KASNEB

DCM LEVEL III

PRACTICE OF CREDIT MANAGEMENT

TUESDAY: 22 November 2016. **Time Allowed: 3 hours.**

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

QUESTION ONE

EDDY SOFTLINE LIMITED (ESL)

Eddy Softline Limited (ESL) is an information technology company specialising in computer software engineering. The company sells its own customised computer softwares as well as products from other well known firms' softwares through dealership.

The dealership programme is for products copyrighted by internationally recognised computer software developers who do not have local operations in ESL's country. The softwares developed by ESL, are based on specific client's requests and might not fit for solving a different client's information technology (IT) challenges, except for cases of same industry clients with substantial common characteristics.

For the dealership contracts, ESL buys the products at a discount from the copyright owner paying for it promptly. ESL thereafter supplies, installs and provides support services to the clients on credit. Although other software developing companies provide credit to customers, their terms are net 30 days which is below the 60 to 90 days credit period offered by ESL to its customers.

The standard contract between ESL and its clients has a clause requiring for the supply, installation and support services on a pilot programme, with 50% of the contract value being paid after the first 30 days from the date of signing the contract and the balance spread as follows:

- 30% of the invoice value is paid within 60 days and,
- 20% of the invoice value is paid within 90 days from the invoice date.
- This last 50% of the payment is conditioned on the successful implementation of the software and its operational efficiency in solving the IT challenge.

In a bid to ensure efficient operation of the software, ESL recommends its clients to purchase compatible machines. These machines are supplied by their associate company, Capital Business Machines (CBM). CBM's arrangement with ESL is such that ESL was to receive 40% of the merchandise value of the business referred to them by CBM.

During the first few years, the business recorded good performance, but in the recent past, ESL has registered dismal performance owing majorly to bad debts losses. Some clients blame ESL for not providing a matching solution to their IT problems while others are across the border operations and enterprises whose follow up for payments has not been effective owing to the difficulties in reaching them regularly. Copyright legislations in some jurisdictions outside ESL's country make it difficult for ESL to collect payments after provision of its services since some of the clients, through their lawyers adversely exploits these laws.

The sales team has mostly focused on growing the market, an operation that has resulted to many customers coming on board on credit terms, only for majority of them to turn out as bad debtors if not difficult customers to handle. In a bid to minimise cost, collections are done by the same sales team causing conflict with the credit team. The sales team report to their departmental head, from where the credit team gets information to update customer ledgers. When the debts reach the point of difficult customers or default, the credit team is called upon to assist in collections.

ESL's cash flow challenge has been fueled by CBM's failure to submit the 40% of the referred business due to ESL after supplying the required machines compatible with ESL's softwares solutions. As business partners, the two firms had agreed that ESL finances 30% of the cost of the machines to be supplied to their clients through CBM.

In order to meet its cash requirement, ESL has been operating an overdraft facility with their bankers and since the account is rarely regularised, the overdraft interest expense has become burdensome. In order to improve on collection of revenue and thus enhance cash inflow, ESL has contracted an external debt collector to help them. They are paid on a percentage commission on the amount collected in addition to 10% on the allocated portfolio which is paid at the time of signing the contract. It is now the third year, since the external collector came on board but no notable improvement on cash inflows has been registered.

Required:
You have been approached by the management of Eddy Softline Ltd. (ESL) to assist them in reversing the current trend in their company.

(a) Analyse ten credit management mistakes made by ESL. (10 marks)

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

(c) Suggest to the management of ESL, eight strategies of handling export credit to ensure compliance with credit terms and timely payments. (8 marks)

(d) Highlight eight ways of managing departmental conflicts within ESL. (8 marks)

(e) Advise the management of ESL on how they could utilise third party debt collection effectively. (4 marks)

(Total: 40 marks)

QUESTION TWO

(a) Outline six causes of credit information sharing disputes. (6 marks)

(b) After witnessing the way women livelihood had been positively changed through Table Banking, Maureen Savy decided to go back to her rural home and sell the idea to the women in her village. Her idea is to replicate the Table Banking model to them. She has approached you for advice on the following issues:

(i) Difference between "Table Banking" and "Merry-go-Round". (4 marks)

(ii) Five appropriate rules to keep the group orderly and to govern the group efficiently. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) Summarise seven factors that should be considered when evaluating credit quality of leases. (7 marks)

(b) Discuss four causes of credit problems experienced by lending institutions. (8 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Analyse five risks associated with using group-lending mechanism in Micro Finance Institutions (MFIs). (5 marks)

(b) Credit insurance is designed exclusively to protect trade receivables. However, the product is not without weaknesses.

With reference to the above statement, evaluate four weaknesses that are commonly associated with credit insurance. (8 marks)

(c) Citing two merits, justify the need for political-risk insurance by exporters. (2 marks)

(Total: 15 marks)

QUESTION FIVE

(a) In the context of bad debts, explain the following Cs' as propagated by Golden and Walker:

(i) Complacency. (1 mark)

(ii) Carelessness. (1 mark)

(iii) Communication breakdown. (1 mark)

(iv) Contingency. (1 mark)

(v) Competition. (1 mark)

(b) Analyse three factors that a borrower should consider while choosing a lending institution. (6 marks)

(c) In each billing cycle, a credit card issuer is required to send a statement to a card holder.

In relation to the above statement, outline four contents of the statement sent to a card holder. (4 marks)

(Total: 15 marks)

....