CENTRAL UNIVERSITY

END-OF-FIRST SEMESTER EXAMINATION: 2018/2019

DEPARTMENT OF BANKING AND FINANCE

CBBF 305

CREDIT MANAGEMENT (3 Credits)

LEVEL 300 (MATAHEKO & MIOTSO)

(MORNING, AFTERNOON, EVENING & WEEKEND)

December 2018

3 Hours

STUDENT ID No..

INSTRUCTIONS

SECTION A

Answer ALL questions from this section (Answers should be provided in the answer grid **on page 5** of the question paper)

SECTION B

Answer the COMPULSORY question in this section (Answer should be provided in the booklet)

SECTION C

Answer TWO questions from this section (Answers to be provided in the booklet)

DO NOT TURN OVER THIS PAGE UNTIL YOU HAVE BEEN TOLD TO DO SO BY THE INVIGILATOR

SECTION A (30 questions for 1 mark each) – Answer ALL questions

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) Which of the following is the most similar to an overdraft facility
   A) Line of credit
   B) Bankers acceptance
   C) Letter of credit
   D) Short-term loan

2) The following are factors that can affect the gross margin of a business EXCEPT
   A) Operating expenses
   B) Sales volume
   C) Cost of sales
   D) Pricing of products

3) Which of the following items will NOT be found in the Credit Policy of a typical bank?
   A) Loan pricing guidelines
   B) Ethnic origin of personal borrowers
   C) Desirable types of loans
   D) Collateral margin requirements

4) Which of the following statements is NOT CORRECT?
   A) A sole proprietorship cannot have more than one owner.
   B) A company must have at least two owners.
   C) Apart from partnership, the other two forms of business can have only one owner.
   D) A partnership must have more than one owner.

5) A "management succession" plan can tell you:
   A) How management plans to be successful
   B) How the company intends to replace key managers when necessary
   C) Who will inherit the investment in the company when the current owner dies
   D) Management's strategic plan for the company

6) If a company's inventory turnover increases from *55* days to *75* days, it means that the company is:
   A) Overall more liquid than before
   B) Moving its inventory more slowly
   C) Waiting longer to pay its suppliers
   D) Experiencing higher sales volumes

7) The Operating Margin is a ratio that shows a company's:
   A) Operating profit divided by gross profit
   B) Increase in operating profit from year to year
   C) Increase in net income from year to year
   D) Operating profit divided by sales

8) "Total Equity" on a company's balance sheet represents:
   A) The difference between what the business owns and how much it owes others
   B) The total capital contribution by the owners
   C) The amount the business could be sold for
   D) Money the company has available to cover expenses and debt payments

9) Which of the following does NOT measure the profitability of a company?
   A) Return on assets
   B) Net margin
   C) Current ratio
   D) Gross margin

10) If a company's Total Liabilities/Tangible Net Worth ratio has increased from 2.1x to 3.4x it indicates that the company is becoming:
   A) More liquid
   B) More leveraged
   C) Less leveraged
   D) Less liquid

11) Which of the following is NOT part of Michael Porter's framework for assessing the competitive forces in an industry?
   A) Bargaining power of labor unions
   B) Rivalry among current competitors
   C) Threat of new entrants into the industry
   D) Threat of substitute products

12) Assume a company wants to purchase a piece of equipment for $500,000. It will pay $100,000 in cash and borrow the rest. The bank's loan/value ratio would be:
   A) 130%
   B) 30%
   C) 80%
   D) 70%

13) Which of the following facilities is most likely to be used if a client wants to purchase equipment?
   A) Letter of credit
   B) Bridge loan
   C) Line of credit
   D) Term loan

14) A lender taking security for a loan should structure the loan so that it relates to the ________ _______ of the security.
   A) Liquidation value
   B) Book value
   C) Market value
   D) Insolvency value

15) A written, legally binding agreement that obligates the bank to lend a firm any amount up to a stated maximum, as long as the firm satisfies any restrictions in the agreement is called
   A) a short-term mortgage loan.
   B) a single, end-of-period-payment loan.
   C) a committed line of credit.
   D) a bridge loan.

16) Which of the following is NOT a symptom of overtrading?
   A) Increases in sales volumes
   B) Increases in cash and cash equivalent
   C) Increases in short term borrowing
   D) Increases in overheads

17) Which of the following is NOT part of the 5 Cs lending framework?
   A) Capacity
   B) Covenants
   C) Conditions
   D) Collateral

18) Assume a company's gross margin has improved from 16% to 20%. The change could be due to higher:
   A) Depreciation
   B) Labour costs
   C) Raw material costs
   D) Selling prices

19) Which of the following could cause a company accounts receivable turnover to slow down?
   A) More stringent collection efforts
   B) Some customers having financial difficulties
   C) More strict credit approval requirements
   D) Higher sales levels

20) A business that uses materials to produce a tangible product is called a:
   A) Manufacturer
   B) Retailer
   C) Service provider
   D) Wholesaler

21) "Capital expenditures" are amounts a business spends to:
   A) Raise additional equity
   B) Make investments in other companies
   C) Buy fixed assets
   D) Support the operations of the business

22) The financial statement that shows the actual cash inflows and outflows during the period is called the:
   A) Income statement
   B) Statement of finances
   C) Balance sheet
   D) Statement of cash flows

23) The cash conversion cycle (CCC) is defined as
   A) Inventory Days + Accounts Receivable Days + Accounts Payable Days.
   B) Inventory Days - Accounts Receivable Days - Accounts Payable Days.
   C) Inventory Days + Accounts Receivable Days - Accounts Payable Days.
   D) Inventory Days + Accounts Payable Days - Accounts Receivable Days.

24) Intangible assets are those that:
   A) Do not exist
   B) Cannot be seen or touched
   C) Cannot be sold
   D) Do not add value to the company

25) Which of the following is a common primary source of repayment for working capital loans?
   A) Liquidation of collateral
   B) Conversion of short-term assets into cash
   C) Sale of fixed assets
   D) Equity injection

26) Why is Risk an inherent part of any business? This is because
   A) the aim of every business is to make profit
   B) risk is insured by insurance company
   C) every business is directed towards the future which itself is unpredictable
   D) risk is the deviation from the actual expected result

27) One of the credit risks of offering a line of credit that is too large is that the company may:
   A) Not have enough money to meet its objectives
   B) Use the funds for unintended purposes
   C) Not use the entire facility
   D) Pay a higher rate of interest

28) Which characteristic given below is NOT a characteristic of an overdraft facility?
   A) It is provided by the bank up to a stated limit.
   B) It is granted by the bank for a given period of time.
   C) Interest is payable on the total amount of the facility.
   D) Interest is payable only on the overdrawn balance.

29) Which of the following assets is part of the "working capital" of a business?
   A) Inventory
   B) Real estate
   C) Retained earnings
   D) Fixed assets

30) Current assets on the balance sheet of a typical business are those that are:
   A) Borrowed temporarily from the business owner
   B) Listed as "cash" or "cash equivalents"
   C) Expected to be converted to cash within one year
   D) Expected to be collected or sold within 30 days

MULTIPLE CHOICE ANSWER GRID

1		11		21	
2		12		22	
3		13		23	
4		14		24	
5		15		25	
6		16		26	
7		17		27	
8		18		28	
9		19		29	
10		20		30	

SECTION B (30 marks) – Answer this COMPULSORY question

CASE STUDY

You have just finished meeting with David Kossi, Managing Director of Wuudmak Manufacturing Company. As a Business Development Officer for Lakeside Bank, you are responsible for loans to companies with sales of up to GH₵5 million. Although your bank does not do business with Wuudmak now, the company is on your prospect list and you have called on David twice in the last eighteen months. Today's meeting was at David's request, because he is considering moving his banking relationship. Apparently Lakeside and one other bank are in the best position to win the business.

Through your previous two visits with David, you have gathered a fair amount of information about the company. Wuudmak Manufacturing Company is a private business located in Pokuase, near Nsawam. It was founded twenty years ago by David's father Joseph Kossi, and the business is now owned by David and two other individuals, who purchased the company from the senior Mr. Kossi three years ago.

Wuudmak manufactures and sells decorative outdoor benches and bamboo canopies to primary and nursery schools, outdoor entertainment centres, and home improvement stores. Known for their stylish designs as well as functionality, Wuudmak's products are sold to retailers throughout the Greater Accra Region and Central Region. Recently, some of Wuudmak's competitors have started bringing in plastic equivalents of the company's products from China, which are cheaper but not as durable. The durability and solidity of Wuudmak's products is preferred by many of its customers but a number of others are going for the cheaper alternatives.

Wuudmak is organized as a limited liability company owned by David Kossi, Michael Fofie and Christian Kootin. David owns *50%* of the company's shares and serves as the CEO, while Michael owns *25%* of the shares and is the Executive Director in charge of operations. Christian, who owns the remaining *25%* of the company, does not participate in the day-to-day operations. In addition to David and Michael, there are two other managers - a Production Manager and a Marketing Manager - an Administrative/HR Officer, and ten full-time production workers.

David has given you financial statements for Wuudmak for the last three years. He has mentioned that sales were lower than expected in 2017, but that he expects the company to hit its sales targets this year. According to him, the company has increased its advertising since the beginning of the year and is currently negotiating with two medium-sized furniture retailers in Kumasi and Takoradi to carry their products in the Ashanti Region and Western Region.

Wuudmak currently does business with another bank headquartered in Accra. According to David, that relationship dates back to when his father started the company; however, David has been somewhat dissatisfied with the relationship and is asking your bank, Lakeside, and one other local bank to consider his current loan request.

At present, Wuudmak's banking relationship includes a GH₵175,000 overdraft limit with GH₵159,000 outstanding at year-end, and a GH₵32,000 term loan. The term loan, which was originally made in the amount of GH₵80,000, matures in two years, with payments of GH₵4,000 per quarter. The loan was made to facilitate the purchase of the business from the senior Mr. Kossi.

The only other debt on Wuudmak's balance sheet, other than routine trade payables, was originally a shareholders loan given to the company by the former owner a few years before he sold the business. This loan, which was originally for GH₵110,000 now has eight years remaining until maturity, and calls for semiannual payments of GH₵5,000 by the company to the former owner.

David is requesting facilities totaling GH₵267,000 to be used as follows, which would enable Wuudmak to move their business to your bank:

i. To refinance the outstandings under the overdraft with the company's present bankers. In addition, he would like to increase the overdraft limit to GH₵200,000.

ii. To refinance the existing GH₵32,000 term loan with the company's present bankers.

iii. A new loan of GH₵35,000 to upgrade several pieces of woodworking equipment.

Although you will need to send the request to the Head Office Credit Department to be processed and ultimately approved, you are expected to provide write a credit proposal with your recommendations.

The company's financial statements for the past three years submitted to the bank are presented below with a selection of ratios calculated with your bank's spreadsheet software. Note that all currency units are Ghana cedis.

Required:

Evaluate Wuudmak's credit request and prepare a concise credit write-up with your recommendations on the credit to the Head Office Credit Department for their review and onward transmission to the Credit Committee for their consideration. You should employ a suitable format for your write-up and address important and relevant areas including the following:

i. A summary of the details of the request and other relevant general information.

ii. A review of the qualitative risks you observe about Wuudmak Companyin relation to its request, focusing mainly on its management risk and market and industry risk.

iii. A review of the financial statements and the ratios, and comments on the trends in the financial performance and strength of Wuudmak Company on the basis of its sales and profitability, liquidity, management of working capital assets, and existing and projected debt levels.

iv. The overall track record of the company and any other relevant factors.

Wuudmak Manufacturing Company Ltd.
Income Statement for the Years Ended 12/31
Currency Units: GH₵

	2015	2016	2017
Revenues	1,085,020	1,113,150	1,074,980
Cost of Goods Sold	(770,010)	(790,070)	(775,120)
Gross Profit	315,010	323,080	299,860
Operating Expenses:			
Owner Salaries	(140,000)	(140,000)	(140,000)
General and Administrative Exp.	(119,450)	(121,100)	(121,840)
Depreciation Expense	(11,000)	(11,000)	(11,000)
Total Operating Expenses	(270,450)	(272,100)	(272,840)
Operating Profit	44,560	50,980	27,020
Other Expenses	(5,000)	0	0
Interest Expense	(9,478)	(10,020)	(10,060)
Profit Before Tax	30,082	40,960	16,960
Income Tax	(9,026)	(12,288)	(5,088)
Net Income	21,056	28,672	11,872

Income Statement Ratios:

Sales Growth	n/a	2.6%	(3.4)%
Gross Margin	29.0%	29.0%	27.9%
Operating Expenses	24.9%	24.4%	25.4%
Operating Margin	4.1%	4.6%	2.5%
Interest Coverage	4.17x	5.08x	2.69x
Net Margin	1.9%	2.6%	1.1%

Wuudmak Manufacturing Company Ltd.
Statement of Financial Condition as of 12/31
Currency Units: GH₵

	2004	2005	2006
Assets			
Cash	19,975	24,770	24,158
Accounts Receivable	107,025	115,250	121,210
Inventory	155,090	160,752	170,494
Prepaids	3,000	7,000	10,000
Total Short-term Assets	285,090	307,772	325,862
Net Fixed Assets	179,000	169,300	158,800
Total Assets	464,090	477,072	484,662
Liabilities			
Accounts Payable	53,090	53,950	55,200
Accruals	16,950	17,000	17,028
Short-term Bank Debt	129,000	138,400	158,840
Total Short-term Liabilities	199,040	209,350	231,068
Term Debt	64,000	48,000	32,000
Loan (Seller)	100,000	90,000	80,000
Total Liabilities	363,040	347,350	343,068
Equity			
Owners' Equity	75,000	75,000	75,000
Retained Earnings	26,050	54,722	66,594
Total Equity	101,050	129,722	141,594
Total Liabilities & Equity	464,090	477,072	484,662
Balance Sheet Ratios:			
Current Ratio	1.43x	1.47x	1.41x
Quick Ratio	0.65x	0.70x	0.67x
Accounts Receivable Turnover	36 days	38 days	41 days
Inventory Turnover	74 days	74 days	80 days
Payable Turnover	25 days	25 days	26 days
Total Liabilities/Tangible Net Worth	3.59x	2.68x	2.42x

SECTION C (40 marks) – Answer TWO questions from this section

Question 1.

a) Discuss four (4) strategies you would recommend to your bank in managing problem loans. **(8 Marks)**

b) In credit extension, Credit Reference Bureaus (CRBs) are expected to play significant roles in the overall process of managing loan quality.

i. Discuss two (2) functions of CRBs. **(6 Marks)**

ii. Explain two (2) criticisms levelled at CRBs **(6 Marks)**

Question 2

a) Discuss two reasons each for why land and life assurance policy are preferred securities in lending propositions.

(12 Marks)

b) Identify and explain four (4) issues paramount in developing Credit Policy for a bank.

(8 Marks)

Question 3.

a) From the general experience of bank lenders, what is the main feature that distinguishes small business credits from larger business credits? Discuss what challenge(s) this poses in evaluating small business credits.

(8 Marks)

b) Discuss three key areas that should be carefully examined in appraising small business credits. **(12 marks)**

Question 4.

a) Explain the purpose of loan monitoring, and why it is an important component of credit management in a lending institution?

(5 marks)

b) Explain how loan covenants are used in the loan monitoring process. Give examples.

(5 marks)

c) Discuss two (2) major information sources for loan monitoring, and three (3) early warning signs that could indicate deteriorating loan quality.

(10 marks)