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DCM LEVEL III

PRACTICE OF CREDIT MANAGEMENT

TUESDAY: 18 May 2021. **Time Allowed: 3 hours.**

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

QUESTION ONE

FIRST HAND SAVINGS AND LOANS LIMITED (FHSL)

First Hand Savings and Loans Limited (FHSL) was licensed by the Central Bank in 1993 to provide banking services. It started operations on 25 September 1996. FHSL is a leading Savings and Loans company in the country, with a mission to provide convenient access to efficient innovative and responsive financial services to the Small and Micro Enterprise (SMEs) on a sustainable basis for the mutual benefit of all stakeholders.

The institution has earned its current enviable status through its relentless pursuit of customer-centered services and the continuous introduction of innovative products which have become the lifeline of many SMEs and individuals who were marginalised by the formal financial system.

The credit management process of FHSL is coordinated by the head of credit who oversees and supervises all the various applications that come from various departments and branches. He works closely with a credit committee that goes through and vets all credit applications presented for approval. The head of credit, together with the committee updates the credit management policy on a regular basis and reports to the management concerning the updated policies and provides a report on portfolio of the institution as submitted by the various branches. This allows for management to be abreast with current happenings and to be able to report to the board of directors which has ultimate oversight responsibility over the credit management and risk control policy of the institution.

The firm's credit management policy includes cash collateral which provides a cushion during the default, use of loan history which facilitates the process of loan graduation, increased monitoring of customers accessing loans at shorter period, and the introduction of micro-insurance which reduces the risk of default. Another important factor is the use of legal and risk departments in coordinating debt recovery.

The credit management policy provides a solid guide for credit officers in granting loans as well as helping improve loan portfolio quality. Furthermore, it also serves as a solid road map for all credit activities, helps in decision making process and serves as performance indicator to measure growth. It also helps prevent bad loans through the provision of a solid monitoring system that helps to reduce the risk of loan default, and improves commitment to loan repayment.

However, the credit management policy of the firm is characterised by huge amounts of paper work during the credit granting process which makes the process very slow. This manual process drives some customers away.

The credit management procedures also lack supervision, proper communication, failure to enforce loan provisions when customers default and rigidity of certain provisions which prevent customers from accessing loan facilities. The credit management policy lacks enforcement provision in loan contracts due to poor documentation coupled with inadequate information provided by the customers. There has been an increase in the non-performing assets of FHSL Limited.

Required:

(a) Enumerate five benefits that First Hand Savings and Loans Limited is enjoying from its current credit management policy. (5 marks)

(b) The head of credit works in conjunction with the credit committee.

With reference to the above statement, describe five roles of the credit committee. (5 marks)

(c) Analyse five factors that could have prevented FHSL customers from accessing loan facilities. (10 marks)

(d) Suggest five measures that the management of FHSL could put in place to overcome the weaknesses of its credit management policy. (10 marks)

(e) Explain five reasons that might have led to an increase in the non-performing assets in FHSL. (5 marks)

(f) State five measures that the management could put in place to minimise the element of risk in granting credit. (5 marks)

(Total: 40 marks)

QUESTION TWO

(a) Enumerate five types of risks in export credit that could lead to delay or non-payment of goods or services. (5 marks)

(b) Discuss three differences between "Private Credit Bureaus (PCBs)" and "Public Credit Registries (PCRs)" in relation to credit information sharing. (6 marks)

(c) Analyse four circumstances that are ideal for a firm to outsource debt collection services. (4 marks)

(Total: 15 marks)

QUESTION THREE

(a) Trade credit can be used by sellers and buyers advantageously in enhancing sales revenue and expanding businesses.

Analyse three general costs associated with this type of business model. (6 marks)

(b) Explain the following terms as used in trade credit:

(i) Documentary collections. (2 marks)

(ii) Documents against payment. (2 marks)

(iii) Documents against acceptance. (2 marks)

(c) Explain three factors to consider before extending trade credit to customers. (3 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Highlight five factors that determine a consumer credit score. (5 marks)

(b) In assessing the creditworthiness of a company, the lender must consider the type of lending being proposed.

Analyse the three primary types of lending to a company. (6 marks)

(c) Highlight four reasons why mobile lending is popular among households. (4 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Explain three best practices in managing credit risk in banking sector. (6 marks)

(b) Describe five strategies that a credit controller could use to strengthen internal debt collection process in a firm. (5 marks)

(c) Analyse one advantage and one disadvantage to a firm as a result of operating a liberal credit policy. (4 marks)

(Total: 15 marks)

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