KASNEB

CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 27 May 2016. **Time Allowed: 3 hours.**

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

QUESTION ONE

Kujikuza Sacco Society Ltd. has been in existence for the last ten years. It has a current membership of 45,000 comprising of traders from diverse businesses in the informal sector. The sacco started as a rotating savings and credit association (ROSCA) with membership being drawn purely from second hand clothes sellers in one small town. With a view to expand their businesses and create more personal wealth, the ROSCA members resolved to make their savings grow by avoiding the annual distribution of the accumulated fund and instead choosing to pay a certain percentage on the amount each member had saved. By so doing, they were able to accumulate a substantive amount of permanent capital within the ROSCA. With permanent capital available, the members of the ROSCA who at that time were 3,000 resolved to convert the ROSCA into a Sacco society by the name Kujikuza Sacco Society Ltd.

With the help of Katiba Company Advocates, by-laws were set out to govern the savings and lending of money among members as well as rules governing the operations of the sacco, which at this time were yet to be registered with the regulator as it had failed to meet the required minimum capital. Nevertheless, the members strongly agreed to continue carrying on their operations as a sacco, collecting monthly contributions from members and granting credit at an interest rate of 9% per annum with a maximum loan of three times one's shares.

The security of the loan advanced to a member was the members shares and a guarantee from three other members whose shares could cover the required loan amount.

Two years into the business, Kujikuza Sacco Society Ltd. suffered its worst setback when the government imposed punitive excise duty on imported second hand clothes so as to promote the local textile industry. This move by the government made the cost of running second hand clothes' business unbearable. Consequently, the sacco started experiencing reduced savings and defaults on loans including getting absolute losses from members who could not cope with the business conditions brought about by the government's directive.

To cope with the sudden change of legislation by the government, the sacco management agreed to open their common bond to other sectors of the economy, provided a member had a stable business anywhere in the country. This was informed by some great losses suffered in the immediate last four years.

To facilitate the expansion upon opening of the common bond to other sectors of the market, the sacco opened branches in all major towns and recruited credit officers and other staff for the running of the branches. With the opening of branches, strategic decision making became very difficult since all the members of the senior management were the large savers in the sacco and opposed any strategic move which was considered unfavourable to them. This led to setting of goals customised to meet the desires of a few members of the Sacco.

Every manager wanted his or her person to get employed within the branches. As a result, nepotism hit the sacco with the result of recruitment of staff just because they were related to the senior savers in one way or the other. There was no oversight body like a board of directors because the large savers believed that they could manage the funds of the sacco in a sound manner.

In order to beat competition from other established saccos, the management changed the loan capping to a maximum of six times a member's share. As a result of the new loan policy, funds are no longer sufficient to satisfy loan demands. Members have to wait for more than two months for their applications to be processed since the sacco has to wait for funds from repayments and savings which are inconsistent due to the nature of the pool from where members are drawn.

Collection of loans is merely dependent on the members own volition to remit loan repayments and share contributions. Members have not received dividends for two years now and some members are threatening to file a petition in court to have the sacco wound up.

The management, in response to this threat from members, has approached your firm for advice on how to change things for the better. Your firm has selected you as the lead credit management consultant of the team assigned with this task of helping the sacco out of its woes.

Required:
Advise the management of Kujikuza Sacco Society Ltd. on the following:

(a) (i) Six credit management and other related issues facing the sacco. (12 marks)

(ii) Six remedies to the credit management and other related issues identified in (a)(i) above. (12 marks)

(b) With reference to the sacco's situation, discuss the main agency problem surrounding the sacco and the necessary remedy. (9 marks)

(c) Explain adverse selection as one of the information asymmetry element in the sacco's woes and how the same could be minimised. (7 marks)

(Total: 40 marks)

QUESTION TWO

(a) You have been appointed to a taskforce tasked with the preparation of a draft Consumer Credit Act. The Act will be tabled before a conference of the relevant stakeholders for deliberations and further reading before being forwarded to the country's legislative body for enactment.

Required:
Analyse five aspects that you consider as important contents of the draft Consumer Credit Act. (10 marks)

(b) Explain the process of perfecting title to land as collateral in your country. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) Credit crunch is an economic condition in which investment capital is difficult to obtain.

With reference to the above statement, explain a four step process that a firm could follow to manage risk under credit crunch conditions. (8 marks)

(b) A credit memorandum should accompany all commercial loans to help lending institutions measure objective and subjective risk characteristics and to understand the borrowers probability of default.

With reference to the above statement, summarise the contents of a credit memorandum. (7 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Microfinance institutions (MFIs) often operate in disaster-prone environments, both of the human and natural varieties. Consequently, MFIs should prepare for such events and have disaster management schemes ready to pull off the shelf as soon as a crisis occurs.

You have been tasked by the Board of directors of Badilisha MFI to head a team that will develop a credit management disaster scheme policy.

Required:
Examine five key considerations that your team should take into account in designing the credit disaster management scheme. (10 marks)

(b) Discuss five credit management costs that could be accurately planned for and measured on a monthly basis in the credit department. (5 marks)

(Total: 15 marks)

QUESTION FIVE

The National Credit Act Steering Commission of your country has been tasked with coming up with rules and regulations governing best practice and conduct of debt collection. The commission liaison officer has approached you with a request that you become one of the commission resource person(s) in developing the Act since you are a credit professional.

Required:

(a) Categorise parties that might be contacted other than for the purpose of obtaining information concerning the debtor's location when trying to follow up on a debt. (5 marks)

(b) Summarise five prohibited acts of debt collection that could amount to harassment of a debtor. (5 marks)

(c) Analyse five sources of information that is used for the evaluation of a customer's creditworthiness. (5 marks)

(Total: 15 marks)

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