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DCM LEVEL III

PRACTICE OF CREDIT MANAGEMENT

TUESDAY: 22 May 2018. **Time Allowed: 3 hours.**

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

QUESTION ONE

CHATTELS BRIDGE ENTERPRISES LIMITED

Chattels Bridge Enterprises (CBE) Limited are dealers in all household assets and appliances with a wide branch network in the country. The company has been in operation for the last twenty years and it sells its products on hire-purchase terms. The company has adequate staff in terms of numbers in all its branches. However, a close examination of the staff competencies reveals that it only requires basic marketing and sales skills for one to join the company's sales and marketing team.

The company's head of finance, who doubles as the Chief Operations Officer (COO), is a competent accountant but the rest of his team have middle level and elementary knowledge and skills in finance and accounting. The company utilises an enterprise resource planning (ERP) software for financial recording and reporting, procurement, human resource functions and billing among other functions supported by the ERP system.

In the last five years, CBE Limited has been grappling with an increasingly poor performing debtors' portfolio evidenced by late repayments, difficult customers, non-performing accounts and at worst bad debts write-offs due to non-collectability of some debts. As a matter of policy, the company allows hire purchase terms to all customers regardless of their occupation and only requires 20% of the marked price as a down payment, with the rest of the purchase price being spread equally over nine months.

This means that salaried customers, farmers, business people, pensioners and casual workers are allowed the same hire-purchase terms. The heads of departments process the hire purchase agreements fully and forward them to the appraisal officers whose role is limited to completing the process and having deliveries made to the customer. It has been observed that some heads of departments approve hire purchase terms that are beyond the allowed nine months.

The evaluation of the propensity of the customers to purchase is under the finance department in which some middle level accountants have been assigned the assessment and appraisal duties. Due to their poor skills in credit management matters coupled with pressure to hit targets from the sales team, the appraisers grant hire purchase facilities to almost all customers who approach the company. Conflicts are common between the finance team and the sales team regarding the steady increase in non-performing accounts. Each of the team members blames the other for the poor results posted in relation to the management of the debtors' portfolio.

Collection of debts is majorly dependent on the customers making monthly instalments via standing orders signed with their respective banks. The bank, which does not play a financier role in the agreements, usually remits information on running and dishonoured standing orders on a monthly basis. This information is used by the finance department to update the customers' ledgers in the ERP system. Aged debtors listing is produced on a monthly basis, analysed and handed over to the sales team for payment follow-up on the past-due accounts. The sales team carries out the collections task reluctantly through phone calls, reminder letters and customers visits. This has not been consistent and as such, most defaulters have taken advantage of the poor payment follow-up, paying an instalment only when consistently reminded.

The finance department has a debt recovery section that takes up delinquent accounts once the hire-purchase period is over, to mainly execute repossession of the assets from the defaulting customers with the aim of reselling them in the second hand assets' markets to recoup the company's money. This team and management in general, has always believed that the threat of

repossession is the best security under the hire-purchase agreements and that the company may not lose its funds since the goods could always be repossessed from defaulters and hence the company requires no provision for alternative additional collateral to offer credit to its customers.
The repossessions have been facing numerous challenges ranging from resistance by rogue debtors, failure to locate the assets, poor condition of the repossessed assets to low proceeds from the repossessed assets to the extent of not satisfying the outstanding non-performing debts. As such, bad debts write-offs have been recommended and approved for such cases among other challenges to recover debts.

Due to the non-performing accounts, the company is unable to offer competitive remuneration; hence motivation is through commissions which are only paid from profits accruing from fully paid transactions.

An analysis of the customer complaints and other correspondences from defaulters has revealed the involvement of staff, some of whom have left the company, in fraudulent deals, using the customers' profiles to acquire their own Chattels with promises to the customers that the staff so concerned would make the required payments. This information reaches the company too late, when the account is overdue and assets cannot be located. It becomes difficult to follow up on the staff after exiting the service of the company many of whom deny the claims arguing that all relevant documentation points to the transaction having been done between the particular customer and CBE Limited. The management and administration of the company's credit granting process is quite wanting.

The directors have now demanded from the managers urgent action to reverse this worsening trend. The managers have thus hired your services as a consulting credit management practitioner to guide them in coming up with appropriate strategies to save their company from further bad debts losses.

Required:

(a) Analyse five credit management aspects troubling CBE Limited. (10 marks)

(b) Propose a remedy for each of the credit management aspects identified in (a) above. (10 marks)

(c) The credit department has the powers to stop orders, change terms and act as a gate-keeper for new businesses.

With reference to the above statement, advise the management of CBE Limited on the structure of a credit department. (8 marks)

(d) Prepare a summary to CBE Limited's management outlining three duties and three obligations of the parties to a hire purchase agreement for their better understanding when dealing with their customers. (12 marks)

(Total: 40 marks)

QUESTION TWO

(a) Describe seven parameters that a credit controller could use in the reassessment of a customer risk rating for a loan refinancing proposal. (7 marks)

(b) Explain four forms of letters of credit (LC). (8 marks)

(Total: 15 marks)

QUESTION THREE

(a) Discuss four performance indicators of a microfinance institution. (8 marks)

(b) Outline seven objectives of the savings and credit co-operative societies (Saccos). (7 marks)

(Total: 15 marks)

QUESTION FOUR

(a) An emerging and quickly developing trend has been the use of alternative dispute resolution mechanisms in the recovery of commercial debts.

With reference to the above statement, explain the following:

(i) Early neutral evaluation. (2 marks)

(ii) Expert determination. (2 marks)

(iii) Mediation. (2 marks)

(iv) Court-connected mediation. (2 marks)

(v) Court-mandated mediation. (2 marks)

(b) Discuss five advantages of using invoice discounting as a source of finance. (5 marks)

(Total: 15 marks)

QUESTION FIVE

(a) "Effective paper work is the foundation of an effective credit control".

With reference to the above statement, enumerate five good practices pertaining to the use of a customer statement for the purpose of debt collection. (5 marks)

(b) Discuss four factors influencing a bank's loan policy. (4 marks)

(c) Describe six factors that influence the choice of credit terms. (6 marks)

(Total: 15 marks)

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