



## Decision-Making of Working Capital Managers: A Behavioral Approach

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### Abstract

*This study focuses on the behavior of working capital managers when they take decisions concerning the different components of working capital during the global financial crisis. To find out which behavioral biases influence the decision of working capital managers when they decide about cash, inventory, receivables and payables, we based our investigation on questionnaire. More precisely, we aim to find out if working capital managers are likely to have influence of heuristic-driven biases, like high confidence level, loss aversion, self-serving biases and anchoring. Our results show that working capital managers are prone to behavioral biases when they take their decisions.*

**Keywords:** Behavioral biases, working capital management, financial crisis.

**Jel classification:** G02- G01-G3

### 1. Introduction

The last global financial crisis highlighted the importance of short term financing decision. Working capital management includes the management of cash, inventory, accounts receivable, and accounts payable. The reduction of the working capital implies financial constraints for the company, but an excessive working capital is a signal of an extra liquidity. Thus, managing and monitoring working capital is crucial for the company to insure its financial health and to avoid financial distress. The literature on working capital management focuses on its determinants or its influence on profitability (Biais and Gollier, 1997; Bellouma, 2011). However, the behavioral aspect of short-term decision was neglected. In fact, the integration of psychological elements to explain the irrational behaviors of decisions-makers tend to cover only long-term decision as capital structure or investment in stock market (DeBondt and Thaler, 1987; Bateman and al., 2015; Lai and Wang, 2015; Uhl, 2014). Yet, no study has scrutinized the effect of behavioral biases on working capital components management.

Therefore, we attempt to address this gap in literature by verifying human behavioral biases relating to overconfidence, self-serving, anchoring, representativeness, and loss aversion biases on the decision of working capital manager (Kahneman and Tversky, 1979; and Kahneman and al., 1982). More specifically, the primary goal of this article is to document the contemporary

practices of working capital managers. The second goal is to shed light on the latest developments in the field of working capital management. Generally, behavioral finance researchers study how these biases affect financial practices. However, this study searches how they precisely affect the decisions of working capital managers and advances a profile for these managers.

Overall, this research attempts to address the following questions:

1. What are the determinants of working capital?
2. What are the contemporary working capital practices in Tunisia?
3. Do fundamental characteristics such as size, credit rating, firm performance, gender, age, education, and industry affect working capital management in Tunisia?
4. How behavioral biases of Tunisian corporate treasurers affect their decisions?

Overconfident manager overestimates its knowledge and ability to control events to extent that he underestimates risks. Management confidence is one of the factors that explain firm financing decisions (Graham et al., 2009). Therefore, overoptimistic and overconfident manager relies on higher debt levels because they accept the control of debt holders. Besides, the manager is prone towards the self-serving biases. This potential problem occurs when the manager assigns the success to internal or personal factors and attributes the failure to external sources (Miler and Ross, 1979; Zuckerman, 1979). Another psychological heuristic that influences the decisions taken and makes managers rely excessively on a specific trait is the anchoring bias. This behavioral bias is related to the management overconfidence (Russo and Schoemaker, 1992; Hoch and al., 2004). Based on the arguments developed by Kahneman and Tversky (1979), manager judges events based on stereotypes, tendencies and arrangements. This representativeness bias is documented by Curley and Golden (1994), Kholas (1989) and Johnson (1983). They find that this behavioral heuristic affect managerial decision with respect to default expectation's, real estate management and legal decisions. Finally, Kahneman and Tversky (1991) emphasize that at the same level, losses have greater value than gains. Thus, the loss aversion bias can affect the decision of the managers by taking risks to avoid losses but they are repugnant to have the same behavior in case of gain. Based on this brief review of literature, decisions makers are prone towards these biases. However, how these behavioral heuristic affect the decisions of working capital manager is currently unaddressed. The main objective of this research is therefore to document the outcome of the different biases on our sample of working capital manager.

## **2. Data and Methodology**

In this study, we carried out 13 interviews from June 2015 to September 2015 with working capital managers to document the new working capital management practices that the current literature failed to address. Simultaneously, we gather information about the company and the working capital manager. Participants were asked to answer 10 questions about working capital management. The interview duration was to be around two hours. Significant facts about contemporary working capital management techniques were detected from the seven initial interviews. Information collected from these interviews was used to design the questionnaire with 23 questions sent to 236 Tunisian working capital managers by email. This investigation tool mostly asked close-ended questions dealing with general information about the company (size, foreign sales, gender, age and education of the working capital manager), working capital tools (day-to-day working capital management, importance of working capital in the organization, governance, performance drivers, outperform average targets) and behavioral

biases. 176 questionnaires were returned. In 49 of them, managers were reluctant to complete the questionnaire. Generally, four main industries compose our final sample: industry, services, commercial and distribution.

### **3. Results and Discussions**

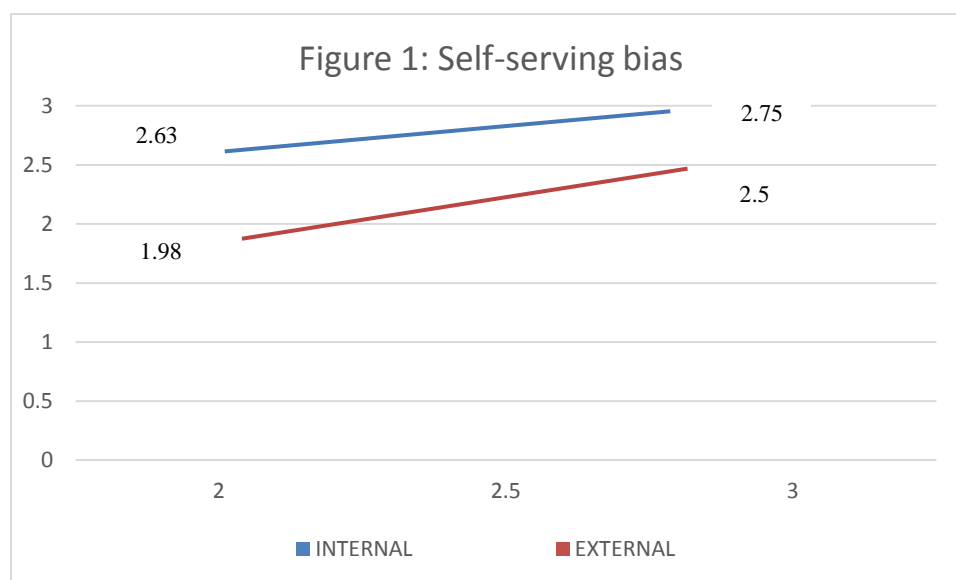
As suggested by the literature, some fundamental factors influence working capital management (Belt and Smith, 1991; Graham and Harvey, 2001; Bellouma, 2011). Particularly, we examine the effect of size, foreign sales, firm performance, industry, gender, age and education on working capital decisions.

From the first set of questions (see appendix), we note that small companies use traditional working capital management practices (only 12% of small organizations use goal setting and 18% have liquidity reserves). However, large sized companies rely on sophisticated techniques to manage their cash and inventory such as the financial and the banking environment, technological techniques... and prefer the use of account receivables instead of cash. Thus, the factor of size may explain the cash policy.

Exporting companies tend to optimize working capital decisions in order to reduce the volatility of their foreign sales to enhance their performance (Bernard and Jensen, 2004; Girma and al., 2004; Bellouma, 2015). Hence, they prefer the use of accounts receivable rather than cash and reduce their inventory by relying on “Just in Time” techniques. Furthermore, exporting companies control their liquidity, operational and market risks by using more adopted working capital practices like liquidity reserves, bank products... The finding emphasize also that successful performing companies are more likely to attach more importance of working capital decisions than poorly ones.

Working capital managers in Tunisian companies are generally male. In our survey, there are only 2 female participants. Considering the targets aimed, male respondents try to outperform the more profitable companies operating at the same industry, while female respondents reach to attempt the targets designed. This is consistent with the risk aversion feature between the two genders. Moreover, women are disposed to rely less on debt since they considered it as a source of important risk. This reaction to undertake more risk by younger working capital manager is relevant (Trimpop, 1994). In fact, elderly managers prefer stock and accounts receivables to cash. Besides, job training is more important than education level for the position of working capital managers. However, post graduated working capital managers tend to rely on risk measurements, return on investment instead of simple net working capital.

The main contribution of this paper is to emphasize the ignored effect of behavioral heuristic on the decisions of working capital managers in previous study. In order to identify the self-serving bias, respondents had to rate how they perceive the impact of external factors measured by economic environment and internal factors on financial distress using a five-point Likert scale. If a respondent gives a high ponderation to both the economic environment as a source of financial distress and his own financial policy when the company performs, we can detect that he is prone the self-serving bias (Miller and Ross, 1975). The main finding of this survey showed that in period of financial distress, respondents attribute bad performance to external factors. In periods of good performance, external and internal factors are the necessary combined source to enhance financial situation. This is corroborated by the mean difference observed between two categories of factors, which is on a scale of 0.52 (2.5 – 1.98), with an associated t-statistics equal to 3.20 (Figure 1).



More precisely, among the 176 respondents, 41 have this bias. By comparing working capital management behavior between the two groups (Table 4), we argue that working capital managers with the self-serving bias set aggressive targets to outperform the others companies in the same industry and are less likely to have liquidity reserves when compared to the non-self-serving bias respondents. Managers with the self-serving bias attach a greater importance to external factors like the financial, banking and economic environment. Additionally, they use accounts receivables to reduce transaction costs. Finally, they give a relatively greater importance to operational and liquidity risk.

Table 1: Self-serving bias and working capital management

	Yes	No	Difference	t-statistics
The importance attributed to working capital	0.52	0.67	-0.15	-1.06
Outperform average targets of company operating in the same industry	0.06	0.00	0.06	1.67*
Setting a goal approach	0.26	0.22	0.04	0.41
Relying on net working capital	0.45	0.78	-0.33	-1.79
Relying on return on investment	0.28	0.20	0.08	0.42
Taking into account risk management	0.34	0.23	0.11	0.54
Relying on bank credit	0.5	0.49	0.01	0.00
Managing cash	0.12	0.14	-0.02	1.02*
Liquidity reserve	0.34	0.30	0.04	0.27
Financial and banking environment	2.75	1.13	1.62	2.87**
Economic environment	3.16	2.12	1.04	2.44**
Just in time inventory techniques	0.26	0.40	-0.14	-0.54
Economic method of inventory	0.22	0.00	0.22	1.00
Inventory management motivation is transaction motives	0.56	0.05	0.51	2.89**
Inventory management motivation is tax-based motives	0.07	0.11	-0.05	-0.55
Inventory management motivation is price motives	0.26	0.20	0.06	0.44
Financial flexibility	2.00	2.30	-0.30	-0.51
The transactions costs of issuing debts	1.71	1.75	-0.04	-0.08
Credit risk	2.89	2.54	0.35	0.89

Operational risk	3.79	2.43	1.36	2.43***
liquidity risk	3.89	3.45	0.44	2.76***

To capture the overconfidence bias, we ask respondents to which extent they are confident when they take decision during good performance periods. Using a five-point Likert scale, a high rate is signaling that the respondent is prone to the overconfidence bias. 63 of the respondents are considered having this bias. Particularly, as shown in Figure 2, they are overconfident when the company has a good performance with a t-statistics equal to 3.98.

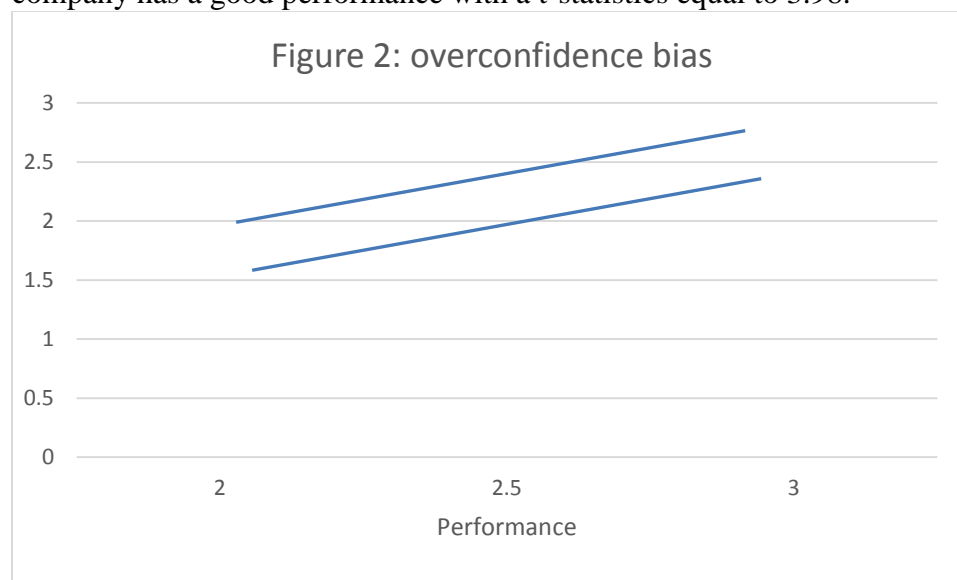


Table 1 illustrates the difference in working capital management techniques between managers when they are overconfident and when they are not. Managers with the overconfidence bias appear to attach more importance to return on investment and economic method of inventory. Furthermore, around 70% of overconfident respondents attach a higher importance to the economic environment. The results are also coherent with pecking order theory and the transaction cost theory. In fact, overconfident managers issue debt when internal funds are not sufficient. Finally, our results demonstrate that overconfident managers are more likely to attribute a higher importance to liquidity, operational and credit risks.

Table 2: Overconfidence bias and working capital management

	Yes	No	Difference	t-statistics
The importance attributed to working capital	0.62	0.67	- 0.05	-1.36
Outperform average targets of company operating in the same industry	0.17	0.01	0.16	0.69
Setting a goal approach	0.29	0.24	0.05	0.76
Relying on net working capital	0.32	0.78	-0.46	-2.17
Relying on return on investment	0.37	0.11	0.26	1.95*
Taking into account risk management	0.24	0.03	0.21	0.78
Relying on bank credit	0.49	0.49	0.00	0.00
Managing cash	0.17	0.14	-0.03	0.02
Liquidity reserve	0.14	0.13	0.01	0.23
Financial and banking environment	0.75	0.13	0.62	2.81
Economic environment	3.02	2.12	1.14	3.56**

Just in time inventory techniques	0.16	0.02	-0.14	-0.62
Economic method of inventory	0.08	0.00	0.08	2.07***
Inventory management motivation is transaction motives	1.71	1.78	0.07	0.08
Inventory management motivation is tax-based motives	0.05	0.11	-0.07	-0.32
Inventory management motivation is price motives	0.29	0.19	0.10	0.92
Financial flexibility	2.04	2.00	0.04	0.61
The transactions costs of issuing debts	0.06	0.00	0.06	1.77*
Credit risk	2.09	2.04	0.05	1.29***
Operational risk	0.77	0.43	0.34	1.03***
liquidity risk	1.23	1.21	0.02	0.47***

Representativeness bias and the anchoring bias are similar. To verify if the working capital manager is prone to such biases, we adopt the procedure of Tversky and Kahneman (1979) under specified conditions to identify how he would have reacted in such an environment. We assume that the respondent had offered in the past a trade credit to a company with cash constraints, which has fulfilled payment on time. We asked him to attribute his probability to give another similar company the same conditions of payment using a five-point Likert scale. If the respondent gives a high rate to this case, we assume that he is prone to the representativeness and anchoring biases since he based his decision on a recent payment history. Globally, 14 respondents are prone to the representativeness and the anchoring biases. As shown in figure 3, if the cash constrained company paid its accounts payable on time, the Tunisian working capital manager will be not reluctant to delay payment for another similar company in the future. However, the respondent refuses delaying payment for the same company if it defaults (the t-statistics of the mean difference is 7.17).

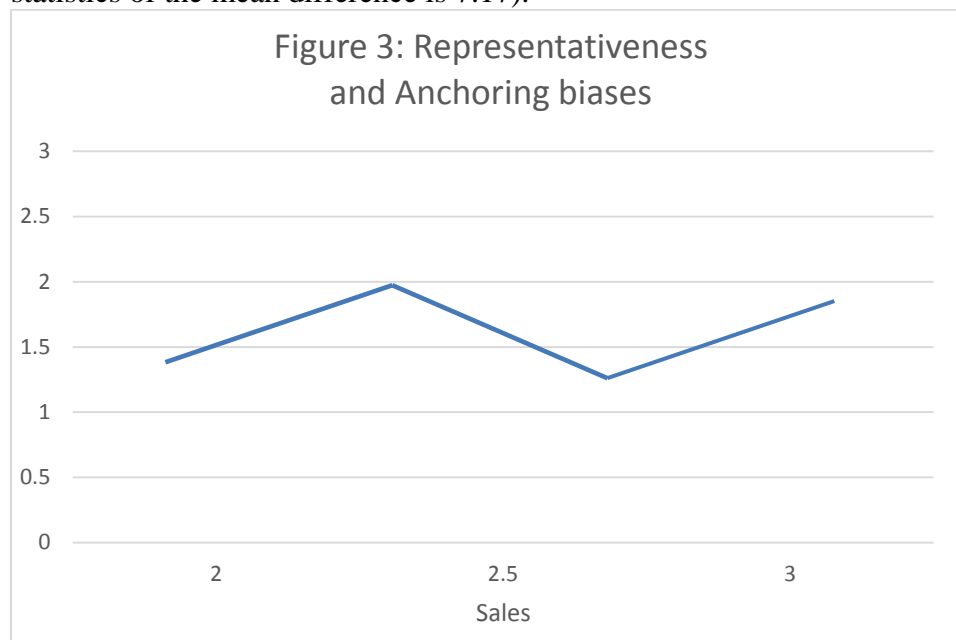


Table 3 indicates that working capital managers with the representativeness and anchoring biases are more likely to give more importance to setting a goal approach that serves as a representative case to undertake future decisions. Furthermore, working capital managers are

likely to prefer financial flexibility by delaying payment for their customers compared to those without such biases. Lastly, they are less likely to rely on credit risk.

Table 3: Representativeness and Anchoring biases and working capital management

	Yes	No	Difference	t-statistics
The importance attributed to working capital	0.98	0.54	0.44	1.42
Outperform average targets of company operating in the same industry	0.45	0.05	0.40	0.13
Setting a goal approach	0.48	0.17	0.31	0.94**
Relying on net working capital	0.43	0.22	0.21	1.19
Relying on return on investment	0.12	0.11	0.01	0.15
Taking into account risk management	0.63	0.03	0.60	0.58
Relying on bank credit	0.59	0.43	-0.16	1.57**
Managing cash	0.34	0.10	0.24	0.16
Liquidity reserve	0.54	0.12	0.42	0.43
Financial and banking environment	0.15	0.23	0.12	1.65
Economic environment	1.12	0.12	1.00	1.13**
Just in time inventory techniques	0.23	0.01	0.12	0.45
Economic method of inventory	0.04	0.00	0.04	1.09**
Inventory management motivation is transaction motives	1.41	1.21	0.20	0.05
Inventory management motivation is tax-based motives	0.09	0.03	0.06	0.67
Inventory management motivation is price motives	0.34	0.12	0.22	0.76
Financial flexibility	1.06	0.02	1.04	0.87**
The transactions costs of issuing debts	0.13	0.02	0.11	1.43
Credit risk	1.14	2.24	-1.10	2.16***
Operational risk	0.18	0.29	0.11	0.67
liquidity risk	1.23	1.22	0.01	0.06

As mentioned earlier, based on the prospect theory, Kahneman and Tversky (1979) argue that people choose to avoid losses over than accumulating gains. As a result, for the same amount, the disappointment felt in loss scenario is more intensive than the satisfaction in winning scenario. To identify the loss aversion bias, we asked the respondent to specify on a five-point Likert scale how satisfied or distraught he would be if he gained or lost 5%, 10%, 20% or 30% of his sales revenue.

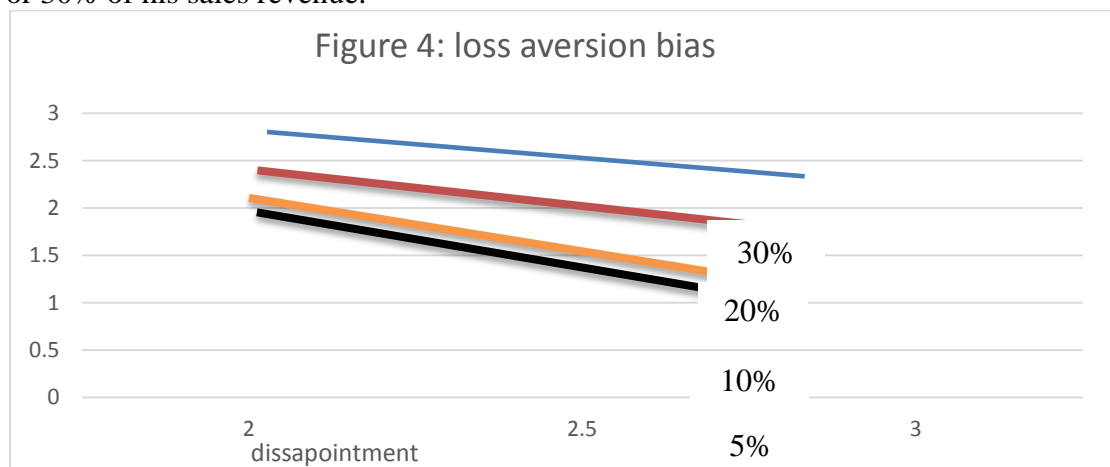


Figure 4 demonstrates that for the same amount, disappointment is linked to higher scores than satisfaction. Overall, for 32 respondents the mean of satisfaction is lesser than the mean of disappointment, which can explain that they are prone towards loss aversion bias (the t-statistics of the mean difference are respectively 9.56, 7.83, 5.32, and 2.9 for 5%, 10%, 20%, and 30% of the sales revenue). Concerning the difference between the techniques used in managing working capital, table 4 shows that working capital managers with the loss aversion bias are more expected to highlight the prominence of working capital management. Besides, risk management and bank credit are crucial for them when compared to those without such a bias.

Table 4: Loss aversion bias and working capital management

	Yes	No	Difference	t-statistics
The importance attributed to working capital	1.94	0.92	0.02	1.98*
Outperform average targets of company operating in the same industry	0.78	0.34	0.44	0.12
Setting a goal approach	0.56	0.98	-0.42	-0.56
Relying on net working capital	0.23	0.22	0.01	2.07
Relying on return on investment	0.43	0.66	0.23	0.15
Taking into account risk management	0.11	0.91	0.80	0.16*
Relying on bank credit	0.56	0.33	0.23	0.89**
Managing cash	0.22	0.20	0.04	0.56
Liquidity reserve	1.54	0.12	1.42	0.69
Financial and banking environment	0.35	0.89	0.54	0.72
Economic environment	2.85	0.15	2.70	2.34
Just in time inventory techniques	0.29	0.08	0.11	0.63
Economic method of inventory	0.13	0.01	0.12	0.18
Inventory management motivation is transaction motives	2.80	1.50	1.30	0.09
Inventory management motivation is tax-based motives	0.17	0.03	0.14	0.78
Inventory management motivation is price motives	0.13	0.03	0.10	0.36
Financial flexibility	0.06	0.12	0.06	0.73
The transactions costs of issuing debts	0.10	0.02	0.08	1.22
Credit risk	1.98	1.45	0.54	0.49
Operational risk	0.67	0.54	0.13	0.33
liquidity risk	0.23	0.21	0.02	0.18

#### 4. Conclusion

The main objective of this paper was to investigate the behavioral biases that affect working capital management in Tunisia. The literature treating working capital management fails to consider the behavioral aspect. The empirical results show that Tunisian working capital managers exhibit various behavioral biases, such as the self-serving, overconfidence, loss aversion, and anchoring biases, and these biases affect their decisions. Moreover, fundamental factors such as size, credit rating, firm performance, gender, age, education, and industry affect the decisions of working capital managers. In fact, large firms make more seriously their working capital management decisions. However, unsuccessful firms are subject to mimetic behavioral in their working capital practices. The age of the managers, the number of years of its experience and his education also affect its behavior when taking risky decisions.



Besides, behavioral biases can be used to draw a specific profile of a working capital manager according to each financial situation. More precisely, under financial distress, companies should hire a working capital manager with representativeness and loss aversion biases to reduce risk taking, control debt and monitor doubtful customers. However, under prosperity scenarios, working capital managers are asked to be more confident and with self-serving bias.

Instead of the contribution of our study, further investigation is required in the same field by studying other countries to compare results or including other behavioral heuristics.

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## Appendix: Survey questionnaire

In order to understand working capital management, we sent to your finance manager or treasurer this questionnaire. We will be grateful if you could fulfill it. All the information gathered are not publically communicated.

### **Survey On working capital management**

#### 1- Information about you

##### **Gender**

- Male  Female

##### **Age**

- <40  40-49  50-59  ≥ 60

##### **Education**

- <undergraduate  undergraduate  master

#### 2- Description of the company

##### **Industry**

- Energy  Information Technology  Materials  
 Telecommunication services  Distribution  Financials  
 Health care  Industrials  others

##### **Company type**

- listed  non-listed

##### **Number of employees**

- <50  50-100  100-500  ≥ 500

##### **Annual revenues**

- ≥ 2 m dinars  2-1 m dinars  1- 0,6 m dinars  <0.6 -0.1 m dinars  < 0.1 m dinars

##### **Foreign sales**

- 0%  <25%  25%-50%  ≥ 50%

##### **Working capital % sales**

- <10%  ≥ 10%

#### 3- The financing policy of the company

- Moderate  aggressive  conservative

4- The working capital management approach

- emphasizes the importance of working capital management
- aims to outperform industry average targets
- attempts a goal setting

5- The value metrics for the working capital management

- Net working capital
- Return on investments
- Risk management

6- Rate the importance of the following financial risk management functions in the company

	0	1	2	3	4
Cash and liquidity risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Credit risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Risk management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

7- The cash management approach used by the company

- Diversification of banks
- Emergency liquidity reserves
- meet payment in a timely manner

8- Rate the importance of the following factors in cash management decisions

- Financial and banking environment
- Economic environment
- other

9- The inventory management approach used by the company

- Just in time
- supply chain management
- Inventory methods

10- What factors motivate your company to use accounts receivable rather than cash?

- Financial motives
- Price motives
- transactions motives
- tax based motives

11- When your company is financial distressed, how you rate these following factors:

	0	1	2	3	4
Your own decisions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Economic environment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

12- If the economic environment is good, how confident are you in your cash management?

Not at all					very much
0	1	2	3	4	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

13- If a low rated company get credit sales and paid on time with which likelihood do you

	Not at all likely			very likely	
	0	1	2	3	4
Make credit sales to another low	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

rated company                                 

14- If your performance is high, how confident are you in your cash management decisions?

Not at all confident					very confident
0	1	2	3	4	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

15- If your performance is poor, how confident are you in your cash management decisions?

Not at all confident					very confident
0	1	2	3	4	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

16- When your company has good financial performance, how you rate these following factors:

	0	1	2	3	4
Your own decisions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Economic environment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

17- If a low rated company get credit sales and paid on time with which likelihood do you

	Not at all likely			very likely	
	0	1	2	3	4
Make credit sales to another low	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Rated company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

18- If a low rated company get credit sales and did not paid on time with which likelihood do you

	Not at all likely			very likely	
	0	1	2	3	4
Make credit sales to another low	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Rated company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

19- How satisfied would you be with an annual profit of sales?

	0	1	2	3	4
5%	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10%	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20%	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
30%	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Thank you for completing this questionnaire.