**CHAPTER ONE**

***INTRODUCTION***

***Receivable Management***

Receivable management refers to the decisions a business makes regarding its overall credit and collection policies and the evaluation of individual credit applicants. In formulating an optional credit policy, finance manager must analyze the marginal benefits and costs associated with changes in credit standards, credit terms, collection efforts etc. Receivable management proves for a firm both, an asset and a problem: an asset because of the need to obtain financing while waiting for the future cash flow.

Account receivable is also the total of all credit extended by a firm to its customers; therefore this balance sheet account represents unpaid bills owed to the firm.

The level of accounts receivable depends primarily on the sales volume of the firm and its credit policy. The basic decisions are whether or not to extend credit to a given customer and what the maximum amount of credit should be. The general credit policy of the firm provides a basis for these decisions and affects the sales volume of the firm. Restrictive credit policies reduce bad debt losses and the amount of investment in accounts receivable relative to sales. However, restrictive policies also limit sales. An evaluation of alternative credit policies must consider the impact of additional sales volume on the investment in inventory as well as accounts receivable.

* 1. ***BACK GROUND OF THE STUDY***

Account receivables are funds owed to the firm as a result of sales, but which have not yet been collected. The objective of managing accounts receivable is to collect accounts receivable as quickly as possible without losing sales from high-pressure collection techniques. Accomplishing this goal encompasses three techniques: (Lawrence. *Ghitman, 2006).*

1. Credit selection and standards
2. Credit terms, and
3. Credit monitoring.
4. ***Credit Selection and Standards:***

Credit selection involves application of techniques for determining which customers should receive credit. This process involves evaluating the customer’s credit worthiness and comparing it to the firm’s credit standards and its minimum requirements for extending credit to a customer.

***Five C’s of credit:***

* **Character**: The applicant’s record of past obligations. Here it means that in order to pay the debts and the willingness to pay the debts. In assessing character, the credit analyst considers all the information that relates to willingness to pay is the applicant’s Management. What is the applicant’s history of payments to the trade? Has the firm defaulted to other trade suppliers? Does the applicant’s management make a good-faith effort to honor debts as they come due? Information in these areas bears on the analyst‘s assessment of the applicant’s character.
* **Capacity**: The applicant’s ability to repay the requested credit, as judged in terms of financial statement analysis focused on cash flows available to repay debt obligations. This dimension has two aspects: management‘s capacity to run the business and applicant firm’s plant capacity. Management’s capacity to run the business relates to the competency (ability) of the management personnel in the applicant’s operations. Any information relevant to this capacity is assessed, including personal impressions, the history of success or failure by the managers running the applicant business, the number of years that the applicant has been in business, and so forth. The better is management’s capacity to run the firm, the lower is the chance of default.
* **Capital**: The applicant’s debt relative to equity. To assess the capital dimension, the credit analyst considers the data obtained from applicant’s financial statements. The usual procedure is to perform an extensive ration analysis, comparing the applicant’s financial ratios to ratios for the applicant’s industry and performing trend analysis of the applicant’s ratios over time. This ratio analysis can be quite sophisticated, using graphical presentations of ratio trends and statistical comparison of the applicant’s ratios with industry standards.
* **Collateral**: The amount of assets the applicant has available for use in securing the credit. The larger the amount of available assets, the greater the chance that a firm will recover funds if the applicant defaults.

If the applicant’s experiences financial difficulty, it may be forced to liquidate. In such a situation, the recoveries to trade creditors will depend on (1) the recoveries on assets sold, (2) the amount of debt owed by the firm, and (3) the extent to which theses debts are secure. If the firm liquidates, the recoveries on assets that are security for debt will go to the holders of that have been granted to them as security. Since, in general, it is very difficult for trade creditors to obtain secured position, this means that the recoveries to trade creditors are significantly lower when the applicant has financed by using secured borrowings. Information on secured borrowings is gleaned from the applicant, or directly from conversations with the applicant. More existing secured financing means lower creditworthiness from the trade creditor’s standpoint.

* **Conditions**: Current general and industry-specific economic conditions, and any unique conditions surrounding a specific transaction. If there is a good deal of foreign and domestic competition in the applicant’s industry, the possibility of failure and default to trade creditors is larger, since profit margins are likely to be lower. If the economy in general is undergoing a contraction, failures are likely to occur than during an expansion period.
1. ***Credit Terms***

Credit terms are the terms of sale for customers who have been extended credit by the firm. Terms of net 30 mean the customer has 30 days from the beginning of the credit period (typically end of the month or date of invoice) to pay the full invoice amount. Some firms offer cash discounts, percentage deductions from the purchase price of paying within a specified time.

Credit terms vary by industry and even within industries. Differences are linked to product characteristics as well as market structure and market condition.

1. ***Credit Monitoring***

The final issue a firm should consider in its accounts receivable management is credit monitoring. Credit monitoring is an ongoing review of the firm’s accounts receivable to determine whether customers are paying according to the stated credit terms. If they are not paying in a timely manner, credit monitoring will alert the firm to the problem. (Lawerence J. *Ghitman, 2006)*

* 1. ***STATEMENT OF THE PROBLEM***

The success of Insurance Companies in maintaining a profitable operation largely depends on its ability to underwrite insurable risks at appropriate rate and collect full premium from clients. To ensure full collection of premium the ideal mechanism would be to underwrite on cash basis only. However, due to competition and the desire to attract a wider sector of the business community, the Nile Insurance Company, like many others, is engaged more in credit sales. This inter related in a huge amount of uncollected premium accumulated over a period of time, which ultimately affected the financial picture of the company.

The researcher has found that it is important to explore the success and/ or failure of the company in its huge amount of uncollectible premium or outstanding premium which affects the company’s profitability as well as its existence in the competitive market.

The National Bank has already issued directives No.SIB/26/2004 on trade receivables in respect of the general insurance business. NBE Directives specifies the minimum provisioning percentage that insurers have to apply in estimating provisioning amounts on trade debtors.

The Proclamation No. 86/1994 puts forward the minimum Margin of Solvency to be maintained by an insurer for general and long-term insurance business, on manner of computing margin of solvency in which debtor’s balance with ageing above 90 days will not be accepted as admitted asset, shall mean any property, security, item or interest of an insurance company recorded in the financial statement of the insurance company but excluding:

1. Premiums that became due to the insurer but remaining unpaid for more than 90 days except in so far as provisions are held against the premiums in the manner as specified by the National Bank of Ethiopia pursuant to the authority vested in it by Article 41 of the Monetary and Banking Proclamation No. 83/1994 and by Article 20 (4) and
2. (42) (G) of the Licensing and Supervision of Insurance Business Proclamation No. 86/1994.
3. Prepaid expenses
4. An asset that is mortgaged or charged for the benefit of a person other than insurer to the extent that it is so mortgaged.
5. Intangible asset such as good will
6. Unsecured or, in the opinion of the Bank, inadequately secured loans, if any
7. Equity share in any other insurance company, if any
8. Life policy loans in excess of the surrender value of the policy
9. Assets in excess of limits prescribed by law or directives of the Bank

An important aspect of effective and efficient management of business, more importantly financial institutions is a satisfactory and timely recovery of the receivables.

**(Source from Nile Insurance Financial Report)**

As can be seen in the graph, the Company registered an increase in premium production over the years. However, it had not able to produce adequate return on the capital invested. The company has not yet set out the plan of action to mitigate this poor level of performance. This would continue to impact the earning position of the Company much more seriously than before if immediate and strategic solution will not be devised.

The Company has a written credit policy. However, the outstanding premium (trade debtors) balance is increasing from time to time. This is partly due to the failure of the Company to strictly comply with its own credit policies. The trade debtor’s balance reported, as at June 30th 2007/08 was 28,340,520, as at June 30th 2008/09 was 38,643,000, as at 30th June 2009/10 was 58,200,000 and as at 30th June 2010/11 was 59,809,191.65. This increase in trade debtor’s balance forced the company to provide 19.2 million under doubtful debt account, which has been reflecting its impact directly on the earning position of the company.

Ratio Acceptable Industry

 Margin Nile Average %

*Liquidity Ratio Max. Of 105% 114% 99%*

*Current Ratio >=1 0.71 1.02*

***(Nile Insurance Financial Report)***

***This ratio shows that Nile’s Liquidity position as deficient***

 The above ratio also indicates that the Company liquidity position also is affected by the collection problem. This means that the liquidity ratio (Total current asset / Total current Liability stood at 114%. The result is higher than both the standard ratio of 105% and the industry average ration of 99%. Furthermore, the current ratio (current asset to current liability is 71 % which is by far deviated from the minimum acceptable range and the industry average of 150%. This clearly indicates that the Company’s current resource not adequate enough to meet its current obligation.

* 1. ***RESEARCH OBJECTIVES***

***General Objectives:***

The study focuses generally to analyze the impact of National Bank of Ethiopia (NBE) Directives in relation to receivables on the performance of Nile insurance companies in Ethiopia.

***Specific Objectives:***

The study focuses specifically to meet the following:

* To analyze the strength/weakness of Nile Insurance Company in its profitability and leading position in relation to credit sales of premium.
* To analyze the existing credit policy
* To analyze cash discount policy
* To analyze competition tools & premium rates
* To check the company’s ability to settle claims in connection with liquidity

**CHAPTER TWO**

***REVIEW OF RELATED RESEARCH***

* 1. ***DEFINITION***

Scholars and writers have given various definitions of insurance from different perspectives such as economic, social, legal, etc. Some of them are given below.

From economic perspective Insurance is a device for the reduction of the uncertainty of one party called the insured, through the transfer of particular risks to another party, called the insurer , who offers a restoration, at least in part, of economic losses suffered by the insured (Kumsa Hailemichael,1992).

From legal aspects an insurance policy is a contract whereby a person called the insurer undertakes against payment of one or more premiums to pay to a person, called the Beneficiary, a sum of money where a specified risk materializes. (“Article 654(2)) of the Commercial Code of the Empire of Ethiopia (1960:140). (Zeleke, Hailu 2007).

**The definitions presented above disclose the following:**

There are at least two parties in an insurance contract: they are the insured (beneficiary) and the insurer.

There is a transfer of risk from one party (the insured) to another (the insurer).

There is payment of a price (premium) by the insured (beneficiary) for the transfer of the risk; and the insurer pays a sum of money to the insured (beneficiary) in the event of occurrence of the risk and creates a loss to the insured.

 Further more; Insurance is a contract where the insured buys a future promise of payment contingent upon the occurrence of specified events. This means, funds are entrusted to insurers which in large part constitute various forms of reserves. Fund under the custody of insurers could be invested in the economy to generate additional returns. Such investments could in turn significantly influence the direction and tempo of nation’s economic development. Appropriate incentive and prudent management could help to channel these funds to strategic sectors of the economy for maximum development effect. Developing countries where money for investment is often scarce can use the fund generated by insurers for developmental purpose in manner that may not affect their liquidity.

In general insurance is an economic device for reducing and eliminating risk through the process of combining a sufficient number of homogeneous exposures to make the losses predictable for the group as a whole.

**Economic contribution of Insurance**

* Creates certainty about burden of loss
* Spreading losses that do occur
* Provides for an optimal utilization of capital
	1. ***THE NATURE AND FUNCTION OF INSURANCE***

Insurance is a complicated and intricate mechanism, and it is consequently difficult to implement. However, in its simplest aspect it has two fundamental characteristics transferring or shifting risk from one individual to a group and sharing losses, on some equitable basis, by all members of the group. (William Arthur C. Jr. Michael L. Smith, 1995)

The primary function of insurance is to act as a risk transfer mechanism. There are also two other functions: the common pool and equitable premiums. In one sense we could say that the common pool and equitable premiums represent the way in which the main function of risk transfer is provided. However, the provision of a risk transfer mechanism could be made without the need for either a common pool or equitable premiums, and so they are functions in their own right ((Kumsa Hailemichael, 1992).

* 1. ***BASIC CHARACTERISTICS OF INSURANCE***

It has certain characteristics. They include the pooling/sharing principle which means that those policyholders in the pool who have not suffered losses are contributing to those who have suffered to losses. By pooling or combining the loss experience of a large number of exposure units, an insurer may be able to predict future losses with some accuracy from the view point of the insurer. If future losses can be protected, objective risk is reduced. Thus, another character that is often found in many lines of insurance is risk reduction based on the law of large numbers.

The second character of private insurance is the payment of fortuitous losses. A fortuitous loss is one that is the unforeseen and unexpected that occurs as a result of chance. In other words, the loss must be accidental. The law of large numbers is based on the assumption that losses are occurring randomly.

The final characteristics of insurance are indemnification for losses. Indemnification means that the insured is restored to his or her approximate financial position prior to the occurrence of the loss. (SR. Diacon R.L.Carter, 1956)

* 1. ***REQUISITES OF INSURABLE RISKS***
* We could compile a list of the type of events which would be acceptable for insurance purposes, but there are at least two problems with this approach:
* The list would be almost endless. There are all kinds of incidents which can occur and would be perfectly acceptable for insurance protection. It would be almost impossible to list them all.
* The list would never be up to date. Risk is dynamic, in the sense that it is always changing, so that any list of events which are suitable for the form of risk transfer we have described would also have to change continually.

However, it is still necessary to have some idea of what can and can not be insured and, with the above problems in mind; a different approach is called for. Rather than list the events themselves, we have noted the characteristics or nature of insurable risks. (S.R. Diacon R. L Carter, 1956)

The world of business is not a static environment. It changes to adjust to circumstances as they are perceived, and what may be an uninsurable risk today, could be vey well being insurable tomorrow.

A risk could be considered an ideally insurable risk if it satisfies the following c onditions.

* + 1. **Large number of similar exposure units**: Since insurance operates through pooling resources, the majority of insurance policies are provided for individual members of large classes, allowing insurers to benefit from the [law of large numbers](http://en.wikipedia.org/wiki/Law_of_large_numbers) in which predicted losses are similar to the actual losses. However, all exposures will have particular differences, which may lead to different premium rates.

* + 1. **Definite loss:** The loss takes place at a known time, in a known place, and from a known cause. The classic example is death of an insured person on a life insurance policy. [Fire](http://en.wikipedia.org/wiki/Fire), [automobile accidents](http://en.wikipedia.org/wiki/Traffic_collision), and worker injuries may all easily meet this criterion. Other types of losses may only be definite in theory. [Occupational disease](http://en.wikipedia.org/wiki/Occupational_disease), for instance, may involve prolonged exposure to injurious conditions where no specific time, place or cause is identifiable. Ideally, the time, place and cause of a loss should be clear enough that a reasonable person, with sufficient information, could objectively verify all three elements3.
		2. **Accidental loss:** The event that constitutes the trigger of a claim should be fortuitous, or at least outside the control of the beneficiary of the insurance. The loss should be pure, in the sense that it results from an event for which there is only the opportunity for cost. Events that contain speculative elements, such as ordinary business risks or even purchasing a lottery ticket, are generally not considered insurable.
		3. **Large loss:** The size of the loss must be meaningful from the perspective of the insured. Insurance premiums need to cover both the expected cost of losses, plus the cost of issuing and administering the policy, adjusting losses, and supplying the capital needed to reasonably assure that the insurer will be able to pay claims. For small losses these latter costs may be several times the size of the expected cost of losses. There is hardly any point in paying such costs unless the protection offered has real value to a buyer.
		4. **Affordable premium:** If the likelihood of an insured event is so high, or the cost of the event so large, that the resulting premium is large relative to the amount of protection offered, it is not likely that the insurance will be purchased, even if on offer. Further, as the accounting profession formally recognizes in financial accounting standards, the premium cannot be so large that there is not a reasonable chance of a significant loss to the insurer. If there is no such chance of loss, the transaction may have the form of insurance, but not the substance.
		5. **Calculable loss:** There are two elements that must be at least estimable, if not formally calculable: the probability of loss, and the attendant cost. Probability of loss is generally an empirical exercise, while cost has more to do with the ability of a reasonable person in possession of a copy of the insurance policy and a proof of loss associated with a claim presented under that policy to make a reasonably definite and objective evaluation of the amount of the loss recoverable as a result of the claim.
		6. **Limited risk of catastrophically large losses:** Insurable losses are ideally [independent](http://en.wikipedia.org/wiki/Independence_%28probability_theory%29) and non-catastrophic, meaning that the losses do not happen all at once and individual losses are not severe enough to bankrupt the insurer; insurers may prefer to limit their exposure to a loss from a single event to some small portion of their capital base. [Capital](http://en.wikipedia.org/wiki/Capital_%28economics%29) constrains insurers' ability to sell [earthquake insurance](http://en.wikipedia.org/wiki/Earthquake_insurance) as well as wind insurance in [hurricane](http://en.wikipedia.org/wiki/Tropical_cyclone) zones. In commercial fire insurance it is possible to find single properties whose total exposed value is well in excess of any individual insurer's capital constraint. Such properties are generally shared among several insurers, or are insured by a single insurer who syndicates the risk into the [reinsurance](http://en.wikipedia.org/wiki/Reinsurance) market.( Wikipedia, the free Encyclopedia)
	1. ***BENEFITS AND COST OF INSURANCE***

Insurance has particular advantages as a device to handle risk and sought to be used to bring about the greatest economic advantage to society. Among these advantages, the major benefits are indicated below:

1. **Indemnification of Loss**

The primary purpose of insurance is to provide financial compensation (indemnity, in insurance terminology) to the policyholder in the event the risk insured against materializes and a loss occurs to the policy holder, which leads to a decline in the financial position of the policyholder.

Through indemnification, the policyholder would then be restored to approximately his/her financial position just before the occurrence of the risk (except in the case of life and personal accident insurance) (S. R. Diacon R.L. Carter, 1956)

Indemnity is provided to the policyholder only if the risk materializes in accordance with the terms and conditions of the insurance policy purchased. Insurance indemnity takes the form of either cash payment, reinstatement of the property damaged, or replacement of the property, which is at the option of the insurer.

1. **Less Worry and Fear**

The second benefit of insurance is reducing worries and fears. This is true both before and after a loss occurs. In addition to this, insurance reduces the uncertainty and anxiety associated with the occurrence of misfortune. A person who purchases medical insurance feels protected, as he/she does not have to worry much about medical costs in case of sickness. In this way, purchase of insurance brings peace of mind to the policyholder, which, in turn, enables him/her to make decisions in a more stable and rational manner.

Insurance also protect families against financial distress in the event the breadwinner dies or sustains disabling injury that leads to loss of job, which is, of course, loss of income. A breadwinner that purchases life or disability insurance is making a contingency plan for the family to receive financial compensation from the insurer in the event of his/her death or disability. As a result the family’s stability would be maintained and the family will not be forced to depend on others (friends, relatives, or the government).

1. **Foreign Exchange to The Country**

A strong insurance industry in a country can get opportunity to sell insurance services to clients outside the country. This export of insurance services brings foreign exchange earnings to the country. There may, of course, be foreign exchange outflows when claims are paid in the event of loss. It is likely that with proper risk selection and management the net effect could be a net inflow of hard currency. Moreover, in situations where there are large risks, insurance spreads the potential loss across different economies through reinsurance to a foreign insurer. This brings favorable effect on the foreign exchange position of poor nations from the sharing of claims in the event of loss.

1. **Sources of Investment Funds**

The Insurance industry is an important source of funds. For capital investment and accumulation premiums are collected in advance of the loss, and funds not needed to pay immediate losses and expenses can be loaned to business firms. These funds typically are invested in factories, housing developments, and new machinery and equipment. The investments increase society’s stock of capital goods, and promote economic growth. Insurers also invest in social and economic development projects.

1. **Loss Of Control**

Another social and economic value of insurance lays in its loss control or loss prevention activities. The main function of insurance is not to reduce loss but to spread losses among members of the insured group. Insurers know that if no effort is made in this regard, losses and premiums would have a tendency to rise. It is human nature to relax when it is known that the loss will be fully paid by the insurer. Further more, in any given year, risk in loss payments reduced the profit of the insurer. So loss prevention provides a direct means for increased profit.

1. **Reduced Credit Risk**

Insurance has been called the basis of the nation’s credit system. It follows logically that if insurance reduces the risk of loss from certain sources, it should mean that an entrepreneur is at better credit risk if adequate insurance is carried. Today it is impossible to borrow money for many business purposes without insurance protection that meets the requirements of the lender.

1. **Business And Social Stability**

Finally, the existence and availability of insurance can lead to increased business and social stability. For example, if adequately protected, a business need not face the problem of liquidation in following the death or permanent disability of one or more income producers. A business venture can be continued without interruption even though a key person or the sole proprietor dies. A family need not lose its life savings following a bank failure. Old-age dependency can be avoided. Loss of a firm’s asset by theft can be reimbursed. Whole cities ruined by a hurricane can be rebuilt from the proceeds of insurance. (Trieschman James, and Sandra G. Gustavson, 1998)

* 1. ***MAJOR CLASS OF INSURANCE***

Now days a wide variety of insurance are recognized by the European Community and, with the insurance companies Act. 1981 (subsequent repealed and consolidated into the insurance companies Act 1982), in the United Kingdom also. The best way to examine these insurance is to break down the 25 types into five main classes. (SR. Diacon, 1956)

* Transportation insurance, which covers land vehicles, railway rolling stock, air-craft, and ships, goods in transit, motor vehicle liability, aircraft liability, and liability for ships;
* Property insurance, covers, which covers damage to property, including damage by fire and natural force;
* Pecuniary insurance, covers, surety ship, miscellaneous financial losses, and legal expense;
* Other liability insurance covers generally liability;
* Personal and long term insurance, which covers life and annuity, linked long-term permanent health, tontines, capital redemption, pension fund management, and accident and sickness insurance.
	+ 1. **Transportation Insurance**
			1. **Marine insurance**

Marine insurance provides compensation for property losses and injury or damage to third parties (that is, person other than the insured and the insurer) caused by perils of the sea (such as damage due to bad weather, sinking, collision, or standing) and by fire, theft, and other similar perils. Marine losses arise in four main areas:

1. **Hull**: Hull losses relate to damage or loss of the vessel and associated machinery. Polices are available to cover vessels under construction or navigation, and specialized cover can be obtained against damage to offshore and gas installation. Polices are usually arranged to give cover for a period of twelve months.
2. **Cargo**: Cargo insurance covers goods that have been sold and are being shipped to a buyer; the conditions of sale thus affect the scope of cover required. Cargo insurance is usually provided for an agreed value.
3. **Freight**: is the cost of transporting cargo, including the hire of the ship necessary. Freight may be lost if the cargo cannot be delivered for any reason. If freight is payable in advance, the cargo- owner must bear this loss; it is then normally added to the agreed value for cargo. Otherwise the ship-owner or cattier will insure for loss of freight on annual basis.
	* + 1. **Aviation insurance**

Aviation insurance of hulls, cargo, freight, and liability is available to aircraft owners, operators, and manufacturers, as well as to airport authorities.

* + - 1. **Transit insurance**

This provides compensation to the owners or carriers of goods which are lost or damaged in overland transit. The scope and nature of the cover required depends on whether the transit is international or within a single country, on the nature of the transport, and on the type of goods.

* 1. ***TRANSPORTATION INSURANCE: MOTOR VEHICLES***
		1. Compulsory minimum cover, provides insurance cover of injury or death of third parties (including passengers) arising from the use of a vehicle on the roads.
		2. Third party covers: gives protection against liabilities to third parties for bodily injury or death, to their property, and legal costs.
		3. Third party fire and theft cover: this covers liabilities to third parties plus damage or loss to the policyholder’s own vehicle from fire or theft.
		4. Comprehensive cover: this is the most common form of motor insurance. It covers accidental or damage to the policyholder’s own vehicle in addition to third party, fire, and theft cove.
	2. ***PROPERTY INSURANCE: OTHER DAMAGE OR LOSS***

Besides fire, other perils cause damage to or loss of property. Some of these peril, such as ‘’ Special perils’’, can be covered as additional items in the insurance policy, but others must form the subject to separate insurance contracts. Under this cover the following can be extended:

* All- risks insurance
* Theft insurance
* Engineering insurance
* Glass insurance
* Livestock and blood stock insurance
* Travel and breakdown insurance
	1. ***PECUNIARY INSURANCE***

Pecuniary insurance means ‘relating money’, and it covers the risk to an organization that it may find either that it has to pay out an unexpectedly large amount of money or that money it receives is unexpectedly diminished. There are five main types:

* Fidelity guarantee
* Legal expense insurance
* Credit insurance
* Interruption insurance
* Mortgage indemnity insurance
	1. ***LIABILITY INSURANCE***

This cover includes employer’s liability insurance, public liability insurance, product liability insurance and professional indemnity insurance.

Further more; liability insurance is a very broad superset that covers legal claims against the insured. Many types of insurance include an aspect of liability coverage. For example, a homeowner’s insurance policy will normally include liability coverage which protects the insured in the event of a claim brought by someone who slips and falls on the property; automobile insurance also includes an aspect of liability insurance that indemnifies against the harm that a crashing car can cause to others’ lives, health, or property. The protection offered by a liability insurance policy is twofold: a legal defense in the event of a lawsuit commenced against the policyholder and indemnification (payment on behalf of the insured) with respect to a settlement or court verdict. Liability policies typically cover only the negligence of the insured, and will not apply to results of willful or intentional acts by the insured.

* 1. ***LIFE AND HEALTH INSURANCE***
		1. **Life insurance** pays death of benefits when the insured dies. Death benefits typically cover burial expense and can also provide periodic income payments to the deceased’s dependents. Life insurance also sells private pensions and individual annuities to meet the need for income after retirement.

Generally, life insurance provides a monetary benefit to a descendant’s family or other designated beneficiary, and may specifically provide for income to an insured person’s family, burial, funeral and other final expenses. Life insurance policies often allow the option of having the proceeds paid to the beneficiary in a lump sum cash payment or an annuity.

* **There are three types of life insurance.**
1. **Term insurance**

Designed to provide protection /compensation to the beneficiary if, the insured person dies during the specified period.

**Basic characteristics**

* It provided protection for a temporary period
* Most of term policies are renewable, and convertible
* It has no cash value /saving elements/
* They are relatively cheap
* Can be single premium or level premium
1. **Whole Life Insurance**

 **Characteristics**

* It provides protection throughout the life of the insured
* Premiums are payable either through out the life of the assured or can cease at a certain age
* It allows for the accumulation of savings over the life of the insured
* If the owner of a whole life policy decides to terminate It prior to the insured’s death, then the cash value can be surrendered

Generally, there are three types of whole life insurance. These are: Ordinary life insurance, Limited Life insurance, and Single payment life insurance.

1. **Endowment insurance policy**

**Characteristics**

* Provides for payment of face amount of the policy
* If the insured dies within a specified period; face amount paid to the beneficiary
* If the insured survives the policy period; the face amount is paid to the policy owner at that time
* It has protection as well as savings elements
* It has surrender option, loan provision, dividend, settlements, etc…
* Relatively high premium
* Endowment assurance can be used by those buying houses loan
	+ 1. **Health Insurance: provides for payment of medical expense in the event of** sickness or injury.
		2. **Disability income insurance** provides coverage to meet the problem of the loss of earnings during a period of disability.
		3. **Pension and Annuity**

An annuity is a contract under which the purchaser, in return for either a lump sum or a series of payments, receives a guaranteed income, often for the rest of his life. The insurer undertakes to repay in installments the annuitant’s capital plus any interest that has been earned on it. Occupational pension scheme is a systematic plan which provides benefits for employees who cease to be employed, usually through retirement, but also on changing jobs or on death. The benefits are not provided directly by the employer but by another financially independent organization, such as a trust or an insurance company.

* + 1. **Tontines and Capital Redemption Policies**

It provides sums of money after a pre specified interval. In a tontine, a group of people agree together to make contribution to a fund, which is then divided among the survivors at the end of the specified period. A capital redemption policy, on the other hand, provides a fixed capital sum at the end of a period-often whether or not the policyholder has died.

* 1. ***PREMIUM***

Premium is the price of an insurance protection which keeps the policy in force. Premium may be paid annually, semi-annually, quarterly or monthly by the insured under the control of insurance. In principle, it is set in advance and it is an identity for stable insurance credit sale. Insurers sell promise, where as, the price of this promise known as premium.

Loading is a process used to determine insurance premium by adjusting the expected value of claim payments to account for the cost of administrating the insurance claims, providing other services associated with the insurance and allowing a margin for profit. When a portion of all insurers costs of running the business are added to the net premium, the resultant premium is called the Gross premium. This is the amount the policyholder pays to the insurer to keep the policy in force. It is equal to net premium plus loading (The Chartered Insurance Institute, 1995).

Further more, insurance premium is the actual amount of money charged by insurance companies for active coverage. An insurance premium for the same service can vary widely among insurance providers, which is why experts strongly recommend getting several quotes before committing to an insurance policy. Insurance agents or brokers will take your basic information and calculate insurance agents or brokers will take your basic information and calculate an insurance premium estimate based on your answers and other factors. The lowest quoted price on an insurance premium may be the better bargain, but the level of coverage may also be lower.

The cost of an insurance premium is largely based on statistics, not necessarily on individual habits or history. A 22 year old male seeking car insurance for sports car can often anticipate a higher insurance premium than a 45 year old woman driving a mid- size sedan. Both may have excellent driving records, but the insurance company considers a younger driver in a faster car to be more at risk for accident. Therefore the insurance premium quotes will be noticeably different. In general, a more expensive or faster car will cost more to insure, simply because owners of those vehicles tend to drive faster.

The same philosophy holds true for medical insurance premium costs. Non smokers statistically live healthier lives than smokers, for example. Construction workers may have more serious on-the-job accidents than accountants. A 55 year old person who smokes may be charged a higher health insurance premium than a 30 year old non-smoker working in an office. Conversely, an insurance premium may be reduced if the policy holder changes his or her habits and lifestyle.

An insurance premium is generally collected in monthly or semi- yearly payments. If the policy holder fails to make a scheduled payment, the insurance company can choose to cancel the policy entirely. This is often referred to as a ‘lapsed policy’. Either the customer will pay the balance of the insurance premium and become reinstated or the policy will become null and void. Because the billing cycle can be lengthy, it is not unusual for policy holders to forget to make a payment before the policy lapses.

An insurance premium is always in a state of flux. Rates can go up or remain stable between billing cycles. An accident claim can dramatically change the insurance premium rate of the claimant, especially if the accident report shows the policy holder was at fault. Because most states now have a mandatory minimal insurance coverage law for drivers, there may be no other choice but to pay the increased insurance premium or find another company willing to insure a high-risk driver. Insurance agencies are for-profit business, so they will make every effort to recoup their losses after a pay-out. Paying an insurance premium may seem like a waste of money, but knowing your expenses will be met after an accident can bring peace of mind. (Kumsa Hailmichael, 1992).

* 1. ***Receivables Management***
		1. ***Conceptual Framework***

Account receivables are asset accounts representing amounts owed to the firm as a result of the sale of goods and services in the ordinary course of business. The value of these claims is carried on the balance sheet under titles such as accounts receivable, trade receivables or customer receivables the financial manager can add value to the company’s shares by properly influencing three arias: the company’s aggregated investment in receivables, its credit terms and its credit standards. Overinvesting in receivable can be costly because the investment is typically finessed by short-term borrowing and because it may signal acceptance of late-paying customers. If the credit terms (cash discount and period allowed for payment) are not competitive when compared to other sellers in the same industry or are misaligned with the product line profitability they can also diminish shareholder value. Setting the credit standard for customers incorrectly can erode shareholder value because of lost sales (when too stringent) or uncollectible sales (when too lenient).

Customers incorrectly can erode shareholder value because of lost sales (when to stringent) or uncollectible sales (when too lenient).

Like insurance concepts Account Receivable also has different definitions from different sources.)

Account receivables are funds owed to the firm as a result of sales, but not yet collected. (Veghan Emmet J. and Therese M.Voghan, 1995).

Receivables management refers to the decisions a business makes regarding its overall credit and collection policies and the evaluation of individual credit applicants.

In formulating an optional credit policy, finance manager must analyze the marginal benefits and costs associated with changes in credit standards, credit terms, collection efforts etc.

Receivables management proves for a firm both, an asset and a problem: an asset because of the promise of a future cash flow and a problem because of the need to obtain financing while waiting for the cash flow.

A system must be in place to track accounts receivables. This will include balance forwards, listing of all open invoices, and generation of monthly statements to customers. An aging of receivables will be used to collect overdue accounts. You must quickly collect overdue accounts. Try to negotiate settlement payment, such as installments or asset donations. If your collection effort fails, you may want to use a collection agency. Yimam (2010)

Also remember that the collection process is the art of working the customer. A psychological understanding of the customer gives you insights into what buttons to push in collecting the account. One of the biggest mistakes made in the collection process is a ‘’ stick only’’ approach. For some customers using a carrot can work wonders in collecting the overdue account. (Yimam.2010)

* + 1. ***Credit Policy***

Designing credit policy is the first step in receivables management. In designing credit policy, the management can follow two broad approaches. Firstly, the policy can be designed under the assumption of unlimited production/ sales and this assumption and subsequently some constraints are experienced on sales or funds available for receivables, then managers have to restrict the credit at the time of implementing the credit policy. But this may cause certain difficulties to customers because of deviation from the announced credit policy. For example, if a company announces that credit will be unlimited to certain categories of customers based on unlimited funds assumption and subsequently refuse to grant credit due to limited funds available for investment in receivables, it will create hardship to the customer. Under the second approach, the credit policy could be designed keeping in mind the limitations on production/sales volume and funds available for investment in receivables. This is aimed to achieve optimum utilization for production capacity and funds available for receivables. It also ensures consistency of credit policy. (Working Capital Re-print, 2008)

* + 1. ***Managing Credit***

An account receivable is created from any sales without immediate payment generates. In general firms prefer immediate payment, but it is often impossible to avoid account receivable. The total amount the firm invests in account receivable depends on the annual credit sales, and on the average collection period, as follows:

 Account Receivable = S/365\*Average collection period

The credit policy must balance the value of increasing sales through credit with the costs of uncollectible accounts. Because the firm makes a significant investment by extending credit to a customer, it must have a credit policy to control the investment. A credit policy is the set of principles that govern the extension of credit to customers. It must address three related issues. First, to whom will credit be granted? Though its credit standards the firm specifies the conditions that customers must meet. Second, for how long will credit be granted and in what amounts?

The credit period is the time for which the firm grants credit. Third, what actions will be taken against customers who abuse credit?

The Ethiopian Insurance legislation does not include ‘’ No premium No Cover’’ provision. Trade credit has been considered as a competition tool in the Ethiopian Insurance Industry. Allowing credit sales prudently may stimulate insurance demand; but whether insurers in Ethiopian exercise prudence in granting credit sales raises questions. The available data indicate that a significant percentage of the gross trade receivables of the industry at June 30, 2005 were outstanding for a longer period (56% over 6 months past due; 45% over one year past due).

Imprudent trade credit also leads to undesirable behavior on the part of policyholders. A study by Feyessa Shiferaw (2004) indicates that a client with large unpaid premiums in an insurance company goes to a second insurer and buys policy on credit. He will then moves to a third insurer and manage to buy policies on credit without settling his debts in the first and second insurer.

The repercussion of imprudent credit sales as a competition tool is evident from the above finding. It looks that insurers themselves are spoiling market discipline through imprudent credit sales.

* + 1. ***Rational for the extension of credit***

The rationale for the extension of credit may be found in the following motives:

* ***Financial motive***

Sellers charge a higher price when selling on credit, generating a greater present-value profit based on the implicit interest rate charged ; sellers raise capital at lower rates than their customers and have cost advantages vis-à-vis banks due to (a) the similarity of customers, (b) the information gathered in the selling process, (c) a lower probability of default ( because the purchased goods are part of a product which is an integral part of the buyer’s business), and (d) a greater value of collateral to sellers in that they can rework and resell the product without much difficulty or expense.

* ***Operating motive***

Here suppliers to variable and uncertain demand by the way in which they extend trade credit, instead of using more costly responses such as installing extra capacity, building or depleting inventories, or forcing customers to wait in line.

* ***Contracting cost motive***

Sales contracting costs between buyers and sellers are reduced for buyers because they can inspect the quantity and quality of goods prior to payment and reduce the payment if some goods are missing or defective; sellers have less employee or third party theft because goods are less liquid than cash and collection is not made at the time of deliver, while the separation of collection and delivery allows sellers to achieve efficiency gains due to the specialization of labor.

* ***Pricing motive***

Sellers in certain industries are unable to alter their prices, perhaps because they are part of an oligopoly (and face a kinked demand curve or are part of a collusive agreement) or due to governmental regulation; unpublished variations in credit policy allow these sellers to charge varying amounts to their customers.

Financial market imperfection stands behind all of these motives, which represent company responses to the imperfections. In each case, trade credit is more economical and efficient than using other responses open to the companies. These motives are difficult to test in the real world, and it is very difficult to say which of these motives dominates as the rationale behind most trade credit.

* + 1. ***Collection Policy***

Collection policy refers to the procedure as letters, phone calls, personal calls and legal action. The extent to which the company uses each of these will be dependent on its collection policy. Furthermore it is to be expected that the incidence of bad debt losses and the average collection period will be reduced as the amount spent on collection expenditure is increased. However, the benefits and costs associated with a particular collection policy are not likely to be linear. It is contended that an initial small level of expenditure is unlikely to have any marked effect in reducing bad debts and the average collection period, while additional expenditure are likely to have a much greater effect.

Beyond a certain level of collection expenditure, the benefits will diminish until eventually a saturation point is reached.

Every company should have some difficulty with bad debt expenses. It means that the probability of uncollectability of premium is very high, no matter how carefully a company screens out a credit worthiness of its customer.

Furthermore, if a firm could make its credit standards so severe that it has no bad debt loss, it would be making a mistake, because it must be running away some potentially good customers. Since some credit-granting decisions turn out to be mistakes, every firm must plan to collect late accounts.

The account receivable aging schedule is one technique to determine the duration of receivable to collect at its earliest time. It classifies accounts according to the amount of time they have been outstanding and also how much of the balance is overdue.

The first action the firm usually takes to collect a late account is to send a letter. Usually this first letter is extremely polite and merely tells the customer that a payment is past due. It might even apologize in case the customer has already sent back a check. If this does not produce the desired payment, latter ones adopt increasingly harsher tones, eventually confronting the customer with the possibility of a collection agency or legal action. At this point, many customers choose to send the payment. If letters fail to produce results, the firm can call the customer directly. Calls, particularly to people at their place of employment, often produce results.

 In general, they are likely to be more effective for individuals than for firms. However, some laws limit the kinds of calls that can be made, for example, late – night harassment is not allowed.

When you've worked hard to get a sale, and then deliver your goods or services, you have a right to expect to be paid for your efforts. However, anyone who has been in business for even a month has learned that prompt payment is not always the case.

Often, accounts become seriously past due, or there are insufficient funds in your customer's account to cover his or her check. Besides becoming frustrated, here are ten steps you can take to fight bad debt losses.

* **Develop A Defined Credit And Collection Policy**

One of the major causes of overdue receivables is that the company has not defined to its customers and staff when accounts are to be paid. If customers are not educated that accounts are to be paid on time, then chances are they'll pay late or not at all.

* **Offer A Discount For Early Payment**

Giving your customers an incentive to pay early is another way of assuring payment. While it is standard to offer a two percent discount within ten days, you can structure whatever type of discount suits your business. Then make sure that your customers know about the discounts.

* **Invoice Promptly And Bill Regularly**

If you don't have a systematic invoicing and billing system get one! You'd be surprised at how many customers delay paying simply because they haven’t been reminded. If you have to do it manually, set up a calendar "tickler file" to remind you to send out regular statements. Pick a day each (maybe the 3rd Thursday) and send out your statements. Or hire an outsourcing service to handle this for you. If you have a computer, there are software programs that can be of enormous help. Find a way to bill regularly. You can also contact the professional additional ideas.

* **Contact Overdue Accounts More Frequently**

There is no law that says you can contact your customers only once a month. The old adage "A squeaky door gets oiled" has a great deal of merit when it comes to collecting past due accounts from your customers. Here's a special tip: contact your late payers every 10-14 days. Doing so will greatly increase your company's cash flow.

* **Develop A Systematic Plan To Follow Up Past Due Accounts**

Determine ahead of time what action you will take and at what time you will take it. Write out a visual "flow chart" of the steps you can take. Post this on your wall to remind you and your staff of what to do when you have a past due account. A sample plan might look like this for a company that has net 30 terms:

* + 1. ***Sample Follow Up Plan***

***Day Action to Take***

*First day:* Give customer opportunity to pay when service is rendered or products delivered. Prepare invoice with terms clearly stated.

30 days Send 1st statement.

45 days Make phone call/ Send letter.

On the 60 days\* Send 2nd statement.

 On the 75 days\*\* Make phone call/ Send 2nd letter.

 On the 90 days Outsource to professional for systematic follow-up

 \* Consider sending final notice at this time for service providers.

 \*\* Send to professional

* + 1. ***Use Your Aging Sheet - Not Your Feelings***

Have you ever let an account age beyond the point of ever being collected because you "felt" that your customer would eventually pay? If so, you're not alone. Besides, are your terms of payment Net Eventually? While there certainly are a few isolated cases of unusual customer situations, the truth is that if you aren't being paid - someone else is being paid. That's why it's so important that you stick to your plan of systematic follow-up. You'll soon know which customers intend to pay and which don't. Once you know where you stand, you can take the right action to get paid. First, you have to know where you stand.

* + 1. ***Make Sure Your Staff Is Trained***

If you or the members of your staff have not had any special training in bad debt recovery, get some. Not only are there specific skills involved in collecting money, there are also legal issues to consider. (If you're not aware of these laws, look for upcoming newsletters: "What's Your Legal I.Q. Regarding Collections", "Hot Water Collection Tactics That Can Get You into Big Trouble", and "It's the Law- Fair Debt Collection Practices Act".)

Some of the skills that need to be acquired for collecting past due accounts and bad checks are:

* Dealing with difficult people
* Asking questions to get information
* Overcoming stall tactics debtors use to avoid paying
* Negotiation skills to resolve conflicts

Because collecting past due account is a communication skill, your collection staff could benefit from customer service and sales training.

* + 1. ***Admit And Correct Any Mistakes On Your Part***

Sometimes your customers don't pay because they feel you've made a mistake. If you have, quickly admit it and correct it. Your customer realizes that mistakes can happen in any business. If you deny an obvious error, you'll just fan the fire of resentment your customer may already feel. When dealing with a customer who is upset over a mistake made by someone on your staff, the best thing you can do is listen to their complaint completely before making any comments. Accept the blame and diffuse the situation. If you try to ask for payment before your customer has a chance to air his complaint, you'll only compound the problem. Once you agree with him that it's your mistake, you've taken away any reason for further argument.

* + 1. ***Hire A Professional***

A professional collection service can motivate customers to pay in ways you simply cannot. There are different types of debt collection assistance from which you can choose. Some of your options include small claims court, collection attorneys, and collection agencies. Before using these expensive and time consuming options, consider using the services of the professional. Your accounts can be collected for as little as 5% - no matter how much is owed or where the account is located.

* + 1. ***Remember That Nobody Collects Every Account***

Even by setting up and adhering to a specific collection plan, you will probably have a few accounts that will not get collected. By identifying these accounts early, you will save yourself and your company a lot of time and energy. Even though a few accounts may slip by you, you'll find that the overall number of slow pay and no pay accounts will greatly diminish.

To receive complete information on how you can get your past due accounts collected for as little as 5% regardless of how much is owed to you or where the account is located, contact your professional. (From Google website)

Encyclopedia of Banking and finance also defines Account receivable as a claim against others for future receipt of money, goods or services. It includes account receivable (some times called trade receivable). Account receivable arises from sale of goods or services on account. A major problem associated with accounts receivable is determining what recognition should be given to the possibility that the amount owed may not be collected. The allowance method and the direct write-off method are employed to deal with uncollectible accounts. Under the allowance method, an estimate of uncollectible account is made at the end of each accounting period and reported in the income statement as an expense.

On the balance sheet, estimated uncollectible receivables are deducted from the gross amount of account receivable. This deduction serves as a contra asset or valuation account. The estimated amount of accounts is determined as a percentage of the ending accounts receivable, or by aging the account receivable. The allowance method is used when there is high probability that some receivables will not be collected and when the seller can estimate the dollar amount considered to be uncollectible. When the direct write-off method is used, the account is written-off and an expense is recognized in the income statement when a customer actually defaults on payment.

The write-off method can not be used when uncollectible amounts are significant and can be estimated.

* + 1. ***Credit Evaluation Models***

An experienced credit analyst can evaluate the credit worthiness by simply scanning the information received or collected for the credit proposal. When the credit transactions increase or number of customer increases, it may be difficult to apply this methodology. It will also cause delay in processing credit proposals and lead to inconsistent decision. Thus, it is always useful to create a credit evaluation system and standardize the appraisal. Decision-tree model and multivariate statistical model are generally used to create credit evaluation system.

* ***Decision Tree Model***

Under decision-tree, credit applications are rated under different parameters. For instance, if a company uses five Cs factors, the analyst rate the credit applicant under each of the five Cs.

The traditional way of organizing this information is to characterize the applicant along.

* ***Multivariate Statistical Model***

Many firms have started using sophisticated statistical techniques in conducting their credit analysis. Multiple Discriminate analyses(MDA) employs a series of variables to categorize people or objects into two or more distinct groups. A credit scoring system utilizes multiple discriminate analyses to categorize potential credit customers into two groups: good credit risk and bad credit risk. An important advantage of credit scoring system is that all of the variables are considered simultaneously, rather than individually as in the decision tree analysis. The model is capable of handling both numerical measures such as debt-equity ratio, current ratio, profit margin, etc., as well as non numerical measures like character of the customer as good, bad, average.

Credit scoring models are periodically updated to take into account changes in the environment and also reassess the credit worthiness of the customers. An outdated model may wrongly classify the customers and lead to heavy losses.

* + 1. ***Rating Methodologies of Credit Rating Institutions***

Credit rating has become one of the professionalized services in the recent past. Though rating is more common with different securities offered by industrial units, there is also focus on the rating of individuals and institutions as credit applicants.

Credit rating methodologies include the following key factors for deciding the credit worthiness of a customer.

1. **Business analysis**
* Financial analysis
* Management Evaluation
* Regulatory and competitive environment
* Fundamental analysis
1. **Individual Credit Rating**

In general managing receivables do not end with granting of credit as dictated by the credit policy. It is necessary to ensure that customers make payment as per the credit term and in the event of any deviation, corrective actions are required. Thus, monitoring the payment behavior of the customers assumes importance. There are several possible reasons for customers to deviate from the payment terms. (Working capital Re-print, 2008)

**CHAPTER THREE**

**DATA ANALYSIS**

The success of an insurance company in maintaining a profitable operation largely depends on its ability to underwrite insurable risks at appropriate rate and collect full premium from clients. To ensure full premium collection, the ideal mechanism would be to underwrite on cash basis only. However due to different reasons, the company, like many others in the industry, is engaged more on credit sales.

 Nile Insurance Company has formulated a credit policy to guide its credit underwriting activities. However, the policy has its own drawbacks in the light of its marketing strategy aimed at attracting, new customers and retaining the existing ones. The company has thus maintained to give services on credit terms, sometimes to the extent of extending the term of outstanding credits. Consequently, collection of the accumulated debt balances has become one of the critical problems of the company nowadays.

* 1. ***Reasons for uncollectible premium***

Due to the fast environmental changes and other factors, the expected amount of premium was collected only partially for so many years. There were in fact incidents where premium was not collected at all. These situations led the Company to incur financial loss. Had this financial loss been material, the company could go bankrupt. There are many reasons for the receivable to remain uncollectible. The problem of uncollectible may arise due to the company’s weakness or customers failure to meet their contract obligations. Among the problems from the company side, weakness of customer selection procedures, lack of clarity set terms (such as credit limits, credit period, settlement, discounts), and inefficient collection policy were the major ones. In addition to theses customer’s negligence, customer unwillingness to continue with the service, or customer bankruptcy in which case the customer fails to meet its obligation under the insurance contract are also contributes to outstanding debts.

In principle, credit sales is a good sales attraction mechanism, and the longer the time a company allows its customers to pay, the greater the volume of sales and also the profits. However, the longer the credit terms, the greater the amount of debtors and the higher will be the possible strain on the company’s liquidity. In order to minimize the uncollectable premiums and also to improve profitability of the company, a sound and effective credit policy is necessary.

* 1. ***The Impact of uncollectable Premium***

One of the chronic and long standing challenges of the company has been the collection of outstanding premium of trade debtors. This has many side effects on its financial activity, i.e profitability, and solvency of the company.

The financial activity of Nile Insurance Company is classified as life and non-life. The company provides credit sales only for non-life business activities.

There is a common truth that, for a given level of return, there is also an equivalent amount of risk attached with it (i.e., high return, high risk). In any business when goods or services are provided on credit basis, there is a risk of uncollectibility. The main difference is the probability of this uncollectibility from one company to another and from one business to another depending on the firms’ internal and external environmental conditions, and customers’ behaviors.

Nile Insurance Company provides its services on credit for private as well as corpora. Hence Nile Insurance Company sets restrictions in the provision of credit to its customers in order to reduce the risk of uncollectibility. Amount required as down payment depends on the category of the clients, i.e 30% for corporate clients and 50 % for individual clients. What the company expects from these credit sales are increased sales, attracting new customers, improved profitability, maintaining better liquidity position. These are however subject to fulfill the requirement of the governing body’s, National Bank of Ethiopia directives.

The following table presents the recent four years mounted credit sales and its respective uncollectible premium.

 ***Table 1: Uncollectible Premium***

|  |  |
| --- | --- |
| **DESCRIPTION** | **YEAR** |
| **2008** | **2009** | **2010** | **2011** |
| Credit Sales | 85,527,432 |  94,965,716 | 109,890,388 |  147,611,008 |
| Uncollectible Premium | 37,853,871 |  37,186,608 |  40,281,137 |  48,492,989 |
| % of Doubtful debts | 44% | 39.16% | 36.66% | 32.85% |
| Provision Held |  17,216,926 |  18,759,448  |  16,848,174 |  19,788,146 |

***Sources: Annual report of Nile Insurance Company from 2008-2011***

The balance of credit sales as shown has been increasing for the past four years. The amount of uncollectible premium has also been increasing. This increment of uncollectible premium has many side effects on the financial activity, profitability, and solvency of the company. Among the impacts of uncollected premium, the reduction of profitability was the major one. Uncollectible premiums were reflected as an expense in the form of ‘Provision for Doubtful Debts’ account under the Profit and Loss Account of the non-life business. Here, the table also indicates that the trend of provision is increasing from year to year except year 2010; a large amount was collected during this year which was under legal process.

In this situation, on average the amount of uncollectible was 38.16% from 2008 to 2011 from the total sales. Now, let us observe the impact of uncollectible premium and credit sale for the current four years in graphical format.

***Sources: Annual report of Nile Insurance Company from 2008-2011***

The trend of uncollectible premium and credit sale from year 2008-2011 is shown above. Credit sale receivables were parts and parcel of the company’s current asset, and are reflected in the debtors account. Credit management was given attention by the company due to a risk of uncollectibility and because the company would fail to generate the desired earnings if uncollectible amount comprises a significant share.

***Table2: Percentage share of credit sales out of the company’s total asset, for the year 2008 up to 2011***

|  |  |
| --- | --- |
| **DESCRIPTION** | **YEAR** |
| **2008** | **2009** | **2010** | **2011** |
| Trade debtors | 37,853,871 | 37,186,608  | 40,281,137  | 47,609,907 |
| Total asset  | 203,702,079  | 194,972,679  | 245,278,357  | 232,849,684 |
| Percentage share of Credit sales from total asset  | 18.5 | 19.07 | 16.42 | 20.44 |

 ***Sources: Annual report of Nile Insurance Company from 2008-2011***

As it is shown in the above table, the trade debtors balance increases from year to year. This indicates that the company sales were increasing. The collection status also is not in a better situation and also the uncollectibility of the huge amount of outstanding leads the company to loss

 ***Sources: Annual report of Nile Insurance Company from 2008-2011***

The trend of credit sales from the total assets compared for recent four years on the above graph.

The management of credit is an important part of financial management. Fast growing companies in particular, can find their liquidity position under considerable strain if the level of their debtor is not kept in hand. The Company has also to produce a higher level of future sales than past sales; if it does not collect from the past sales in a reasonable time, it can find itself with liquidity crises. In order to minimize the risk of liquidity crises, Nile established a collection policy of receivables. It is well known that the credit policy cannot be formulated without reference to constraints. The liquidity position presents obvious constraints.

In the annual report for the year 2010 the current ratio and hence the liquidity of the company were improved substantially by the efforts made in collection and the recovery of Birr 25million. Accordingly, the current ratio has increased to 2.2 from 1.3 in previous years, an increase by 67%. As a result of this, Birr 30 million was deposited to interest bearing time deposit account and the company was able to settle Birr 4.5million of unpaid dividends for its ex-shareholders.

If receivables are not collected on time, the provision of credit terms may become a means of resource wastage rather than a profit generating mechanism. It was also necessary to consider such things as legal cost, time value of money, and other related costs.

* 1. ***Credit policy and Procedure of Nile Insurance Company***

For a number of years, managing credit sales was a very serious problem of the company. The National Bank has also issued directives at different times, but it is not implemented due to internal and external factors. In March 2004, the Bank issued Directive No. SIB/26/2004 to set how to calculate margin of solvency. The purpose of this directive was to underline what would constitute. ‘Admitted Assets’ and to show what portion of credit sales are to be considered as Admitted Assets. Accordingly, the Bank has defined Admitted Assets as any property, security, item or interest of an insurance company recorded in the financial statements of the insurance company but excluding premiums that are due to the insurer but remaining unpaid for more than 90 days except in the manner as specified under.

***Table 3: The National Bank Minimum provisioning requirements for outstanding trade balance***

|  |  |
| --- | --- |
| ***Age of Outstanding Balance*** | ***Percentage of Provision*** |
| 91-180 days from effective date of the policy | 25% |
| 181-360 days from the effective date of the policy | 50% |
| 360 days from the effective date of the policy | 75% |

***Source National Bank of Ethiopia Directive No.SIB/26/2004***

However, it has been very difficult to implement these and also to exercise adequate control towards their implementation and their suitability to meet the needs of the market. Following the issue of the Directive, the company was able to prepare its credit policy and procedures in March 2004.

The objective of the policy was:

* To highlight the overall parameters within which the company wants to conduct its business.
* To categorize clients according to their aggregate premium and their business package.
* To set the maximum credit terms of the client.
* To control clients that failed to settle due premium within the allowed maximum credit period.
* To guide the company’s employees that are engaged in credit management, in meeting the company’s objective of balancing quality and volume of the credit sales ratio.

The company’s credit policy requires that a credit audit be conducted by the responsible audit unit which directly reports to the Board of Directors of the company about credit sales outside the credit area.

Collection follow-up steps and collection commission modalities were also fixed. Renewal processes and steps for credit unworthy clients were set. The responsibilities and accountabilities of all parties involved together with measures to be taken in case of policy violations were also stipulated.

* 1. ***Strategies used in Credit Granting in Nile Insurance Company***

Depending on the customers the following strategies were designed:

* Individual clients shall make at least a down payment of 50%; the remaining balance will be paid within four consecutive months.
* Corporate clients must effect payment at least 30% of the premium; the remaining balance will be paid within four consecutive months.
* Clients with bank interest shall pay 70% down payment; the remaining balance will be paid within three consecutive months.
* Short term policies premium shall be paid in cash.

Normally a credit is considered as defaulted starting from the first day repayment is past due. But this does not mean Nile starts taking action immediately; rather it waits until the clients are not able to repay for 90 days.

Even after undergoing through the work out credits process, some credits cannot be recovered for various reasons. Therefore, when Nile is left with no other option of recovery of the premium it takes legal action as the final step. The process of litigation would be handled by the legal department of the company.

* 1. ***Problems of Credit management in Nile Insurance Company***

Questionnaire respondents pointed out a number of problems as the main causes of the premium to be uncollectible. The following are the main problems that contributed to the poor performance of the company, which is expressed by the rising level of uncollectible premium.

***Table 4***

 ***Customer Evaluation:***

|  |  |  |  |
| --- | --- | --- | --- |
| **Problem** | **Response** | **No. of Respondents** | **%age** |
| Debtors Reputation (character) | YesNoN.C | *20**80**20* | 17%67%16% |
| Capital Strength | YesNoN.C | 307020 | 25%58%17% |
| Amount Owed | YesNoN.C | 257520 | 33%63%4% |
| Adequacy of Collateral | YesNoN.C | 406515 | 33%54%13% |

 ***Character of the customer:*** as respondents for Finance, Underwriting, and Senior management responses the following findings has been detected:

17% respondents, said that the poor performance relates to poor customer evaluation such as the character of the customer, 67% responded the evaluation does not consider debtors reputation in respect of the customer character, and 16% of the respondents give no comment for same.

This shows that most of underwriting branches do not make the evaluation practical, which in effect means improper surveying of the customer. This also can be one of the reasons for outstanding balance to increase every time. From these we can judge the concerned underwriters are more focused on just issuing policies without considering this fact.

From the above data we can conclude that the company’s system requires evaluation of customer physical survey and proper filling of proposal forms by the customer before issuance of the policy. These can serve as a control mechanism to collect pre risk material fact. This assessment helps the underwriter to identify the insured as well as insured interest including physical hazard and moral hazards of the individual. Here all the material facts shall be disclosed in the proposal form i.e. anything which is not clearly put in the proposal form might bring rejection at the time of claim.

 In addition to these the insurance business is based on the principle of utmost good phase, it means that most of the material facts are expected from the customer. The experience of the customer in settlement of premium is also one factor to be cleared at the initial stage. Since there is no mechanism or system which the company can know simply the previous experience of the customer is considered and any additional fact should be disclosed in the proposal form honestly.

***Strength of Capital of the insured:***

It is very essential to identify financial strength of the customer. However 25% of the respondents answered that capital strength is considered for few clients especially related with bond policy, 58% of the respondents demonstrated that the company does not consider capital strength of the customer for any class of business. From this information we can deduce that the company is not considering this fact as a serious issue, which later makes to be difficult.

***Amount owed:***

 63% of the respondents explained that amount owed from the customer does not have any value in customer evaluation. 25% of the respondents replied the evaluation consider amount owed from the customer. Those who replied that the company considers amount owed from the customer stressed more on those with huge amount of risk. On the other hand the majority of the respondents more explained that their evaluation does not consider amount owed from the customer, which means the previous outstanding balance as a constraint. This is in fact the main cause for the uncollectibility of outstanding balances. Unless there is a strict measure on the previous debt, this makes customers to be reluctant to settle their outstanding debt.

***Adequacy of collateral***: Regarding adequacy of collateral, 54% responded that collateral is not applicable to all class of business except bond policies. Even for this class of business the amount is not equivalent to guarantee issued. This means that if the customer fails to perform his obligation the company will face problems in two ways i.e from the claim of the third party and also on the unpaid part of the premium. Therefore, it is very important to hold collateral to minimize the risk. On the other hand 33% of the respondents replied that there is adequate collateral held by the company, for performance and advance payment Bonds. 13% of the respondents give no comment. In general this implies that the company should request collateral to minimize the risk behind.

 ***TABLE 5***

***Evaluation of Company’s Credit Policy***

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Responses** | **No. of Respondents** | **%age % age** |
| Existence of Credit policy  | YesNo | 1200 | 100% |
| Effectiveness of Credit policy  | a) very effectiveb) effectivec) less effective | 201585 | 17%12%71% |
| Overriding of the Credit policy by share holders & Senior management | Yes No  | 8535 | 71%29% |
| Participation of Branches | Yes No | 9525 | 79%21% |
| Proper Documentation for legal action | Yes No NC | 258015 | 21%67%12% |

***Existence and Effectiveness of Credit policy:***

The existence of a safe and sound control over receivables in a company can possibly be achieved through preparation of effective credit policy, and by employing various technologies, which can improve the collection of receivables.

As it is demonstrated in table no. 5, from the 100% of respondents who agreed on the existence of credit policy, 17% rated the company’s credit policy as very effective, 12% rated as effective, and 71% rated as less effective. It is signified here that although there exists a formal credit policy, it is not as effective as desired, as far as receivable control of the company is concerned. This shows that still more efforts need to be made to enhance the effectiveness of credit policy in view of the ultimate goal of coming up with better receivables control position.

The reason for limited effectiveness of credit policy is significantly due to incomplete or improper application of the policy by employees of the companies. In this regard, it needs corrective measure to enhance employees’ ability and willingness to work effectively in line with the company’s credit sales policy.

Even though, Nile Insurance Company has established credit policy, the data shows that it has not been made practical. This prevents the company from generating excess funds so as to enjoy other investment opportunities like building real estates. The company is also losing opportunity income from short term investment and interest income on deposit due to the improper implementation of the credit policy.

There are different responses for the non-effectiveness of the credit policy. As per the questioner, the following were depicted from the respondents: As the senior management demonstrated, the overall management of the company management pertaining to receivable collection and credit system shows that the company lacks strict follow up and this makes it difficult to change receivable to other forms of asset on time.

The senior management is also involved in a special task force to make collection of the outstanding balance of some share holders and their affiliated companies, which means that management’s time is wasted on routine tasks.

There is also a problem in existing credit system, for which there is no guarantee attached or not binding if the client refuses to pay, especially huge amount of premium. Here, it means that if the credit policy requires guarantee before providing service to the client, this would help the company to take legal action accordingly.

The respondents also mention other factors which contribute to non effectiveness of the credit policy.

Unwillingness of customer to settle overdue balances and change of addresses are among the problems of account receivable of the company. Here it means that once clients get their policy they do not bother about their outstanding balance. Instead of paying to the insurance, they may give priority to other purposes.

There is no employee assigned for debtors follow up. The present practice (trying to apply the policy), the main problem is that there is no accountable department for the follow up.

The main problem in execution of the credit policy is that the customer has many options in the market. Therefore, to maintain the client, one must violet the credit policy of the company. Generally, as the operation staffs suggest either it should be revised or should be out sourced to make a new policy which can be practical and convenient to the clients as well as to operational staffs.

 Nile Insurance Company’s top management tries to formulate a task force which can follow the progress of the debtors account, but still there is a problem to make it effective since it is additional assignment for the task forces. Therefore, the branch managers suggest out- sourcing of the collection follow up rather than assigning taskforce.

It was very known that Nile Insurance Company has been in a leading position next to the government insurance i.e. Ethiopian Insurance Corporation, but now it is losing its position due to the uncollectible provision held as per the National Bank of Ethiopia Directive. That means the provision increases from time to time and this leads to increase bad debt expense of the Nile Insurance Company. Therefore, this weakness must be avoided very soon.

The participation of senior management in collection of outstanding balances is very important because some big customers are willing to pay when senior management are involved in the collection, but done only at the end of the fiscal year. . Usually the Nile Insurance Company used to visit client mostly at the end of financial period. This trend is not good to make collection follow up easy for the clients as well as for the staffs, rather it makes rushing and also clients will not have available time for effecting payment. So that senior management of Nile Insurance Company must work before hand either on quarterly basis or semi-quarterly basis.

Mostly the management participates in collection at the end of the fiscal year. In Nile insurance company most of the time orders are given by shareholders or senior management to issue policy violating the credit policy. This leads lower level managers to be discouraged and also not to practice properly. Even the shareholders order the senior management to order underwriters to issue policies without any down payment for those whom they want to

***Overriding of Credit and collection polices:***

From the respondents 71% mentioned that there is overriding of credit policy and 29% responded that there is no overriding of the credit policy. Here, as the majority disclosed senior management and the influential share holders do override the credit policy.

Sometimes outstanding premium payment from this group of clients would remain unpaid until it is deducted from claim payments in the future. If such is the case, customers would secure a great deal of benefit without any cash outflow to the company. Although the status of outstanding premium is improving from the share holders and their affiliated companies, still the outstanding balance is very much related with the other customers.

***Participation of Branches:***

As it is demonstrated in the table No.5, 79% of the respondents replied that all branches participate in the execution of the credit policy, and 21% explained the non- participation of branches in execution of the credit policy.

In the responses it is expressed that there is no measure to encourage the employees to work hardly on collection other than collectors who are entitled to commission on the collection of overdue debtors balance.

But, emphasis should be given to those who are participating in the collection of long outstanding balances as this may be a better way to reduce the outstanding receivables as well as to meet company’s goals.

***Proper Documentation for legal action:***

21% of the respondents confirm that there is proper documentation of the necessary documents for legal action, and 67% replied that there is no proper documentation. Here the majority argued that had there been proper documentation of polices, those overdue balances under legal action might get solution. Still most of them are pending due to lack of proper documents, such as properly signed policies, pending uncollected cheques. This shall be considered as a critical factor for the increasing of outstanding balances for those which can be collected through legal action.

***TABLE 6***

|  |  |  |  |
| --- | --- | --- | --- |
|  ***Existence and Effectiveness of Cash Discount*** |  |  |  |
| Applicability of cash discount | YesNo | 8535 | 71%29% |
| Effectiveness of cash discount | a)very effectiveb)effectivec)less effective | 102585 | 6%15%50% |

***Applicability of Cash Discount:***

Among the respondents 71% replied there is cash discount allowed to clients for full settlement of premium at the policy inception, 29% said there is no cash discount.

***Effectiveness of cash discount:***

From those who agreed to its existence, 6% rated cash discount as very effective, 15% as effective and 50% as less effective. From majority of respondents we can see that due to different factors the cash discount set by the company is weak and needs more work. The factors indicated by the respondents for its less effectiveness are several.

The cash discount offered by the company is less, and does not attract clients, and it doesn’t consider credit experience of the customer. Regarding this case for many years it has been a big issue which still has no solution. As per a branch manager’s comment the existing cash discount needs further revision so as to encourage the client as well as to minimize credit sales.

In general the cash discount taken by the company is very low and the customers prefer to buy insurance on credit basis. Therefore, it is better for the company to take action on the existing cash discount rate.

***TABLE 7***

**Adherence of NBE Directive**

***Adherence of National Bank of Ethiopia’s Directive No. SIB/26/2004:***

|  |  |  |  |
| --- | --- | --- | --- |
| Adherence of NBE’s Directive No. SIB/26/2004 | Yes, a) Monthly follow upYes, b) QuarterlyYes, c) Yearly | 2585 10 | 21%71% 8% |

 All of the respondents argued on the adherence of National Bank of Ethiopia Directive.

Among them 21% responded that reporting is made monthly, 71% said report are sent on quarterly basis, and 8% on yearly basis. As the majority demonstrated, the National Bank requires the report every quarter. This report includes only “Admitted Assets” according to

the relevant Directive of the Bank.

 The senior management of Nile Insurance Company is strictly following the adherence of the National Bank’s Directive; also it is reported every quarter in its financial report. Therefore, there is no strategic option to let it go, other than implementing it accordingly. The Directive obliges to hold provision on those outstanding balances that are overdue for more than 90 days. It is also reported to the governing body every quarter in its financial report. Only outstanding balances within 90 days are considered as part of admitted assets. Significantly part of the rest would be treated as a bad debt expenses, and this directly affects the profit of the company. It is also addressed that there mismatch of the Directive issued by the National Bank of Ethiopia and the credit policy of Nile Insurance Company. This is manifested the company’s extending the customer to settle the outstanding premium within maximum six months, while the directive needs the provision to be applied immediately after three months. Therefore, all outstanding debts within the credit policy of the company will be provision.

|  |  |  |
| --- | --- | --- |
| ***TABLE 8******Proper Management of Accounts Receivable:*** |  |  |
| Aging of Debtors Account |  Yes No | 1200 | 100%0% |
| Reconciliation of Account Receivable  |  Yes No  NC | 901515 | 75%13%12% |
| Effectiveness of reconciliation of accounts receivable | a)Very effectiveb)effectivec)less effective | 851025 | 71%8%21% |
| Company’s Liquidity Position | a)improvingb)decliningc)some how same | 951510 | 79%13%8% |

***Aging of Debtors Effectiveness:***

100% ofthe respondents also argued that there is a proper classification of customers in accordance with age, and type (such as current debtors falling within 90 days, 91-180 days, 181-270days, 271-365days and those above 365 days accordingly).

***Reconciliation of Account Receivable:***

Among 100% respondents, of the aging of debtors 75% responded that there is reconciliation of account receivable, 12% responded non existence of reconciliation of account receivable.

***Effectiveness of Accounts Receivables Reconciliation:***

Out of the respondents who agree to existence of reconciliation, 56.25% rated reconciliation as very effective, 9.37% effective and 9.38% less effective. This shows that reconciliation of account receivable is very strong and properly set in the company system. As it is mentioned by the respective respondents it becomes strongly applicable due to the existence of information system in the company and also the credit sales transactions are recorded immediately through the Company’s IT system.

As far as computerization is concerned, respondents also answered that the company employed computerized system of accounting to record receivables. This is helpful for the account receivable follow up. It is also indicated by respondents that the company is changing along with technological development; this may ultimately improve receivable control efficiency of the same.

The implication of the data is that the existing technology and strong reconciliation between receivables and credit sales transaction brings improvement.

***Company’s Liquidity Position:***

From the total number of respondents, 79% confirmed that the liquidity of the receivables is improving over time, 13% replied that it is declining, and 8% responded some how the same., In fact, due to the directives issued by the national Bank of Ethiopia and the strict supervision now a days the Company is improving its liquidity position overtime, so as to meet obligation timely such as settlement of claims, refund of premium and the rest.

It is also presented in the financial report of year 2010 that the current ratio and hence the liquidity of the company were improved substantially by the efforts made in collection and the recovery of Birr 25million. Accordingly, the current ratio has increased to 2.2 from 1.3 in previous years, an increase by 67%. As a result of this, Birr 30 million was deposited to interest bearing time deposit account and the company was able to settle Birr 4.5million of unpaid dividends for its ex-shareholders.

From this as well as from the responses the respondents under consideration that the liquidity position of the company is improving overtime.

***TABLE 9***

***Existence and effectiveness of Internal Control***

|  |  |  |  |
| --- | --- | --- | --- |
| Existence of Internal Control System | Yes No |  120 0 |  100% 0% |
| The effectiveness of Monitoring account Receivable position | a)very effectiveb)effectivec)less effective |  20 30 70 |  17% 25% 58% |

***Existence of Internal Control System:***

All the respondents argued the existence of internal control system, but 17% of the respondents rated its efficiency as very effective, 25% as effective and 58% less effective. From this data, we can infer that, although most of the respondents acknowledge for the existence of internal control system, many of them again are doubtful of its contribution towards receivable control effort of the company. Therefore, the internal control system is expected to do more effectively for organizational success.

 ***The effectiveness of Monitoring account Receivable position:***

 Among the respondents, 17% rated the effectiveness of monitoring account receivable position as very effective, 25% as effective and 58% less effective. This indicates that the majority of the respondents assured that there are different failure factors for the effectiveness of monitoring account receivable. These includes: unhealthy competition between the different insurance companies, the flow of customers from one company to another without settling the outstanding balance and incomplete or improper application of the credit policy by employees of the company. The cumulative effect of the problems raised above caused poor credit management in Nile Insurance Company. This was manifested by customer dissatisfaction, long credit processing time, inefficiency in credit assessment and decision making, employee dissatisfaction, reduction of customer loyalty to the company, lack of creativity and initiative from the credit staff, loss of market share, inefficient manpower utilization and inefficient resource utilization, reduced or loss of dividend to share holders and the increasing rate of uncollectible premium.

In this regard, corrective measures are needed to enhance employee’s ability and willingness to work effectively in line with the company’s credit policy. Underwriting branches are always complaining about this case, it means that implementation of the credit policy is weak; no one is responsible to follow such cases or to address the weakness of the credit policy. Therefore from time to time the debtors balance increases and goes to unmanageable situation.

Currently the share of owners from the total outstanding is decreasing compared to the previous period. Since the share holders are user from such opportunities, they must give more emphasis to timely settlement of their outstanding balances.

Therefore, the senior management tries to minimize the outstanding receivables using different mechanisms such as establishing collection taskforce committee, strictly addressing concerned branches to minimize outstanding of their respective customers and strict follow up of the adherence of the credit policy through internal audit report.

 The senior management as well as managements have discussed in every meeting of management the problem of the uncollectible premium and the increased share of the bad debt expense and addressed to the shareholders to take their own part to settle the outstanding premium of their company as well as sister company balances. Due to this effort by now the balance of the share holders is decreasing.

 Senior management’s response, regarding the action of bad debt is that it is mostly done every quarter. It is still a critical problem of the company to take action on those accounts to be written off. But finance manual is on process for the approval of taking action on those outstanding balances to be written off.

 The experience of the staff as well as their skill about insurance is inadequate. These make the staff to lose their confidence. The non-existence of clearly set standards and guidelines of the credit policy has also an indirect impact to clients to other insurance company. This directly or indirectly affects the number of customers to continue in Nile insurance company.

The previous trend was not very successful, but currently it is improving. Each underwriting branch is seriously following up its collection in the credit period. There is also no adequate information from the industry regarding the client’s debt status, controlling turnover of the debt client without settling the outstanding premium. Here, this shows that there is unhealthy competition which makes the client to run from one company to another without any restriction. This problem also reflects in Nile Insurance Company as a major one. Even the client also can change his address in order to be untraced by the previous insurance company.

Regarding the question rose about the overall practice of the company pertaining to receivables collection and credit system most of the senior management response shows that the company lacks strict implementation; receivables are not in a position to change to other asset on time.

**CHAPTER FOUR**

**SUMMARY, CONCLUSION AND RECOMMENDATION**

**4.1. SUMMARY**

Account receivables are funds owed to the firm as a result of sales, but which have not yet been collected. The objective of managing accounts receivable is to collect accounts receivable as quickly as possible without losing sales from high-pressure collection techniques. Accomplishing this goal encompasses three techniques: (*Ghitman, 2006)*.

* Credit selection and standards
* Credit terms, and
* Credit monitoring.

The most common and important form of receivable is accounts receivable, which is debt owed to the firm by customers for the goods or service the firm delivered or sold to them in the ordinary course of business. When the firm makes a sale and does not receive cash payment, the firm grants trade credit, which creates an account receivable.

***General Objectives:***

The objective of this study is to assess the impact of National Bank of Ethiopia (NBE) Directives in relation to receivables on the performance of Insurance companies in Ethiopia. The research also intends to asses the problems related to Accounts Receivables in Nile Insurance Company with the methods through gathering, compiling and analyzing primary data (such as questionnaires, interview ) and secondary data by reviewing relevant documents,( such as annual report, financial statement, ratios). The researcher also uses graphical and descriptive methods for analyzing the data.

***Specific Objectives:***

The study focuses specifically to meet the following:

* To analyze the strength/weakness of Nile Insurance Company in its profitability and leading position in relation to credit sales of premium.
* To analyze the existing credit policy
* To analyze cash discount policy
* To analyze competition tools & premium rates
* To check the company’s ability to settle claims in connection with liquidity

In this regard Nile Insurance Company is critically examined under this study. Work units and departments under considerations were mainly Finance and Underwriting.

All the respondents witnessed the existence of formal credit policy in the company. However, most of them are doubtful about its effectiveness due to inappropriate implementation of the policy by employees.

On the other hand majority of the respondents said that the company has formal collection policy and follow up procedures, yet most of them has rated the management of receivables of the company as less effective.

As replied by the majority the respondents, there is no established accountability for decision taken by authorized personnel in regard to credit giving. Furthermore, it is also overridden by top executives of the company by giving extended credit terms contrary to credit policy.

As we can see from the findings of the study, the company has prompt recording system of credit sales and adequate recording system for collection of accounts receivables.

In the request forwarded to them, respondents replied in support of some improvement in the liquidity (convertibility) of the company’s account receivable overtime.

* 1. **CONCLUSIONS**

The quality of receivable control practice does have a significant effect on the performance and efficiency of a given organization as related to its achievement to achieve its overall mission and vision. This is mainly true of for profit organizations. The overall results of this survey indicate that most of the key parameters of the receivables control practice are below satisfactory level as far as this efficiency is concerned. The results also indicated that the company has been “quick fix” personalized or individualistic solutions to problems rather than sustainable solution supported by strict adherence of designed policies that are associated with receivables control practice.

On the other hand, lack of commitment by senior executives to initiate receivables collection effort of has contributed negatively for lesser efficiency of receivable control practice.

Moreover, although the existence of a formal credit and collection policy is vital for better management of receivables, the current condition of the company with regard to strict adherence and implementation of policies is unsatisfactory. This might lead to high accumulation of account receivables to the company.

* 1. ***RECOMMENDATIONS***

In this study, the research tried to indicate the reasons for uncollectible premiums and the impact of uncollectible premium from different sectors of the company and each class of business. The major chronic cause of less profitability of the company has been uncollectible premium, which has decreased its market share in the industry. However, Nile Insurance Company has a chance to minimize premium uncollectibility of in advance by establishing a sound and efficient credit policy. Considering the above mentioned facts in the analysis section, the researcher believes that the following matters should be given attention to reduce uncollectibilty of premium and to create conducive business environment around the credit policy.

* ***Customer selection procedure:***

In granting credit, a firm takes a risk because there is certain probability that the customer will not pay. In setting credit standards, the problem is to grant credit to the right customers, even though the company lacks complete information about them.

Gathering information helps the company to establish better credit standards, although information is costly to acquire. So, by weighing its benefit against its costs, such as credit worthiness, the company should opt for higher credit standards.

* ***Credit Terms:***

The company conducts a sizable portion of its trade on credit, thus generating trade receivables. The gravity of trade receivables has increased in both absolute and relative terms in the recent past. Therefore credit period should be re- defined for all types of debtors when insurance policies are sold on credit bases. Credit limit also should be re-defined to the different classes of business and clients, especially for individual policy holders.

* ***Establish efficient collection policy:***

Even though there are a formal credit and collection policy and procedures, they are not properly implemented, and thus are not effective.

In addition to these, the credit policy must balance the value of increasing sales through credit with the costs of uncollectible accounts. Bearing this fact in mind, the researcher recommends the company to establish an effective collection policy through:

* Collecting long over due outstanding balances either by commission or by contract employees.
* Sending reminder letters repeatedly
* Making strict follow ups through telephone and personal visiting
* Withholding future- services
* Frequently providing debtors with up to date statements to alert them of their outstanding debt balances.
* Strengthening the IT system for timely information
* ***Cash discounts***

Encourage clients to purchase their insurance policies by paying cash as this undoubtedly reduces the debtor’s volume significantly and the sales volume increases.

* ***Interest charges***

Charging interest on over due balances may not be a common phenomenon to the Ethiopian insurance industry and therefore may be a relevant option if it was implemented. Yet attempts must be made to acquaint this “time value” concept to the client and the industry,

* ***Factoring***

 This concept also is not known in the insurance industry as well as others who introduce credit sales. But it should be well known and used as an instrument for overdue debtors balances, in such a way the company can outsource those overdue client balance through such mechanism.

The researcher recommends to the credit management staff strictly to consider the above mentioned factors in order to minimize uncollectible premium and also to improve the credit policy of the company, and hence its profitability.

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