

# KASNEB

## DCM LEVEL III

### PRACTICE OF CREDIT MANAGEMENT

TUESDAY: 24 May 2016.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

#### QUESTION ONE

Eloham Packers, a supplier of plastic bottles, commenced business six years ago as a sole proprietorship. The sole proprietorship was owned by Eloham Packers who before starting the business had worked as a production manager in a similar firm for a duration of five years during which he gained experience in the manufacture of plastic bottles. Within two years of starting his business, Eloham Packers decided to convert the sole proprietorship into a limited company (Eloham Packers Limited) in order to participate in tenders for supply of his product to public corporations and the government.

The initial capital outlay was Sh.2.5 million which was financed from Eloham Parkers terminal benefits after resigning from his former employer. Due to high demand for plastic bottles by suppliers of bottled water, the investment has significantly grown.

As a result of the huge expansion, the company has employed a large workforce comprising of all departments necessary for the running of the company. Eloham Packers Limited trades on credit.

The finance manager has charged the management of credit to one of the accountants and has allocated him one assistant. Every customer who presents a 30 days' post-dated cheque is allowed to receive the supplies. The approval of the award of credit rests with the finance manager and is done on a case to case basis. The sales and marketing team on realising that the advancing of credit to customers is relatively easy, embarked on aggressive marketing and promotion of the company's product. This has resulted to a significance increase in the number of clients purchasing the plastic bottles from Eloham Packers Limited on credit.

Consequently the credit section is overwhelmed with work. The invoices, delivery notes, customers' orders, post dated cheques and other important documents are piled up in cartons and kept in one of the rooms at the general warehouse.

Currently, the company is experiencing cash flow problems leading to difficulties in paying its suppliers for raw materials required for the production of the plastic bottles. In a consultative meeting, the sales manager has blamed the credit team for not collecting debts from the customers on time and for poor relations in the way they follow-up payments from the customers. The credit team has in turn blamed the sales team for overtrading leaving the credit team with no option but to approve orders for supply as per the negotiated terms so as to get the business. The finance manager also observed the failure of the credit team to collect debts on time and taking too long to settle disputed accounts citing inadequate documentation.

For purposes of transactions recording, the data from the credit section is input to the accounting software on a monthly basis, an operation that has proved burdensome to the team to the extent of working on weekends and late night as well as hiring data entry clerks on a casual basis. To solve the cash flow problem, the finance manager has proposed to request for enhanced credit limits from the suppliers and to increase the bank overdraft. Even after implementing these strategies for the last one year, liquidity has proved to be a major challenge. Some of the company's suppliers have threatened to file insolvency proceedings against the company.

#### Required:

You have been hired as a credit management consultant by the directors of Eloham Packers Limited to help them solve their cash flow challenges through sound management of the credit function.

(a) Explain five credit management concerns that the company should address. (10 marks)

(b) Propose solutions for each of the five credit management concerns identified in (a) above. (30 marks)

(Total: 40 marks)

**QUESTION TWO**

- (a) In one of the credit seminars organised by your company, a credit specialist was quoted as saying "Companies can better reduce payment risk in their receivables portfolio by upgrading internal policies and procedures than focusing on customer creditworthiness".

**Required:**

Explain eight policies and procedures that a firm could use to reduce payment risks in its receivables portfolio. (8 marks)

- (b) The effectiveness of a credit department depends upon a good computerised credit management system.

**Required:**

In relation to the above statement, analyse the credit management tasks which could substantially be aided by computer systems. (7 marks)

**(Total: 15 marks)**

**QUESTION THREE**

- (a) Financial statements are a useful source of information to an astute credit manager. The assessment of the financial statements should form part of the process of credit analysis.

With reference to the above statement, describe the following ratios:

- (i) Payables payment period. (2 marks)
- (ii) Stock turnover. (2 marks)
- (iii) Current ratio. (2 marks)
- (iv) Debt equity ratio. (2 marks)
- (v) Acid test ratio. (2 marks)

- (b) Legal action on debt recovery does not guarantee a payment at the end of the process.

With reference to the above statement, outline five factors to consider before commencing debt recovery through the legal process. (5 marks)

**(Total: 15 marks)**

**QUESTION FOUR**

- (a) Highlight three objectives of a loan portfolio. (3 marks)
- (b) Analyse six factors that a micro finance institution (MFI) should consider when designing its loan products to minimise credit risk. (6 marks)
- (c) Describe six strategies designed to balance incentives and penalties when developing a loan delinquency management system. (6 marks)

**(Total: 15 marks)**

**QUESTION FIVE**

- (a) A debt collector should act ethically in the process of debt collection.

With reference to the above statement, describe five actions by a debt collector that might be considered unethical when collecting debts. (5 marks)

- (b) Explain five reports used in measuring performance of a credit department. (5 marks)

- (c) Describe five requirements of a successful credit department. (5 marks)

**(Total: 15 marks)**

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