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Debtors' Management Practices and Resilience of Small and Medium Enterprises in South Africa

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Abstract

Aim: This research aimed to assess the relationship between debtors' management practices and the resilience of small and medium-sized enterprises in South Africa. **Methods:** Employing a quantitative research design, the study employed purposive sampling to select a cohort of 110 SME owners operating in Durban, South Africa. 94% response rate was achieved, yielding 103 valid responses. **Results:** The results of the analysis unveiled a statistically significant positive correlation between effective debt management and the resilience of SMEs. This empirical evidence signifies that proficient debtors' management plays a pivotal role in enhancing the resilience of SMEs operating in South Africa. **Contribution:** This study contributes to the growing body of knowledge by affirming the positive influence of debtors' management on the resilience of SMEs in South Africa. Drawing on the findings of this study, government agencies and industry associations should collaborate to develop supportive initiatives and policies that aid SMEs in optimizing their debt management strategies.

Keywords: *Debt Management; Small and Medium-Sized Enterprises (SMEs); Resilience; South Africa; Creditworthiness; Debtors' Monitoring*

1.0 Introduction

Small and Medium-Sized Enterprises (SMEs) are integral to the economic development of many developing nations, including South Africa (Mafini, Dhurup & Madzimure, 2020). They are catalysts for job creation, economic growth, tax revenue generation, and resource utilization, providing a diverse range of goods and services (Verma, 2019). In South Africa, SMEs are no exception, playing a significant role in bolstering the country's economic vitality (Fubah & Moos, 2022). However, despite their importance, SMEs in South Africa, like their global counterparts, face various challenges that threaten their sustainability and resilience. Tarambiwa (2021), argue that the concern is the fact that more than 60% of these SMEs encounter insurmountable difficulties, largely attributed to management-related issues, leading to their annual closure. Although previous research has been undertaken on a similar problem, the present study used deference theories to provide an alternative perspective. Furthermore, the current study was conducted in the aftermath of the Covid-19 pandemic, at a time when SMEs are particularly concerned with financial resilience.

Bowen, Morara and Mureithi (2020) argue that SMEs grapple with numerous hurdles, including fierce competition within the sector, limited access to financial capital, competition from competitively priced imported goods, security concerns, and challenges in recovering debts. Empirical evidence indicates that credit constraints have eased, particularly when SMEs lack access to credit facilities, compelling them to extend credit to customers as a strategic necessity for survival in the market (Amadasun, & Mutezo, 2022).

While cash transactions remain common in the business world, credit sales are prevalent. However, mismanagement of credit strategies can lead to a cascade of debtors defaulting on their obligations, potentially causing severe harm to enterprises (Barney & Souksakoun, 2021). In such cases, delayed debt collection results in financial losses for the company, negatively impacting working capital ratios (Barney & Souksakoun, 2021). Bartlett and Morse (2021) stated that in the worst-case scenario, business owners may need to inject additional capital or take on more debt, jeopardizing overall resilience. Wadesango et al. (2019), revealed that inadequate debtor management can lead to cash flow problems, a major contributor to business failure. A study by Kamberidou (2020), found that approximately 75% of small businesses in South Africa fail within the first three years, with poor cash flow management cited as a leading cause. Furthermore, a 2022 survey by the South African Reserve Bank revealed that 40% of SMEs reported late payments from debtors as a significant operational challenge. Altman et al. (2023), argue that this problem is exacerbated by the fact that, the average debtor days for SMEs in South Africa is 60 days, significantly higher than the global average of 40 days. Moreover, a survey conducted by the South African Reserve Bank (2023) indicated that about 60% of SMEs in South Africa struggle with debtor management, primarily due to late payments and non-payments. Msomi and Olarewaju (2019), stated that these issues not only affect SMEs' cash flow but also hinder their ability to invest in growth and innovation, impacting their sustainability.

Moreover, the failure of debtors to meet financial obligations extends to affecting essential commitments, such as staff salary payments. As operating cash decreases due to outstanding debts, it can lead to a cash crunch, hindering inventory procurement and daily operational expenses (Brunnermeier & Krishnamurthy, 2020). These liquidity challenges are exacerbated by poor debtors' management practices, often branding SMEs as high credit risk entities, making financial institutions reluctant to extend credit, further increasing their vulnerability to financial distress and potential failure (Richard & Kabala, 2020). In summary, effective debtor management is crucial for safeguarding the financial stability and long-term viability of businesses.

Manelli, Pace and Leone (2022) posit that the deficiency in debtor management within most SMEs can be attributed to the absence of formal credit policies. SMEs frequently lack proper systems to oversee their debtors, extending credit without thorough creditworthiness assessments, leading to high rates of bad debts and cash flow issues. According to Sah (2022), selling on credit remains a pivotal marketing strategy Furthermore, effective receivables management can positively impact a company's financial performance by ensuring timely fee collection for products and services rendered (Sah, 2022). Money is the lifeblood of any business, particularly for companies extending credit to their clientele (Bushe, 2019). This makes it imperative for firms to exercise prudence in lending, implement formal credit policies and robust debtor management systems to safeguard their financial stability and long-term prosperity (Asah & Louw, 2021).

Given the aforementioned obstacles encountered by SMEs in South Africa, the correlation between practises related to managing debtors and the ability of these enterprises to withstand and recover from difficulties assumes a significant level of urgency. The significance of inadequate debtor management is apparent, as it can lead to serious repercussions such as financial instability and even business collapse. However, there is a necessity for thorough investigation in order to gain a better understanding of the full scope of this correlation. The issue under consideration pertains to the dearth of empirical data and comprehensive comprehension regarding the precise effects of particular debtor management strategies on the ability of SMEs in South Africa to withstand challenges and maintain stability.

2.0 Literature Review

In this section, we conduct a comprehensive examination of research pertaining to debtors' management practices and the resilience of SMEs. Subsequently, the literature review scrutinizes essential theories that encompass debtors' management practices and resilience on a broader scale, while also investigating the specific relationship between debtors' management practices and the resilience exhibited by SMEs.

2.1Theoretical Framework

In this study, two theories, namely the Trade Credit Theory and the Resource-Based View, were employed to explain the exploration of the connection between debtors' management practices and the resilience of SMEs.

Trade Credit Theory: The Trade Credit Theory asserts that trade credit, which involves extending credit to customers, serves as a strategic financial tool for businesses (Jory et al, 2020). It proposes that businesses strategically oversee their accounts receivable, including debtors' management practices, to attain a competitive edge and enhance financial performance (Wanyoike, Onyuma, & Kung'u, 2021). Applying this theory to this study allows us to investigate how SMEs strategically employ trade credit and the effectiveness of their debtors' management practices optimizing cash flows, reduce financial risks, and boost overall sustainability. The Trade Credit Theory offers a framework to comprehend how SMEs strategically leverage debtor management to fortify their financial stability (Pastore, Ricciardi &Tommaso, 2020). Through the implementation of efficient debtor debtors' management practices, SMEs can enhance cash flow, diminish reliance on external financing, and allocate resources more effectively. This theory aids in assessing how SMEs utilize debtor management to minimize the risk of bad debts and financial distress, thereby contributing to their long-term sustainability.

Resource-Based View (RBV) Theory: RBV emphasizes the significance of a firm's internal resources and capabilities in achieving sustained competitive advantage (Donnellan & Rutledge, 2019). RBV was underpinned in this study to allows us to explore how effective debtors' management practices represent a valuable internal resource that can contribute to the sustainability of SMEs. It highlights the idea that debtor management capabilities can be a source of competitive advantage and resilience. RBV offers a valuable lens through which to assess debtor management as an internal resource. (Weigel & Hiebl, 2022; Lukovszki, Rideg & Sipos, 2021) on their studies mentioned that RBV helps us understand how SMEs can develop and leverage their debtor management capabilities to achieve competitive and sustainable outcomes. Understanding debtor management within the RBV framework can inform strategic decisions related to resource allocation and capability development. SMEs can use this insight to optimize their debtor management strategies and enhance their sustainability.

2.2 Debtors Management

Debtors' management practices encompass a comprehensive set of strategies and actions that businesses employ to effectively oversee and control their accounts receivable (Mang'ana, Hokororo & Ndyetabula, 2023). These practices play a pivotal role in ensuring the prompt and efficient collection of outstanding debts, ultimately contributing to the financial well-being and sustainability of the organization. Monnet (2023) mentioned that one fundamental aspect of debtor management is the development of a clear and well-defined credit policy. This policy outlines the terms and conditions governing the extension of credit to customers, encompassing criteria for credit approval, credit limits, payment terms, and, when applicable, interest rates. Before extending credit, businesses conduct thorough credit assessments of potential customers. This assessment involves a meticulous review of credit reports, financial statements, and payment histories to gauge the creditworthiness of customers. Furthermore, continuous credit monitoring of existing customers helps identify any signs of financial distress or changes in their risk profiles, allowing businesses to adjust credit terms as needed (Milana & Ashta, 2021).

As per Adjei-Boateng (2023), timely and accurate invoicing stands as a cornerstone of effective debtor management. Invoices should be clear, detailed, and promptly delivered to customers to ensure they are fully aware of their financial obligations. Enforcing payment terms rigorously and promptly addressing overdue accounts through reminders, statements, or collection efforts is essential. Effective communication with customers regarding their outstanding debts is key. Establishing transparent and open lines of dialogue often leads to more successful debt recovery. Regularly reviewing aging reports aids in tracking the status of outstanding invoices and prioritizing collection efforts based on the age of the debt. Businesses also develop collections strategies that may include options such as offering payment plans, negotiating settlements, or involving collection agencies or legal action when necessary. Integrating debtor management data into cash flow forecasting helps anticipate and plan for potential cash flow challenges (Raimo et al. 2021).

Additionally, Haque (2023), mentioned that providing training and education to employees involved in debtor management ensures they are well-versed in relevant laws and regulations and equipped with effective negotiation and communication skills. Utilizing technology, such as accounting software and customer relationship management (CRM) systems, streamlines debtor management processes, tracks customer interactions, and generates reports for in-depth analysis (Hawkins & Hoon, 2019). Regular analysis of debtor management data identifies trends and evaluates the effectiveness of credit policies, enabling informed decisions to optimize cash flow and minimize bad debt. Parker and Sheedy-Reinhard (2022) mentioned that by diligently implementing these debtors' management practices, businesses can bolster their financial stability, reduce the risk of bad debts, and maintain positive customer relationships, all while ensuring the efficient collection of outstanding receivables.

2.4 Relationship between Debtors' Management Practices and Resilience of SMEs

Debtors are those customers who owe the company money, is a critical aspect of SME financial management (Mang'ana, Hokororo, & Ndyetabula, 2023). Debtor management, also known as accounts receivable management, is a multifaceted process within SMEs encompassing the monitoring, control, and collection of outstanding customer payments (Aransiola, 2021). The significance of effective debtors' management practices cannot be overstated, as they exert a direct influence on a company's cash flow, liquidity, and overall financial well-being (Tang, 2020). Intricate components constitute debtors' management practices, which include formulating credit policies, conducting credit assessments, defining credit terms, and devising collection strategies (Zhao, 2022). According to Odinet (2020), SMEs frequently grapple with a pivotal challenge, striking a balance between the imperative of extending credit to attract and retain customers and the attendant risk of bad debts that can strain their financial resources. The landscape in which SMEs operate is characterized by dynamism and uncertainty, underscoring the critical role of resilience in their survival. Resilient SMEs are better equipped to navigate the complexities of economic downturns, market fluctuations, and unforeseen disruptions. They not only possess the capacity to absorb financial shocks but also possess the agility to seize growth opportunities (Sharma et al., 2023).

The nexus between debtors' management practices and the resilience of SMEs has garnered significant attention in both academic research and practical business domains. Several pivotal themes emerge from the extant literature:

a. **Cash Flow and Liquidity:** Effective debtors' management practices have the potential to enhance an SME's cash flow through mechanisms such as reducing the average collection period, refining working capital management, and mitigating the risk of bad debts (Braimah et al., 2021). A robust cash position equips SMEs with the resilience to withstand financial challenges and capitalize on growth prospects.

b. **Financial Stability:** Debtors' management practices play a pivotal role in bolstering the financial stability of SMEs by diminishing the likelihood of cash flow crises, insolvency, or bankruptcy (Rahman & Mahali, 2023). This financial stability is a cornerstone of resilience within SMEs.

c. **Competitive Advantage:** SMEs endowed with efficient debtors' management practice can extend more flexible credit terms to customers, potentially conferring a competitive edge in their respective markets (Richards, 2020). This capability to attract and retain customers, even amidst economic downturns, enhances the overall resilience of these businesses.

d. **Risk Mitigation:** Prudent debtor management contributes to risk mitigation by effectively mitigating the threat of non-payment or delayed payments. This is achieved through rigorous credit assessments and the implementation of effective collection strategies (Chioma et al., 2021). Such risk mitigation measures serve to diminish the financial repercussions of defaults on SMEs, further enhancing their resilience.

2.5 Conceptual Framework

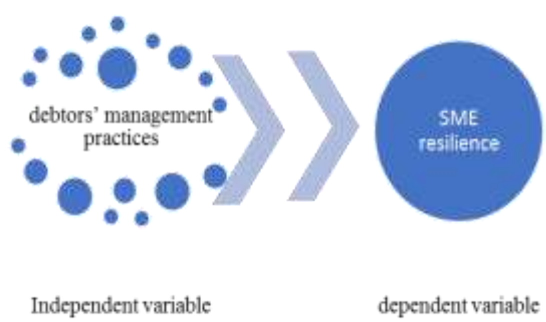

Figure 1: Conceptual framework to debtors' management practices and SME resilience
Source: Authors' Design (2023)

The conceptual framework that was presented earlier demonstrates the hypothesized relationship between debtors' management practices (independent variable) and the SME resilience (dependent variable).

In light of this, the following hypotheses and conceptual framework were developed for this study:

H_0: Debtors management have no influence on the sustainability of South African SMEs.

H_1: Debtors management have an impact on the sustainability of South African SMEs

3.0 Methodology

This research employs a quantitative methodology to investigate and analyze the relationship between debtors' management practices and the resilience of SMEs in South Africa. To align with the quantitative research approach, we adopt the positivist paradigm. Data collection is facilitated through the use of a structured questionnaire guide, employing a 4-point Likert scale survey to gather responses.

Sampling Strategy: The research utilizes a nonprobability (purposive) sampling approach, a suitable strategy when the characteristics of the target population are not precisely defined. Initially, invitations were extended via email to all prospective participants listed in the Durban Chamber of Commerce and Industry (DCCI) database, inviting them to participate in the study. A total of 110 questionnaires were distributed to the selected SMEs.

Participant Profile: Participants in this study comprise business owners of SMEs, chosen to ensure a direct evaluation of the research objectives against their debtors' management practices.

Data Collection: A total of 107 responses were collected from participants who completed the survey, reflecting a remarkable 97% response rate. This high response rate indicates a significant level of engagement and cooperation from the participants. It is noteworthy that even in cases where a small number of surveys were partially filled out due to time constraints on the participants' side, the response rate remains exceptionally high. The research instruments' reliability was assessed using Cronbach's alpha.

Data Processing and Analysis: Subsequently, the gathered data was meticulously assembled, coded, and entered into a computer system for systematic processing. We employed the SPSS 20.0 program to conduct the data analysis. This software is chosen for its capabilities in conducting comprehensive statistical analyses, allowing for a thorough examination of the relationship between debtors' management practices and SME resilience.

4.0 Data Analysis and Discussion of Findings

4.1 Descriptive Analysis: Debtors' Management Practices and the Resilience of Small and Medium-Sized Enterprises

A descriptive study of research participants' responses on debtors' management practices and the resilience of small and medium-sized enterprises in South Africa

Table 1: Responses from SMEs owners and percentage distribution

Debtors' management practices on SMEs	**Strong disagree**	**Disagree**	**Agree**	**Strong Agree**
Debtor management policies are being implemented?	55 (51.40%)	30 (28.04%)	19 (17.76%)	03 (2.80%)
Debtors are constantly reminded of their obligations?	68 (63.55%)	22 (20.56%)	12 (11.21%)	05 (4.67%)
Debtor's creditworthiness is constantly assessed before granting credit?	70 (65.42%)	18 (16.82%)	08 (7.48%)	11 (10.28%)
Debtor's capacity is often assessed before eviction credit?	48 (44.86%)	25 (23.36%)	22 (20.56%)	12 (11.21%)
All credit conditions are scrutinized before being agreed to?	58 (54.21%)	19 (17.76%)	14 (13.08%)	16 (14.95%)
Credit Limits are taken into consideration before giving credit?	61 (57.01%)	11 (10.28%)	20 (18.69%)	15 (14.02%)
Organizational effectiveness is being approved after all credit conditions have been assessed?	32 (32.04%)	46 (17.48%)	10 (12.62%)	19 (37.86%)
Debt management affect the performance of my business?	07 (06.54%)	10 (09.35%)	19 (17.76%)	71 (66.36%)
I have adequate knowledge on debt management?	30 (28.04%)	06 (05.61%)	15 (14.02%)	56 (52.34%)
Resilience of SMEs	**Strong disagree**	**Disagree**	**Agree**	**Strong Agree**
Are you secure with the overall yearly income generated during the previous fiscal year?	52 (48.60%)	26 (24.30%)	10 (9.35%)	22 (20.56%)
Has your business seen a sustained increase in income over the course of the last three years?	61 (57.01%)	29 (27.10%)	7 (6.54%)	3 (2.80%)
Is there a provision for offering discounts to clients who make early payments in order to incentivize quick payment?	28 (26.17%)	55 (51.40%)	7 (6.54%)	7 (6.54%)
Assessment of credit Limits promote improved business performance?	44 (41.12%)	27 (25.23%)	16 (14.95%)	20 (18.69%)

Source: Authors' Design (2023)

From the table above, it reveals that 80% of the SMEs are not implementing their own debtor's management policies. Some further stated that they do not have strict debtor's management policies. The result in the table above shows that the vast majority of respondents 84%, this indicate that small and medium-sized enterprises (SMEs) are not effectively notifying debtors of their financial responsibilities. Additionally, 82% revealed that creditworthiness is not properly assessed before lending money, leading to a rise in bad debt. According to the result above 72% of respondents revealed that SMEs do not carefully consider their credit conditions before approving them. This shows that there is a lack in credit conditions because they are not thoroughly examined before approval. When it comes to credit limits, 33% agree that they are considered before granting credit, while 77% disagree. This clearly indicates that credit limits are not properly considered in the majority of SMEs before granting credit. From table shown above, 66% of the respondents strongly agreed that debt management affects their businesses, 18% agreed, and 9% disagreed and 7% strongly disagreed. This implies that management of the debtors has an impact on the success of the business. Additionally, 66% indicated that SMEs lacked sufficient knowledge of debt management.

4.2 Regression Analysis on Debtors' Management Practices and the Resilience of SMEs

The linkage between the debtors' management practices and the resilience of small and medium sized enterprises. An initial analysis into the relationship between the independent and dependent variables was carried out, and its findings are shown below. The outcome of running a linear regression to analyze the effect of the independent variable on the one that is being studied (the dependent variable) is shown in Table 2.

Table 2: Influence of debtors' management practices and the resilience of SMEs

Variables in the equation	B	Beta	T	p-value	R^2	F	df	pvalue
Constant (Debtors' management practices)	18.225		4.725	<.005	.109	12.365	1; 101	<.005
SMEs Resilience	.301	.330	3.516	<.005				

DV – SMEs Resilience

The results of the regression analysis, as summarized in Table 2, unveil valuable insights. Notably, the R^2 value stands at 0.109, indicating that Debtors' management practices account for 10.9% of the variance in SME sustainability. This suggests that a portion of SMEs' Resilience can be attributed to their management of debtors. Moreover, a statistically significant linear relationship between debtors' management practices and SME resilience emerges, as evident from the statistical tests ($F (1, 101) = 12.365$, $p < 0.005$). This underscores the substantial impact of debtors' management practices on SME resilience, reinforcing their interconnectedness.

In further detail, the independent variable of debtors' management proves to be a significant predictor of SMEs Resilience, as evidenced by a Beta value of 0.330 and a significance level of $p < 0.05$. These findings align with previous research conducted by Roffia, and Dabić (2023), which also identified a significant linear relationship between debtors' management practices and SME resilience. The study by Brown et al. (2022), emphasized that effective implementation of credit policies positively contributes to the financial sustainability of businesses, corroborating the importance of prudent debtor management.

Similarly, the findings resonate with the research conducted by Agbanyo, Ganza and Sambian (2022), which identified a linear relationship between debtors' management practices and SMEs Resilience. Their study also highlighted the critical nature of proper debt management in preventing substantial losses due to bad and doubtful debts. This underscores the pivotal role of debtor management in enhancing working capital management and ultimately fostering the resilience of SMEs.

4.3 Pearson Correlation Coefficient on Debtors' Management Practices and the Resilience of SMEs

Table 3 Correlation between debtors' management practices and the resilience of SMEs

Construct A	Construct B	Pearson's correlation (r)	p -value
Debtors' management practices	SMEs Resilience	.330**	<.005

**Correlation is significant at the 0.01 level (2-tailed)

The result of the Pearson correlation coefficient in Table 3 shows that there is a statistically significant association between debtors' management practices and SMEs Resilience (r =.330) (p< 0.005). The positive correlation between constructs A and B (SMEs Resilience) is an indication of a direct relationship between the two constructs.

The above findings are consistent with the finding of Atiase et al., (2023), they observe that there is significant positive correlation between debtors' management practices and the resilience of SMEs. Again, in Malaysia, Saidi and Saidi (2022) found a positive and significant correlation between debtors' management practices and viability for businesses. The study that was conducted in Ghana and South Africa by Abor (2007) concur that indeed there is positive relationship between proper managing of debtors and SMEs financial health. These findings are in line with the findings of most research done in developing countries, which suggest that debtors' management practices and the resilience of SMEs have a positive relationship.

5.0 Conclusions and Recommendation of the Study

The study concluded that there is a statistically significant association between debtors' management practices and the resilience of SMEs (r =.330) (p< 0.005). The paper advised that SMEs employ both liberal and severe debtor debtors' management practices. The optimal debt management approach will strike a balance between generating earnings and maximizing the likelihood of collecting outstanding debt. The manner in which a company handles its debt may be affected by factors like the volume of sales made on credit, the amount of time it takes to recover debt, and its discount strategy. In addition, the firm's overriding philosophy for debt management should be that the advantages of administrative expenditures associated with debt collection should not outweigh the costs. The way in which businesses deal with their debt has a direct effect on their bottom lines. When a business can efficiently manage its debt, the result is an increase in its bottom line as well as a simplification of its operations. The purpose of debt management should be to cut costs associated with debt while simultaneously increasing the advantages obtained from it. Customers whose creditworthiness is not completely known can receive credit under lenient debt management policies, which have more lenient terms and standards, longer credit periods, and higher discount rates; customers whose creditworthiness is completely known and financially strong can receive credit under stringent debt management policies, which have shorter credit periods and lower discount rates. The study's results underscore the interdependence between debtor management and financial resilience within the context of SMEs in South Africa. The implementation of efficient policies and the provision of adequate support mechanisms have the potential to empower SMEs in overcoming financial difficulties, strengthening their capacity to withstand adversity, and making substantial contributions to the overall economic development and stability. It is of utmost importance for policymakers and stakeholders to take aggressive measures in addressing these concerns in order to cultivate a flourishing small and medium-sized enterprise (SME) sector in South Africa. In addition, customers whose creditworthiness is not completely known can receive credit under lenient debt management policies, which have more lenient terms and standards, longer credit periods, and higher discount. The study also suggests that business owners of SMEs evaluate their customers' willingness to pay before extending credit to them for the purchase of goods and services. Further to that, SMEs should work credit score companies to check regular the customers credit ratings. Further investigation might be carried out to see if some other elements may debtor's management. We strongly advocate that future researchers interested in investigating the management of debtors and financial resilience among South African SMEs should consider conducting comparative analyses of debtors' management practises and resilience across distinct regions within the country. This analysis should encompass a comparison between rural and urban areas, as well as provinces characterised by varying economic conditions. This phenomenon may serve to accentuate geographical inequities and provide distinct issues.

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