Credit Risk Management Practices by Oil Companies in Kenya

Patricia Gachambi Mwangi
Lecturer
Department of Business Administration
Chuka University
P.O. BOX 64589 – 00620 Nairobi, Kenya

Martin Mutwiri Muriuki
Purchasing Manager
Total Kenya Limited
P.O. BOX 64589 – 00620 Nairobi, Kenya

Abstract

Credit can be applied by firms to increase sales volumes and thus profitability. However it can lead to liquidity problems if not efficiently managed. The purpose of this study was to understand how oil companies managed their credit risk and the factors influencing their credit risk management approaches. From primary and secondary data collected, the study determined that most oil companies had formal credit management practices with documented credit policies and procedures which are reviewed biannually and fully constituted credit management departments. The study established that understanding of the financial exposure, default probability, industry norms and availability of credit information greatly influenced credit management practices. The study concluded that use of credit information from various sources was paramount in maintaining optimal credit risk levels.

Key Words: Credit, credit management, credit risk, default, bad debts, liquidity, oil companies, petroleum.

1.1 Introduction

Credit is one of the many factors that can be used by a firm to influence demand for its products. According to Horne and Wachowicz (1998), firms can only benefit from credit if the profitability generated from increased sales exceeds the added costs of receivables. Myers and Brealey (2003) define credit as a process whereby possession of goods or services is allowed without spot payment upon a contractual agreement for later payment.

1.1.1 Credit Management

The concept of credit management cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. Myers and Brealey (2003) describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. Nelson (2002) views credit management as simply the means by which an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have a zero credit or default risk. The higher the amount of accounts receivables and their age, the higher the finance costs incurred to maintain them. If these receivables are not collectable on time and urgent cash needs arise, a firm may result to borrowing and the opportunity cost is the interest expense paid.

Effective management of accounts receivables involves designing and documenting a credit policy. Many entities face liquidity and inadequate working capital problems due to lax credit standards and inappropriate credit policies. According to Pike and Neale (1999), a sound credit policy is the blueprint for how the company communicates with and treats its most valuable asset, the customers. Scheufler (2002), proposes that a credit policy creates a common set of goals for the organization and recognizes the credit and collection department as an important contributor to the organization's strategies.

1.1.2 Credit Risk Management

Copeland, Weston and Shastri (2005) assert that the biggest disadvantage of credit sales is the potential credit and default risk exposures. According to Copeland et al (2005) these risks if not efficiently managed and assessed affect businesses adversely and in severity, may lead to insolvency and collapse. Firms manage credit risks by determining exposure portrayed by the value of credit amount extended so that they devise efficient credit management methods in monitoring (Brigham, Gapenski and Daves, 1999).

Credit risk is a situation where debtors fail to meet their contractual obligations on debts they owe an entity (Fabozzi, Modigliani, Jones and Ferri, 2002). Depending on business nature, certain business sectors cannot eliminate credit and therefore are exposed to credit or default risk. Mwirigi (2006) views credit risk as the potential that a counterparty will fail to meet its obligations in accordance to agreed terms. According to Fabozzi et al (2002), credit risk assessment involves consideration of these factors; default probability, credit exposure and recovery rate. Default probability is the likelihood that the counterparty may default on his transactions either over the life of the obligation or over a specific time horizon. Credit exposure is the size of the total outstanding balance of the obligation at default time while recovery rate is the fraction of exposure during default which can be collected through bankruptcy proceedings or through any other form of settlement (Arnold, 2003).

Credit management and creditworthiness determination are two inseparable aspects of credit. According to credit theorists, creditworthiness is inversely related to the degree of portfolio credit risk. Balduino (2000) contrasts the traditional 4Cs of credit (Character, Capacity, Condition and Capital) with the new 4Cs of credit (Consistency, Creativity, Compliance and Consultancy) to conclude that whereas the former focused on the borrower's point of view, the latter employ a balanced aspect of lender-borrower relationship in credit risk determination.

According to Balduino (2000) the emphasis should be on the internal organization's creativity, knowledge and data manipulation for decision making rather than just considering the borrowers' characteristics which can be misrepresented by window dressing. Timely identification of potential credit risk is important as high default rates lead to decreased cash flows, lower liquidity levels and financial distress. In contrast, lower credit risk exposure means an optimal debtors' level with reduced chances of bad debts and therefore financial health.

According to Scheufler (2002), in today's business environment risk management and improvement of cash flows are very challenging. With the rise in bankruptcy rates, the probability of incurring losses has risen. Economic pressures and business practices are forcing organizations to slow payments while on the other hand resources for credit management are reduced despite the higher expectations. Therefore it is a necessity for credit professionals to search for opportunities to implement proven best practices. By upgrading your practices five common pitfalls can be avoided. Scheufler (2002) summarizes these pitfalls as failure to recognize potential frauds, under-estimation of the contribution of current customers to bad debts, getting caught off guard by bankruptcies, failure to take full advantage of technology, and spending too much time and resources on credit evaluations that are not related to reduction of credit risks.

1.1.3 The Oil Industry in Kenya

The oil industry in Kenya is characterized by about 26 oil marketers. It is governed by the Kenyan law which covers operations from crude importation, refining and retailing. It is an oligopolistic structure dominated by about 3 major players. The three players control over half of the market share with 56.9% of the total market share as at December 2012 (Total Kenya controlling 20.5%, Kenol Kobil 20.1% and Shell 16.3%). The sector is very competitive characterized by price controls, common non-differentiable products and strict taxation structure within a liberalized economy therefore requiring adoption of other strategies besides price and its related derivatives as a competitive strategy. Amongst the strategies is use of credit sales and therefore its management cannot be ignored.

1.2 Statement of the Problem

Oil resource is an important energy source world over with its prices purely dictated by OPEC strategies (Wachira, 2007). The frequent disruption of supply in the Middle East region has led to an increase in barrel crude price from USD 49 in October 2004 to USD 65 in December 2006 (Wachira, 2007).

The Kenyan tax law was amended on 01/08/2005 requiring upfront payment of taxes at entry point to curb dumping (Petroleum Amendment Act, August 2005) with the Kenya Revenue Authority's slow refund process of Value Added Tax and customs duties notwithstanding. Consumer protection groups in conjunction with the Parliamentary Energy Committee (PEC) lobbied for a motion of amendment of the Petroleum Act for price controls and this has forced the industry to reduce pump prices with the prices being dictated by the Energy Regulatory Commission.

The above aspects affect the oil companies adversely. First the working capital requirement has gone up because of rising crude prices and upfront tax payments. Secondly unit margins have shrunk overtime due to price controls and therefore there is need for strategies to ensure survival bearing in mind the enormous pressure on the oil companies liquidity needs. From the foregoing, the oil sector due to its nature engages in credit sales with a view to increase market share and sales volume. The multiplier effect is credit risk coupled with high liquidity needs (Kimutai, 2006). This study therefore sought to determine the credit risk management practices within the oil industry in Kenya and the factors affecting the choice of credit risk approaches within the industry.

1.3 Objectives of the Study

The research objectives were:

- To establish the practices applied by oil companies in credit management.
- To determine factors affecting the choice of credit management approach within the oil industry.

1.4 Significance of the Study

The study will benefit a number of interest groups starting with the credit professionals within the oil firms who will use the research findings and recommendations to lay out strategies to strengthen their credit management practices. It will also enable the oil industry stakeholders including investors, suppliers and financiers judge the degree of risks they are associated with in their relationships and interactions with the industry. The study will create a foundation in credit management for academicians upon which related and in depth analysis can be based on. Oil companies are among the biggest contributors to the exchequer in form of taxation and this study forms a basis for assessing the liquidity position of the oil companies for the tax authorities and policy makers.

2.0 Review of Literature

2.1 Credit

Credit is created when organizations trade with others on specific agreed terms and negotiate for delayed payments rather than cash on delivery. Generally this is trade credit where goods and services are extended by suppliers to their customers for later payments. According to Patsula (2001), the main advantage of trade credit is the attraction of additional customers and increased sales volume. Myers and Brealey (2003) suggest that it is imperative for almost all business entities, irrespective of industry, to offer credit in order to survive. However they contend that though this increased sale is advantageous to growth and expansion of market share, it is associated with direct and indirect costs including extensive book keeping, invoicing and collection procedures. These costs affect cash transactions to a lesser extent. Moreover, a portion of credit granted may never be honored resulting in bad debts.

2.1.1 Types of Trade Credit

Patsula (2001) suggests that organizations can classify trade credit into three broad categories depending on its characteristics and properties. The first category is open credit which is open account or regular credit. This is where organizations extend short term credit to its customers without any requirement for a down payment and without charging any interest or carrying charges. It is the most common type of credit and is usually payable within thirty days or at the end of the month. The second category is option-terms credit. This is where organizations allow credit to their customers up to a certain limit and payments due within thirty days of billing without a penalty. However, the company can assign a carrying charge to amounts due and not paid within that time period and release additional credit up to the preset agreed limit. The last category is the revolving charge credit. It is a situation where organizations continuously release credit subject to a certain preset ceiling as payments are being made. It is the common type of business credit in the corporate world where organizations have a long term relationship with their customers.

2.2 Credit Management

Before an organization extends any credit to its customers a policy or a list of rules must be established to prevent any potential credit risks (Horne and Wachowicz, 1998). According to Pike and Neale (1999), credit management entails a design process starting all the way from a credit sale to the very end when the payment relating to that sale is fully collected. Many organizations have gotten into pitfalls of credit such as cash flow problems or constrained working capital because they have not established good systems to be able to collect debts in a pace consistent with the way sales are made. This has led to inevitable financing of accounts receivables and at times costly borrowing to be able to meet short term working capital requirements.

Organizations can avoid cash flow problems if they administer and manage credit with financial prudence by ensuring that all goods and services rendered are promptly paid for (Grover, 2002). Accounts receivables account for a big proportion of assets in businesses averaging 15% to 20% of the total assets of a typical business. Accounts receivables for oil firms in Kenya form about 25% to 30% of the total assets (Kimutai, 2006). To control credit sales it is necessary to specify clear responsibilities for the credit department in its credit management functions. This function should be instilled with specific goals and objectives (Knox, 2004). This corroborates the fact that no matter the size of any business operation the focus should be on managing and collecting accounts receivables efficiently and effectively to maximize essential cash inflows.

Credit management decisions involve a trade-off between credit risks and profit margins. A common mistake is the assumption that a credit sale is a 'one off' ignoring potential repeat business (Pike and Neale, 1999). Pike and Neale (1999) assert that the credit management process involves a number of stages starting with drafting of credit mission and goals, formulation of a credit policy, implementation of the credit policy and critical assessment of the credit management performance.

2.3 Risk

Risk refers to the potential that some unfavorable event will occur. This is deviation from the desired outcome (Brigham et al, 1999). Risk is determined by the probability of occurrence and the magnitude of deviation, that is, the higher the chances of occurrence and the variability, the higher the risk levels.

2.3.1 Credit Risk

Credit risk in business is the risk that a buyer will fail to satisfy the obligation terms in regards to timely payment and eventual payment of the whole amount of debt (Fabozzi et al, 2002). Many organizations have experienced liquidity problems as a result of their customers' failure to honor their part of trade credit obligations on time. Fabozzi et al (2002), describe this as the probability that a counterparty may fail to meet his part of obligations in accordance with agreed terms. In case of default the credit exposure should be established, which is the size of the total outstanding balance of the obligation at the time of default (Arnold, 2003). It is also basic to determine the recovery rate so as to make decisions on the usefulness of committing resources towards the recovery process. Arnold (2003) describes the recovery rate as the fraction of the exposure during default which can be collected through any other form of settlement other than direct payments.

Firms facing default risks are sometimes forced to seek alternative sources and in extreme liquidity needs they engage costly borrowing from financial institutions to satisfy their working capital requirements. If these debts are not collectable at all in the long run, the resulting bad debts depending on magnitude may trigger financial distress and hence bankruptcy. It is important therefore for any organization to critically assess credit risk as regards any single customer it interacts with and strategize on the best methods for credit risk minimization.

2.3.2 Other Risks Affecting Credit Risk

There are other risks that are related to credit risk which are liquidity risk, market risk, foreign exchange risk, political risk and interest rate risk. Liquidity risk is the risk that an organization is unable to meet its cash flow obligations as they fall due. According to Ross, Westerfield and Jordan (2003), the primary concern for a firm's liquidity is its ability to pay for its obligations in the short run without undue stress. Inadequate liquidity in a firm can lead to decrease in profitability as short term profitable investment decisions are forgone and in extreme cases may lead to insolvency. Poor credit management methods can accelerate liquidity risks as slow debts collection leads to lower cash inflows and this may be overtaken by the short run liquidity needs.

Market risk refers to overall risk associated or brought about by changes in general macroeconomic variables. Market risk stems from factors which systematically affect all firms in an economy such as forces of nature, war, recession, inflation and high interest rates. No single firm can control any of these factors as they negatively affect them and therefore market risk cannot be eliminated by diversification (Brigham et al, 1999). As these factors adversely affect organizations they consequently trigger a greater need for cash and therefore cash and cash equivalent sources must be streamlined. This underscores the importance of credit management as a cash inflow source or contributor.

Foreign exchange risk is the risk that a currency's value may change adversely. An organization which performs cross border trade experiences foreign exchange risk as it deals with different currencies. Depending on the movement of either currency, a credit transaction due across different currencies may either get more valuable or less valuable. This is considered as foreign exchange gains or losses (Fabozzi et al, 2002). Foreign exchange losses complicate cash flows further especially if a firm is in a borrowing positioning. On the other hand if an organization is owed by an international firm and terms of trade were negotiated upon foreign currency and there was no hedging arrangement during the contract, if the home currency appreciates against the foreign currency at repayment time the organization is at a losing position because this is lower than anticipated cash inflow. This has a multiplier effect to credit risk especially if the foreign firm defaulted payment until when the other firm's currency appreciates in comparison to its own, therefore adherence to credit terms is of utmost importance for cross border transactions.

Political risk is the risk associated with the socio-political environment of an organization's trade partner. The risk arises when these factors interrupt the smooth repayment schedule of an outstanding debt or the overall fulfillment of the obligation hence credit risks. All Kenyan oil marketers with export partners from Rwanda, Burundi and the Democratic Republic of Congo are forced to engage in only cash transactions because of the prevailing political risks (Gandhi, 2006).

Interest rate risk refers to the exposure of an organization's financial position due to adverse movements of interest rates. According to Pike and Neale (1999), ordinarily the interest rate increases with the term of advance, the actual rate being linked to a bank's base rate which in turn depends on the base rate set by the monetary authority usually the central bank. If the Central Bank base rate is increased in monetary policy strategies the basic lending and borrowing rates follow suit. This has the implication of making outstanding loans more expensive than before. It may affect credit risk in situations whereby an organization's trade partner had an outstanding loan with a banking institution and by the virtue of bank credit being secured the counterparty diverts more funds to service the loan and overlooks payment of its trade credit.

All these types of risk directly or indirectly affect credit risk and therefore affect credit. In credit risk management therefore their contributory elements must be considered for incorporation to credit management methods and procedures to enhance efficiency.

2.4 Credit Risk Management

Credit risk management in an organization encompasses a number of processes both within and outside the firm all aimed at creating the best strategies to minimize the adverse effects of credit risk and improve on cash inflows to enhance liquidity. It is basic to start with the constitution of a credit control department formed from a team of finance professionals bestowed with the responsibility of managing a firm's credit portfolio. This defines clearly their responsibilities and defines a logical manner in which they are supposed to interact with the other interrelated departments within the organization such as the sales or marketing team as well as treasury or the cash management arm of finance department. This ensures that conflicts are minimized and the overall organization objective is maintained.

The functional responsibility of credit control department starts with formulation of a sound credit policy which stipulates acceptable credit standards and desired credit terms to be extended to the customers. Credit terms can be described in terms of factors like credit period, collection policy, allowable cash discounts and discounts period all which are incentives in credit management. All these credit parameters in the credit policy must be designed in such a manner that they conform to the overall organizational policy and goal of profit maximization (Fabozzi et al, 2002).

The balancing factor is an optimal equilibrium situation whereby credit risk is minimized to the best level possible while on the other hand the sales volumes and market share are not compromised by restrictive and constrained selling. Credit risk management extends outside the organization through a process whereby credit control professionals carry out credit risk assessment for their trade partners. This is achieved through sourcing organizations' credit history and credit data through for example credit referencing and other data sources like financial statements. It is then followed by credit data analysis to achieve specific credit scores and ratings for different enterprises (Horne and Wachowicz, 1998). According to them, credit scoring and rating determines the potential credit risk exposure an organization is faced with if it interacts with a particular trade partner.

At this point the credit professionals are at a position to make a decision whether it is prudent or not to offer credit to a particular customer depending on the strength of his credit score or credit rating. If credit is to be extended the question is, how much to offer (credit limit) and over what period (credit period). Thereafter, the final credit management step i.e. the collection policy comes into place (Pike and Neale, 1999).

2.5 Credit Analysis

This is the study and analysis of credit information available in determination of an entity's creditworthiness in a process termed as credit assessment. This is can be done in-house by the credit department or alternatively by engaging services of specialist credit analysts such as Moody's, Standard and Poor's, ratings from Credit agencies e.g. Dun and Bradstreet or even consulting banks to carry out credit checks on your behalf (Myers and Brealey, 2003). Horne and Wachowicz, (1998) confer that after establishment of terms of sale, organizations must evaluate their credit applicants to determine their credit risk exposure. This credit evaluation procedure involves three related steps; obtaining credit information from an applicant, analyzing this information to determine an applicant's creditworthiness and making the credit decision.

2.6 Collection Policy

Collection policy involves all processes and strategies an organization employs to ensure that what has been extended as credit sales is fully collected and on time. According to Pike and Neale (1999), a good credit collection policy is one in which procedures are clearly defined, clearly communicated to customers and customers know their rules well. Organizations always strategize to embrace policies which hasten to reduce the debt collection cycle as long cycles affect both cash inflows and liquidity adversely. Therefore to avoid incompatible collection policies which manage debt collection poorly, all essential departments of an organization including finance and sales department must sit and decide on unified ideas in structuring the collection policy. Myers and Brealey (2003) note that many times conflicts of interest arise between an organization's collection department and sales department in circumstances where their ideas are not unified in a policy. This leads sales departments to complain that no sooner than they win new credit customers than the collection departments scare them away with threatening letters. Arnold (2003) agrees with the above idea that good administration of debtors can only be achieved through a clear, concise and well communicated collection policy. He further suggests three principles towards a maintaining a good collection policy i.e. being strict with credit limits, sending invoices promptly and systematically reviewing debtors.

Arnold (2003) describes the Perkin's principle of late payment which is a common practice whereby firms dishonestly delay to pay their debts. Finance personnel responsible for raising payments instruct their secretaries not to pass through demand calls from their creditors. Creditors are usually given explanations like they are in meetings, they will call back, they are out of office or on another line and this goes on for some time leading to late payments. According to Arnold (2003), one in four business failures in the European Community are as a result of late payments and bad debts. Late payments can be avoided by strategies like setting strict credit limits and sticking to them, involving sales team in negotiations for payment terms to ensure they are agreed upon by the customer at the onset, regular credit checks on existing customers, instituting stop supplies for defaulting customers, contractual agreement for charging late payment fees or interest and if all else fails engagement of a debt collection agency. This is because an organization may waste useful resources which could have been channeled to profitable investment options and in the long run end up incurring bad debts. Therefore to avoid such a situation a credit policy must set out clear criteria for determination of a debt's write-off point.

2.7 Other Debt Management Methods

2.7.1 Factoring

According to Myers and Brealey (2003), factoring is described as an arrangement whereby a financial institution buys an organization's accounts receivable and collects the debts based on an agreed commission percentage on invoice value. The factor and the client agree on credit limits for each customer as well as the average collection period. Thereafter, the client notifies his customers that the factor has purchased the debts. Henceforth after every sale, invoices are forwarded to the factor with the customers paying directly to the factor while the factor pays the client on basis of agreed average collection period irrespective of whether the customer has paid or not. Arnold (2003) highlights three benefits associated with debt factoring namely provision of finance, sales ledger administration and provision of credit insurance.

2.7.2 Invoice Discounting

In invoice discounting, invoices are pledged to a finance house in return for an immediate payment e.g. 90% of the face value. The supplying company guarantees to pay the amount represented on the invoice and is responsible for collecting the debt. The customers are generally unaware of the arrangement. At the due date, irrespective of whether the invoice has been collected or not, the supplying company submits the total invoice amount to the finance house and in return receives the remaining 10% less service fees and interest. Two key factors to guide the finance house is the supplier's nature of business and its profitability (Arnold, 2003).

3.0 Methodology

A census survey design was used in this study to facilitate comparison of data from different respondents. The target population was all the oil firms in Kenya which were 26 operational oil marketers and since they were few no sampling was undertaken. Questionnaires consisting of open-ended, structured and unstructured questions were administered to obtain primary data. Secondary data from in-house credit management publications, reports and brochures was used to supplement primary data. Data collected was examined for completeness, reliability and consistency. Content analysis of data collected was done by use of tables, frequencies, percentages and factor analysis.

5.0 Results and Discussions

Out of the 26 questionnaires administered, 19 were fully completed, 1 was partially completed and 5 respondents declined. The partially filled questionnaire was not admissible for analysis and therefore the response rate was 73%. All the 19 respondents indicated that their firms engaged in credit transactions for various reasons i.e. 52.6% indicated that credit was a key competitive strategy, 26.3% to increase market share, 10.5% to increase sales volume and 5.2% for both profitability and promotional reasons. The most common type of credit extended in the industry was open terms credit with 100% of the respondents indicating they extend it and on top of that 73.6% indicated that they engaged in option terms credit while 11.1% indicated they participated in revolving charge credit. All the firms indicated that they sensitized their employees on credit risk through regular training (63.2%), circulation of brochures and credit manuals (57.9%), regular meetings (47.4%) and credit controls meetings and the intranet (5.2%). In addition, 73.7% of the respondents indicated they had fully operational credit departments while on the other hand 26.3% indicated that they did not have them.

18 out of 19 respondents indicated that they had a documented credit policy with 72.2% of the respondents indicating it was the responsibility of the Chief Executive and the credit control team to formulate it while 16.7% indicated that it was done only by the credit control team and 11.1% indicated that this was done by the Chief Executive together with the credit manager. The credit policy was reviewed regularly with 83.3% doing it semi-annually, 11.1% annually and 5.5% on a quarterly basis. In setting credit standards the respondents indicated default probability as the most important factor, followed by added profits from increased sales volume, then opportunity cost of additional debtors and lastly the overall increased cost in managing debtors. In determining the credit period 89.5% of the respondents indicated they considered both the normal terms of credit for the industry and credit rating for customers, 84.2% indicated availability of customers' credit information and 63.2% indicated consideration of trade credit as a marketing tool. In addition, to determine the credit limit 89.5% of the respondents indicated they based it on customer's financial strength, 84.2% indicated they considered customer's credit rating, 63.2% indicated they considered how well they knew the customer and 5.3% based it on customer's request.

The credit limits were reviewed frequently with 78.9% of the respondents indicating they reviewed them semi-annually, 10.5% reviewed them annually and 5.2% for both quarterly and whenever there was a credit scare for example late payment occurrence or credit score deterioration. Some of the respondents indicated that they would use credit terms as strategies to shorten credit period with 84.2% indicating that they issued cash discounts, 5.2% used seasonal dating and 10.5% would not.

In the credit assessment process 89.5% indicated that they combined both in-house credit personnel and specialist credit analysts, 63.2% indicated both use of in-house credit personnel and trade referencing, 57.9% indicated use of credit analysts only, 52.6% indicated in-house credit personnel only and 47.4 % indicated use of specialist credit analysts and trade referencing. The respondents indicated that they obtained information from several sources. 84.2% indicated they used audited financial statements, 78.9% indicated they used trade checking and referencing, 36.8% indicated use of credit rating reports, 31.6% indicated bank checking and 5.3% indicated company's own experience. In addition, 94.7% indicated they were involved in sharing credit information while 5.3% admitted that they did not participate in credit information sharing.

All the respondents indicated that they considered credit scoring important in their decision making. They also indicated that they had a collection policy which incorporated the principles of strict credit limits, systematic debtors review and prompt invoice sending. In addition they indicated that the most widely used strategies in collection were order stopping when contractual credit limit was reached (94.7%), late payment charges on overdue accounts (84.2%) and use of debt collection agencies (73.7%). 42.1% of the respondents indicated that they engaged in invoice discounting and factoring while 57.9% indicated they did not. Of the respondents who engaged in factoring and invoice discounting 75% indicated it was due to provision of finance, 62.5% due to credit insurance and 37.5% due to sales ledger administration. Most of the respondents (84.2%) indicated that determination of bad debts write-off point was done by the credit committee, 10.5% indicated it was determined by the managing director and 5.3% indicated it was determined by the finance manager.

5.0 Conclusion

This study investigated the risk management practices applied by the oil companies in Kenya and the factors affecting them. On analyzing the data collected the study concluded that the oil industry just like any industry dealing with credit was affected by adverse effects of credit risks. Further it found out that oil companies in Kenya managed credit risk through a number of ways including having credit departments, drafting and documenting credit policies and collection policies, credit assessment and appraisal, information aggregation and sharing, credit rating and scoring, invoice discounting and factoring and proper bad debt write-off. In addition credit risk management strategies were designed and formulated to guide credit management based on stipulated documented procedures to enhance effectiveness of the incorporated processes. The study also concluded that it was critical to analyze all the prevailing factors and conditions in order to design appropriate credit risk management processes so that credit risk exposure can be minimized to an optimal level. This demands a thorough understanding of all the factors affecting this process as found out in this study.

6.0 Recommendations

Effective credit risk management is critical for the success of all oil companies in Kenya in the face of stiff competition and restrictive policies. To maintain financial stability oil firms must clearly understand the adverse effects of credit risk and its associated consequences. This is because credit risk adversely affects cash inflows, constrains working capital and may lead to eventual financial distress at critical points. Oil companies must engage in credit risk management and should strive to incorporate the best practices to guide this process. It is also critical to regularly review these processes and methods since credit risk exposure levels change with change in associated prevailing conditions and factors. Timely and accurate credit decision making is basic in credit risk management and this can be achieved through incorporation of valid credit information from all relevant sources as well accuracy in its analysis. To achieve this there must be proper training of the responsible credit personnel so that they add value through objectivity in credit decision making.

7.0 Limitations of the Study

This study experienced some cases of apathy in that some of the respondents declined to fill the questionnaires for no apparent reason. However, the non-response rate of 26.9% or seven respondents was considered insignificant to the validity and reliability of this study.

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