IMPROVING PROFITABILITY OF THE NIGERIAN HEALTH CARE SECTOR THROUGH THE MANAGEMENT OF TRADE CREDITS

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ABSTRACT

The study evaluated the influence of trade credit management on profitability and liquidity of listed manufacturing firms in the Health Care Sector of Nigerian Stock Exchange (NgSE). Firms' management must understand that in this era where only short term planning is the feasible option, the components of working capital, specifically, debtors and creditors involving human behavior should be taken care of in lieu of liquidity profitability trade-off and cash flow synchronization. Panel regression was employed in analyzing collated secondary data of the sampled firms. The study depicted significant negative relationships between ROA and AR (p-value = 0.002 < 0.05) and between CASH and APCOS (p-value = 0.031 < 0.05). It has shown that the continued use and survival of trade credits as a marketing strategy improves liquidity through cash flow synchronization of inventory purchase, account payables and accounts receivables. The study suggested that finance managers of manufacturing companies should regularly review the firm's credit policies and align same to prevailing economic and industry wise peculiarities.

Keywords: Profitability, Liquidity, Firms, Trade Credits.

INTRODUCTION
Background of the Study

Granting credit to customers is inevitable in the very competitive manufacturing industry in Nigeria. It performs dual function of acting as a means of payment using acceptable documents and as means of financing for the buyer if the payment is due at a future date. Granting credit to customers is one of the many profit maximizing strategies of firms. Long, Malitz, and Ravid (1993) postulate that trade credit evolved as a source of short term finance in colonial era to smoothen the exchange of commodities among firms. Historically, the credit usually stretched up to twelve months. However, recent improvements in transportation and commercial activity via information and communication technology (ICT) have not only made official this source of finance but reduced reasonably the credit period. Trade credit is made up of accounts receivable, accounts payable and consumer credit when firms sell directly to final consumers (Brealey, Myers and Marcus, 2007). Accounts payable is included as the supplying firm opens an account receivable in lieu of the transaction, the receiving / downstream firm simultaneously opens an accounts payable in lieu of same transaction.

Sale of goods on credit entails setting up optimal terms of sales, the later depending on the firm's peculiarities and industry- wide characteristics. Pandey (2004) opines that trade credits are given

by suppliers to cement relationships with existing customers / middlemen and form new ones via attracting potential customers using juicy terms of credit. Since each industry seems to have its own typical terms of credit sale, there are no stereotyped rules regarding terms of sale. In these recessive times, Bastor and Pindado (2012) asserted that credit constraints have forced firms to delay payments to their suppliers in ascending order thereby leading to credit crunch. Further, both accounts receivables and accounts payables greatly complement each other as a channel of trade (Ferrando and Mulier, 2012).

Every credit policy is targeted towards an optimal mix / tradeoff of profitability and liquidity, the later ensuring the continual survival of the firm. In other words, a firm becomes illiquid albeit profitable if it cannot offset its short term obligations as they fall due. The right policy ensures that the right customers are granted credit at reasonable terms simultaneously minimizing all risks inherent in credit monitoring and collections (Brealey, et al, 2007). Trade debtors (i.e. accounts receivable) being a significant current asset must be properly managed as it takes up to 20% sometimes of the total assets of the manufacturing companies (Dunn, 2009). A functional / good credit policy minimizes costs associated with granting trade credits simultaneously maximizing the benefits there from (Kungu, Wanjau, Waititu and Gekara, 2014). Although the contents of credit policies of most firms differ, they contain four basic elements: credit standards, credit terms, credit periods and collection periods. For continued survival of a company, its credit policy must be dynamic in the ever changing business environment (Ojeka, 2012). Example of credit term is 5/20 net 60 which denotes a 5% discount for payment within 20 days and a net payment period ending on day 60.

Trade credit being the single most important and largest source of short-term business credit in the United States and the whole world (en.wikipedia.org, 2012) underscores the relevance of this study. Further, the demise of most indigenous manufacturing firms is not dissociated from bad management of trade credits (Ifurueze, 2013). Most studies on trade credit management especially in Nigeria emphasized account receivables of firms, neglecting account payables. This is necessary as most manufacturing firms themselves are customers of either extracting firms or farmers and overseas vendors. Manufacturing firms are not at the end of the value chain.

Statement of the Problem

Trade credit in Nigeria is essentially used as a marketing tool to acquire bargaining power for the firms and to survive stiff competition from powerful competitors. It is also to meet up with the buyers' requirements status of large scale wholesalers and maintain long standing relationships with customers. Striking a balance among these functions of trade credit is not without problems. It has been shown that developing economics are characterized by poor developed markets and financial sectors with practically no alternative sources of finance (Ge and Qui, 2007).

Further, Niskanen and Niskanen (2006) opined that use of trade credits, are prevalent with young companies as mature firms must have built up adequate reputation, size and credit worthiness. Credit policies of firms, specifically manufacturing firms in Nigeria are highly unstable such that changes are sporadic and not industry specific. If these changes are controlled and aligned to ever changing business environment, it would have been desirable and positive. In addition, trade credits granted to customers, from experience, were never fully realized in any financial year.

This culminates in financial statements of firms not depicting a true and fair view as required in the International Financial Reporting Standards and International Auditing Standards (IFRS & IAS).

Financing in Nigeria is hampered by high interest rates and ever rising exchange rates for firms that source materials abroad. Also, the unstable political and economic climate (Boko Haram and youth unemployment) emanates in declining of economic activities (Ojenike and Olowoniyi, 2012). Although suppliers and buyers enjoy symbiotic relationship, being in the same value chain, information asymmetry between firms and lack of moral values in society have hitherto increased risks of granting trade credits. That is, in asymmetric information conditions, firms grant credit to allow clients to attest to real quality of the goods purchased. However, they usually tighten the terms of credit since buyers' credit worthiness is in doubt.

Ifurueze (2013) postulated that a highly geared company's cost of obtaining funds from alternative sources may be high. It affects the firms' credit worthiness and increases its credit risks from the suppliers' point of view. Though manufacturing firms in Nigeria buy and sell on credits (maintain accounts receivables and payables), the researcher suspects that the extent to which these contribute to profitability has not been empirically fathomed, hence, the study.

Objectives of the Study

The study primarily tried to ascertain how profits and financial performance of manufacturing firms are increased by proper management of trade credits. Specifically, the study focuses on:
(i) Examining the extent to which accounts receivables and accounts payables at cost exert significant influence on Returns on Assets (ROA);
(ii) Investigating the extent to which debtors' turnover exerts significant influence on liquidity; and
(iii)Evaluating the extent to which creditors' turnover exerts significant influence on liquidity.

LITERATURE REVIEW
Conceptual Framework

According to Tsuruta and Uchida (2013), trade credit is an agreement to make payment at a later date by the recipient of goods, services and otherwise, the buyer to the suppliers account due to the fact that a real transaction has taken place. It is also, in most instances, the cheapest source of financing for the buyer. Management of trade credits involves minimizing cost of granting and stretching trade credits, simultaneously maximizing benefits derivable from it using such techniques as credit procedures, credit standards and credit terms. These are aimed at maximizing real profits in these hard times.

Effective credit policies must employ such procedures as issuing reminders to customers/ debtors factoring debts insuring anticipated bad debts, use of vicious litigation and writing off bad and irrecoverable debts against profits. Credit management is a vital survival tool for all businesses, irrespective of size and industry. Good credit management commences even before the actual sales and adopts cash flow boosting elements: vetting credits, issuing credits on suppliers own terms and conditions, invoicing immediately after delivery, making courtesy call before

collection payment is due, reconcile accounts and monitor performance via feedback loop (Brealey et al, 2007).

Empirical Review

Ojeka (2012) embarked on a study of the effect of credit policy on the liquidity of manufacturing firms in Nigeria. The study adopted a sample of four firms: Cadbury Nigeria Plc., Nestle Nigeria Plc., Nigerian Bottling Company Plc. and Unilever Nigeria Plc. 100 structured questionnaires were administered and shared equally among the sample firms. Judgmental sampling technique was employed. Measures of Central Tendencies, Dispersion and Analysis of Variance were incorporated in the analysis. Result of tested hypothesis proved that F- calculated (0.573) < F – tabulated (3.96) at $\infty = 5\%$ i.e. credit policies of firms, impact positively on the liquidity.

Ifurueze (2013) in his study of the impact of effective management of credit sales on profitability and liquidity of Nigerian firms in the Food and Beverage industries made use of secondary data collected from audited annual financial statements of six selected firms for the five year period (2007- 2011). The six companies chosen were based on ease of access and availability of data. Hypothesis one was tested using analysis of variance (ANOVA). Results signify that the relationship between effective management of credit sales and operating profit of the firm is positively and statistically significant at $\infty = 5\%$ with F- calculated (4.74) > F – tabulated (3.10). Further, the second hypothesis was tested using the same test statistic and revealed at 5% level of significant, that F-calculated (23.68) > F – tabulated (3.10). That is, there exists a significant positive relationship between liquidity position and debtors' turnover of the sampled firms. He suggested that firms maintain adequate liquid assets and minimize all costs associated with granting of credits.

Ksenija (2013) studied empirically the influence of accounts receivable management on the profitability of companies in Serbia during the financial crisis period of four years (2008 – 2011). Using purposive sampling technique, a final sample of 108 big and medium publicly – listed non-financial firms was drawn across all sectors, listed on the Belgrade Stock Exchange. Two dependent variables, return on assets (ROA) and operating profit margin (OPM) were regressed against the independent variables: the accounts receivable to revenue ratio (ARRR), receivables turnover ratio (RTR) and the current liquidity ratio (LIQ). Size measured by natural logarithm of sales was the control variable. The study showed a positive but insignificant statistical relationship between the ROA, OPM and accounts receivables. However, the result is most likely to be different if a longer term period is used and financial and unlisted firms are included.

Kungu, et al (2014) investigated the effects of credit policy on profitability of manufacturing companies in Kenya using the descriptive research design. Stratified random sampling technique was employed in selecting 81 manufacturing firms. Out of 81 structured questionnaires distributed, only 71 were valid for collation and analyses. Adopting Analysis of Variance and Regression Analysis, three independent variables; credit terms, credit periods and collection efforts (proxies for credit policy) were run against, the dependent variable; profitability. Hypothesis drawn was tested using the F- test statistic. Results indicated that credit policy accounted for only about 9% of the profits of the sampled firms. The study suggested that finance managers of manufacturing companies should regularly review the firm's credit policies and align same to prevailing economic and industry wise peculiarities.

Kapkiyai and Mugo (2015) investigated the relationship between trade credits and financial performance of small scale enterprises located at Eldoret town in Kenya. The study adopted descriptive research design in collating and analyzing secondary data of fifty SMEs in the district. The financial statements of these firms are audited, hence reliable. Analyses of Variance (ANOVA) depicted that F-statistic = 17.54 is significant at 0.05 level of significance for the variables entered: profit margin ratio, liquidity ratio, return on assets and trade credits. In other words, there is a significant influence of trade credits on these performance variables.

Kim (2016) assessed the determinants of trade credits in Korean firms. The study hypothesized that firm size; growth and age are directly proportional to accounts receivables and payables. Employing panel regressions on data collected from 763 non-financial companies quoted on the Korean Stock Exchange for the period 1992 to 2011, the results showed that larger companies with lower growth rate and profits do widen significantly their accounts receivables. Further, high leveraged firms albeit larger with ageing or young products make significant use of accounts payables.

In these studies, further work is necessary in that some of the local studies concentrated on the use of primary data. Where secondary data are used, the numbers of firms is inadequate given the number of quoted companies on the Nigerian Stock Exchange (NgSE). Moreover, these studies albeit carried out in both local and foreign economic climates depicted varied results. The limitations enumerated above accentuated the need for this study.

Theoretical Framework

The study is anchored on inductive theories of trade credits. Specifically, the study is buttressed on the financial advantage and price discrimination theories. According to Peterson and Rajan (1997) and Huyghebaert (2006), firms with external financing constraints use much more trade credits than others. Consequently, larger and older companies are more credit worthy than smaller companies and they expectedly have larger trade debtors from granting credit to financially constrained smaller firms. Further, they have easier access to external finance. Hence, they can afford to act as intermediaries between the supplying company or banks at the top of the chain and riskier companies at the bottom of the credit chain. In other words, the supplier of input goods can extend trade credit period or offer unearned discount rate to customers / buyers with long term standing relationships. Firms with strong market influence grant more trade credit. The financial advantage theorists postulate / assume that:
  i) Suppliers can easily evaluate buyer's financial performance and creditworthiness through his business.
  ii) Suppliers have more power to enforce repayment by threatening to reduce buyer's future supply of goods most effective in a sellers' market.
  iii) Suppliers can repossess the goods quite easily in the event of buyer's payment default and have them resold to other customers (most effective with durable goods).
  iv) Firms with unlimited access to capital markets will extend more trade credit to those who do not.
  v) Firms with high quality products offer longer trade credit period to customers / buyers to confirm quality (buyers are used as advertising / sales agent especially for new products / entrants to a market).

vi) Cash cow firms (i.e. firms with surplus cash) needing less external finance are able to extend more trade credits to customers.

vii) The level of trade credit is increased significantly during periods of liquidity squeeze in most economies as bank loans becomes much more costlier than the trade credits.

viii) Firm targeting higher sales volume accept more trade credit transactions to achieve high gross profit margin.

However, the big firms can bypass the banks via sale of securities backed by future cash flows realizable from trade debtors. Also, they can discount these account receivables with discount houses i.e. debt factorization. Hence, the continued survival of trade credits since the older firms can afford to extend such trade credits to riskier firms as a form of competitive strategy. This is obvious as diverting goods is harder than diverting cash. It is quite difficult for banks to duplicate supplier-provided trade credit as suppliers possess insider information and peculiar knowledge of operating environment. Moreover, there exists empirical evidence that trade credit flows naturally from the supplier customer relationship. That is, theories are inductive developing from everyday practices between the suppliers and customers (Peterson and Rajan, 1997).

Further, Daripa and Nilsen (2011) postulate that downstream firms including merchandizing firms are most likely to grant advance payments to their upstream suppliers (i.e. extractive and manufacturing companies) to smoothen productive runs, hitherto avoid disruptions. Similarly, Mateut (2011) demonstrated the use of prepayments by firms to ensure smooth production runs and minimize default risk inherent in the use of trade credits. Also, Bougheas, Mateut and Mizen (2009) opined that firms with seasonal sales and encumbered with warehousing and financing costs of inventory resort to trade credits during periods of low demand to stimulate sales, minimize these costs and increase contribution margin.

Next, Ferrando and Mulier (2012) opined that both accounts payable and accounts receivables simultaneously minimize imperfections both in the financial and product markets respectively. They conducted over 2.5 million observations for 600,000 firms in 8 European countries for a 17 year period (1993 – 2009) and averred that firms use the trade credit channel to sustain growth. Further, they showcased that firms heavily influenced by market imperfections and financially handicapped, make much use of the trade credit channel to sustain growth. Burkart and Ellingsen (2004) developed a new theory of trade credit. They asserted that the supplier has a monitoring advantage albeit it applies exclusively to input transactions. In other words, input transaction is the suppliers' sole informational advantage. The theory showed that banks are willing to lend as trade credit complements bank credit and available trade credit enhances investment, given that it is much more difficult to divert goods than cash.

In these recessive periods exacerbated by the current liquidity squeeze globally, the need to understand the influence of trade credits (accounts payables and accounts receivables) on both liquidity and profitability is uppermost on the minds of most managers. Long term planning has become practically impossible being hampered by credit crunch and liquidity squeeze. The financial advantage theory did show that suppliers have input /insider knowledge advantage than finance houses, including banks. The suppliers of trade credits have comparative advantage over banks as commodities are harder to divert than cash. As regards relevance, the theories have

proven the continued use and survival of trade credits as a marketing strategy and improves liquidity through cash flow synchronization of inventory purchase, account payables and accounts receivables. Further, Burkart and Ellingsen (2004) theory of suppliers having a monitoring advantage has proven the reason why banks grant to large firms acting as intermediaries to small riskier firms.

METHODOLOGY

The study concentrated on data collected from eleven manufacturing firms in the Health Care Sector *(Nigerian-German Chemicals, Evans Medical, GlaxoSmithKline Nigeria, May & Baker Nigeria, Neimeth International Pharmaceuticals, Pharma-Deko, Union Diagnostic & Clinical Services, Fidson Healthcare, Afrik Pharmaceuticals, Ekocorp and Juli Plc)* quoted on NgSE for the period 2003 to 2015 (i.e. 13 x 11 = 141 firm-years). Panel data regression is employed to usurp its merits over time series regression: its control for unobservable heterogeneity. To determine the positive influence of trade credits on profitability and liquidity, the model equations are:

$$\text{ROA}_{it} = \beta_{0} + \beta_{1}\text{AR}_{it} + \beta_{2}\text{AP}_{it} + \beta_{3LnTA_{it}} + \beta_{4Lev_{it}} + \beta_{5}\text{SG}_{it} + u_{i} + \lambda_{t} + e_{it} \qquad (1)$$

$$\text{CASH}_{it} = \beta_{0} + \beta_{1}\text{ARTR}_{it} + \beta_{2}\text{APCOS}_{it} + \beta_{3LnTA_{it}} + \beta_{4Lev_{it}} + \beta_{5}\text{SG}_{it} + u_{i} + \lambda_{t} + e_{it} \qquad (2)$$

Accounts Receivable (AR) and Accounts Payable (AP) are proxies for Trade Credits for firm (i) at time (t). They are both deflated by total assets to enhance the linearity of the models. CASH denotes cash and cash equivalents measuring liquidity, ARTR is debtors' turnover ratio (i.e. accounts receivable / turnover) and APCOS is proxy for creditors' turnover (i.e. accounts payable / cost of sales). Control variables include Firm Size proxied by LnTA (Natural Logarithm of Total Assets), Sales Growth [SG = (Sales$_t$ – Sales$_{t-1}$ / Sales$_{t-1}$)] proxy for Growth Opportunities and Leverage (LEV) which stands for the ratio of Total Long-Term Debt to Equity. Further, u_i denotes the company's unobservable individual effects, λ_t equals time dummy variable that captures external factors beyond management control, and e_{it} is the disturbance term.

RESULTS

Table 1

Variable	Obs	Mean	Std. Dev.	Min	Max
cash	143	.1462286	.2925006	-.9295439	1.642372
roa	143	.3338944	.3032425	-.1131	.98
ap	143	.2420729	.2754765	-.2925296	1.27876
artr	143	.5538209	.7015332	.03222	7.531397
apcos	143	.063281	.1938179	-.63	1.0296
lev	143	.1100819	.229194	-1.57434	.59046
lnta	143	14.80635	2.74034	.0008	20.6937
sg	143	.1694327	.2019046	-.79351	.8705
ar	143	.1191144	.0924414	.01646	.98436

Table 2

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   Prais-Winsten regression, correlated panels corrected standard errors (PCSEs)

Group variable:    firm                 Number of obs      =        143
Time variable:     yrs                  Number of groups   =         11
Panels:            correlated (balanced)  Obs per group: min =       13
Autocorrelation:   common AR(1)                          avg =        13
                                                         max =        13
Estimated covariances    =        66    R-squared          =     0.1034
Estimated autocorrelations =       1    Wald chi2(5)       =      19.94
Estimated coefficients   =         6    Prob > chi2        =     0.0013
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roa	Coef.	Panel-corrected Std. Err.	z	P>|z|	[95% Conf. Interval]	
ap	-.2558731	.0820816	-3.12	0.002	-.4167502	-.0949961
ar	-.0143752	.0832387	-0.17	0.863	-.1775201	.1487698
lev	-.1162073	.0724744	-1.60	0.109	-.2582545	.0258399
lnta	.0045782	.0078663	0.58	0.561	-.0108394	.0199957
sg	-.0059785	.06395	-0.09	0.926	-.1313181	.1193612
_cons	.3338958	.1286125	2.60	0.009	.08182	.5859716
rho	.684525					

Table 3

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 Prais-Winsten regression, correlated panels corrected standard errors (PCSEs)

Group variable:    firm                 Number of obs      =        143
Time variable:     yrs                  Number of groups   =         11
Panels:            correlated (balanced)  Obs per group: min =       13
Autocorrelation:   common AR(1)                          avg =        13
                                                         max =        13
Estimated covariances    =        66    R-squared          =     0.0542
Estimated autocorrelations =       1    Wald chi2(5)       =       7.53
Estimated coefficients   =         6    Prob > chi2        =     0.1842
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cash	Coef.	Panel-corrected Std. Err.	z	P>|z|	[95% Conf. Interval]	
artr	.0098594	.0202343	0.49	0.626	-.0297991	.0495179
apcos	-.2486594	.1151976	-2.16	0.031	-.4744426	-.0228762
lev	-.0609568	.1043017	-0.58	0.559	-.2653844	.1434709
lnta	-.002869	.0035888	-0.80	0.424	-.0099028	.0041649
sg	.0233394	.0837142	0.28	0.780	-.1407374	.1874162
_cons	.1967007	.0612815	3.21	0.001	.0765911	.3168103
rho	.6347852					

Source(s): Authors' STATA 11.2 Outputs of Collated Data

DISCUSSION

In table 1, the mean presumed to estimate the true population from the sample space, is quite smaller than the standard deviation for most of the variables. This is peculiar to heterogeneous data commonly applied in panel methodology. Further, Levin-Lin-Chu unit-root test, a diagnostic tool, was employed which assumed that the number of panels is fixed while the number of time periods tends to infinity such that the ratio N_p to N_T approaches zero. At 95% confidence level which, hitherto, is the default for most statistical analysis, both the p-values and adjusted t-statistic (All Variables < 1.95) strongly suggest absence of a unit root. That is, all the entered nine variables are stationary.

Table 2 depicted a significant negative relationship between ROA and AR (p-value = 0.002 < 0.05). In other words, a unit increase in accounts payable *decreases* profitability of the sampled firms by 0.25587 units. That is, stretching accounts payable acts negatively on these firms' reputation, then, profits. This is why manufacturing firms in reality stockpile enough cash to avoid the wrath of trade creditors and debenture holders.

Table 3 showed a significant negative relationship between CASH and APCOS (p-value = 0.031 < 0.05). That is, credit turnover (accounts payable / cost of sales) ratio influences liquidity negatively. Trying to optimize profits by stretching suppliers' accounts beyond the elastic limit (leading to negative reputation) is not a viable option.

CONCLUSIONS

The study embarked on ascertaining the effect of trade credit management on profits optimization. The major findings indicated the relevance of not stretching the accounts payable, and by extension, not jeopardizing the firm reputation with suppliers. Further, firms' management must understand that in this recessive era, where only short term planning seems to be the only feasible option, the components of working capital, specifically, debtors and creditors involving human behavior should be taken care of in lieu of liquidity profitability trade off and cash flow synchronization. Although not significant in this study, to maximize receipts from trade debtors warrants employing optimal credit policies in terms of credit terms, credit period and collection strategies. Effective management of trade credit ensures comprehensive protection against risk of insolvency, improved customer-supplier relationships and banking relationships. It also facilitates sales expansion.

Firms should have an aged accounts receivable report to facilitate planning and control of accounts receivables. In addition, establish a credit policy for determining the optimal amount of account receivables considering the trade-off between the securing of sales and profits (proxied by ROA) and the amount of opportunity cost and administrative costs of increasing account receivables. Firms achieving and maintaining a significant positive relationship between accounts receivable turnover and liquidity entails provision of adequate liquid resources simultaneously maintaining an optimal profitability liquidity trade-off. Embracing credit insurance ensures positively improved liquidity and financial performance via reduced accounts receivable periods and optimized accounts payable periods. Credit insurance ensures reduced level of bad debt and incidence of fraud, higher levels of repeat business, lower levels of customer queries and disputes, more profitable sales, etc.

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