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Credit Sales Risk Management in the Case of Libya Oil Ethiopia Limited

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DECLARATION

I, **Eyerusalem Zewge**, registration number CBE/PE/266/11AA, do hereby declare that this thesis is my original work, and that it has not been submitted partially or in full, by any other person for an award of master's degree in any other university or institution.

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ABSTRACT

This research deals with the Credit Sales Risk Management of Libya Oil Ethiopia Limited. The objectives of the research were to assess the management of credit sales risks in Libya Oil Ethiopia Limited. One crucial element that must be controlled is credit sales risk. Credit sales risk management is based on analyzing the creditworthiness of customers and is one of the most central risks for any company. It is caused by a debtor's failure to perform their responsibilities. The research was carried out on Libya Oil Ethiopia Ltd. One of the key elements assessing credit sales risk management is the potential for a customer to default on their payments. By evaluating the current practice, this research aims to propose potential solutions that could address this issue in credit sales risk management. A descriptive type of research method was used in conducting this study. The result of this study evidence that there is a big gap between the current company's collection policies and procedure and current states of market computation therefore, Libya Oil Ethiopia Ltd has to revise the current policies and procedures in considering the current inflation, compotator and customer status. Trade debt has an impact on the company's performance by lowering its revenue and net income, the case thus supports the idea that the company needs strong credit sales risk management. The study's findings indicate that setting clear credit sales, collection and receivable management is essential to effectively manage credit sales and improve the company's performance.

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Credit is the common fundamental component in any financial system. Different economic units, both demand and supply side, require credit. Individuals require credit for economic and social need. Governments also require credit for financing its deficit and building public projects. Most business organizations heavily rely on external sources of finance for expansion, modernization, working capital requirement and financing new projects. As a result of this, credit risk is the most important risk companies can face. Despite its economic and social benefits, credit is evil for the economy if it is not properly used and managed. Its improper management causes default and bad reputation and credit losses /bankruptcy Joseph, (2013).

Credit sales 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 sales if the profitability generated from increased sales exceeds the added costs of receivables. Myers and Brealey (2003) define credit sales as a process whereby possession of goods or services is allowed without spot payment upon a contractual agreement for later payment.

Many authors considered that failure of credit risk management system and practice as one of the main causes of financial crises in general (Hussain & Al-Ajmi, 2012), (Al-Tamimi & Al-Mazrooei, 2007).

With the rise in bankruptcy rates, the probability of incurring losses has risen. Economic pressures and business practices are forcing organizations to slow down 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.

The issue of management of trade credit has every cause to be given reasonable attention considering the incessant liquidation (Winding -up) of some manufacturing firms in recent times due to the effect of credit sales. Granting credit indeed increases sales volume and consequently profit

level. In a competitive environment such as Nigeria, increasing one's level of profit is one of the ways to ensure survival or continuity in business.

Business organizations, in their attempts to make profit, adopt several strategies and one of which is allowing credit to customers. Pandey, (2004) In line with Pandey's idea, credit is a marketing tool for expanding sales. Credit sales to customers, however, must be well monitored because regardless of an organization share of the market and demand for its products, if there are no measures put in place to regulate sales made to customers on credit, there could be problems, especially those related to liquidity and cash flow.

Trade credit arises when a firm sells its products or services on credit and does not receive cash immediately. It is an essential marketing tool, acting as a bridge for the movement of goods through production and distribution stages to customers. According to Pandey (2004), a firm grants trade credit to protect its sales from the competitors and attract potential customers to buy its products at favorable terms. Trade credit creates accounts receivable or trade debtors that the firm is expected to collect in the near future.

A firm's investment in accounts receivable depends on the volume of credit sales and collection period. The customers from whom receivable must be collected in the future are called trade debtors or simply debtors and represent the firm's claim or asset.

Trade debtors form a major portion of the current assets of any company next to stock. It arises when customers are allowed to buy goods or services on credit and payment deferred till a later date. Thus, the working capital management presumes the effective use of trade debtors (accounts receivable) to ensure increased profitability and liquidity in the firm.

Culp, (2002) states that financial risk is the possibility that certain events can unexpectedly and adversely affect a firm's financial performance, whether by reducing its net asset value or cash flow, or by lowering its reported earnings. The financial stability report (2007) discusses that enterprises and households are increasingly exposed to financial risks. Hardy (2007, para. 1) points out that financial risk management has become an extremely important discipline for corporations, financial institutions and many government enterprises. Gheorghe and Gabriel (2010, p. 139) state that financial risk management has gained importance for the companies and financial institutions. Eberlein, Frey, Kalkbrenner and Overbeck (2007, p. 1) argue that the role of financial risk

management is to measure and manage risks and the main application area of financial risk is credit risk.

Accordingly, the purpose of this research is to investigate the level of credit sales risk management system and practice Libya Oil Ethiopia Limited and assess the perception and awareness of risk management staff as well as to identify the types of credit risks and risk identification method through descriptive survey research approach.

1.2. Background of the Organization

Libya Oil Ethiopia Limited is a major petroleum products marketer in the country operating through its vast retail outlets (gas stations). In addition to private and individual customers, the company has B2B customers operating in hotel, industry, construction and aviation sectors. The company was formerly known as Shell Ethiopia Limited founded in 1929 and changed its name to Libya Oil Ethiopia Limited when the OiLibya Group or Libya Oil Holdings Limited acquired 100% shares of Shell Ethiopia Limited from Royal Dutch Shell Group the in November 2008. As a key player in the African energy industry, the Group's core values are firmly rooted in Africa. The company's presence in 17 African countries makes it a prominent member of the communities where it operates, contributing to its economic and social development, and therefore to that of the continent.

As a subsidiary of the OiLibya Group, Libya Oil Ethiopia is engaged in the supply, distribution and marketing of fuels, lubricants and other petroleum products with its extensive retail network of 180 filling/service stations located across the country, 73 Industry & Wholesale (I & W) customers, 30 Aviation Customers, and over 10 major Lubricants Distributors and 30 transporters (fuel transporters).

Fuels that Libya Oil Ethiopia supply include Motor Gasoline Regular (MGR) or Benzene, Ethanol-MGR Blend (E-5 or E-10), Automotive Gas Oil (AGO) or Diesel, Furnace Fuel Oil (FFO/HFO), Kerosene and Jet Fuel. Lubricants consist of Automotive Oils such as Petrol and Diesel Engine Oils, Gear Oils, Transmission Fluids, Brake and Clutch Fluids, Motorcycle (2-Stroke Engine) Oils and Greases, Industrial Oils and Greases. Information Booklet, Oil Libya Ethiopia Limited (Dec. 2018).

1.3. Statement of the Problem

Credit sales management is a prerequisite for any profit entities for stability and continuing profitability, while failing credit quality is the most frequent cause of poor financial performance and condition. According to Gitman (1997), the probability of bad debt increases as credit sales standards are not stated properly. Firms must, therefore, ensure that the management of receivables

is efficient and effective. Such delays in collecting cash from debtors as they fall due has serious financial problems that increase bad debts and affect customer relations. If organizations make payment late, then profitability will be eroded and if they don't make payment at all, then a total loss will be incurred. On that basis, it is simply good to do business by putting credit sales management at the front end and managing it strategically.

In situations where a company is engaged in selling strategic commodities like petroleum products such as (gasoline, benzene, kerosene, Jet fuel, light fuel oil, and heavy fuel oil) by paying huge amount of money in foreign currency and undertaking 75% of its sales on credit basis (based on the financial statements of the company) and the rest of its sales on cash basis, as the credit sales is more, the management of credit sales risks becomes mandatory. The consequence of any failure in the management of credit sales can seriously affect the earnings of the company. Libya Oil Ethiopia Limited deals with such a sensitive operation of petroleum product sales on a two to five and fifteen days (2 to 5 and 15 days) credit periods and earning of its revenue from the sales of petroleum products and lubricants to each Stations and commercial customer sites. The company has internal and external issues or challenges related to receivables or uncollected sums. When I say internal issues I mean credit administration, credit approach, abrogate choices made by best administration, fitting chance evaluation sometime giving credit deals for modern clients. One of the external issues the company is facing is the political circumstances of the country. A case in point is a few of the retail stations that have failed to run their businesses due to the recent war that broke out in the north part of the country. Inaccurate organizational rating or deficiency of data regarding the client's status, and legal cases of the entire credit deals, for instance, the five years sums that are not collected from credit customers are some of the external challenges to mention.

Some of studies which were conducted previously on this issue such as “The Management of Credit Sales Risk in Ethiopian Petroleum Supply Enterprise” by Kebede (2013), and “Analysis of Credit Sales Risk of Emerging Market Product” by Jianhui Konga, B & Yimao Zhouc (2016) are not comprehensive, and the credit risk management system may differ and change over time. Also, these studies do not assess the challenges they encounter in the manner that loans will manage on the diversified and intensified investment in the country. Therefore, this study will attempt to assess the credit sales risk management systems and practices in Libya Oil Ethiopia Limited.

1.4. Research Questions

The following were the research questions that this study will discuss thoroughly.

1. What is the level of the credit sales risks in the company?
2. What mechanisms does the company use to identify, measure, and manage credit sales risk?
3. What are the practices of credit sales and collection management and the lessons that the company can learn?

1.5. General Objective

The general objective of this study will be assessing the management of credit sales risks in Libya Oil Ethiopia Limited.

1.6. Specific Objectives

1. To assess the practices of credit sales or receivables management.
2. To assess the credit sales and collection policies
3. To measure the influence of credit sales on the performance of Libya Oil Ethiopia Limited.

1.7. Significance of the Study

This study will make several contributions to both knowledge building and practice improvement in credit sales risk management, improving collection policies and profitability and identifying some gaps in credit control department as it is crucial for the company. It is expected that the study will aid the management members in their effort to revamp the company. It will also be of great relevance to the company under study as well as other oil companies and significantly assist all department managers and concerned employees in setting a clear credit sales risk controlling strategy and reducing bad debts to the barest minimum. Considering the present challenges that the company is facing in the management of credit sales, to ensure minimal loss on credit sales through maintenance of a good risk assessment and control from the beginning of customer selection, bring to the notice of credit sales managers or credit controller the significance of effective risk assessment and control in credit administration and make useful contributions to effective and efficient credit sales risk management are of paramount importance.

1.8. Scope of the Study

This research is limited only to the study of the relationship between credit sales and credit sales risk management. It seeks to analyze vigorously the credit sales risk management of Libya oil Ethiopia Limited and to determine the level of the company's credit sales risk exposure and thus, the study will assess the credit sales of the company systems and practices. The research data collection area is

limited in Libya Oil Ethiopia Limited specifically, i.e., Finance, B2B, Retail and Customer Service Departments. The Company is located around Gotera roundabout adjacent to Modjo Edible Oil Factory. The expected time of completion of this research paper is two months.

CHAPTER TWO

LITERATURE REVIEW

2.1. Theoretical Review

2.1.1. Credit Sales Management

Credit sales management is one of the most important activities in any company and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. It is the process to ensure that customers will pay for the products delivered or the services rendered. Myers and Brealey (2003), describe credit sales 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 how an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have zero credit or default risk.

The higher the number of accounts receivable and their age, the more the finance costs to be incurred by the company to maintain them. If these receivables are not collectible on time and urgent cash needs arise, a firm may result in borrowing money and the opportunity cost is the interest expense paid. Credit sales management starts with the sales and does not stop until the full and final payment has been received. It is as important as part of the deal closing the sale. In fact, a sale is technically not a sale until the money has been collected.

2.1.2. Effect of Credit Sales Management on Financial Performance

Credit sales management is the method by which you collect and control the payments from your customers. 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.

2.1.3. Credit policy

Any business organization cannot be over emphasized because it is a factor that has a strong influence on the cash inflow of an organization from its sales activities, which is very critical to any business organization. Every credit policy set by an organization seeks to achieve adequate profitability and flow of cash (liquidity) which are the two basic factors that sustain a business in the present and determine its position in the long run. A company's credit policy refers to the actions taken by a business to grant, monitor, and collect the cash for outstanding accounts receivable (Maysami, 2010). The credit policy of a typical organization contains the following variables: collection policy, cash discount, credit period and credit standard, while Miller (2008), classified it as credit limits, credit term, deposits, customer information and documentation. Each of the components of a company's credit policy is used as a tool for monitoring account receivables which is the outcome of credit sales; it covers from the kind of customers that credit may be extended to when actual collections would be made. There is, however, no universal credit policy that should be adopted by every organization. The credit policy of an organization should therefore be based on its business and cash flow circumstances, industry standards, current economic conditions, and the degree of risk involved. For a manufacturing business organization to achieve its critical objectives of liquidity as it allows credit to customers, concern should be given to its credit policy, it should be adequately planned, and its adherence must be strictly emphasized.

2.1.4. The Benefits of Having a Clear Credit Sales policy

According to Pandey (2004), The very word 'policy' may appear off-putting to some, but in essence, all it means is 'this is our preferred way of doing things'. There can be nothing onerous or contentious in that definition, and in many spheres of any business operation, various 'policies' will guide bosses, employees and customers alike. It should go without saying, of course, that any business should conduct its affairs in a lawful manner. There is legislation covering a range of issues, including health and safety, employee rights and benefits, environmental protection and so on. We drive on the left, tires have a legal minimum tread depth, and the movement of aircraft is under strict control. In other words, guidance exists in many spheres, whether as legally enforceable obligations, or as strong recommendations. To enter into any situation without a plan of action or any guidelines to cover problem situations can only lead to inefficiency, loss and possibly ultimate failure.

Tim Demetriou (2023) said that. One of the main benefits of having credit policies in place is that they help to minimize risk for the business. Credit policies establish clear guidelines for approving and managing credit accounts, which can help to reduce the likelihood of a default or delinquency.

Why is this so important? Because unpaid debts can have a significant impact on a business's bottom line. Credit policies also help to ensure consistency in the credit approval process. Without credit policies, there is a risk that credit may be extended to customers on an inconsistent basis, which can lead to confusion and dissatisfaction among customers. By establishing credit policies, businesses can ensure that all customers are treated fairly, and that credit is extended in a consistent manner. Credit policies can also help to improve communication between the business and the customer. Credit policies provide customers with clear information about the terms and conditions of credit, including the interest rate, payment terms, and any fees associated with the credit account. This can help to prevent misunderstandings and disputes between the business and the customer. In addition, credit policies can help to establish a positive image for your business. By having clear and fair credit policies in place, businesses can demonstrate to customers that they are responsible and trustworthy. This can help to build customer loyalty and increase the chances of repeat business.

Provide customers with clear information about the terms and conditions of credit, including the interest rate, payment terms, and any fees associated with the credit account. This can help to prevent misunderstandings and disputes between the business and the customer. In addition, credit policies can help to establish a positive image for your business. By having clear and fair credit policies in place, businesses can demonstrate to customers that they are responsible and trustworthy. This can help to build customer loyalty and increase the chances of repeat business.

2.1.5. Implementing Effective Credit Policies

In the intricate world of financial management, credit policies play a pivotal role in an organization's ability to optimize cash flow and maintain financial stability. These policies define how a company extends credit to its customers, govern the terms of repayment, and guide the process of debt collection when payments are overdue. This introduction delves into the fundamental importance of credit policies in the context of improving cash flow, touching upon various perspectives and insights.

From a business owner's viewpoint, an effective credit policy is the linchpin of financial health. By defining clear credit terms and credit limits, a company can minimize the risk of late or defaulting payments. This not only ensures a consistent cash flow but also mitigates the impact of bad debts on

the bottom line. In essence, credit policies act as a protective shield, shielding businesses from potential financial crises and instability.

From a customer's standpoint, credit policies can influence their perception of a company. Generous credit terms may attract more customers, but it could also lead to difficulties in managing cash flow. On the other hand, overly stringent credit policies might deter potential buyers. Striking the right balance is essential to maintain a positive relationship with customers while safeguarding the company's financial interests.

Now, let's delve into the key aspects of the importance of credit policies through a numbered list:

1. **Risk Management:** Credit policies are a primary tool for assessing and managing risk. By setting clear credit limits and terms, companies can identify potential problem areas and act proactively to minimize bad debt.
2. **Cash Flow Optimization:** An efficiently designed credit policy ensures a steady influx of funds, allowing a business to meet its operational expenses and investments promptly.
3. **Customer Relations:** Credit policies can influence how customers perceive a company. Striking a balance between accommodating credit terms and protecting financial interests is crucial for maintaining good relations.
4. **Legal Compliance:** Credit policies also need to adhere to legal regulations and ethical standards. This ensures that businesses operate ethically and avoid legal troubles.
5. **Competitive Advantage:** A well-designed credit policy can give a business a competitive edge. It can be used as a marketing tool, attracting customers with favorable terms while maintaining financial stability.
6. **Adaptability:** Credit policies should be flexible enough to adapt to changing market conditions and evolving customer needs. An agile credit policy can respond effectively to economic shifts.
7. **Communication:** Clearly communicated credit policies not only protect the company but also set expectations for customers. This transparency can help in managing customer relationships.
8. **Credit Scoring:** The development of credit scoring systems is a key component of credit policies. These scores help in evaluating the creditworthiness of customers and determining appropriate credit limits.

9. Debt Collection Strategies: Credit policies should outline procedures for debt collection, which could range from friendly reminders to legal action. These strategies need to be well-defined to minimize loss.

Incorporating these elements into a well-structured credit policy is paramount for businesses seeking to maintain financial stability and enhance cash flow. The following sections of this blog will delve into each of these aspects in greater detail, providing insights and practical examples to illustrate their importance and impact.

2.1.6. Risk

Risk in financial terms is usually defined as the probability that the actual return may differ from the expected return, Howells & Bain, (1999). In the financial system, there are at least three broad categories of risks, financial risk, business risk and operational risk.

Oil companies are facing critical challenges in finding new and better ways to increase top-line revenues, maintaining necessary capital ratios, improving margins, strengthening balance sheets, and enhancing efficiencies within the organization. These companies, therefore, employ risk management practices whose objective is not to prohibit or prevent risk taking activity, but to ensure that the risks are consciously taken with full knowledge, clear purpose and understanding so that it can be measured and mitigated.

According to Maina (2007), oil marketing firms face more risks than other companies due to their dependence on exchange rates, local and international trades, and the only way to manage these risks is to appreciate their root determinants. Manfredo et al (2003) also noted that since oil marketing firms themselves tend to face more sources of both business and financial risks, it is imperative to identify the causes of these risks as oil marketing firms operate under pooling arrangements and in a wide geographic area which maximizes their level of diversification. Financial risk or the risk of losing money is real and fundamental in modern society; unlike for individual loss of income, for corporations, financial risk can affect the value of business investments and financial assets (shah, 2004). Risk is an old concept associated with uncertainty. In the course of running a business, managers are confronted with many challenges, and in focus are decisions made in regard to risks. Some risks are associated with the underlying nature of the business and normally deal with issues like uncertainty of future sales and are called business risks. Another class of risk is financial risks, which deal with the uncertainty of such factors as interest rates, exchange rates, stock prices and commodity prices (Li, 2003).

2.1.6.1 Credit Sales Risk

Credit sales risk in business is the risk that a buyer will fail to satisfy the obligation terms in regard 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), describes this as the probability that a counterparty may fail to meet its 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 they engage in 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 with regards to any single customer it interacts with and strategize on the best methods for credit risk minimization.

2.1.6.2. Other Risks Affecting Credit Sales

There are other risks that are related to credit sales 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 a 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 position. On the other hand, if an organization is owned 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 fulfilment 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. As stated by 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.

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

2.1.6.3. Credit Sales Risk Management

Credit sales risk management in an organization encompasses several 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 clearly defines their responsibilities and outlines a logical way 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 the credit control department starts with the 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 of 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).

2.1.6.4. Bad Debt

According to Ross, Westerfield and Jordan (2003), One sensible outcome of identifying high risk accounts is having some prior indication of debts likely to turn bad. Bad debts have a direct impact on profits, and every attempt is made to avoid them, but some bad debts may be inevitable, and seeing them coming gives the opportunity not only to reduce the ultimate exposure, but also to forecast the likely level of bad debt to be experienced. Having made that forecast, the correct procedure is to make a bad debt provision, that is, note a reduction of booked profits. Bad debt provisions are expensive, and deplete current profits, because such provisions come out of profits, but they are necessary. The Companies Act clearly defines debtors as a current asset – capable of being liquidated within 12 months – and as auditors in the UK expect any doubtful debts to be fully provided for, the net balance sheet figure should reflect debtors as collectable and less than 12 months old. There is some confusion surrounding provisions, both general and specific (more on this below), not least because many credit managers in the UK work for the UK division or the UK

subsidiary of a multinational corporation. The parent corporation may well operate in a different bad debt provision environment and expect their UK businesses to operate in the same way. For example, it is common practice for some US corporations to ‘take the hit’ as soon as a bad debt occurs, and not make any specific provision as a yearly or half-yearly exercise. The hit come straight off the bottom line, and is not taken against any provision, which in some cases does not actually exist.

A common accounting practice in the UK is to make provision on an ongoing basis for bad debts, both as those quite likely to happen (specific) and a figure to cover the unexpected (general). Often, in the year end rush, accountants will make provisions based on history, or as a simple percentage of total debtors. It is the credit manager, however, who has the greater knowledge as to the collectability of debts and, having identified high risk accounts, it seems reasonable to base the bad debt provision on these only.

As stated, the provision is a charge against profit, and credit managers may look at the bad debt provision from two standpoints. If the company is making a very healthy profit and seeking to reduce its tax liability (or dividend distribution), it may well ask the credit manager to do a ‘belt and braces’ job on the provision. In other words, provide for all known doubtful, all borderline possibilities, and any other accounts which might have been particularly troublesome with payments and in the extreme could, maybe, possibly, perhaps be considered likely to fail soon! Alternatively, profits may be thin and the company looking to keep charges against the profit base to an absolute minimum. In this scenario, the credit manager is required to justify in detail each customer’s provision, and the slightest chance of recovery may mean that debt is not being provided for. Credit managers will readily recognize either situation, but the common-sense approach is to be realistic – there is always the danger that unnecessarily providing for a not particularly doubtful customer will deflect normal collection activity with that customer and precipitate a crisis.

Old or disputed debts should not be cleared out by writing them off against the bad debt reserve, if those customers are still trading. That should be done by a sales credit note. Real bad debt write-offs are a measurement of the effectiveness of the company’s risk assessment and credit controls and should not be distorted by other kinds of write-off. (Ross, Westerfield and Jordan) the typical bad debt reserve policies include:

1. 100% with reversal: Each month, the total value of all ‘C’ category accounts is reserved, that is, a transfer is made from profit and loss to bad debt reserve. If accounts are paid, the value is reversed (transferred back to profit and loss). In

practice, all that is needed is to keep a separate bad debt reserve for the total of high-risk accounts and adjust it each month to agree with the new total balance.

2. Reserve according to age: This method recognizes that risk increases with the age of 'C' risk accounts. Therefore, a reserve is made as a percentage of the age analysis of 'C' accounts, for example, 25% of balances one month overdue, 50% two months overdue, 75% three months overdue and 100% at four months. The percentages are the company's experience of the collectability of its marginal accounts. To avoid a heavy depletion of profit, this method provides an extra incentive to collect overdue 'C' accounts.
3. Annual write-off experience: This method recognizes a company's bad debt experience each year. It may have a policy of reserving 1% of all sales, but finds that its actual bad debts occur only in the 'C' category accounts. Of sales made to 'C' customers, the bad debt losses may be 5%. So, the company gradually builds a reserve through the year of 5% of sales value to 'C' accounts. This can considerably reduce the profit reduction caused by excessive bad debt reserves.
4. General and specific: Something of a combination of the above methods whereby a sum is transferred each month to the bad debt reserve, based upon either a small percentage of total sales, or a larger percentage of 'C' sales (as above), plus accounts recognized by the credit manager as being potentially doubtful. The likelihood is that these will be 'C' accounts, but losses in 'B' and even 'A' can be experienced, and their transfer to 'C' may well follow.

2.1.6.5. Assessment of Credit Sales Risk

Every customer will be given a credit rating and a credit code, established by the credit manager with the cooperation where required of sales personnel. To achieve meaningful ratings and codes, the credit manager will use financial and other data obtained from specialized credit reference agencies (Experian, Dun & Bradstreet, etc.), together with trade and bank references when required. The credit ratings and codes assigned to each customer will be reviewed annually, or sooner if deemed necessary.

2.1.6.6. Credit Sales Risk Policy

There are two ways of looking at risk policies for all customers:

1. Maximum sale and no credit checking

Higher sales, and therefore higher profits, are certainly possible, but so is high interest expense because of more overdue. There is a much greater risk of losses due to bad debts, and it is not

rocketing science to calculate the volume of extra new sales required to recoup the losses from one bad debt, particularly in a low margin environment. Add to that the expense of employing extra resources to collect ballooning debts on the ledger and dealing with myriad unknown customers with little or no knowledge or previous experience, and it is apparent that such profits as can be obtained from higher sales can soon disappear Ernst & Young (2010)

2. Selective sales and credit checking

Sales may be lower, but profits from those sales will be much more reliable. Fewer bad debt losses will be incurred, there will be more accounts paid to terms and less in the way of interest costs on overdue. Rather than throwing the sales net out as far and wide as possible, targeting known better customers and reducing sales to bad risks ultimately leads to fewer collection resources and a general reduction in overheads.

Understanding the ways of looking at the risk policies explained earlier, to achieve profits from high-risk customers, it is necessary to have strict controls in place, from risk assessment until collection. That much is obvious, but it is just as important to know how much should be at risk as a percentage of total debtors as a maximum. In other words, the total value of high-risk debtors should be kept within known and decided limits. For example, a company may decide that 15% of debtors can be in the high-risk category. If the average debtors are 6 million birrs, then the high-risk limit should be birr 900 000, that is, 15% of birr 6 million. If credit assessments are accurate, then bad debt losses should only come from accounts in the birr 900 000 sector, apart from the totally unexpected collapse, which is quite rare. Both credit and sales staff know from this simple formula what efforts are required, both in selling and collecting, as far as high-risk customers are concerned, and the company is working within acceptable high-risk bounds. It would soon become apparent if the limit were exceeded, with drastic remedial action instantly required.

As a further precaution, it would be prudent to accrue additional provisions for bad debts, and to ensure that sufficient resources are allocated to monitor the high-risk accounts. As the purpose of a high-risk strategy is to be able to squeeze extra sales from customers identified as risky, it would be pointless to use up the high-risk limit with delinquent overdue or by extending terms in other areas. It also follows that collection procedures and/or application of the stop list must be firmly and swiftly enforced to ensure minimum exposure.

The credit manager should also study and report on the progress of the strategy, looking for variation or deterioration, with revision when needed. The selling price in the high-risk area must be commensurate with the fact that such sales are high risk – extra profit is necessary to offset extra

losses and higher credit and collection expenses. Losing sight of the objective is losing sight of the profit, and if it is not done properly, it is not worth doing at all.

Generally, one can be reasonable that sales on credit have a few challenges impacts on the profitability's of the company. Still there is a need to consider history of credit deals on Ethiopian oil companies. Agreeing to Patricia Gachambi Mwangi & Martin Mutwiri Muriuki (2013) it is possible to conclude that credit is influenced by unfavorable impacts of credit risks and the analysts too expressed those ways of overseeing credit sales risk in Kenya oil companies. Kebede (2013), stated that there's a huge gap between the specified and the current credit deals administration and it encompasses a negative effect on the supply of petroleum items in Ethiopia. This study will particularly analyze the credit sales risk in Libya Oil Ethiopia Limited through counting qualitative and quantitative data.

2.2 Empirical Review

There have been many empirical studies in safety and soundness especially in credit sales risk management while few academic and professional research related to history and performance of credit sales in companies were conducted. The following attempt was made to summarize the main finding of some selected studies in credit sales risk management in different companies.

(Kebede, 2013) who carried out comparative study of credit sales risk on Ethiopian Petroleum Supply Enterprise recognizes that the extent of the problem (the management of credit sales) of EPSE is very high which demands timely response to minimize the financial loss that may happen to achieve its mission driven objectives. There is a big gap between the desired and the current credit sales management and that should be addressed very soon. Failure in credit sales management can negatively impact the supply of petroleum products in Ethiopia. The management of financial risks with emphasis on credit sales may be a decisive mechanism which enables the enterprise to play its expected role in the economy by raising awareness on credit sales risk to make a continuous and uninterrupted supply of petroleum products. Proper management of credit sales is crucial to the health and survival of the firm to carry out the very reason for its existence.

(Konga,b,& Zhouc 2016) identified that the accounts receivable holdings and the credit costs is the key content of the enterprise's product credit sale risk management. (IFURUEZE, 2013) conducted research entitled The Impact of Effective Management of Credit Sales on Profitability and Liquidity of Food and Beverage Industries. He pointed out that the companies in the Food and Beverage sector succeeds in their credit policy administration because they strike a correct balance (trade-off) between the total of opportunity costs/lost contribution and credit administration costs and bad debts

losses at minimum which improves the overall profitability, efficiency, and survival of the firms. The companies in the Food and Beverage sector maintain a desirable level of liquidity due to their optimum credit standards, terms, collection period and procedures; and they are regularly revisited and adjusted. The Food and Beverage Industries maximized their operating profit due to effective management of credit sales. The operating profit of any firm is a function of sales or turnover. Among the reasons for granting credit to customers are competition, market tools to expired sales, relationship with dealers, buyer's status, and requirements. Etc. There is no recommended credit policy for organizations (Schilling, 1996); credit policy should therefore be established considering factors as the nature of the firm's business, its share of the market, its immediate external environment and level of competition.

Tyburski (2010, p. 190) recognizes that “control of receivables largely depends upon the system of credit control practiced by a business enterprise.” It becomes a part of the organization’s obligation to obtain full and relevant information completely in all respects before deciding upon the right customer for the right amount of credit grant. Salek (2005, p. 5) states that “the quality of the receivables asset is an excellent barometer of credit sales or customer service.” A critical part of managing receivables is determining who should be extended credit and who should not. Whenever an order is placed by an applicant financial position and credit worthiness becomes essential. “Only after ensuring the degree of safety an order should be accepted and delivered” Schwarz (2011, p. 10).

2.3 Summary and Knowledge Gap

It is important to reiterate that this literature was embarked upon with the main objectives of reviewing and compiling the literature on the theories and best practices of the management of financial risks with emphasis on credit sales. Topics such as credit sales management, the effect of credit sales management on financial performance, credit policy, the benefits of having a clear credit sales policy, other risks affecting credit sales, market risk, and foreign exchange were covered under this chapter. All the topics that are dealt with are the policies and objectives that should be followed to manage credit sales. These are taken as a benchmark to evaluate the practice of managing financial risks with special emphasis on credit sales and forward recommendations that may improve credit sales management of the company under consideration. The main advantage of credit sales is that it will attract additional customers and increase sales volume and profit. It can also increase direct and indirect costs, which must be weighed against its potential benefits. In addition to the costs associated with managing credit sales, the most critical problem which needs a special focus is

the possibility of non-payment of customers. The whole concern of credit sales risk management falls on this point among other things.

Hence, implementing the theories and best practices presented under the review of related literatures can improve the management of financial risks resulting from credit sales. Relating the theories of credit sales management against the actual practice of the company shows that there is a gap in defining risk, using aging schedule for receivables, using the important dimensions of credit policy, and the overall credit sales risk management which the study liked to fill in.

2.4 Conceptual Framework

The conceptual framework seen below will be used as the guideline as well as the structure for the overall research study. It is developed from the literature (theories and empirical results) discussed previously. As can be seen below on figure 1.1., there is a theoretical as well as empirical relationship that exists in the logical structure and influence between variables.

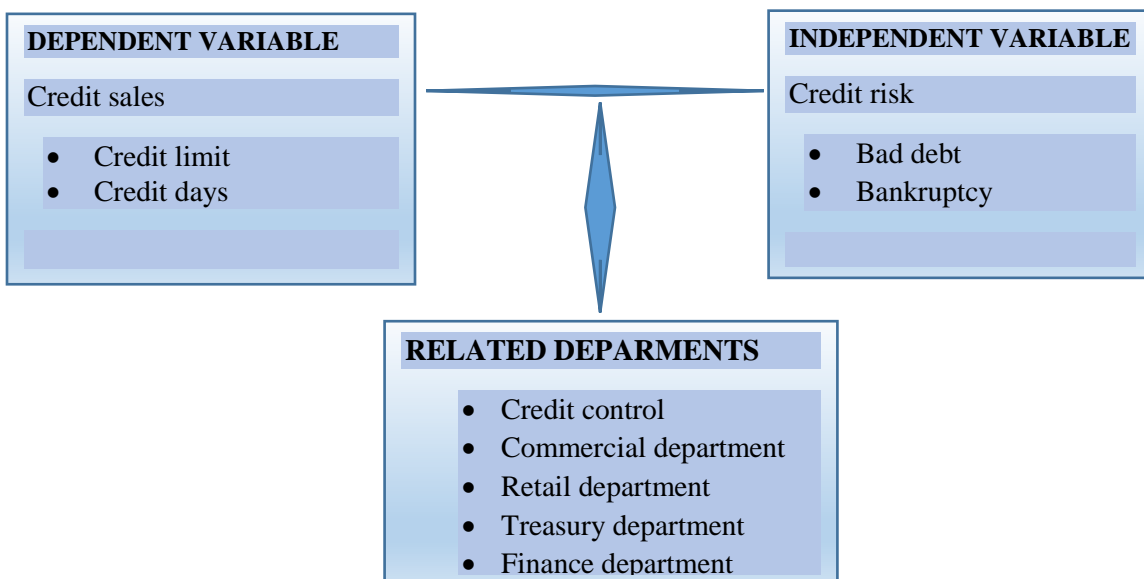


Figure 1.1. Conceptual Framework

Source: Developed by the researcher-based theories and empirical literatures

CHAPTER THREE

RESEARCH DESIGN AND APPROACH

In this chapter, the researcher describes the methods used and how the study will be conducted. This chapter contains research design, population, sample and sampling techniques, data collection methods and the methods used in data analysis.

3.1. Data Type and Source

To collect reliable data, both primary and secondary data sources will be used. To achieve the objectives of this study, the primary data will be collected through open and closed-ended questionnaires and interview questions. Secondary data which is also relevant to this research work will be collected from studies conducted by different researchers on international and local organizations, documents prepared by different governmental and non-governmental organizations.

3.2. Research Design

In this study, a descriptive type of research method will be adopted with the help of quantitative and qualitative study techniques. Descriptive research is the one in which the subject is observed, and the behavior is described in a natural way. Case study design is the focus area to provide details. The purpose is to describe the existing practices of the elements of credit sales risk that are being studied to suggest solutions.

Some open-ended, and interview questions will be included in the research in addition to the structured questionnaire so that respondents can make in-depth suggestions on the existing condition that may help to make future improvements by using questions with an open-ended nature which we may not get from the closed-ended questions.

3.3. Population Size and Sampling Techniques

The target population of the study consists of the employees under sales, finance, audit departments and the management members in the Libya Oil Ethiopia Ltd. The choice of these departments and the management members' stalk from the fact that these employees and management members are believed to have the appropriate knowledge and practices of credit sales, collection, and creditworthiness analysis of the company. The total number of populations is 100 from the above-mentioned departments.

3.4. Sample and Sampling Techniques

Because the total population is finite and small, the study will cover all the total population of the study, and no sampling technique is applied.

3.5. Sources of Data

The study will use primary and secondary data sources. Both are important sources of data to complete the intended research work.

3.6. Procedures of Data Collection

Every study has its own framework for collecting data to ensure that the required data will be collected accurately. The data collection plan, preparation and distribution of structured questionnaire will be administered properly to obtain primary data from the respondents in a timely manner. Thus, 110 questionnaires will be distributed to respondents.

3.7. Methods of Data Analysis

Data will be collected from primary and secondary sources and analyzed, summarized, and interpreted accordingly with the aid of the descriptive statistical techniques such as simple

percentages and tables. This method will be used to enable the researcher to draw precise and valid conclusions and recommendations. Using the simple percentage for analysis, higher percentages will be considered the best in drawing conclusions and validating research questions/ statements.

According to Raimo Streefkerk (2019) Quantitative research is expressed in numbers and graphs. It is used to test or confirm theories and assumptions. This type of research can be used to establish generalizable facts about a topic. Common quantitative methods include experiments, observations recorded as numbers, and surveys with closed-ended questions. It is at risk for research biases including information bias, omitted variable bias, sampling bias, or selection bias.

Whereas qualitative research is expressed in words. It is used to understand concepts, thoughts or experiences. This type of research enables you to gather in-depth insights on topics that are not well understood. Common qualitative methods include interviews with open-ended questions, observations described in words, and literature reviews that explore concepts and theories.

According to Kumar (2011) to analyze qualitative data, the researcher needs to do content analysis. This is a process that involves analyzing the contents of questionnaires to identify main themes and effort to carefully understand and interpret the information. Therefore, the qualitative analysis of the study conducted by analyzing the content of the questionnaire and interpreted accordingly.

Therefore, in this research we use both qualitative and quantitative data analysis methods.

3.8. Research Instrument

The instrument that this study will use is primary data which includes interviews, questionnaire and group discussion, and the secondary data obtained from a booklet. The questionnaire consists of two parts as shown below. Part One contains details on personal information of respondents and Part Two deals with measuring the creditworthiness analysis of customers, the management of credit sales, and the collection aspect of the enterprise.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND RESULT

4.1. Descriptive Analysis

The data presentation, analysis, and interpretation are covered in this chapter. Questionnaires given to different department employees of Libya Oil Ethiopia Limited (LOEL) in Addis Ababa provided the study's data. SPSS software was utilized to organize, summarize, and evaluate the obtained data. The primary goal of the research was to evaluate Libya Oil Ethiopia Limited's credit sales risk management. Descriptive statistics, including charts, percentages and frequency distributions were employed to accomplish this goal. According to the study's goals and research questions, the data is presented.

4.1.1. Response Rate

The response rate to the distributed questionnaire was presented in this part. Initially, the aim was to gather information from a large number of professionals, employed by Libya Oil Ethiopia Limited (LOEL) in Addis Ababa in order to include a sample size that was representative of the entire company. At my organization, I successfully distributed 110 questionnaires. 90% of the questionnaires were returned, with 10% not being returned.

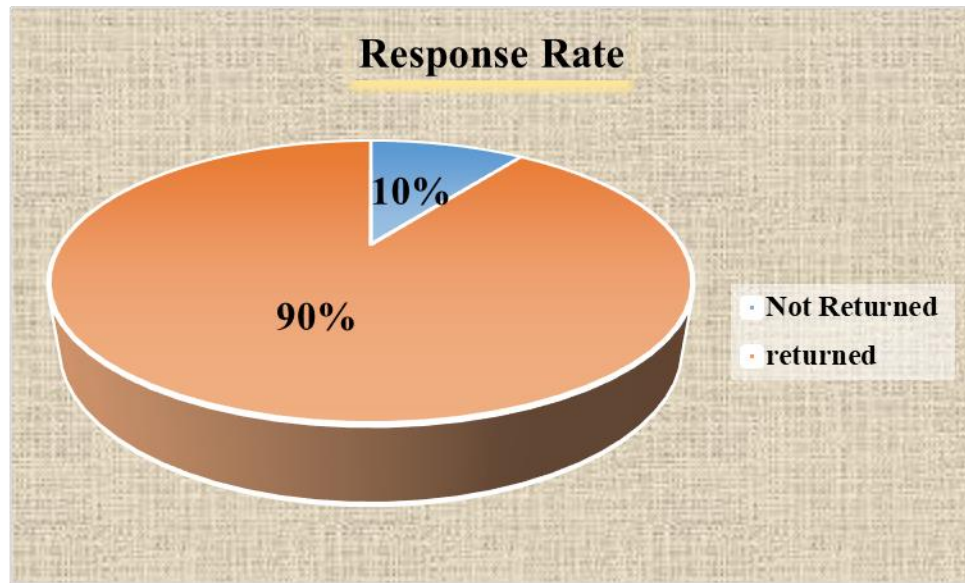


Figure 4.1. The response rate of respondents

Source: Own computation.

4.1.2. Academic Qualification

Among the sample respondents, 53% of employees have bachelor's degrees, and the rest of the respondents (47%) employees are master's degree holders.

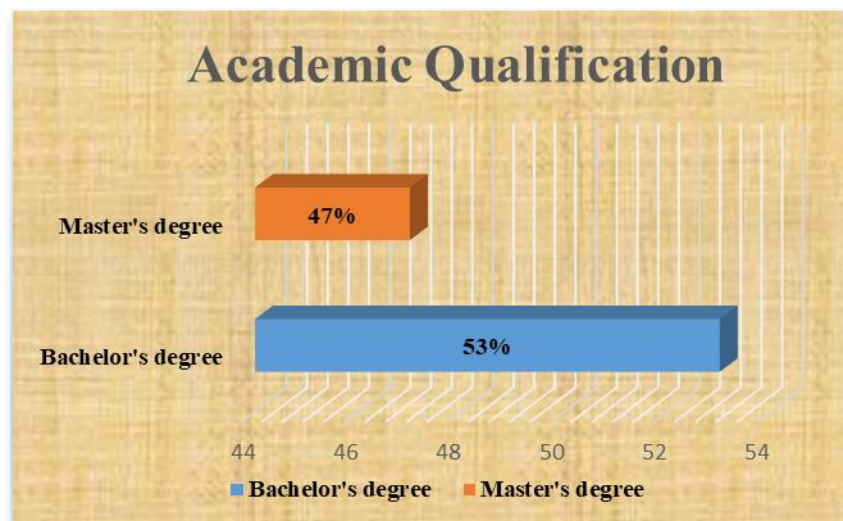


Figure 4.2. Academic Qualification

Source: Own computation

4.1.3. Work Experience

Given the importance of work experience in providing precise advice in this area, the respondents' levels of experience vary. Of them, 9% have less than five years' experience, 40% have five to ten years of experience, 32% have eleven to twenty years' experience, and the remaining 19% have more than twenty years' experience. This indicates that the majority of the respondents are seniors, which presents opportunities for gathering accurate information.

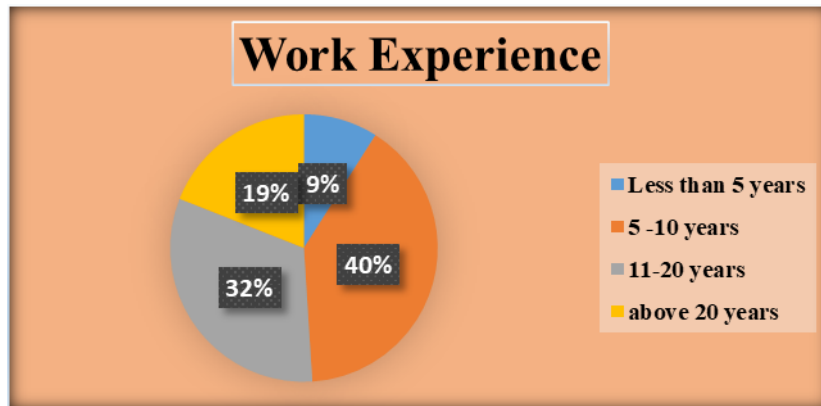


Figure 4.3. Work Experience

Source: Own computation.

4.1.4. Professions

From the sample responses, twenty-six are juniors professionals, fifty-two are senior professionals, and twenty-two are managers. Since senior professionals make up the majority of respondents, the research's findings are likely to be accurate, and the organization employs more experienced workers.

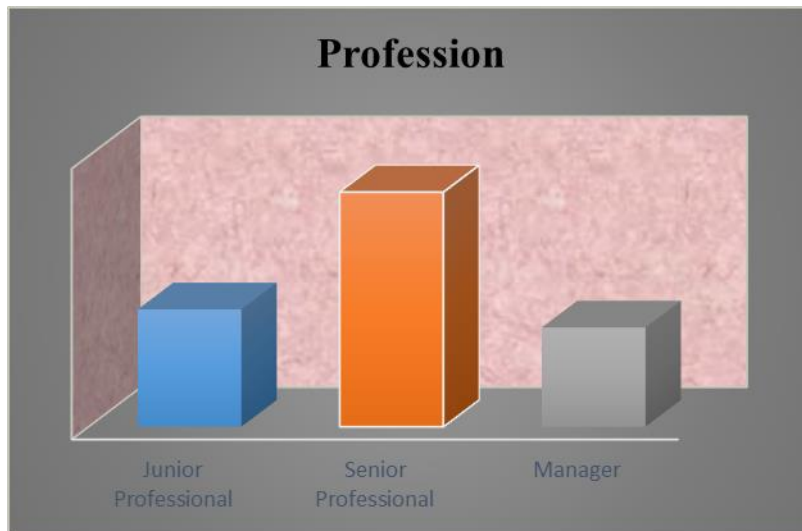


Figure 4.4. Respondents' Profession

Source: Own computation.

4.1.5. Gender

The majority of respondents were men (77%) and 33% were women.

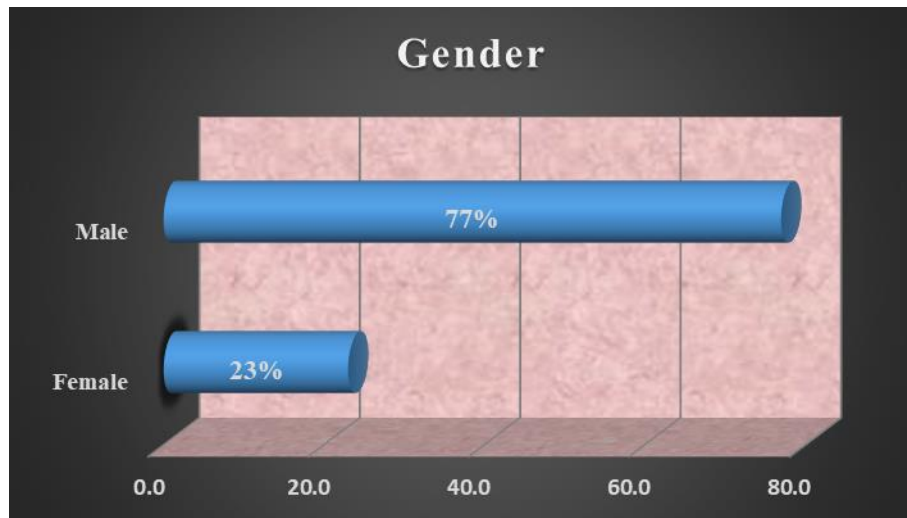


Figure 4.5. Gender

Source: Own computation.

4.2. The Practices of Credit Sales or Receivables Management

4.2.1. Do You Agree that the Company's (Libya Oil Ethiopia Ltd) Credit Sales Management Is Well Organized?

According to the respondents' feedback, 30% of respondents chose "strongly agree", 61% of respondents selected "agree", and the remaining (9%) picked "disagree", This clearly indicates that the organization has a well-organized credit sales management structure.

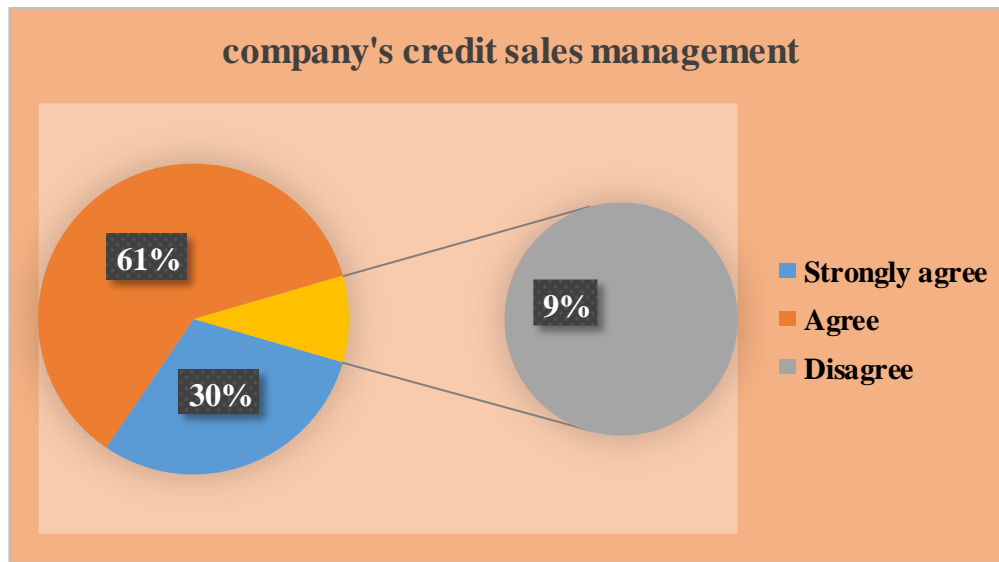


Figure 4.6. Companies credit sales management

Source: Own computation.

4.2.2. The Policies, Procedures and Objectives for Managing Credit Sales Consider the Most Important Aspects of Safeguarding the Collection of Receivables.

A credit policy is a set of rules that businesses and organizations use to manage the extension of credit to customers and clients. A credit policy is put in place to minimize financial risks and ensure a healthy and stable cash flow for any business or organization. Respondents questioned whether the policies, procedures and objectives are important for collecting receivables, Out of 100 responses, 42% strongly agree and 47% agree, with it the remaining respondents disagreeing on the topic of receivables management policies and procedures. This shows that policies, procedures and objectives for managing credit sales are considered the most important aspects and protecting the collection of receivables.

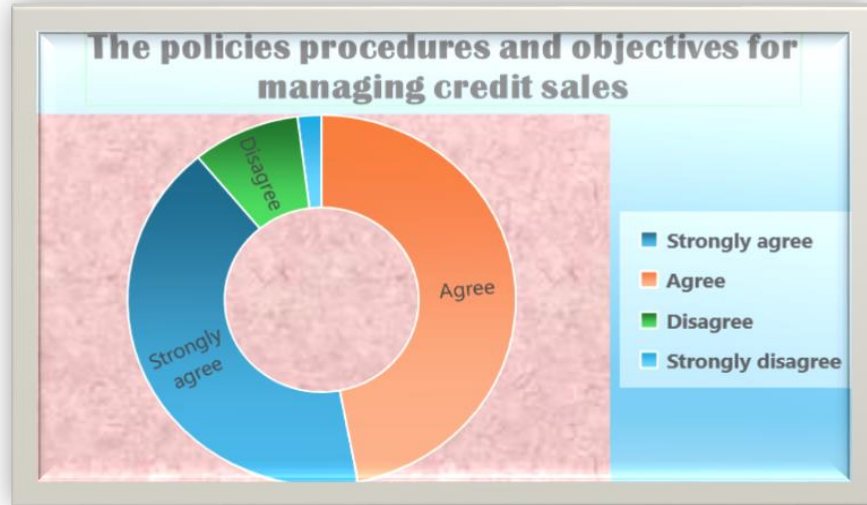


Figure 4.7. The policies procedures and objectives for managing credit sale

Source: Own computation.

4.2.3. Do You Agree that the Company's Receivables Management Is Well Organized?

Effective management of accounts receivable may improve cash flow, enhance collection procedures, and improve payment to any business. It can also significantly improve the experience of the customers. The majority of respondents from the data collection below agreed that the company's receivable management is well-organized.

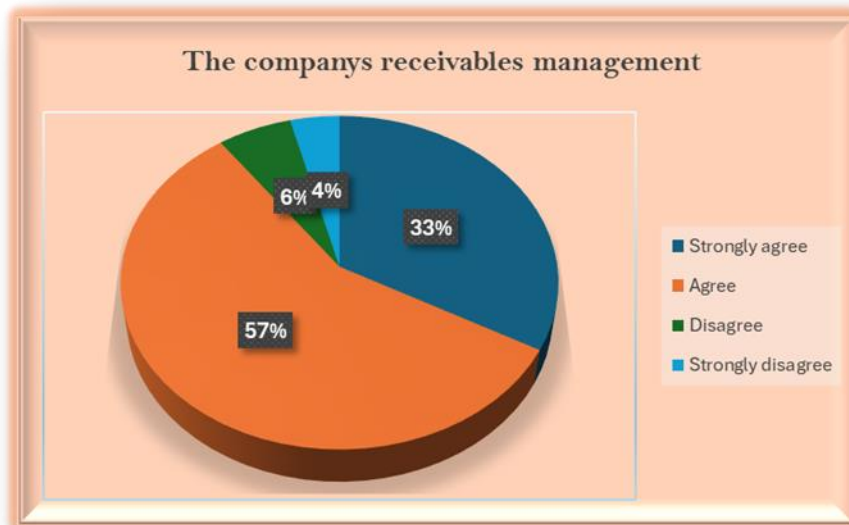


Figure 4.8. The company recievable management

Source: Own computation.

4.2.4 The Credit Days Given to the Customers to Settle the Overdue Amount Is Reasonable.

Based on the feedback provided by the respondents, half of them believe that credit days are a legitimate way to settle overdue amounts; 22% disagree, 6 strongly disagree, and the remaining respondents strongly agree. This shows that the credit days provided by the company to its customers are reasonable.

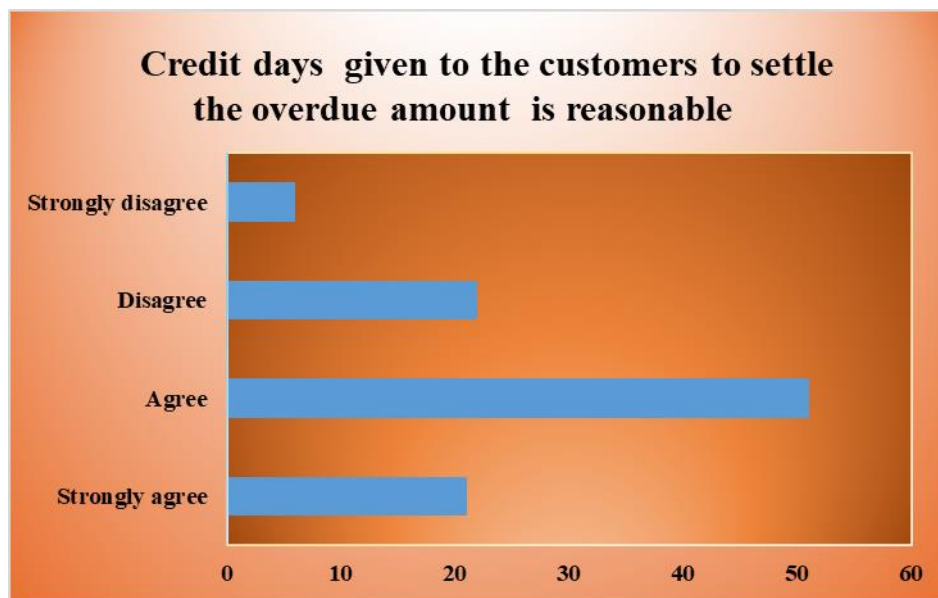


Figure 4.9. The company recievable management

Source: Own computation

4.2.5. The Company Must Use Additional Receivable Controlling Mechanisms.

Receivable management can have a variety of effects on a company, including increasing cash flow, maximizing working capital, increasing sales volume and profitability, and lowering the risks related to late payments. Therefore, in order to handle receivables, the company needs to utilize additional mechanisms including credit checks, collateral, credit insurance, payment terms, reminders, collection plans, collections procedures, and customer communication.

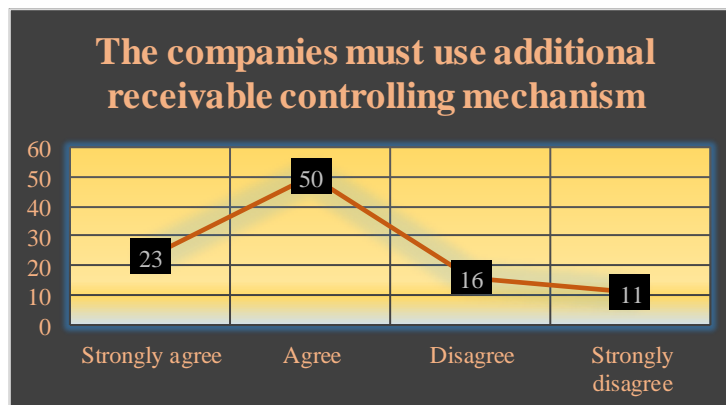


Figure 4.9. Receivable controlling mechanism

Source: Own computation

Based on the feedback given by the respondents, it is obvious that the company has to implement additional receivable control mechanisms given that 23% of respondents strongly agree, 50% of respondents agree, 16% disagree, and the remaining respondents strongly disagree.

4.2.6. There is a Major Weakness in Credit Sales Management in the Company (Libya Oil Ethiopia Ltd).

Credit sales are transactions in which clients buy goods or services with the plan of paying for them later. Credit sales can build up and become a liability for our company if they are not properly managed. Considering the responses, it is clear that the organization has a major weakness in its credit sales management system, as 38% of respondents agreed, 21% of the respondents strongly agreed with it, 27% strongly disagreed, and 14% disagreed. This indicates that there is some weakness in the company's credit sales management.

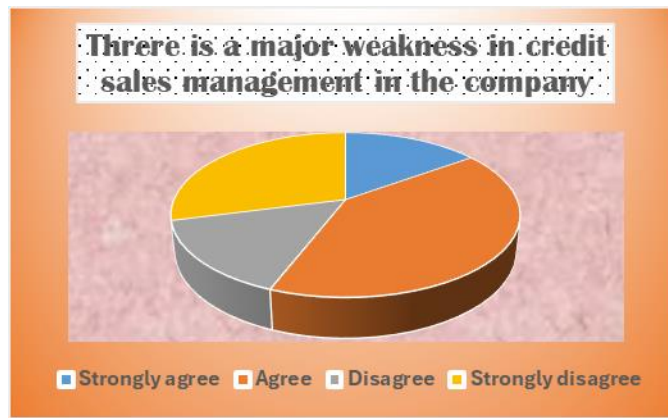


Figure 4.10. Weakness of credit sales management in the company

Source: Own computation

4.2.7. The Credit Limit Process and Procedure are Free from Any Risk.

A credit limit is the maximum amount of money that a lender will grant a borrower depending on certain details about the borrower, such as their income and work status, and an examination of their financial records. One significant element that may impact a consumer's future credit availability is their credit limit.

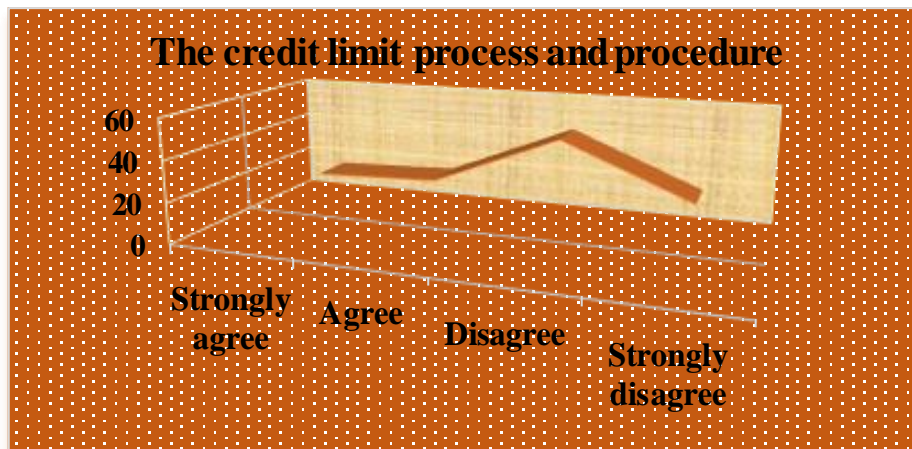


Figure 4.11. The credit limit process and procedure

Source: Own computation

According to the respondents' data, 17% strongly agree, 19% agree, 45% disagree, and the remaining respondents strongly disagree, which makes it clear that the company's credit limit process and procedures are not risk-free.

4.2.8. Do You Think that the Business Unit (Departments) Influence Collection Policies Effectively?

It makes sense that the credit and sales departments of businesses would regularly disagree. While a credit manager's main objective is to safeguard the company's assets through careful screening procedures, the sales department has only one main goal: to sell. Naturally, there may sometimes be disagreement.

According to the data collected from the respondents, 51% of them strongly agree with it, and the remaining 49% disagree. Requesting managers to release credit hold orders above the credit limit shows that each department or business unit has an impact on the collection policies.

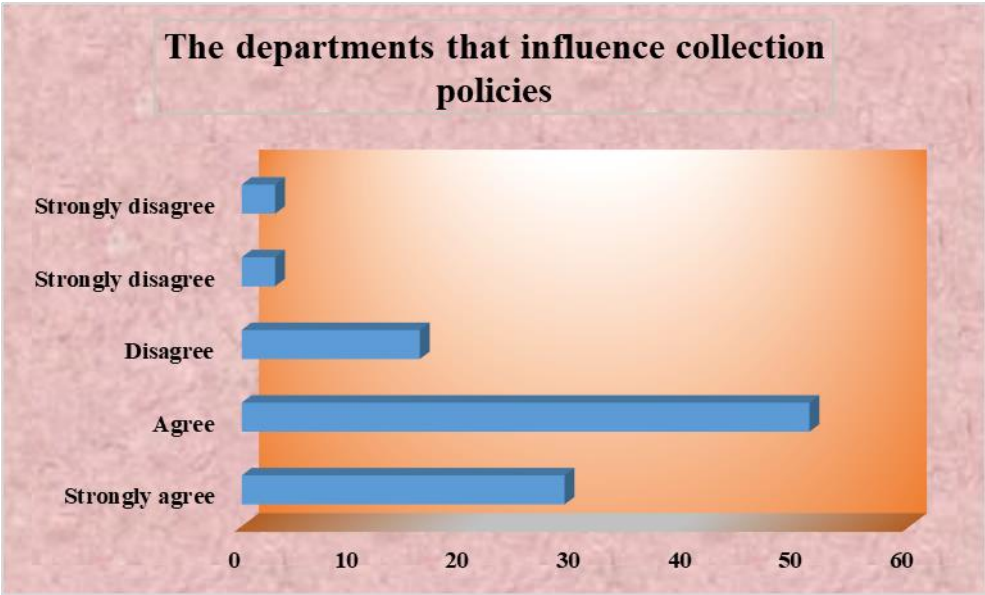


Figure 4.12. The departments that influence collection policies
Source: Own computation

4.2.9. How Do You Evaluate the Existing Credit Sales Management of the Company Regarding Credit Worthiness Analysis, Credit Sales Collection Policies and Procedures?

Credit sales management includes policies and practices that help businesses manage credit risk and ensure healthy cash flow.

Here are some best practices for credit sales management:

- Creditworthiness analysis: Evaluate a customer's creditworthiness before extending credit. This can include considering their payment history, credit history, and financial health.
- Credit policies: Establish clear policies for extending credit, including credit terms, credit limits, and payment deadlines. Communicate these policies to customers upfront.

According to the data gathered from the respondents, over 45% of them agree with or support the current credit worthiness analysis and credit sales collection policies and procedures as being sound and risk-free. The rest suggested that the company should revise the current policies and procedures and that the policies should also take the current inflation of the economy into account.

4.3. The Credit Sales and Collection Policies

4.3.1 Existing Policies Procedures and Objectives for Managing Credit Sales are Effective and Adequate.

When a company lends money, products, or services to someone else, the credit management function ensures that the customer's transaction is profitable and secure. This involves managing the customer's account and business relationship, responding to any questions or concerns, and determining a potential credit user's dependability or "creditworthiness." The goal is to ensure future, continuous business and timely repayment of the credit provision. According to the data collected, 29% of respondents strongly agree and 54% of respondents agree, indicating that the company's policies and procedures are effective. The remaining respondents disagree with the policy's positive aspects.



Figure 4.13. The credit limit process and procedure

Source: Own computation

4.3.2. The Collection Policies and Procedures of the Company are Well Organized.

An official method the company employs to reach and exceed its accounts receivable targets is a collection policy. This written document outlines precise instructions that specify who, what, and why credit should be given. It also contains the procedure for handling delinquent accounts.

According to the data collected, 62% of respondents agree that the company's policies and procedures are well organized.

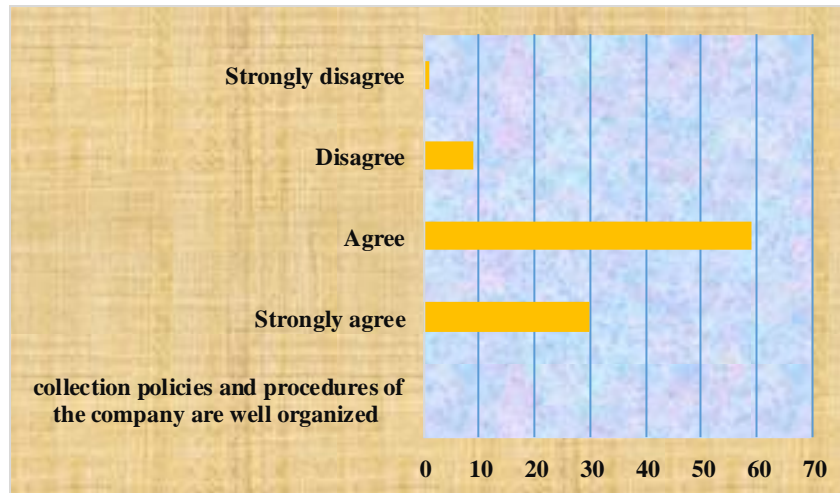


Figure 4.13. The collection policies and procedures of the company
Source: Own computation

4.3.3 Do You Think that the Company’s Credit Sales Policies Must be Changed?

A collection policy is a set of guidelines and procedures for handling unpaid consumer debts. It is a formal strategy used by businesses to reach and exceed their accounts receivable targets. It facilitates on-time payments, which support a stable cash flow. By offering open communication and flexibility in handling certain circumstances, a collection policy can also aid in building customer loyalty. This written document contains precise instructions on who should receive credit, how much they should receive, and why. It also outlines the procedure for dealing with unpaid debts. 55% of respondents agree with the policy change, that the company should revise its current credit sales policies.

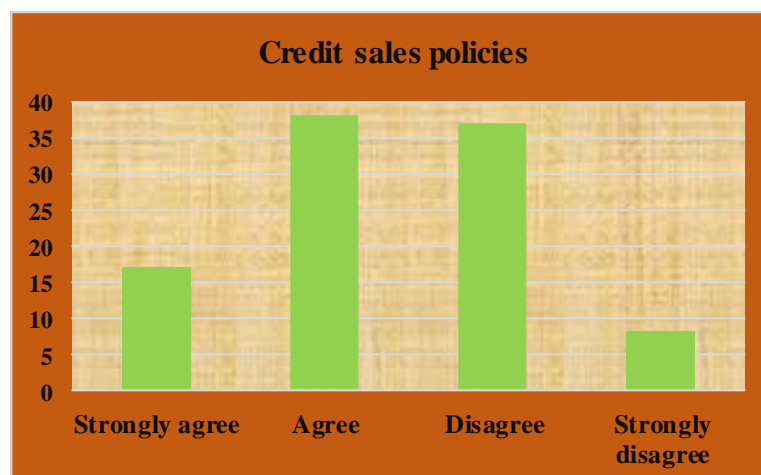


Figure 4.14. Credit sales policies

Source: Own computation

4.3.4 The Company’s Credit Sales and Collection Risk Need Special Attention.

As company-to-business credit transactions become more frequent, credit sales risk management has emerged as an essential part of modern business operations and administration. Due to ineffective internal management mechanisms and a lack of an efficient credit sales risk management system, accounts in arrears between businesses have currently have become a very serious problem. As per the collected data, 36% of the respondents strongly agree with it, and 56% agree while the remaining respondents disagree with it. This suggests that the company's needs special attention to credit sales and collection risk.

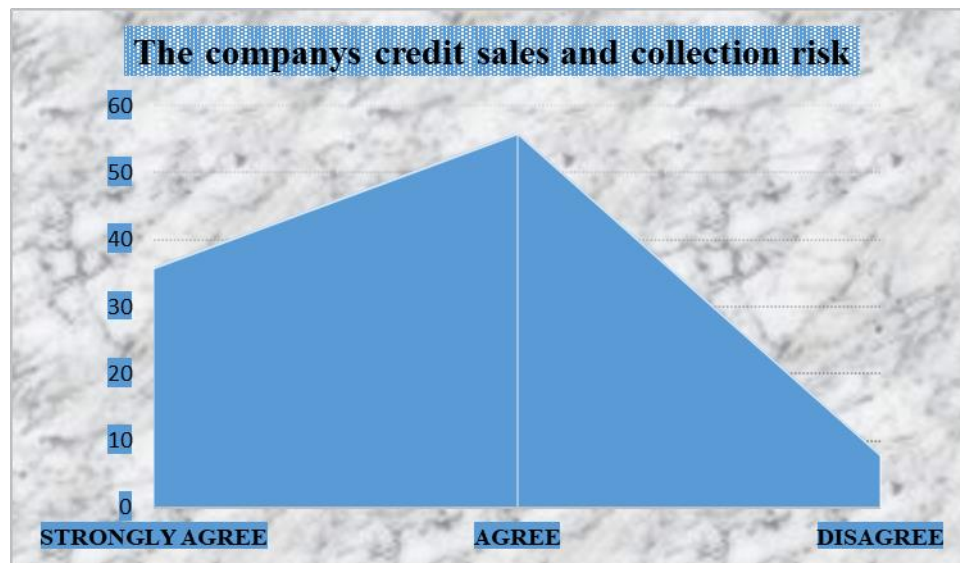
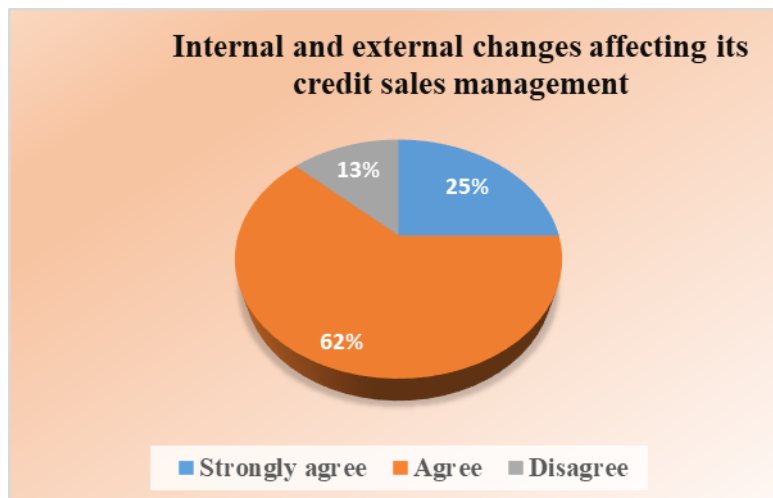


Figure 4.15. The companys credit sales and collection risk

Source: Own computation.

4.3.5 The Company Considers Both Internal and External Changes Affecting Its Credit Sales Management.

The risk is external and Examples of include as Gross



company's credit sales affected by both internal changes. external influences financial variables such Domestic Product

(GDP) and interest rates. Internal factors can be seen in direct contacts between companies, such as banks, suppliers, and manufacturers. A single customer's default could lead to a series of bankruptcies, especially during economic downturns, and the currency of credit spread is higher (Kiyotaki & Moore, 1997). According to the data collected, 62% of respondents agree, 25% strongly agree, and the remaining respondents disagree with the internal and external changes that affect credit sales management.

Figure 4.16. internal and external changes affect on credit sales

Source: Own computation

4.3.6 The Company Takes Immediate Actions on Long Term Debtors.

Debt with maturities longer than one year is considered long-term debt. There are two ways to look at long-term debt: financial investment and the issuer's financial statement reporting. Companies are required to include long-term debt issuance and all related payment obligations on their financial statements as part of financial statement reporting. Conversely, investing in long-term debt involves funding debt investments with maturities more than one year. To understand how the company handles long-term debtors, respondents replied to this question. Out of all respondents, 27% strongly agreed, 59% agreed, 12% disagreed, and the remaining respondents strongly disagreed.

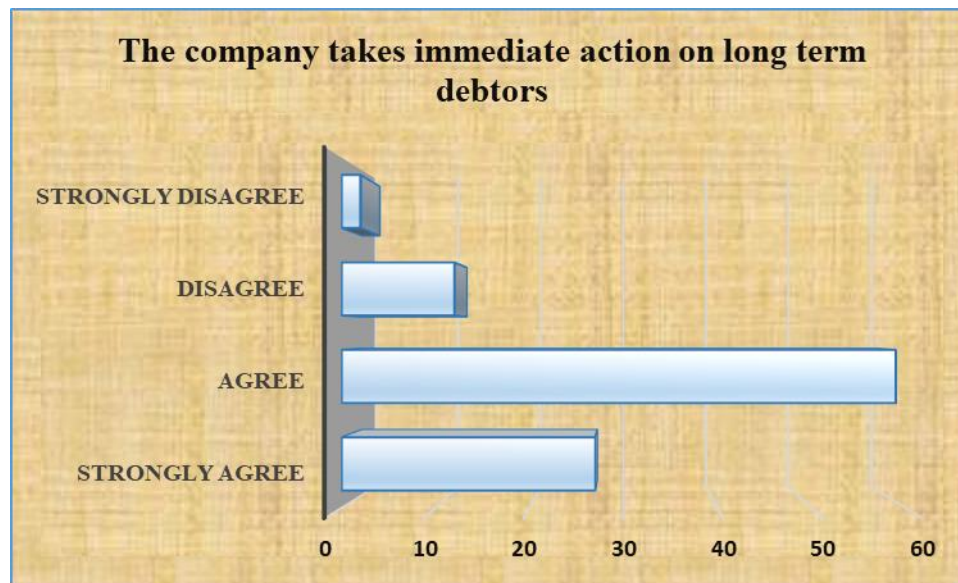


Figure 4.17. Action on long term debtors

Source:Own computation.

4.3.7 What are Your Recommendations on the Improvement of the Company’s Credit Sales and Collection Policies?

The respondents made some comments, but the majority of them focused on prompt collection; otherwise, the company's interest payments to banks would increase due to the collection delay. Another suggestion was to employ more technology to speed up collection and follow-up, as well as consider the financial condition of the customers and local computation when choosing and granting credit to both new and existing customers.

4.4 The influence of Credit Sales on the Trade Debt Performance of Libya Oil Ethiopia Limited.

4.4.1. Do You Agree That Credit Sales Without Conducting Credit Worthiness of the Customers can have a Serious Negative Impact on the Company’s Trade Debt Performance?

Creditworthiness refers to the process of evaluating how likely a customer will default on their payment obligations. It is critical for businesses as it helps assess customers’ financial reliability before deciding on payment terms and determining whether they should be allowed to purchase on credit. Selling on credit can boost sales, but it also carries the risk of late or missed payments. So, what can companies do to protect themselves from potential losses? The key is to assess their customers’ creditworthiness. Creditworthiness refers to determining the likelihood of a customer settling their payment obligations on time.

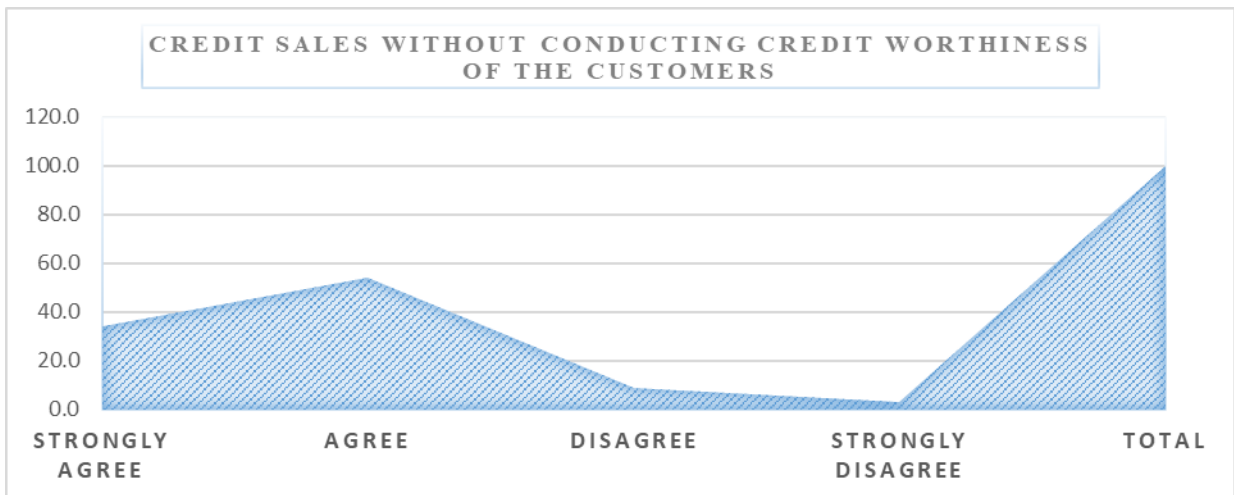


Figure 4.18. The companys credit sales and collection risk

Source: Own computation.

It reflects a customer’s financial stability and reliability before a business sets credit terms. Numerous factors impact the credit analysis process, including credit and payment history, trade references, credit reports and scores, and financial statements. To check creditworthiness and increase accuracy, consider automating the data gathering process, leveraging granular data from various financial statements and credit reports from different agencies, and enabling real-time risk alerts. The data collected shows that 34% of respondents strongly agree and 54% of respondents agree, suggesting that a company's trade debt performance is significantly impacted by its credit worthiness. The rest of the responders disagree.

4.4.2. Signing Sales Agreement Between Libya Oil Ethiopia Limited and Its Customers without Conducting Credit Worthiness Analysis can have a Serious Negative Impact on the Company’s Performance.

Assessing a customer's creditworthiness and lowering your financial risk are made possible by efficient credit risk evaluations. On the other hand, if you refuse credit to a well-paying customer who is eager to make more purchases, your business may lose out on opportunities due to excessively cautious risk selections. Finding the ideal balance is essential to increasing the profitability of the business. Another crucial next step is to run a business credit report, which shows a customer's ability to make payments based on payment history and public data. It's also a good idea to ask the customer's bank and other lenders for trade references, as well as companies or suppliers who have previously granted trade credit to that customer. Libya Oil Ethiopia Ltd. evaluates a customer's ability to pay by looking at their payment history with other lenders,

examining their financial statements and accounts, and requiring them to present original bank guarantees in order to lower risk.

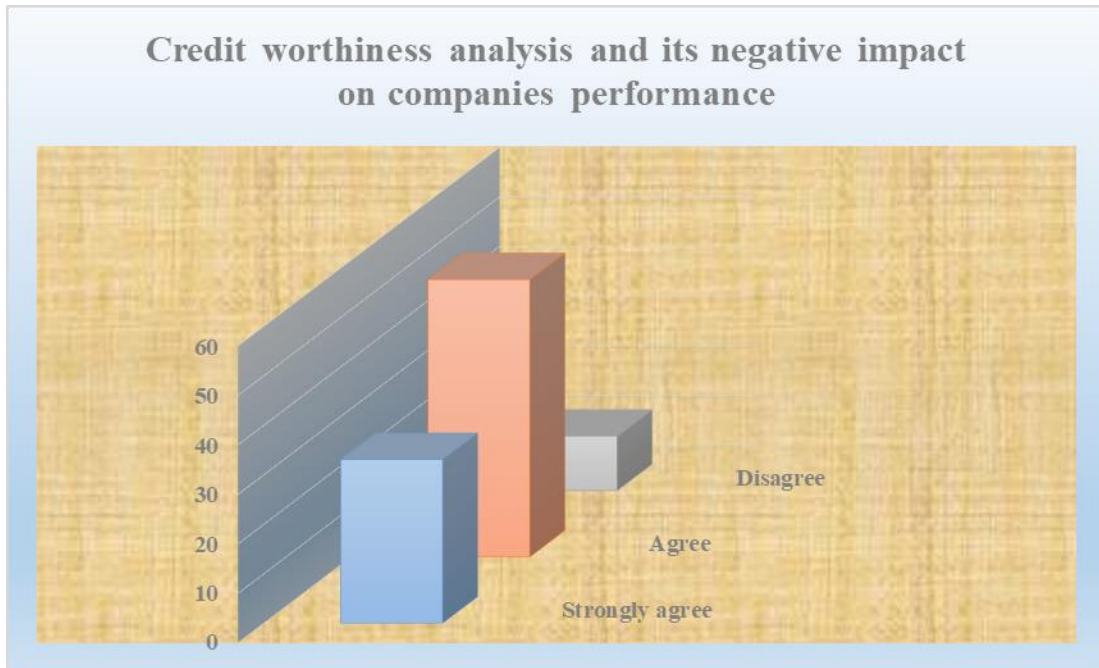


Figure 4.19. Credit worthiness analysis and its negative impact on companies’ performance

Source: Own computation.

According to the data collected 33% of respondents strongly agreed with it, 56% agreed, and 11% disagreed. This indicates that the contract between the company and its customers has a negative impact on the company's performance.

4.4.3. The Level of Credit Sales Risk in the Company is Very Low.

The potential loss resulting from a customer's failure to fulfill their payment obligations is measured by a company's credit sales risk level. Credit sales have certain risks including cash flow, bad debts, accounts receivable, and collection insolvency, but they can also be a very effective strategy for competition. Commercial and consumer credit sales risk management are the two categories. Credit sales to businesses are managed by commercial credit sales risk management, whereas credit sales to consumers are managed by consumer credit sales risk management. Of those surveyed, 21% disagreed, 4% strongly disagreed, 20% agreed and 55% agreed. This suggests that there is less credit sales risk.

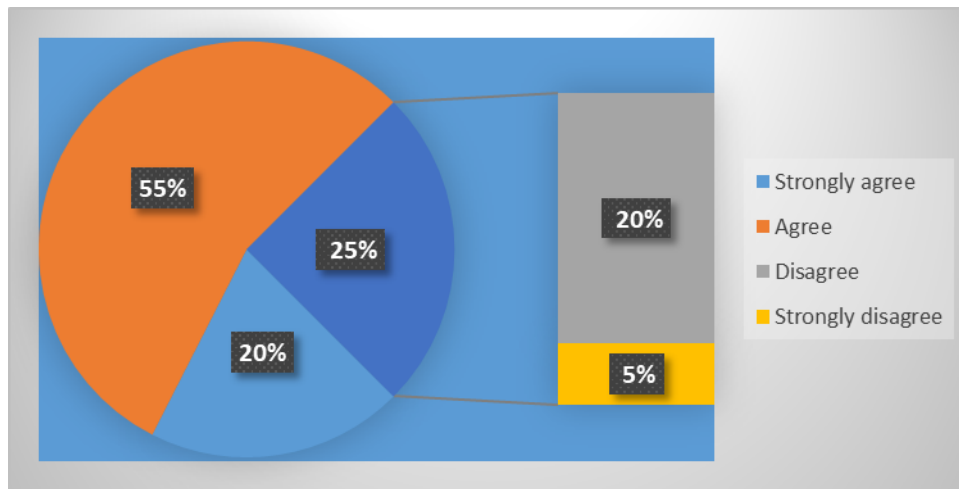
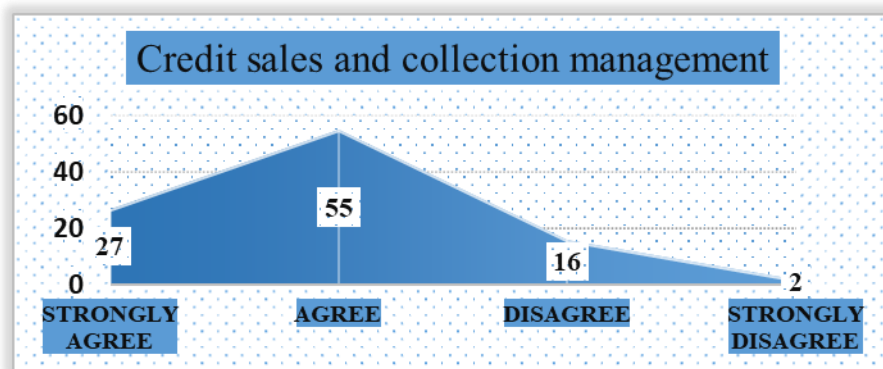


Figure 4.20. The level of credit sales risk in the company

Source: Own computation

4.4.4. The Company's Performance is Affected by Credit Sales and Collection Management.

Credit management, which begins even before the sale, is crucial for risk prediction. It can help a business avoid giving out too much credit while lowering the danger of bad debts. In the event that favorable or unfavorable circumstances change, it is also critical for the company to keep its clients on course. Being proactive and following up prior to the invoice's due date can help the company to resolve the issue before payment is delayed. The company may treat it as a "customer support" call rather than a collection call. One of Libya Oil Ethiopia Ltd.'s collection methods is to remind clients of the invoices' due dates and to ask for their commitment at the end of the conversation. Based on the data gathered, 27% of respondents strongly agreed with it, 55% agreed, 16% disagreed, and the remaining respondents strongly disagreed. This indicates that the collection management techniques



or methods have an impact on the performance of the company.

Figure 4.21. credit sales and collection management

Source: Own computation

4.4.5. The Performance of the Company is Affected by Trade Debt Controlling Mechanisms.

Trade credit is a means of conducting business, which includes purchasing raw materials and selling completed goods on credit. Because it guarantees the financial security of the company, this channel must be maintained consistently. However, this channel is hampered by a few things, such as a lack of inventory and ineffective production process management, which eventually reduces profitability. Longer trade loan periods might also negatively impact financially disadvantaged companies' overall Performance. It reduces the manufacturing channel and limits new fresh investment prospects. According to the data gathered, 24% of respondents strongly agreed with it, 57% agreed, 13% disagreed, and the remaining respondents strongly disagreed. This implies that the performance of the company is affected by trade debt control mechanisms.

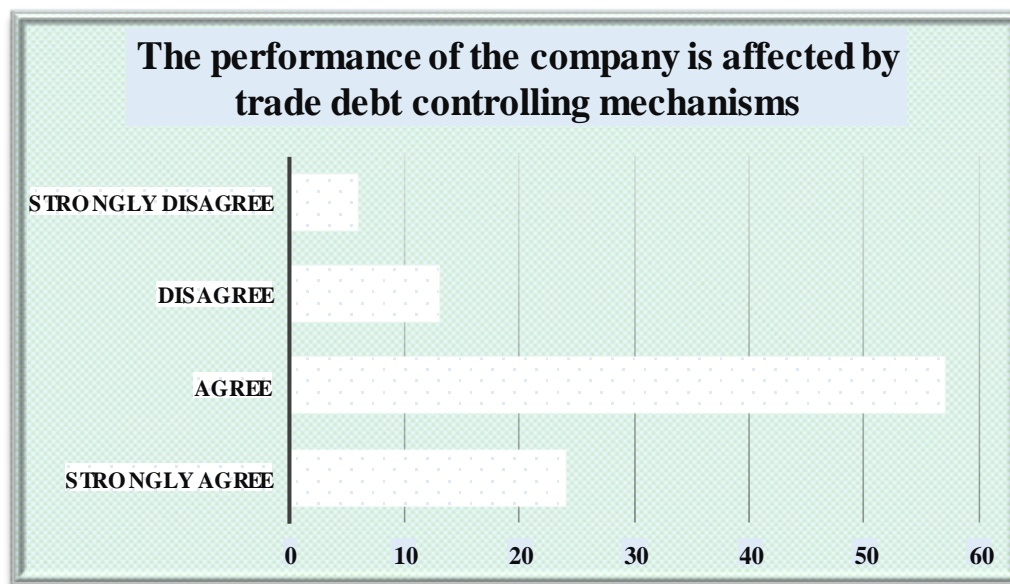


Figure 4.22. Trade debt controlling mechanisms

Source: Own computation

4.4.6. The Company will Face Credit Sales Risk in the Future

Credit sales can help companies by opening up new avenues to generate for generating revenue through customer retention and acquisition. By analyzing out your credit sales, you can determine how much money is made from this source of income and how it compares to against other payment methods.

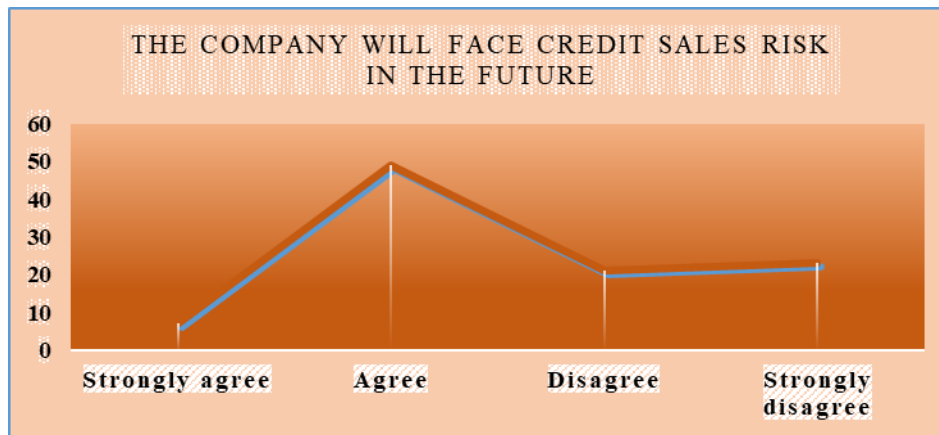


Figure 4.23. Trade debt controlling mechanisms

Source: Own computation

Credit sales risk is the term used in business to describe the potential financial losses that could arise from a debtor's inability to repay a loan. It also includes the risk that the company will not be able to repay its suppliers. According to the data gathered, 7% of respondents strongly agreed with it, 49% agreed, 21% disagreed, and the remaining respondents strongly disagreed. This implies that the company will face credit sales risk in the future.

4.4.7. Do You Think That the Company's Current Credit Sales Policies and Procedures is Controlling Mechanism for Bad Debt.

A credit policy can reduce the probability of bad debt by defining credit limits and standards for customer creditworthiness. A well-designed credit policy can support the maintenance of healthy cash flow by setting clear rules for when payments are due. Building customer trust, encouraging business expansion, and boosting sales and market share are some other advantages of a credit strategy. Credit standards, credit period, discounts, and collection procedure are some of the components of a credit policy.

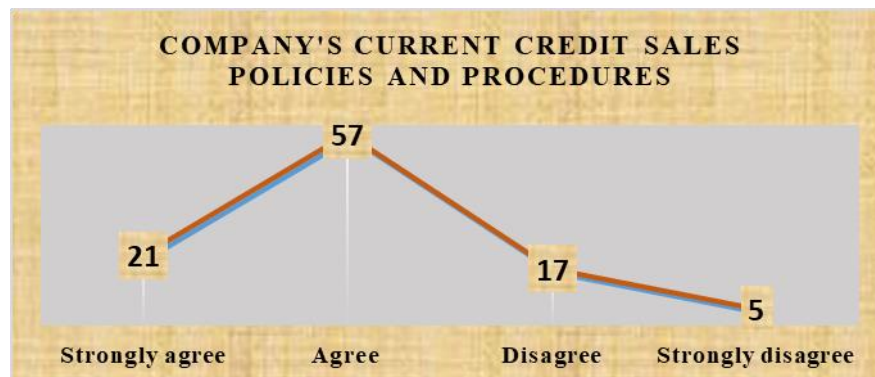


Figure 4.24. company's current credit sales policies and procedures

Source: Own computation.

Figure 4.24. display that, out of 100 respondents 57% said agreed, 21% strongly agree, 17% disagree and 5% strongly disagree. This indicates that the current credit sales policies and procedures are the controlling mechanism for the company's bad debt.

4.4.8. What are the consequences of the existing credit days in all financial aspects of the company?

According to the data collected from open-ended questions, about 70% of respondents recommended that the company pay Ethiopian Petroleum Supply Enterprise (EPSE) and other suppliers in advance, collect money from customers early, or have minimum credit days to pay suppliers. Therefore, the current credit days must be reduced and it also has an impacts on cash flow. The remaining respondents stated that the current credit days should be revised or increased in order to remain competitive and increase sales volume, and build positive relationships with customers.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1. Introduction

This chapter presents the findings based on the analysis conducted throughout the entire study. The chapter also provides recommendations for the study, which are required to determine credit sales risk management at Libya oil Ethiopia Limited. Subsequently, the chapter ends with conclusions and some relevant recommendations for the company's management team use.

5.2. Findings and Conclusions

To collect their opinion and perspectives on the management of credit sales risk, questionnaires were distributed to respondents who are employed by Libya Oil Ethiopia Limited, including those from sales, finance, customer service, and management team. According to the responses, the company's credit sales management is well-organized, as more than half of the respondents agreed. However, 30% of respondents indicated that there are some gaps or weaknesses in the company's credit sales management. The majority of respondents agreed with the current credit days for the customer, and over 80% agreed with the safeguards provided by policies, procedures, and objectives for managing receivables collection. However, 28% disagreed with the reasonableness of credit days to settle the overdue amount. The majority of respondents (83%) agreed that the organization needs to improve its receivable policy and procedures by implementing additional receivable mechanisms. Since 56% of those respondents agreed, the feedback highlighted the risk associated with the company's credit limit procedure. The feedback indicated that the company's credit limit process is not risk-free. Among the risks presented to the company are the following: clients may bring blank checks (with no balance) and delay payment until after the product is delivered, there may be strong relationship between bank employees and customers, and customers may request the bank to postpone the payment of the check. According to the respondents' feedback, 51% of them agree that departments have an impact on the collection policies. For instance, business units (such as Retail, Commercial, and Customer Service departments) can influence collection policies by requesting the management team for approval to release hold orders due to over credit limit. This is a significant problem, and the company needs to address it accordingly.

The data collected from the respondents indicates that 45% of them support or agree with the policies and procedures currently in place for credit sales collection and credit worthiness analysis. The remaining respondents suggested that the business updates its current policies and procedures, considering the economy's current inflation rate. According to the collected data, 55% of respondents support the policy change, indicating that the company should modify its current credit sales policies and procedures in consideration of the present economic condition of the country. The research also reveals that there are gaps in the credit sales collection policies and procedures, as 38% of the respondents disagreed that they are well-organized.

According to the data gathered, 92% of the survey participants agreed, indicating that the business should pay particular attention to the risks associated with credit sales and collection management. Additionally, 87% of respondents stated that the credit sales management is impacted by both external and internal changes. Since delays in collection would result in higher interest payments to banks for the company, the majority of respondents' comments focused on the importance of timely collection. Another suggestion was to use more technology to expedite collection and follow-up, as well as to consider local computation and the customers' financial status when selecting and granting credit to both new and existing customers. However, the credit sales without conducting creditworthiness of the customers have a significant impact on the trade debt performance of the company as 89% of the respondents agreed on it. According to the data collected 89% of the respondents agreed that signing contracts between the company and its customers without conducting creditworthiness has a negative impact on the company's performance. Additionally, 82% of the respondents agreed that the company's performance is affected by credit sales and collection management and making it clear that credit sales and its collection management are fundamental to the company's performance. Furthermore, 81% of the respondents agreed on the company's performance is impacted by trade debt control mechanisms. For example, one of the company's retail customers, Haben Oilibya, had a debt balance that remained unresolved for a long period of time and held by the company's Legal Department. Around 59% of the respondents agreed that the company faces future credit sales risk implying that the company will encounter, credit sales risk in the future.

According to the data, almost 70% of respondents suggested that the business established minimum credit days for paying suppliers, collect payments from customers earlier, or pay EPSE and other suppliers in advance. Consequently, it is necessary to reduce the current credit days, as this also impacts cash flow. The remaining respondents, believe that the current credit days should be revised or extended in order to remain competitive, increase sales, and foster positive customer relationship.

5.3. Recommendation

It is clear that the study's conclusions reflect the reality on the ground, highlighting the current issues with credit sales management. Based on the main conclusions and findings discussed above, the following recommendations are made to inform Libya Oil Ethiopia Ltd.'s management teams, future researchers, and other interested parties about this issue.

Since the company pays in advance to EPSE (Ethiopian Petroleum Supply Enterprise), interest to banks, and other suppliers, the credit days granted to customers must be periodically reviewed and adjusted in accordance with the customer's financial situation and current inflation. Additionally, the company should assess the customer's financial situation and previous interactions with banks and other lenders.

- ✓ In order to prepare for payments, the receivable collection mechanism needs to be modified, and additional technology should be used. Customers should be contacted using more effective or different technology than just phone or mobile device. They should be informed in advance of the entire payment details for the upcoming weeks or months through online Customer Service Center. This method will help monitor customers' needs and track their requests.
- ✓ In regard to the credit limit procedure, the company should consider the customers' ability to pay all the overdue amounts promptly, as some customers place orders up to the credit limit, and delay payment until the end of the month. This affects the company's working capital and cash flow.
- ✓ The feedback from respondents shows that 51% agreed that departments influence collection policies. For example, business units (such Retail, Commercial, and Customer Service departments) could approach the management team members for approval to release hold orders due to over the credit limit. This is a serious issue, and the company must act on or address this issue accordingly.
- ✓ Most respondents stated that the country's current economic status, the ability of competitors, product shortages, internal and external influences on sales, and a reassessment of the business environment were all considered when revising or changing the company's credit sales policies and procedures.
- ✓ Trade debt impacts the company's performance by lowering its revenue and net income. Therefore, the Company should set a limit on the amount and duration of the outstanding balance before it accumulates by the end of the year.

- ✓ Since they account for more than half of the current collection efforts, the company should focus on and follow up on all payments from large-volume customers (those who have purchased a significant number of products). Additionally, it should offer discounts for early payments to encourage all customers.
- ✓ It is risky to sign a contract with a customer without conducting a creditworthiness analysis. For this reason, the company should further assess both new and existing customers by obtaining financial statements and customer history data from banks and previous lenders.
- ✓ The company should implement procedures and control mechanisms for the number of orders placed at a time as the customers may place a large number of orders on the system with the equivalent amount of credit limit. When the payment for the delivered products becomes due the customer may be unwilling to pay because they may have multiple orders on the system that remain unpaid until the end of the month or until the orders are completed from the system or fulfilled.
- ✓ The company should communicate all of its challenges, such as the advance payments for EPSE (Ethiopian Petroleum Supply Enterprise) and other suppliers, via email or new system processes, since each employee has a single goal to accomplish in their daily activities and may not be aware of the challenges faced by other departments (Finance, Sales, or Customer Service Center).
- ✓ It is suggested that frequent customer visits and meetings be conducted. These visits and meetings will provide customers with the opportunity to discuss their issues, allowing for the accurate identification of each customer's unique needs. Additionally, customers will appreciate it when the company contacts them regularly and on special occasions such as anniversaries and birthdays.

5.4. Limitation of the Study and Recommendation for Further Study

There is a smaller sample size for this study because other departments, such as Engineering, Human Resources, and half of the Operations departments, are unaware of the credit sales process and procedures.

Additionally, due to employee's busy schedules, the researcher thought that they may not have enough time to complete the questionnaire, which could delay the data collection period.

A few recommendations for further research are presented here based on the results of this study and the previously mentioned constraints. To identify any gaps or issues related to this subject, the

researcher should involve other oil companies or obtain similar studies conducted on these companies to a broad perspective from all aspects of the oil industry.

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APPENDIXES

MEKELLE UNIVERSITY
Department of Management
MASTER OF BUSINESS ADMINISTRATION

Dear respondents,

First, I would like to thank you for your positive response and valuable cooperation as your participation supports the success of the study highly. This questionnaire only serves for my academic purpose in Master of Business Administration (MBA) program. Besides, there are no right or wrong answer to the following questions. Rest assured that all responses will be kept confidential.

The topic of my study deals with Credit Sales Risk Management in the case of OLA Energy Ethiopia Limited. This study is assumed to add value on managing credit sales of the enterprise depending on reliable data to be collected from the respondents and other secondary sources.

I have tried to simplify the questionnaire in a way that respondents can manage it within not more than 15 minutes of time. I once again thank you.

Respondent's Personal information:

1. Academic qualification:
 1. Bachelor's degree
 2. Master's degree
2. Gender:
 2. Female
 2. Male
3. Work experience:
 3. Less than 5 years
 2. 5 -10 years
 3. 11- 20 years
 4. above 20 years
4. Position:

1. Junior professional 2. Senior professional 3. Manager

a) The practices of credit sales or receivables management

1. Do you agree that the company's (Libya Oil Ethiopia Ltd) credit sales management is well organized?

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree.
2. The policies, procedures, and objectives for managing credit sales consider the most important aspects of safeguarding the collection of receivables.

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree
3. Do you agree that the company's receivables management is well organized?

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree.
4. The credit days given to the customers to settle the overdue amount is reasonable.

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree
5. The companies must use additional receivable controlling mechanism.

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree
6. There is a major weakness in credit sales management in the company (Libya Oil Ethiopia Ltd).

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree
7. The credit limit process and procedure are free from any risk.

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree
8. Do you think that the business unit (Departments) that influence on collection policies effectively

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree

9. How do you evaluate the existing credit sales management of the company regarding creditworthiness analysis, credit sales collection policies and procedures?

b) The credit sales and collection policies

1. The existing policies, procedures, and objectives for managing credit sales are effective and adequate.

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree

2. The collection policies and procedures of the company are well organized.

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree

3. Do you think that the company's credit sales policies must be changed?

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree.

4. The company's credit sales and collection risk need special attention.

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree.

5. The company considers both internal and external changes affecting its credit sales management.

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree.

6. The company takes immediate actions on long term debtors.

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree.

7. What are your recommendations on the improvement of the company's credit sales and collection policies?

c) The influence of credit sales on the trade debt performance of Libya Oil Ethiopia Limited

1. Do you agree that credit sales without conducting credit worthiness of the customers can have a serious negative impact on the company's trade debt performance?

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree

2. Signing sales agreement between Libya oil Ethiopia Limited and its customers without conducting credit worthiness analysis can have a serious negative impact on the company's performance.

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree.

3. The level of credit sales risk in the company is very low.

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree

4. The company's performance is affected by credit sales and collection management.

1. Strongly agree 2. Agree 3. Disagree 4. Strongly disagree

5. The performance of the company is affected by trade debt controlling mechanisms.

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree

6. The company will face credit sales risk in the future?

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree

7. Do you think that the company's current credit sales policies and procedures is a controlling mechanism for bad debt?

1. Strongly agree 2. Agree 3. Moderately agree 4. Disagree 5. Strongly disagree

8. What are the consequences of the existing credit days in all financial aspects of the company?
