



DCM LEVEL III

PRACTICE OF CREDIT MANAGEMENT

TUESDAY: 31 August 2021.

Time Allowed: 3 hours.

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

QUESTION ONE

COMFORT FURNITURES LTD.

Comfort Furnitures Ltd. is a privately owned company. They are in the business of retailing furniture. The company started its operations in the year 2008. The company targets the high-end market with a wide assortment of luxurious furniture products. The company sells 80% of its products on credit basis.

The company has introduced hire purchase sales facility in all its outlets which has resulted in an increase in the sales volumes. Reliance on credit sales implies that Comfort Furnitures Ltd. cash is lying in accounts receivables with 37% of the accounts being received after 181 days, 22% received between 121-180 days, 25% received between 61-120 days and 16% of the debtors paying between 0-60 days. Comfort Furnitures Ltd. credit policy states that all accounts should be cleared within 180 days, however, 37% of debtors are long overdue resulting in cash constraint on operations. In 2019 alone, the company had 12% of its total debtors being declared as bad debts. Suppliers enjoy a 30-day payment period. Comfort Furnitures Ltd. is already experiencing cash flow problems and is not able to meet its obligations as they fall due.

Even though the company's credit policy states that all accounts should be cleared within 6 months (180 days), nothing or little is being done to ensure that the cash collection system of the organisation is effectively managed. As a result, much of the company's cash is lying in accounts receivable. The company uses 3C's when assessing the creditworthiness of its customers.

The most demanding factor being character followed by capacity and capital. The source of information used to assess the credit worthiness of the customers is the assessment forms filled by the customers. However, not all customers reveal the truth about their indebtedness for proper risk assessment.

Comfort Furnitures Ltd. does not make use of the credit information captured in the assessment forms. The company uses letters of demand, telephone calls and personal visits as follow-up techniques. Reminder letters are sent four weeks after the due date. Final demand letters together with telephone calls are made if the customer fails to respond to reminder letter. There is a long gap between the first and the second reminder letter. This hinders effective collection as other delinquent customers require persistent follow ups before they can settle their accounts. Interest is not charged on overdue accounts. Personal visits are used in tracking long outstanding debtors and this is rarely done.

The company uses ageing analysis as a way of monitoring accounts receivables. Most of the company's debtors periods fall beyond their due dates of 180 days. Invoices and statements are sent to customers after four weeks, this has worsened the cash flow position of Comfort Furnitures Ltd. Debt collection is a function of the accounts department.

The management of Comfort Furnitures Ltd. have approached you as credit management professional to advice on how to address the above challenges and enhance the effectiveness of accounts receivables management.

Required:

- (a) Discuss five weaknesses in the administration of Comfort Furnitures Ltd.'s credit sales that you would address. (10 marks)
- (b) Explain two other C's that the management of Comfort Furnitures Ltd. would consider in the assessment of customers' risk. (4 marks)

- (c) Analyse four approaches that the management of Comfort Furnitures Ltd. would have used to analyse credit information provided by the customers on the assessment form. (8 marks)
 - (d) In addition to the aged analysis, list five measurable items that the credit manager of Comfort Furnitures Ltd. could have used to measure the performance of the collection team. (5 marks)
 - (e) Highlight five ways that the credit manager of Comfort Furnitures Ltd. could have used to minimise the credit losses. (5 marks)
 - (f) Analyse four advantages that could have accrued to Comfort Furnitures Ltd. if they had undertaken detailed risk assessment on their customers. (8 marks)
- (Total: 40 marks)**

QUESTION TWO

- (a) Explain the following steps in risk management:
 - (i) Risk identification. (2 marks)
 - (ii) Risk prioritisation. (2 marks)
 - (iii) Risk monitoring. (2 marks)
 - (b) Analyse three advantages of trade credit to the buyers. (6 marks)
 - (c) List three types of export documents. (3 marks)
- (Total: 15 marks)**

QUESTION THREE

- (a) Discuss three benefits of credit information sharing. (6 marks)
 - (b) Distinguish between “credit management” and “risk management”. (4 marks)
 - (c) List five factors to consider before initiating a legal process to recover debts. (5 marks)
- (Total: 15 marks)**

QUESTION FOUR

- (a) Explain the term “credit report”. (2 marks)
 - (b) List five components of the score cards that credit bureaus use when calculating a loan applicant’s credit score. (5 marks)
 - (c) Describe three sources of political risks in export credit. (3 marks)
 - (d) Outline five business conditions under which a restrictive credit policy would not be appropriate. (5 marks)
- (Total: 15 marks)**

QUESTION FIVE

- (a) Describe three ways in which a firm could respond to risks. (6 marks)
 - (b) State four signs of problem loans. (4 marks)
 - (c) Enumerate five circumstances when a court could intervene in debt dispute arbitration proceedings. (5 marks)
- (Total: 15 marks)**
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