

KASNEB

DCM LEVEL III

PRACTICE OF CREDIT MANAGEMENT

TUESDAY: 23 May 2017.

Time Allowed: 3 hours.

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

QUESTION ONE

Anna Monre is the proprietor of Anna Massage Solutions (AMS), a small firm of trained masseurs that run office wellness programmes for a select number of corporate clients. After 12 months in operation, the business sought to expand its client base. However, they struggled to acquire new clients because they didn't offer trade credit.

Anna had heard some unpleasant stories about consequences of small businesses extending credit and was a bit wary about the idea. However, as she discovered, if undertaken properly, granting credit could be a major boost to a firm's profitability. Anna did some research and found out that managing credit in a small business hinges on information, communication and cash flow.

Information

Anna realised that in order to make smart business decisions, she needed quality information at her fingertips. The more she knew about her customers before she extended credit to them, the better her chances of getting prompt and full payment.

To achieve the required level of customer understanding, Anna implemented a simple credit checking process within her business. She also established a credit policy to ensure that all potential customers were checked prior to the extension of credit.

Anna also made it clear to her team of masseurs that they might have to turn away customers with a poor payment record because the loss of a sale is less costly than persistently following up a late payer, which impacts on cash flow and spreads resources thin.

Communication

Clear communication and quality documentation contribute significantly to a good business relationship. Anna made sure that her team communicated effectively with their customers and provided all necessary documentation at the outset of a relationship. She also insisted that follow up on invoices be timely, a key aspect in managing collections and cash flows.

Cash flow projection

Cash flow is the lifeblood of a business and lack of funds is a key contributor to the vast majority of business failures. Anna took the necessary precautions to ensure that her business maintained a healthy cash position.

She also managed her cash flow by properly controlling the credit extended. This meant ensuring that debts owed were paid in a timely manner. Late payment or non-payment of debt wreaks havoc with cash flow, not to mention the high labour costs associated with collection efforts.

By going through this planning process before providing credit, Anna's business was able to achieve its planned expansion through the acquisition of new customers.

Required:

As a credit professional:

- (a) Explain to Anna Monre five advantages and five disadvantages of extending credit to customers for her size of business. (10 marks)
- (b) Propose five sources of credit information that Anna Monre could use while undertaking the "Know your customer" (KYC) analysis. (10 marks)

- (c) Anna Monre is not sure whether to put in place a “conservative” or “liberal” credit policy.
- Required:**
- (i) Differentiate between a “conservative credit policy” and a “liberal credit policy”. (4 marks)
- (ii) Propose three factors favouring each of the two credit policies mentioned in (c)(i) above. (6 marks)
- (d) Analyse five benefits of cash flow projection that could accrue to Anna Massage Solutions. (10 marks)
- (Total: 40 marks)**

QUESTION TWO

- (a) Explain five key points worth noting by credit managers in preparing collection letters. (10 marks)
- (b) Discuss five limitations of using credit cards to finance a business. (5 marks)
- (Total: 15 marks)**

QUESTION THREE

“In planning and measuring debtors, monthly reports should be as analytical as time allows both as a means of improving credit management and to amplify the basic figures to top management”.

With reference to the above statement:

- (a) (i) Discuss the six stage sequence of receivables budgeting and reporting. (6 marks)
- (ii) Outline the measurable items used by most companies supplying goods on credit in measuring receivables. (6 marks)
- (b) Plastic money is a convenient service that allows exchange of goods and services without the need for cash.

With reference to the above statement, highlight three parties involved in plastic money business. (3 marks)

(Total: 15 marks)

QUESTION FOUR

- (a) Evaluate five components of a receivables management system. (10 marks)
- (b) Highlight five factors that could influence the level of staffing in a credit department. (5 marks)
- (Total: 15 marks)**

QUESTION FIVE

- (a) Describe three disadvantages of legal redress in debt recovery. (6 marks)
- (b) Discuss three likely causes of mortgage foreclosure in your country. (3 marks)
- (c) Analyse three applicable risks associated with real estate and construction lending. (6 marks)
- (Total: 15 marks)**
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