PAPER NO. CP 53

PART III

SECTION 5

CERTIFIED CREDIT PROFESSION

(CCP)

CREDIT MANAGEMENT IN FINANCIAL SECTOR

STUDY TEXT

GENERAL OBJECTIVE

This paper is intended to equip the candidate with the knowledge, skills and attitude that will enable him/her to apply the principles of credit management in the financial sector

LEARNING OUTCOMES

A candidate who passes this paper should be able to:

- Analyse different credit applications
- Extend different credit facilities for different customers
- Apply credit management skills in the context of asset financing
- Assess the impact of microfinance in promoting small and micro enterprises in the economy
- Undertake credit management activities in the co-operative sector,

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TOPIC 1

CREDIT CARD RISK MANAGEMENT

CREDIT CARDS

A credit card is defined in the consumer Credit Act 1974 (UK) as a credit token, voucher, coupon, stamp, form, booklet and or other documents.

The credit card provides:

- means of verification
- means of transferring value from a seller to a buyer
- use of a credit facility which has been agreed by a third party

The money transmission can be paper based or electronic through data capture transmission. Credit cards are personal customer instruments but some organizations allow the use of cards by individual company. employees.

PARTIES TO CREDIT CARD TRANSACTIONS

The parties involved in plastic money business are normally but not limited to the following

1. **Card issuers**: - This is a bank or any other organization that issue plastic cards to customers to facilitate payments for good and services. For example in Kenya, Barclays bank, STD Bank, KCB, Post Bank, Total (K), Caltex, Nakumart are issuers among others.
2. **Cardholder** – Any person issued with a plastic card is referred to as cardholder.
3. **Merchants** – All those businessmen that do accept plastic cards as means of payment for goods and services e.g. Super markets, Petrol Stations, Hotels, airlines etc. are referred to as merchants.
4. **Acquirer**- This is any organization in most cases banks that have been licensed to sign agreements with merchants so that they can start accepting cards. Acquirers settle merchant's plastic card business transactions directly and then claim refund from card issuers. Card issuers settle acquirers and in return they bill their customers (cardholders) who are later on required to pay upon receipt of statements.
5. **Visa International /Master Card / Diners International – these are among many international Franchise** holder of Visa, Master card & Dinners brand respectively. They are regulatory bodies and card issuers are required to become members in order to be allowed to issue cards pertaining to a specific brand. Issuers are bound by rules and regulations

periodically released by these bodies. These regulatory bodies are the one's who come up with new products.

6. **Types of plastic cards** - There are different products in terms of plastic cards. The most common types are
   a) **Credit Cards: -** A credit cardholder uses his payment card to buy goods and services instead of using cash. The merchant receives reimbursement for the transaction from an Acquirer who in return receives payment from card issuers. Card issuers then debit the cardholder with transaction amount and send a statement to the cardholder. The cardholder can choose to pay all the balance outstanding to the issuer or just part of it – usually subject to minimum monthly amount. Interest is charged on the outstanding balance
   b) **Debit Card** – A debit cardholder uses his payment card to buy goods and services instead of using cash. The amount is automatically taken out of the cardholder's bank account and transferred to the merchant's account. The authorization must be approved 100% online or real time.
   c) **Specific products**: -
   - **Normal credit card**- mostly used for normal and ordinary transactions. You can pay partly and carry forward an agreed balance
   - **Charge cards-** operates like the normal credit cards but no provision of caring forward the balances
   - **Affinity cards**- The usage has a provision for donations to charity such that any transactions have a small amount donated to an organization or a charity home.
   - **Co- branded cards**- These are cards issued jointly by an issuer and a non financial institution which has a well known name. Mainly used in conjunction with the credit card companies and non financial institutions- an example is the Nakumatt card.
   - **Company cards**- Used by big stores instead of their staff walking with cash every other time.
   - **Gold cards-** can either be normal credit card or a charge card. However the credit limit allows the card holder to transact huge businesses because the credit limit is quite high.
   - **Store cards**- Issued by retailers and are accepted only by departmental stores in the company.

7 **Authorization** – This is the process whereby merchants seek approval on–line for card transactions before rendering the service. Authorization can either be on-line or off-line but for debit card it must be on-line.

Problems of the card market

1. **Frauds –** There has been a significant increase in card-related fraud and this has discouraged some potential cardholders from applying for cards. The issue is being addressed by the members of the card companies. They have formed a fraud awareness council which addresses the issue of fraud trends and preventive strategies
2. **Internet services-** where there is a problem with the internets save to say that the fiber cable may be a solution to the problem.
3. **Telecommunication problems** –Debit card issuers have been worst hit by this problem for their cards require 100% authorization. Some telephone exchanges are always congested and these frustrate a customer who uses their cards on-line.
4. **Ignorance**- Most Kenyans are ignorant to the level of using the credit card with some thinking that somebody will pay whatever they incur. A lot need to be done in terms of education.
5. **Credit abuse**- Many people are not aware of the issues they need to look at on the use of the card. Consultancy in credit matters would come in handy to offer advice and counseling.
6. **Flow of information**- information is not readily available for purposes of efficient assessment. The government needs to put credit bureau in various sectors.
7. **Sharing information-** Many card business players are not ready to share information
8. **Availability of reputable merchants-** the locations and reputability of the retailers and willingness to accept the credit cards.
9. **Resistance to change-** many people are not ready to change to match the global demand.
10. **poverty level –** where there is not enough money to warrant the use of the credit cards
11. **Professionalism-** Many players in the market have relied on operations that are still foreign based where some of them have failed miserably. Example the credit scoring systems

In the Kenyan market today we have merchants in almost all sectors and spread across the country. Most merchants are found in urban centers and Nairobi having over 60% of all merchants.

MAIN FEATURES OF CREDIT CARD

Make payments. With the debit card, the primary concern is whether there are sufficient merchants to accept cards. None of the card products is likely to succeed if there are not enough merchants who are set up to accept the card as payment for goods and services. The debit card is new in the Kenyan Market and has to be encouraged. The debit card acceptance network is in its infancy stage as compared to developed countries.

Withdraw Cash: - For cards to withdrawals cash banks need to install ATMs at strategic locations

For Credit card the payment method is monthly billing with an option to pay in full or any amount from minimum percentage of the total outstanding balance –usually 20%. This method is known as revolving credit.

Charge Card – Monthly billing with the only one option of paying in full the outstanding, balance by a specified date.

Access credit- obtains goods and services to be paid later.

Introduction to consumer credit business

- In U.K., the consumer trade is regulated by the consumer credit act 1974.
- It covers all unsecured lending to individuals up to £ 25,000.
- The act requires that terms of credit are contained in the form of an agreement that is set out in accordance with the act.
- It should be noted that if some certain components of the agreement are omitted from the agreement known as prescribed terms, then the agreement is not enforced in court of law.

However, in Kenya we do not have a credit act and the Business is controlled by the market forces.

- Credit cards – This is one of the most profitable businesses since it is controlled by the individuals.
- The consumer credit business has not taken off in Kenya due to various reasons

a) Consumer credit abuse.
b) Lack of knowledge in use of the consumer credit.
c) Negative marketing in a bid to meet the target other than use of credit as a marketing tool.
d) Lack of training to users and hence works out as a punitive business.
e) Only targets a certain group f people and hence no expansion.
f) Punitive interest rates that make the society to repel from the consumer credit.
g) Interests changed on interests and hence work out as a way of making the society run away from the very good business.
h) Lack of knowledge of the people running the business and matching the western world.
i) Professionalism
j) Disclosure of information
k) Public awareness