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A Study on Credit Risk Management Practices for Trade Receivables in Distribution Businesses in the Gulf Region

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Abstract

Within business-to-business trading, selling goods on credit can be beneficial to the seller in order to encourage and retain business. However, this practice can pose problems if customers do not pay on time, or in some cases, do not pay at all. As distribution companies purchase goods from manufacturers or principals to sell to many customers, ensuring timely payments are received is essential to maintain cash flow within the business. In the Gulf region, managing credit risk is becoming increasingly important to distribution companies due to increasing late payments, increased payment timeframes and uncertain economic conditions.

This research paper looks at methods distribution companies can implement to manage credit risk. This includes; implementing appropriate credit policy and credit terms, assessing customers for credit worthiness, managing receivables and collections, and using financial and insurance instruments. Benefits of these methods are investigated, as well as challenges that may occur. Secondary research has been undertaken, including research papers, regulatory advice and industry questionnaires. From researching previous literature, it appears that distribution companies can be more efficient in managing credit risk by having clear credit policies, accurate customer information and regularly managing credit. However, challenges may exist in practice. These include a lack of information on private customers, a desire to ensure sales are not lost, and difficulty in enforcing credit terms. It can be concluded that distribution companies can ensure appropriate cash flows are maintained to support sales by implementing appropriate credit policy, carefully assessing customers, and actively managing credit.

1 Introduction

Credit is often provided within business-to-business transactions. This allows suppliers to attract and retain customers. However, it causes cash to be tied up in receivables. For distribution businesses, appropriately managing credit is vital to efficient management of finances.

Within the Gulf region credit is heavily used. In the UAE, businesses sell on credit to other businesses in an average of 47% of business-to-business transactions. Further to this, more than double as many businesses are experiencing increasing delays in payment compared to those with decreasing delays (Atradius, 2026). Within the Middle East, in over 1300 publicly traded companies in 2026 it was found that the median collection period has increased from 60 days in 2022 to 68 days in 2024 (Allianz Trade, 2026).

Due to these trends, effective credit risk management is becoming more relevant. Credit risk management with receivables includes determining credit granting criteria, monitoring payments,

resolving overdue debt, and limiting risk. For distribution businesses, implementing credit limits, analyzing customers' payment histories, keeping track of Days Sales Outstanding and creating clear exceptions policies are all actions which can occur in credit risk management.

Credit may be granted due to the advantages suppliers have in comparison to other lenders. As suppliers are providing goods to customers, they can obtain knowledge about the customers, recover value from the goods, and have a vested interest in the customer's survival (Petersen and Rajan, 1997). Despite this, there is still risk of non-payment, meaning credit granting must be well managed.

Effectively managing credit risk is important to improve business performance. With improved management of receivables, distribution businesses can secure cash flow in the business, reduce overdue debt and be able to support sales in the business with more confidence.1.1 Background of the Study

Distribution businesses sit between manufacturers and end customers. They usually buy goods from principals, hold stock and sell to customers such as retailers, contractors, fleet operators and other businesses, often with payment terms of several weeks. Because they must pay for goods and operating costs while waiting for customers to pay, delays in collection can quickly put pressure on working capital.

Firms have more than one way to manage receivables. Mian and Smith (1992) studied the choice of accounts receivable management policies, including the use of factoring, receivables-secured debt, captive finance subsidiaries and general corporate credit. They found that factors such as a firm's size and the credit standing of its traded debt and commercial paper were important in explaining these choices.

Credit terms also vary. Ng et al. (1999) examined whether firms extend credit or require cash payment and, where credit is extended, whether they use simple net terms or offer discounts for prompt payment. Their results support the view that credit terms can be a way of solving information problems about product quality and buyer creditworthiness.

Despite the availability of these tools, applying them is not always easy. Customers differ in size and financial strength, sales teams may want to offer flexible terms to win business, and information about private customers can be limited. These challenges can make businesses hesitant to tighten credit even when payment delays are increasing.

This study examines how credit risk management practices can help address these concerns and support more reliable collection of trade receivables.

2 Statement of the problem

Credit management in distribution environments is vital in increasing sales, maintaining good customer relations and ensuring healthy cash flows.

However, if credit is not well managed, for example too liberal credit is offered, credit is not closely monitored past due amounts, or exposure increases with a few customers, late payments may occur, increasing bad debt and putting pressure on cash flow. Alternatively, if credit is too restrictive, sales could be lost and customer relationships damaged.

Despite many credit management tools being available, poor data on customers, pressure to increase sales and time-consuming regular monitoring can all limit effective credit management.

The core issue within this study is how credit risk can be managed effectively within trade receivables in the distribution environment in the Gulf region, in order to support sales.

3 Importance of the study

Knowledge of credit control in businesses can help reduce late payments, reduce bad debt and improve cash efficiency. It can encourage businesses to consider changes to credit policy, evaluation of creditworthiness of customers and monitoring procedures.

This study may be useful to finance managers, credit controllers, business owners, sales managers and students with an interest in corporate finance and credit control. It shows an understanding of how credit control can be used to achieve business aims, in terms of cash flow, maintaining a good relationship with customers and ensuring long term competitiveness**.**

4 Research objectives

To understand how credit control can be improved within distribution companies in the Gulf region.

4.1 Specific objectives

1. Understand why trade credit is provided within a business and the risks that come with providing it for suppliers.
2. Identify key aspects of credit control of trade receivables.
3. To understand the impact on sales and risk by setting credit conditions and credit limits.
4. Understand approaches used to determine customer credit worthiness.
5. Identify key issues faced by distribution companies in controlling trade receivables within the Gulf region.
6. Suggest practical improvements which can be made to credit control within distribution companies.

5 Research questions

This study seeks to answer the following questions:

1. Why do businesses extend trade credit, and what risks does it create?
2. What practices can distribution businesses use to manage credit risk in trade receivables?
3. How do credit terms and credit limits affect both sales and risk?
4. How can businesses assess the creditworthiness of their customers?
5. What difficulties do distribution businesses face when managing receivables in the Gulf region?
6. What steps can distribution businesses take to improve their credit control?

6 Review of literature

A review of existing research helps explain why businesses extend trade credit and the practices available to manage the risks involved.

6.1 Why businesses extend trade credit

Petersen and Rajan (1997) look at trade credit. The research shows that trade credit increases when firms are unable to obtain finance from financial institutions. In addition, firms with greater access to credit will provide higher amounts of trade credit. It was also suggested that trade credit is given by suppliers to restricted firms due to advantages in gaining information on creditworthiness of the buyer, ability to repossess assets, and an implicit interest in the continuation of the firm.

This research demonstrates that trade credit can be seen as a financing option. Within a distribution business, decisions around granting trade credit will impact relationships within the business, and also the need for financing. However, results were drawn from data within the USA. Therefore great caution must be applied when applying these findings to other markets.

6.2 Credit terms and receivables policy

Ng et al. (1999) examine the credit granting policies adopted by firms. It was found that credit granting policies can be justified in order to overcome information asymmetries relating to product quality and credit worthiness of buyers.

Mian and Smith (1992) examine the different trade receivables management strategies adopted by firms. Different strategies include factoring, secured debt through trade receivables and captive finance subsidiaries. This study shows that different strategies are adopted depending on the characteristics of the firm, such as firm size and credit worthiness.

It appears therefore that credit granting policies and trade receivables management policies are dependent upon the type of business, information known by suppliers about their customers, and the financial status of the supplier. In particular, within distribution businesses, credit granting policies should be tailored to suit the characteristics of the customers and products within the business rather than simply adopting credit granting policies implemented by competitors.

6.3 Assessing customer creditworthiness

Altman (1968) used multiple discriminant analysis to combine several financial ratios into a single measure that could help distinguish firms that later failed from those that did not. The approach has since been widely used as a basis for credit scoring and early-warning methods.

The study shows that financial information can be used in a structured way to assess risk. However, the approach was developed using data on manufacturing firms, and it depends on the availability of financial statements. Many customers of distribution businesses are private companies, and their financial information may be limited or out of date. In such cases, other information, such as a customer's payment history with the supplier, becomes particularly important.

6.4 Credit risk management principles

The Basel Committee on Banking Supervision have provided guidelines for managing credit risk (Basel Committee on Banking Supervision, 2000). These guidelines outline how credit risk should be appropriately managed within a bank.

They include:

- Having appropriate credit risk framework in place.
- Applying appropriate lending processes.

- Applying appropriate credit management, measurement and monitoring.
- Implementing appropriate credit risk controls.

Although these guidelines were developed specifically for banks and have been updated in later Basel documentation, the underlying principles can be applied to trade credit. These principles are applying an approved credit policy, having clear lending criteria, regular credit monitoring and independent review of credit decisions. This means that credit control within a distribution business should be seen as a systematic process and not individual decisions made by sales people.

6.5 Payment practices and receivables in the Gulf region

Evidence of payment issues can be drawn from industry research. Within the UAE, it has been found that business to business trade credit is common and increasing, although there are increasing delays in payment (Atradius, 2026). In addition, within the Middle East, median DSO levels have increased in listed companies between 60 days in 2022, to 68 days in 2024 (Allianz Trade, 2026; based on KPMG).

Therefore, it appears that payment risk is an ongoing issue within the region. However, research into this issue within the region has predominantly focused on either the UAE or information from listed companies meaning it may not be fully representative of smaller markets such as Bahrain, and non-listed distribution businesses.

7 Research gap

Research exists into why trade credit is granted, what factors determine credit conditions, how to assess credit risk in clients and how credit risk should be controlled within banks.

However, much of this research is drawn from the US markets or relates to listed companies and financial institutions. Surveys exist within certain industries in various regions. These however are generally not academic research, and tend to relate to the United Arab Emirates. Within smaller markets in the Gulf, businesses within the distribution industry dealing with numerous private customers, and reliant on supply from principals do not seem to be well addressed in the literature. The difficulties faced by these businesses may also vary depending on business size, availability of finances, and client diversity.

This study considers issues around trade receivable credit risk control and challenges faced in implementing these within distribution businesses across the Gulf region.

8 Research methodology

8.1 Research design

This study follows a descriptive research approach. It examines existing information about credit risk management practices and explains how they can contribute to better control of trade receivables in distribution businesses.

8.2 Sources of data

The study uses secondary data collected from academic journal articles, supervisory guidance and industry surveys related to trade credit, receivables management and credit risk.

The main sources include research by Petersen and Rajan, Mian and Smith, Ng, Smith and Smith, and Altman, guidance from the Basel Committee on Banking Supervision, and industry reports by Atradius and Allianz Trade.

8.3 Method of analysis

Themes identified from data include the use of credit, credit conditions, assessment of customers, management and recovery procedures, payment patterns by region and obstacles to effective credit control. It therefore gives an indication of best practice within distribution businesses, rather than an analysis of credits performance in any specific business.

8.4 Scope of the study

This paper focuses mainly on credit in B2B trading and distribution in the Gulf region. However there is no coverage of credit to consumers, nor to banks. It has been considered what general credit management issues will be relevant for distributors in other regions.

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