *et. al*., 2012; Al-Mwala, 2012). But most of them focused on profitability alone as a measure of business performance. More studies are required in this area to explore the relationship between debtors and other business performance measures.

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SMEs usually sell their goods to customers on credit, a pattern, which can be quite profitable because it allows customers to make larger purchases and builds goodwill (Klaras, 2014). However, SMEs that sell on credit reported that they experienced bad debts in 31.1 percent of all cases. A survey conducted in the United Kingdom (UK) indicated that more than 20 percent of firm failures were due to irrecoverable debts or poor management of debtors (Masoud and Mbega, 2013). SMEs suffer financially when debtors do not pay on time or do not pay at all (Yusuf and Dansu, 2013). Consequences of poor credit management not only cause a business to incur additional costs in terms of time and resources in collecting debts but also in delaying conversion of its sales into cash, which may affect its growth and stability (CIMA, 2009). Therefore, this study focused on answering the following question: what is the effect of selling on credit on performance (cash revenue and operational costs) of SMEs in Tanzania? The study used a credit risk management perspective.

Klaras (2013) explained that businesses that do not have a risk management system have a tougher time recovering debts than those where business owners take steps to manage risk prudently. Therefore, managing the risk from selling on credit cannot be underestimated because customers are important for generating cash for businesses. The study is grounded on two theories: asymmetric information theory and trade-off theory of liquidity. The former theory elaborates that debtors often have better information about their financial health than outsiders as a result of imperfect information. The latter theory explains that businesses need to strive to balance costs and benefits of holding cash. Debtors are a component of cash flow and involve funds, which are an opportunity cost (Mbula, Memba and Njeru, 2016). The dataset used had 6,134 Tanzanian SMEs and was collected by the Financial Sector Deepening Trust (FSDT) while conducting a National Baseline Survey (FSDT, 2012). The data covered various questions, which were then examined using descriptive and econometric analyses. The results showed that 54 percent of sales made by SMEs were on credit, implying that majority of SME customers buy on credit rather than with cash. We found that 26 percent of debts were bad, implying that SME owners had to write them off, a pattern, which puts SMEs at great risk. The regression results showed that bad debts are positively related to operational costs. We observed and thus, argue that costs incurred are administrative and financially related. The paper proceeds as follows: Section 2 starts by providing an overview of SMEs in Tanzania and proceeds with literature review followed by section 3, which presents the methodology. Section 4 presents results and discussion, while section 5 concludes the paper.

## Literature Review

### Small and Medium Enterprises

Small and Medium Enterprises (SMEs) have acquired a significant position in the economic development process in the world (Smit and Watkins, 2012; Yazdanfar and Öhman, 2014). It is estimated that a third of industrial jobs in developed countries like the United States of America (USA) and the United Kingdom (UK) are created by SMEs (*ibid.*). Furthermore, in the USA, SMEs generate at least 60 percent of Gross Domestic Product [(GDP) Ovia, 2001]. Studies conducted in developing countries indicate that SMEs have greater economic benefits than large firms in terms of employment generation, efficiency and growth since they use more of what a country possesses and less of what it lacks (Mbura, 2014). In Tanzania, this sector has played a critical role in developing the economy through creation of employment opportunities, income generation and equitable distribution of incomes thereby contributing to poverty alleviation (Mori, 2014; Hamisi, 2011; Ubabuko *et al.*, 2010). More than 5.2 million people in Tanzania are employed by SMEs (Oyen and Gedi, 2013) and more than 20 percent of the GDP originates from SMEs (MIT, 2012). As far as income generation is concerned, SMEs play a fundamental role in utilizing and adding value to local resources and thus, facilitating distribution of economic activities within the economy as well as fostering equitable income distribution (URT, 2003). SMEs can also be easily established in rural settings thereby add value to agricultural products while at the same time facilitate dispersal of enterprises (Mashenene and Rumanyika, 2014).

Despite their importance, SMEs in Tanzania still face several challenges. Among them tthey include bad debts from credit sales/debtors (i.e., customers taking products on credit and not repaying), harassment by authorities, lack of access to credit at a reasonable cost, insufficient working capital, high taxes, high cost of inputs, untrustworthy workers, lack of proper workplaces and lack of access to utilities like electricity as well as water, to mention a few (MIT, 2012). It has also been observed that several SMEs survive for a short time after starting, but most of them fail due to poor working capital management [debtors, cash, account payable/creditors and inventory/stock (Kahinde, 2011)]. Most SMEs do not use their working capital in such a way as to make good profit. The study by Padachi and Howorth (2013) revealed that SMEs tend to neglect the area of working capital management that is often given as the main reason for their poor performance. In Tanzania, SMEs are defined according to number of employees or capital invested. Table 1 provides a clear definition of SMEs.

**Table 1: Definition of SMEs**

| Category | No of Employees | Capital investment in machinery (TZS) |
|---|---|---|
| Micro enterprise | 1-4 | Up to 5 mill |
| Small enterprise | 5-49 | 5 mill to 200mill |
| Medium enterprise | 50-99 | 200 mill to 800 mill |
| Large enterprise | 100+ | Above 800 mill |

Source: *SME Development Policy of the URT (2003)*

**Asymmetric Information Theory**

Asymmetric Information Theory explains the situation of information imperfection between sellers (SMEs) and buyers (debtors in our case). The theory explains that debtors often have better information about their financial health than outsiders. Such imperfect information can be *ex-ante* and/or *ex-post*. On one hand, *ex-ante* involves a situation whereby SMEs select debtors without having sufficient information, which puts them in situation known as adverse selection risk, meaning that they have chosen a defaulting debtor. On the other hand, *ex-post* involves a situation whereby the debtor may decide to act in his/her own interests but against SMEs' interests, a pattern, which contravenes terms of either the formal or informal contract between the two parties. This is referred to as moral hazard. The theory suggests that it is difficult for SMEs to detect and punish opportunistic behaviour of the debtor. However, the theory stresses the importance of managing debtors to avoid the cost of non-recovery of business funds. Trade-off theory of liquidity highlights the importance of balancing the cost and benefits of holding cash.

**Trade-off Theory of Liquidity**

Management of debtors comes at a cost and Trade-off Theory of Liquidity explains that businesses need to strive to balance costs and benefits of holding cash. On the one hand, costs include low rate of return on assets due to liquidity premium and uncertain tax disadvantages. On the other hand, benefits involve using savings when needed to support business activities and the like. Debtors' management has a direct effect on the level of cash of any business (Mbula, Memba and Njeru, 2016). Thus, its proper management cannot be overemphasized. This study employed the risk management approach, for managing debtors is a process.

**Management of Debtors' Risk**

Management of debtors involves designing and monitoring policies that govern how a company extends credit to its customers. The idea behind management of debtors is to minimize the amount of bad debt that SMEs incur due to debtors failing to honour their commitments (Harris, 2014). A common goal of management of debtors is to ensure that debts are collected within the specified credit terms. The act of managing debtors involves adhering to the credit limit, monitoring how well debtors make use of the credit received, including making regular repayments according to terms associated with provision of the loan, conducting an analysis of age of debtors on a regular basis and implementing a fair but firm collection procedure (Harris, 2014).

Drever and Armstron (2005) suggested measures that could be used to assess debtors' capacity to service their loans, which include duration the client has been in business, bank or trade references and credit agency checks, if available. SMEs could also assess customers by using referrals from previous clients or from other suppliers (Mori and Charles, 2016). Absence of a written customer credit policy may also be a cause of SMEs' poor credit management and their inability to ensure adequate cash flow through efficient and effective management of debtors. It is further known that the longer the debt remains outstanding, the greater the risk of it becoming uncollectible.

When selling on credit, enterprises need to consider that trust is important, such as importance of 'soft' information arising from personal relationships and networking and duration of the business relationship (Kubíčkova and Souček, 2013). However, trust and good management of debtors do not entail managing them to prevent late payment or default, but rather, create a system for managing commercial relationships aimed at preventing the risk of late payment or default together with optimizing costs and facilitate ability to pay on time (Kubíčkova and Souček, 2013). It is known from literature that SMEs are, in most cases, under-capitalized and have limited access to external debt and equity (Mori and Olomi, 2015). In this case, management of debtors is critical for SMEs for financing their daily operations. The cash conversion cycle that arises from, among other things, outstanding debt, is associated with SMEs' profitability and is key to their financial success or failure (Deloof, 2008; Olouch, 2016; Gul *et. al*., 2013).

Empirical studies show that management of debtors is fundamental for managing credit risk and cash flow. White (1998b) argued that sellers are unable to identify individual debtor types at the time of default. The author (*ibid.*) concluded that although USA bankruptcy filing rates are high, some households would benefit from filing for bankruptcy but do not do so because they default and sellers never attempt to collect debts. Results from this study lead to suggest that the high cost of following up debtors may shape SMEs' strategies for monitoring their debtors and controll their losses from selling on credit. Deloof (2003) used a sample of Belgian SMEs and found that they can increase their profitability by reducing the loan period. He (*ibid.*) also found that less profitable firms wait longer to pay their bills. Teruel and Solano (2007), using a sample of Spanish SMEs for the 1996-2002 period, found that they can create value by, among other things, reducing the loan period. Ahmet and Önder (2007), using secondary data collected from 75 manufacturing firms listed on the Istanbul Stock Exchange for 2002 to 2009, demonstrated that firms can increase profitability measured by gross operating profit by shortening collection period of accounts receivable and cash conversion cycle.

Kubíčkova and Souček (2013) studied management of debtors in 120 SMEs of the Czech Republic. They (*ibid.*) analyzed debtors by identifying the status of receivables management in SMEs and examining effects of unpaid debts on their overall performance. Their (*ibid.*) results indicated that 93 percent of all SMEs monitor and closely follow up status of their clients' debts. Monitoring takes place using one or a combination of procedures, which are reminders, negotiating with the debtor and limiting further supplies. The findings further revealed that monitoring helps to recover money that has not been repaid. The results also showed that non-performing debts burden most companies and affect their profitability.

Nyabwanga and colleagues (2012), on one hand, observed, among other aspects, that efficiency of receivables management has a positive effect on financial performance of SMEs in Kisii South District in Kenya. On the other hand, Gul and co-workers (2013) observed the opposite in that number of days of account receivables has a negative relationship with SMEs' profitability in Pakistan. Thus, there is a contradiction concerning direction of the relationship between debtors' management and performance of SMEs. This study attempted to fill in this gap and analysed the influence of debtors on SMEs' performance in Tanzania, mostly from credit risk management perspective.

**Methodology**

This study used data collected by FSDT for the purpose of conducting a national SME survey in Tanzania. Interviews were conducted with SME owners, aged 16 and above (FSDT, 2012). Collected data had many variables and 6,134 observations were gathered, which represented a response rate of 98 percent. The questionnaire covered 20 different topics with 192 questions focusing on entrepreneurs' profile, business profile, markets, finance, management practices, business support services, business performance and livelihood demographics (FSDT, 2012). Questions that related to our study were divided into two segments. First, there were questions concerning administration of debtors that included the following: i) Does the business regularly experience bad debts or late payment as a result of customers not repaying as agreed? ii) Does the business keep proper records of debtors? iii) To what extent do they follow up debtors? iv) To what extent do they review debtors' ability to pay? v) To what extent do they verify the ability of debtors to pay? Questions concerning performance were on average monthly cash revenue and monthly operational costs of the business. From the questions and based on literature review, we developed a set of variables.

**Variables and Model**

The study used two dependent variables. The first variable is ***cash revenue*** measured as an average amount of cash received per month, which is equivalent to 123 United States of America (US) dollars. The second variable is ***operational costs***, which includes costs associated with goods and services. This is measured as an average amount of costs incurred per month, which is equivalent to 88 US dollars.

Two independent variables were tested in the regression model. ***Credit sales*** as a binary variable measured whether or not SME owners sell their products on credit. Results showed that 54 percent of sales were on credit. ***A bad debt was*** measured as percentage of debtors who did not repay their debt and it was found out that 26 percent of SME debtors were bad.

We used two sets of control variables. The first encompassed those relating to owners since SMEs are strongly connected to owners. We found that average ***age*** of owners was 36 years old and only 19 percent received post-primary ***education***. Furthermore, 76 percent owners are ***married***. The second set of control variables is associated with the enterprise. Results showed that SMEs were in operation for 6.8 years, only 4 percent were ***registered*** and 55 percent were involved in ***trade*** (retail and wholesale). Table 2 provides the measurements and a summary of statistics of variables included in the regression model. The model used is as follows:

$$\textbf{\textit{Performance}} = \textit{constant} + \beta_1 \textit{ Credit Sales} + \beta_2 + \textit{Bad debts} + \beta_3 \textit{ Owner Control variables} + \beta_4 \textit{Enterprise control variables} + E$$

**Table 2: Definition of Variables in the Regression Model**

| Variables | Definition | Average |
|---|---|---|
| **Dependent Variables** | | |
| Cash Revenue | Average revenue per month (TZS) | 257,567/- |
| Operational costs | Average costs per month (TZS) | 184,000/- |
| **Independent Variables** | | |
| Credit Sales | Binary = 1 if there are credit sales, 0 otherwise | 54% |
| Bad Debts | The percentage of bad debts an enterprise has | 26% |
| **Control variables (Owner)** | | |
| Age | Number of years | 36 years |
| Education | Binary = 1 if the owner has secondary and above | 19% |
| Marital status | Binary = 1 if the owner is married, 0 otherwise | 76% |
| **Control variables (SME)** | | |
| Business Age | Number of years since the business started | 6.8 years |
| Registration | Binary = 1 if the SME is registered by BRELA, 0 otherwise | 4% |
| Business Sector | Binary = 1 if the enterprise engages in trade, 0 otherwise | 55% |

## Results and Discussion

### Owners and Enterprise Demographics

Table 3 presents characteristics of SME owners found in our database. A bit over two-thirds (67%) of owners were aged between 25 and 45 years old. This implies that owners are young and energetic, which is a good indication of contribution they can make to the sector. However, 81 percent completed only primary education. This indicates that people with low education level occupy the sector. Similar results were found in other studies conducted in Tanzania (for example, ILO, 2015; Mori, 2014). This implies that in most cases, understanding level limits growth of their enterprises. In addition, ability to sell their products or services on credit and the capacity to manage debtors may also be affected due to the fact that they do not know how to handle debtors. That pattern may hamper their enterprises' performance. Results further showed that 76 percent of all owners were married, implying that they have spouses to assist them in their businesses (see also Charles and Mori, 2016).

**Table 3: Characteristics of SME Owners in Tanzania**

| **A. Age of Owners** | **Percent** |
|---|---|
| Under 25 | 11 |
| 25 to 45 | 67 |
| Over 45 | 22 |
| **B. Highest Education attained** | |
| Primary School | 81 |
| Secondary School | 11 |
| Technical and University Education | 8 |
| **C. Marital Status** | |
| Single | 10 |
| Married | 76 |
| Separated/Divorced | 8 |
| Widowed | 6 |

Table 4 Part A presents results on enterprises' characteristics in the database. Results revealed that a bit over two-thirds (66%) are micro, employing only one employee, while the other category is still micro but employing up to four employees (31%). It means that 97 percent of SMEs in Tanzania are micro enterprises. Other studies showed similar results that the SME sector is crowded by micro entrepreneurs (ILO, 2015). Similar results are seen in Part B of Table 4 whereby 95 percent are sole proprietors, while only 2 percent are limited companies. Part C of Table 4 further shows that majority (96%) of businesses have not been registered by the Tanzanian Business and Registration Licensing Authority (BRELA). The three parts (A, B and C) of Table 4 are linked, meaning that enterprises with one employee are those led by a sole proprietor and are informal. These characteristics may have implications for management of debtors. First, the entrepreneurs might not know how to assess clients before selling on credit and hence, credit sales may kill the business. Second, since the owner is also the manager, he/she might not get enough time to follow-up debtors because of many activities he/she has to do alone. In this case, the debtors may delay repaying due to lack of follow-up and in most cases, debtors will default as well as move to a competitor.

Part D of Table 4 shows that 54 percent of enterprises are owned and operated by women. These results are in line with previous those from studies (for example, IMED, 2011; ILO, 2015). This can also have an impact on managing debtors because women are softer than men in following up creditors. Part E of Table 4 indicates nature of businesses whereby majority are involved in trade. This makes it easy for them to sell on credit.

**Table 4: Characteristics of MSMEs**

| **A. Number of employees** | **Percent** |
|---|---|
| 1 employee | 66 |
| 2 to 4 employees | 31 |
| 5 or more employees | 3 |
| **B. Legality** | |
| Sole proprietor | 95 |
| Limited liability company | 2 |
| Partnership | 3 |
| **C. Registration (BRELA)** | |
| Registered | 4 |
| Not registered | 96 |
| **D. Ownership** | |
| Male Owned | 46 |
| Female Owned | 54 |
| **E. Business Sector** | |
| Trade | 55 |
| Service: Catering; Accommodation | 31 |
| Manufacturing | 14 |

Sources: Extracted from MIT (2012) and Mori (2014).

**Management of Debtors' Risk**

Table 5a provides descriptive results on management of debtors. The study findings indicated that 61 percent SMEs provide a credit period that varies between 1 and 30 days. It means there are special cases where customers are given longer than one month. The trend of giving credit for up to 30 days is also found in SMEs operating in the developed world. The FSB (2011) report shows that 69 percent of SMEs in the UK give credit for up to 30 days and very few go beyond 90 days. The implication here is that SMEs are able to finance debtors up to a maximum of one month and thereafter, they will likely face a cash flow problem that may affect their operations as well as growth.

Table 5b indicates that SMEs try hard to manage their debtors by reminding them to repay their dues, cross-checking their ability to pay and keeping proper records of theirs debtors' status. However, the results (Table 5a) further indicate that some debtors (42%) delay repaying their dues, either as a result of lack of follow-up by the SMEs or other reasons different from debtors' management. Delay in repayment is usually a sign of non-repayment, which, in most cases, results in bad debt (FSB, 2011; Klaras, 2014) and in our case, it accounted for 26 percent. The main problem that arises with delayed repayment and bad debts is the effect on cash flow, which was explained before by Trade-off Theory of Liquidity.

**Table 5a: Management of Debtors**

| | Percent |
|---|---|
| Sales on Credit / Debtors | 54 |
| Credit Duration (30 Days or less) | 61 |
| Delay in Repayment | 42 |
| Bad Debtors | 26 |
| **Screening Debtors** | |
| Credit sales to trusted and long-term customers | 85 |
| Credit sales to customers with collateral | 15 |
| **Monitoring Delay and Bad Debtors** | |
| No additional credit sales for them | 33 |
| Continue to Follow up | 12 |
| Charge interest for the Delay | 2 |
| Report them to other authorities like the Police | 4 |

**Table 5b: Debtors' Management**

| | Mean | Std Deviation |
|---|---|---|
| Frequent follow up of debtors | 4.78 | 0.756 |
| Keep proper records of debtors | 4.87 | 0.752 |
| Frequently review debtors' ability to pay | 4.46 | 0.857 |
| Verify debtors' ability to pay | 4.46 | 0.875 |

**Debtors and SMEs' Performance**

Table 6 provides results of ordinary the least square regression when all independent variables were regressed together. The main hypothesis tested here concerns relationship between debtors and SMEs' performance. The *results in model 1* showed a negative effect (coefficient -0.25 with $p<0.10$), which means that credit sales reduce the number of cash sales. When customers know they can purchase on credit, they will not pay cash upfront but would prefer to use the opportunity to purchase on credit and spend their cash on other things. Sharan (2012) suggests that reasons customers do not purchase with cash are that purchasing on credit increases their liquidity and for those who resell, it helps them sell their merchandise as well as repay later. In addition, the price for customers is lower because of time value of money (*ibid.*). These reasons cause the relationship between the two to be negative. In addition, our results show that bad debts are negatively related to cash sales, although the result is insignificant. This indicates clearly that the greater the number of bad debts, the poorer the performance and so customers are more likely to buy goods on credit for reselling, leading to fewer cash sales.

Model 2 shows that both credit sales and bad debts are positively related to operational costs (coefficient 0.81, $p<0.001$ and coefficient 0.61, $p<0.001$). This explains costs associated with management of debtors. Costs that come with debtors are various. First, financing cost whereby the owner has to bear in order to continue operating while the money is with debtors. Second, administrative costs of screening customers, keeping records and other related costs. Third, collection cost, especially when customers delay repaying. The owner has to start following up the customer to remind him or her to repay. Such costs increase when customers become bad debtors and the owner has to write off their debts. The pattern leads to loss of revenue and affects the relationship between the owner and debtors. Our findings are in line with literature, which suggests that debtors undermine firms' performance, which may lead to closure of businesses, especially SMEs (Sharan, 2012).

Results for control variables are also important. The study shows a negative relationship between education level and operational costs (coefficient -0.58, $p<0.05$). This implies that being educated helps entrepreneurs to manage costs for their businesses, which, in turn, contributes to good performance. Married owners are positively related to cash revenue (coefficient 0.06, $p<0.10$). The possible explanation here is that spouses may assist in following up debtors thereby collecting the amount due. Similarly, duration of the enterprise is seen to be positively related to cash revenue (coefficient 0.12, $p<0.10$), implying that experience in business matters when it comes to management of debtors.

**Table 6: OLS Regression for Debtors and Performance**

| | **Model 1** | **Model 2** |
|---|---|---|
| | **Cash Revenue** | **Operational Costs** |
| **Independent Variables** | | |
| Credit Sales | -0.25* | 0.81*** |
| Bad Debts | -0.17 | 0.61* |
| **Control variables (Owner)** | | |
| Age | -0.41 | 0.69 |
| Education | 0.016 | -0.58** |
| Marital status | 0.06* | 0.05 |
| **Control variables (SME)** | | |
| Age | 0.12* | -0.09 |
| Registration | 0.08 | 0.14 |
| Business Sector | 0.06 | 0.08 |
| $R^2$ | 0.12 | 0.37 |

* $p< 0.10$ ** $p< 0.05$ *** $p < 0.01$

## Conclusion and Implications

### Conclusion

Findings from this study show that management of debtors is critically important for SMEs' survival because it affects their performance. Most SMEs in Tanzania rely on trust while a few use collateral to screen customers before selling on credit. They keep on following them up while monitoring them. To control the debtors, a few stop completely selling on credit while others charge interest on delayed payments. Despite all these efforts in striving to administer their debtors, some still delay repaying their dues. That could be either due to SMEs' ineffective ways of managing them or other uncontrollable factors. Debtors affect SMEs' performance negatively. Furthermore, the greater number of debtors leads to higher financing and administrative costs.

## Implications

This study has theoretical as well as practical implications. It contributes to Asymmetric Information Theory, which indicates importance of managing debtors to avoid bad debts. It also contributes to Trade-off Theory of Liquidity whereby it holds that the higher the debts, the poorer the performance because SMEs lose their cash and so they are forced to look for other costly sources of funds to finance their activities. Practically, the study highlights main challenges faced by SMEs while managing debtors. High agency costs influence on their decision to sell on credit, a pattern, which affects their business. Bad debts put pressure on SMEs' cash flow thereby limiting growth of their businesses. Low education level was seen to be significant when it comes to managing debtors. This suggests that SMEs face difficulties, especially on managing costs associated with debtors. Furthermore, businesses with long-term experience have a greater chance of being able to manage their debtors and thus, performing well. The study recommends, among other strategies, use of networking while screening and monitoring debtors. Such measure may significantly enable them to select good debtors. In addition, there should be training SMEs in efficient ways of managing debtors to enable them to recover most of their debts and thus, enable them to perform well as well as to continue to contribute to our economy.

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