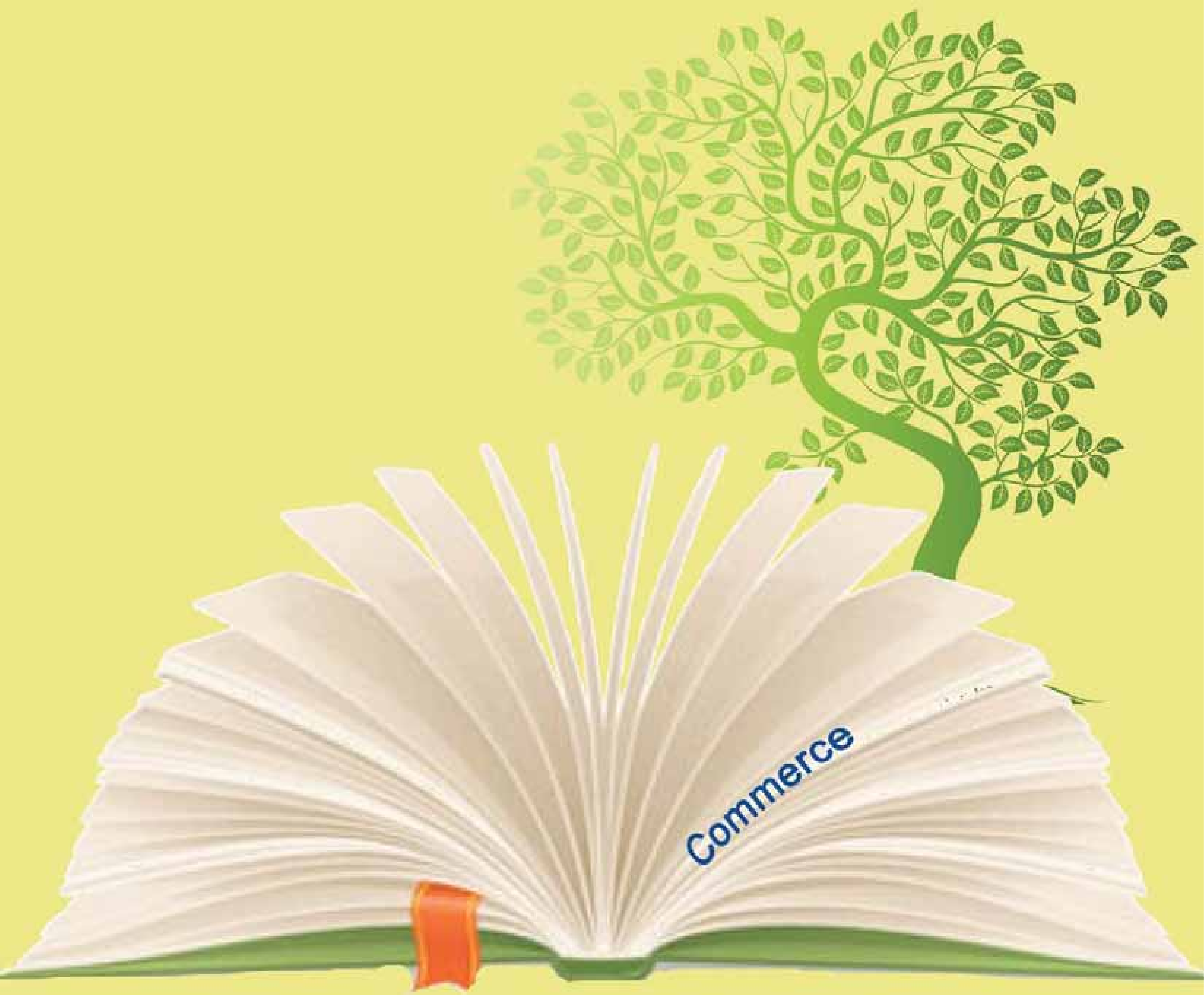

OPEN EDUCATIONAL RESOURCES 4 OPEN SCHOOLS

Taking Education to the People

Open Educational Resources (OER) for Open Schooling

The Commonwealth of Learning (COL) Open Schools Initiative launched an Open Educational Resources (OER) Project to provide materials under the Creative Commons license agreement to support independent study in 17 specially selected secondary school subjects. Funded by the William and Flora Hewlett Foundation its aim is to broaden access to secondary education through the development of high quality Open Distance Learning (ODL) or self-study materials.

These specially selected OER subjects include:

1. Commerce 11
2. Coordinated Science 10 (Biology, Chemistry and Physics)
3. English 12
4. English Second Language 10
5. Entrepreneurship 10
6. Food & Nutrition
7. Geography 10
8. Geography 12
9. Human Social Biology 12
10. Life Science 10
11. Life Skills
12. Mathematics 11
13. Mathematics 12
14. Physical Science 10
15. Physical Science 12
16. Principles of Business
17. Spanish

Open Educational Resources are free to use and increase accessibility to education. These materials are accessible for use in six countries: Botswana, India, Lesotho, Namibia, Seychelles and Trinidad & Tobago. Other interested parties are invited to use the materials, but some contextual adaptation might be needed to maximise their benefits in different countries.

The *OER for Open Schooling Teachers' Guide* has been developed to guide teachers/instructors on how to use the Open Educational Resources (OER) in five of these courses.

1. English
2. Entrepreneurship
3. Geography
4. Life Science
5. Physical Science

The aim of this teachers' guide is to help all teachers/instructors make best use of the OER materials. This guide is generic, but focuses on Namibian examples.

Print-based versions are available on CD-ROM and can be downloaded from www.col.org/CourseMaterials. The CD-ROM contains the module and folders with additional resources, multimedia resources and/or teacher resources. Note that not all subjects have multimedia resources.

Acknowledgements:

The William and Flora Hewlett Foundation
Namibian College of Open Learning (NAMCOL): www.namcol.com.na
National Institute of Educational Development (NIED): www.nied.edu.na
Ministry of Education of the Republic of Namibian (MoE): www.moe.gov.na
Ministry of Education, Seychelles: www.education.gov.sc
Ministry of Education and Training, Lesotho: www.gov.ls/education
Ministry of Education Trinidad& Tobago: www.moe.gov.tt
National Open School of Trinidad & Tobago (NOSTT): www.moe.gov.tt/NOSTT
Ministry of Education and Skills Development, Botswana: www.moe.gov.bw
Botswana College of Distance and Open Learning (BOCODOL): www.bocodol.ac.bw
Ministry of Education Zambia: www.moe.gov.zm

Commonwealth of Learning, 2012

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The Commonwealth of Learning (COL) is an intergovernmental organisation created by Commonwealth Heads of Government to encourage the development and sharing of open learning and distance education knowledge, resources and technologies.

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Acknowledgements

The Col Open Schools Initiative wishes to thank those below for their contribution to the Grade 11 Commerce 11 course material.

Enid Habweza	Content Developer
Nkomeshya Jane Bweendo	Content Developer
Chanda Pascal	Content Developer
Chibinga Benstern	Content Developer
Gertrude Mutesha	Content Developer
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Wendy Nyangu	Principal Education Officer, Distance Learning.
Ministry of Education	Administrative and auxiliary support

Contents

About the Course

Grade 11 Commerce has been produced by COL Open Schools Initiative. All Course materials produced by COL Open Schools Initiative are structured in the same way, as outlined below.

How the Course Material is Structured

Course Overview

The course overview gives you a general introduction to the course. Information contained in the course overview will help you determine:

- If the course is suitable for you.
- What you will already need to know.
- What you can expect from the course.
- How much time you will need to invest to complete the course.

The overview also provides guidance on:

- Study skills.
- Where to get help.
- Course assignments and assessments.
- Activity icons.
- Units.

We strongly recommend that you read the overview *carefully* before starting your study.

The Course Content

The course is broken down into units. Each unit comprises:

- An introduction to the unit content.
- Unit outcomes.

- New terminology.
- Core content of the unit with a variety of learning activities.
- A unit summary.
- Assignments and/or assessments, as applicable.

Resources

For those interested in learning more on this subject, we provide you with a list of additional resources at the end of the course; these may be books, articles or websites.

Your Comments

After completing Grade 11 Commerce, we would appreciate it if you would take a few moments to give us your feedback on any aspect of this course. Your feedback might include comments on:

- Course content and structure.
- Course reading materials and resources.
- Course assignments.
- Course assessments.
- Course duration.
- Course support (assigned tutors, technical help, etc.)

Your constructive feedback will help us to improve and enhance this course.

Course Overview

Welcome to Grade 11 Commerce

Grade 11 Commerce is a high school programme designed for both young and adult learners wishing to further their education in business studies. You have made a wise decision to start this course. Whether you wish to further your studies or start your own business, we are confident that you will find this course material helpful.

This course is designed to equip you with knowledge and understanding of the environment within which commercial activities take place. It will also equip you with background knowledge, skills, attitudes and values that you need to proceed to higher levels of education in business. The need for this course arises from the popularity of business in today's world. This course aims at preparing you for employment when you leave school by providing you with the skills that will make it possible for you to join the world of business with some basic knowledge of what is expected. The business principles and practices in foreign trade, business units, stock exchange and banking will give you the competence to plan and organize your own businesses. It will also help you to understand the broad environment of commerce locally and internationally.

The content of this course material is vital for those who intend to sit for the General Certificate and School Certificate Examinations. When preparing the content for this course, every effort was made to ensure that the content was systematically arranged and the language simplified to make it easy for you to clearly understand the content.

This course is divided into nine units.

Unit 1 leads off with a definition of foreign trade, followed by a discussion on the reasons for foreign trade, problems, documents used and middlemen in foreign trade.

Unit 2 describes the roles of the Revenue, Customs and Port Authorities, Trading Blocks, Free Trade, Free Ports, Bonded Warehouses, means of payments and the balances of trade and payment. All of these institutions and activities fall under foreign trade.

Unit 3 examines how businesses in the private sector function and how they are organized.

Unit 4 explores businesses in the public sector, specifically how they function and are organized.

Unit 5 looks at the general background of the stock exchange, definition of terms, purposes and functions of the stock exchange and types of shares.

Unit 6 discusses the Lusaka stock exchange, its objectives and purposes including benefits and risks of being a shareholder. It also looks at the regulation of the stock market.

Unit 7, 8 and 9 explain various financial institutions (Commercial banks, Central bank, Building societies, Insurance companies etc.) and their functions. It also looks at bank accounts, means of payments, trends in banking and the rights of the customer in banking.

All of the nine units in Grade 11Commerce are as important as those you covered in Grade 10 as well as those you who will study commerce in Grade 12. All of these topics will help you prepare you for the General Certificate of Education examinations you will do in Grade 12. Therefore each and every activity in this course counts.

We trust that you will enjoy Grade 11 Commerce!

Grade 11 Commerce—is this Course for You?

This course is intended for open and distance learners who wish to acquire knowledge and understanding of the broad commercial environment as represented by activities like foreign trade, business units, the stock exchange, operations of the stock exchange, regulation of the stock market and banking activities.

This course is for you if you are a holder of a grade nine certificate and have successfully completed Grade 10. The knowledge acquired will enable you to proceed to Grade 12 after which you will be able to proceed to institutions of higher learning to train as an entrepreneur, stock broker, banker, or a manager of business enterprise to mention a few.

The knowledge and skills acquired in the course will enable you to start your own business in the private sector or become a part-owner of businesses by buying shares at the stock exchange. The knowledge of foreign trade will empower you with the necessary skills to become an importer or exporter. The course will also provide you with adequate knowledge of banking services which are an essential part of business.

Remember, the business principles and practices in foreign trade, business units, stock exchange and banking will give you the skills to plan and organize your own businesses, while also helping you to understand the broad environment of commerce locally and internationally.

Course Outcomes

Outcomes

General aims:

The Grade 11 Commerce syllabus aims to develop knowledge and understanding of:

- The environment within which commercial activities take place.
- Aims and activities of business and non-trading concerns.
- The purposes and functions of important commercial activities.
- Language concepts and procedures in commercial activities.
- Skills of numeracy, literacy, communication, enquiry, presentation and interpretation.
- The significance of innovation and change within the context of commercial activities.

General outcomes:

Upon completion of Grade 11 Commerce you will be able to:

- *Use* the acquired knowledge or skills to pursue a career in business studies.
- *Interpret* business documents.
- *Display* an understanding of commercial activities in everyday life, taking into account gender issues by applying the principles taught in business activities.
- *Distinguish* between evidence and opinion so as to make a reasonable judgment.

Timeframe

How long?

As an open and distance learner, you are free to enrol at any time and complete the course at your own pace, but we expect that you complete the course in a time frame of 45 weeks or 225 hours.

This gives you approximately 20 hours per unit which includes time for reading, doing in-text activities and topic exercises. For the assessments (which comprise self and tutor-marked assignments), you will need between 2 and 3 hours per unit. The number of hours per unit may vary from individual to individual. You might spend less time on shorter units and more time on the longer units. Similarly, you may spend less time on self-marked assignments and more on tutor-marked assignments. You may require about 3 hours for tutor-marked assignments and 2 hours on self-marked assignments.

For every unit, you need about 2 hours for tutorials.

You are expected to spend a minimum of 5 hours of self-study time per week.

Study Skills

As an adult learner your approach to learning will be different from that of your school days. You will choose what you want to study, you will have professional and/or personal motivation for doing so and you will most likely be fitting your study activities around other professional or domestic responsibilities.

Essentially you will be taking control of your learning environment. As a consequence, you will need to consider performance issues related to time management, goal setting, stress management, etc. Perhaps you will also need to reacquaint yourself in areas such as essay planning, coping with exams and using the web as a learning resource.

Your most significant considerations will be *time* and *space* i.e. the time you dedicate to your learning and the environment in which you engage in that learning.

We recommend that you take time now—before starting your self-study—to familiarize yourself with these issues. There are a number of excellent resources on the web. A few suggested links are:

- http://www.how-to-study.com/

  This "how to study" website is dedicated to study skills resources. You will find links to study preparation (a list of nine essentials for a good study place), taking notes, strategies for reading text books, using reference sources, test anxiety.

- http://www.ucc.vt.edu/stdysk/stdyhlp.html

  This is the web site of Virginia Tech Division of Student Affairs. You will find links to time scheduling (including a "where does time go?" link), a study skill checklist, basic concentration techniques, control of the study environment, note taking, how to read essays for analysis and memory skills ("remembering").

- http://www.howtostudy.org/resources.php

  Another "how to study" web site with useful links to time management, efficient reading, questioning/listening/observing skills, getting the most out of doing ("hands-on" learning), memory building, tips for staying motivated and developing a learning plan.

The above links are our suggestions to start you on your way. At the time of writing these web links were active. If you want to look for more go to www.google.com and type "self-study basics", "self-study tips", "self-study skills" or similar.

Need Help?

Help

In case you need help, you can get in touch with the tutors in the Commerce Team, Zambia College of Distance Education, Plot No. 41, Independence Avenue, Private Bag 20, Luanshya. Telephone No. +260 212 510271 e-mail zacodeducation@yahoo.com between 08:00 and 17:00hrs.

For inquiries, you can get in touch with the learner support committee, secretary or registry staff at the above stated location, using the above stated contact details.

The Zambia College of Education is still in the process of reorganising itself as such, at the moment there is no:

- Librarian or research assistant.
- Technician at the moment whom learners can contact for technical issues.
- Learners' resource centre
- Website address; but this issue is being addressed.

Nevertheless, the learner support committee will attend to most of your problems. We offer:

- Tutorial support
- Book lending at study centers
- Guidance and counselling (academic and personal)

Some helpful websites for Grade 11 Commerce are:

http://www.businessdictionary.com/

http://www.zambiachambers.org/

http://www.mcti.gov.zm/

Assignments

Assignments

Aside from the in-text questions and activities with immediate feedback, all units have assignments at the end with instant feedback. You will need to mark your own assignments using the feedback given.

Assignments should be answered in the order in which they are presented. Make sure you do each Assignment after reading through the respective topic. Avoid the temptation to look at the feedback before attempting the questions.

Assessments

Assessments

Assessments will be in form of self and tutor-marked assignments. There will be 9 assessments; five will be self-marked and four will be tutor marked.

In a unit where there is no tutor-marked assignment, a self-marked assignment will be given. These assignments are found in the Assessment Section of the unit. Assessments will be found in the following units:

Self-Marked Assignments

Self-Marked Assignment 1 is based on Unit 1
Self-Marked Assignment 2 is based on Unit 3
Self-Marked Assignment 3 is based on Unit 5
Self-Marked Assignment 4 is based on Unit 7
Self-Marked Assignment 5 is based on Unit 8

Note that for all self-marked assignments you will mark your work. You do **not** need to send them to the college for marking.

Tutor-Marked Assignments

Tutor-Marked Assignment 1 is based on work discussed in Unit 1 – 2
Tutor-Marked Assignment 2 is based on work discussed in Unit 3 – 4
Tutor-Marked Assignment 3 is based on work discussed in Unit 5 – 6
Tutor-Marked Assignment 4 is based on work discussed in Unit 7 – 9

Note that tutor-marked assignments will be given at the end of every 2 units except for assignment 4 which covers 3 units.

You will be required to send tutor-marked assignments to tutors at the college for marking.

It will take between 2 to 3 weeks for a teacher to mark the assignments.

It will take you about 2 hours to complete self-marked assignments and about 3 hours to complete tutor-marked assignments.

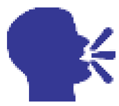
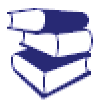
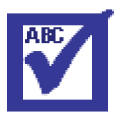
There is a final assignment that covers the entire course. It will be written at the study centre under the supervision of a tutor. It will be marked by your tutor at the College.

Getting Around the Course

Margin icons

While working through the course material, you will notice the frequent use of margin icons. These icons serve to “signpost” a particular piece of text, a new task or change in activity. Margin icons have been included to help you to find your way around the course.

A complete icon set is shown below. We suggest that you familiarize yourself with the icons and their meaning before starting your study.

 Activity	 Assessment	 Assignment	 Case study
 Discussion	 Group activity	 Help	 Note it!
 Outcomes	 Reading	 Reflection	 Study skills
 Summary	 Terminology	 Time	 Tip
 Objectives	 Feedback	 Answers to Assessments	 Basic Competence

Unit 1

Foreign Trade

Introduction

COURSE MATERIAL

Welcome Grade 11 Commerce! We trust that you will enjoy studying this course. As you have read from the course overview, this course has nine units and you are now in the process of going through the first of these units. Congratulations on making the decision to study this course!

In this unit we are going to discuss foreign trade. Foreign trade is one of the many interesting topics in commerce as it deals with several aspects of the broad environment of commerce internationally. Foreign trade is not a totally new topic because it is directly related to what we already know. In Grade 10 Commerce, you learned a lot about home trade. Home trade is closely related to foreign trade in that both topics deal with the core commercial activities: 'Trade and Aids to Trade'. Commercial activities play a vital role in providing consumers all over the world with the goods and services they need.

Foreign trade is the buying and selling of goods and services between two or more countries. Foreign trade is the backbone of every country's economy. For many countries, foreign trade is considered a 'major source of economic revenue'. Although it has been in existence for many centuries, today its importance has increased both economically and socially. With the development of transportation and the growth of electronic commerce (e-commerce), foreign trade has become more vibrant and interesting.

In this unit, we shall define foreign trade. We shall also examine the many reasons why countries trade with each other and the problems which traders in foreign trade experience as they go about their business. We shall move on to identify the middlemen in foreign trade and explain their various roles/functions in foreign trade. Finally, we shall explain the commercial documents used in foreign trade.

The unit is divided into three topics. In the first topic we shall define foreign trade and examine its importance to a country's economy while also exploring the possible challenges related to foreign trade. Topic 2 shall examine problems experienced by traders in foreign trade. We shall also discuss middlemen in foreign trade. In Topic 3, we shall examine relevant commercial documents used in foreign trade.

The core content of the unit has a variety of activities. You are encouraged to answer all the questions in the topic activities and to check your work against the answers given in the feedback only after completing the activities. This will help you to assess your progress and understanding of the different sections while working through the unit. It will also enable you to take corrective action where necessary.

You will be required to do the three end-of topic exercises for the three topics in this unit. You will find the exercises in the assignment section of this unit. There is also a self-marked assignment which you will find in the Assessment Section at the end of the unit. There is no tutor- marked assignment for Unit 1. It is only at the end of Unit 2 that you will be required to complete a tutor -marked assignment based on the first two units. You will be required to send this tutor-marked assignment to your tutor at the college for marking.

We hope you will find this unit exciting and beneficial.

By now you may have realized from the general outcomes listed in the course overview that these outcomes relate to all aspects of the Grade 11 Commerce. To provide more guidance on what you are expected to achieve in each unit, these general outcomes have been broken into specific outcomes.

Let us start by looking at the specific outcomes of this Unit.

Upon completion of this unit you will be able to:

Outcomes

- *Define* foreign trade
- *State* the reasons for foreign trade
- *Discuss* the advantages and disadvantages of foreign trade
- *Explain* the problems experienced in foreign trade
- *Identify* types of middlemen
- *Explain* the functions of middlemen
- *Explain* the documents used in foreign trade
- *Use* the documents.

Resources

Tips

These materials are self-instructional materials, but you can use the given resources to improve your understanding of the content in this unit.

- Computers, internet and mobile phones (where possible) to research the content under discussion and to communicate with tutors, other learners and the College
- To visit libraries to research the benefits and challenges of foreign trade and documents used (where possible).
- Attend Tutorials at study centres (for 2 hours).
- Visit any or all the following institutions: airports, customs and excise offices, forwarding agents and transport firms in your area.

Learning and Teaching Approaches

Tips

The following learning and teaching approaches will be used:

- **Content based approach** has been used to present the core content of the course. It is linked to the other two approaches mentioned below because it is the springboard for doing activities and solving problems. It encourages you to base your learning on the subject matter provided, read and follow instructions and improve your knowledge, skills and competencies on foreign trade. All this is intended to help you learn effectively.
- **Problem based approach** aims to make you responsible for your own learning in order to promote higher level learning skills like critical thinking on foreign trade. Your study units are like a teacher in print form in that they facilitate your learning and assist you when solving problems rather than merely providing you with the solutions.
- **Activity based approach** which should enable you to physically interact with the content and people in order to acquire foreign trade related skills and general learning skills by being actively involved in the discussions and activities within the unit.

Time

You will need between 20 – 25 hours to study this unit. Do not worry if it takes you more or less time than this – we do not all work at the same pace. You will need about 16 hours to study each topic. This includes 6 hours for reading and doing the in-text activities and end-of-topic exercises and two hours for doing the self-marked assignment.

Terminology

Benefits:	Advantages of something.
Challenges:	Any issue or factor that hinders someone/something's progress.
Comparative advantage:	The advantage a country has to produce particular goods efficiently and at reduced costs in relation to another country.
Competition:	A manufacturer or trader's effort to try and win another's business by offering better conditions.

Consumer:	The final user of goods.
Currency:	The kind of money a country uses.
E-Commerce:	The buying and selling of goods and services online or internet.
Endorsed:	Signed at the back to transfer ownership.
Export:	Goods and services sold to other countries.
Foreign Exchange:	Foreign money used by a country to carry out foreign trade.
Foreign Exchange Rates:	The value of a country's currency compared to another country's currency.
Gemstone:	A valuable and durable mineral.
Imports:	Goods and services bought from another country.
Skilled labour:	Workers who are trained in the work they do.
Technology:	Use of machinery and equipment to produce goods.
Trade:	Exchange of goods and services for a profit.

Topic 1: Reasons for Foreign Trade

Introduction

Welcome to Unit 1, Topic 1 on reasons for foreign trade. You may recall from your Grade 10 work that **trade** is the buying and selling of goods and services with the goal of making profit. Different people have different opinions about trade. Your understanding of trade may be restricted to the buying and selling of goods and services within a country because home trade is what we studied in Grade 10. In this topic, we are going to discover interesting ways which indicate that trading could extend beyond national boundaries.

Before we do that, we need to understand why we are suggesting that trade extends beyond boundaries or borders, and also to investigate the benefits which might arise in the process. Therefore, in this topic we shall define foreign trade and look at the reasons and benefits for foreign trade. The topic will address three of the unit outcomes listed in the Unit Objectives Section above.

Upon completion of this topic you should be able to;

- *Define* foreign trade.
- *State* the reasons for foreign trade.
- *Discuss* the advantages of foreign trade.

Outcomes

You should spend at least 6.5 hours on this topic.

Time

What is Foreign Trade?

Think of the goods and services you buy in your daily life. Are they all produced locally? The answer is certainly no. Next time you visit a shop, look at the tags and labels on the items to see which countries the goods came from. You will discover that about fifty percent of the goods and services you buy come from other countries. Someone had to buy them from that country so that you could buy them from your local shop. Your country also sells goods and services to other countries. Countries these days depend on each other for the provision of goods and services to satisfy the needs and wants of their citizens. They are involved in foreign trade.

You will recall that in the introduction to this unit, we defined foreign trade as the buying and selling of goods and services between two or more countries. It may simply be defined as 'business across international boundaries'. For this reason, foreign trade is sometimes called international trade.

You are now aware that buying and selling is an essential part of foreign trade. The buying of goods in foreign trade is called **importing,** while the selling of goods and services to other countries is called **exporting**. People who buy goods from other countries are **importers** and those who sell are called **exporters**. Goods and services made in one country and bought by another are called **imports** and those produced in one country and sold to another are called **exports**. Do you know any goods or services that your country imports or exports? Answers may vary from country to country. For Zambia, imports in the form of goods include: motor vehicles, machinery, fruits, clothing and many more other goods. Imported services include: manpower in form of doctors, engineers, teachers and many more. Zambia imports goods and services from many countries worldwide. Zambia's exports in the form of goods include: copper, gemstones, agricultural products and many more. Her exports in the form of services on the other hand include tourism which is when people from different countries come to see Zambia's beauty in the form of natural wonders, wildlife etc. Victoria Falls is one of the natural wonders that Zambia has. Figure 1 below shows Victoria Falls and some tourists viewing Victoria Falls.

Figure 1: Victoria Falls and some tourists (Photo taken by Nkomeshya J B. 2010).

Manpower is also another of Zambia's service exports. This is in form of teachers, doctors, nurses and a lot of other professionals who go to work in other countries.

Before you proceed, do the following activity. It should take you 5 minutes to complete.

Activity 1

1. Foreign trade may be bilateral or multilateral. What do you understand about the terms bilateral and multilateral trade? Write your ideas in the space provided below.

Feedback

Check if your ideas are similar to the ones provided below.

Bilateral trade is where your country and another country are involved in trade. This means that they buy and sell to each other. For example, if Zambia buys goods and services from Congo DR and Congo DR sells to Zambia only, the two countries are involved in bilateral trade. If your country trades with more than two countries then it is involved in multilateral trade. For example, Zambia buys goods and services from China, India and Congo DR and these countries sell goods and services to Zambia and other countries. They are therefore involved in multilateral trade.

Note it!

You should always remember that:

Foreign trade does not only take place between two governments or nations, it takes place even between two individuals or organisations found in two different countries.

Let us also note that a country may not only export and import goods, but services as well as capital items.

Reflection

You may have observed that foreign trade involves the buying and selling of goods and services just like home trade. Remember that wherever buying and selling takes place, the motive is profit making. However, foreign trade differs in many ways from home trade. Before you proceed:

Consider what you learnt about home trade in Grade 10. Compare it with foreign trade

How does it differ from foreign trade?

As you thought over the questions in the above reflection activity, you may have thought of many differences. Some of the differences are given in Table 1 below. Check if they match with the differences you gave.

Foreign Trade: How it differs from Home Trade

Table 1 below shows the differences between foreign trade and home trade.

	HOME TRADE	FOREIGN TRADE
Buying and Selling of goods and services	○ Done within the country	○ Done between two or more countries
People involved in the buying and selling	○ Wholesalers and retailers	○ Importers and exporters
Language of communication	○ Uses same official language to communicate	○ Uses different official languages to communicate
Customs duties	○ No customs duties	○ Customs duties imposed on imports
Currency	○ Same currency used	○ Different currencies used
Units of measurements and weights	○ Same units of measurements and weights	○ Different units of measurements and weights
Documentation	○ Short and fewer	○ Long and complicated

Table 1: A summary of the differences between home trade and foreign trade. Created by Commerce Team, ZACODE, 2010.

You now know the meaning of foreign trade and how it differs from home trade. We shall now examine the reasons for foreign trade.

Reasons for Foreign Trade

Zambia like any other country is involved in foreign trade with other countries including her neighbours. Countries trade with each other for various reasons.

Before you read on, look at the map in Figure 2 below which shows the flow of goods into and out of Zambia. The box in the map of Zambia shows goods. The blue arrows show the flow of goods into Zambia from neighbouring countries, while the yellow arrows represent the flow of goods out of Zambia .We shall re-use the map in Topic 2 on problems of foreign trade.

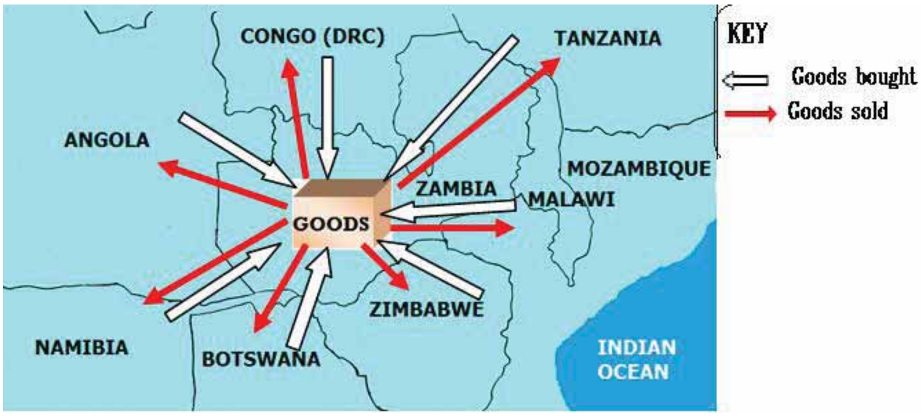
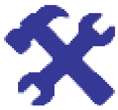


Figure 2: Flow of goods in and out of Zambia. Hand drawn by Commerce Team, ZACODE, 2010.

Before you go on reading, do the following activity.



Activity 2

Why do you think Zambia trades with her neighbouring countries? Write your ideas in the space below.

Feedback

Your wording may be different, but check whether your ideas are similar to those included in our discussion below. You may also not have included all the different aspects discussed below. It is important that you revise your notes after reading the discussion below and include any points you may have omitted. If you wrote them all in your first attempt, congratulations!

Zambia trades with neighbouring countries because:

- **It cannot produce all the goods and services required by its citizens.**

  There is no country in the world that is self-reliant. It is often said that 'no man is an island.' All countries in the world depend on each other for the provision of goods and services due to a number of factors. This could be because no two countries are the same in terms of availability of natural resources, climate, labour, equipment or machinery.

- **It may not have certain raw materials because different countries have different natural resources.**

  Different countries are gifted with different natural resources. Do you know the natural resources your country has in abundance? Zambia for example has copper in abundance, but lacks oil. So it becomes inevitable that Zambia imports oil from countries like Iraq, Saudi Arabia and Kuwait.

- **Its climate may not favour the growth of particular crops.**

  Climates also differ considerably from region to region. While one region may have climatic conditions that favour the growth of a certain crop, another region may lack such climatic conditions. For example, climatic conditions in Zambia favour maize production and not cocoa production. Again it becomes necessary that Zambia imports cocoa from countries like Ghana, Nigeria and Ecuador.

- **Some countries lack skilled labour, equipment and machinery.**

  While some countries may be favoured in terms of natural resources and climate, they may not have skilled manpower, advanced equipment or machinery to exploit these raw materials. The implication here is that a country that is unable to exploit its natural resources will remain underdeveloped and depend on other countries for the provision of goods and services.

- **Some goods may be produced cheaply in other countries.**

  A country with the necessary raw materials, skilled manpower, equipment and machinery could produce more of a particular product efficiently and cheaply. Another country may find it more expensive to produce the same product because it lacks the resources. Assuming that Country A is able to produce goods cheaply and Country B finds it expensive, Country B will have no alternative but to import cheaper goods from Country A.

- **It is a source of revenue for the government.**

  The other reason which we mentioned earlier in our introduction to this unit is that foreign trade provides many countries with a 'major source of economic revenue'. The revenue raised is used to improve infrastructure like schools, hospitals etc. and to pay for imports.

- **To meet the different preferences of consumers.**

  Again, consumers in a given country may prefer to use goods made in another country because they think if they use these goods their quality of life will improve. What do you think of this? As a consumer, given an opportunity to choose between locally produced shoes and similar shoes produced in United Kingdom, which ones would you buy? There is a high possibility that you would opt for U.K. made shoes probably because you think shoes made elsewhere other than your country are of high quality. Consumer preferences are therefore another reason for foreign trade.

- **To get rid of surplus goods so as to avoid wastage.**

  Other than the reasons mentioned above, countries may trade with each other to get rid of surplus goods produced through specialisation in order to avoid wastage. Specialisation is not a new concept; we covered it in Grade 10. Remember that specialisation leads to large quantities of goods being produced and these goods need a large market. Foreign trade provides that market.

Reasons for foreign trade are many and varied as you may have seen above. When a country trades with another, it also enjoys several benefits or advantages. You should be familiar with some of the advantages. We suggest the following advantages and hope they will be in line with what you have in mind.

Advantages of Foreign Trade

- Foreign trade promotes friendship between countries, making it easy for countries to exchange knowledge and skills.

- Foreign trade provides a wide variety of goods and improves your standard of living.

- Many employment opportunities arise from the increasing levels of production.

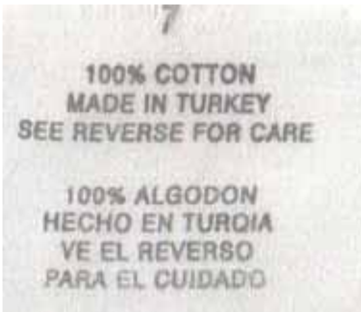
- Foreign competition forces local industries to improve quality of their goods and services for the benefit of the consumer.

Now that you know why countries trade with each other and the advantages of foreign trade, do the following activity. The first question in this activity requires you to analyse the price tag and answer the questions below. Question 2 requires you to state whether the given statements are true or false. Ultimately, the activity is intended to assess your understanding of topic 1. After completing the activity, mark your own work by comparing your answers with those provided in the feedback soon after the activity. Avoid the temptation to check the answers before completing the activity

Activity 3

Write the answers to this activity on a separate sheet of paper.

1. Examine the cloth tag below and answer the questions that follow:



a) In which country was the item made?
b) How did the item get into your country?
c) What is foreign trade?
d) List at least two services which Zambia exports to other countries and four goods which Zambia imports from other countries.

2. Why do countries trade with each other?

If you are working alone, write down the reasons why countries trade with each other and compare your answers with the feedback below.

If you are working in a group, write down the reasons for foreign trade and then discuss them with your group.

Discussion

As mentioned above, consumers often have a preference for products made in other countries. If you have access to the internet, please go to: http://www.conservationzambia.org/actlocal/buylocal.htm

If you are working in a group, discuss why you think people prefer to buy exports from other countries rather than locally made products. What are the benefits of buying local products?

Feedback

Now compare your answers with the ones below.

1. (a) *Turkey*
   (b) *Through foreign trade/someone bought/imported it from Turkey.*
   (c) *Foreign trade is trade between or among countries.*
   (d) *Exported services are tourism and manpower.*
   Imported goods are motor vehicles, machinery, fruits and clothes.

2. *Why do countries trade with each other?*
   Countries trade with each other because;
   - *No country can produce all the goods and services required by its citizens.*
   - *Different countries have different natural resources.*
   - *Some climates may not favour the growth of particular crops.*
   - *Some countries lack skilled labour, equipment and machinery.*
   - *Some goods may be produced cheaply in other countries.*
   - *It is a source of revenue for the government.*
   - *To meet the different preferences of consumers.*
   - *To get rid of surplus goods so as to avoid wastage.*

Congratulations if after comparing your answers with our answers in the feedback above you got all the answers correct! You are now ready to move on to the next topic after reading the topic summary and successfully completing the Topic 1 Exercise. If you did not get them all correct, then we suggest you go through the activity again. You may be required to read through the topic again in order to gain more understanding

Topic 1: Summary

We have now come to the end of the first topic of this unit where we defined foreign trade as trade between two or more countries. We looked at the reasons why countries trade with each other. We observed that the differences in natural resources, climates, labour, equipment and machinery make it difficult for any given country to be self-reliant. We discussed advantages of foreign trade. We noticed that foreign trade:

- promotes friendship
- creates employment
- provides a wide variety of goods and
- encourages world competition which improves the quality of local goods.

We hope you found the discussion in this unit very helpful and are now able to define foreign trade, state reasons for foreign trade and discuss its advantages.

You had a chance to check your understanding through the activities given in this topic. We hope you did all the three activities correctly.

Before you move on to the next topic, find out how much you remember from the content you have just covered by completing the activities without referring to the text.

You can now check your understanding of the topic by doing End-of - Topic Exercise 1 in the assignment section of this unit. We recommend that you complete the exercise before reading our feedback. This will give you an accurate assessment of your understanding of what you learned from the topic. If you discover that some of your answers are incorrect when reviewing the feedback, revise the relevant sections of the topic before moving on to the next topic.

In the next topic we shall look at the problems faced by traders in foreign trade. We will also look at middlemen in foreign trade and their functions.

Topic 2: Problems Experienced in Foreign Trade

Introduction

In Topic 1 we defined foreign trade. We saw that foreign trade involves buying and selling of goods between two or more countries. We also took time to look at the reasons for foreign trade and the benefits of foreign trade to countries. We discovered that all countries in the world depend on each other for the provision of goods and services and that no country is self-reliant due to differences in climates, natural resources, labour, equipment and machinery. In this topic we will look at the problems traders involved in foreign trade experience and other challenges or disadvantages of foreign trade. We shall also explore the services of middlemen in foreign trade.

Upon completion of this topic, you should be able to:

Outcomes

- *Identify* and explain the problems experienced in foreign trade.
- *Discuss* the disadvantages of foreign trade.
- *Identify* middlemen in foreign trade and explain their functions.

Time

You should spend at least 6.5 hours on this topic.

In your study of Topic 1, you may have observed that foreign trade has a lot of benefits. The problems are equally abundant. You may be aware of the problems of traders in foreign trade.

Now do the following activity to assess how much you already know about problems experienced in foreign trade and where to get assistance.

Activity 4

1. In your own opinion, what are some of the problems you would face as an exporter or importer?

2. As a trader in foreign trade, where would you get help?

If you work alone, write your ideas in the space below:

If you work as a group, identify and discuss the problems as a group. Then write down ideas from your discussion in the space below:

Feedback

1. Your ideas may have included problems of distance, differences in units of measurements and weights, documentation, payments, trade restrictions and problems in accessing information on foreign markets.

2. You may have identified the following sources of help:

- *Middlemen*
- *Commercial banks*
- *Chambers of commerce*
- *Ministry of commerce and industry*
- *Trade Missions Abroad and*
- *Export Credit Guarantee Department*

Please note that in this unit we shall only discuss middlemen. You will learn more on other sources of help in your future studies in business.

In the next section, we will examine these problems in detail. After reading the discussion below, you may want to improve on what you wrote in Activity 4 above.

Problems

1. Problems of Distance

We saw in Topic 1 that foreign trade is trade between two or more countries. Some of these countries may be miles away from each other, while others may be in the neighbourhood as we saw in the diagram in Figure 2 of Topic 1.

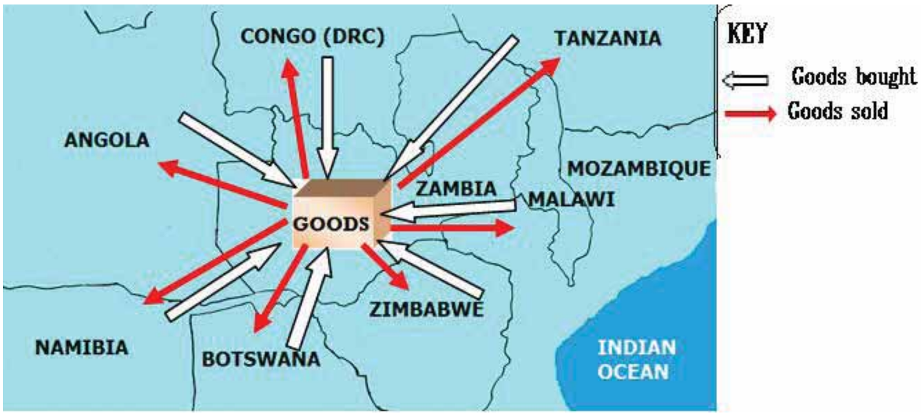


Figure 2 Flow of goods in and out of Zambia. Commerce Team, ZACODE, 2010.

Now do the following activity. You are expected to do this activity with a member of your family or a friend.

Activity 5

1. Examine the above diagram and come up with reasons why Zambia would find it easier to move goods to Zimbabwe. Why would Zambia find it difficult to move goods to India?

2. As you identify the reasons, write them down and then discuss them with members of your group before reading the feedback below. If you are working alone, write them down and then compare them with the feedback below.

Feedback

Your ideas may include the ones given below.
Do not worry if some of your answers have not been included. As long as they are related to distance and transport costs, they are right.

Why it is easy to move goods from Zambia to Zimbabwe:

- *short distances involved*
- *low cost of transport*
- *may use one type of transport*

Why it is difficult to move goods from Zambia to India:

- *long distances involved*
- *high cost of transportation*
- *use of more than one mode of transport*
- *no direct access to ports*

You may be aware that the cost of transport depends on distance. Moving goods in foreign trade may prove to be costly and time consuming as the exporter and importer are usually miles away from each other.

The problem is worse for landlocked countries like Zambia. As you may know, Zambia faces a serious problem of long distances to international ports like Dar-es-salaam in Tanzania, Beira in Mozambique and Port Elizabeth in South Africa. As the goods are being moved to these ports, there is a high possibility that the goods will be transferred from one mode of transport to another, raising the transport costs even further. For example, if you are transporting goods from Lusaka, Zambia to Mumbai, India via Port Elizabeth in South Africa, you will first have to send the goods to Port Elizabeth using a truck. When the goods reach Port Elizabeth, they will be transferred from the truck and loaded onto a ship going to Mumbai, India. The process of transferring goods from one form of transport to another is called **transhipment**. Transhipment is always associated with certain problems.

What are the problems of transhipment?

Transhipment increases transportation costs and because of the high possibility of theft and damage, insurance costs also go up.

Apart from long distances and transhipment, transport costs are increased further by packaging. Remember, in Grade 10 you learned about **pre-packaging**. Pre-packaging is when goods are put in containers, wrappers, boxes and other materials by manufacturers. We called it ‘pre-packaging’ because it is done by manufacturers ‘before’ sale. Packaging is the actual putting of goods in wrappers, boxes, containers, packets and other materials. Why should goods be packaged? The answer is obviously protection and easy carriage.

Goods, especially those going to distant places need to be well protected not only from adverse weather conditions but theft, as well as damage. Proper packaging is a must especially in sea transport, where moisture is a serious problem. Proper packaging is needed even where a ship has a dehumidifier. A **dehumidifier** is a machine or device you would use to remove excess moisture from the air in a room or ship.

Proper packaging would be necessary even when sending goods by air. Goods must still be adequately protected, especially when sending goods that are precious and at a high risk of being stolen. One problem of packaging is that it increases the cost of transportation.

How packaging increases transportation costs.

Some packaging materials are so heavy that they add to the weight of an item. You may be aware that transportation charges depend on the weight of an item. Take for instance bottles of Fanta© cold drink in wooden crates. Transporting these bottles of Fanta© may be costly because the bottles of Fanta© are heavy and the crates are also heavy.

2. Different units of measurement

Units of measurement vary from country to country. Some countries like Zambia use kilograms for weight while others use pounds. Converting kilograms to pounds may be difficult, however many countries have converted to the new metric system which is a common system of weights and measures adopted by countries worldwide. To convert units of weights and measurements easily, standard conversion formulae are used. Let us study the conversion table on mass below.

Conversion formulae for mass

To convert	**Multiply by**
Grams into milligrams	64.79891
Pounds into kilograms	0.4535924
Tonnes into kilograms	1016.0469
Tonnes into metric tonnes	1.01605

To convert to another unit you simply multiply the imperial measurement/weight by the conversion factor.

To help you understand this, let us look at the following example:

Example

1. Convert 10 tonnes of maize into kilograms.
2. Convert 500 grams into milligrams.

Solution

1. To convert 10 tonnes into kilograms you will have to multiply 10 tonnes by the conversion factor 1016.0469.
   10 X1016.0469
   = 10160.469 Kilograms

   Similarly,

2. To convert 500 grams into milligrams you will have to multiply 500 grams by the conversion factor 64.7989
   i.e. 500 X 64.7989
   = 32399.45 milligrams

Note it!

Note that this conversion table only contains a few selected items on mass.

Now do the following activity to check your understanding on conversion of units of weights and measurements.

Activity 6

Convert the following;

a) 50 pounds into kilograms
b) 12 grams into milligrams
c) 30 tonnes into metric tones
d) 45 tones into kilograms

Feedback

Check whether your answers are similar to the ones given below;

a) 22.67962 kilograms
b) 777.58692 miligrams
c) 30.4815 metric tonnes
d) *45722.1105 kilograms*

If your answers are different re-do the activity and ensure that you multiply the figures in the question with the one appearing besides the conversion in Table 2 above. Well done if you got all of the answers correct!

3. Problems of documentation

Encarta© Dictionaries (2008) defines **documentation** as “documents provided or collected together as evidence or as reference material”.

Documents are not new to us; they were covered in Grade 10. Although documents serve an important purpose, in foreign trade they also numerous and complicated. This may be because of the many commercial activities involved. The challenge is in meeting the many documentation requirements for transportation, storage and clearance of goods etc.

4. Payment problems

When goods are sold on credit, there is always a high possibility of bad debts. Bad debts are not a new concept; we covered them in Grade 10. **Bad debts** may be considered as one of the payment problems which traders face in both home and foreign trade. The problem may be worse in foreign trade because the exporter may not know the importer personally, let alone their credit worthiness.

What are the causes of bad debts?

Bad debts in foreign trade may be the result of a change of government or cancellation of an import licence. Often governments as well as import regulations and rules change. This has repercussions on foreign trade. Where the importer’s licence is revoked before payment for the goods, exporters have always found it difficult and expensive to take legal action.

Also directly linked to payment problems are the different currencies used by different countries. To trade with an exporter in another country, as an importer you must first convert your currency into the exporter’s currency through a foreign exchange market which can either be a bank or bureau de change.

It is important that you also learn how to convert your currency into other countries’ currencies.

Let us now study the following table showing exchange rates as compiled by the Bank of Zambia November 30th, 2010.

Bank of Zambia		
	November 30, 2010	
Currency	**Buying**	**Selling**
Dollar ($)	4,500	4,630
British Pound (£)	6.200	6,400
Euro (€)	5,000	5,200
South African Rand (R)	430	470

Table 2: Exchange Rates adapted from the Times of Zambia, 30 November 2010.

Now let us work out the following example together:

Example

Mr. Komba, a Zambian businessman, is buying goods worth R5,000 from South Africa. How much money does he need in Zambian kwacha to buy R5,000?

Mr. Komba is going to pay in South African Rand and not Zambian Kwacha. Therefore he must buy the rand from a bank or bureau de change. Since the bank or bureau de change is selling the rand to Mr. Komba, we shall use the figures in the selling column.

Tip!

Solution

From the table, the selling price of 1 rand is K470

If R1 is equal to K470 then R5,000 is equal to an unknown figure.

Therefore; let the unknown figure be x

So : R1 $\longrightarrow$ K470

R5,000 $\longrightarrow$ x

Therefore; $\frac{5{,}000}{1} \times \frac{x}{470}$

Cross multiply.

i.e 1 $\times$ x and

5000 $\times$470

Thus: $1x = 2{,}350{,}000$

$$\frac{\cancel{1}\,x}{\cancel{1}} = \frac{2{,}350{,}000}{\cancel{1}}$$

Divide both sides by 1 to remain with x

$x = \underline{K2,350,000}$

Therefore, Mr. Komba will need K2,350,000 to buy goods worth R5,000 from South Africa.

Now do the following activity. The activity will give you an opportunity to convert another country's currency to your local currency.

Activity 7

Mr. Komba, buys R9,500 to carter for other expenses. After paying all the expenses, he was still left with R2,500. He decides to convert it back to Zambian Kwacha. How much will he receive?

Feedback

You should have realised that the bank or bureau de change buying the rand from Mr Komba may have converted it as follows:

If *1 rand* $\longrightarrow$ *K430*

Then *2,500 rands* $\longrightarrow$ x

$$\frac{2{,}500,}{1} \times \frac{x}{430}$$

$$1x = 1{,}075{,}000$$

$$\frac{\cancel{1}\,x}{\cancel{1}} = \frac{1{,}075{,}000}{\cancel{1}}$$

$$x = \underline{K1{,}075{,}000}$$

Therefore, Mr. Komba will receive K1,075,000.

You have had a chance to convert South African currency into your local currency. We hope this activity has been an eye-opener on conversion of currency. You can now convert currencies of other countries into your local currency. We encourage you to convert the remaining currencies in Table 2 to your local currency on your own. You can then discuss your answers with your friends or tutor.

Although the conversion of currency is easy and can be done within a few minutes, it has serious implications for the exporter as can be seen below:

- Exchange rates fluctuate. This puts the exporter at a disadvantage if their currency is devalued. To **devalue** is to lower the value of a countries currency. This means the exporter will be paid less for their goods.
- Commissions charged by banks or bureau de changes are an extra cost.

Having looked at problems of payment, let us now discover how countries restrict trade.

5. Trade Restrictions (barriers)

In spite of the many benefits of foreign trade, countries still put in place restrictions to limit trade. The most common trade restrictions are **tariffs**, **quotas** and **embargoes**.

Activity 8

Take time to examine the words highlighted above. Write down the meaning of each word in the space provided below. You may use a dictionary.

Feedback

Compare your answers to the ones given below;

*A **tariff** is a tax on imported goods. The money collected on imports is called **customs duty**. Customs duty is one such tariff. A **quota** is a limit on the number of items to be imported in a given year. A complete ban on the importation of goods in a given year is an embargo. Not only do governments impose **embargoes** on imports, but on exports as well.*

Countries impose customs duty in order to make imports expensive. The main aim is to limit foreign trade.

The major consequence of the trade restrictions identified above is that they all make imported goods more expensive than locally produced goods. The main motive here is to protect local industries from foreign competition. However different countries have their own reasons for trade restrictions.

Why restrict trade?
Whereas countries have various reasons for restricting trade, many countries do it for some or all of the following reasons:

- To raise government revenue.
- To stop the importation of unsafe goods.
- To reduce imports in order to save foreign currency.
- To discourage dumping.

What is dumping?

The term dumping may be used differently by different people. To help you understand the term better, do the following activity. You are required to use a dictionary.

Activity 9

1. From your own understanding write down three different meanings of the word dumping in the space provided.

   a)

   b)

   c)

2. Use a dictionary to confirm your answers. Only refer to the dictionary after you have given your own answers.

Feedback

Compare your answers to the ones given below;

You are right if you thought of things such discarding, throwing away, getting rid of something or other ideas similar to these. Although these words appear different, they may be summarised in this definition: "the activity of depositing waste in an area or place". Encarta© Dictionary (2008).

People in foreign trade know **dumping** as a situation where an exporting country sells its products at lower prices in a foreign market than the prices offered locally. When goods are dumped in a country, local industries suffer. People prefer to buy imported goods whose prices are typically lower instead of locally produced goods.

You can clearly see that foreign competition has a serious adverse effect of forcing local industries out of business. For example, the textile industry in Zambia has suffered greatly in this regard. The importation of cheap clothes, especially second hand clothes has forced the textile industry out of business. Supporting industries like suppliers of raw materials have also suffered the consequences. As a result, many workers have found themselves out of employment.

6. Problems in accessing information on foreign markets

Before anyone can consider selling goods and services abroad, there is a need to gather as much information as possible on foreign markets. You need to be knowledgeable on matters like measures and weights, customs, rules and regulations and other related matters. Communication is the only sure way of gathering information. Communication enables traders to share ideas and information by writing or talking to others.

Nowadays communication takes various forms: telephone, fax, letters, e-mail and internet, using skype, Facebook, face-to-face meeting and many others. All of these have implications for foreign trade and are also costly. If there are any of these means of communication that you do not know, look them up in the dictionary, ask family, friends and/or your tutor.

In addition, gathering information might not be that easy as different countries use different languages. Language is the main method which people use to communicate with each other. Where people speak different languages there is usually a communication breakdown. We may have had an encounter with a foreigner where communication became difficult because of differences in languages. Attempts to overcome the problem of language differences could be costly. For example, a translator is needed to translate trade documents like information leaflets, labels and other related documents into different foreign languages.

Now that you know the problems of foreign trade, see if you can come up with other challenges or disadvantages not mentioned in our topic.

Activity 10

Disadvantages of Foreign trade

Use this space.

Feedback

This activity should have made you realise that there are many disadvantages which the list above has not covered. You may have come up with the following disadvantages:

- *Countries may end up using all their natural resources to meet worldwide demand. The process by which natural resources are used up is called **depletion**.*
- *Harmful goods like fire arms and illicit drugs may find their way into the country.*
- *Serious economic difficulties may be experienced by a country that depends too much on others during emergence periods e.g. during war times.*
- *A country may not develop its resources fully if it depends on imported goods.*
- *Diseases such as swine flu, bird flu and foot and mouth disease may be transferred from one country to another through foreign trade.*

If you came across other disadvantages not included above, that is fine.

Discussion

Invasive species are non-native plants, animals or microorganisms that invade a habitat causing environmental or economic damage. Many of these invasive species are introduced via transportation of exports and imports. If you have access to the internet, please go to: http://www.scidev.net/en/news/invasive-weed-strangles-zambian-park.html and read about an invasive species in Zambia. Discuss with your friends and family the impact of invasive species.

You have so far examined the various challenges of traders in foreign trade. Remember, the problems are common to all exporters and importers, whether new or experienced. To trade successfully, exporters and importers need help from some quarters. There are individuals and firms that help traders with export and import procedures. These individuals or firms are called middlemen. Let us now discuss some of the middlemen found in foreign trade.

Middlemen in Foreign Trade

You are already familiar with the term middlemen. In Grade 10 we discussed **middlemen** like wholesalers who handle goods between the producer and the consumer. Just like wholesalers, middlemen in foreign trade middlemen act on behalf of importers and exporters. You will definitely find the services of middlemen helpful if yours is a small scale business. You may also find them useful if you don't know much about international business. You will need to know the various types of middlemen and the kind of services they offer. Your choice of middleman will depend on the kind of services you require. Let us now look at different types of middlemen and the types of services they offer. Middlemen in foreign trade include; forwarding agents, brokers, factors and import merchants.

Forwarding agents

Forwarding agents are middlemen of international trade who assist people to export goods for a fee. They are sometimes referred to as freight forwarders. Before you read on do the following activity:

Activity 11

1. With the help of your friend or a member of your family, identify at least two forwarding companies in your country. List them down in the space provided.

2. What kind of services do the companies identified in one above do? Explain.

Feedback

For Zambia, you may have identified companies like SDV, Manica and Azfreight co.

You may have observed that the companies above operate on an international level.

***Services**.*
These companies mainly deal with customs clearance, shipping and freight forwarding.

Other freight companies not mentioned here may be accepted. Find out more on your own from people or companies involved in foreign trade like commercial farmers and mining companies in your area.

The work or functions of forwarding agents in foreign trade

Exporters worldwide find the services of forwarding agents helpful. Some of the help you would get from forwarding agents include:

- Preparation of documents.
- Booking of transport.
- Obtaining insurance cover for the goods that are being exported.
- Packing the goods and storing the goods before shipment (before the goods can be transported).
- Sending the documents and instructions to their representatives or agents abroad.
- Despatching goods to the (importers) through their representatives.

For the work they do on your behalf, they get a commission.

Other people or firms that act on behalf of exporters and importers are brokers and factors. Let us start by examining the work/function they do in foreign trade.

Brokers and Factors

Brokers and factors are not new concepts. We covered them in Grade 10 under wholesaling in home trade. Do you still remember what you learnt about them? To see how much you still remember, do the following activity.

Activity 12

The Table below is meant to summarise the features of each agent. You are required to complete the table without referring to the answers. The first one has been done for you.

Feature	Broker	Factor
Buying and selling	Buy and sell goods/services on behalf of the principal.	Only sell on the behalf principal.
1. Handling of goods		
2. Ownership of goods		
3. Remuneration (reward)		

Feedback

Compare your answers with the ones given below:

Feature	***Broker***	***Factor***
1. Handling of goods	*They do not handle the goods they sell.*	*They handle the goods they sell.*
2. Ownership of goods	*They do not own the goods and cannot sell in their own names. They simply bring the buyer (importer) and seller (exporter) in contact.*	*They own the goods and can sell the goods in their own names, sometimes even on credit.*
3. Remuneration (reward)	*They are paid a commission known as brokerage.*	*They are paid a commission but when they sell on credit they receive an extra commission called Del Credere commission.*

We hope you were able to remember all of the features. If you forgot some of the features, this activity has acted as a reminder.

Remember:

- The principal is the person who owns the goods or services being offered for sale by an agent. It may be a local manufacturer or seller.
- The factor may also collect and forward the payments to the principal, less their agreed commission.
- The factor may also take the responsibility of insuring goods in their possession with an insurance company in their own names.

Not all middlemen are agents, some are principals themselves. Here is one such middleman.

Import Merchants

Import merchants are actually wholesale traders (principals) who buy goods in bulk from abroad and sell them locally for a profit. Import merchants buy and sell for themselves; they do not work for anybody. When they sell goods, they do it in their own names. In reality, they are wholesalers that provide wholesale services like delivery service, warehousing and other wholesale services. The services offered by wholesalers were discussed in Grade 10, so you should remember what this means. If you do not, review your Grade 10 notes or textbook. You may even discuss this with your friends.

You can now make the right choice of middlemen in foreign trade as you now know the functions of each middleman.

Topic 2: Summary

You have now come to the end of the second topic on 'problems experienced by traders in international trade'. We saw that the main problems experienced by traders in foreign trade are caused by long distances, differences in languages, units of weights and measurements, and currencies used by different countries, as well as trade restrictions like tariffs, quotas and embargoes. Other challenges of foreign trade range from depletion of natural resources to transfer of diseases. We further discussed in this topic the middlemen in foreign trade and their functions. From the services offered, you may have observed that middlemen are very helpful to small scale business with little or no knowledge of international business.

As in Topic 1, you had a chance to check your understanding through the activities given in this topic. We hope you did all the nine activities and found them useful.

Before you move to the next topic, go to the assignment section and do Topic 2 Exercise. Ensure that you do the exercise to review and check your understanding of the topic. Avoid the temptation to look at the answers before completing the exercise. This will give you an accurate assessment of your understanding of what you learned from the topic. If you discover that some of your answers are incorrect when you compare them to the feedback, review the relevant sections of the topic before moving on to the next topic.

We hope that you have found the topic beneficial and are now familiar with the problems faced by traders in foreign trade and how to address them.

In the next topic we shall explore the documents used in importing and exporting.

Topic 3: Documents Used in Foreign Trade

Introduction

In Topic 2 we discussed the problems of exporters. We saw that both exporters and importers experience problems in carrying out their commercial activities of buying and selling. You will remember that we said in Topic 2 that one of the problems in foreign trade is that the documents are usually numerous and complicated due to the many commercial activities involved. Documents are needed in the transportation, storage and clearance of goods, as well as in exchanging currencies.

In this topic we shall explore the common documents used in the exportation and importation of goods.

Let us start by looking at the topic outcomes.

Upon completion of this topic, you should be able to:

Outcomes

- *Explain* documents used in foreign trade.
- *Use* the documents.

Time

You should spend at least 6.5 hours on this topic.

Dealing with documents in foreign trade may not be an easy task. We have seen in Topic 2 that documentation in foreign trade may be costly and time consuming to organise. Although this is the case, as a prospective trader and business studies learner, you need to know the importance of these documents.

What is the Importance of Documents?

Documents are the only sure way of providing a written record of transactions. This is not only done to provide proof, but to provide traders with a pathway of their business activities.

Documentation needed by one country may not be needed by another. This is because different countries have different import and export regulations. The documentation requirements will depend mainly on the destination of shipment.

Before you read on, see if you can come up with at least five common documents used in foreign trade. Write your answers in the space below the heading.

Activity 13

Common Documents used in Foreign Trade

1.
2.
3.
4.
5.

Feedback

If you managed to write down any of these five documents on your first attempt, well done! If you did not, keep trying until you manage to write all of them without first referring to the answers.

Your list may have included documents such as:

- *Import/export permits*
- *Export/import declaration forms*
- *Bill of lading*
- *Charter party*
- *Airway bill*
- *Commercial invoice*
- *Certificate of insurance*
- *Certificate of origin*

We are now going to look at how each of these documents is used, starting with import licenses or permits. While studying these documents, we advise that you pay particular attention to their usage.

Import Permit/License

Before an importer considers importing goods into a country, they must be issued an import permit or license. An import permit is a document issued by a government allowing the importation of specified goods into the country. Which government ministry or department is responsible for issuing import permits? In Zambia, import permits are issued by the Ministry of Commerce and Industry. Any importing company wishing to obtain an import permit in Zambia can get in touch with the Ministry of Commerce and Industry. There is a possibility that in other countries different ministries are responsible for the issuance of import permits.

Each license specifies the volume of imports allowed. In a country where a quota has been imposed, the total volume allowed should not exceed the quota. Remember, a **quota** is a limit in the number of items to be imported in a given year.

It is important to note that some countries do not require permits to import goods.

Import licences may be required by customs and excise authorities at the port of entry. Therefore, problems with customs officials can be avoided if the importer puts the import permit together with the other documents. While import permits may be used for other purposes like customs, they are used by some governments to protect their local industries against foreign competition by discriminating against another country's goods.

Export Permit/License

Exporting goods to another country may require an export permit. An export permit is a document issued by government to allow someone to export specific quantities of particular goods to a given destination. Export permits are slowly being replaced by export declaration forms in a number of countries including Zambia.

What is an Export Declaration Form?

An export declaration form is a document used in the clearance of goods by the customs authorities. As an exporter you need to complete an export declaration form whenever you are exporting goods. The form helps customs officials to collect the necessary statistical data from the exporter which the government can use to verify and regulate exports. You will discover why the government needs to do this in Topic 2 of Unit 2. The customs authorities require that an original commercial invoice, packaging list and an airway bill or bill of lading accompany the export declaration form. In Zambia, a standard customs authority form **ZRA CE 20** is used mainly for statistical purposes.

However, there still remain some instances when export permits may be used. You still need an export permit to export goods like gemstones, games skins, timber etc. In Zambia, you obtain such permits from respective ministries or departments. To export gemstones for instance, a permit may be obtained from Ministry of Mines. Note that export licences and permits are used synonymously. Export permit requirements may depend on the destination of your shipment. You will come across trading blocs in Unit 2 of Grade 11Commerce.

Import Declaration Form

When importing goods, you will need to complete an Import Declaration Form. Like the export declaration form, an import declaration form provides the customs authorities with the necessary statistical data on imports which may be used by government to verify and control imports. In some countries, different forms may be used for small consignments and commercial consignments respectively. For example, in Zambia the CE 7 form may be used for consignments below USD 500.000 and CE 20 for commercial consignments above USD 500,000.

Bill of Lading

A bill of lading is a document used when sending goods by sea transport. The bill of lading will show full details of goods, the name of the ship to carry the goods and the ports of departure and destination.

Importance of the bill of lading

We saw earlier in this topic that documents provide a written record of transactions as well as helping traders keep track of their business activities.

The bill of lading is equally important because it:

- is a receipt for the goods received on board the ship.
- is a contract of carriage between the ship-owner and exporter.
- is a dispatch note (informs the importer of the impending arrival of the goods).
- gives the holder title to the goods. This means that when the goods finally arrive, the holder of the bill can use the bill of lading to claim them.
- is transferable, which means that the importer may sell the goods even before they arrive and hand over the bill of lading to the buyer in the same way a title deed is transferred to the buyer of a house.
- shows the state in which the captain received them.

Remember, a bill of lading only acts as a receipt when signed by the ship's captain. It is therefore important that as the ship's captain is receiving the goods, they sign the document. If goods are received in good condition, a clean bill is signed. On the contrary if goods received are damaged a dirty bill is signed.

The holder of the bill of lading may be the importer or any person to whom the bill has been transferred.

Note it!

How the bill of lading is transferred

You may be aware that when a person sells a house, they must also handover the title deed. Similarly, if the importer decides to sell their goods before their arrival, they must also handover or transfer the bill lading to the buyer. Bills are transferred from one person to another by way of **endorsement**. To endorse is to sign the bill at the back. Figure 3 below shows the transfer of ownership of goods from the importer to another buyer.

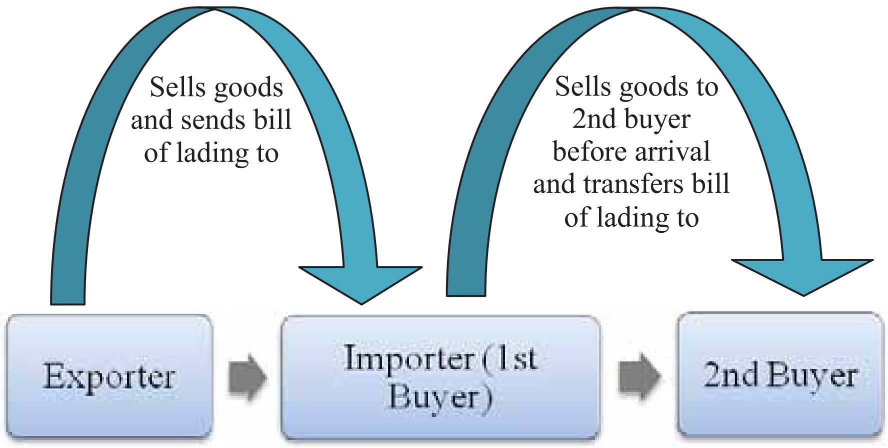


Figure 3: Transfer of ownership of goods. Created by Commerce Team, ZACODE, 2010.

It is important to note that once the second buyer takes possession of the bill of lading, they can use it to claim the goods when they arrive. Remember, we mentioned earlier that the bill of lading is a document of title.

Another document essential in the shipment of goods by sea is a charter party.

Charter Party

To send goods by sea you need to hire a ship if you don't own one yourself. Ships may be hired just like trucks or cars in road transport. The hiring of a ship is called chartering. A charter party is a document used when one is using a hired ship to transport goods. A Charter Party is, therefore, a contract between the owner of the ship and the business person.

Ways of Hiring a Ship

You can hire a ship for a specific period of time, like 3 months, six months or even 1 year or more during which your business can make many trips. This way of hiring a ship is called **time charter**. Alternatively, you can hire a ship for a specific sea journey or trip (voyage) after which you can return the ship to the owner. For example you may hire a ship to carry goods from Port Mumbai in India to Port Beira in Mozambique and back to Mumbai, India. This is called **voyage charter**.

As we have seen, a bill of lading is associated with shipment of goods by sea. But goods may also be sent by air transport and when this happens, another document called an airway bill is used.

Airway Bill

As indicated earlier an **airway bill** is a document used when sending goods by air transport. This document is as important as a bill of lading in that both have similar functions. An airway bill, on the other hand cannot be used to claim ownership of the goods when they arrive. This means that it is not a document of title and thus it cannot be used to transfer ownership of goods.

Now that you know the major difference between an airway bill and bill of lading, see if you can come up with your own functions of an airway bill by doing the following activity. You may refer to our discussion on the bill of lading.

Activity 14

1. What are the functions of an airway bill? Write your answers in the space below.

2. Kaasu wants the right to claim ownership of some goods when they arrive at the Port Elizabeth in South Africa. Which document does she need to claim her goods?

Check whether your answers are similar to those in our feedback below:

Feedback

1. *Functions of an airway bill includes the following:*
   - *It is a receipt for the goods received aboard a named plane.*
   - *It is a contract of carriage between the airline and exporter.*
   - *It is an invoice for the freight, reflecting the shipper, the consignee and the goods being shipped as well as the full freight amount.*
   - *It is a certificate of insurance (if carriers insurance is requested by the shipper).*
   - *It also guides airline staff on the handling, dispatch and delivery of the consignment.*
2. *A bill of lading.*

From the answers above, you may have seen that a bill of lading and airway bill are similar in a number of respects. For this reason, some people still refer to an airway bill as a bill of lading or air consignment note. You learnt about consignment notes in Grade 10.

Commercial Invoice

When a transaction is agreed upon whether in home trade or foreign trade, the seller must send a bill for the goods to the buyer. A bill is a document that shows the buyer how much he owes the seller. In home trade, an ordinary invoice is that bill. In foreign trade, commercial invoices are used for the same purpose. You already know much about ordinary invoices. You may recall from your Grade 10 work that an ordinary invoice contains the names and addresses of the buyer and seller, the order number, the date of invoice, quantity, description of the goods, unit price, total prices and terms of payment among other things. Similarly a commercial invoice gives the following details:

- the names and addresses of both the (buyer) importer and (seller) exporter.
- the quantity of goods including the number and kinds of packaging involved.
- an order number or reference to correspondence between the exporter and importer.
- A full description of the goods in question (including brand marks).
- the total price of the goods (and unit price where applicable).
- the type and amount of discount given.
- the likely delivery schedule and delivery terms.
- the payment terms, for example 30 days on sight.

In addition, commercial invoices may show:

- packing details where there is separate packing list.
- the currency in which the goods will be sold (e.g. British pound or US dollars).
- the payment methods, for example cash in advance or Letter of Credit (L/C).
- the exporter's banking details.
- freight and insurance charges to be paid.

From your knowledge of ordinary invoices covered in Grade 10 and the details given above, you can come up with your own example of a commercial invoice. In the next activity you are given an opportunity to apply this knowledge.

Activity 15

1. Draw an example of a commercial invoice in the space provided below:

You may have come up with a commercial invoice similar to the one given in the feedback below.

Feedback

COMMERCIAL INVOICE

BENJAGET TEXTILES ZAMBIA LIMITED
Plot No. 7, Buntungwa Road, Luanshya
Telephone No. 0212512704
Email address: benjagetex@yahoo.com

Invoice No. 669
Invoice Date: 07/06/11
Due Date: 08/07/11

Account No. 063-78654000

Bill to:
George Clothing Factory
1 Quinton Road, Birmingham
United Kingdom

Your Order No. 90

Quantity	Weight KGs	Commodity Code	Description	Unit Value (K)	Total Value (K)
600	1000	WG1	Roles Wax Material	20,000	12,000,000
50	200	CT56	Roles Chitenge Material	5,000	2,500,000
200	800	VVT9	Roles Velvet Material	25,000	5,000,000
				Total	19,500,000
				Currency	Zambian Kwacha

Payment Method: L/C (Letter of Credit)

Signature: Ben

Figure 4: Sample Commercial Invoice. Created by Commerce Team, ZACODE, 2010.

If your commercial invoice included all the details in the invoice above, congratulations! If on the other hand your commercial invoice did not contain all the details or included more details, do not worry. As long as the details were obtained from a recognized source like the internet or textbook that is fine.

You can see from the commercial invoice above that to arrive at the total value, we multiplied the quantity by the unit value just as we did with the ordinary invoice in Grade 10. It is clear that the minor differences are in terminologies because terminologies in home trade and foreign trade differ.

Governments use commercial invoices to arrive at the true value of goods for customs and import control purposes.

When a copy of a commercial invoice is certified correct by the consul, it becomes a consular invoice. Let us now discuss a consular invoice.

Consular Invoice

We have seen that commercial invoices provide the government with important information that enables them to arrive at the true value of goods being imported or exported. Many governments require commercial invoices to be certified correct by their trade missions in the exporting country. A consular invoice is a certified copy of a commercial invoice. However, some countries use specified forms for consular invoices. A consular invoice is certified correct when a consul or their representative stamp and append their signature to it for a small fee.

Who is a consul?

A consul is an official sent to live in another country and look after their own country's citizens and business interests there. You may be using terms such as diplomats or ambassadors to refer to consuls.

Why do consuls certify consular invoices correct? Consular invoices are certified correct as a control measure. It is required by the customs officials to assess customs duty. Without the diplomat or consul's signature, some traders may cheat by reducing the price of goods on the invoice so that they pay less duty. Certification on consular invoices also prevents the importation of forbidden goods in the country. It is important to note that:

Note it!

Consular invoices are written either in English or the official language of the importing country.

Certificate of Insurance

A Certificate of Insurance is a document issued in order to protect the goods against risks while in transit. We saw earlier in Topic 2 that as goods are being moved from one place to another, they are exposed to a number of risks. Do you remember some of the risks? You may have recalled risks such as theft and damage to the goods in transit. Other risks like fire, accident, floods, and bad weather may affect both goods in transit and those awaiting collection from warehouses. You may also insure against loss of profits as a result of fire or other risks.

To reduce serious losses resulting from such risks, you can insure your goods, property or life. To insure something, you need to pay a small amount of money called a premium to the insurance company. Upon payment of this premium, the insurance company initially issues you with a cover note to provide you with temporary cover while an insurance policy is being prepared. An insurance policy is a contract of insurance; it provides you with the terms and conditions of insurance. The benefit is that when you are in possession of a cover note or insurance policy, if your goods are for example destroyed by fire, the insurance company will replace them. You will get to know more about insurance in Grade 12.

In reality, a certificate of insurance is a cover note or insurance policy covering goods in transit. One has to make a choice whether to obtain a certificate of insurance to cover a specific sea journey or a specific period. When the certificate of insurance is issued for a specific journey, it is called a **voyage policy**. If it is for a specific period of time, it is a **time policy**.

What is the importance of a certificate of insurance?

A certificate of insurance proves to the transport firm that the goods in transit have already been insured against risks by the exporter. With this proof, the transport firms can handle the goods with confidence, knowing that they will not be responsible for any risk that may occur to the goods in their custody.

Certificate of Origin

Some countries may require a signed certificate showing the name of the country where the exported goods were manufactured. Since the certificate shows the origin of the goods, it is called a certificate of origin. Certificates of origin are usually obtained through a local Chamber of Commerce. A chamber of commerce is an association of people who own businesses in a given area. It is common for large cities that have a chamber of commerce. The main goal of a chamber of commerce is to improve conditions for business in their area. To achieve this aim, chambers of commerce provide advice and information to their members on issues relating to their businesses. Sometimes training courses may be provided to their members.

What is the importance of a certificate of origin?

Many governments find certificates of origin helpful in preventing the importation of goods from countries where imports have been stopped by means of a government order such as a quota.

By showing the country of origin, customs officials are guided as to how much customs duty should be charged. This is particularly important where countries have agreed within their region not to pay customs duties or to pay less. Such a regional grouping is called a **trading bloc**. An example of such countries would be those in the SADC region. You will learn more about trading blocs in Unit 2.

So far we have discussed the common documents used in foreign trade. There are however, several other documents used in foreign trade, some of which we are now going to discuss.

Other Documents used in Foreign Trade

Packing List

Another important document worth mentioning is a packing list. When preparing goods for export, a detailed packing list may be required. A packing list is a document prepared by either a shipper or forwarding agent to give a breakdown of the items in the shipment, including identification or special marks. Such identification marks may be essential in case the goods are lost or stolen for the purposes of claiming insurance and tracking them. In addition, a packing list shows the customer's purchase order number and destination. From this information, we can design a packing list together using bits of information given above.

Can we identify from the passage above some of the pieces of information we will require to design a packing list. We will require:

- the shipper's name and address.
- the customer's order number.
- the description of the goods together with identification or special marks.
- the consignee or importer's name and address (destination).
- the quantity.

SHARMATAN INTERNATIONAL HAULAGE COMPANY

Sharma Building, Shang Rd, P.O BOX X9001

India

PACKING LIST

RECEIVER: DATE ____________

____
____
____
____

Customer's Purchase Order No. ____________

Case No.	Identification marks/Code	Description	Quantity

Signature: ____________

Figure 5: An example of a packing list form. Created by Commerce Team, ZACODE, 2010.

As you can see from Figure 5, a packing list is not a complicated document.

It is important to note that:

Note it!

Packing lists are usually written on printed forms like the one we have designed above. However, there may be variations in layout and design.

A packing list must be stuck to the outside of the package in a waterproof envelope or plastic sheath and marked “Packing list enclosed".

Why is a packing list needed? A packing list helps shippers or forwarding agents in ascertaining the weight and volume of the goods as well as ensuring that the correct goods are being transported. Customs officials may also use a packing list to verify the cargo.

Now that we have designed our packing list, see if you can manage to complete it using the details in the activity below. The activity is intended to help you learn how to use some of the documents in foreign trade. We will not give you practice on all the documents in foreign trade because they are many, thus we have selected some commonly used documents.

Activity 16

1. (a) Sharmatan International Haulage Company has a Consignment of books to deliver to Janet Mabbola of Luanshya Book sellers, P.O. Box 90700. You have been asked to help Sharmatan International Haulage Company to prepare a packing list. Use the form we designed above and the information given below.

   50 Mastering Commerce, case no 1, code **1A/300**

   45 Commerce Around You, case no 3, code **BN/111**

   110 Tips on Commercial Knowledge, case no 5, code **CC90C**

   95 Business Economics Book 2, case no 6, code **MAC56**

   200 Reality of Climate change, case no 7, code **1GTR3**

   (b) Attach the document you have just prepared to your package.

   (c) What is the importance of the packing list to forwarding agents or shippers?

   (d) Which document would you use to send goods using sea transport?

   (e) Which document is used when goods are sent by air?

   (f) Which document would you use to prove to the customs officials that the prices indicated on reflect the true values?

2. For more practice on the use of documents, we advise that you visit airports, customs and excise offices, forwarding agents, airports and transport firms in your area. Make a collection of documents and make comparisons.

Check if your answers are similar to those provided in the feedback below.

Feedback

1. (a)

SHARMATAN INTERNATIONAL HAULAGE COMPANY

Sharma Building, Shang Rd, P.O BOX X9001

India

PACKING LIST

RECEIVER:

Janet Mabbola

Luanshya Book Sellers

P.o Box 90700

Luanshya

Customer's Purchase Order No. *34091*

Case No.	Identification marks/Code	Description	Quantity
1	1A/300	Mastering Commerce	50
3	BN/111	Commerce Around You	45
5	CC90C	Tips in Commercial knowledge	110
6	MAC/56	Business Economics Book 2	95
7	1GTR3	The reality of Climate Change	200

Signature: *smg*

Congratulations if you managed to enter the details correctly. If not, go through the activity again. You may find it necessary to *compare our packing list with actual packing lists. To do this you are advised to visit forwarding companies, international transporters, airports, railway stations or mining companies in your area. This will also give you a chance to collect some documents and learn how to use them.*

(c) It helps them in determining the weight and volume of the goods and making sure that the correct goods are being transported.
(d) Bill of lading.
(e) Airwaybill.
(f) Consular Invoice.

Tips

When preparing the packing list, it is important to ensure that quantities/ items on the packing list should match with those on the commercial invoice and bill of lading to avoid delay in sending the goods.

Now that you know the packing list and how it is used, let us proceed and look at a shipping note.

Shipping Note

When sending goods to the docks, the person sending the goods prepares a shipping note and gives it to port officials a few days before the ship starts off. The shipping note gives full information about the goods including handling instructions. It also names the ship to carry the goods and the port where the goods will be offloaded from. The port authorities will find the shipping note helpful in comparing the goods being exported against those written on the shipping note. If satisfied with the details on the shipping note, the port official signs it. At this stage the signed shipping note may act as a dock/warehouse receipt. Alternatively, the port officials may issue a separate dock or warehouse receipt.

What is a dock or Warehouse Receipt?

A **dock or warehouse receipt** is a document that provides proof that the shipping company has accepted the goods and will be putting them aboard a named ship. The dock/warehouse receipt shows the goods have moved from the home transporter to the port of loading and have left with the international transporter. This means the home transporter is no longer responsible; the responsibility has been transferred to the international transporter.

The Indent

The word 'indent' might mean different things to different people. For instance in writing, to indent is to move either from the left or right margin at least 5 spaces inside the paragraph. An **indent** in foreign trade is a document which instructs an agent to order goods from abroad. Remember in Topic 2 of this unit we saw that agents help traders either with the buying or selling of goods.

An indent may be mistaken for an order in home trade because the information on these two documents is similar. For example, the quantity of goods that is to be ordered, their prices, the terms of payment, where there are discounts and many more. The only difference is that with the order, the buyer directly requests the seller to supply him with the required goods. On the contrary, an indent requests an agent to look for goods from sellers (exporters) abroad on behalf of the buyer (importer). This means that the importer leaves the task of placing an order to the agent. When an importer does not give the agent specific details of the supplier to order goods from the indent, this is called an **open indent**. In this case, the agent is given the liberty to look for his own source of supply. When the importer specifies to the agent which supplier goods should be ordered, the indent is a **closed** one.

Now that you know what an indent is proceed to the next document.

Letter of Credit

In Topic 2 You learnt that whenever goods are sold on credit, the possibility of bad debts is high. You saw that bad debts may be worse in foreign trade because the importer and exporter do not personally know each other. Under such circumstances, exporters may be reluctant to release goods before payment. On the other hand importers may be reluctant to make payment before receiving goods. Banks play an intermediary role. Remember, we did mention in Topic 2 that banks are a source of help for traders in foreign trade. One way in which banks help is by issuing a letter of credit.

What is a letter of Credit?

A letter of credit is a document that can be used by an importer to request their bank to assure the exporter that the payment for goods will be transferred to them. In short, the importer's bank adds its promise to that of the importer to pay the exporter. With the bank's promise, the exporter is assured that payment for the goods sold to the importer will be made within a specified period. However, this requires that the exporter meet the conditions stated in the letter of credit. For example, the exporters must commit themselves to provide proof that goods have been shipped. This is done by sending shipping documents like the bill of lading, certificate of insurance etc. by a given date. Payment for the goods will then be made on the basis of these documents. The letter of credit eliminates the risks of bad debts and other risks that may arise from change of governments.

As an importer you will find the letter of credit helpful as it will meet you and the exporter half way. There is no need for you to worry about the goods. Similarly, the exporter does not have to worry about the payment. Letters of credit are used to arrange for documentary credits, a means of payment we shall consider in Topic 3 of Unit 2.

As an importer, you can choose to cancel or revoke a letter of credit without the consent of the exporter. This is called a **revocable letter of credit**. Some letters of credit may only be cancelled or revoked with the consent of the importer. Such letters are called **irrevocable letters of credit**.

You have so far looked at the different documents used in foreign trade. You may have observed that we have only looked at the common documents and not all the documents that other countries require. This is done because documentation requirements vary from country to country.

Topic 3: Summary

In this topic you learned about the common documents used in the shipment, customs clearance and handling of goods. You looked at documents like the bill of lading, airway bill, certificate of insurance, charter party, consular invoice etc. You have seen that the bill of lading and charter party are particularly important when sending goods by sea transport, while the airway bill is necessary when sending goods by air transport. Other documents looked at in this topic included the export packing list, declaration forms, dock receipts which are as important as the other documents in this topic. We noted that the packing list gives a detailed list of what is in the shipment and the dock receipt provides proof that the goods have been accepted and will be loaded on a named ship.

We hope the activities in this topic were done correctly, if not go through the topic and re-do the activities you did not do correctly. You also have an end-of-topic exercise to do at the end of the unit summary. The end-of-topic exercise will enable you to review different aspects of documents used in foreign trade. This will give you a clear understanding of the topic. The answers to the End-of-Topic Exercise 3 are given just below the exercise.

This is the last topic in this unit. We hope you have found the topic very helpful and that you now know the common documents used in foreign trade.

Unit Summary

Summary

Congratulations! You have now come to the end of the first unit of Grade 11 Commerce. In this unit you learned the reasons, benefits and problems of foreign trade. You also looked at some of the middlemen and their functions and the documents used in foreign trade. The unit had three topics. In Topic 1 of this unit you learned that foreign trade involves business across international boundaries. You had an opportunity to see how foreign trade differs from home trade. You further learned the reasons for foreign trade and benefits of foreign trade. We saw that the main reason for foreign trade is that there is no country in the world that can provide all the goods and services needed by its citizens. Countries depend on each other for the provision of goods and services because the differences in natural resources, climates, labour, equipment and machinery make it difficult for any given country to be self-reliant. Among the advantages, we saw that foreign trade promotes friendship, creates employment and provides a wide variety of goods.

In Topic 2, you learned about the problems experienced by traders in foreign trade and other challenges of foreign trade. You noticed that the main problems experienced by traders in foreign trade are caused by long distances, differences in language, differences in units of weights and measures, differences in currencies, as well as trade barriers like tariffs, quotas and embargoes. Other challenges of foreign trade discussed were the problem of smuggling and overdependence and depletion of natural resources. You also learned about the middlemen in foreign trade and their functions. You saw that middlemen are very hepful to small scale business with little or no knowledge of international business.

In Topic 3, you learned about documents used in foreign trade. You had an opportunity to look at important documents like the bill of lading, airway bill, consular invoice etc. You were also given an opportunity to use some these documents.

We hope you have done all the in-text activities and end-of-topic exercises to assess your understanding of the topics.

There is also a self-marked assignment for you to do in the assessment section of this unit. The assignment is intended to help you review and assess your understanding of the whole unit. You are not required to send this assignment to the college for marking; mark it yourself and compare your answers with those provided just below the assignment. Avoid the temptation to look at the answers before attempting the assignment. There is no tutor-marked assignment in this unit; it will be given in Unit 2.

We hope that the activities in this unit have been sufficient in helping you to assess your own progress.

Now go back to the outcomes at the beginning of this unit and review them again. Have you achieved them all? If there is any outcome that is not clear to you? Go back to the relevant topic and read it again or write to your tutor for clarification.

In the next unit we shall look at the work of port and customs authorities, balance of payment and trade, and methods of payments in foreign trade.

Now that you have come to the end of the unit, move to the assessment section and do the self-marked assignment.

References

Reading

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Assignment

Assignment

Topic 1 Exercise

This activity has two parts, A and B. Answer all questions.

Part A

Part A contains five multiple choice questions. Choose the correct answer and write the relevant letter of the alphabet (A, B, C OR D) in the box provided'

1. Business across international boundaries is called:

   A. Export Trade
   B. Home Trade
   C. Foreign Trade
   D. Import Trade

2. What are imports?

   A. Goods sold to other countries
   B. Goods and services bought from other countries
   C. The buying of goods and services from other countries
   D. Goods and services sold to other countries

3. Tourism is an example of Zambia's:

   A. Exports
   B. Imports
   C. Imports and exports
   D. Foreign trade

4. Which of the following is **not** an advantage of foreign trade?

   A. It creates employment
   B. It improves the standard of living of people.
   C. It involves buying and selling of goods and services
   D. It promotes friendship

5. Foreign trade provides many countries with:

   A. Goods
   B. A major source of revenue
   C. Services
   D. Tourism

Part B

1. State whether the following statements are true of false:

   a) Foreign trade provides many countries with a source of revenue.

b) Home trade deals with imports and exports.
c) Imports is the buying of goods and services.
d) Foreign trade is trade across international borders.
e) Foreign trade provides employment.
f) Competition from foreign trade improves the quality of imported goods.

2. In the table below, write down your country's exports.

EXPORTS

GOODS	SERVICES
a)	a) ....
b)	b) ....
c)	c) ....

Topic 2 Exercise

Before you read on, do the following activity. The exercise has three questions. Answer all the questions. The answers to the activity are given in the feedback below.

1. Give one word or phrase to mean the following:

a) Trader who buys goods from abroad and sells goods for himself.
b) The sale of goods cheaply to other countries.
c) Tax levied on imported goods.
d) The transfer of goods from one type of transport to another.
e) Complete ban on the importation of a particular item in a given year.

2. State how each of the following middlemen is rewarded:

a) Broker
b) Import merchant
c) Forwarding agent
d) Factor

3. You own a diary farm, selling dairy products on the home market and have decided to extend your market to foreign markets. How would you benefit from the services of a forwarding agent?

Topic 3 Exercise

1. Fill in the blank spaces

a) A .... is a certified copy of a commercial invoice.
b) The method of hiring a ship for a specified period is called ....
c) A .... shows the country of origin of goods.
d) ZRA Form CE 20 is mainly used for .... purposes.
e) A .... provides proof that the shipping company has accepted the goods and will put them aboard a named ship.

2. Mr. Mwale has a consignment of timber which he intends to send to India using sea transport.

a) Which document would you advise him to use:

   i. To hire a ship
   ii. To contract a shipping company.

b) Explain to him the importance of a bill of lading.

Feedback

Topic 1

Check whether the answers you gave included the ones provided below.

Part A

1. C   2. B   3. A   4. C   5. B

Part B

1. State whether the statement is True/False

a) *True*   *b) False*   *c) False*   *d) True*
e) True   *f) False*

2. EXPORTS (for Zambia)

GOODS	***SERVICES***
a) Copper	*a) Tourism*
b) Gemstones	*b) Electricity*
c) Agricultural products	*c) Manpower*

Well done, if these were your answers. You may have given different answers for exports. If your exports include the ones given below, that is fine.

- *floricultural products*
- *processed foods e.g. sugar, molasses, honey and bees wax*
- *building materials e.g. cement, PVC pipes asbestos pipes*
- *animal products such as crocodile meat, poultry, fish and leather products*

Well done! You are now ready to move to the next topic on problems and challenges of foreign trade.

Topic 2

Check whether your answers are similar to the ones given below:

1. ***Word or phrase***
a) Import Merchant
b) Dumping
c) Customs duty
d) Transhipment
e) Embargo

2. Rewards for middlemen
a) Broker – Commission called brokerage
b) Import merchant – Profit
c) Forwarding agent – Commission
d) Factor – Commission

3. How you would benefit from the services of forwarding agents

Forwarding agents would assist you in preparing the necessary documents in the exportation of dairy products, book suitable transport to carry the dairy products and get insurance cover for the dairy products being exported. Before the products are transported, they would provide storage for the products. For example, they would store the dairy products in a cold storage or refrigerated room to prevent them from going bad. They would also ensure that the products are properly packaged. They would also send the documents and instructions to their representatives or agents abroad after the goods have been sent. When the diary products arrive, the forwarding agents through their representatives abroad would then dispatch the goods to the buyers according to specific instructions.

Well done! You are now ready to move to the next topic on documents used in foreign trade.

Topic 3

Now, check whether your answers are similar to the ones given in the feedback below.

1. a) Consular Invoice
b) Time Charter
c) Certificate of Origin
d) Statistical
e) Dock/Warehouse Receipt

2. a) I would advise him to use a;
i) Charter Party to hire a ship
ii) Bill of lading to contract a shipping company

b) A bill of lading is a document is used when goods are sent by sea transport. It is important because:
i) It is a contract between the shipping company and the exporter.
ii) It indicates the condition of the goods.
iii) It acts as a receipt for the goods.
iv) It is a document of title.
v) It acts as an advice note.

Assessment

Self-marked Assessment 1

This is a self-marked assignment and not tutor-marked. It is aimed at assessing your understanding of the unit. You are encouraged to do it without referring to the unit content or feedback.

This assignment has three parts, A, B and C. Answer all questions.

PART A:

You are to answer the following multiple choice questions by writing down the letter of your choice provided.

1. __________ is the main reason for foreign trade.

A. Foods B. Comparative advantage
C. Trade C. Life

2. Imports are goods and services

A. bought from another country
B. sold to another country
C. bought from within the country
D. sold within the country

3. One advantage of foreign trade is that it promotes

A. Dumping B. Friendship among countries
C. Foreign trade D. Food production

4. Trade barriers include tariffs and __________

A. Quotas B. Currency
C. Skilled manpower D. Trade war

5. Which middleman imports goods from outside and sells them locally in their name for a profit

A. Broker B. Factor
C. Del credere agent D. Import merchant

6. Which document is used to hire a ship

A. Consular invoice B. Charter Party
C. Packing list D. Shipping Note

7. A________ is signed by the consul or ambassador

A. Consular invoice B. Shipping Note
C. Dock receipt D. Certificate of origin

8. A bill of lading acts as a _________

A. A receipt
B. Method of payment
C. A record
D. List of goods sent by sea

9. Which document shows the country of origin of the goods

A. Charter Party
B. Bill of lading
C. Certificate of Origin
D. Commercial Invoice

10. Which one of the following is not a reason for imposing trade restrictions?

A. To make a profit
B. To make imports expensive
C. To protect the local industry
D. None of the above

PART B

This part contains one essay type questions

1. Ms. Kambole owns small ceramic factory. She has extended her market for ceramics to India.

   a) Explain to her the work of the following middlemen in foreign trade.

      i. Brokers

      ii. Factors

   b) Why would your country impose trade restrictions?

   c) What are the similarities between an airway bill and bill of lading?

Self-Assessment Feedback

Compare your answers with the ones given in the feedback below.

Feedback
PART A.

1. B	2. A	3. B	4. A	5. D
6. B	7. A	8. A	9. C	10. A

PART B

1. a) i) Brokers

- *They will help her to sell her goods on foreign markets by finding customers for her as their main function involves selling and buying goods on behalf of the principal. In return she will pay them a commission called a brokerage.*

ii) Factors

- *They will help her to sell her goods on the foreign market.*
- *They will get the goods from Ms. Kambole and sell them in their own names.*
- *They may even sell the goods on credit since they own them.*

b) Trade Restrictions would be imposed to:

- *To raise government revenue.*
- *To stop the importation of unsafe goods.*
- *To reduce imports in order to save foreign currency.*
- *To discourage dumping.*
- *Protect the local industry.*

c) Similarities between the airway bill and bill of lading.

The following are the differences between an airway bill and bill of lading. Both:

- *act as a receipt for the goods received.*
- *are contracts of carriage for the goods.*
- *act as a despatch or advice note.*

Differences between the airway bill and bill of lading:
There is only one major difference between an airway bill and bill of lading. While the bill of lading is a document of title the airway bill is not. Thus, it is not quasi-negotiable; it cannot be transferred by endorsing.

How a consular invoice differs from a commercial invoice.
There is only one difference between a consular invoice and commercial invoice. A consular invoice is actually a copy of a commercial invoice certified correct by a consul or their representative for a fee. The certification is what makes the two documents different.

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 2

Customs Authority

Introduction

Welcome to Grade 11 Commerce Unit 2 on Customs Authority. Customs Authority is important in foreign trade because it is the authority that monitors the goods that come in and those that leave a country. The customs authority also falls under foreign trade

The unit you have just completed (Unit 1) is a very useful resource. It has taught us various aspects of foreign trade. We learnt in that unit how trading with other countries is done and the reasons for foreign trade. We also discussed the problems faced by traders in foreign trade and looked at the export and import procedures and the documents used, which is why we are going to learn about the importance of the customs authority. Some of the documents discussed and used in Unit 1 will be discussed again in Topic 3 of this unit under means of payment in foreign trade.

In our discussion of the customs authority, we are going to use the country Zambia and the Zambia Revenue Authority as examples. Hopefully this will improve your understanding of the customs authority because you will be learning about what applies in our own country.

In Topic 1 we will discuss customs authority and port authority. We are first going to discuss the customs authority and its functions. Later we are also going to discuss the port authority and its functions.

Topic 2 will cover balance of trade and balance of payment under which we are going to discuss favourable and unfavourable balance of trade and favourable and unfavourable balance of payment.

Topic 3 will discuss the different means of payment used in international trade (foreign trade).

Upon completion of this unit you will be able to:

Outcomes

- *Explain* the functions of the Zambia Revenue Authority, Customs and Excise Authority and Port Authority.
- *Distinguish* between excise and customs duties.
- *Discuss* the requirements of a harbour or port.
- *Differentiate* between free trade and free port.
- *Explain* the advantages and disadvantages of joining a trading bloc.
- *Describe* bonded warehouses.
- *Discuss* the balances of trade and balance of payments.
- *Explain* the means of payment.
- *Name* different means of payment.

Tip

Resources

These materials are self-instructional and contain all the information you will need to study this topic However, the resources listed below have been given to improve your understanding of customs and excise authority, enable you to communicate and share ideas with other learners and your tutor and to research the various concepts taught in this unit:

- Computer, internet and mobile phone (where possible).
- To visit libraries (where possible).
- Visit customs and excise department if it is near your area, to familiarise yourself with its operations.
- Attend tutorials at study centres and discuss with other learners.

Tip

Learning and Teaching approach:

- **Content based approach** - To encourage you to base your learning on customs authority, in order to improve your skills and competencies and to give you instructions to help in your learning.

- **Problem-based approach -** To encourage open minded, reflective, critical and active learning; encourage the development of commercial thinking. The problem-based approach respects the fact that both you and the teacher have knowledge and understanding on customs authority. You will, therefore, be expected to use this knowledge in your interaction with the content and the activities within this unit.

- **Activity-based approach -** To help you develop skills and understanding of customs authority in the cognitive, psychomotor and affective domain and general learning skills as you interact with people and content. The activities that you will find in this unit are meant to encourage such interaction. It is important to discuss these activities and the content of this unit with other learners and your tutor at the learning centre. These discussions will enable you to find immediate solutions to your study problems, broaden your knowledge and break the isolation you may experience as a distance learner.

Time

You will need between 24 and 25 hours to study this unit. This means you will need about 8 hours to study each topic in this unit. This time also includes doing the topic exercises. Do not worry if it takes you more or less time than this - we do not all work at the same pace.

Terminology

Balance of payment: This is the difference between total exports and total imports (including the visible, invisible as well as capital items).

Smuggling: This is a situation where importers use illegalised footpaths to run away from customs authorities to avoid paying customs duties on dutiable goods.

Dutiable goods: These are goods on which duties have to be paid while duty free goods are those goods which can be imported without paying any duty.

Dock: Enclosed area of water in a port, where ships stay while goods are taken on and off, passengers get on and off or repairs are done.

Dredging: To remove dirt and sand from the bottom of a river or lake.

Wharves: A structure built for boats to stop at, at the edge of the land or leading from the land out into the water.

Topic 1: Customs and Excise Authority

Introduction

In this topic, we will discuss the customs and excise authority and port authority. We are first going to discuss the customs and excise authority because it is important for us to understand the functions of the customs and excise authority, to enable us link them to the port authority. Later we will discuss the port authority and its functions. We will also learn that the port authority provides office space for the customs and excise authority at ports and harbours.

In our discussion of the customs and excise authority, we will define the terms customs and authority. In the same way, we will define the term port in our discussion of the port authority.

Here are the outcomes that this topic will cover:

Topic Outcomes

By the end of this topic, learners should be able to:

- *Explain* the functions of the Zambia Revenue Authority, Customs Authority and Port Authority.
- *Distinguish* between Excise and Customs duties.
- *Discuss* the requirements of a harbour or port.
- *Differentiate* between free trade and free port.
- *Describe* bonded warehouses.
- *Explain* the advantages and disadvantages of joining a trading bloc.

Time

You should spend at least 6.5 hours on this topic.

Let us start by looking at the Zambian Customs and Excise Authority. We have mentioned above that you have prior knowledge on some of the things that we will be discussing in this unit. In some of the activities in this unit you will be asked to use this knowledge before reading what we have to say. The first activity below is asking you to revise your knowledge of the Zambian custom Authority. Please write your answers below each question before checking our feedback.

Activity 1

What is the Zambian customs and excise authority?

What do you think some of its functions are?

The feedback to these questions is contained in our discussion in the next section under the Zambian Customs and Excise Authority. As you read this part, compare it with your answers and note the differences or omissions you may have in your answers to ensure common understanding of this section.

Feedback

The Zambian Customs and Excise Authority

The Department of Customs and Excise Authority in Zambia falls under the Ministry of Finance and National Planning. Its primary responsibility is to deal with the movement of goods into and out of the country. The Zambian government through the Ministry of Finance and National Planning has appointed an independent agent called the Zambia Revenue Authority to perform the functions of the customs authority. An agent is somebody who officially represents somebody else in business.

The Zambia Revenue Authority is an organ of the government which has the right and power to enforce the collection of government duties and taxes. It performs many functions which we are now going to discuss.

We will start by looking at the functions of the Zambia Revenue Authority under the overall mandate or in relation to the Ministry of Finance and National Planning in Zambia.

Functions of the Zambia Revenue Authority

The functions of the Zambian Revenue Authority are as follows:

1. Collecting statistics on imports and exports

The customs authority keeps a statistical record of goods that leave (exports) and enter (imports) the country. This helps the country to calculate the balance of trade and balance of payment. Remember, we discussed imports and exports in Unit 1. We will discuss balance of trade and balance of payment in our next topic.

A record of what goods are exported, at how much they are exported, as well as their value, has to be kept by the customs authority. The details of imported goods including their value are also kept. These records are important because they will help the government to:

- Assess and design its trade policies.
- Determine the needs of the people at home.
- Calculate balance of trade and balance of payment.
- Assess the usefulness of their tax collection methods.

2. To enforce trade restriction also known as quotas

Remember, we learnt about import quotas in Topic 2 of Unit 1 when we were discussing trade barriers.

The customs and excise authority enforces trade restrictions. This means there should be a limit on the amount of imports and exports allowed in a country in a given year. A physical limit or amount of goods allowed to be imported or exported in a given year is known as a **quota**. Such quotas are carried out by the customs and excise authorities. Sometimes, the government puts a limit on the importation of certain goods. This is in order to:

- Protect local industries from collapsing due to unfair competition from foreign goods.
- Prevent the dumping of cheap and poor quality goods in the country.
- Encourage consumption of locally produced goods to promote the local industry and reduce the consumption of imported goods.
- Restrict the importation of a particular product in order to correct unfavourable balance of trade. Unfavourable balance of trade is when visible imports exceed visible exports (we will discuss it later in this unit).

We have looked at the two functions of the Zambia Revenue Authority that relate to the Ministry of Finance and National Planning. Now, let us look at the specific functions of the Zambia Revenue Authority in relation to foreign trade. They are as follows:

3. Collecting Revenue

The customs and excise authority collects customs and excise duties. Let us first define the words customs, authority and duty, and then later define the word excise.

The words customs, authority and duty may have different meanings. The word **customs** may be used to mean something people do that is traditional or usual. In the commercial context however, it means a government department that collects taxes on goods that people bring into a country. It may also mean a place at a port, airport or border where officials check that the goods that people are bringing into a country are legal. **Authority** means an administrative body that is set up by the government to be in charge of affairs in an area or activity.

The word **duty** can mean things that you have to do as part of your job. It also means a legal or moral obligation. In the commercial context, it means a tax that must be paid on something that is bought or a tax on something brought into one country from another. Let us now discuss customs duty.

Customs Duty

This is a levy which is charged on some dutiable imported goods entering a country such as equipment. Collecting duties is an important function of the customs and excise authority. You may remember that we discussed the process of exports and imports at length in Unit 1. We also highlighted that various governments in various countries may charge these levies for specific reasons some of which may include the following:

- To restrict imports in order to improve the balance of payment position (balance of payment will be discuss in our next topic).
- To raise revenue (income) for the country. The revenue that the customs and excise authority raises is used to finance development projects like building of hospitals and schools, roads and many other projects.
- To protect the local industry. This is done by making imported goods more expensive, thereby discouraging people from buying them.
- To save foreign exchange by reducing imports. In other words, a country saves money when it reduces buying goods from other countries.
- To discourage importation of goods like tobacco and spirits which are harmful our health.

Now that you understand what customs duty is and why it is charged, let us now discuss the types of customs duty.

Types of Customs Duty

There are two types of customs duty. These are specific duty and advalorem duty.

Specific duty is customs duty levied according to the amount or quantity of goods imported. This may be in terms of weight, volume or number of goods. For example, a manufacturing company imports 2 tonnes of copper. It is required to pay K4 000,000 specific duty. This means that the charge per 1 tonne of copper is K2 000,000. To arrive at K2 000,000, we simply divided K4 000,000 by 2 tonnes as follows:

$$\frac{K4\,000\,000}{2\ tonnes} = \text{K}\underline{\textbf{2 000,000}}$$

The manufacturing industry will therefore, pay K2 000 000 per tonne.

The other type of customs duty is **advalorem duty**. This is customs duty charged according to the percentage of the value of imported goods.

Advalorem is a Latin word meaning "to the value". This simply means that to every improvement that is done to an item, more value is added to it therefore, a charge is attached to it. For example, Zambia exports copper, but before this copper is exported, some improvements to it need to be done. These may include the separation of the actual copper from other impurities and even the packaging. All these processes add value to the copper and attract a charge which is called advalorem duty.

Let us look at the following example for easy understanding of how advalorem duty is charged.

Example

An importer may be importing expensive goods which may be valued at K3, 000,000. The government charges customs duty (advalorem duty) at a fixed rate of 10%. How much do you think the importer will need to pay? The customs duty will be calculated as follows:

$$\text{K3 000,000} \times \frac{10}{100}$$

$$= \textbf{K300,000}$$

The importer will be required to pay the sum of K300,000 as **advalorem duty**.

Let us not forget that specific duty and advalorem duty are types of customs duty.

Having discussed the types of customs duty, let us now look at excise duty.

Excise Duty

The word excise in medical terms means to remove something harmful that is growing inside a person's body. It is also a term used to mean to remove part of a book or film because it is considered offensive. In the commercial context, excise means a tax that a government charges on services used and goods sold within a country.

We defined the term duty when we were discussing customs duty. We are therefore, not going to define it again under excise duty.

Excise duty is defined as a levy charged on goods that are produced locally which might include carbonated drinks, soaps and many other products. The government charges excise duty for the following reasons:

- To raise income for the government.
- To balance any price advantage of locally produced goods over imported goods which are dutiable.
- To discourage consumption of certain goods that might be harmful to health, like cigarettes.

Now that we have looked at both customs and excise duties, we will now proceed and look at the differences between the two. Before we proceed, do the activity below in order to help you understand the reasons why customs and excise duties are charged.

Activity 2

In Unit 1, we discussed the advantages and disadvantages of foreign trade. Some of the advantages and disadvantages can be linked to the reasons why customs and excise duties are charged. Can you think of some of these advantages and disadvantages and link them to either customs or excise duties?

Feedback

As you thought about the activity above, you may have come up with other advantages and disadvantaged that can be linked to either customs or excise duties apart from the ones given in the feedback below. Remember, there are many other advantages and disadvantages of foreign trade. You can also go back to Unit 1 and check which other advantages and disadvantages can be added to the ones below.

Let us consider some of the advantages and disadvantages below:

One disadvantage of foreign trade is that local industries suffer as goods that are imported dominate the local market. Imported goods, therefore, are charged customs duty. This raises the prices of imported goods, which in turn discourages people from buying them. The local industry, therefore, is protected.

One advantage of foreign trade is that it raises revenue for the government. This can be linked to the reason why customs duty is paid. Dutiable imported goods like equipment are charged customs duty. The money raised from such goods goes to the government.

Let us now link one disadvantage of foreign trade to excise duty. Usually foreign trade leads to competition between locally produced goods and the imported ones. Remember, we learnt that excise duty is charged on locally produced goods like cigarettes in order to discourage their consumption. When goods are charged excise duty, their prices go up and do not vary much with the imported goods. This therefore, means the locally produced goods will be competing with the imported goods on the market.

Having done the activity, we are now going to summarise the differences between customs and excise duties using the table below.

Differences Between Customs and Excise Duties

Customs duty	Excise duties
1. It is charged on dutiable imported goods such as equipment.	1. It is charged on some locally produced goods like cigarettes in order to discourage their consumption as these might be harmful to health.
2. It is charged to raise prices on imported goods in order to discourage people from buying them and thus, protecting the local industry.	2. It is charged to raise income for the government.

3. It is charged to save foreign exchange by reducing imports. In other words, a country saves money when it reduces buying goods from other countries.	3. It is charged in order to balance the price of locally produced goods over imported goods. This enables locally produced goods to compete with imported goods.

Figure 1: Differences Between Customs and Excise duties.

From the table above, we have seen that customs duty is charged on dutiable imported goods while excise duty is charged on locally produced goods. We have also noted that customs duty is charged to raise prices on imported goods, while excise duty is charged to raise income for the government. Lastly, we have learned that customs duty is charged to save foreign exchange by reducing imports while excise duty is charged in order to balance the price of locally produced goods over imported goods.

We have discussed three of the functions of the customs authority: collecting statistics on imports and exports, enforcing trade restriction also known as quotas and collecting revenue. In the next section, we will discuss the last three function of this authority. Let us start with the control of public health.

4. To Control Public Health

The customs and excise authority promotes the enforcement of public health policies of the country. This may be done by restricting or banning imports which may pose a danger to the health of the citizens. For example, in Topic 1 of unit 1 under the disadvantages of foreign trade, we said that the importation of livestock may facilitate the transfer of livestock diseases. Such diseases can be bird flu or foot and mouth diseases. When in contact with or consumed by humans, the infected animals may be dangerous to human life.

The custom authority should therefore ensure that animals coming from other countries be accompanied by correct the documents of vaccination.

Another function of the customs authority is to supervise the movement of goods. Let us discuss it.

5. Supervising the movement of goods

In order to prevent smuggling and bringing prohibited goods which may pose a danger to national security or heath into the country, the customs authority supervises the movement of goods entering or leaving the country. They also supervise the movement of vehicles, ships, aircraft and trains.

We will now discuss the last of the functions of the custom authority.

6. Controlling of bonded warehouses

Customs authorities also control bonded warehouses in order to enforce payment of duties or to prevent the non-payment of duty on smuggled goods. We will discuss more about bonded warehouses later in the topic.

Let us first define a bonded warehouse.

A **bonded warehouse** is a place used for the storage of dutiable goods on which duty has not yet been paid. The government may own bonded warehouses and sometimes, they may be privately owned. Private owners of bonded warehouses give their bond or agreement to the customs authority not to release goods without custom duties being paid. Once duty has been paid, the goods can be released in bits or at once. If the goods are to be re-exported, they can be kept in bonded warehouses without paying duty.

Goods in bonded warehouses can be prepared for sale by labelling. This is when a piece of paper or material is fastened on an object which gives information about it. It can also involve **blending,** which involves mixing of different foods or substances together or **bottling** which means to put a liquid in bottles in order to sell it or store it. Tea, for example, can be packed while it is still in bond. Traders can also sell their goods while in bond to avoid paying duty.

Now do the activity below to access your understanding of what we have learnt so far, but do not look at the answers in advance.

Activity 3

1. List three functions of the customs and excise authority.
2. State two differences between customs and excise duties.

Compare your answers to the ones provided in the feedback. If you did not get some of the answers correct, you can read through the topic again and make sure you understand the content. If your answers were correct, you can proceed with the rest of the topic.

Feedback

- *Functions of the customs and excise authority:*
  a. *Collecting revenue.*
  b. *Collecting statistics on imports and exports.*
  c. *Supervising the movement of goods.*

- *Differences between customs and excise duties.*

  a. *Customs duty is charged to raise prices on imported goods in order to discourage people from buying them, thereby protecting the local industry.*

  Excise duty is charged to restrict consumption of goods that are considered harmful to health.

  b. *Customs duty is charged on dutiable imported goods such as equipment.*

  Excise duty is charged on some locally produced goods like cigarettes.

  c. *Customs duty is charged to save foreign exchange by reducing imports.*

  Excise duty is charged in order to balance the price of locally produced goods over imported goods.

  (Any two of the above answers are correct)

You now know the functions of the customs authority. Do you know that the customs authority is not only found at border points, but also at our ports, harbours and airports? It is found at these points as well because they are also entry and exit points to and from other countries.

In the next section we are going to discuss the port authority. The port authority regulates the use of a port. In other words, it monitors and sees that laws governing the usage of a port are followed. Before we proceed, do the following activity to see how much you know about the port authority. You can write your answers below each question.

Activity 4

Do you know what a port is?

Is there a port in your area?

If there is, what are some of the facilities that are provided at the port which you can easily notice?

As we discuss Port Authority in the next section, take note of the facilities that the port authority offers and compare them to the answers you have provided. Note that our discussion of the port authority below is the feedback to the questions above. We will first start by defining a port before we look at the facilities provided.

Feedback

Port Authority

A **port** is a place by the sea, river or other waterway where ships and boats can dock, load and unload. A **harbour** is also a port although it is much smaller and is intended for smaller boats. A harbour is an area of water near the land where it is safe for boats to stay.

Let us look at the map below which was given to you in Figure 2 of Topic 1 in Unit 1 concerning the flow of goods in and out of Zambia.

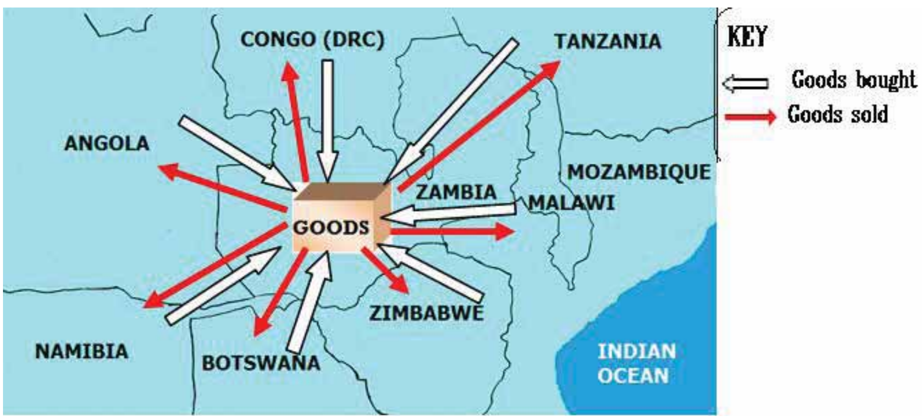

Figure 2: Flow of Goods in and out of Zambia. Hand drawn by Commerce Team, ZACODE, 2010.

Activity 5

From the map above, can you identify which of the countries in the SADC region are likely to have a port or a harbour? Can you also state the reasons why you have chosen those countries?

Feedback

Compare your answer to the one given below:

The countries that have an outlet to the sea are more likely to have ports or harbours. Examples of such countries on the map are Tanzania, Namibia, Mozambique and Angola. These countries are likely to have a port or harbour because they have access to the sea.

If your answers were similar to the ones given above, that is very good. If they were not, read through the map again and make sure you understand it. You may also consult a bigger map in an atlas which will show all the areas that have access to the sea. You may also discuss your answer with other learners or your tutor.

Since we have defined what a port is, let us now discuss the facilities provided by the port authority.

Facilities Provided by Port Authorities

Port authorities must provide dock facilities to allow the ships to offload, load, refuel and fulfil other requirements efficiently. To **dock** is to put ships in an enclosed area of water in a port where they can stay while goods are taken on and off, passengers get on and off or repairs are done. Some ports are privately owned while others are owned by the government.

The following are some of the facilities provided by the port authority:

- It needs to provide office space for customs and immigration authorities, banks, shipping warehouses, companies, restaurants and many other organisations. These are meant for the convenience of the public using the port.
- There should be easy access to the port. This means that the port authority should provide good transport connections inland. A port must be linked to the road and railway networks by a transport system which is capable of managing the volume of traffic that passes through the port.
- Ship repair yards and dry docks should be provided by the port authority for routine maintenance on ships to be carried out.
- There must be clear access to the port. The larger the ships that use the port, the deeper the water needs to be. It should also provide pilots with detailed knowledge to take over steering of vessels entering and leaving the port.
- **Wharves** – These are mechanised handling facilities which a port must have for the speedy discharge and loading of vessels. Cranes and labour warehouses must be available to deal with

ships as soon as they arrive. Provisions must be made by port authorities for ships to refuel and take on other supplies that they need. Efficient cargo handling will reduce the time a dock is occupied. It also cuts on dock and freight costs.

- It must provide special facilities for handling cargo such as grain, timber, coal and oil.

Some of answers you wrote down earlier at the beginning of our discussion of the port authority may be the same or similar to the ones given above.

Some ports are called free ports. Let us see what makes them different from other ports.

Free ports

Some ports are called **free ports** because at these ports ships can dock, load and offload freely, refuel and get all other requirements without any restrictions from the port authority. This makes them different from other ports.

Having discussed the port authority, let us now discuss in detail bonded warehouses which we briefly looked at under functions of the customs authority. Some goods that enter our countries through borders, ports, harbours and airports need to be kept safely before they are transported to their destinations. These goods can be stored in bonded warehouses.

Bonded Warehouse

As we said earlier, a bonded warehouse is a place for the storage of dutiable goods on which duty has not yet been paid. We said the government may own bonded warehouses and sometimes, they may be privately owned. Private owners of bonded warehouses give their bond or agreement not to release goods without customs duties being paid. Once duty has been paid, the goods can be released in bits or at once. If the goods are to be re-exported, they can be kept in bonded warehouses without paying duty.

Traders can keep their goods in bonded warehouses while they are still looking for money to pay customs duty. Traders can also raise money through selling their goods while they are still in bond in order to avoid payment of duty. In this case, the buyer would be responsible for paying duty.

We also said earlier that goods in bonded warehouses can be prepared for sale by labelling, blending, bottling or packaging.

We are now going to discuss the reasons why bonded warehouses are different from other types of warehouses. Examples of the other types of warehouses are manufacturers' warehouses, retailers' warehouses and cold storage warehouses which we learnt about in Grade 10.

Differences between bonded warehouses and other types of warehouses

Bonded warehouses are different from the other types of warehouses in the following ways:

- They are controlled by the customs and excise authority.
- Goods are released only when duty is paid.
- While still in bond, goods may be manufactured or prepared for sale by blending, bottling, labelling and packaging.
- Only dutiable goods on which duty has not yet been paid are stored.

Traders may prefer to use bonded warehouses than other types of warehouses because:

- Imported goods can be stored when not required immediately.
- Goods can be packed, labelled, blended or bottled while in the bonded warehouse.
- Goods can be re-exported thus, no duty would be paid.
- Goods can remain under the custody of the customs and excise authority if the trader does not have enough money to pay duty for them until they are paid for.

Note it!

In Zambia, the Minister of Finance and National Planning decides the charging of duty on goods. This is announced during the annual budget speech.

Bonded warehouses also assist in entrepot trade. Let us define entrepot trade and briefly discuss it.

Entrepot Trade

The word **entrepot** is a French word which in the English language means buying of goods from another country with the intension of re-exporting them. It carries the same meaning even in the commercial context. This type of trade is usually carried out in goods such as diamonds, tea and many others. Such goods are imported into the country, processed and then re-exported to another country. Usually customs duty on such goods is avoided by storing and processing them in bonded warehouses.

Let us bear in mind that when goods are in bonded warehouses at the port, border, harbour or airport, they have not yet entered a country and therefore, customs duty cannot be paid on them. Customs duty is only paid on goods that enter a country.

Goods that are processed while in bonded warehouses and re-exported straight from there, do not pay customs duty because they have not entered a country.

We have so far discussed the port authority and its functions. In the next section, we are going to discuss free trade and trading blocs. We will start by discussing free trade.

Free Trade and Trading Blocs

Free trade means countries are able to trade freely with each other without any artificial difficulties or barriers. Artificial difficulties or barriers may include a lot of documentation or paperwork to be done and long procedures to follow when importing or exporting goods and services. When there is free trade, a country will allow goods to enter from other countries without restrictions. What then is a free trade area?

Free trade area refers to a region comprising of member countries in which barriers put in the way of international trade are reduced. Examples of such free trade areas are **Common Market for East and Southern Africa** (COMESA) and **Economic Community of West African States** (ECOWAS) which we will discuss later. Usually nations are encouraged to trade among themselves. Free trade usually leads to greater competition, specialisation, increases in technology, efficient production and lower prices. These are the advantages of free trade. Let us briefly discuss them.

Advantages of Free Trade

1. Specialisation

Due to free trade, a country may greatly specialise in the production of a commodity which other countries may not produce. It will therefore, have an advantage over other nations.

2. Increases in technology

If there is free trade, countries freely trade and interact with each other. They learn and copy the latest technology from each which leads to efficiency and improvements in the quality of goods and services produced. This will further lead to reduced prices of goods and services.

Though free trade may be good, it also has disadvantages. These are as follows:

- If a country is not as efficient as other countries, then its goods would be inferior or more expensive.
- A country may specialise in only one type of product and may have economic difficulties when that product is not in demand.
- Import spending would increase due to free trade and therefore, increase the deficit in the balance of payment.
- Free trade may also lead to the importation of prohibited or harmful substances which are dangerous to the lives of a country's citizens.

Consumers prefer buying foreign or imported goods to locally manufactured ones. This can cause local industries to suffer and in some cases, wind up going bankrupt. This leads to mass unemployment. To avoid this situation, some imported items can be taxed to make them more expensive than the local ones. Consumers in this case would prefer local products, boosting the local industry and in turn increasing employment opportunities. This means that artificial difficulties or barriers (in this case, tax) would be in the way of international trade and trade would not be free.

There are organisations which have been formed to encourage free trade among member states and also try to reduce the artificial barriers which have been put in the way of international trade. Below are two examples of these organisations.

Organisations such as COMESA are formed to encourage trade among member countries and to allow free movement of factors of production and reduce tariffs. Do you still remember the factors of production we learnt in Grade 10? Some examples of these are labour and capital.

Free trade areas may also reduce trade barriers between member states. An example of such integration is ECOWAS. However, each member country stills has the right to impose tariffs on goods from non-member countries. In other words, the ECOWAS member countries are free to charge tax on imported goods from countries that are not members of ECOWAS. The full names of ECOWAS and COMESA were given above. If you do not remember them, go back and check the names in the section on free trade areas above.

Organisations such as the ones we have stated are called **trading blocs**. Trading blocs can be defined as organisations formed to encourage trade among member countries, allow free movement of the factors of production and reduce tariffs.

Having come this far, you can now do the activity below to review what you have learned, but do not check the answers in advance.

Activity 5

1. State whether the following statements are True or False.
   a. Port authorities do not need to provide office space for customs and immigration authorities, banks, shipping warehouses, restaurants or any other organisation.
   b. Free ports are ports where ships are charged when they want to dock, load, unload and refuel.
   c. A bonded warehouse is a place for the storage of dutiable goods on which duty has not yet been paid.
   d. One disadvantage of free trade is that it leads to increase in technology.
   e. The Economic Community of West Africa States is an example of a tree trade area.

1. Explain the following:
   a. Free ports
   b. Free trade

Feedback

Since we have discussed trading blocs, free trade and free ports, you may have found the activity easy to do. Compare your answers to the ones given in the feedback below.

1. a. False
b False
c. True
d. False
e. True

*2. a. **Free ports***

These are ports where ships can dock, load and offload freely, refuel and get all other requirements without any restrictions from the port authorities.

*b. **Free trade***

Free trade means that there are no artificial difficulties or barriers put in the way of international trade. A country will allow goods to enter from other countries without restrictions. Free trade usually leads to greater competition, specialisation, increases in technology, efficient production and lower prices.

Now read topic summary below.to revise what you learned in the whole topic

Topic 1: Summary

We have come to the end of Topic 1, in which we started by discussing the customs authority. We discussed the functions of the Zambia Revenue Authority and looked at the differences between customs and excise duties. We also discussed port authority and looked at the facilities that it provides. We defined free trade and trading blocs. We said free trade means there are no artificial difficulties put in the way of international trade. We defined trading blocs as organisations formed to encourage trade among member countries and to allow free movement of the factors of production and reduce tariffs.

In the next topic, we are going to discuss the balance of trade and balance of payment. You can now do the Topic 1 Exercise which you will find at the end of the unit under assignment. Check your answers with the feedback provided only after completing the exercises. If you are happy with your progress continue to Topic 2. If not, review the sections where you experienced difficulties before moving on to the next topic.

Topic 2: Balance of Trade and Balance of Payment

Introduction

In the last topic, we discussed the customs authority. We looked at the functions of the Zambia Revenue authority and discussed customs and excise duty. We also discussed the port authority. We first defined what a port is and looked at the facilities it provided. We further discussed free trade and trading blocs.

In this topic, we are going to discuss Balance of Trade and Balance of Payment and learn how the two are calculated. We will also discuss favourable and unfavourable balance of trade and favourable and unfavourable balance of payment. Below are the outcomes that are covered in this topic:

Topic Outcomes

By the end of this topic, you should be able to:

- Discuss the balance of trade and balance of payments.
- Calculate balance of trade and balance of payment.

Time

You should spend at least 6.5 hours on this topic.

We are going to learn how to calculate balance of trade and balance of payment and discuss the effect that the two have on a country. It is important that we learn how to calculate balance of trade as it will enable us to know the difference between what a country gets from its exports and what it spends on imports. We are going to start by discussing balance of trade.

Balance of Trade

We stated earlier that the statistical record on imported and exported goods which is kept by the customs and excise authority enables a country to work out the balance of trade.

We will now define balance of trade, but before we proceed with the definition of the concept, let us investigate the meaning and origin of the key word balance. In the English language, the word balance could mean the ability to remain steady in an upright position or it may mean an amount of something that remains after part has been used. The last meaning of the word applies in commerce. Let us now look at the definition below.

Balance of trade can be defined as the difference between the amount of money a country earns from its exports and its expenses on imports. It can simply be defined as the difference between visible exports and visible imports. For easy understanding, let us write it down as follows:

Balance of trade	=	Visible exports	---	Visible imports

Visible exports are goods that a country exports that can be seen and even touched. Examples of such can be motor vehicles, minerals and agricultural products. On the other hand, **visible imports** are those goods that a country imports that can be touched and seen. Examples of such goods can be as the ones under visible exports. We will discuss invisible exports and invisible imports later.

For us to calculate balance of trade, we are first going to look at an example of export and import figures for country B for the years 2008 and 2009.

Export Figures for 2008 and 2009

Principal Export Commodities (Million/ Kwacha)	**2008**	**2009**
Gold	4 000	3 000
Maize	2 000	15 000
Cotton	2 000	35 000
Sunflower	3 000	7 000
Other	3 200	10 000
Total	14 000	70 000

Figure 3: Table of imaginary export figures for 2008 and 2009. Created by Commerce Team, ZACODE, 2010.

Import Figures for 2008 and 2009

Import of commodities (Million/Kwacha)	**2008**	**2009**
Machinery	5 000	7 000
Textiles	2 000	5 000
Vehicles	1 500	4 500
Food	3 000	6 540
Building materials	4 000	8 000
Other goods	2 100	9 400
Total	17 600	40 440

Figure 4: Table of imaginary import figures for 2008 and 2009. Created by Commerce Team, ZACODE, 2010.

From the above tables, we are going to calculate balance of trade for the years 2008 and 2009. We are going to subtract the import figure from the export figure to calculate balance of trade.

We will first calculate balance of trade for 2008. We have seen that in 2008, country B exported goods worth K14 000 000 and imported goods worth K17 600 000.

We are going to use the formula:

Balance of trade = Visible exports – Visible imports

= K14 000 000 – K17 600 000

= - **K3 600 000**.

The figure we have found is negative (-) because the visible imports were more than the visible exports. This is because country B imported more goods than it exported in 2008. This situation is called **unfavourable balance of trade** and is not ideal for a country. Unfavourable balance of trade is when visible imports exceed visible exports.

The government may improve unfavourable balance of trade by taking the following measures:

- It can increase customs duty on dutiable goods.
- It can restrict the issuing of import licences.
- It can completely ban the importation of goods that are harmful to health.
- It can reduce on quotas.

Since we have calculated balance of trade for 2008, we will now calculate balance of trade for 2009 from the figures in the tables above.

In 2009 country B exported goods worth K70 000 000 and imported goods worth K40 440 000. We will use the formula:

Balance of trade = Visible exports – Visible Imports

= K70 000 000 – K40 440 000

= **K29 560 000**

Activity 6

What do you think the situation we have found above is called? Write your idea in space provided below.

You can now compare your answer to the one provided below.

Feedback

A situation like the one above, where visible exports exceed visible imports is called ***favourable balance of trade***

All countries prefer to have more exports than their imports so that they can build a foreign exchange reserve. A **foreign exchange reserve** is an accumulation of foreign currencies that come into a country through its exports. This reserve would help a country in difficult times, for example, when there is war, floods and drought.

We now know what balance of trade is and have looked at unfavourable and favourable balance of trade. Let us now discuss balance of payment.

What is Balance of Payment?

Balance of payment is defined as the difference between total exports and total imports (which includes visible, invisible and capital items). Balance of payment summarises all payments made to and received from other countries. As stated earlier, these payments are made for visible, invisible and capital items. Balance of payment can be written, therefore, as:

Balance of payment = visible exports + invisible exports – visible imports + invisible imports.

Before we proceed, let us discuss what visible, invisible and capital items are.

Visible items

These are physical goods which can be seen, touched, measured and weighed.

Invisible items

This refers to services bought and sold among countries. These services may be in the form of human resources, for example, teachers and doctors. Other services would be in form of loans, consultancy and banking.

Capital items

These show the amount of money borrowed from abroad and the amount of money which has been lent abroad. Do you know what the words borrowed and lent mean? Let us look at the difference between the two words. To **borrow** means to receive something that belongs to someone else and promise to give it back to them later. Something which is borrowed, therefore, should be given back to the owner later. On other hand, to **lend**, means to give someone something for a short time, expecting that they will give it back to you later. Something which is lent, therefore, is given to someone to use for a short time.

When money is lent out, that sum or amount leaves the country. This means that there will be a reduction in the amount of money a country has. In other words, when a country gives out, it loses. This is classfied as an **import** because every time an item is imported, money is spent.

On other hand, when money is borrowed from another country it is regarded an **export** because money has come into the country and nothing has been spent on it. It is called an export because when we export an item, money is received in a country and not spent on that item.

Note it!

Read the examples given under capital items several times so that the concepts of imports and exports do not confuse you.

Balance of payment can either be favourable or unfavourable. Let us discuss these terms.

Favourable Balance of Payment

Favourable balance of payment exists when the total amount of money received from exports exceeds that spent on imports. When this situation happens, then the country is said to have a **surplus**. Surplus means to have more of something than is necessary or more than is needed.

Balance of payment can also be unfavourable.

Activity 7

Having learnt what favourable balance of trade is, do you have an idea of what unfavourable balance of payment is? Write your answer in the space provided below the heading unfavourable balance of payment.

Unfavourable Balance of Payment

Feedback

Compare your answer to the one provided below.

There will be unfavourable balance of payment when the total amount of money spent on imports exceeds that received from exports.

Congratulations if the answer you gave was similar to the one given in the feedback. If it was not, read through the feedback again and make sure you understand it.

A country is said to have a **deficit** when the total amount of money spent on imports exceeds that received from exports. Deficit means that you have less that you need or should have.

We are now going to look at an example of how balance of payment is calculated.

Example

In a given year, country C had the following:

200X	**K..................(Million)**
Visible exports	6 000
Visible imports	4 500
Invisible exports	2 000
Invisible imports	5 000

Let us now calculate balance of payment from the above figures.

Remember that:

Balance of payment = visible exports + invisible exports – visible imports + invisible imports.

Balance of payment = 6 000 + 2 000 – 4 500 + 5 000

= 8 000 – 9 500

= - **<u>K1 500 000</u>** (unfavourable balance of payment).

The answer we have found is negative. This means there was unfavourable balance of payment in 200x. An unfavourable balance of payment is not a good situation for a country because the number of total imports should never exceed the number of total exports. Remedial action has to be taken to improve the unfavourable balance of payment.

The following is the action a government may take:

- Ban the importation of goods which may be harmful or those not essential to the community.
- Impose quotas to restrict importation of some goods. A quota is a limit that is set on the amount of imports allowed in a country in a given year.
- Borrow money from abroad or within.
- Draw on its foreign exchange reserves to offset the balance of payment deficit if it has these reserves.
- Sell its invisible items or services it may have, to enable it earn money to offset the unfavourable balance of payment.
- Use tariff or customs duties to restrict the imports by making them expensive, thereby discouraging people from buying imported goods.

We have so far discussed balance of trade and balance of payment. You can now do the activity below to access your understanding of what we have discussed in this topic, but do not check the answers in advance.

Activity 8

1. Briefly discuss
   a. Balance of trade
   b. Balance of payment

2. Country C, had the following import and export figures for the year 2010.

Import and Export Figures for 2010

Export and Import of commodities (Million/Kwacha)	2010 Exports	2010 Imports
Machinery	5 000	3 000
Textiles	4 000	3 500
Vehicles	2 500	1 500
Food	3 000	1 540
Building materials	4 000	2 000
Other goods	9 100	3 400
Total	27 600	14 940

   a. Calculate balance of trade for the year 2010 from the figures given in the table above.
   b. State if the answer in (a) above is favourable or unfavourable balance of trade.

3. Differentiate:
   a. Favourable from unfavourable balance of trade.
   b. Favourable from unfavourable balance of payment.

Compare your answers to the ones given in the feedback. If you did not get some of the answers correct, read through the topic again and find the answers before you proceed to the next topic.

Feedback

1. a. *Balance of trade*

   This is the difference between the amount a country earns from its exports and its expenses on imports. It can also be defined as the difference between visible exports and visible imports.

   b. *Balance of payment*

   It is the difference between total exports and total imports (which includes visible, invisible and capital items). Balance of payment summarises all payments made to and received from other countries.

2. a. *Balance of trade =Visible exports – Visible imports*

   Therefore, balance of trade = 27 600 – 14 940

   *= **12 660***

   ***12 600** is balance of trade.*

   b. *The answer in (a) if favourable balance of payment because exports were more than the imports in the year 2010.*

3. a. *Favourable from unfavourable balance of trade:*

   ***Favourable balance of trade** is a situation where visible exports exceed visible imports while **Unfavourable balance of trade** is when visible imports exceed visible exports.*

   c. *Favourable from unfavourable balance of payment*

   ***Favourable balance of payment** exists when the total amount of money received from exports exceeds that received from imports while **unfavourable balance of payment** is when the total amount of money received from imports exceeds that received from exports.*

Topic 2: Summary

We have come to the end of Topic 2 in which we discussed balance of trade and balance of payment. We defined and discussed favourable and unfavourable balance of trade and favourable and unfavourable balance of payment. We also looked at examples on how they can be calculated. We saw that having an unfavourable balance of trade and an unfavourable balance of payment was not ideal for a country.

In Topic 3, we are going to discuss means of payment in international trade. Before we proceed, do the Topic 2 exercise which is under assignments at the end of the unit. You can then do as you have done in the previous topic and check your answers against the feedback provided and review the sections you found difficult if necessary.

Topic 3: Means of Payment in International Trade

Introduction

In Topic 2, we discussed balance of trade and balance of payment. We defined balance of trade as the difference between the amount a country earns from its exports and its expenses on imports. On the other hand, we defined balance of payment as the difference between total exports and total imports (which includes visible, invisible and capital items).

We also discussed favourable and unfavourable balance of trade and favourable and unfavourable balance of payment. We learnt that having an unfavourable balance of trade or an unfavourable balance of payment was not ideal for any country. We also learnt how these are calculated.

We will discuss the different means of payment used in international trade in this topic.

Here are the outcomes that cover this topic:

Topic Outcomes

By the end of this topic, you should be able to:

- Name different means of payment
- Explain the means of payment

Time

You should spend at least 6.5 hours on this topic.

In Unit 1, we discussed the problems faced by traders in international trade. Do you still remember them? Do the activity below to review what you already know and help you understand our discussion on means of payment in international trade.

Activity 9

Think of the problems faced by traders in international trade that we learnt in Unit 1 and list them. Write your answers and then compare them to the ones given in the feedback below.

Feedback

The answers that you might have come up with may have included the following:

- *Distance problems*
- *Communication difficulties*
- *Complicated and long documentation*
- *Payment problems*
- *Trade barriers problems*
- *Different unit of measurements*

From the answers we have given above, we are going to single out **payment problems** and link it to our topic, which is Means of Payment in International Trade. We have picked on payment problems because it has a direct link to the means of payment that we are going to discuss.

To solve the payment problem faced by traders in international trade, a lot of means of payment in international trade have been developed. Let us first list them down as follows:

- Letter of credit or documentary credit
- Banker's draft
- Telegraphic transfer or cable transfers
- Bills of exchange
- Documentary bills (documentary bill of exchange)
- Letter of hypothecation
- Clean bill of exchange

We will now discuss each one of the methods of payment mentioned above separately. Remember we discussed the letter of credit as one of the documents used in foreign trade in Topic 3 of Unit 1.

Documentary Credits / Letter of Credit

When people doing business together do not know each other personally, each of them has fears. The seller may fear releasing their goods to a person they do not know. Equally, the buyer may fear sending their money to a person they do not know. To clear these fears, a letter of credit is used. A **documentary credit** is a facility used in international trade to pay for imports. The importer asks their bank (which is referred to as the issuing bank in their country) to send a letter of credit in favour of the exporter to the exporter's bank. In short, the letter of credit will add the bank's promise to pay for the goods as long as the exporter abides by its terms and conditions.

The terms and conditions are that the exporter must ship the goods and produce a bill of lading as well as a certificate of insurance and the invoice before they are paid. The bill of lading, certificate of insurance and the invoice were all discussed in Topic 3 of Unit 1. The exporter is paid immediately upon producing the necessary documents showing that the goods have been shipped. The documents are then sent to the importer so that a claim is made of the goods upon their arrival.

The exporter's bank, where the letter of credit is sent, is referred to as the correspondent bank.

The letter of credit is issued by the importer's bank for the following reasons:

- The importer's bank promises to pay the exporter provided they produce the relevant documents proving that the goods have been shipped.
- To advise the exporter on how the goods should be packed.
- To specify the various documents demanded by the importer, which the exporter must present at their bank before they are paid.
- Advise the importer on how much insurance cover is required.
- Authorise the exporter to withdraw money from their bank where the documentary credit has been sent upon presentation of the necessary documents confirming that the requirements of the letter of credit has been met.

Help

If you have access to the internet, please go to: http://en.wikipedia.org/wiki/Letter_of_credit for a diagram of this process.

Another means of payment that we are going to look at is the banker's draft.

Banker's Draft

A banker's draft is a cheque drawn on a bank instead of on an individual's account. In other words, it is equivalent to a banker's own cheque.

The bank prepares a banker's draft for a fee. For example, a bank customer wishing to pay for goods or services by a banker's draft in international trade initially pays their bank the local currency equivalent to the amount of the foreign currency required to pay for goods or services. The bank then prepares the bank's draft and gives it to the customer. The customer using any quick and safe means then sends it to the exporter who presents it to their bank for payment.

Let us now look at circumstances in which the banker's draft is used. They are as follows:

- Where the transaction involves a large sum of money.
- Where both the importer (buyer) and exporter (seller) do not know each other well.
- Where the exporter may not accept the importer's cheque for fear of it being dishonoured. A **dishonoured cheque** is a cheque which a bank refuses to pay for a given reason.

The following are the benefits of a banker's draft in payment for goods and services:

- The importer pays for value of the banker's draft in advance therefore; the banker's draft cannot be dishonoured.
- Large sums of money are paid safely by the banker's drafts.
- It guarantees payment because it is drawn by the bank itself making it safe, acceptable and reliable.

Since we have discussed the banker's draft, let us look at another means of payment which is the telegraphic transfer or cable transfer. Thereafter we will discuss direct payments and bills of exchange.

Telegraphic Transfer or Cable Transfer

This is the fastest method of paying for goods and services in international trade. This involves the transfer of money electronically between banks. The importer pays the money directly into the account of the exporter. The importer pays his/her bank the local currency required to pay for the goods.

The importer gives instructions to the bank to transfer money from their account to the exporter's account using fast communication facilities such as fax, internet, teleprinters etc. Money is not physically transferred but only account transactions take place. Settlement between banks takes place later when a number of such payments are "set off" against each other, that is, where these payments occur in both directions.

The following are some of the advantages of sending money through cable transfer:

- It is quick and more useful where payment needs to be made urgently.
- The exporter is guaranteed payment for goods and services provided.

Direct payments

This method is used when the exporter or seller is selling to a well-known and trustworthy customer. The payment can be made direct to the customer either by using a banker's draft or cable transfer.

Bills of Exchange

Under the bill of exchange, the exporter and importer first agree on a sale of goods. These bills are a means of payment normally drawn for a future date either three or more months.

The following are how the bill of exchange is used:

- The exporter of goods writes and signs a bill of exchange and then sends it to the importer for either payment or acceptance.
- The importer signs across it and writes "accepted".
- The importer returns the accepted bill of exchange to the exporter.
- The exporter can also endorse it and then use it to pay another company for goods bought from them.
- It can also be discounted by the exporter. This means that the exporter can sell it off to the bank before maturity at a price slightly lower than its face value as the bank waits for its maturity date in order to claim its full value. A summary of how a bill of exchange is used is given below.

Summary of how a bill of exchange is used:

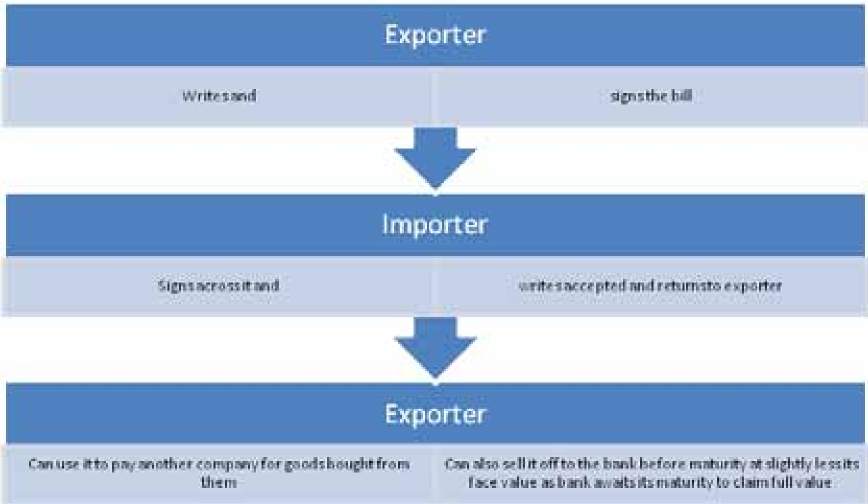

Figure 5: A summary of how a bill of exchange is used*. *Created by Commerce Team, ZACODE, 2010.

You now know what telegraphic transfer or cable transfer, direct payments and bills of exchange are and how they are used. We will now discuss the documentary bill and letter of hypothecation.

Documentary Bill of Exchange

It is a means of payment that is similar to a bill of exchange which is usually handled between banks. Attached to it are some shipping documents to show that goods have been despatched. These documents are given to the exporter's bank. The bank will then send them (documentary bill and shipping documents) to the importer's bank with relevant instructions. The documents will only be released to the importer upon accepting the bill or having paid cash. It is more useful when exporting to familiar and trustworthy customers.

Letter of Hypothecation

This letter is attached to the bill of exchange together with other relevant documents. This letter gives authority to the importer's bank to sell the goods if the importer fails to pay or accept the bill of exchange.

Let us now look at the clean bill of exchange and see why it is called by that name.

Activity 10

Do you have an idea why it is called a clean bill of exchange? Write your idea in the space provided below the heading clean bill of exchange.

Clean Bill of Exchange

You can now compare your answer to the one provided in the feedback below.

feedback

This clean bill of exchange has no documents attached to it and is usually used when the exporter and importer know each other well. We can simply say that it is the opposite of the documentary bill. Remember we have learnt that the documentary bill of exchange has shipping documents attached to it. Since a clean bill of exchange is sent alone without any documents attached, it is said to be clean, hence the name clean bill of exchange.

Case study

Koehlo wants to import textiles from an exporter in China she has never done business with. There is no rush for the payment, but there a very large sum of money involved so naturally, she is quite nervous. Which form of payment would you recommend to Koehlo?

Having looked at the clean bill of exchange, we will now look at the topic summary to remind us of what we have covered in the topic.

Topic 3: Summary

We have come to the end of Topic 3 in which we discussed the means of payment in international trade and how they are used. We specifically looked documentary credit which is a facility used in international trade to pay for imports. We also looked at the bankers draft and the telegraphic transfers. We discussed a bill of exchange and gave a summary of how it is used. Finally, we discussed the documentary bill of exchange, letter of hypothecation and lastly the clean bill.

You can now do the Topic 3 exercise which is at the end of the unit under assignment. You can then compare your answers to those provided. You should then read the Unit summary to remind yourself of what you learned in this unit and what you need to do next.

Unit Summary

Summary

In Topic 1 of this unit we learned about the customs authority. We discussed customs and excise duties and looked at the differences between the two. We further discussed port authorities, free trade, trading blocks and free ports.

In our discussion of the customs authority, we used the Zambia Revenue Authority as an example. Using this example, we discussed the functions of the customs authority. We are most familiar with our country Zambia. This is the reason why most examples are based on it.

In Topic 2, we discussed balance of trade and balance of payment. We saw that a country can have either a favourable or unfavourable balance of trade. It may also have a favourable or unfavourable balance of payment.

Topic 3 discussed the different means of payment in international trade. We also discussed how these are used.

It is necessary that you compare what you have learnt in this unit to the situations that happen in your area.

In the next unit, we are going to discuss business units that are under the private sector.

You can now look at the unit outcomes again and see whether you have achieved them. If there is any that you still have not met, go back to the relevant section(s) and ensure you read and understand the content well or seek clarification from your tutor.

When you are sure you have achieved all the objectives, do the tutor marked assignment given at the end of the topic. This assignment will include work that was done in Units 1 and 2. The assignment will have to be marked by your tutor at the study centre. Now take a short break and relax before you do the assignment.

References

Reading

Lobley Derek. 2004. *Success in Commerce*. London: John Murray Ltd.

Encarta Encyclopedia. 2008. *Balance of Payment.* Microsoft ® Student [DVD]. Redmond, WA: Microsoft Corporation.

Wokorach,J. B. 2002. *Commerce- A Complete Course*. Mochudi: Salama.

Assignment

Assignment

Topic 1 Exercise

Using the list of given words or phrases, fill in the blank spaces.

List

Artificial difficulties or barriers

Bonded warehouse

International trade

Entrepot trade

Quota

Common Market for East and Southern Africa

Produced locally

Statistical record

Port

Specific duty

a. The customs authority keeps a _______________ of goods that leave and enter a country.

b. A physical limit or amount of goods allowed to be imported or exported in a given year is known as a ______________.

c. There are two types of customs duty. These are _________________ and advalorem duty.

d. A _____________ is a place by the sea, river or other waterway where ships and boats can dock, load and unload.

e. A _____________________ is a place for the storage of dutiable goods on which duty has not yet been paid.

f. Free trade area refers to a region comprising of member countries in which barriers put in the way of ____________________ are reduced.

g. Organisations such as the ______________________ are formed to encourage trade among member countries.

h. Excise duty is a levy charged on goods that are _________________.

i. Free trade means countries are able to trade freely with each other without any _____________________.

j. ___________ means buying of goods from another country with the intention of re-exporting them.

Topic 2 Exercise

1. Differentiate the following:
   a. Balance of trade from balance of payment.
   b. Unfavourable balance of trade from unfavourable balance of payment.
   c. Visible exports from visible imports.

2. State the formulae for:
   a. Balance of trade.
   b. Balance of payment.

Topic 3 Exercise

1. Outline four means of payment in foreign trade.

2. Explain the four means of payment in 1 above.

Question 3 below consists of multiple choice questions. Indicate either A, B, C or D for the correct answer in the given boxes.

3. 1. One of the reasons why a letter of credit is issued is to:
      A. Advise the exporter on how the goods should be packed.
      B. Make the importer sign across it and write 'accepted'.
      C. Give authority to the importer's bank to sell the goods if the importer fails to pay.
      D. Make the importer and exporter to know each other.

   2. A banker's draft is:
      A. A letter attached to the bill of exchange.
      B. A clean bill.
      C. A cheque drawn on a bank instead of an individual's account.
      D. A means of payment that is attached to the bill of exchange.

3. Which means of payment has no documents attached to it and is usually used when the exporter and importer know each other well?

   A. Letter of hypothecation.

   B. Bill of exchange.

   C. Documentary bill.

   D. Clean bill of exchange.

4. Direct payment is a method used when the exporter or seller is selling to a well-known and trustworthy customer. The payment can be made direct to the customer either by using:

   A. A banker's draft or cable transfer.

   B. Documentary bill.

   C. Letter of hypothecation.

   D. None of the above.

Feedback

Topic 1

Now, compare your answers to the ones provided below.

a. statistical record

b. quota

c. specific duty

d. port

e. bonded warehouse

f. international trade

g Common Market for East and Southern Africa

h. produced locally

i. artificial difficulties or barriers

j. entrepot trade

Topic 2

Compare the answers that you have given to the ones below.

1. a. *Balance of trade is the difference between the amount a country earns from its exports and its expenses on imports. Balance of payment is the difference between total exports and total imports (which includes visible, invisible and capital items).*

   b. Unfavourable balance of trade is when visible imports exceed visible exports. Unfavourable balance of payment is when the total amount of money spent on imports exceeds that received from exports.

   c. Visible exports are goods that a country exports that can be seen and even touched. On the other hand, visible imports are those goods that a country imports that can be touched and seen.

2. *a. Balance of trade =Visible exports – Visible imports*

   b. Balance of payment = visible exports + invisible exports – visible imports + invisible imports.

Topic 3

1. *Four different means of payment.*

- *Letter of credit or documentary credit.*
- *Banker's draft*
- *Telegraphic transfer or cable transfers*
- *Documentary bills*

2. *Explaining the means of payment.*

- *Letter of credit or documentary credit.*

A documentary credit is a facility used in international trade to pay for imports. The importer asks his/her bank (referred to as the issuing bank) in his/her country to send a letter of credit in favour of the importer to the exporter's bank. The bank in the exporter's country is referred to as the correspondent bank. The importer's bank then issues a letter of credit in favour of the exporter.

- *Banker's draft*

A banker's draft is a cheque drawn on a bank instead of on an individual's account. This is equivalent to a banker's own cheque.

The bank at a fee prepares a banker's draft. For example, a bank customer wishing to pay for goods or services by a banker's draft in international trade initially pays her or his bank the local currency equivalent to the amount of the foreign currency required to for goods or services. The bank then prepares the bank's draft and gives it to the customer. The customer using any quick and safe means then sends it to the exporter who presents it to his/her bank for payment.

- *Telegraphic transfer or cable transfers*

This is the fastest method of paying for goods and services in international trade. This involves the transfer of money electronically between banks. The importer pays the money direct into the account of the exporter. The importer pays his/her bank the local currency required to pay for the goods

The importer gives instructions to the bank to transfer money from his/her account to the exporter's account using fast communication facilities such as fax, internets, teleprinters etc. Money is not physically transferred but only account transactions take place. Settlement between banks takes place later when such a number of such payments are "set off" against each other i.e. where these payments occur in both directions.

- *Documentary bills or credits.*

It is a means of payment that is similar to a bill of exchange *which is usually handled between banks. Attached to it are some shipping documents to show that goods have been despatched and they are given to the exporter's bank. The bank will then send them (documentary credit and shipping documents) to the importer's bank with relevant instructions. The documents will only be released to the importer upon accepting the bill or having paid cash. It is more useful when exporting to familiar and trustworthy customers.*

3.
   1. *A*
   2. *C*
   3. *D*
   4. *A*

Assessment

Assessment

Tutor-Marked Assignment 1

This is a tutor-marked assignment and should be sent to the College for marking.

1. Write brief notes on the following:
   a) Trading blocks
   b) Free trade
   c) Free ports
   d) Bonded warehouses
2. Differentiate customs from excise duty.
3. State the facilities provided by the port authorities.
4. Multiple choice questions. Choose A, B, C or D for the correct answer.
   1. Which of the following is not a problem of foreign trade?
      A. Communication
      B. Imports and exports
      C. Distance
      D. Customs duty
   2. Which of the following is not a Middlemen in international trade:
      A. Exporters
      B. Importers
      C. Import merchants
      D. Export merchants
   3. Which of the following increases transportation costs?
      A. Transhipment
      B. Banking
      C. Transport
      D. Commission
   4. Which of following is **NOT** a disadvantage of foreign trade?
      A. It facilitates the transfer of diseases.
      B. It promotes the importation of dangerous and harmful goods.
      C. It discourages self-sufficiency.

D. It enables countries to specialise.

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 3

Organisation of Business Units – Private Sector

Introduction

Welcome to Unit 3 of Grade 11 Commerce on organisation of business units. In Unit 2, you learned about foreign trade, a form of trade or business which involves many countries. You learned that in order to carry out foreign trade, customs and port authorities play vital roles such as controlling imports and exports in order to correct an unfavourable balance of payments or trade, or to maintain a favourable one. You also learned how foreign trade is financed.

These business activities require an organised approach. For trade to take place, whether foreign or local, an organisation or business unit is required to provide goods and services wanted by the people. There are different types of business units, those under the private sector and public sector.

In this unit we will consider how business units under the private sector are organised. Organisation of business units involves several aspects of different business environments. In many countries, the majority of the business units are under the private sector.

This unit is divided into three topics. In the first topic we shall focus on sole trading and partnership. In the second topic we will discuss limited companies and in the third topic we shall consider multinational companies. In each topic we will look at formation, features, advantages and disadvantages.

We trust you will enjoy working through this unit and that you will find this unit interesting.

Outcomes

Upon completion of this unit you will be able to:

- *Explain* the term private sector.
- *Discuss* the advantages of the private sector.
- *Identify* different types of business units under the private sector.
- *Discuss* the characteristics of business units under the private sector.
- *Discuss* advantages and disadvantages of business units under the private sector.
- *Discuss* the documents used in the formation of different types of business units.
- *Discuss* the similarities and differences between private and public limited companies.

Resources

Tips

In order to study this unit with minimum difficulties, you need:

- A computer with internet connectivity (where possible) – to do research and send and receive e-mails.
- Mobile phone (where possible) – to make calls, sms and access internet for research and sending e-mails.
- To visit libraries to research on customs and excise authority (where applicable).
- Where possible attend tutorials at study centres and discuss with other learners and tutors.

Learning and Teaching Approaches

Tips

The following learning and teaching approaches will be used:

- **Content based approach** – To encourage you to base your learning on the subject matter provided, improve your skills and competencies on foreign trade and receive and to follow instructions. All of these will help you to learning effectively.

- **Problem based approach** – To make you responsible for your own learning in order to promote higher level learning skills like critical thinking on foreign trade. Here the teacher is viewed as a facilitator who assists you to solve problems rather than merely provide his/her own solutions.

- **Activity based approach** – To enable you to physically interact with people and the content in order to acquire foreign trade related skills and general learning skills by being actively involved in the discussions within the unit. You will be required to visit sole traders.

Time

You will need between 20 – 25 hours to study this unit. Do not worry if it takes you more or less time than this – we do not all work at the same pace.

Terminology

Audit:	A formal examination or checking of books of accounts. Audited is in the past tense.
Bankrupt:	A state of having no money to pay debts.
Board of Directors:	A group of directors elected by shareholders at the annual general meeting to supervise the running of the company and deal with policy matters.
Consent:	To agree to something proposed by another person.
Dissolution:	A formal ending of a partnership relationship due to various reasons e.g. resignation or death.
Entity:	A separate unit that is complete and has its own features, which makes it a single separate object.
Incorporated:	Established legally as an entity or business unit.
Legal:	Something allowed by law.
Partnership Agreement:	Rules that govern a partnership.
Personally Liable:	Any debts or damages incurred by the business are your debts and you must pay them, even if it means selling your home, your car and so forth.
Shareholders:	People who have bought shares in the company and are considered owners of the company.
Shares:	Capital of a limited company which is divided into units of uniform value.

Topic 1: Business Units: Private Sector

Introduction

Welcome to Topic 1 of this unit on the organisation of business units within the private sector. The word ‘unit’ has different meanings. In Grade 11 Commerce, we have used the word ‘unit’ to represent a group of topics to be covered. The word ‘unit’ in busines means one person or a group of people forming one entity. Business units therefore refer to the way businesses are organised. Business units will be discussed in more detail later in this topic. We will start the unit by defining the terms business and private sector. We will then discuss the benefits of the private sector to a country’s economy. We will further explore common ways of organising businesses in the private sector: sole trading and partnerships. We shall focus on the characteristics, formation, advantages and disadvantages of these business units.

By the end of this topic you should be able to:

Topic Outcomes

- *Explain* the term private sector.
- *Discuss* the advantages of the private sector.
- *Explain* the characteristics of a sole trading and a partnership business.
- *Discuss* the documents used in the formation of a partnership.
- *Discuss* the advantages and disadvantages of a sole trading and partnership business.

Tips!

To obtain more information on this topic:

Where possible:

- Visit sole partnerships in your area.
- Visit libraries to research on these business units.
- Attend tutorials at a study centre and discuss with other learners and tutors.

Time

You should spend at least 6.5 hours on this topic.

Defining a Business

We are all familiar with the term business. In the English language, the word business may be used to refer to many different situations. Before you proceed, do the following activity:

Activity 1

In your own words define a business in the space below.

Feedback

Now compare what you wrote with the three definitions provided below;

Business might refer to:

1. *What keeps one busy, for example: an occupation, trade or profession.*
2. *Private concerns and responsibilities.*
3. *Key things that somebody has to do.*

In commerce, the term also refers to a variety of activities ranging from commercial activities to organisations.

In this unit we will use the term 'business' to refer to commercial activities that provide customers with goods and services they want, as well as organisations that provide goods and services or makes goods.

Many people are involved in one form of business or the other. You may also be involved in some business activities. What type of business activities are some of the people that you know involved in? They may be involved in manufacturing goods for sale, buying and selling goods or providing services. Why would they engage in such activities? They would probably engage in business to make money or an income. Just like any person working for a company or someone being paid a wage or salary as his/her reward, a person who starts a business also expects a reward called a profit for taking the risk.

However business is not all about risk taking. It is much more than just buying and selling in order to make a profit. In addition to profit making, some people may just want to do something of their own and 'be their own boss'. You can also make the decision of starting your own business today and become 'your own boss' as an entrepreneur.

Starting a business of your own requires proper planning and organisation. What are some of the things you need to do before starting your business?

The following are some of the things you need to do:

- Make a decision to start a business with a particular product in mind.
- Make a decision on the type of business organisation that would be suitable for you.
- Organise the factors of production.

- Acquire some knowledge on the business, laws and regulations that apply to the kind of business you intend to start.

If the business succeeds, you would reap the reward of profits. However, if it fails, you must bear the loss.

From the above discussion, you should now know the meaning of business in commerce and some of the business activities undertaken. You also know that business requires planning and organization and can involve risks and rewards. In the next topic, we will discuss the meaning of private sector before moving on to business units within this sector.

Private Sector

Many countries today are encouraging people to invest in the private sector. Before you move on, do the activity below.

Activity 2

What do you think the private sector is? Write your ideas in the space provided below.

Feedback

Your answer may have included elements of private, individual or group ownership and not state owned. Our definition of private sector is:

> *Any business that is owned and controlled by an individual or a group of individuals is said to be a privately owned enterprise. All privately owned enterprises put together form the **Private Sector**. So, we can say that the private sector is the part of the economy that is not owned and controlled by the state, but by private individuals or institutions. The main motive of the private sector is profit making.*

In contrast, a business that is owned and controlled by the state on behalf of the general citizenry is called a public enterprise. All public enterprises put together form the public sector. We will discuss the public sector in detail in Unit 4.

An economic system where the private sector is stronger than the public sector is called capitalism. On other hand, an economic system where the public sector prevails is called socialism.

The private sector encourages ownership of private property, which is a right to own property such as land, a house, a car and/or businesses. This means that as an individual or group of individuals, you are free to buy whatever property you can afford to buy. You are also free to do as you wish with your property as long as you are not interfering with other people's rights.

Reflection

Do you know of any benefits of the private sector? Of course you may think of the reward that the business person gets if he manages his business well. Can you think of other benefits to the country's economy?

As you thought about the questions in the above Reflection activity, you may have come up with many benefits. Let us consider some of the benefits:

- The private sector is the chief employer. Many people are employed in the private sector compared to the number employed by government.
- The private sector pays tax to the government thereby boosting the country's income. The tax paid is used for developmental projects like building schools, hospitals, roads etc. So the private sector contributes to the development of a country.
- The private sector is the chief supplier of goods and services to consumers in and outside the country. By doing so, it helps in improving the standard of living of people.

Now that we have defined the private sector and know its benefits let us discuss business units under the private sector. This discussion will include many aspects, for example structure, types, characteristics, establishment and advantages and disadvantages of certain business units.

Business Units

Remember, in the Introduction to this unit we said that business units are ways of organising or owning businesses. One can own a business alone, as a sole trader or proprietor, or own it with another person as a partner (known as a partnership). One can also form limited companies such as private limited companies, public limited companies and multinational companies which also fall under public limited companies. All of these fall under the structure of business units. This structure can be illustrated diagrammatically as shown in Figure 1 below.

Structure of business units under the private sector

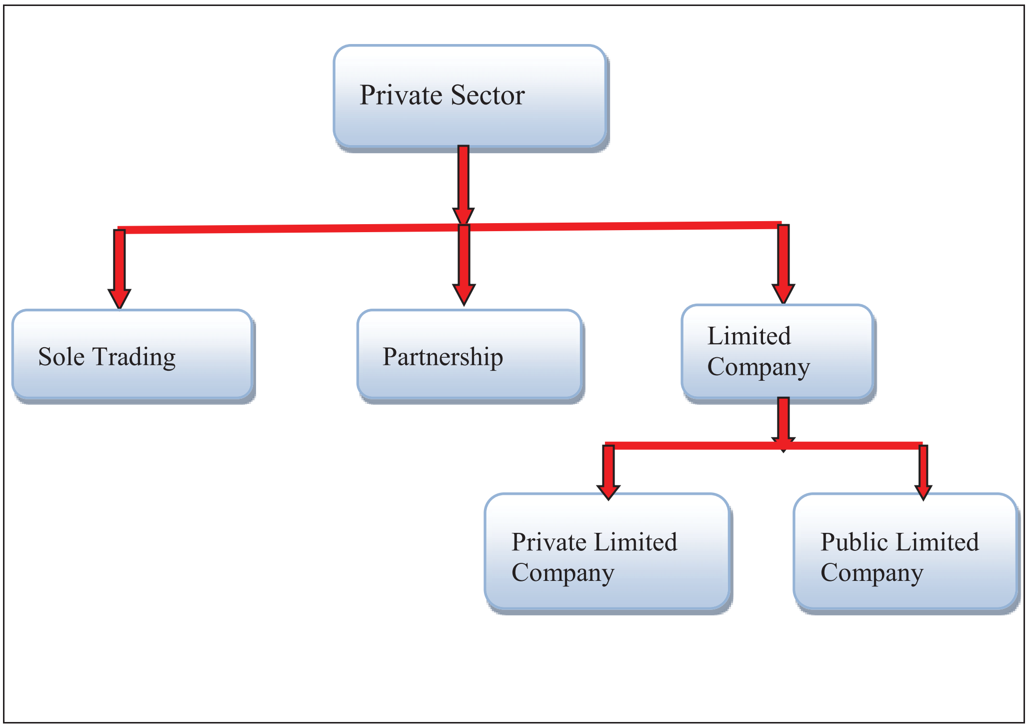

Figure 1: The structure of business units under the private sector (Hand Drawn, by Commerce Team, ZACODE, 2010.).

We have already stated that a business can be owned by an individual as a sole trader or by a number of individuals as partners in a partnership. These are the common ways of organising business under the private sector. However, in our communities we may have hawkers and pedlars. These are people who sell their commodities using bicycle or baskets. They prefer doing this type of business because it is easier to start than sole trading and partnerships which might require more resources to set up.

We shall now further examine each of the business units mentioned above.

Sole Trading

Since sole trading is a very common business unit worldwide, you may have different ideas of what it is. So let us define sole trading in order for us all to come to a common understanding.

Sole trading is a type of business that is owned and controlled by one individual who raises the capital for the business from his/her own private resources and enjoys all the profits as his/her reward. This one individual makes all the decisions and bears all liabilities. This type of business has no separate legal existence and as such, when the owner dies it also comes to an end (liabilities and separate legal existence are explained below). A sole trading business is also called sole proprietorship. An individual who runs business alone is called a **sole trader**.

The passage above gives the main characteristics of a sole trading business which we are now going to discuss under the following headings:

- Ownership
- Control
- Capital
- Profit
- Decision making
- Liability to debts
- Separate legal existence (entity)
- Continuity of existence

Main Characteristics of Sole trading

Ownership - A sole trading business is owned by one person.

Control – It is controlled by one person.

Capital – Capital is money or anything of value, used to start or introduced into an already existing business. The purpose of introducing capital into an already existing business is to enhance its expansion. Capital is raised by the owner of the business from their own resources or by getting a small loan from either friends or relatives. This does not mean that sole traders cannot borrow money from banks. They can still borrow money in their own individual capacity, but some may not have property that they can surrender to the banks in case they fail to pay back the loan.

Profit and losses – the owner enjoys all the profits and bears all the risks or losses.

Decision making – decisions are made by the sole owner of the business, which gives them the freedom to decide on the times of opening and closing their shop.

Figure 2: Sole traders make her own decisions. Photo by Commerce Team, ZACODE, 2010.

Figure 2 above shows a sole trader trying to make a decision. Study Figure 2 and then answer the question in the next activity.

Activity 3

1. What do you think are some of the disadvantages of sole traders making their own decisions? Write your ideas in the space provided.

Feedback

We believe from your experience that you were able to come up with some of the disadvantages of sole traders making their own decisions. Check whether your ideas are included in the discussion below.

Some of the disadvantages of sole traders making their own decisions are that:

- *They decide when to open and close their shops. They may decide to open late which might reduce their profits. They may also decide on closing their shops late which might be risky.*
- *Sole traders may make wrong decisions which would lead to having a lot of debts. Other disadvantages of sole trading are discussed below.*

We have said that sole traders are liable to debts, what does this mean? Below are explanations of liability to debts, separate legal existence and continuity of existence which all have a bearing on sole trading.

Liability to debts - the sole trader is personally liable for the debts incurred by the business. This state of being personally liable to the debts of the business is called **unlimited liability**. For example, if a sole trader fails to pay debts because the business is not doing well financially, the private property of the sole trader will be taken and sold to repay the debt of the business.

Separate legal existence (entity) - a sole trader is not a separate legal entity. An entity is 'something that exists independently'. This means that there is no legal separation between the owner and the business. For example, if the sole trader fails to pay the creditors, the creditors will sue the owner of the business and not the business. Contracts are also entered into under the individual name of the owner and not the business.

Continuity of existence - the death of a sole trader may bring the business to an end. However, there are instances where the business may continue and an example is if a **successor** (a relative or friend) takes over. Sometimes, the absence or sickness of a sole trader may also affect the business negatively.

In addition, a sole trader does everything alone or may hire a family member or employ a worker. Sole traders do not disclose their financial records to the general public, they keep them confidential. However, they declare their financial records to the revenue authorities in their respective countries for tax purposes.

You are now familiar with the features of sole trading. You have defined sole trading as a type of business that is owned and controlled by one individual. You have also learned the characteristics of sole trading and noticed that these range from sole trading to decision making. We will now look at the procedures to follow when setting up a sole trading business.

How to set up a sole trading business

There are few legal requirements in setting up a sole trading business. One needs to obtain a trading licence from a local authority and to pay the required fee. Immediately after this is done, the business starts its operations. Some small sole trading businesses operate without trading licences, although that is not legal.

You can start a sole trading business by simply opening a small shop (Kantemba) in front of your yard, making fritters for sale at home or by buying and selling vegetables. You may open a restaurant or start a grocery store in town. Many businesses of this nature that we know are those of sole traders.

Even if it seems sole trading is common in retail, it is not typical of retail trade only. You learnt in Grade 10 that retailers buy goods from different wholesalers and sell them to the consumers in smaller quantities. We also know of builders, plumbers, hairdressers, radio/ TV repairers (to mention just a few) who run their businesses alone. In addition, there are small scale manufacturing enterprises, hotels and bars owned and run by individuals. These individuals are also known as sole traders although they are not involved in the actual buying and selling of goods, but sell their services and may do their businesses alone.

Doing business as a sole trader does not only come with challenges (such as liabilities and continuity) as the above section may have suggested. There are also a lot of benefits. Let us discuss some of the benefits or advantages.

Advantages Sole Trading

A sole trading business is very easy and cheap to set up because you do not need to use specialist services, all you need is to open a bank account and obtain a licence.

Before you read on, take a few minutes to do the following activity which requires you to explain the reasons for setting up sole trading in your area.

Activity 4

1. Why do you think people in your area decide to start sole trading businesses? Do the reasons below relate to why people in your area choose to start sole trading businesses?

- Poverty
- Self-help
- Family support
- Women and sale of goods at the local markets

Write brief notes on each of the above aspects in relation to what transpires/takes place in your area.

Feedback

Your answer to the above activity may contain very interesting reasons related to practices in your area. As long as you have covered the above reasons your answers should be acceptable. In the section below, we will briefly explain the above reasons and you should then compare these to the answers you stated in your answer. Note what you may have omitted in your answer and make additions to your notes where necessary.

In order to reduce poverty, most people decide to start sole trading businesses. This may also lead to people being self-reliant (self-help) as they do not depend on other people for help but on their sole trading businesses. Through these businesses, people are able to support their families. Women nowadays no longer stay at home and solely care for children, but sell goods at local markets. They are therefore, also involved in sole trading businesses.

From your own personal experience you have explained the reasons why people in your area start sole trading businesses. You then had an opportunity to compare these with our views in the feedback above. We can now move on to discussing the advantages of sole trading.

The advantages are:

- The decision making process, as we have already discussed above, is easy and fast since one does not need to consult anyone.
- As the owner of the business, you keep all the profits to yourself; you do not need to share with anyone. This motivates you to work even harder. The feeling of being 'your own boss' can also be motivating and inspiring.
- Your total control over the business allows you to make your own decisions in relation to the management of the business without any external interference.
- Your business records are kept secret; they are not made known to members of the general public except to the revenue authority of your respective country.

While a sole trading business is easy and fast to set up, it has its own challenges which we shall now discuss. These include the challenges we mentioned when we were defining terms like liability and continuity.

Disadvantages of Sole Trading

- The sources of capital are restricted. Capital is usually raised from the sole trader's own savings and by borrowing from friends or relatives. Banks and other lending institutions may not be willing to lend money to very small businesses. This limits the capital that can be raised by the business which means even business expansion is limited.
- One person cannot have all the skills needed to run a successful business. As sole trader you may be a good hairdresser, but may lack good customer relations, a quality that is necessary for business success.
- As a sole trader you have to do all the work by yourself or you may hire a family member or employ a worker. Good and reliable workers are not easy to find. When found they have to be trained and retained, which is also difficult. This makes the sole trader inefficient.
- The business is small so it is does not reap the benefits of bulk buying, such as reductions in price. Reductions in price are often offered for bulk buying, which a small business is unable to do.
- The operations of a sole trader may come to an end if the owner dies and when the owner is committed elsewhere, the business comes to a standstill.
- A sole trading business is not a separate legal entity which means that the owner and the business are legally viewed as one person; there is no legal separation between them.
- The owner has unlimited liability which means that the owner is fully liable for the losses or debts the business incurs. In the event that your business fails to pay the creditors, your personal property would be grabbed from you to pay for the debt.

So far, we have been discussing advantages and disadvantages of sole trading. Now do the activity below. This activity is more substantial than the ones you have done above. It should help you to assess your understanding of the private sector and sole trading in particular. Feedback is given below the activity and you should use it to check your answers and make improvements where necessary.

Activity 5

Answer the questions given below.

1. Visit sole traders in your area and observe how they conduct their business. Make notes of what you observed.
2. A sole trader is a common privately owned business. How does the private sector benefit your country?

   If you are working alone, write down a list of the benefits of the private sector to your country and discuss them with a member of your family or a friend using the observations you made in 1. above.

   If you are working in a group, write down the benefits of the private sector to your country and discuss them with your group using your observations in 1. above.

Feedback

You may have found this activity easy to do because we believe you have often had personal contact with sole traders found in your community. During your visit you may have observed that sole traders carry out their business alone. They are their own bosses. Some of your observations may not have been included here, but this does not mean that they are incorrect. We have only mentioned a few here.

Our answers to the question 2 above are as follows:

2. *The benefits of the private sector:*

   The private sector is the chief employer. It provides the majority of citizens in the country with secure jobs compared to the number employed by government.

   The private sector pays tax to the government thereby boosting the country's income. The tax paid is used for developmental projects like building schools, hospitals, roads etc. So the private sector contributes to the development of a country.

   The private sector is the chief supplier of goods and services to consumers in and outside the country. By so doing it helps in improving the standard of living of people.

If these were your answers, well done! If you had problems in getting some answers, read through the relevant section/s of the topic again.

We have completed our discussion on sole trading and are now moving on to partnerships. The disadvantages of sole trading are the reasons most sole traders enter into partnerships. In partnerships, there is capital expansion and sharing of skills and ideas. We have looked at sole trading as a way of organising and owning business alone. We are now going to discuss partnerships along similar lines as we have done with sole trading. This should enable you to compare and contrast the two kinds of business units with relative ease.

Partnership

A **partnership** is a business that is co-owned and controlled by two or more people who contribute capital, make decisions and share responsibilities, profits and losses. The people who own and control a partnership are called partners. Like a sole trading business, a partnership is not a separate legal entity as you will notice in our discussion of the characteristics of a partnership below:

The characteristics of a partnership include:

- Membership is from 2 up to 20 people. In certain partnerships however, the maximum number of partners is either less or more than 20.
- The books of accounts are confidential. This means that the financial status of a partnership is not known to outsiders.
- The partners are the owners of the business.
- Control of partnership is shared amongst the partners.
- The death of a partner leads to the dissolution of the partnership. This is a legal requirement. The remaining members of the partnership can establish a new partnership after such dissolution.
- A partnership business requires a few logistics and documents to be put in place. For example, only a partnership deed may be required.
- Like in sole trading business, partnerships have no legal status. This means there is no legal difference between the partners and the business and therefore, they can sue and be sued in their individual capacities.
- Every partner is involved in the running of the business.
- Partners have unlimited liability except for a limited partner (the term limited partner will be discussed later in the topic).

Partnerships are common among professions such as insurance brokers, dentists and builders. However, they are also found in other professions and practices.

Earlier in this topic we discussed features of a sole trading business, and now that you know the features of a partnership, let us compare the two business units. We will start with similarities and the differences will follow thereafter.

Similarities

Both sole trading and partnership business:

- Are not separate legal entities.
- Keep books of accounts confidential.
- Lack continuity of existence. If the owner or owners die(s) the business will either come to an end or dissolve.
- Have unlimited liability.
- Are easy to set up as they have fewer legal formalities.

While sole trading and partnership businesses are similar in some ways, they differ considerably in some respects. Table 1 below shows the differences between sole trading and partnership businesses.

Table 1: Differences between sole trading and partnership businesses

	SOLE TRADING	PARTNERSHIP
Ownership	Owned by one person	Owned by 2-20 partners
Control	Controlled by one person	Controlled by two or more partners
Capital	Capital is provided by one person	Capital is contributed by partners
Profits	All profits are enjoyed by one person	Profits are shared among the partners
Decisions	Sole traders make their own decisions. This gives them freedom to decide on the times of opening and closing their shop.	Decisions are made by the partners by consulting each other.

Now that you are able to distinguish a sole trading business from a partnership, let us proceed and look at the legal formalities required to set up a partnership business.

How is a Partnership Formed?

Just like a sole trading business, a partnership does not require a lot of legal formalities. However, since the business in not owned by one individual, there is a need for a written legal document that will guide all partners in case of any future disagreement. This document is called a **partnership deed** or **articles of partnership.**

Before you proceed, do the following activity. This one question activity will enable you to assess your prior understanding of how partnerships are formed. Feedback to this activity is given below the activity. You are advised not to look at the feedback before you do the activity.

Activity 6

1. What do you think are some of the points the partners need to agree on in the partnership deed or articles of a partnership document?

If you are working alone, write down a list of the possible points that the partners need to agree on in this document. After, you should compare your answer with the feedback below.

If you are working in a group, write down some of the points the partners need to agree on and discuss these points with your group.

Write down the main points of your group discussion and compare them with the feedback given below.

Feedback

You may have provided your answers from your own experiences in your environment or from some areas you may have visited or even heard of. You can now compare your answers to the ones provided below.

Your list may have included some or all of these;

- *Capital contribution*
- *Profit sharing*
- *Drawings*
- *Salary to working partners*
- *Rate of interest on capital and drawings*

The list of points above will be discussed under the partnership deed below. These are usually the areas which need to be addressed as the partnership is being formed.

Other points that you may consider include:

- *The name of the business*
- *The activities you are going to be involved in*

All the points we have raised above need to be written down in a partnership deed as they are important for the partnership.

Having discussed how a partnership is formed, we will now move on and discuss the partnership deed which, as we have already mentioned, covers all the points that have to be considered in forming a partnership.

Partnership Deed

We have so far learnt that in order for the partners to avoid future conflicts or misunderstandings, they should prepare a written legal document to guide them. This document is called a partnership deed or articles of partnership. In this document, the partners must specify the following aspects:

- Their own rights and duties.
- The name of the partnership.
- Objectives of the partnership.
- The amount of capital each partner will contribute.
- The amount of drawings to be made by each partner.
- The ratios in which profits and losses will be shared.
- The rate of interest on capital and on drawings.
- The amount of salary (if any) that will be paid to partners working in the business.
- Where the books of accounts will be kept.
- How assets of the partnership may be shared on dissolution of the partnership, and
- May also state how future partners may be admitted in the partnership.

Not all partnership deeds contain all the points raised above. The contents of the partnership deed may depend on what the partners themselves have actually agreed upon.

There is a second way in which partnership may be formed. In Zambia, partnerships could be guided by the Partnership Act of 1890. Using the Zambian experience, let us now look at the second way partners can organise themselves apart from preparing a partnership deed discussed above. That is by using the Partnership Act of 1890.

Partnership Act of 1890

The partners could decide not to prepare the partnership deed. In this case they would choose to follow the rules of the Partnership Act of 1890. These rules would apply to matters which are not agreed upon. The following are some of the rules contained in this Act:

- The books of accounts must be kept at a place of business and all partners must have the right to read through the books of accounts.
- Profits and losses should be shared equally.
- Partners should not claim a salary for working in the partnership business.
- Partners are to contribute the same amount of capital to the business.

We have dealt with two ways of forming partnerships: by a Partnership Deed and through the Partnership Act of 1890. People may decide to join together for various reasons. Let us consider some of the reasons why people would consider forming a partnership. You may have deduced some of these reasons from earlier discussions on similarities and difference between sole trading and partnerships. In that case, the next section may merely serve to consolidate what you know. Whatever the case, read the section in order to deepen your understanding of partnerships.

Why Form a Partnership?

The idea of forming a partnership may cross your mind because as a sole trader, you may not have enough capital to expand your business. You would therefore join together with other sole traders so that you can raise more capital.

In addition, you may not have all the necessary skills required to run a successful business, so you could consider joining together with other sole traders in order to put your skills together. Let us assume that you and your partner open a florist shop. You are good at arranging flowers and your partner is good at customer relations. Both of you would contribute your skills to make the business more successful. There will be division of labour. This means each partner will do the work they are skilled or good at. If you owned the florist shop alone, your business would lack good customer relations which may negatively affect your business. Putting your capital and skills together are the major advantages of forming a partnership.

Other advantages include:

- It does not involve many legal procedures. All that is needed is a partnership agreement.
- Decision making is consultative, which often makes the quality of decisions better than those of a sole trader.
- There is privacy in the business because financial records are not made available to the public.
- The absence of one partner may not cause the business to come to a standstill.
- Management and expenses are shared.

Like a sole trading business, a partnership has disadvantages which we shall now consider.

Disadvantages of a Partnership

- Partners have unlimited liability and therefore, their personal assets are at risk as each partner is personally liable to the creditors should the business fail to pay its debts.
- A partnership is not a separate legal entity. Partners can be sued or only sue in their individual capacities.
- The death or resignation of one partner leads to the dissolution of the partnership business. This requires a new partnership agreement which is irritating to the remaining partners.
- Partnerships depend on partners' contributions which are usually not enough because membership is limited to 20 partners. This limits the expansion of the partnership business.
- Since each partner is entitled to participate in the management of the business, disagreements may arise causing delay in the decision making process.

- A decision may adversely affect the partnership even when it is made by one partner since one partner's decision is binding on all the other partners.
- Misunderstandings among partners may arise. Sometimes a clash between partners can be caused by one partner.

We have so far discussed two business units: sole trading and partnerships. This is a good opportunity for you to take a few minutes and think of which type of business unit you would prefer. Once you have decided do the following activity to examine your reasons for forming both types of business units discussed in this topic.

Activity 7

1. Why would you decide to form a sole trading business?
2. Why would you decide to form a partnership?

Write down a list of possible reasons for forming both sole trading and partnership businesses and discuss them with a member of your family/friend. If you are working in a group, discuss your responses together.

Feedback

Now compare the answers you have given to the ones given below*:*

We do not know the reasons you have written and discussed. However, these reasons would have been based on the benefits/advantages of the two types of business units.

1. *Your reasons for deciding to form a sole trading business could include any of the following advantages of sole trading:*
   - *It is cheap and easy to set up.*
   - *The decision making process is easy and fast.*
   - *You will keep all the profits to yourself.*
   - *Your total control over the business allows you to make your own decisions in relation to the management of the business without any external interference.*
   - *Your business records will be kept private.*
2. *In the case of partnerships, your reasons could be any of the following advantages:*

- *More capital is raised since many people are involved.*
- *You will have more skills compared to a sole trading business, as partners will pool together their skills.*
- *It does not involve many legal procedures. All that is needed is a partnership agreement.*
- *Management and expenses are shared.*
- *Better decisions than those of sole traders are made because the partners will consult each other before a decision is made.*
- *There is privacy in the business because financial records are not made available to the public.*
- *The absence of one partner may not cause the business to come to a standstill.*

We hope your answers are similar to these. If you gave the disadvantages of a sole trading business for choosing a partnership, you are still on the right track. However if you got some answers wrong, go through the topic again.

Having done this activity, let us move on and look at the types of partners.

Types of Partners

There are two main types of partners. One is called an **ordinary partner** and the other a **limited partner**.

Ordinary Partner

An ordinary partner has unlimited liability and takes an active part in the running of the business. Unlimited liability means that if the partnership runs into financial problems, the personal belongings of an ordinary partner may be sold to pay off the creditors (the people and lending institutions that the business owes).

The second type of partner is called a limited partner.

Who do you think a limited partner is? From the above description of unlimited liability, we are sure that you can easily deduce the answer. However, you can also get the answer from the section below.

Limited Partner

A limited partner has limited liability and does not take an active part in the running of the business.

What is limited liability?

This means that the limited partner’s personal belongings are not at risk. This means that they cannot be sold in the event that the partnership fails to pay its creditors. However, this partner may be asked to contribute a larger part of capital. This partner is usually well known in the community and the use of her name might bring greater benefits to the business. In our country, the inclusion of this kind of partner is supported by the Partnership Act of 1907. In other countries, this would be controlled by different set of legal procedures.

Topic 1: Summary

We have now come to the end of the first topic of this unit where we defined a business and the private sector. We also discussed the benefits of the private sector to a country. Under business units, we explored common ways of organising businesses under the private sector. We particularly looked at sole trading and partnerships where we focused on their characteristics, how they are set up and the advantages and disadvantages. The other types of business units under the private sector will be discussed in the next topic.

You had a chance to check your understanding through the activities given in this topic. We hope you did all the activities and found them useful.

In the next topic we shall proceed to look at limited companies which still fall under the private sector. We will look at their characteristics, the legal procedures followed when setting them and the advantages and disadvantages.

You can now do the End-of-Topic Exercise 1 which you will find at the end of the unit after the unit summary. This exercise will help you to review what we discussed in the topic. We recommend that you complete the exercise before reading our feedback. This will give you an accurate assessment of your understanding of what you learned from the topic. If, on comparing your answers you discover that some of your answers are incorrect, review the relevant sections of the topic before moving on to the next topic.

Topic 2: Limited Companies

Introduction

In Topic 1, we defined the private sector. We further discussed two business units under the private sector, namely sole trading and partnerships. We considered the characteristics, formation, advantages and disadvantages of these business units.

In this topic, we will discuss limited companies which also fall under private ownership. We stated earlier in the previous topic that a limited partner has limited liability and does not take an active part in the running of the business. A limited company on the other hand is not a living being like a limited partner. As stated below, it is an association of individuals who contribute money and or assets to a common stock or business.

Our discussion will focus on private and public limited companies. We will specifically look at the characteristics, formation, advantages and disadvantages of these companies.

By the end of this topic you should be able to:

Topic Outcomes

- *Explain* the characteristics of limited companies.
- *Discuss* the advantages and disadvantages of limited companies.
- *Discuss* the documents used in the formation of limited companies.
- *Discuss* similarities and differences between a private and public limited company.

Time

You should spend at least 6.5 hours on this topic.

Remember from our discussion in Topic 1 that the sole trading and partnership businesses have the following limitations:

- They have limited capital,
- They lack continuity of existence.
- There is no separation between the owners and the business.
- The liability of owners to debts is unlimited.

These problems can be overcome by forming a limited company. In our discussion of limited companies below you will see how limited companies aim to address these problems.

What are Limited Companies?

We will start by defining the words limited and company before we discuss limited companies in detail.

From our discussion of a limited partner in Topic 1, you may have figured out that the word **limited** refers to a restriction imposed on something. In this case, it means that the liability of the company is restricted to its total resources.

A company is an association of individuals who contribute money and or assets to a common stock (business). These people are referred to as shareholders or stockholders. The stock they contribute is called capital. The same stock is used as a starting point for trading and they share the profits and losses accrued from the same business. In short, a company is also a business.

A limited company therefore is a business that is legally considered a separate legal entity and whose financial liabilities are restricted to the amount of money provided by the shareholders in the business. This means that if the company at some point goes bankrupt, the owners of the company will only lose the money they have contributed as capital to the business. Being **bankrupt** is a state where an organisation fails to pay its creditors. The creditors to the business have no right to claim any personal properties of the shareholders. A **creditor** is an individual or organisation a company owes money.

There are two types of limited companies: private and public limited companies. Remember, we said earlier that business may be organised under the private or public sector. It is important to note that public limited companies fall under the private sector although their names bear the word "public". They are called public limited companies because their shares are offered to the members of the general public.

Main Characteristics of Limited Companies

The two types of limited companies have similar characteristics with regard to the following aspects:

- Ownership
- Control/organisation
- Capital
- Profit
- Decision making
- Liability to debts
- Separate legal existence (entity)
- Continuity of existence

Let us examine each of the above aspects/ characteristics in some detail.

Ownership

A limited company is owned and formed by not less than two people and there is no maximum number of shareholders, although some countries have maintained a minimum number of fifty shareholders for a private limited company. Try to find out the minimum number of shareholders that private limited companies in your area or country are allowed to have. The number may be different from what we have stated above because different countries or areas have different policies.

Control/Organisation

A limited company is controlled by a **board of directors** elected by the shareholders at the Annual General Meeting. We need to understand the meanings of the terms ‘board of directors’ and ‘annual general meeting’.

What is a Board of Directors?

This is a group of people elected (chosen by voting) by shareholders from among themselves to oversee the running of the company, usually for a period of three years. It is this group of directors that direct the activities of the company by coming up with the goals and policies to be followed by the company.

The board of directors appoints a full time managing director or general manager who is responsible for the day-to-day running of the company. To **appoint** means to select an individual or a group of individuals for an official position or job. The managing director has an important role to play on the board of directors. In a small company the managing director is also the chairman of the company, but in large companies, the chairman is usually not the managing director. The board of directors also employs a management team to work with the managing director. The whole process is summarised in the organisation chart shown in Figure 3 below.

Organisation of a limited company

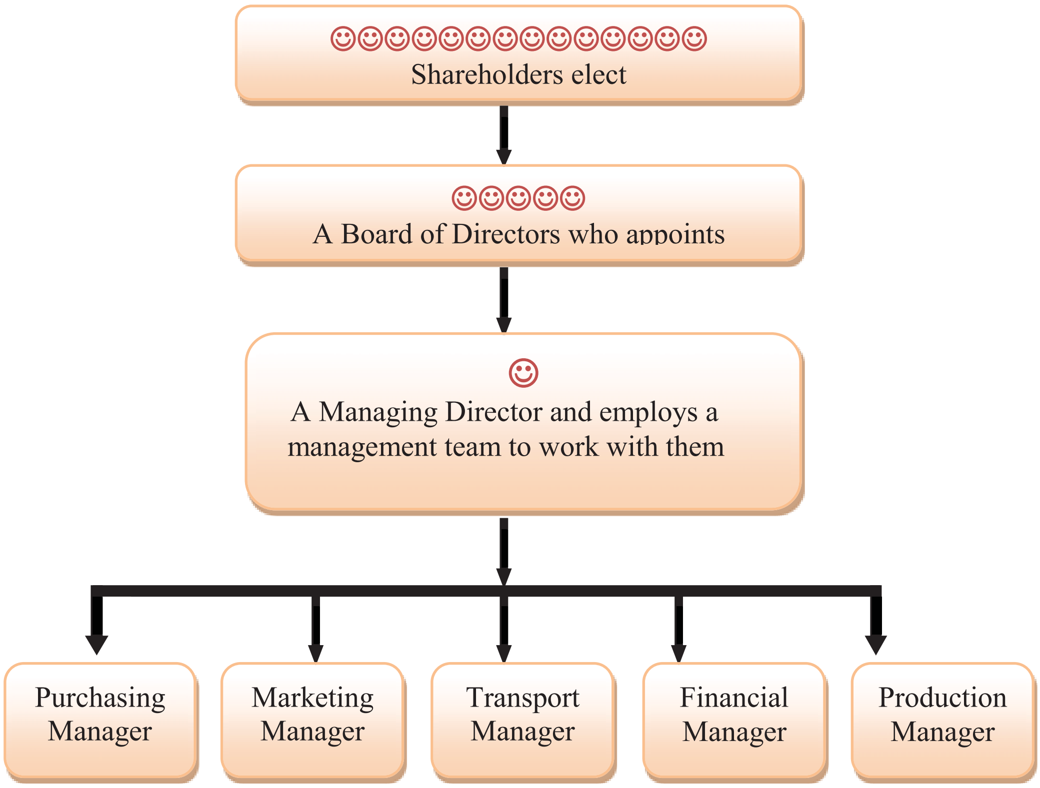

Figure 3: Organisation chart of a limited company hand drawn by Commerce Team, ZACODE, 2010.

Figure 3 above is an organisation chart, which is a diagram or table showing information concerning the relationships that exist between separate components (departments) of the organisation. For example purchasing, marketing etc. The organisation chart also includes the staff structure. For example the above chart shows the position of the director and his/her relationship with the board of directors and the departmental managers. The chart can be expanded to include the lower staffing structure within each department.

We have mentioned earlier that the board of directors are elected by the shareholders at an annual general meeting.

What is an Annual General Meeting?

This is a yearly meeting held by all shareholders (members) to meet the requirements of the provisions of the **company's act**. At this meeting, in addition to electing a board of directors, shareholders:

- approve the audited accounts presented by the managing director,
- discuss the affairs of the company,
- and deal with issues that could not be settled by the board of directors.

Separate Legal Existence

By law, a limited company is a separate legal entity. A separate legal entity is, as we have already discussed, viewed as separate from the people that formed it. The company is not related to its shareholders. The company can own and dispose of its assets as a business. It can even enter into contracts and suffer penalties for the actions of its employees. In short, it is an artificial person although it cannot marry, go to jail or suffer other penalties a person can suffer.

Limited Liability

The liabilities of the shareholders are limited. This means that the shareholders are answerable only to the extent of the amount of capital invested in the business, and cannot lose more than their investment should the business face financial problems.

Profits

Profits are shared according to the type, number and value of shares held by each member. The more shares a shareholder has, the more profits he or she would get. The share of profit each shareholder gets is called a **dividend**.

Continuity of Existence

In topic 1 we said that the death of a sole trader means the end of the business. Equally, the death, resignation or retirement of a partner in a partnership means the dissolution of the partnership. On the contrary, a limited company does not come to an end even if a shareholder dies, it will continue to exist. It is not disturbed by the coming and going of shareholders. Shareholders can sell their shares and still others can buy the shares of the company and become part of the company. This explains why some companies have existed for decades.

Capital

Capital of a limited company is raised through the sale of shares. The investments in the limited company are divided into shares. Each shareholder will receive shares equivalent to the amount they have contributed.

You are now familiar with the main characteristics of limited companies. These characteristics apply to both private limited and public limited companies as they are both limited companies. Let us move on and look at the differences between private limited and public limited companies.

A Private Limited Company and How it Differs From a Public Limited Company

You may have observed that some companies are small family businesses which sell shares to family members or friends privately. Such a company is called a private limited company. It is called a ‘private’ limited company because it sells its shares privately. The shares of such a company are not sold on the stock exchange. When it comes to the transfer of shares, there are usually some restrictions. For example, if as a shareholder you want to sell some of your shares to another person, you have to do it with the permission of other shareholders. When the shareholders do not agree with the buyer of shares a shareholder has chosen, they have to find a new one.

The name of a private limited company ends with ‘Ltd’ or ‘Limited’. For example: Chibambula Construction Ltd. The inclusion of ‘Ltd’ or Limited in the name acts as a warning to potential creditors that should such a company become bankrupt, the liability of shareholders will be restricted to the capital invested in the company.

The private limited company begins its operations as soon as it is given a certificate of incorporation; it does not have to wait for a certificate of trading. A **certificate of incorporation** is a document issued by the registrar of companies to show that a company has been registered and can now start operating, while a **trading certificate** is a document which provides proof that a registered company has been allowed to begin its operations. The **registrar of companies** is a government official responsible for keeping a record of companies allowed to operate officially.

The books of accounts of a private limited company are kept private. They are not disclosed to members of the general public. These are the characteristics that make a private limited company different from a public limited company.

A Public Limited Company

On the other hand, a public limited company has the following characteristics:

- It is allowed to invite the public to invest in the company by selling its shares on the stock exchange.
- Shares are freely transferred without any control from other shareholders of the company.

- The company begins to operate legally after being issued the certificate of trading.
- The name of the public limited company end with **Plc**. For example a company can be called Sugar Producing Company Plc.
- The books of account of a public limited company are disclosed to the public. This allows potential shareholders to know the financial position of the company and decide whether to invest in the company or not.

Let us move on and look at the advantages and disadvantages of forming a private limited company first and thereafter those of the public limited company.

Advantages of Private Limited Company

The advantages of the private limited company are that:

- the company can start operating legally as soon as the certificate of incorporation is issued,
- a private limited company is a separate legal entity which makes it possible for the company to enter into contracts, sue and be sued in its own name and capacity,
- it is an ongoing enterprise because the business is not affected by changes in its membership,
- the company can have as many members as it wants especially in countries where the number of membership is not restricted to fifty,
- the books of accounts are confidential since the company is not required by law to publish them to the public,
- the shareholders keep direct control of the affairs of the company especially at the annual general meeting where they express opinion regarding the operations of the company.

Although a private limited company has all these benefits, it also has some disadvantages.

Here are some of the disadvantages of a private limited company:

Disadvantages of a Private Limited Company

- The decision making process passes through many management channels and this may cause a delay in decision making.
- The company is not flexible. This is because it is regulated by the Articles of Association and Memorandum of Association and changing the business would mean to start the company formalities again.
- The company has limited sources of capital because it is not allowed to sell its shares to the public for additional capital.
- There is restriction in the transfer of shares. This is because shares cannot be sold to another person without the consent of the other shareholders.

- Forming this type of a company is expensive as it demands large sums of capital.
- The company has many legal formalities such as holding of the annual general meeting and auditing of books of accounts. This is a must and is done annually.

We have discussed advantages and disadvantages of a private limited company. We will now proceed to the advantages and disadvantages of a public limited company.

Advantages of a Public Limited Company

The following are some of the advantages of a public limited company:

- The company can sell it shares and debentures to the public to raise its capital and it is usually done through the stock exchange.
- The company has continuity of existence. The company continues to operate normally even when a shareholder decides to leave the company. Shares can be sold to other people wishing to become shareholders in the company.
- The company has limited liability. This reassures the shareholders that their personal belongings are not at risk in case of company debts.
- The company is able to employ specialists in departments such as accounting and human resource which makes the organisation to operate more efficiently and effectively.
- The company is able to use modern technology and also buy modern equipment. This saves on the costs of labour and other expenses.
- Shareholders can sell their shares freely. They do not need any permission from other shareholders.
- The opportunities of borrowing are very high for the company as most banks are more willing to lend money to larger business units than the smaller ones.
- The company has the capacity to raise more capital by use of various means which makes it enjoy the economies of scale. It is able to provide goods in bulk at lower cost.

The following are the disadvantages of a public limited company:

Disadvantages of Public Limited Company

- When the business grows in size, it becomes difficult to manage.
- Decision making is slow as there are so many channels to be followed before a decision is finally made.
- As the business grows bigger, the original owners of the company lose control.

- It is very costly to establish this type of a business unit because of many legal procedures to be followed before the company begins to operate officially by law.
- Since shares can easily be bought on the stock exchange, there is a risk of being taken over if another company decides to buy shares at fifty-one percent (51%).

In the above section, we have covered a lot of content on private limited and public limited companies. Before we proceed with the rest of the topic, you should do the activity below which is a case study to assess your understanding of what we have learnt so far in the topic. A case study is an analysis of a particular situation used as a basis for drawing conclusions in similar situations. The case study below will assist you in drawing similar conclusions to similar situations that you may come across.

Read the following case study and answer the questions:

Activity 8: Case Study

Mr. Chola did business with a very small carpentry shop and worked alone for 10 years. One day he went to town to buy timber. There he met an old friend, Chomba. The two discussed business and eventually agreed to form a partnership. They were in this partnership for two years until Chomba resigned because he was leaving the country. This led to the dissolution of the partnership. Chola realised that even when he was in a partnership business, he experienced some problems. He has decided to invite some relatives and friends to contribute capital so that they form another type of business unit after the dissolution of the partnership.

Now answer the following questions:

1) Name the type of business unit that Mr. Chola was involved in for 10 years.
2) What led to the dissolution of their partnership?
3) What type of business unit did Chola decided to form after the dissolution of the partnership?
4) State any two reasons why Chola did not decided to form another partnership.
5) Explain to him at least four characteristics of a private limited company.
6) State five strengths and five weaknesses of a private limited company.

Feedback

Check whether your answers are similar to the ones given below.

1. Sole trading.
2. The resignation of Chomba.
3. A private limited company.
4. - Limited capital
- Lack of continuity of existence
- Unlimited liability
- It is not a separate legal entity
- Misunderstandings may occur among partners.
(Any two of the answers)

*5. **Characteristics of a private limited company***

a) It is owned by a minimum of two shareholders and no maximum.
b) It is controlled by a board of directors.
c) It is a separate legal entity.
d) Shareholders have limited liability.
e) It has continuity of existence.
f) It is registered with the Registrar of Companies.
g) Shares are not transferred freely.
h) Its name ends with 'Ltd' or Limited.
i) Its shares are sold privately and are not sold on the stock exchange.
(Any four)

Note that these characteristics also apply to a public limited company

*6. **Five strengths of a private limited company***

a) It can start operating legally as soon it is incorporated.

b) It is a separate legal entity which makes it possible for the company to enter into contracts, sue and be sued in its own name and capacity.

c) It is an ongoing enterprise because the business is not affected by changes in its membership.

d) The books of accounts are kept private.

e) The shareholders keep direct control of the affairs of the company especially at the annual general meeting where they express opinion regarding the operations of the company.

f) It has more capital than a sole trader and partnership since many people are involved.

(Any five)

Five weaknesses of a Private limited company

Again, any five of the following will be adequate:

a) The company has many legal formalities such as holding of the annual general meeting and auditing of books of accounts. This is a must and is done annually.

b) Forming this type of a company is expensive as it demands for large sums of capital.

c) *The company has limited sources of capital because it is not allowed to sell its shares to the public for additional capital.*

d) *The decision making process passes through many management channels and this may cause delay in decision making.*

e) *The company is not flexible. This is because it is regulated by the Articles of Association and Memorandum of Association and changing the business would mean to start the company formalities again.*

f) *There is restriction in the transfer of shares. This is because shares cannot be sold to another person without the consent of the other shareholders.*

The case study and questions above should have enabled you to review the content that we provided in the first part of this topic, including the strengths and weaknesses of a private limited company. Let us now look at the formation of a limited company.

The formation of a limited company involves more legal procedures and costs a lot of money compared to a partnership. A discussion of the procedure for setting up a limited company is what follows below.

Setting up a Limited Company

For a limited company to be recognised as a separate legal entity, it must be registered with the Registrar of Companies. By law, no limited company should start its operations without being registered with the registrar of companies.

Figure 4 below shows the procedure for setting up a limited company.

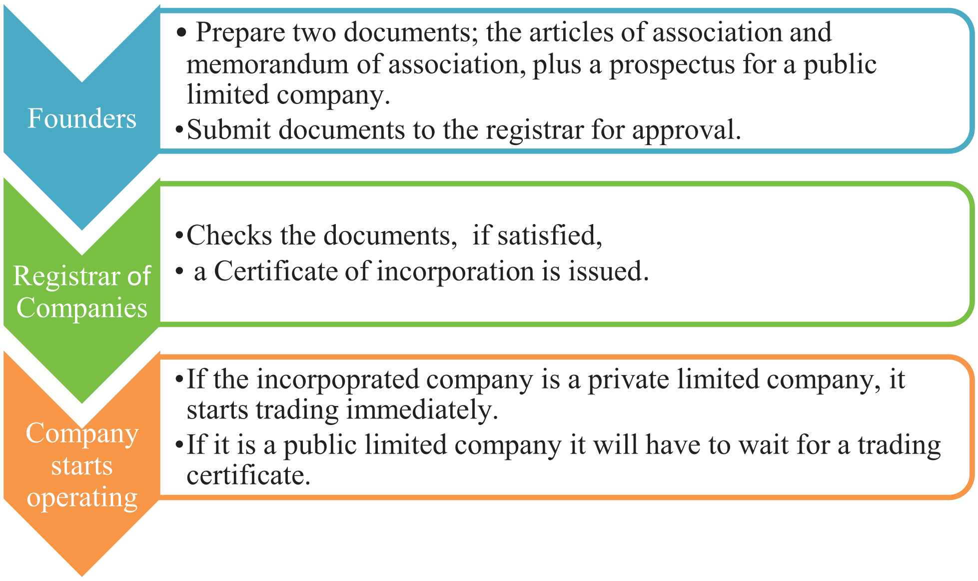

Figure 4: showing the procedure for setting up a limited company. Hand drawn by Commerce Team, ZACODE, 2010.

Let us now look at each of the documents required in the setting up of a limited company in detail.

Memorandum of Association

This is a document which defines the powers and limitations of the company. The document serves the purpose of governing the relationship of the company with the outside world. What do you think are the contents of the memorandum of association?

The memorandum of association provides the following information:

- The name of the company, which must end with:
    - Ltd or limited for a Private Limited Company
    - PLC for a Public Limited Company.
- The location of the company's registered office to enable correspondence on various matters concerning the company to be sent to the right place.
- A statement stating whether it is a public limited company or private limited company.
- The objectives of the company. The promoters must state the exact activities the company will be carrying out.
- The statement that shareholders have limited liability. This serves as a warning to creditors of the company that in the event of bankruptcy or financial difficulties of the company, the liability of shareholders is limited to the capital they have invested or agreed to invest in the company.
- The amount of authorised capital. This is the amount of capital the company is expected to raise through the selling of shares. Authorised capital is divided into different kinds of shares of specified amounts, for example, 1,000,000 5% preference shares of K500 each, and 10,000,000 ordinary shares of K10, 000 each.
- Names of directors and the number of shares to be taken by each one of them indicated against their names.
- Names and addresses of the first members of the board of directors.

The memorandum of association is a very important document and must be prepared before forming a limited company.

Having looked at the memorandum of association, let us now discuss the articles of association in order to understand the similarities and/or difference between the two documents.

Articles of Association

The articles of association contain rules and regulations for the internal affairs of the company. It states clearly how the company is going to be managed and run.

Here are some of the things that are included in the articles of association:

- The voting rights of each type of shareholder. For example, there may be a rule that preference shareholders will have no voting rights at company meetings.
- The procedure of electing directors, their powers and duties.
- The procedure for issuing and transfer of shares.
- Procedure for conducting annual general meetings.
- Where and how books of accounts will be kept.
- Method of distribution of profits.
- The borrowing power of the company.
- How changes in the amounts of capital will be dealt with.

In addition to the memorandum of association and articles of association, a public limited company is required by law to produce a **prospectus**.

Prospectus

This is a document that a public limited company uses to invite the members of the general public to buy shares. It contains the company's history and future plans and forecasts of business future profits. It gives details of the composition of the board of directors. In addition, it gives the number of shares to be issued and the type of shares and their prices.

The **certificate of incorporation** which we will now discuss in the next section is in contrast to a prospectus issued by the registrar of companies and not the public limited company.

Certificate of Incorporation

This is a document issued by the registrar of companies to show that the company has been registered and can now start operating. At this point, as we have already noted, a private limited company can start its operations, but a public limited company will have to wait for a trading certificate to be issued. Once a company is issued this document, it now exists as a separate legal entity and can sue or be sued in courts of law. It can own property, enter into contracts with people and organisations, employ people, buy and sell goods and services and perform any other function a person can do.

So far we have discussed the procedures for setting up a limited company and the documents used. It is time for you to find out how much you can still remember by doing the following activity. The answers to this activity are given below, but do not read them before completing your answers.

Activity 9

This activity contains three questions, please answer all.

1. Fill in the blank spaces

   A ____(a)_____ limited company uses a _____(b)______to invite the members of the general public to buy shares. It contains the company's ____(c)_____, future plans and forecasts of business future profits. It gives details of the composition of the board of directors. It gives the____(d)_____ of shares to be issued and the type of shares. It also shows the _____(e)_____ at which shares are offered.

2. In column form suggest the differences between private and public limited company. The first one has been done for you.

Private Limited Company	Public Limited Company
a) Sells its shares privately	a) Sells its shares to the general public
b)	b)
c)	c)
d)	d)
e)	e)
f)	f)

3. By law, no limited company should start operating without being registered with the registrar of companies and two important documents must be availed to the registrar of companies.

a) Name the two documents.

b) If you are working alone, write down the document that governs the internal affairs of the company.

   If you are working as a group, discuss the document that governs the internal affairs of the company and write down the main points of your discussion.

Feedback

Now compare your answers with the ones provided below:

1. *(a) Public limited company*
(b) Prospectus
(c) Company history
(d) Number
(e) Prices

2. ***Differences between a private and public limited company:***

Private limited company	***Public limited company***
a) It sell its shares privately	*a) It sells its shares to the general public*
b) Its name ends with Ltd	*b) Its name ends with **Plc***
c) Books of accounts are kept private	*c) Books of accounts are published to the general public*
d) Shares are transferred with the consent of other shareholders	*d) Shares are transferred freely*
e) It starts trading immediately after incorporation.	*e) It does not start operating until the certificate of trading is issued.*
f) It is not allowed to sell shares on the stock exchange.	*f) It is allowed to sell shares on the stock exchange.*

You may not have provided your answers in the order given above. Any order is acceptable.

3. *(a) Memorandum of association and articles of association*

(b) Articles of Association

The articles of association contain the rules and regulations for the internal affairs of the company. It states clearly how the company is going to be managed and run. It includes the voting rights of each type of shareholder, for example, there may be a rule that preference shareholders will have no voting rights at company meetings. It also includes procedures for conducting annual general meetings, electing directors, their powers and duties, issuing and transfer of shares, and distribution of profits. The articles of association also contain a clause on how changes in the amounts of capital will be dealt with and *borrowing powers of the company. It further states where and how books of accounts will be kept.*

Topic 2: Summary

We have come to the end of Topic 2. In this topic we discussed other better ways of organising business, which may overcome the shortcomings of sole trading and partnerships. We particularly looked at limited companies, which also fall under private ownership. We saw that there are two types of limited companies, private and public limited companies. We paid particular attention to the characteristics, formation, advantages and disadvantages of these companies.

You had a chance to check your progress through two activities which we hope were useful to you.

In the next topic we will consider the last type of business unit falling within the private sector, multinational companies. As in the other business units discussed in Topics 1 and 2, we will discuss their characteristics, advantages and disadvantages.

Below is an end of topic exercise which you should do. This exercise will help you review what we discussed in the topic. Complete the exercise first and then compare your answers with those provided in the feedback. As you have done in Topic 1, revise those sections you did not do well in before moving to the next topic.

Topic 3: Multinational Companies

Introduction

In Topic 2 we learned about limited companies. We saw that there are two types of companies, private and public limited companies. We discussed the features, formation, advantages and disadvantages.

In this topic we will explore multinational companies. We are again going to look at features, advantages and disadvantages. Multinational companies are found in our communities. The definition of multinational companies is given below in the body of the topic. After reading the definition, you can think of examples of such companies in your area so that you are familiar with the type of companies we are discussing as we proceed with our topic.

This is the shortest topic of this unit and you will be able to study it in less time than the first two topics. The other reason it will take you less time is that you have already learned most of the ideas regarding the nature of private companies in the first two topics. The topic also has only one activity and an end of topic exercise.

Before we start our discussion, let us look at the topic outcomes below that we need to achieve at the end of the topic.

Topic Outcomes

Topic Outcomes

- *Outline* the features of multinational companies
- *Explain* the advantages and disadvantages of multinational companies

Time

You should spend at least 6.5 hours on this topic.

Multinational Companies

Let us start our discussion by defining the words multi and national. The word multi means many and national means found within a nation. Therefore, multinational means found across nations or found in other countries.

A public limited company may grow to an extent that branches may be opened within and outside a country. When a public limited company grows to the extent that it opens branches in other countries, it becomes a multinational company. The original company that opens branches in other countries is called the **parent company** and the branches are called **subsidiary companies**.

Activity 10

You may know of such companies in your area. Write your examples in the space provided.

Feedback

We do not know which companies you mentioned. However, your ideas may have included: Bata Shoe Company, Shoprite Checkers and B P Company whose parent companies are in Czechoslovakia, South Africa and Britain respectively. You may have noticed that we have used the term parent company instead of headquarters. This is because there is a difference between the two terms. The parent company was described earlier as original company that opens branches in other countries. ***Headquarters****, on the other hand, is the main office where company decisions are made. Bata, for example, was founded in Czechoslovakia (parent company), but its headquarters are currently in Switzerland.*

You may have mentioned other examples and this is also fine as long as the companies have the features we have discussed above.

Multinational companies are controlled from head office where the parent company is situated, but the implementation of policies is through the branches which are situated in different countries. Their main objective is to gain the largest share of the world market. Gaining the largest share of the world market means trying to get as many customers as possible to branches or shops. This is in order to get large profits.

Like other business units that we have already discussed, this type of business has advantages as well as disadvantages. In the next sections we will look at the advantages and disadvantages of a multinational company.

Advantages of a Multinational Company

The following are the advantages of a multinational company:

- It enjoys great economies of scale because of its size. This means that they have large amounts of capital which enables them to buy goods in large quantities direct from manufacturers at a discount. This in turn enables them to sell their goods at attractive prices and increase sales.
- It is able to provide a wider variety of goods and services, better customer service and higher quality products than what local companies can provide. They are able to achieve this because they have large amounts of capital and are able to employ expert staff.

- It is able to provide employment to the local people in areas where it has branches.
- Business knowledge, skills and technology are transferred from one country to another through multinational companies.
- The parent company receives foreign exchange through the selling of goods abroad.
- The tax it pays boosts the host country's income.
- The worldwide contact it has enables the host countries to boost their export sales.

We can now proceed to look at the disadvantages:

Disadvantages of a Multinational Company

A multinational company may not provide good business in a host country because of the following reasons:

- When drawing up its policies, a multinational company does not take into consideration business conditions in the host countries since it is controlled from the head office.
- It brings its own experts in decision making instead of training the local people to take up these important jobs.
- It has a tendency of dominating export markets, taking over local industries and forcing some out of business.
- Technology is not fully transferred because research facilities are usually retained by the parent company.
- It offers better conditions of service and attractive salaries to its workers, attracting most of the skilled labour at the expense of the local industries.
- It takes all the profits made in the host country to the country where the parent company is, draining the foreign exchange reserves in the host country.

So far we have looked at both the advantages and disadvantages of multinational companies. You can now read the topic summary below to review and get an outline of what we did in this topic.

Topic 3: Summary

We have come to the end of Topic 3. In this topic we discussed multinational companies. We looked at features, advantages and disadvantages. We defined multinational companies and said that these companies are found in our communities. The examples that we gave of multinational companies were Bata Shoe Company, Shoprite Checkers and B P Company.

Now do the end of topic exercise which you will find at the end of the unit. This exercise will enable you to revise different aspects of multinational companies. Once you have finished this task you can read the unit summary below to help you review the whole unit.

Unit Summary

Summary

In this unit you learned what a business is. The unit also discussed the private sector where we looked at the different types of business units falling within this sector. We discussed sole trading, partnerships, limited companies and multinational company. Under each business unit we looked at formation, features, advantages and disadvantages.

We learnt that a sole trading business is owned, organised and controlled by one person. On the other hand, partnerships are co-owned, organised and controlled by partners who contribute capital towards the running of the business. We saw that limited companies are owned and organised by shareholders who buy shares from the company, and are controlled by a board of directors elected by the shareholders. We also learnt that when a public limited company grows to an extent of opening branches in other countries, it becomes a multinational company.

It is necessary that you compare or relate what you have learnt in the unit to your own situations in your area.

In the next unit we shall look at different types of businesses in the public sector, how they are organised, their advantages and disadvantages

Now go back to the objectives at the beginning of this unit and review them again. Have you achieved them all? If there are any objectives that you are not sure about, refer to the relevant section or write to your tutor for clarification. If you have achieved all the outcomes, take a short break.

We have come to the end of the unit and once you are ready you can do the self-marked assignment given below. Remember, this is a self-marked assignment. A tutor-marked assignment will be given in Unit 4. After you have answered all questions, compare your answers to those provided in the feedback which you will find below the assignment. If your answers were correct, congratulations! You can proceed to the next unit. If some answers were not correct you can read through the unit again and make sure you understand the relevant sections.

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Reading

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Assignment

Assignment

Topic 1 Exercise

This exercise has three parts, A, B and C. Answer all questions.

Part A

Part A contains five multiple choice questions. Choose the correct answer and write the relevant letter of the alphabet (A, B, C OR D) in the box provided'

1. Three of the following are characteristics of a sole trader. Which one is not?
   A. Controlled by one person
   B. Enjoys all profits
   C. Makes own decisions
   D. Shares ideas

2. Which of the following is an advantage of a sole trader?
   A. The decision making process is easy and fast
   B. The owner has unlimited liability
   C. As owner of the business, you keep all the profits to yourself
   D. Your business records are kept secret

3. One of the similarities between a sole trading and partnership business is that both:
   A. Are not separate legal entities
   B. Do not keep books of accounts confidential
   C. Do not have unlimited liability
   D. Have many legal formalities

4. A written document which is prepared in order for the partners to avoid future conflicts or misunderstandings is called:
   A. Certificate of incorporation
   B. Licence
   C. Partnership deeds
   D. Share certificate

5. One of the rules contained in the partnership act of 1890 states that:
   A. Books of accounts are to be kept secret to all partners except those who handle the books
   B. Profits and losses should be shared according to the amount each partner has contributed
   C. Partners are to contribute different amounts of capital to the business
   D. Partners should not claim a salary for working in the partnership business

Part B

1. In table form, list the differences between sole trading and partnership businesses.

DIFFERENCES BETWEEN SOLE TRADING AND PARTNERSHIP

SOLE TRADING	PARTNERSHIP

Part C

1 State whether the following statements are true or false.

a. The private sector is the sector of the economy that is owned, controlled and financed by individuals or groups of individuals.
b. A sole proprietorship is a business formed by two people.
c. A sole trading business comes to an end when the owner dies.
d. The sole trader raises capital from his own savings.
e. A sole trading business is not a separate legal entity.
f. Sole traders are free to open and close their shops any time.

Feedback

Compare your answers to the ones given below.

Part A

1. d 2. b 3. a 4. c 5. d

Part B

The answers that you gave for the differences between sole trading and partnership businesses might be similar to the ones contained given below.

DIFFERENCES BETWEEN SOLE TRADING AND PARTNERSHIP BUSINESSES

	SOLE TRADING	***PARTNERSHIP***
Ownership	*Owned by one person*	*Owned by 2-20 partners*
Control	*Controlled by one person*	*Controlled by two or more partners*
Capital	*Capital is provided by one person*	*Capital is contributed by partners*
Profits	*All profits are enjoyed by one person*	*Profits are shared among the partners*
Decisions	*Sole traders make their own decisions; this gives them freedom to decide on the times of opening and closing their shop.*	*Decisions are made by the partners by consulting each other.*

Part C

1. a) True
b) False
c) True
d) True
e) True
f) True

Topic 2 Exercise

This activity has two parts, A and B. Answer all questions.

Part A

Part A requires you to fill in the blank spaces.

Fill in the blank spaces:

1. A company is an association of individuals who contribute money and /or assets to a common business. These people are referred to as _________.
2. Being ___________ is a state where an organisation fails to pay its creditors.
3. A ________________ is an individual or organisation a company owes money.
4. A limited company is controlled by a board of directors elected by the shareholders at the _______________________.
5. In a small company, the ____________________ is also the chairman of the company.
6. The death of a sole trader means the end of the business. Equally, the death, resignation or retirement of a partner in a partnership means the ______________of the partnership.
7. The name of a private limited company ends with Ltd or limited while that of a public limited company end with ______________.
8. A __________________ is a document which defines powers and limitations of a company.
9. The articles of association contain ______________ and____________ for the internal affairs of the company.
10. The certificate of incorporation is a document issued by the _____________________ to show that the company has been registered and can now start operating.

Part B

Write short notes on the following:

a) Prospectus
b) Annual General Meeting
c) Board of Directors

Check whether the answers you gave included the ones provided below.

Part A

1. *Shareholders*
2. *Bankrupt*
3. *Creditor*
4. *Annual general Meeting*
5. *Managing director*
6. *Dissolution*
7. *Plc*
8. *Memorandum of Association*
9. *Rules and regulations*
10. *Registrar of companies*

Part B

The answers to the short notes that you have given might have contained the points given below that we discussed in the topic above.

11. *a)* ***Prospectus***

This is a document that a public limited company uses to invite the members of the general public to buy shares. It contains the company's history and future plans and forecasts of business future profits. It gives details of the composition of the board of directors. It also gives the number of shares to be issued and the type of shares and their prices.

a) Annual General Meeting

This is a yearly meeting held by all shareholders (members) to meet the requirements of the provisions of the Company's Act. At this meeting, in addition to electing a board of directors shareholders;

- *approve the audited accounts presented by the managing director,*
- *discuss the affairs of the company and*
- *deal with issues that could not be settled by the board of directors.*

b) Board of Directors

This is a group of people elected (chosen by voting) by shareholders from among themselves to oversee the running of the company, usually for a period of three years. It is this group of directors that direct the activities of the company by coming up with the goals and policies to be followed by the company.

Topic 3 Exercise

This exercise has two parts, A and B. Answer all questions.

Part A

Part A contains five multiple choice questions. Choose the correct answer and write the relevant letter of the alphabet (A, B, C OR D) in the box provided.

1. A company that operates factories or sales offices (branches) in other countries is called a:
A. Limited company
B. Partnership
C. Shoprite
D. Multinational company

2. A multinational company is controlled from:
A. Headquarters
B. Branches
C. Both the parent and subsidiary company
D. The host country

3. Which of the following are business units under the private sector?
A. Public corporation, sole trading, partnership.
B. Public limited company, partnership, sole trading.
C. Local government, private limited company, partnership.
D. Public corporation, local government, public limited company.

4. In the absence of a partnership deed, a partnership follows the guidelines of the:
A. Memorandum of association
B. Articles of association
C. Partnership Act 1890
D. Articles of partnership

5. Which one is **not** an advantage of a multinational company?
A. It boosts the country's income through the payment of tax.
B. It enjoys great economies of scale.
C. It provides the local people with jobs.
D. It starts trading immediately it is incorporated.

Part B

1. Imagine you are Minister of Finance and National Planning and there is a multinational company that intends to invest in your country. Explain 3 advantages and 3 disadvantages of allowing this multinational company into the country to the President.

Feedback

Check whether your answers include the ones given below:

Part A

1. D   2. A   3. B   4. C   5. D

Part B

The answer to this part of the activity is contained in the advantages and disadvantages of multinational companies as discussed above. The reasons you could have given to the President could have included the following:

Advantages of a Multinational Company:

- *a) It is able to provide a wider variety of goods and services, better customer service and higher quality products than what local companies can provide.*
- *b) It is able to provide employment to the local people in which it has branches.*
- *c) Business knowledge, skills and technology are transferred from one country to another through multinational companies.*
- *d) The parent company receives foreign exchange through the selling of goods abroad.*
- *e) The tax it pays boosts the host country's income.*
- *f) The worldwide contact it has enables the host countries to boost their export sales.*

Disadvantages of a Multinational Company:

- *a) When drawing up their policies, it does not take into consideration business conditions in the host countries since it is controlled from the head office.*
- *b) It brings its own experts in decision making instead of training the local people to hold these important jobs.*
- *c) It has a tendency of dominating export markets, taking over local industries and forcing some out of business.*
- *d) Technology is not fully transferred because research facilities are usually retained by the parent company.*
- *e) It offers better conditions of service to its workers, attracting most of the skilled labour at the expense of the local industries.*
- *f) It externalises all the profits made in the host country, draining the foreign exchange reserves in the countries where its branches are.*

(Any three advantages and any three disadvantages

Assessment

Self-Marked Assessment 2

As indicated earlier, there is no tutor-marked assignment in this unit. The next tutor-marked assignment will be found at the end of Unit 4.

This assignment has two sections, A and B. Answer all questions

SECTION A

Fill in the blank spaces.

1. As a sole trader one would keep all the _____________to themselves.
2. The sole trader has __________ __________ which means that they would lose their personal ____________ if the business became _______.
3. Partners have unlimited liability except for ______________.
4. A ___________ ___________ is a company that is found in one country but operates factories or has offices in several other countries.
5. The initiators of the formation of a limited company are called ______________ or ___________________ They have to prepare the ___________ of ___________ and __________ of association according the Company's Act.
6. A private limited company is a business organisation where __________ are not freely transferred without the agreement of the _____________.
7. The memorandum of association defines the __________ and ______________ of the company.
8. The main reason for including the word limited in the Memorandum of Association is to warn any person dealing with the company that the _______________ are not personally responsible for any _________ __________ by the ___________.
9. The private sector is that section of the economy ___________, _________ and _____________ by private individuals or institutions for profit making and not controlled by the state.
10. The _____________ ____ _______________shows that the company has been registered and can start operating.

SECTION B

This section contains an essay type question.

1. Private limited and public limited companies have similar characteristics. Identify these characteristics and briefly discuss them.

Self-Assessment Feedback

SECTION A

1) *profits*
2) *unlimited liability, property, bankrupt*
3) *limited partners*
4) *multinational company*
5) *promoters, founders, memorandum of association, articles*
6) *shares, shareholders*
7) *powers and limitations*
8) *shareholders, debts owed, company*
9) *owned, controlled, financed*
10) *Certificate of incorporation*

SECTION B

Your answer to this part of the assignment should have identified and discussed the following characteristics:

Ownership

A limited company is owned and formed by not less than two people and there is no maximum number of shareholders, although some countries have maintained a minimum number of fifty shareholders for a private limited company. The number may be different because different countries or areas have different policies.

Control/Organisation

A limited company is controlled by a Board of Directors elected by the shareholders at the Annual General Meeting.

Separate Legal Existence

By law a limited company is a separate legal entity. A separate legal entity is looked at as separate from the people that formed it. The company is not related to its shareholders. The company can own and dispose its assets as a business. It can even enter into contracts and even suffer penalties for the actions of its employees.

Limited Liability

The liabilities of the shareholders are limited. This means that the shareholders are answerable only to the extent of the amount of capital invested in the business, and cannot lose more than their investment should the business face financial problems.

Profits

Profits are shared according to the type, number and value of shares held by each member. The more shares a shareholder has the more profits he or she would get. The share of profit each shareholder gets is called a dividend.

Continuity of Existence

A limited company does not come to an end even if a shareholder dies, it will continue to exist. It is not disturbed by the coming in and the going out of shareholders. Shareholders can sell their shares and still others can buy the shares of the company and become part of the company. This explains why some companies have existed for decades

Capital

Capital of a limited company is raised through the sale of shares. The investments in the limited company are divided into shares. Each shareholder will receive shares equivalent to the amount they have contributed.

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 4

Organisation of Business Units 2: Public Sector

Introduction

Welcome to Unit 4 of Grade 11 Commerce on organisation of business units. In Unit 3 we looked at the Organisation of Business units that fall under the private sector. If you can remember, we explained the term private sector including its advantages and disadvantages. We considered how business units under the private sector are organised. This is one of the most important topics of this course as it involves several aspects of different business environments. The majority of businesses in countries are under the private sector. We discussed sole trading, partnerships, limited companies and multinational companies. Further, we learnt that a sole trader is owned, organised and controlled by one person while partnerships are co-owned-organised and controlled by partners who contribute capital towards the running of the business. We saw that limited companies are owned and organised by shareholders who buy shares from the company, which is controlled by a Board of Directors chosen by the shareholders. In addition, we learnt about the characteristics and necessary documents required for the formation of these different types of business units. We also learnt that when a public limited company grows and opens branches within and outside a country, it becomes a multinational company.

Let us now proceed and look at another very interesting unit. In this unit we will discuss the business organisations that fall under the public sector or state enterprises. Further, we will look at how the government runs businesses under the public sector, including the advantages and disadvantages. Differences between the public corporation and the public limited company will also be stated.

Upon completion of this unit you will be able to:

Outcomes

- *Explain* the term: public sector.
- *Identify* different types of state enterprises.
- *Discuss* the reasons for existence of the state enterprises.
- *Outline* the advantages and the disadvantages of state enterprises.
- *Distinguish* between public corporations and public limited companies.

Resources

Tip

- A computer is needed in order to enable you to access the internet for the search of different types of state enterprises.

- Libraries are needed for you to do research on state enterprises the reasons for their existence.

Learning and Teaching approach:

Tip

- **Content based approach** - To encourage learners to base their learning on the subject matter provided to improve their skills and competencies in organising business units, and to give learners instructions to help in their learning. Under differences between public corporations and public limited companies content will be delivered in a manner that you will be able to solve a tabular form of the differences.

- **Problem-based approach -** To encourage open minded, reflective, critical and active learning as well as encourage the development of commercial thinking. The problem-based approach respects the fact that both the learner and teacher have knowledge and understanding on business units that they bring to the problem. You will be given problems on explaining what the public sector is and the different types of state enterprises.

- **Activity-based approach -** To help learners develop business skills on how to organise and run business units in the cognitive, psychomotor and affective domain and general learning skills as they interact with people and content. This will require you to do activities on public corporation and public limited companies.

Timeframe

Time

You will need between 20– 25 hours to study this unit. Do not worry if it takes you more or less time than this – we do not all work at the same pace. The time of study to be spent indicated, includes for activities, Topic Exercises and the assessment

Terminology

Economy: The production and consumption of goods and services of a community as a whole. Prudent or carefulness management of resources to avoid unnecessary expenditure.

Monopoly: A situation in which one company controls an industry and is the only provider of a product or service.

Communism: Political theory or system in which all property and wealth in a classless society is owned by all the members of the society.

Share: A portion of the entitlements in a company after investing in it.

Securities: Tradable shares at a market

Bureaucracy: Complex rules and regulations applied rigidly. An administrative system, especially in government, that divides work into specific categories carried out by special departments of non-elected officials.

Dividends: When an individual or institution buys shares in a company a reward is expected. The benefits of a shareholder in a company.

Topic 1: Public Sector and Different Types of State Enterprise

Introduction

Welcome to Topic 1 of Unit 4 on the organisation of business units within the public sector. The **public sector** is the part of the economy controlled by the state or simply by the government. We will look at the business units we saw in Unit 3 individually under public sector.

In this topic we will look at the public sector and proceed to identify different types of state enterprises which are also called public corporations. A **state enterprise** is an organised business activity aimed specifically at growth and profit owned and controlled by a country or nation with its own government. We shall further discuss the reasons that make governments own and control enterprises (which we are calling state enterprises) in the section referred to as: reasons for the existence of state enterprises. We shall also focus or concentrate on outlining the advantages and disadvantages of state enterprises. This will be very interesting to you because it will give you an insight of the good and bad of the public sector. Where possible, compare the different business units under the public sector.

Let us begin by looking at the topic outcomes.

By the end of this topic you should be able to:

Outcomes

- *Explain* the term: public sector.
- *Identify* different types of state enterprises.
- *Discuss* the reasons for the existence of the state enterprises.
- *Outline* the advantages of the state enterprises.

Time

You should spend at least 10 hours on this topic.

Public Sector

Let us now look at the public sector.

Public relates to or concerns the people at large or all members of a community or provided for the use of a community. It also means open to everyone and frequented by large numbers of people. The word ‘sector’ has different meanings. The meaning of sector in the business sense is: an area, branch or portion.

Therefore, the public sector in this unit refers to that part of the economy which is in the hands of the government on behalf of its citizens. The word **economy** refers to efficiency and conservation of effort in the operations or achievement of something, a financial saving or an attempt to reduce expenditure and the careful management of resources in order to avoid wasteful expenditure. The public sector consists of public enterprises which are businesses run and controlled by the government. An **enterprise** in commerce is an organised business activity aimed specifically at growth and profit. Therefore, an enterprise owned and controlled by the government is called a **state enterprise** or a **public corporation**.

Now that we have explained the public sector and know what it is made of, let us now look at business in the public sector.

The government can run a business in two ways either through:

(i) The local government or

(ii) The central government

Let us now proceed and look at businesses that are run by the local and central governments.

Local Government

The government of a town, county or region is run at a local level by locally elected politicians or an organisation of people. Most of those elected govern an area smaller than a state, usually a county, district or town and are known as local government. Remember, in the introduction of this unit we said a **state** is a country or nation with its own government.

The local government on behalf of the local people in the city or district may own local markets, bus stations and also provide services like street lighting. These services are provided free of direct charge from actual users but are paid for indirectly by the local community in the form of taxes and government grants. A government grant is financial help provided by the central government. We shall learn what a central government is below.

Having explained what local government is and how it runs some businesses, we can now proceed to explain what central government is and how it may run businesses. You should also remember the definition of a **business** from our immediate previous unit as commercial activities that provide customers with goods and services they want, as well as organisations that provide goods and services or makes goods.

Central Government

A **government** is a group of people who have the power to make decisions and enforce laws for a country or area. It might also refer to the state and its administration viewed as the ruling political power. Therefore, a **central government** is a government that is concerned with national issues. These national issues pertain to payment of taxes, defence and security, foreign or international relations and even trade. **Taxes** (as you learnt in Unit 2) are levies payable to the government while **defence and security** relates to safety and protection of the people of the state. **Foreign or international relations** mean how the central governments interact with other countries.

The Central Government can run businesses through two ways:

- Nationalisation of industries
- Public corporation

You may remember in Unit 3 that we dealt with the private sector, where business units are in private hands or individuals. Sometimes these business units may be acquired by the state and when this happens it is then called **nationalisation**. Nationalisation therefore, is the transfer of ownership from the private hands to the state. It then becomes a national property. It is now important for us to explain what a nationalised industry is and also state reasons for nationalising industries.

Nationalisation of Industries

A **nationalised industry** is a business entity previously owned by a private or public limited company but later taken over by the government. In Unit 3 we discussed private and public limited companies and these are the same business units that are nationalised. Why then are industries nationalised? The following are some of the reasons:

- Sometimes an industry may become so run down that only vast sums of money from government can revive it.
- For political interests, an industry may be taken over by government in order to create more employment opportunities to the citizens.
- Some industries are better being in the hands of the government for national wellbeing and security reasons.
- Natural monopoly. A **monopoly** is a situation in which one company controls an industry or is the only provider of a product or service. An industry like power generation is a monopolistic kind of business and cannot be under the control of private hands, in order to ensure control over the prices charged.
- Some members of the branch of government (politicians) believe that private ownership is wrong and that nationalisation is the only way of returning industries to the citizens who are the rightful owners.

Reflection

Can you think of some examples of monopolies in your local economy? In national economy? In international economy? Discuss with others.

We have now come to the end of our topic on nationalisation where reasons were stated that are in favour of nationalisation. These included the need for government to pump in capital in run down industries, job creation and security reasons and also to avoid monopolies.

However, how then does Government nationalise these industries? This will be our next area of focus and it is also one of the more interesting materials in this unit.

You are now going to participate in an activity. This activity is designed to determine your understanding of the material learnt so far; that is the public sector and different types of state enterprises. When you have completed the activity, look for the feedback below. You are advised not to look at the feedback before you do the activity.

Activity 1

Answer the following question by writing a short paragraph.

1 Explain the term public sector and identify different types of state enterprises.

Feedback

We think you found this activity easy to do because you may have a public sector and state enterprises in your country.

Your answers could be based your experiences in your environment or areas you might have visited. Now compare your answer to the one provided below.

The public sector is the portion of a nation's affairs, especially economic affairs, that is controlled by government agencies. It also consists of public enterprises which are businesses run and controlled by the government. Basically, nationalised industries and public corporations are the identifiable state enterprises.

If this was your answer, well done! If you had problems in getting the answer, read through the content again.

We have learnt that a nationalised industry is a business entity which was owned by a private or public limited company but later taken over by the government. This means that the shareholders in these companies were individuals and institutions. You should remember in Unit 3 that **shareholders** are people or institutions who have bought shares in a company and that a **share** is a division of company capital into units of uniform value. It is for this reason that we need to explain how these companies are taken over by government. We are now going to explain how government takes over industries.

How Does Government Take Over Industries?

Remember, we said that a nationalised industry is a business entity previously owned by a private or public limited company that was taken over by the government. Let us now look at ways in which government nationalises industries.

There are basically two main methods by which government can nationalise industries. These are:

1. Expropriation. This means to take property or money from somebody, either legally for public good or illegally by theft or fraud. Fraud is the crime of obtaining money by deliberate deception. (Encarta© Dictionaries)

In this context, this is a situation where the government takes over a business or an industry by force without paying anything to the owners. This method is usually used in communist countries.

2. Compensation. This is where the government takes control of private businesses or industries by buying a certain percentage of shares usually 51% of the ordinary shares at nominal value. Nominal value is the face value of the share. The government does not pay for the shares immediately but pays for them over a period of time from the profits taken from the company.

We have seen that government can own businesses through nationalisation by means of expropriation and compensation. However, nationalisation is not the sole means of government ownership of business. You may recall in Unit 2 that governments collect revenue from individuals and institutions and this revenue is called tax. The tax collected becomes public funds or money which is used for public good like setting up business entities. Such business entities are called **public corporations.**

Now that we have defined nationalisation and know methods used to nationalise industries, let us have a look at public corporations. What do you think a public corporation is?

Activity 2

Answer the following question below.

What do you think a public corporation is? Write your ideas in the space provided.

Feedback

A public corporation is a business entity set up by an act of parliament.

Let us now explain what a public corporation is in details and you should then compare this to the answer you stated.

Public Corporations

A **public corporation** is a business entity set up by an act of parliament. It is public because its initial capital is raised through public funds as we explained earlier on. Furthermore, it is a corporation because it is an individual by law. Each public corporation is a legal entity separate from that of the government and has its own management board selected by the government. Separate legal entity means that the corporation can sue and be sued in its own capacity or name.

These public corporations have features which make them be what they are. Let us then look at these features:

The Main Features of a Public Corporation

- A public corporation is owned by the government on behalf of the citizens of the country. It has no identifiable owners.
- Respective governments appoint the board of directors through the person in charge of the ministry under which the corporation falls.
- A public corporation provides goods and services to the public at reasonable prices.
- Capital of the public corporation come from various sources for example:

  (i) The government may provide capital in the form of grants.

  (ii) By borrowing from the central treasury that is the Ministry of Finance

  (iii) By issuance of securities to the public, this is a way of borrowing money from the public.
- The government may sometimes intervene in the determination of prices for public or political reasons.
- Profits may be used as follows:

  (i) Pay interest on capital borrowed from the government and the public through securities.

  (ii) Retain some for future loan repayment.

  (iii) For government to meet its general expenditure.

  - It has a separate legal entity that is it may sue or be sued in its own name.

We have now come to the end of this section on public corporations where we explained that a public corporation is a business entity that is created by an act of parliament. A public corporation raises its initial capital through public funds. Further, we stated that a public corporation is a legal entity which means that it can sue and be sued in its own name. The main features of a public corporation include: it is owned by the government on behalf of citizens and the appointment of the board of directors done by the ministry under which the corporation falls.

As we discussed in Unit 3 concerning organisation of business units, we saw all the different forms of business units and their advantages and disadvantages. Public corporations also have advantages and disadvantages. Therefore, after the activity we shall proceed to look at the advantages and disadvantages the public corporation.

Having looked at public corporations, you are now required to do the activity below in order to assess your understanding of the main features of a public corporation. However, you are reminded not to look at the feedback found below before attempting this activity.

Activity 3

Answer the following questions:

1 State whether the following are true or false:

a. A public corporation is owned by individuals.

b. The government selects the Board of Directors for public corporations.

c. Public corporations provide goods and services at reasonable prices.

d. A public corporation has no legal entity.

e. Government grants are one of the sources of capital for public corporation.

2 In a paragraph explain what a public corporation is.

Feedback

We hope you enjoyed learning the main features of a public corporation, as public corporations may be found in most countries.

You may have based your answers on your own experiences in your environment or areas you may have visited or even heard of. You can now compare your answers to the ones provided below.

1. a) False

b) True

c) True

d) False

e) True

2 A public corporation is a business set up by an Act of Parliament. Each corporation is a legal entity separate from that of that of Government and has its own management board appointed by the Government.

So far we have gone through how governments take over industries and also had a look at the main features of a public corporation. We also learnt in Unit 3 that business is not all about profit making but it also involves risk taking. By this we mean that most businesses may make a profit or loss and the profit and loss may be caused by the advantages and disadvantages of these business units. It is for this reason that we need to take a look at these said advantages and disadvantages of public corporations. Let us now proceed and look at this.

Advantages and Disadvantages of Public Corporation

Having explained and stated the main features of public corporations we should now proceed and outline their advantages and disadvantages. Remember in Unit 3 we talked of businesses having benefits and risks.

Advantages of Public Corporations

There are several advantages of public corporations. Among them are the following:

- They are a source of income to the government. This is a relief to workers who do not have to pay more tax to raise the income to meet government expenditure.
- They provide cheaper goods and services to the public.
- They provide employment to the general public.
- Through public corporations, the government may control the provision of essential goods and services such as marketing of staple food, electricity, water and telecommunications.

- To avoid wasteful competition involved in having two or more firms competing to offer consumers utilities, such as water and electricity.
- Profits made go to government and can be used to improve infrastructure in the country such as building of school, health centres, rather than going to individual service providers.
- Essential industries to an economy can be kept going as public corporations even if they are not profitable.
- Some politicians believe that private ownership is wrong and that public corporation is the only way to give industries to the people who are the rightful owners.

Now that we have outlined the advantages of public corporations, it is important that we look at its disadvantages Remember in the above topic we informed that business is risky. It is along these lines that we outline these disadvantages.

Disadvantages of Public Corporations

- They are too expensive to run and may stretch taxpayers' money.
- There is too much bureaucracy and 'red tape'. In additional the 'do not care less' attitude dampers the enthusiasm of workers.
- Workers are not usually identified with the business as a result they lack initiative which leads to inefficiency.
- Some business corporations are monopolist (they do not have competitors) they tend to provide poor quality goods and services and sometimes may not even be profitable

Having stated the disadvantages of public corporations, you can now do the following activity. Please do not look at the feedback before doing the activity.

Activity 4

Answer the following question:

Public Corporations are also known as State Enterprises. Like any other business units we have dealt with these too have advantages and disadvantages. Outline the advantages and disadvantages of state enterprises.

Feedback

Compare your answers to the feedback given below. If you got all of the answers right, well done! If you did not get them all right, go through the topic again.

You may have based your answers on your own experiences in your environment or areas you may have visited or even heard of. You can now compare your answers to the ones provided below.

Advantages of State Enterprises:

- *They are a source of income to the government.*
- *They provide cheaper goods and services to the public.*
- *They provide employment to the general public.*
- *Enables government control the provision of some essential goods and services.*
- *Some profits realised may be used for infrastructure development.*
- *Maintenance of essential industries even when they are none profit making.*
- *Benefits accrue directly to the true owners.*

Disadvantages of State Enterprises:

- *Expensive to run and may stretch taxpayers' money.*
- *Excessive bureaucratic tendencies hence slowing the decision making process.*
- *Lack of innovation among workers as there is no personal identity with the corporation.*
- *Some corporation maybe monopolies and as such tend to provide inferior quality of goods and services.*

Having outlined the advantages and disadvantages of public corporations, we are now at the end of Topic 1. It is therefore necessary for us to recap our topic.

Topic 1: Summary

We have now come to the end of the first topic of this unit. In this topic we explained the term public sector and how government can run businesses. We also identified different types of state enterprises which are also called public corporations. Nationalised industries were explained and the reasons for nationalising industries stated. Further, public corporations were defined and we also stated their main features and outlined their advantages and disadvantages.

You had an opportunity to check your understanding through activities given in this topic. It is our hope that you did all the activities and found them useful.

In the following topic we shall look at differences between **public utility corporations** and **public limited companies**. This is an equally interesting topic in our course we hope you will enjoy it.

Topic 2: Differences between Public Utility Corporations and Public Limited Companies

Introduction

In Topic 1 we learnt about nationalised industries and public corporations. We also stated the advantages and disadvantages of public corporations. In this topic we are going to look at differences between a public corporation and a public limited company. We will now proceed by looking at topic outcome.

By the end of this unit you should be able:

Outcome

- *Distinguish* between public utility corporations and public limited companies.

Time

You should spend at least 10 hours on this topic.

You may also recall that in Unit 3 we discussed the businesses that fall under the private sector, some of which are sole trader, partnership, private limited company and public limited company. It is also important for you to understand that public utility corporations are equally known as state or public enterprises. For each business unit, we explained their characteristics in relation to ownership, control, source of capital, usage of profit, decision making process, continuity and liability to debts. We also looked at public corporations or state enterprises in the last topic. We looked at the main features, advantages and disadvantages. Further, nationalisation was explained giving reasons as to its importance. You may have noticed that we dealt with public corporations and public limited companies individually. It is now important to look at their differences because these are both big business organisations which you may think are similar.

We can now proceed and look at the differences between public enterprises and public companies.

These differences will be in tabular form, meaning that they will be arranged in a table or in columns and rows. Tabular presentation is not the only form of information presentation. However, it is one of the clearest ways to compare information.

DIFFERENCES BETWEEN PUBLIC CORPORATION AND PUBLIC LIMITED COMPANIES

Public Corporation	Public Limited Company
A public corporation is set by an Act of Parliament.	Formed by at least 2 people and no maximum number of shareholders.
The board of directors is appointed by the minister in charge of the ministry under which the public corporation falls.	It is controlled by a board of directors elected by shareholders of the company at the annual general meeting.
The government owns the public corporation on behalf of the general public.	The owners of a public limited company are called shareholders.
Profits made by a public corporation are used by the government to improve the infrastructure of the country.	Profits made by a public limited company are shared as dividends among shareholders.
A public corporation raises capital through tax and government grants.	The capital of a limited company is raised by the sale of shares to general public.
Selected committees in parliament have power to make general investigations into the affairs of a public corporation.	The board of directors investigates the affairs of a public limited company.
There is a provision for an annual debate in parliament on the affairs of each corporation.	The public limited company holds an annual general meeting in which the shareholders meet to discuss the affairs of the company.
The government exercises control by the appointment of a government minister to have a political responsibility for each corporation.	The shareholders exercises control at the annual general meeting to elect the board of directors to run the affairs of the business.
The government sometimes intervenes in determination of prices in public interest.	The government does not intervene in the determination of prices in a public limited company.

Having looked at the differences between public corporations and public limited companies, you can now proceed and do the following activity. Remember, you are encouraged not to look at the feedback before attempting the activities.

Activity 5

1. In columnar form, distinguish between public corporations and public limited companies. Some parts of the columns and the first row have been done for you.

Public Corporation	Public Limited Company
(a) A public corporation is set by an Act of Parliament.	(a) Formed by at least 2 people and no maximum number of shareholders.
(b)	(b) It is controlled by a board of directors elected by shareholders of the company at the annual general meeting.
(c)	(c) The owners of a public limited company are called shareholders.
(d) Profits made by a public corporation are used by the government to improve the infrastructure of the country.	(d)
(e)	(e) The capital of a limited company is raised by the sale of shares to the general public.
(f)	(f) The board of directors investigates the affairs of a public limited company.
(g) There is a provision for an annual debate in parliament on the affairs of each corporation.	(g)
(h)	(h) The shareholders exercises control at the annual general meeting to elect the board of directors to run the affairs of the business.
(i) The government sometimes intervenes in the determination of prices in public interest.	(i)

Feedback

Compare your answers to the feedback given below. If you got all of the answers right, well done! If you did not get them all right, go through the topic again.

You may have based your answers on your own experiences in your environment or areas you may have visited or even heard of. You can now compare your answers to the ones provided below.

Public Corporation	***Public Limited Company***
(a)	*(a)*
(b) The board of directors is appointed by the minister in charge of ministry under which the public corporation falls.	*(b)*
(c) The government owns the public corporation on behalf of the general public.	*(c)*
(d)	*(d) Profits made by a public limited company are shared as dividends among shareholders.*
(e) A public corporation raises capital through tax and government grants.	*(e)*
(f) Selected committees in parliament have power to make general investigations into the affairs of a public corporation.	*(f)*
(g)	*(g) The public limited company holds an annual general meeting in which the shareholders meet to discuss the affairs of the company.*
(h) The government exercises control by the appointment of a government minister to have a political responsibility for each corporation.	*(h)*
(i)	*(i) The government does not intervene in the determination of prices in a public limited company*

We have now come to the end of Topic 2. Let us now summarise what has been covered in this topic.

Topic 2: Summary

In this topic we looked at the differences between public utility corporations and public limited companies. We displayed these differences in columnar form highlighting the distinctions between the two. We hope you enjoyed going through the topic.

You were given an opportunity to monitor your progress through an activity which we hope was of great use. You now have an opportunity to review the topic by completing the Topic 2 Exercise which you will find at the end of the unit. Do this as soon as you have read the Unit Summary. This summary is important because it will remind you of what you learned in the whole unit.

Unit Summary

Summary

We have come to the end of Unit 4, where you learned what the term public sector was. The unit also discussed the public sector and different types of state enterprises. We learnt two ways in which governments run businesses: local and central governments.

We learnt that local government was the government of a town, county, or region. Local government is run at a local level by locally elected politicians or an organisation of people, most of whom are elected to govern an area smaller than a state (usually a county, district or town). Further, we learnt that central government is concerned with national issues. These issues pertain to payment of taxes to the government, defence, security and safety and protection of the people of the state.

We also learnt that a nationalised industry is a business entity previously owned by private individuals but later taken by the government. Reasons for nationalising industries were identified and explained. This is done through expropriation and compensation. Expropriation means to take property or money from somebody, either legally for public good or illegally by theft or fraud. We also learnt that compensation is when government takes control of property by paying for it.

What was also learnt is that a public corporation is a business entity set up by an Act of Parliament and that there are advantages and disadvantages of public corporations. Differences between public utility corporations were also learnt.

It is important for you to relate and compare what you have learnt in the unit to your own situations in your area.

You should now go back to the outcomes at the start of the unit and review them. Have they all been achieved? If there are some outcomes that you are not sure of, refer to the relevant topics or consult your tutor for clarification. If all have been achieved and you have completed the Topic 2 Exercise and compared your answers to the feedback, then you can relax a bit before doing the assessment.

Remember the assessment is a tutor-marked assignment and will include material learnt in Unit 3 as well as Unit 4. After all questions have been answered, you should send this assignment to the College for marking by your tutor.

You may proceed to the next unit which will deal with the stock exchange. This unit will define the stock exchange in the context of commerce. Further, you will specifically consider stocks, shares, bonds and debentures. These terms will be defined in both plain English as well as how they are commonly used on the stock exchange.

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Encarta Dictionary.

Assignment

Assignment

Topic 1 Exercise

Fill in the black spaces using the words provided below.

enterprise, local government, expropriation, public sector, central government, nationalised industries, compensation, public corporation

(1) The ______________________ refers to that part of the economy which is in hands of government on behalf of its citizens.

(2) An enterprise in commerce is an organised business activity aimed specifically at growth and profit.

(3) The ________________ on behalf of local people in the city or district may own local markets, bus stations and also provide services like street lighting.

(4) A _________________ is that which is concerned with national issues.

(5) ________________and ________________ are the two ways in which the central government runs business.

(6) __________________ means to take property or money from somebody either legally for public good or illegally by theft or fraud.

(7) Where the government takes control of private business or industries by buying a certain percentage of shares is called ________________.

Topic 2 Exercise

State whether the following statements relate to public corporations or public limited companies.

(1) It is set by an Act of Parliament.

(2) The board of directors is appointed by the minister in charge of the ministry under which it falls.

(3) Formed by at least two people and no maximum number of shareholders.

(4) The government owns it on behalf of the general public.

(5) The owners are called shareholders.

(6) Profits made are used by the government to improve the infrastructure of the country.

(7) Its capital is raised by the sale of shares to the general public.

(8) The government may intervene in the determination of prices in public Board of Directors to run the affairs of the business.

(9) The government does not intervene in the determination of prices.

(10) The shareholders exercise control at the annual general meeting to elect the board of directors.

Feedback

Now compare your answer to these given below:

Topic 1

1.Public sector

2. Enterprise

3. Local government

4. Central government

5. Nationalised industries, public corporation

6.Expropriation

7. Compensation

Topic 2

Compare your answers to the following:

1. Public corporation

2. Public corporation

3. Public limited company

4. Public corporation

5. Public limited company

6. Public corporation

7. Public limited company

8. Public corporation

9. Public limited company

10. Public limited company

Assessment

Assessment

Tutor-Marked Assessment 2

This is a tutor-marked assignment and should be sent to the College for marking.

This assessment has two sections, A and B. Answer all questions.

SECTION A: Essay Questions

1. Sole trading is a type of business that is owned and controlled by one individual who raises capital for the business from his/her own private resources and he/she enjoys all of the profits as rewards. Write brief notes on the following main characteristics of sole trading.

a. Ownership

b. Control

c. Capital

d. Profit and Loss

e. Decision making

2. State any four similarities of sole trading and partnership businesses.

3. For a limited company to be registered as a legal entity, it must be registered with the Registrar of Companies. Among the main procedural requirement is the preparation of two documents; the Articles of Association and Memorandum of Association. Indicate any four contents of the Memorandum of Association and any three rules and regulations contained in the Articles of Association.

SECTION B: Multiple Choice

*Choose the **BEST** answer.*

1. The part of the economy which is in private hands is called:

(a) Private sector
(b) Multi sector
(c) Public sector
(d) Bi-sector

2. The government of a smaller area than a state (usually a county, district or town) is known as:

(a) Central government
(b) Local government
(c) Political government
(d) Public corporations

3. A ______________________ is a business entity previously owned by a private or public limited company, but later taken over by the government.

(a) Public corporation
(b) Nationalised industries
(c) Expropriation
(d) Public limited company

4. Which of the following business entities is formed by an Act of Parliament?

(a) Public limited company
(b) Public corporations
(c) Private company
(d) Limited partnership

5. Which of the following falls under the public sector?

(a) Public limited company
(b) Public corporation
(c) Private limited company
(d) Partnership

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 5

Stock Exchange 1

Introduction

Welcome to Unit 5. In Unit 4, you learned about organisations of business units particularly the public sector. In our discussion, you learnt about different types of state enterprises, public utility corporations and parastatals or nationalized industries. You also learned the differences between public utility corporations and public limited companies. In order for corporations and limited companies to expand and carry out new projects, these projects may require additional finances. To obtain these additional financial resources, the state and limited companies may decide to use the stock exchange and this is the subject we will discuss in this unit.

This topic may not be completely new to you, because, some of the things we will discuss were mentioned in Unit 3 under limited companies. On the other hand, you may have come across issues related to the stock exchange from your general life experience. However, this unit will give you a wider understanding which will be added to your earlier knowledge.

This unit is sub-divided in three topics. Topic 1 will discuss securities on the stock exchange. The discussion will start with the definition of terms used in general English language and in a commercial context.

The discussions will expose you to a lot of new expressions which are important for understanding the stock exchange and the related environment. Therefore, it would be good to have your dictionary close, you may need it.

In Topic 2, we will discuss types of securities. In our discussion, we will specifically consider stocks, shares, bonds and debentures. The terms will be defined both in plain English and explained as used on the stock exchanges. This will enable you to use these terms appropriately when looking at securities in relation to the stock exchange.

In the last topic of this unit, Topic 3, our discussion will particularly focus on purposes and functions of the stock exchange. Further, we will explore trading of these types of securities on the stock exchange. This knowledge will enable you understand more about the stock exchange.

Outcomes

Upon completion of this unit you will be able to:

- *Define* the stock exchange.
- *Identify* securities, shares, stocks, bonds and debentures.
- *Explain* the purpose and functions of the stock exchange.
- *Discuss* trading on the stock exchange.

Timeframe

How long?

We estimate that to complete studying this unit, you will need between 20 and 25 hours. This means for Topic 1, you are expected to spend between 5 and 7 hours to study your work. You are encouraged to spend between 8 and 10 hours for Topic 2 while for Topic 3, you will need study time between 7 and 8 hours.

The time indicated for each topic includes the time you will spend studying your work, doing the activities and topic exercises as well as checking them against the feedback. If you do not finish studying the unit within this estimated time, do not worry since we do not all learn at the same pace.

Learning Resources

Tip

In order to study this unit with minimal difficulties, you must attend tutorials at study centres and discuss with other learners. At study centres, you may also find other additional material that would be useful in studying this unit on stock exchange.

In addition, you may require a computer or a mobile phone so that you will be able to access internet services where possible. The internet services will enable you explore more on stock exchanges especially from other countries that we may not specifically look at in this unit. In addition, you can communicate with the tutors by e-mails and by mobile phone.

Where possible, you can also visit libraries and read more on what other people have written on stock exchange. You can visit stock brokers and the stock exchange in your local area or districts to familiarise yourself on stock exchange activities.

Teaching and Learning Approaches

Tip

In this unit we have used three teaching and learning approaches in presenting the content. These approaches are:

- **Content based approach** - This approach is meant to encourage you to base your learning on the subject matter provided, to improve your skills and competencies on trading on the stock exchange and to give you instructions to help you to learning the content effectively.

- **Problem-based approach** - This approach encourages open minded, critical and active learning and the development of commercial thinking. The problem-based approach respects the fact that both the learner and teacher have knowledge and understanding on trading on the stock exchange.

- **Activity-based approach** - To help you to develop business skills on how to do trading on the stock exchange in the cognitive, psychomotor and affective domain, and general learning skills that will promote active interact with content.

As you read through the unit, do the activities and/or exercise and discuss your ideas with other learners and your tutor. You will then be putting into practice these teaching and learning approaches. We trust that you will achieve a greater understanding of the unit and be able to relate the knowledge to real life situations.

Terminology

Commission:	A fee paid to someone for providing a service usually using a percentage of the total amount of business transaction.
Deferred:	To put something off temporarily or to a later time.
Face value:	Value stated on something.
Financial assets:	Something of value that is owned and relates to money.
Founder members:	Members of an organisation who helped to establish it.
Guarantee:	To make a promise that makes certain that a something or payment will be done.
Investment :	Use of money on something today for future

profit.

Investors:	Individuals, organisations or companies that have put in some money into something that will produce more money later.
Issuer:	These are companies that offer their securities on the primary and secondary market.
Licensed Professionals:	Skilled people in particular areas which they are even given permission to operate.
Principle:	A rule that is mainly followed when doing something.
Secured:	To be certain of getting money from the person or organisation borrowing by promising the lender goods or property if they fail to pay back the loan.
Share certificate:	A document that clearly states the number of shares owned by an investor.
Unimpressive:	An individual thing that is part of the whole thing.

Topic 1: Background and Definitions of Terms on the Stock Exchange

Introduction

In this topic, we will concentrate on definitions related to the stock exchange. The definitions will assist you in differentiating when the terms are being used in a commercial context or general English language.

You may have noticed from your general knowledge that the stock exchange seems to play a very significant role in supporting the economic growth of a country. We trust that this unit will consolidate what you already know and develop new knowledge in this aspect of your Grade 11 studies.

As you study this unit, you will be required to do the activities provided in order to assess yourself. You are encouraged to do the activities first without looking at the feedback provided. We hope you will enjoy studying this topic as it will give you more information on how investments can be expanded instead of just saving money at the bank.

Upon completion of this topic you will be able to:

- *Define* the stock exchange.

Outcomes

You should spend at least 6.5 hours on this topic.

Time

We are sure that you are surprised that this topic covers only one outcome. Although this is the case, to understand what stock exchange is you need to know the meaning of several terms related to stock exchange. These terms include stock, exchange securities and stock exchange.

Definitions of Terms on the Stock Exchange

Let us begin by explaining stock in relation to stock exchange.

Stock

We are all familiar with the term **stock**, however, it may be used differently in different situations. For example, in ordinary English it may refer to the keeping of something for use in future. On the other hand, stock in commercial language may mean assets in form of goods available for sale or capital held by an individual who invests in a business or company. It is the commercial definition that we will use as we discuss in this unit.

Let us now explain the term exchange.

Exchange

The word **exchange** may mean different things to different people. In the English language, the word exchange may be used to refer to many different situations. Before you proceed, do the following activity to start our discussion of the definition of terms related to the stock exchange.

Activity 1

With the help of a dictionary, define the word exchange and write your answer in the space given below.

Now compare what you wrote with the definitions provided below.

From your English dictionary, you may have learned that the term exchange may refer to any of the following situations:

Feedback

- *To exchange is a process where you hand over something which is yours to somebody who receives it in return.*
- *A discussion, often between two people or groups to share ideas.*
- *An argument usually between two people or more who are angry.*

Did you get all these aspects of the definition? Good! We are now ready to see how these definitions compare with the commercial definitions.

In the commercial context, we will use the first definition. For example, when a person wants a book, this person goes to a shop to exchange money with the book needed. Look at the following picture in Figure 1.

Figure 1: Showing an example of exchange taking place. Picture taken by Mr. Musonda, a ZACODE Science Team Member.

From Figure 1, we notice that the man is giving the lady money in exchange for a book. In business, this exchange implies buying and selling. You will also notice that the picture reflects the first definition of the definitions given above.

Before we define stock exchange, let us look at the term: securities. This is important because this term will be used as we define stock exchange. When we reach that point, you will already be familiar with this term.

Securities

The term security is commonly used in our daily lives and can mean different things. If someone was to mention your security, you may quickly associate it with freedom from harm, safety, defense or military matters. Nowadays we also talk about food security, which refers to the different ways of providing reliable or stable sources of food for the country.

However, in the field of finance a **security** is a document representing an investment or right of ownership. From your English dictionary, you will learn that the word **investment** may refer to any of the following situations:

- To give money to a company or bank in order to get a profit.
- To buy something in order to sell it later when the value has increased.
- To buy something and use it to generate some profit.
- To give power to somebody to do something.

For our purposes in the discussion of this topic, we will concentrate on the first three situations. In this case, investment is where expenditure is made today in order to realize more money in future.

Carefully study Figure 2 below reflecting some form of investment.

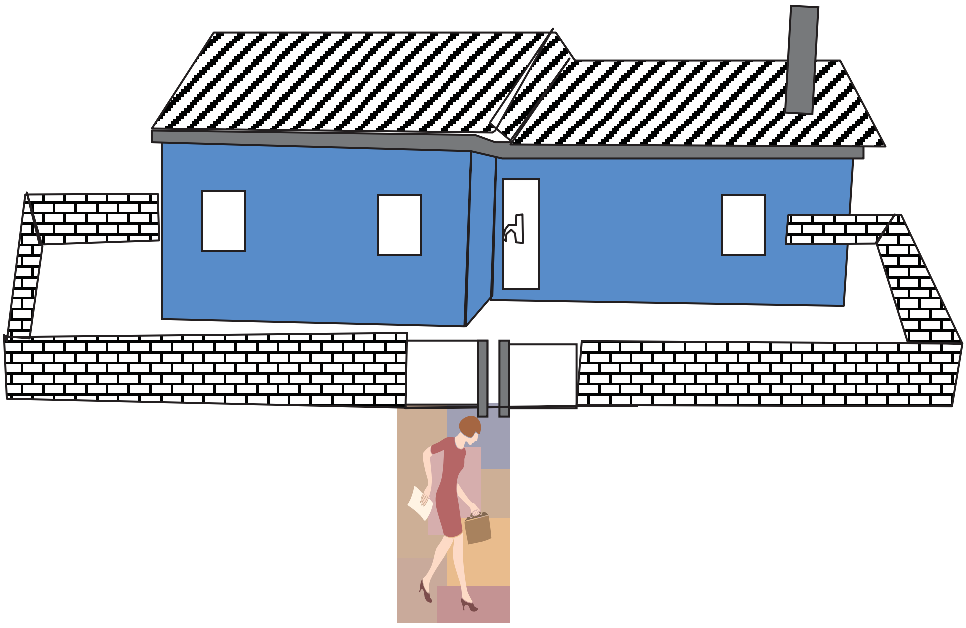

Figure 1: Showing a house as a type of investment accessed from Creative Commons, 2010.

We have already stated the meaning of security. Likewise we have also discussed the meaning of the word investment. From Figure 2, the woman you see in the picture could decide to invest in the house which is shown. On the other hand, she could decide to invest in other forms of securities. Remember the term security can mean the different types of investments made on the stock exchange.

As indicated earlier, securities are documents representing right of ownership of an investment that can be traded on the stock exchange. They therefore represent the financial value invested in the business. They can be in the form of instruments known as shares, stocks, bonds and debentures. We will discuss in detail these forms of securities later in the next topic. Companies raise their capital by selling securities.

Now that the terms stock, exchange and securities have been explained, let us define stock exchange. The definitions we have discussed will assist you to differentiate the terms when used separately from stock exchange as a specific concept.

The Stock Exchange

The stock exchange is an organised market where securities also referred to as financial assets for companies and other institutions are bought and sold. This market is highly regulated. This process of buying and selling securities is called **trading**.

The stock exchange is similar to the way trading is done in supermarkets or in other types of markets. People or organisations supply or buy goods or services at these markets.

Similarly, on the stock exchange individuals, companies and the government are free to buy and sell their securities. In short, the stock exchange is a place where buyers and sellers interact and exchange securities. Most stock exchanges have central locations where trading for securities take place and are highly regulated. The stock exchange also has members.

Members of the stock exchange are called stockbrokers. In Grade 10 and Unit 2, we discussed brokers in home trade and foreign trade respectively. We said they are middlemen in this type of trade. In the same way stockbrokers are middlemen in the buying and selling of stocks. Stocks and shares are therefore traded through stockbrokers (stocks and shares will be explained later in this topic). Stockbrokers buy stocks and shares on behalf of their clients and for each transaction carried out, they are given a commission. We will discuss more on stockbrokers later in Topic 3 of this unit.

Now that stock, exchange securities, and stock exchange have been explained, do the following activity to assess your understanding of the terms especially in the commercial context.

Activity 2

Define the following terms in the commercial context.

1. Stock
2. Investment
3. Security

Now compare the answers you have given to the ones given in the feedback below.

Feedback

1. *Stock in commercial language may mean assets that are in the form of goods available for sale or capital held by an individual who invests in a business or company.*
2. *The term investment in commercial language may mean expenditure made today in order to realize more money in future.*
3. *A security is a document representing an investment or right of ownership.*

We hope that after comparing your answers with the answers provided in the above feedback, you might have got all the answers correct. Congratulations! If not, read through the necessary text again.

We have completed our discussion of the definition of the stock exchange and its related terms. You can now proceed to read the topic summary.

Topic 1: Summary

In this topic, we discussed the general background and definitions of the stock exchange. The definitions were to assist you in differentiating the terms when used in commercial and general English language. In our discussion, we defined security as a document representing an investment or right of ownership. Stock was said to be assets that are in form of goods available for sale or capital held by an individual who invests in a business or company. Exchange was defined as buying and selling. We also defined stock exchange as an organised market where securities also referred to as financial assets for companies and other institutions are bought and sold. We hope this gave you a wonderful experience.

In the next topic, we will discuss types of securities issued on the stock exchange. Before you proceed, do the Topic 1 Exercise which is in the assignment section. This exercise will help you review what we discussed in this topic. You are encouraged to complete the exercise first by answering all the questions and then compare your answers with those provided in the feedback. If you found any to the questions difficult, you should revise the relevant sections before proceeding to the next topic.

Topic 2: Types of Securities on the Stock Exchange

Introduction

In Topic 1 you learnt about different terms related to the stock exchange in plain English language and in the commercial context. We defined stock, exchange, securities and stock exchange. We hope that when these terms are used in this topic or in later topics, you will understand them correctly.

This topic will address the second unit outcome. We will discuss different types of securities on the stock exchange. We will specifically look at stocks, shares, bonds and debentures.

We hope this will give you more knowledge on the various securities you would expect to find on the stock exchange.

You will also be required to do the activities given in this topic. You are encouraged to do the activities first without looking at the feedback provided. We hope this topic will give you more information on types of securities traded on the stock exchange.

Outcomes

Upon completion of this topic you will be able to:

- Identify securities, shares, stocks, bonds and debentures.

Time

You should spend at least 6.5 hours on this topic.

As we discuss the types of securities, we hope you still remember the definition in the commercial context. Just in case you have forgotten, in Topic 1 we defined securities as investment or right of ownership. Following this definition, we considered investment in relation to a business. Therefore, in the following discussion you are going to learn about various securities that can be traded on the stock exchange.

We will begin our discussion with stocks as a type of securities as it sets the foundation for the other terms.

Stocks

Earlier in Topic 1, we defined stocks in the commercial context as assets in form of goods available for sale or capital held by an individual who invests in a business. In this topic, we will use the second part of the definition. This is because stocks on the stock exchange represent the original capital invested in the business by the founding members.

Founder members are individuals who helped in the establishment of the business or organisation through the contribution of their capital. You can also refer to the definition given in the terminology section. As the business continues to operate, the stocks serves as security to creditors as it cannot be withdrawn to disadvantage the creditors. We hope you still remember the definition of creditors. If you have forgotten, read through Unit 4 and the text on limited companies.

In case of any failure in the business, the creditors can be paid off from these stocks. The stocks are different from other properties or assets of the business that change their value from time to time. The stock of a business is divided into units called the shares.

Activity 3

Using the information you learned in Topic 1 on stock and the definition stock you have just learnt, how can you link the two?

Compare your ideas with what is provided in the feedback below and check if any of your ideas are included.

Feedback

You may have written that stock in Topic 1 described some form of goods available for sale or capital held by an individual who invests in a business or company. On the other hand, stocks on the stock exchange represent the original capital invested in the business by the founder members. The important point to remember is that stock means investment and on the stock exchange it is divided into shares.

Let us now look at shares as one of the securities traded on the stock exchange. This discussion will give you a broader understanding on stock which is now divided in shares.

Shares

Earlier in the topic, we mentioned that stocks are sub-dividend in shares. From your English dictionary, you may have also noticed that the word "share" may refer to any of the following situations:

- Use something along with others.
- To have a similar experience with another.
- A part of something that is owned or paid by or set aside for each or several people.

On the stock exchange, a unit (or single part) of a limited company's capital is called a share. These shares are sold in prescribed multiples (amounts of money). The total cost of each share is stated at the time the business is being formed. A share has a certain declared face value which gives the total value of money invested in the business. In the terminology section, face value is defined as the amount that is shown on something and in this case, the shares.

A person who owns shares in a company is called a shareholder. A shareholder is given a certificate called a share certificate. As we have defined in the terminology section, this certificate clearly states the number of shares owned by an investor. A record of this share certificate is also kept by the company. Just as a title deed is given as proof for ownership of a building or a piece of land, a share certificate is also given as proof of ownership of the shares.

When individuals buy shares in a company, they become part owners of that company and are entitled to a share of that company's profits. This is called a dividend. Shares are sometimes called equities because they represent an equal part of a business's capital and divisions of its profits.

Study Figure 3 below carefully. This figure will help you get a better understanding of what a share certificate looks like and the information it contains.

BENG Public Limited Company

This certifies that **Precious Mbuluma** *is entitled to* **10 000** *shares of the Capital Stock of the* BENG Public Limited Company.

M. Bwaila
Secretary

K. M. Chilubi
Director

Capital Stock

K 50 000 000

10 000 Shares

K5 000 each

Figure 3: An example of a share certificate. Created by Commerce Team, ZACODE, 2010.

Figure 3 is an example of a share certificate issued by BENG Public Limited Company to Precious Mbuluma. You will notice that on the left hand side, the certificate indicates that the bearer or holder owns 10 000 shares of stock in the company, each valued at K5 000. This means Precious Mbuluma invested K50 000 000 in this company.

Remember, a share certificate or title is a document which gives proof of owning shares in a company. This is the reason it is sometimes referred to as a document representing an investment.

Shares can be bought and sold on the stock exchange. Anyone who wishes to buy shares from a company is also free to sell them to another person if they wish. This suggests that the ownership of the company or business can change since shares can be bought and sold to any one at any time. This is the reason we said that stock which is later divided into shares is kept in the business in order not to disadvantage the creditors.

We hope you still remember that in Unit 4, we said only limited companies are allowed to sell their shares. Public limited companies can sell their shares privately while public limited companies can sell to the public through the stock exchange.

Limited companies issue different types of shares. The common types of shares include ordinary and preference shares which we are now going to look at in detail.

We will begin with ordinary shares.

Ordinary Shares

You may be familiar with the term 'ordinary' as it is commonly used in the English language. It refers to many different situations .With the help of a dictionary, do the activity below.

Activity 4

With the help of your dictionary, find out the meaning of the word 'ordinary' in plain English. Write the meanings in the space provided below.

You may have seen these meanings in your dictionary:

Feedback

- *Something common in everyday situations.*
- *Common, uninteresting or unimpressive.*

We will use the second meaning. This is because on the stock exchange, the ordinary shares are the most important shares but unimpressive as they hold high risk in the company. This can be demonstrated by the following characteristics of ordinary shares:

- Each share is entitled to an equal share of the company's profits called dividend. This is why ordinary shares are sometimes called equities in the company.
- Shareholders of ordinary shares have voting rights at the annual general meetings. This makes them have control over the company.
- Ordinary shareholders are responsible for electing the board of directors who are responsible for the general policy of the company.
- The shares are sometimes referred to as the risk capital. The holders of this type of shares are the last to receive dividend out of the profits.
- The ordinary shareholders are the last to be paid dividend if a company is being liquidated or winding up. They are last after debenture (debenture will be discussed later in this topic) and preference shares holders.

Notice that it is the last two points that makes these types of shares unimpressive.

Some companies decide to issue a special category of shares called **deferred ordinary** shares or **founders' shares.** These shares are issued to original founders of the company. The following are their main characteristics:

- They have high voting rights to allow founders of the company to maintain control over it.
- They are the last to be paid after the ordinary shareholders.
- The rate of their dividend is not fixed but the rate depends on the performance of the company.
- When the company has not made enough profit, payment of dividends to founder members may be put off temporarily to such a time when the company makes enough profits. This is the reason they are also called deferred shares. When you refer to your dictionary you will find that the word 'deferred' means to be put off temporarily.

Having discussed ordinary shares, do the following activity. This activity will help you to assess your understanding of the work discussed. Feedback to this activity is given below the activity. You are advised to not to look at the feedback before you do the activity.

Activity 5

Answer both questions given in this activity.

1. Define shares in relation to the stock exchange.
2. Identify and explain the characteristics of deferred shares.

Now compare the answers you wrote with the feedback given below.

Feedback

1. *On the stock exchange, a unit (or single part) of a limited company's capital is called a share. These shares are sold in prescribed multiples. The total of the shares is stated at the time the business is being formed. A share has a certain declared face value which gives the total value of money invested in the business.*
2. *The following are the characteristics of deferred shares:*

- *They have high voting rights to allow founders of the company maintain control over it.*
- *They are the last to be paid after the ordinary shareholders.*
- *The rate of their dividend is not fixed but the rate depends on the performance of the company.*
- *When the company has not made enough profit, payment of dividend to founder members may be put off temporarily to such a time when the company makes enough profits. This is the reason they are also called deferred shares*

We hope that after comparing your answers with the answers provided in the above feedback, you have got all the answers correct. Congratulations! You can proceed. If not, read through the text again.

Let us now look at another form of shares known as preference shares. This discussion will help you to distinguish ordinary shares from preference shares.

Preference Shares

You have already learned different meanings of shares from our previous discussion. We also hope that the term preference is not new to you. Just in case you are not sure, the word 'preferred' or 'preference' in everyday English means selection of something or course of action which is more desirable than another. On the other hand, in commerce preference means priority is given to a creditor to receive payment before others. We hope you have noticed that this meaning is derived from plain English.

Preference shares are given first priority in payment of dividends before other holders of other types of shares are paid. Dividends are paid using a percentage of capital invested in the company. The following are the characteristics of preference shares:

Characteristics of Preference Shares

- They are first to receive dividends on the profits of the company after debenture holders.
- They have a fixed rate of dividend. The rate is indicated on the share title (also called share certificate) for example 5% preference shares. This means a shareholder of these shares will receive 5% of the capital invested as dividends.
- They do not have voting rights at the annual general meeting of the company. This makes the preference shares to have no say in the control of the company.

Having looked at the characteristics of preference shares, let us now consider the two types of preference shares, the cumulative and participating preference shares.

Let us begin with the cumulative preference shares.

Cumulative Preference shares

Generally the word cumulative or accumulative means to build up something through gradual additions. In the commercial context, cumulative describes a payment not paid when it is due, but is added to the next payment. You may also find other meanings from your dictionary or books that may relate to this context. With this background, let us discuss cumulative preference shares.

Holders of cumulative preference shares do not receive dividends in bad years when the company experiences a loss or makes little profit. These dividends that are not paid out then accumulate (build up). In the year the company makes a profit, the cumulative preference shareholders will receive dividends even for the previous years they were not paid.

For example, Margaret is the holder of cumulative preference shares worth ZK10, 000, 000 at 5% in a paper making company. The company failed to make a profit in 2007 and 2008, but made a profit in 2009. Margaret (the holder of cumulative preference shares) will receive dividends starting from 2007, 2008 and 2009. How much will Margaret receive as total dividend for the three years? Margaret will receive ZMK1, 500, 000. This amount will be arrived at by the following step-by –step approach shown below:

- Margaret holds shares worth ZMK10, 000, 000 at 5% ; which is equal to ZMK500, 000,
- When this amount is to be paid for three years, Margaret will receive ZMK500, 000 x 3 years and therefore:
- For the three years she will receive a total amount of ZMK1, 500, 000 as dividends.

Let us also look at the other type of preference shares known as the participating preference shares.

Participating Preference Shares

We have seen that preference shares give shareholders the right to receive a fixed rate of dividend. What then are participating preference shares? To answer this question we will start by defining the word participating. In ordinary English language, ‘participating’ means taking part in an activity or event. Participating preference shares therefore are shares whose holders receive a fixed rate of dividend. In addition, when a company makes more profits they take part in the sharing of profits that remain after all shareholders have received their dividends. This additional dividend is based on some set conditions by the company.

Now that you have learned about the types of shares in details, we hope you are able to distinguish the different types of shares. We will proceed and discuss bonds another form of securities.

Bonds

The term bond is another common term used in our daily lives. When you look up in your dictionary, you will notice any of the following meanings:

- The way in which a part or parts sticks to another.
- A sincere agreement promising to do something.
- A sum of money paid to enable a person or people be released from prison or police cells and await trial on the agreed date.
- Something that connects people in a relationship together.
- A legal document that compels one party to make payment to another on the agreed date.

The meanings above are used in varying situations. In the commercial context we will use the last definition for bond. This is similar to how it is defined on the stock exchange.

A bond is a legal document issued (given out) by a company or government to commit itself to pay back borrowed money at a fixed rate of interest on a given date. Fixed rate means the amount does not change over a period of time. The company or government that issues the bond is called the issuer. We hope you won't confuse the term borrowing and lending. You are encouraged to do the following activity to assess how much you understand the terms borrowing and lending.

Activity 6

Define the following terms in your own words. Write your ideas in the space provided.

1. Borrowing

2. Lending

Compare your answers to the ones given below.

Feedback

1. *Borrowing is the act of obtaining something from someone or somewhere with the intention of returning it.*
2. *Lending is the act of allowing someone to use something for an agreed period of time on the*

condition that it will be returned later.

If you did not get all the answers correct, do not worry, you have now learned the meaning. If your answers were correct, well done!

Now you can move on to the next topic.

In summary, bonds are interest bearing loans issued by companies or the government in order to raise money for development, expansion or capital. A loan is a credit given to somebody with a form of agreement that it will be paid back.

People who buy bonds lend money to the issuer of these bonds. Bonds have a fixed (not changing) amount of interest and period of time in which payment should be made. Bonds have a fixed date of maturity. The date of maturity is the time when repayment of the loan is due.

The face value of the bond indicates the actual loan that has been given out to the issuer.

For example, the Zambian government wants to build three schools but do not have enough money for the project. The government decides to issue bonds worth ZMK100, 000,000 with interest of 10% to be paid back after five years. When this loan is received, government can carry out this project. The activity below makes you apply the information provided here to consolidate your knowledge.

Activity 7

Using the example above, find the interest the government would pay after five years. Write your answer in the space provided below.

The answer that you have given should be the same as the one provided in the feedback below.

Feedback

The government will pay an interest of ZMK10, 000, 000 which is a 10% of ZMK100, 000, 000 the face value of the bond issued.

The ZMK10, 000,000 interests to be paid by the government was arrived at by using the calculation shown below:

$$Interest = Face\ value \times interest\ rate$$

$$Interest = K100{,}000{,}000.00 \times 10\%$$

10% is $\frac{10}{100}$

$$Interest = K100{,}000{,}000 \times \frac{10}{100}$$

$$Interest = \frac{K100{,}000{,}000 \times 10}{100}$$

Multiply the numbers forming the numerator

$$Interest = \frac{K1{,}000{,}000{,}00\ 0}{100}$$

Divide 100 into 1,000,000,000

Interest = K10,000,000.00

Did you get the same answer? Good! If not, review the steps taken above to arrive at the answer.

It is also important to note that the investor in bonds can decide to hold the bonds and collect only interest when the bonds mature. The bondholder is also free to sell the bond to a different person who becomes the new owner of the bond and can claim interest.

For example, BENG Public Limited Company decides to buy a bond from the Zambian government at ZMK50, 000,000.00 at 5% interest to be paid back after fives. After three years, the company decides to find another company to buy the bond it held. If PECAL Limited Company buys this bond, in this situation BENG Public Limited Company receives the face value of the bond. In this case, PECAL Limited Company becomes the new owner of the bond. After two years (that is in year five), PECAL Limited Company will receive the face value of the bond and the agreed interest or just the interest.

On the other hand, BENG Public Limited Company can decide to wait five years and receive the face value of the bond with the interest or just interest and enter into a new contract.

Having looked at bonds, we hope you will not confuse this term when used in everyday life and in relation to the stock exchange. Let us move on and discuss debentures.

Debentures

Debentures are loans given by the investing public, company or organisation to a company in need. These are not shares but long-term loans. Long term loans are those paid back over a long period of time, for example: 15 years. A company can issue debentures at a fixed rate of interest. For example, 2000 debentures at K500 each with the interest rate of 8%. Repayment of these loans is normally guaranteed against some property owned by the firm. This means that if the company fails to pay, the agreed property must be sold and money from sale of the property must be used to repay the debenture holders. The fixed rate charged on the debentures must be paid first before shareholders receive their profits. If the debenture holders do not receive their annual interest, they may force the company into liquidation. **Liquidation** is to sell the fixed assets of a company to pay their creditors. **Fixed assets** are assets that can be used for a long period of time. For example, a piece of land or building.

There are two main types of debentures which we will discuss in the following text.

Naked Debentures

In ordinary English, naked means to be without a covering or protection. On the other hand, naked on the stock exchange is used to describe debentures that are not protected from failure of repayment. This means that the company will not surrender any asset as **surety** (an item that can be taken) in case it fails to pay back the loan.

Mortgage debentures

Mortgage debentures are loans given to a limited company that are required to be secured.

With mortgage debentures, the company receiving it will indicate to lenders a valuable asset, for example, a building as surety. In the event the company fails to repay the loans, the creditors will sell the agreed upon property to recover their money.

Having discussed what the stock exchange is and different types of securities, we think it will be helpful for you to do the following activity to assess your understanding. We would like to encourage you do the activity without looking at the answers provided. This will help you to have a true picture on how much you remember the information you have read.

Activity 8

1. Name three types of securities traded on the stock exchange:
2. Using the commercial situation, define debentures.
3. Write brief notes of the following:
    a. Bonds
    b. Naked debentures

Feedback

Now compare your answers with those provided in the below.

1. *You could have written any three of the following types of securities found on the stock exchange:*

- *Stocks*
- *Shares*
- *Debentures*
- *Bonds*

2a. A bond is a legal document issued (given out) by a company or government to commit itself to pay back borrowed money at a fixed rate of interest on a given date. The company or government that issues the bond is called the issuer.

2b. Debentures are loans given by the investing public to a company. These are not shares but long-term loans given to a company by the investing public. Long term loans are those paid back over a long period of time, for example, 15 years.

Naked debentures on the stock exchange are used to describe debentures that are not protected from failure of repayment. This means that the company will not surrender any asset as surety (an item that can be taken) in case it fails to pay back the loan.

We hope that after comparing your answers with the answers provided in the above feedback, you have got all the answers correct. Congratulations! You are ready to move on to the next topic. If you had difficulties then we suggest you read through the text again in order to gain more understanding and try the questions you got wrong again before you proceed to the next part of the topic.

You can proceed and read the topic summary to review what we covered in this topic.

Topic 2: Summary

In this topic you learned about various types of securities on the stock exchange. We considered specifically stocks, shares, bonds and debentures. The terms were defined both in plain English language as well as how they are used on the stock exchange. We noticed that stocks on the stock exchange represent the original capital invested in the business by the founder members. We further discussed shares and the two types of shares which are ordinary shares and preference shares. You may have observed that a bond on the stock exchange is a legal document issued by a company or government to commit itself to pay back borrowed money at a fixed rate of interest on a given date. The other type of securities discussed were the debentures. We said there are two types of debentures namely naked and mortgage debentures.

You had a chance to check your understanding through the activities given in this topic. We hope you did all the activities and found them useful.

We hope you are now familiar with types of securities. You should be able to identify the different types of securities and also be able to provide a description.

In the next topic, we will discuss purposes and functions of the stock exchange. In addition, we will explore trading of the types of securities we discussed in Topic 2 of stock exchange.

Before you proceed, refer to the assignment section and do the Topic 2 Exercise. This will help you to assess how much you have learned in this topic. Work through the exercise first and then compare your answers with those provided in the feedback.

Topic 3: Purposes and Functions of the Stock Exchange and Trading

Introduction

In Topic 2, we discussed types of securities on the stock exchange. We considered specifically stocks, shares, bonds and debentures. The terms were defined both in plain English language and as they are used on the stock exchange. We noticed that stocks on the stock exchange represent the original capital invested in the business by the founder members. We further discussed shares and the two types of shares which are ordinary shares and preference shares. We also observed that a bond on the stock exchange is a legal document issued by a company or government to commit itself to pay back borrowed money at a fixed rate of interest on a given date. Other type of securities discussed were the debentures. We said they are two types of debentures namely naked and mortgage debentures.

In this topic, we will discuss purposes and functions of the stock exchange. Further, we will explore trading of the types of securities we discussed in Topic 2. We will address the third and the fourth unit outcomes which are written below.

Upon completion of this unit you will be able to:

Outcomes

- *Explain* the purpose and functions of the stock exchange.
- *Discuss* trading of securities on the stock market.

Time

You should spend at least 6.5 hours on this topic.

Let us investigate the purpose and functions of the stock exchange. Our discussion will have the following sub-headings:

- The purposes of the stock exchange
- Functions of the stock exchange and
- Trading on the stock exchange.

We will begin our discussion with the purposes of the stock exchange.

The Purposes of the Stock Exchange

In Topic 1, we indicated that the stock exchange is an organised market where securities for companies and other institutions are bought and sold. In the following discussion, we will examine the purposes of the stock exchange.

When you check in your dictionary for the definition of 'purpose', you will notice that it has different meanings such as:

- A reason for which something is established.
- The intended result of something established.
- The desire to achieve the set goals.

For the purpose of this discussion, we will use the first definition. This is because our discussions in Topics 1 and 2 suggest that the stock exchange is an organization which is established for a number of reasons or purposes. It is these purposes that we will consider in this part of our discussion.

The purposes of the stock exchange are to:

- **Enable companies to raise more capital -** This is done by allowing people invest their money in these companies by means of buying securities. These investors benefit in the sense that they have a share in the profits of the company.

- **Facilitate secondary trading -** The other purpose of the stock exchange is to facilitate secondary trading for investors who bought securities the first time they were offered for sale by the company to the public. Secondary trading will be explained in detail later under the sub –heading: trading on the stock exchange.

- **Determine share prices -** It is at the stock exchange where the value and the price of securities are measured. The prices of securities can **appreciate** which means that they increase or **depreciate** which means they reduce in value based on the principle of supply and demand. This means if more people wish to buy shares in a particular company, then the share price may go up. If fewer people wish to buy shares then the share price may go down.

In the activity below we want you to use your current knowledge to begin our discussion on share prices.

Activity 9

What do you think are some of the other factors that may influence share price? Write your ideas in the space provided below.

Feedback

Your ideas may include the ones given below:

- *Political changes such as change of government which may draw new policies.*
- *When a weaker company is taken over by a stronger company by buying its shares, people may want to buy shares in it.*
- *Changes in the market trends. A market trend is the movement of share price of the particular company. The movement will show whether the company is doing fine or not through the progression graph. The graph would go up or down depending on the performance.*
- *The performance of the company: whether it has been good or bad.*

So, the factors given above would help the stock exchange determine the price for the shares so that investors could have a fair deal.

Now that we have discussed the purposes of the stock exchange, it is important to move on and look at the functions of the stock exchange. This discussion gives the justification for the importance of the stock exchange in a nation. Functions in this context mean the roles of the stock exchange.

Functions of the Stock Exchange

Earlier in our discussion of this topic, we mentioned that the stock exchange has some purposes. To achieve its purpose, it performs the following roles:

- To provide the specialised market where companies can raise additional capital when they decide to sell their securities.
- To determine the prices of shares depending on the demand and supply from the public. These prices are published to the public through some media of communication such as newspapers.
- To draw up rules to be followed by anyone participating on the stock exchange. These rules protect the investors against any unfair dealings.
- To give a chance to people who have savings to invest in companies that want to raise capital.
- To allow people to have confidence in companies selling shares. This is due to the fact that they sell their shares through the stock exchange, a genuine market.
- To make it possible for the government to obtain loans which are used for building schools, hospitals and roads in the country.
- To provide all necessary information to the public concerning the stock exchange.

Having looked at the functions of the stock exchange, let us consider the second outcome of this topic by discussing the issues relating to trading on the stock exchange. We will do this in information that follows.

But before we go on, do the activity below to assess how much you have learnt. In addition this will help you meet the first learning outcome stated in the topic outcome section

After completion of this activity you should compare your answers with the ones provided in the feedback. Do not look at the answers before answering the activity.

Activity 9

Answer the following questions based on what we have discussed so for.

1. One purpose of the stock exchange is to determine share price. Explain this purpose.
2. Describe any of three functions of the stock exchange.

Feedback

Check your answers to see if they are similar with these provided below.

1. *One purpose of the stock exchange is to determine the share price. It is at this market where the value and the price of securities are measured. The prices of securities can appreciate (go up) or depreciate (go down) in value based on the principle of supply and demand. This means that if more people want to buy shares in a particular company, then the share price will go up. If fewer people wish to buy shares then the share price will go down. The stock exchange determines the share prices so that investors get a fair deal.*
2. *The functions of the stock exchange include:*

- *To provide the specialised market where companies can raise additional capital when they decide to sell their securities.*
- *To determine the prices of shares depending on the demand and supply from the public. These prices are published to the public through some media of communication such as newspapers.*
- *To draw up rules to be followed by any one participating on the stock exchange. These rules protect the investors against any unfair dealings.*
- *To give a chance to people who have savings to invest in companies that want to raise capital.*
- *To enable people have confidence in companies selling shares since they sell their shares through the stock exchange, a genuine market.*
- *To make it possible for the government to obtain loans which are used for building schools, hospitals and roads in the country.*
- *To provide all necessary information to the public concerning the stock exchange.*

  (Any three answers are correct)

After comparing your answers with the information given in the feedback, can assess how well you have done. If you had problems answering any of the questions, we suggest that you read the relevant text again before you proceed in this topic.

Having discussed the functions of the stock exchange, we can now move on and discuss trading on the stock exchange. This will give you a general picture of how trading is done.

Trading on the Stock Exchange

You should be familiar with the term trading which refers to the act of buying and selling. We defined it in Topic 1.

In the stock exchange, the buying and selling of securities is what is called trading on the stock exchange. It can be primary or secondary trading. Let us look at these types of trading before we discuss the process of trading.

This first offer of shares to the public by companies is called **primary market or trading**. When shareholders decide to sell their shares, it is made on the **secondary market or trading**.

Secondary trading is the process of buying and selling securities in order to make profit. Secondary trading allows investors who bought shares at the primary market to sell securities at prices determined by the stock exchange. In addition, those who did not have the chance to buy shares at primary market are given an opportunity to own shares through secondary trading.

Remember, in Unit 3 we mentioned that ordinary members of the general public are not allowed to trade directly with the stock exchange. However, we said they can buy and sell the shares through the stockbrokers. The latter are licensed professionals who buy and sell stocks on behalf of the investor. The stockbroker will open an account on behalf of the investor. How then is business done on the stock exchange by these brokers?

Stockbrokers get instructions or orders from their clients over the telephone or by use of computer related facilities in order to transact securities on their behalf. Brokers then go to the stock exchange where there is a stock room. In this stock room, names of companies and their shares are displayed. Desks are arranged in a semi-circle so that brokers can clearly observe everything happening in this room in relation to securities. Brokers in this room buy and sell securities on behalf of their clients. After the trading process, brokers then inform their clients on the deals made.

Figure 4 below gives a summary of the process of trading. Study it carefully.

Follow the directions of the arrows. Start with client's instruction to the broker. The latter then going to the stock exchange and makes the deal. Thereafter, the broker goes back to the client.

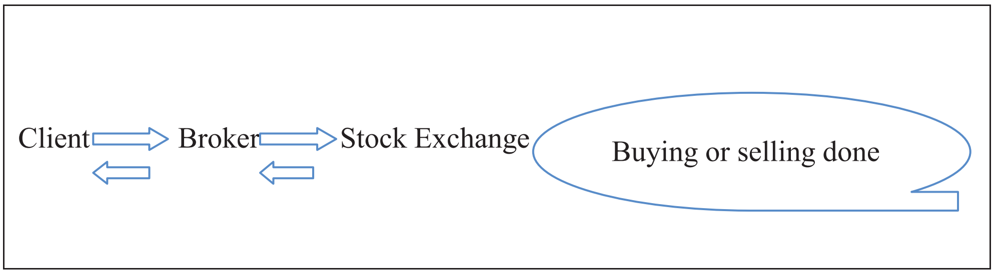

Figure 4: Trading process on the stock exchange. Created by Commerce Team, ZACODE, 2010.

Please note that the process shown above can be done manually or electronically. By manually we mean the stockbrokers could physically carry out the whole process of stock trading. For example, going to the stock exchange and do the transactions in the stock room. When this process is completed, commission is paid to the stockbroker.

Now look at the electronic process of trading as illustrated below.

To understand the process:

- Follow the direction of the arrows and
- Read the explanations in the blurbs.

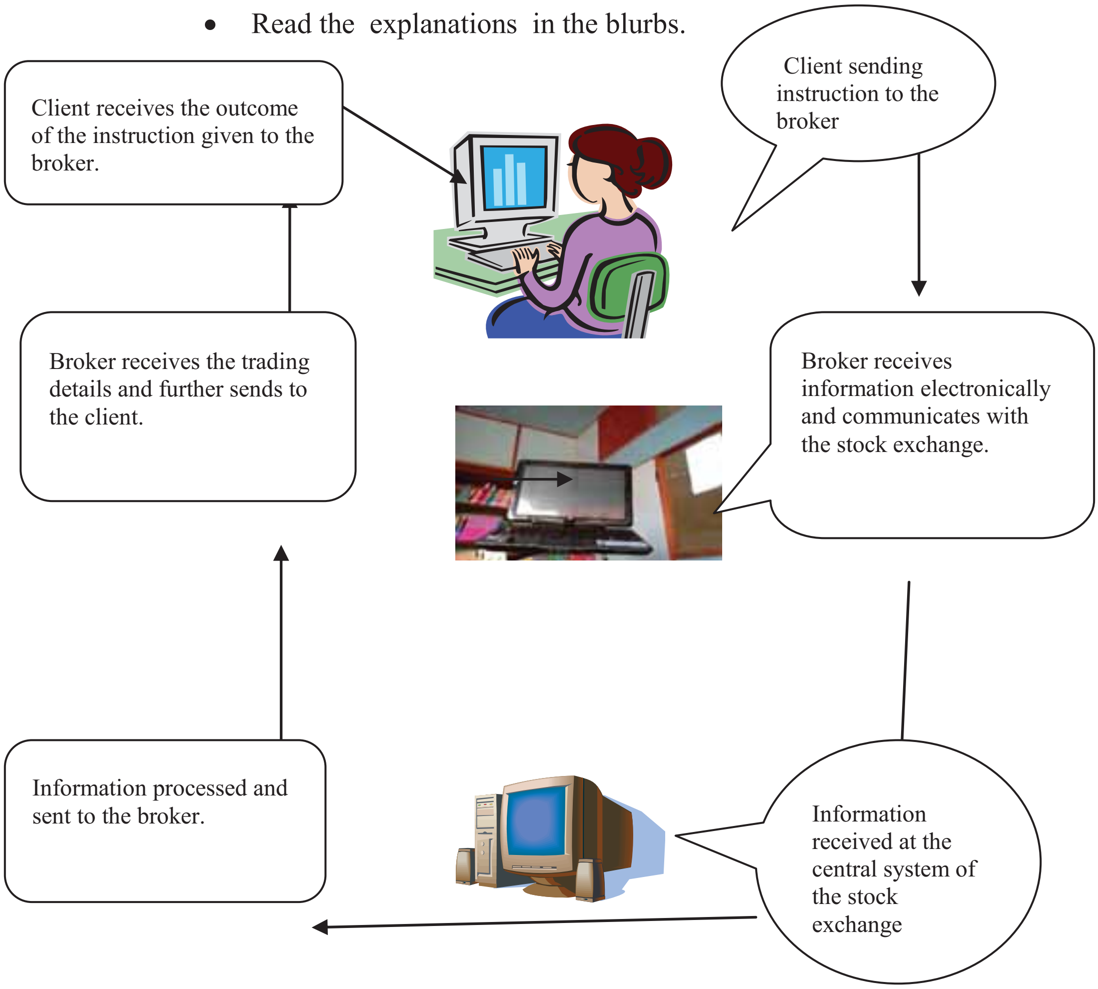

Figure 5: Trading of securities on the stock exchange electronically. Created by Commerce Team, ZACODE, 2010.

The above diagram illustrates transacting securities electronically. This is called an Automated Transaction System (ATS). In this way, the transactions can be made within the shortest period of time possible by using a computerised system.

So far, we have discussed the purposes, functions and the process of trading on the stock exchange. This brings us to the end of this topic. Before you proceed, read the topic summary. It will help you review the main points we discussed.

Topic 3:Summary

In this topic, you learnt in detail trading on the stock exchange. We discussed purposes of the stock exchange. We said it is to facilitate secondary trading, determine share prices and to help companies raise their capital. We further looked at the functions. In addition, we looked at the process of trading both electronically and manually. In electronic trading, the clients can give instructions to the brokers using the telephone or computer related facilities.

Before you study the unit summary, turn to the assignment section and do the Topic 3 Exercise.

Work through the exercise first and then compare your answers with those provided in the feedback. This exercise will help you get an idea of how much you have understood this topic.

Unit Summary

Summary

In this unit you learned about the stock exchange. There were three topics. In Topic 1, we discussed the definition, general background and principles of the stock exchange. The definitions were to assist you in differentiating the terms when used in commercial and general English languages. In our examination, we defined security as a document representing an investment or right of ownership. Stock was said to be assets that are in the form of goods available for sale or capital held by an individual who invests in a business or company. Exchange was defined as buying and selling. We also defined the stock exchange as an organised market where securities also referred to as financial assets for companies and where other institutions are bought and sold.

In Topic 2 we looked at types of securities on the stock exchange. We considered specifically stocks, shares, bonds and debentures. As in the previous topic, the terms were defined both in plain English language and by how they are used on the stock exchanges. We noticed that stocks on the stock exchanged represent the original capital invested in the business by the founder members. We further discussed shares and the two types of shares which are ordinary shares and preference shares. You also learnt that a bond on the stock exchange is legal a document issued by a company or the government to commit itself to pay back borrowed money at a fixed rate of interest on a given date. Other types of securities discussed were debentures. We said there are two types of debentures, namely naked and mortgage debentures.

In Topic 3, we discussed the purposes of the stock exchange. We said it is to facilitate secondary trading, determine share prices and to help companies raise their capital. We further looked at the functions of the stock exchange. In addition we looked at the process of trading in the stock exchange; both electronically and manually. The clients can give instructions to the brokers using any of the said processes.

Congratulations for completing Unit 5 of Grade 11 Commerce! We hope that you now understand the different definitions and types of shares on the stock market. Before you proceed to the next unit, please spend some time doing the self-marked assignment. This will allow you to assess yourself on how well you have understood this unit. Check the feedback only after answering all questions. If you are happy with your progress, you can move on to the next unit. If not, review the relevant sections and ensure that you have understood everything. It will also be a good idea to discuss your difficulties with other learners and your tutor at the learning centre.

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Assignment

Assignment

There are 3 exercises in this assignment, one for each topic. Each one of them should be written after you have completed a specific topic.

Topic 1 Exercise

Answer all the questions in this topic exercise.

1. Use the list of word given below to fill in the blanks in the questions given.

   Stockbrokers

   Trading

   Securities

   Stock

   Expenditure

a. Investment is where ______________is made today in order to realise more money in future.

b. The process of buying and selling is called _____________

c. Different investments traded on the stock exchange are collectively called _________________.

d. ______________may mean assets available for sale by a business or company.

e. _________________buy stocks on behalf of their clients.

2. Write brief notes in relation to stock exchange:

   a. Stocks

   b. Stock exchange

Topic 2 Exercise

This exercise has two sections, A and B. Read carefully and answer all questions.

SECTION A

This part contains five multiple choice questions. Choose the correct answer and write the relevant letter of the alphabet (a, b, c or d) in the box provided.

1. Which one of the following is not a characteristic of preference shares?

a. They are first to receive dividends on the profits of the company after debenture holders.

b. They have high voting rights to allow founders of the company maintain control over it.

c. They have a fixed rate of dividend.

d. They do not have voting rights at the annual general meeting of the company.

2. _____________on the stock exchange represent the original capital invested in the business by the founder members.

a. Bonds

b. Shares

c. Debentures

d. Stocks

3. Participating preference shareholders receive _____________of dividend and have also a share in the profits that remain when the company makes more profits.

a. Fixed rate

b. Preference shares

c. Cumulative shares

d. Commission

4. Mortgage debentures are _________________loans.

a. Unprotected

b. Bond

c. Protected

d. Stocks

5. In commerce, a company that issues bonds is called the ____________of bonds.

a. Creditor

b. Issuer

c. Lender

d. Borrower

SECTICTION B

Answer both questions in this section.

1. Using the characteristics of ordinary shares, identify those that make these shares:

   a. Most important

   b. Unimpressive

2. In 2008, Fridah Bwaila buys cumulative preference shares from BENG Public Limited Company. The face value is K50 000 000. The dividend is to be paid from 2009 at the interest rate of 5%. The company fails to pay the dividend in 2009 but manages to pay in it in 2010. Calculate the dividend Fridah Bwaila would receive in 2010.

Topic 3 Exercise

This exercise has two parts, A and B. Read carefully and answer all questions that follows:

PART A

In this part you are required to state true or false using the space provided.

Read the statements carefully on the purposes of the stock exchange:

i. To enable companies to raise more capital ______________

ii. To control political factors __________________________

iii. To facilitate secondary training ______________________

iv. To determine share prices ___________________________

v. To pay divideds to the shareholders ___________________

PART B

From your own experiences and what we have discussed, answer the questions given below.

1. What is meant by trading on the stock exchange?
2. How do stockbrokers receive orders from their client in order to make deals on their behalf on the Stock Exchange?
3. Discuss how trading is done manually on the stock exchange.

Feedback

The following are the answers to the topic exercises.

Topic 1 Exercise

1. *A Expenditure*

   B Trading

   C Securities

   D Stocks

   E stockbrokers

2. a. *Stocks may mean assets in form of goods available for sale or capital held by an individual who invests in a business or company.*

   b. *Stock exchange is an organised market where securities also referred to as financial assets for companies and other institutions are bought and sold. This market is highly regulated. This process of buying and selling securities is called trading.*

Topic 2 Exercise

SECTION A

1. *b*
2. *d*
3. *a*
4. *c*
5. *d*

SECTION B

1. a. *The characteristics of ordinary shares that make them important are:*

      - *Each share is entitled to an equal share of the company's profits called dividends. This is why ordinary shares are sometimes called equities in the company.*
      - *Shareholders of ordinary shares have voting rights at the Annual General Meetings. This makes them have control over the company.*
      - *Ordinary shareholders are responsible for electing the board of directors who are responsible for the general policy of the company.*

   b. *The characteristics of ordinary shares that make them unimpressive are:*

      - *The shares are sometimes referred to as the risk capital. The holders of this type of shares are the last to receive dividend out of the profits.*
      - *The ordinary shareholders are the last to be paid if a*

company is being liquidated or winding up. They are last after debenture holders, preference shares and then ordinary shares.

2. *The calculation of dividend of Fridah Bwaila is as follows:*

    - *Fridah Bwaila holds preference shares worth ZMK50, 000, 000 at 5% ; which is equal to ZMK5,000, 000*
    - *When this amount is to be paid for two years (2009 and 2010) Fridah Bwaila will receive ZMK5,000, 000 x 2 years and therefore:*

For two years, she will receive a total of ZMK10, 000, 000 as dividend

Topic 3 Exercise

Part A

i. *True*

ii. *False*

iii. *True*

iv. *True*

v. *False*

PART B

1. *On the stock exchange, buying and selling of shares is what is called trading.*
2. *Stockbrokers get instructions from their clients over the telephone or by use of computer related facilities in order to transact securities on their behalf. Getting instructions can also be referred to as getting orders.*
3. *The stock room is a room where names of companies and their shares are displayed. Desks are arranged in a semi-circle so that brokers can clearly observe everything happening in this room in relation to securities. Brokers in this room buy and sell securities on behalf of their clients.*

Assessment

Self-marked Assignment 3

This is a self-marked assignment and not tutor-marked. It is aimed at assessing your understanding of the unit. You are encouraged to do it without referring to the unit content or feedback.

This assignment has two sections. Answer all questions in both sections.

SECTION A

Choose the correct answer from the list provided and to fill in the blank in each question.

Shares

Buying and selling

regulated

Stock exchange

Face value

1. Securities can be traded on the ____________________________.
2. In business, exchange implies ____________________________.
3. The stock exchange is highly ______________________________.
4. A single part of limited companies capital is called _____________.
5. A declared _______________gives the total amount of money invested in the business.

SECTION B

1. Summarize the process of trading on the stock exchange. Start with the client instructing the stockbroker.

2. The stock exchange has some purposes. Explain these purposes.

Self-Assessment Feedback

The following are the answers to the self-marked assignment.

SECTION A

1. *Stock exchange*
2. *Trading*
3. *Regulated*
4. *Shares*
5. *Face value*

SECTION B

1. *The summary of trading on the stock exchange is as follows:*

- *The client instructs the stockbroker.*
- *Stockbroker goes to the stock exchange and making the deal.*
- *The broker goes back to the client.*
- *Documentation is made and transfer of shares or stocks is made.*

2. *The purposes of stock exchange include the following:*

- *One of the main purposes of stock exchange is to enable companies to raise more capital. This is by allowing people to invest their money in these companies by means of buying securities. These investors benefit in the sense that they have a share in the profits of the company.*
- *The other purpose of the stock exchange is to facilitate secondary trading for investors who bought securities the first time they were offered for sale by the company to the public.*
- *Another purpose of the stock exchange is to determine share prices. It is at the stock exchange where the value and the price of securities are measured. The prices of securities can appreciate (go up) or depreciate (go down) in value based on the principle of supply and demand. This means if more people want to buy shares in a particular company, then the share price may go up. If fewer people wish to buy shares then the share price may go down.*

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 6

Stock Exchange 2

Introduction

Welcome to Unit 6, a continuation of the discussion begun in Unit 5 on the stock exchange. In Unit 5, we discussed the stock exchange in general. We started by defining terms related to the stock exchange environment. These included stock, exchange, security and stock exchange. These definitions were defined both in plain English and in the commercial context. We further discussed the types of securities traded on the stock exchange. We identified these securities as stocks, shares, debentures and bonds which were explained in detail. We also outlined the purposes of the stock exchange which is to facilitate secondary trading, enable companies to raise more capital and to determine the share price. The functions of the stock exchange were also discussed and explained in detail. We concluded with a discussion on trading on the stock exchange. We explained that trading on the stock exchange could be done manually or electronically.

In this unit, you will need to apply the knowledge you gained in Unit 5 when we discuss the stock exchange in the specific_context of our country. For this purpose, we will look at the Lusaka Stock Exchange.

This unit is divided into two topics. In Topic 1, we will discuss the Lusaka Stock Exchange where we will specifically look at its purposes (objectives) and functions. In addition, we will discuss the main players and the process of buying and selling on the Lusaka Stock Exchange

As we consider Topic 2, we will focus on the benefits and risks of being a shareholder on the stock exchange. We will further discuss the Securities and Exchange Commission including self-regulation of the Lusaka Stock Exchange.

As our discussion in this unit continues, you will notice that some of the information will not be completely new as we looked at it in Unit 5.

We hope you will enjoy this topic as it will equip you with additional knowledge and experience. This information may be on the operations of the Lusaka Stock Exchange and the benefits and risks of being a shareholder.

Upon completion of this unit you will be able to:

Outcomes

- *Outline* the reasons for the establishment of the Lusaka Stock Exchange.
- *State* the purpose (objectives) and functions of the Lusaka Stock Exchange.
- *Discuss* the main players on the Lusaka Stock Exchange.
- *Explain* the process of buying and selling of shares.
- *Participate* in the buying and selling of shares.
- *Discuss* the benefits of being a shareholder and the risks involved.
- *Explain* the powers and roles of the Securities and Exchange Commission.
- *Discuss* self-regulation of the stock market.

Timeframe

How long?

We estimate that to complete this unit, you will need between 20 and 25 hours.

You will need to spend between 10 hours and 12 hours for Topic 1 and for Topic 2, between 8 hours and 10 hours. This time includes the time you will spend studying, doing the activities and checking them against the feedback but does not include the time you will attend tutorials.

You are encouraged to spend between 2 hours and 3 hours to answer the tutor marked assessment.

If you do not finish studying the unit within this estimated time, do not worry since we do not all learn at the same pace.

Learning resources

Tip

In order to study this unit with minimal difficulties, you will need the following materials:

- Where possible, a computer and mobile phone to enable you do research using internet facilities as well as send electronic mails, calls and text messages to your tutors for necessary help.
- Libraries where possible to research stock exchange and have additional information that we may have not covered in this unit.
- Where possible, visit stock brokers in or near your local area and the Lusaka Stock Exchange to familiarise yourself on its activities.
- Attend tutorials at study centres and discuss with other learners.

Teaching and Learning Approaches

Tip

In this unit, we have used three teaching and learning approaches in presenting the content. These approaches are:

- **Content based approach** – This approach encourages you to base your learning on the subject matter provided in this unit. It will help you improve your skills and competencies on trading on the Lusaka Stock Exchange. We will give you various instructions to help in your learning.

- **Problem-based approach** –This approach encourages you to be open-minded and critical which will result in active learning and development of commercial thinking. The problem-based approach respects the fact that as a learner, you as well as you teachers have some knowledge and understanding of trading on the stock exchange. We encourage you to demonstrate your knowledge in the reflective activities given in this unit.

- **Activity-based approach** –As a learner, this approach will help you to develop business skills on how to do trading on the Lusaka Stock Exchange. It will be in a cognitive, psychomotor and affective way that you interact with the content. This will be through activities, topic exercises and tutor-marked assignment.

As you read through this unit, do the activities and/or exercise and discuss your ideas with other learners and your tutor. You will then be putting these teaching and learning approaches into practice. We trust that you will achieve greater understanding of the unit and be able to relate the knowledge to your real life situations.

Terminology

Board: A group of people chosen in an organisation to make decisions on its behalf.

Depository: A place where something valuable is kept for safety.

Discount: Reduction in the usual price of something.

Financial report: To give detailed information to issues related to money

Genuine: To be valid or true.

Liability: Money owed that individual or organisation should pay back to the owner.

Listing fees: An amount of money a company pays in order to be registered on the stock exchange.

Listing regulations: Rules followed by a company in order to become a listed company.

Parastatal: A company which is indirectly controlled by the government.

Pledge: It is a serious promise that the mentioned issue will be fulfilled.

Primary market: The first time shares are offered to the public.

Professional: These are people who are very skilled in their jobs.

Quoted company: It is a company that has registered its securities on the stock exchange but has not met its full requirements.

Secondary Market: This is where investors sell their securities to other investors .

Ventures: A business activity that includes risk taking but could lead to a profit.

Topic 1: The Lusaka Stock Exchange

Introduction

The previous unit gave you an extensive background of the stock exchange and the related securities. We discussed the definitions of some terms and also outlined the types of securities associated with the stock exchange such as stocks, shares, debentures and bonds. Furthermore, we stated the purposes and functions of the stock exchange.

In this topic, we will discuss the Lusaka Stock Exchange (LuSE) as an example of the operations within the African region, particularly in our country Zambia. We will specifically look at the purpose (objective) and functions. The main players and the process of buying and selling on the Lusaka Stock Exchange will be discussed too.

In this topic, we will address the first five outcomes of the unit outcomes.

Outcomes

- *Outline* the reasons for establishment of the Lusaka Stock Exchange.
- *State* the purpose (objectives) and functions of the Lusaka Stock Exchange.
- *Discuss* the main players on the Lusaka Stock Exchange.
- *Explain* the process of buying and selling of shares.
- *Participate* in the buying and selling of shares.

Time

You should spend at least 10 hours on this topic.

Let us begin by looking a brief background to the establishment of the Lusaka Stock Exchange and investigate the reasons of its establishment.

Brief Background of the Lusaka Stock Exchange (LuSE)

Like many countries, Zambia has a stock exchange called the Lusaka Stock Exchange (LuSE). It was established with specialised help from the World Bank in 1993. It officially started operating in 1994 as a non-profit making limited company. The Zambian Government established the Lusaka Stock Exchange in order to encourage the participation of the private sector. Remember, in Unit 3 we said that the private sector is that part of the economy that is not owned and controlled by the state but by private individuals or institutions. The main motive of the private sector is profit making. So, the government's intention was to encourage more citizens to create their own wealth through the Lusaka Stock Exchange.

Activity 1

Having learned the background of the Lusaka Stock Exchange, outline one of the main reasons that encouraged the Zambian Government to establish the Lusaka Stock Exchange. Write your answer in the space provided below.

Feedback

From the background, one of the main reasons that inspired the Zambian Government to establish the Lusaka Stock Exchange was to encourage participation of the private sector. The government's intention was to see more citizens create their own wealth through the Lusaka Stock Exchange.

Other reasons that encouraged the Government of Zambia to establish the Lusaka Stock Exchange were:

- To enable public limited companies in Zambia to raise more capital through the sale of shares on the Lusaka Stock Exchange.
- To provide a clear, fair and well organised market for secondary trading of shares and other securities in Zambia.
- To determine appropriate share prices as influenced by the market and environment conditions.
- To empower the Zambian citizens through a wider investment in shares and other securities.
- To encourage foreign investors to invest in Zambia's private sector with confidence as they trade their securities on the Lusaka Stock Exchange. Their confidence comes from the fact that the LuSE is highly regulated.
- To enable existing and new companies to function with less government interference. This is because the bigger percentage of the shares in these companies will be in private investors.
- To provide local and foreign investors with a relatively cheap and long term method of financial mobilisation.

Considering the reasons we have discussed above, notice that there is a relationship with the purposes of the stock exchange we discussed in Unit 5 Topic 3. However, the Lusaka Stock Exchange was established to focus specifically on the Zambian situation.

We have come to the end of our discussion where we addressed the first outcome of this unit. This outcome focused on the reasons for the establishment of the Lusaka Stock Exchange. We will now discuss the objectives (purposes) of the Lusaka Stock Exchange. In our discussion, we will address the second outcome of this unit.

Take a minute to reflect on what we have discussed thus far and then complete the following activity:

Activity 2

Using the knowledge that you have gained from our previous discussion in this course, what do you think are some of the objectives of the Lusaka Stock Exchange. Write your thoughts in the space provided below.

Feedback

You might have provided in your response to enable companies raise additional capital, facilitate of secondary trading of securities and determine share prices. You are right. If you gave a different answer, do not worry as the answer has now been given and the next section will provide additional information.

Objectives of the Lusaka Stock Exchange

Just like any other stock exchange in the world, the Lusaka Stock Exchange has some objectives to achieve. This can be seen from the general purposes we discussed in Topic 3 of Unit 5. The Lusaka Stock Exchange does its best to achieve these general objectives taking into consideration the Zambian trading environment.

In Unit 5 Topic 3, we established that one of the objectives of the stock exchange was to enable companies to raise more capital. The Lusaka Stock Exchange ensures that this objective is achieved by creating a favourable environment for Zambian public limited companies. This allows these companies to raise more capital. As a nation with a growing economy, Zambian companies may require more capital for various reasons.

Study the diagram below showing some reasons why companies want to raise more capital. You can even add more using your own experiences in commercial situations.

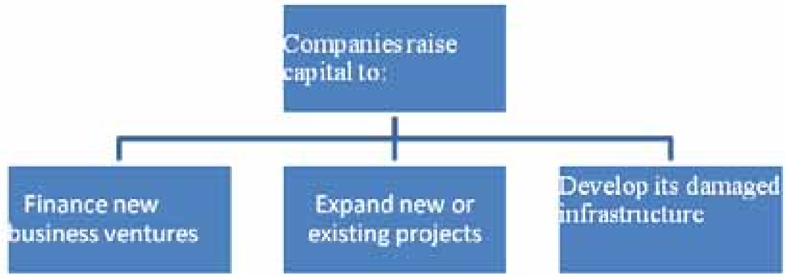

Figure 1: Reasons why companies want to raise more capital. Created by Commerce Team, ZACODE, 2010.

Figure 1 shows that a company can decide to raise more capital to finance new business ventures. The company can also raise capital in order to undertake new projects. Likewise, the company may need to raise capital in order to repair its damaged structures. When such ventures are carried out, progress in companies occurs.

The other objective of the stock exchange in Unit 5 Topic 3 was the facilitation of secondary trading of stock. The duty of the Lusaka Stock Exchange is to ensure that this trading is done properly in Zambia. This allows investors who did not participate in primary trading to buy and sell their securities at prices determined by the Zambian securities market.

Now that you have learned about the objectives of the Lusaka Stock Exchange, let us discuss its functions. In Unit 5 Topic 3, we discussed these functions in a general way. In this discussion we will look at the functions of the Lusaka Stock Exchange and Zambia in particular.

Functions of the Lusaka Stock Exchange

The following are some of the functions of the Lusaka Stock Exchange:

- The Lusaka Stock Exchange provides a specialised market to the Zambian companies that wish to raise additional capital through the sale of securities. This enables the Zambian people and foreigners to have confidence in these companies. Confidence can be assured due to the fact that they sell their shares through the Lusaka Stock Exchange, a genuine (valid) market.
- The Lusaka Stock Exchange determines the prices of shares depending on the demand and supply by the Zambian public and foreigners. These prices are published to the public through print, radio and television media. For example, prices are shown on the Zambia National Broadcasting Corporation (ZNBC) during the main news bulletin time.
- The Lusaka Stock Exchange draws up rules to be followed by anyone participating on the Zambian stock exchange. These rules protect the investors against any unfair dealings. This even facilitates proper privatisation of parastatal companies in Zambia by using the same rules.

- The Lusaka Stock Exchange gives a chance for people who have savings to invest in Zambian companies that want to raise capital. This attracts foreign investors as well since the Lusaka Stock Exchange provides a highly organised securities market. This is in order to improve the Zambian industry and expand it.
- The Lusaka Stock Exchange provides a ready market for the Zambian government to sell and buy its securities such as government bonds. This allows the government to implement various developments. For example, a government can obtain loans to build schools and hospitals.
- To encourage small scale investors to invest in securities and enjoy the benefits of being a shareholder.
- To provide all necessary information to the public concerning business of the Lusaka Stock Exchange. This information includes statistical reports regarding securities traded on the Lusaka Stock Exchange and code of conduct to be followed by members of the Lusaka Stock Exchange.

We have come to the end of our discussion where we addressed the second outcome of this unit on the functions of the Lusaka Stock Exchange.

In the next discussion, we are going to focus on the third outcome of this unit which will address the main players on the Lusaka Stock Exchange.

As discussed earlier in Unit 5 Topic 1 under the subheading “stock exchange”, only members of the stock exchange are allowed to trade on the stock exchange. It will be important to learn in details about these members known as main players although we only mentioned the stockbroker as a member in Unit 5 Topic 1.

The main players on the Lusaka Stock Exchange consist of stockbrokers and dealers, private investors, listed companies, institutional investors, foreign investors, government, underwriters and the Securities and Exchange Commission.

Main players on the Lusaka Stock Exchange

We will look at these main players one after the other. Let us begin by discussing the stockbrokers.

Stockbrokers

Earlier in our discussing in Unit 5, you learned about stockbrokers on the stock exchange. With the knowledge you gained, do the activity given below.

Activity 3

Using the knowledge gained from the previous discussion in Unit 5 Topic 1 under the subheading 'Stock Exchange', define stockbrokers and their role in the stock exchange. Write your definition in the space provided

Feedback

We hope that you were able to remember that stockbrokers buy stocks and shares on behalf of their clients. For each transaction carried out, they are given a commission. Stockbrokers are professionals (skilled people in their jobs as stockbrokers) who are licensed to do business on the stock exchange.

In the following discussion, you will learn more about stockbrokers. We will begin by looking at their duties to their clients as they participate on the Lusaka Stock Exchange.

The duties of the stockbroker to their clients include:

- Advising their clients on the securities they can buy or sell.
- Buying and selling of shares as stated by the investor on behalf of their clients.
- Opening of share accounts on behalf of their clients.
- Arranging for share certificate for their clients.
- Preparation of a contract note between the client and the stockbroker.

Note it!

A **contract note** is a document showing evidence that the client's instructions have been carried out. It gives information such as the number of shares bought or sold, tax paid to government and commission to be received by the stockbroker.

These duties of stockbrokers are very useful especially where the investor or the client may not have adequate knowledge. Remember, members of the general public can participate on the stock exchange through stockbrokers. This is regardless of their status, ethnic group and educational background. Individuals may be at various levels of literacy needed for participation in some of these commercial activities on the stock exchange and this makes the stockbrokers a useful player.

The brokers may sometimes function as dealers. This means they can buy and sell shares on their own behalf and make a profit. In this case they only trade with other stockbrokers and not the general public.

We have looked at the stockbroker. We are now going to discuss the private investors who are also main players.

Private Investors

These are ordinary people with savings who wish to invest by buying shares from companies trading on the Lusaka Stock Exchange. In other words, the private investor can be you, me and the general public.

Let us look at another main player the listed companies.

Listed Companies

Listed companies are companies approved by the stock exchange board but the securities are not yet registered by the stock exchange and cannot be offered to the public through the stock exchange. They should also meet the Lusaka Stock Exchange requirements such as paying the listing fees. As defined in the terminology section, listing fees are the amount of money a company pays in order to be registered on the stock exchange. The securities can be offered by companies to the public through the primary or secondary market. We hope you still remember how we defined primary and secondary market in Unit 5. In case you have forgotten, check in the terminology section where they are defined also. In short, **listed companies** are those companies admitted to the daily official list (daily approval happens) of the Lusaka Stock Exchange. They have to observe the listing regulations of the Lusaka Stock Exchange. Listing in this case means to be registered on the Lusaka Stock Exchange after approval is made by its board. A board in this case is a group of people chosen in an organisation to make decisions on its behalf.

We hope you still remember that only public limited companies are allowed to trade on the stock exchange as we discussed in Unit 5. This means that for the company to be listed or quoted on the stock exchange, it should be a public limited company. A **quoted company** as defined in the terminology section is one that has registered its securities but has not met the requirements for it to be listed on the Lusaka Stock Exchange.

You may be asking yourself, what are some of the requirements for listing a company on Lusaka Stock Exchange? The Lusaka Stock Exchange demands that for any public company to be listed, it should have:

- A record of income and expenditure (financial history) for at least 3 years. This means a company should have existed for not less than three years.
- In those 3 years, a minimum of 250 million Zambian Kwacha (K250 000 000) of its authorized capital should be issued to the shareholders.
- Within its years of existence, the company should have no less than 300 shareholders.
- Within the stated years of existence, the company should have issued a minimum of one million shares with at least 25% of these spread to the shareholder.

Note it!

The company achieves the Lusaka Stock Exchange requirements gradually. This is done within the minimum three years of existence before the shares are issued to the public.

When a company meets the requirements mentioned above, it can then be listed on the stock exchange and enjoys the benefits of being a listed company. The following are the benefits of a listed company:

- The public gains confidence in the company and buys its shares. This enables the company to raise necessary funds from the public.
- The company will enjoy the increase of access of shares from the public.
- The company's status and image is improved and creates a favourable relationship with government, financial institutions, suppliers and the public in general.
- Proper market valuation of shares for a company is done by the stock exchange.

You will notice that some of these benefits were mentioned as part of the reasons for establishment of the Lusaka Stock Exchange discussed earlier in this topic.

We have now come to the end of our discussion about listed companies. Let us now look at institutional investors.

Institutional Investors

You have already learned about the term investors. We defined this term in the terminology section of Unit 5. Let us then define institution. According to Encarta Dictionaries, the word institution may mean any of the following:

- A large organization that is influential in the community, for example, a college, hospital or bank.
- An act of initiating or establishing something.

For the purpose of our discussion, we will consider the first definition. Institutional investors are large companies or organizations that invest funds on the stock exchange in the form of shares and other securities. Examples of institutional investors are pension funds and insurance companies. These organisations invest in long term assets like shares so that they can pay their long term liabilities (money owed) and other payments that have to be made over a long period of time.

The other main players are the foreign investors which we will discuss in the next section.

Foreign Investors

Foreign investors can be individuals, companies or organisations who come from other countries and invest in Zambia. They buy shares on the Lusaka Stock Exchange. They can invest in businesses such as banking, communication, mining and agriculture.

Government is also one of the main players on Lusaka Stock Exchange and we will now discuss this player.

Government

The government also participates as a main player by borrowing funds through issuing securities on the stock exchange, for example, issuing government bonds. This is to raise more funds to undertake its projects such as construction and maintenance of roads, hospitals and schools.

Let us also look at underwriters as some of the main players on the Lusaka Stock Exchange.

Underwriters

Let us begin by defining the term 'underwrite'. This term in this case can be defined as: to print words on underneath previously written information. The words written may have an effect on information already written.

On the other hand, **underwriters** are institutional investors who decide in advance to buy a certain number of shares if they are not bought by the public. When securities are underwritten, the owners of such securities are sure that all the securities issued will be subscribed or bought. This is because when the public does not buy them, underwriters will buy them.

The other main player is the Security Exchange Commission (SEC).

Security Exchange Commission

The Security Exchange Commission is a body with powers to regulate, supervise and monitor all the activities undertaken on the stock exchange. We will learn more in the next topic on how the Securities and Exchange Commission participates on the Lusaka Stock Exchange. Before we move on let us summarise the section on main players by looking at diagram in Figure 2.

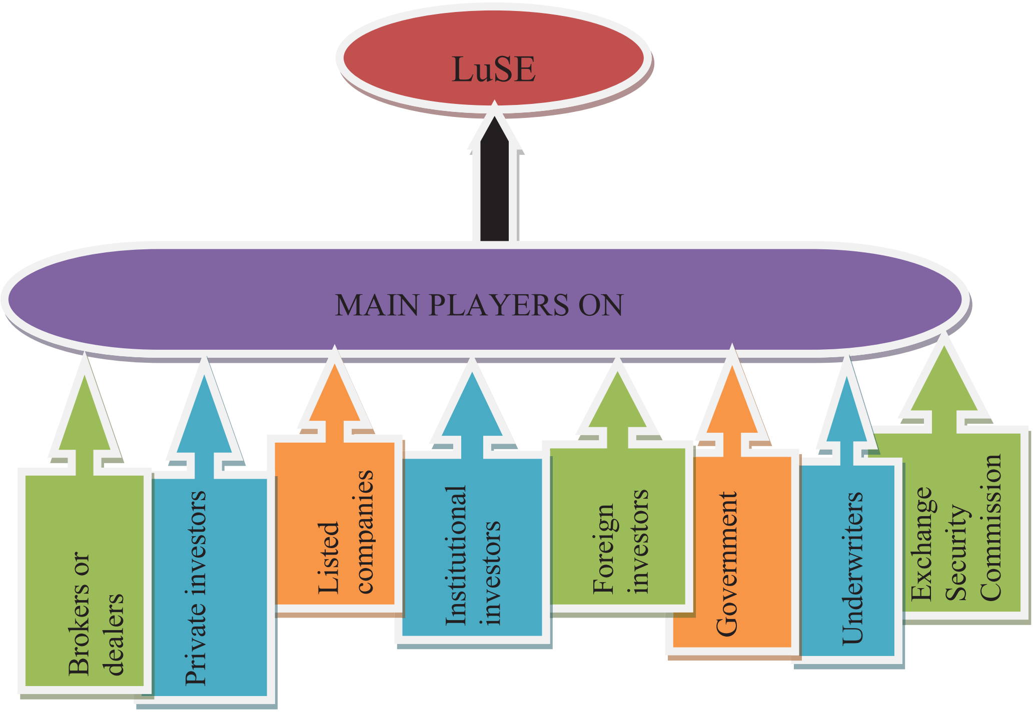

Figure 2: Main players on Lusaka Stock Exchange. Created by Commerce Team, ZACODE, 2010.

In Figure 2, you will notice that we identified the eight main players participating on the Lusaka Stock Exchange. They range from brokers to the Security Exchange Commission.

Having discussed the main players on the Lusaka Stock Exchange, we believe you now know more about them. Before we move on to our next discussion, do the following activity. It will assist in assessing how much you can remember on the topic so far.

Activity 4

Answer both questions given in this activity.

1. Identify five duties of the stockbroker on the Lusaka Stock Exchange and write them down if you work alone. If you work in a group, you can discuss with your group what you have written down for both questions.

2. Write brief notes on how the following main players participate on the Lusaka Stock Exchange:

    a. Private investors

    b. Government

    c. Underwriters

Feedback

Compare your answers with the feedback provided in this section:

1. *The following are the duties of the stockbroker on the Lusaka Stock Exchange:*

- *Advising their clients on the securities they can buy or sell.*
- *Buying and selling of shares as requested by the investor on behalf of their clients.*
- *Opening of share accounts on behalf of their clients.*
- *Arranging for share certificate for their clients*
- *Preparation of a contract note between them the client and the broker.*

2. *The following are the brief notes on how the private investors, government and underwriters participate of the stock exchange as main players:*

   a. *Private investors are people with savings who want to invest. They participate by buying shares from companies trading on the Lusaka Stock Exchange. In other words, the private investor can be you, me and the general public.*

   b. *The government also participate as a main player by borrowing funds through issuing securities on the stock exchange. For example: government bonds. This is to raise more funds to undertake its projects such as construction and maintenance of roads, hospitals and schools.*

   c. *Underwriters are institutional investors who decide in advance to buy a certain number of shares if they are not bought by the public. When securities are underwritten, the owners of such securities are sure that all the securities issued will be subscribed (bought). This is because when the public does not buy them, the underwriters would participate by buying them.*

We hope that after comparing your answers with the feedback given above, you are now able to assess your understanding. If you got most of the answers correct, well done! You can proceed. If you had problems, then we suggest you read through the relevant text before you proceed to the next discussion on buying and selling of shares.

We have come to the end of our discussion that focused on the third unit outcome addressing the main players of the Lusaka Stock Exchange. We will now proceed to the next discussion that will address the fourth unit outcome focusing on the process of buying and selling of shares on the Lusaka Stock Exchange.

Let us now look at buying and selling of shares on the Lusaka Stock Exchange. This discussion will help you to understand more on how trading is done on this particular stock exchange.

How is Buying and Selling done on the Lusaka Stock Exchange?

The process of buying and selling on the Lusaka Stock Exchange is generally similar to how it is done in other countries' stock exchanges in the world. Remember, we discussed trading on the stock exchange in general in Unit 5. This is because all stock exchange centres must follow stock market regulations in order to gain confidence from investors.

Using the knowledge you have gained from our previous discussion in Unit 5 Topic 3 and your own experience, do the following activity.

Activity 5

What should individuals do when they want to buy and sell shares on the Lusaka Stock Exchange? Write down the answer in the space provided.

Read through the feedback provided below and compare in any idea from your answer is included.

Feedback

When a person decides to buy or sell shares, they should be aware that ordinary members of the public are not allowed to deal directly with the Lusaka Stock Exchange but through the stockbrokers. This means they should buy or sell their shares through the stockbrokers registered on the Lusaka Stock Exchange.

Stockbrokers may have their own list of clients whom they call upon when they see that an investment fits such clients.

The following is the expected procedure for buying shares on the Lusaka Stock Exchange through the stockbroker:

- Contact the stockbroker who advises on matters relating to shares.
- Open an account with the stockbroker. Opening an account with the stockbroker is similar with the way a bank account is opened.
- After an account has been opened, a person can buy shares through the stockbroker he or she has opened an account with. Instructions on buying shares can be given in person, telephone, e-mail or by sending information using a fax machine to the stockbroker.
- The payment is made in advance to the broker. The broker is able to pay for the shares three days before they are transferred to the account of the buyer.

- The shares remain in depository (safekeeping) form at Lusaka Stock Exchange.
- The shares are then transferred within three days to the buyer's account who is the new owner of the shares.
- The buyer is also allowed to request that the share certificate from the Lusaka Stock Exchange be issued through the stockbroker. The Lusaka Stock Exchange charges the buyer for this service.

Having looked at the process of buying of shares, let us move on to the process of selling shares after an account is open with the stockbroker. The process is as follows:

- The seller of shares is expected to deposit the share certificate. Depositing the share certificate is similar to the way money is deposited in the bank account.
- The stockbroker verifies the share certificate to ensure that it is a true document.
- The shares certificate remains in the depository system of the Lusaka Stock Exchange up to the time the shares are sold.
- When shares are finally sold, the stockbroker must receive money from the buyer for the shares sold.
- Three days after selling the shares, the shares are transferred to the account of the new buyer. The shares cease to be the stock of the seller.
- The stockbroker gets the agreed commission from the sale of the shares.
- The seller of the shares is then paid what is due by the stockbroker.

Stockbrokers can even match the deals between clients. They can even arrange for two clients to deal with each other.

We have now come to the end of Topic 1 where we addressed five of the unit outcomes. We will be moving on to the next topic were we will address the last two unit outcomes.

In the next topic, we will explore some of the benefits and risks of a shareholder and regulation of the stock market. But before we proceed, read the topic summary to review the main points covered in this topic.

Topic 1: Summary

This topic focused on five of the outcomes of this unit. In this topic, we particularly discussed the Lusaka Stock exchange. We looked at the reasons for its establishment. These included some of the following: to bring about cheaper long term capital for old and new companies, and to encourage local and foreign private investments. In addition, we considered some of the objectives or purposes and functions of the Lusaka Stock Exchange. We also discussed the main players on the Lusaka Stock Exchange: the private and foreign investors, listed companies, stockbrokers, the government and the Securities and Exchange Commission. We further looked at the process and participation of buying and selling of shares on the Lusaka Stock Exchange.

In the next topic, we will focus on the rest of the unit outcomes. We will start with a discussion about the benefits and risks of a shareholder and end with the regulation of the stock market.

Before you proceed, refer to the assignment section and do the Topic 1 Exercise. This will help you to assess how much you have learned in this topic. Work through the exercise first and then compare your answers with those provided in the feedback.

Topic 2: Benefits and Risks of Being a Shareholder and Regulation of the Stock market

Introduction

In the last topic we examined the reasons why the Lusaka Stock Exchange was established. We particularly considered some of the objectives which were to encourage local and foreign investments. In addition, we considered its functions as mainly being capital raising and facilitations of the secondary market. We also discussed the main players on the Lusaka Stock Exchange as being the private and foreign investors, listed companies, brokers, the government and the Securities and Exchange Commission. We further looked at the process and participation of buying and selling of shares on the Lusaka Stock Exchange.

In this topic, we will focus our discussion on the benefits of being a shareholder and the risks involved. Finally we will investigate the regulation process and principles of the stock market in general and with specific reference to Zambia. The following outcomes will be addressed:

Upon completion of this topic, you will be able to:

Outcomes

- *Discuss* the benefits of being a shareholder and the risks involved.
- *Explain* the powers and roles of the Securities and Exchange Commission.
- *Discuss* self-regulation of the stock market.

Time

You should spend at least 10 hours on this topic.

We will begin our discussion of this topic by looking at share prices before we look at our topic outcomes and discuss them. This will help you to understand why there are benefits and risks of being a shareholder. We will then move on to discuss the benefits of being the shareholder. We will proceed in our discussion by looking at the risks involved in being a shareholder. We will then further look at the Securities and Exchange Commission in relation to Zambia. We will conclude our discussion with self-regulation of the Lusaka Stock Exchange.

Let us now look at share prices.

Share Prices

Shares prices on the stock exchange may rise or fall. When there is a rise in share price, then the shareholder may sell them at a good price and this is a benefit. On the other hand, there could be a risk of share prices falling. The following are some of the factors that could lead to either of the situations we have described:

- When there are changes in company rules due to modern developments on the stock exchange, share prices may rise or fall.
- The latest performance of the company whether it made good or poor profits may cause the share price to rise or fall.
- When a company is taken over by or merges with a more powerful company, more people would rush to buy shares. This may also contribute to an increase of share price.
- Generally when a company has a good status such as natural prosperity and good industrial disputes settlements, more people may buy the shares.
- Share prices may be affected by foreign political developments especially for companies that have a large export trade. These developments could affect the company positively or negatively and could result in either more or fewer people buying its shares.
- Political changes affecting the company. For example, a change of government which could lead to the development of a whole range of new policies.

In short, we could say that the principle of demand and supply would be used to determine the share prices. By demand and supply, we mean to have more people selling and buying shares in various companies.

We will now discuss the benefits of being a shareholder. This discussion will focus on the first topic outcome.

With the factors we have examined above that affect share prices in mind, let us further examine the benefits of being a share holder assuming that these factors are in favour of the company.

Benefits of Being a Shareholder

Benefits in this context mean the profits the shareholder can get from their investments in shares.

Based on the farming experience some of us have in this region, it would be practical to compare the process of investing in shares to the process of investing in the ownership of a cow. Remember that the cow could later give the investor a calf and milk.

Ownership of the cow could be compared to investment in shares in company. Milking the cow could be compared to the dividends paid out from the investment and the birth of the calf could be compared to the bonus shares that would accrue (added) for the investor. We will define bonus since you are already familiar with the term shares. Bonus is the unexpected additional thing given to or received by someone. In this case, an extra share issued to indentified shareholders.

There are several benefits an investor could enjoy on the stock exchange. The benefits can be summarised as follows:

- The shareholder could earn dividends from the net profits of the company or companies whom he/she bought from. These dividends become additional income to this investor to carry out other projects.
- The investor benefits in rights issue. **Rights issue** means the right to buy more shares when the company decides to issue more shares to raise more capital. They are usually offered at a discount price to shareholders. This gives the investor an incentive in the company.
- The investor enjoys capital gain. This is when there is an increase in the value of shares held. This is determined by the rise of share price. When an investor decides to sell shares when the share price is high, such an investor gains more money than the initial investment.
- Shares can be easily converted to cash. Just as stock in a copshop can be converted to cash, so can shares. Shareholders can decide to sell shares interested people to obtain cash.
- The shareholder can pledge (promise) their shares as collateral. **Collateral** is the pledge of a specific property to a lender to secure repayment of a loan. In case of failure of repayment, the ownership of such a property goes to the lender. With this understanding, a shareholder can pledge shares as collateral to obtain a loan from any financial institution.

Now that we have discussed the benefits of being the shareholder, you might be interested in owning a cow. If you cannot own a real cow, you could consider buying shares as your cow and enjoy all the benefits that we discussed.

Let us now look at the risks involved in being a shareholder in the event of unfavourable conditions. This is when the benefits expected by the shareholder are not realised. The risks we will discuss could be among the reasons. We are still addressing the first outcome of this topic.

Risks of Becoming a Shareholder

By now we hope you know who the shareholder is considering our earlier discussions. But we will need to define the term risks. A **risk** is the possibility of something going wrong. This definition can apply to risks of being a shareholder. There is a possibility of shareholders experiencing loses from their investment due to various reasons as explained earlier in our discussion.

The following gives a brief summary of some of the risks the investor may experience:

- A loss arising from a drop in share prices due to low demand and supply because of several factors. For example, there may be few people who may want to buy shares in a particular company which may cause the shares price to drop. Other factors that may cause shares prices to change downwards were stated earlier in our discussion.

- Companies may not perform well in a particular year and may fail to declare dividends.

Does this mean the investor cannot do anything to minimise on the risks?

The answer to the above question is no. Old and new businessmen and women have never stopped to continue their businesses despite the risks involved. Through their experience, they have learned to expand into new businesses. Similarly, the investor can do the following to minimise the risks:

- The investor should think of a long term investment strategy which may result in high rewards. For example, holding shares for a long time. This may give an investor a chance sell the shares at a higher price than if they were sold at the time when the price reduced. The investor can also end up with a bonus share(s).
- The investor can invest in different companies. For example, if in one company the share price has fallen, the investor may enjoy a good share price in another company. This would enable the investor to make capital gains from investments made in other companies where share price have increased.
- The investor should seek professional advice from the stockbroker. They should seek information about the share market and the movement of share prices of companies.
- The investor should study or carefully analyse the financial reports of the companies listed on stock exchange. This should be done in order understand the financial activity of such companies.

Having discussed the benefits and risks of being a shareholder, we will now discuss the Security and Exchange Commission (SEC) to understand how investors are protected from unfair practises on the stock exchange. This is in line with second topic outcome. But before we do so, we encourage you to work on the following activity to assess how much you have learnt.

Activity 6

Answer both questions given in this activity.

1. Your friend in considering investing in shares. What benefits would you tell your friend a shareholder can enjoy from the stock exchange? *Write at least 4*.

   If you are working alone, write down the discussion on the four benefits of being a shareholder.

   If you are working in a group, write down the discussion on the four benefits of being a shareholder and then discuss them with your group.

2. What would you tell your friend the two main risks related to investing in shares are? Write down your answers in the space provided below.

Feedback

Compare your answers with these provided in this feedback.

1. *The following are the four benefits of being a shareholder:*

- *The shareholder earns dividends from the net profits of the company or companies that he/she buys the stocks from. These dividends become additional income to this investor to carry other projects.*
- *The shareholders can be issued free issue of share given to existing shareholders depending on the number of shares held in a company. This type of share is called bonus share which become an unexpected extra investment to the investor.*
- *The shareholders can be issued bonus shares. This is where companies issue free shares to existing shareholders. They are given depending on the number of shares held in a company. This type of share is called bonus share because it becomes an unexpected extra investment to the investor.*
- *The investor enjoys capital gain. This is when there is an increase in the value of shares held. This is determined by the rise and fall of share price. When an investor decides to sell shares when share price is high, such an investor gains more money than the initial investment.*
- *Shares can be easily converted to cash. Just as a stock can be converted to cash so are the shares. Shareholders can decide to sell shares to the interested people to obtain cash.*
- *The shareholder can pledge the shares as collateral. Collateral is the pledge of a specific property to a lender to secure repayment of a loan. In case of failure of repayment the ownership of such a property goes to the lender. With understanding, a shareholder can pledge shares as surety to obtain a loan from any financial institution.* ***(Any four answers are correct)***

2. *The following are the main risks related to investing in a shares:*
   - *A loss arising from a drop in share prices due to low demand and supply because of several factors. For example, there may be few people who may want to buy shares in a particular company. It may cause the shares price to drop.*
   - *Companies may not perform well in a particular year and may fail to declare dividends.*

After comparing your answers and the feedback above, you should have marked your work. If you did not do very well in the activity, you need to read through the relevant parts again. If you did well, congratulations! You can proceed to the discussion that follows.

You will now learn about the Security and Exchange Commission (SEC) and examine how investors are assured of fair dealings on the stock exchange.

Securities and Exchange Commission (SEC)

Earlier in Unit 5 we defined **securities** in the commercial context as documents representing right of ownership of an investment that can be traded on the stock exchange. They therefore represent the financial value invested in the business. It is with the same meaning this word is used in this context.

On the other hand, **exchange** in the same unit was defined as buying and selling or trading. We will use the same meaning as we progress with our discussion.

Commission was also said to be a payment given to stockbrokers after they have offered their service. In this section, the term will be defined differently. **Commission** will mean a committee or a group of people given authority to carry out certain responsibilities.

Now that you have learned the definitions, let us define the term **Securities and Exchange Commission**. It can be defined as an independent organisation responsible for protecting the investors against abuse of stock exchange rules by anyone or organisation. In short, it is a body that controls or regulates the activities carried out on the securities market. Like many other countries, Zambia has a Securities and Exchange Commission. This regulatory body was established in 1993. It controls and supervises the Lusaka Stock Exchange.

Figure 3 below represents the structure of the Securities and Exchange Commission. A structure in this context implies parts of organisations that are inter-related.

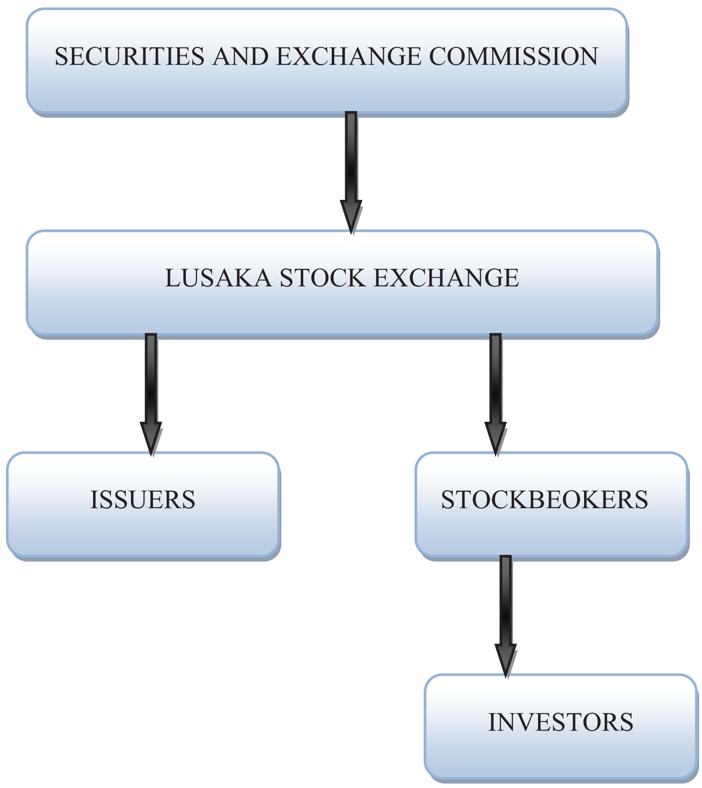

Figure 3: A structure of the flow of regulatory information. Created by Commerce Team, ZACODE, 2010.

Let us examine the structure from the top to the bottom.

- On the top we have the Securities and Exchange Commission which is the highest body that regulates trading on the stock exchange. It formulates policies to be followed by the stock exchange, in this case the Lusaka Stock Exchange.
- The stock exchange (Lusaka Stock Exchange) implements the regulations of the highest body on the stock exchange. The Lusaka Stock exchange formulates policies that meet the demand of the highest body. The Lusaka Stock Exchange ensures that the issuers and the stockbrokers operate within the framework of the highest stock exchange body. Remember, in the terminology section of Unit 5, we defined issuer as companies that offer their securities on the primary and secondary market.
- The stockbrokers also communicate the set regulations to the investors. This is done from the time the investor starts to interact with the stockbroker.

Having closely examined Figure 3, you will still notice that the Securities and Exchange Commission is the highest body on the securities market. This means whatever is done by the Lusaka Stock Exchange, issuers, brokers and investors should be in line with the rules of the commission.

The commission generally bases its regulatory powers on the following principles. By principles we mean the standard or rules followed.

- Ensuring that any person advising or dealing on securities must be licensed by the commission as a member of the stock exchange. To be licensed we mean to be given authority to deal in securities and exchange matters.
- Shares of the public limited company that are publicly traded must be registered by the commission. We hope you still remember the context in which we are using the term commission.
- To establish a compensation fund that will protect investors from suffering losses that may be caused by dealers or investment advisers. Compensation in this text we mean an amount of money or something paid for the loss suffered. This creates confidence in people or organisations who buy shares on the stock exchange.
- In Zambia, any securities market must be licensed by the Securities and Exchange Commission. For example the, Lusaka Stock Exchange.

In order to carry out the principles we have outlined above, the Securities and Exchange Commission carry out the following roles:

- To establish the securities market. In Zambia, the commission had the duty to develop the Lusaka Stock Exchange.
- To help the securities market to operate in a free, orderly and safe stock exchange environment.

- To ensure that the securities market is well informed with necessary information. For example, changes in requirements for any company to be listed on the stock exchange.
- To register all securities of public limited companies.
- To issue and renew licenses to main players such as stock brokers and dealers as well on the stock market as well as the stock exchange.
- To protect investors by making sure that the rules of fair trading is observed on the stock exchange.

So far in this topic we have discussed the benefits of being a shareholder and risks involved. In addition we looked at the Securities and Exchange Commission a body that safe guards the interests of the all those participating on the stock exchange. We will now move on and discuss self-regulation of the Lusaka Stock Exchange. This discussion will help you understand that the Lusaka Stock Exchange has some guiding principles to ensure that stock exchange is done in a correct way. The discussion will also help to address the last outcome of this unit.

Let us now move on and discuss self-regulation of the Lusaka Stock Exchange.

Self-Regulation of the Lusaka Stock Exchange

Let us begin by defining the term self-regulation. In this context it simply means the system by which an individual or organisation establishes own rules that should be followed by members. In case of any legal or disciplinary problem from a member, they may refer to these rules to resolve the problem without any external influence.

Similarly, as the Lusaka Stock Exchange makes every effort to provide a fair, orderly and efficient trading on the stock market, it has its own rules besides those provided by the Securities and Exchange Commission. Anyone participating on the stock exchange should follow them. Any stock exchange member who fails to follow these rules is taken to task by the Lusaka Stock Exchange.

It is also important to note that the rules formulated by the Lusaka Stock Exchange are approved by the Securities and Stock Exchange to ensure that they conform to the established framework.

The rules formulated by the Lusaka Stock Exchange are based on some guidelines such as the following:

- **Membership -** There is a procedure followed to become a member of the Lusaka Stock Exchange. Ordinary members of the general public are not allowed to deal with the stock exchange directly since they are not members. Stockbrokers should be licensed to be approved as a member of the stock exchange.
- **Procedures for listing a company -** Companies to be listed on the stock exchange must be public companies and must produce financial records for the previous three years. This is to assess

their performance in order to know if the companies are doing well. It is also as a way of protecting the shareholders to be.

- **Trading rules -** the Lusaka Stock Exchange has set rules such as fixing trading hours and the process of transacting shares or other securities.
- **Disciplinary and problem solving procedure(s) -**These procedures are clearly laid down so that anyone concerned would know where to start when they need to handle problems or disciplinary issues.

We have now come to the end of Topic 2 which is the last topic in this unit and also marks the end of this unit. We addressed the last three outcomes of this unit.

Before we proceed, do Activity 7 so that you can assess how much you have understood the discussions in this last part of this topic.

Activity 7

Answer both questions in this activity.

1. Define the Securities and Exchange Commission in relation to the stock exchange.
2. The Securities and Exchange Commission bases its regulatory powers on some principles. Explain any **four** roles performed by the Securities and Exchange Commission.

Compare your answers with the feedback given below.

Feedback

1. *The Securities and Exchange Commission is an independent organisation responsible for protecting the investors against abuse of stock exchange rules by any one or organisation. In short, it is a body that controls activities carried out on the securities market.*
2. *The roles performed by the Securities and Exchange Commission include:*

- *To establish the securities market. Like in Zambia, the commission had the duty to develop the Lusaka Stock Exchange.*
- *To help the securities market to operate in a free, orderly and safe stock exchange environment.*
- *To ensure that the securities market is well informed with necessary information. For example, changes in requirements for any company should be listed on the stock exchange.*
- *To register all securities of public limited companies.*
- *To issue and renew licenses to main players such as stock brokers and dealers as well on the stock market as well as the stock exchange.*
- *To protect investors by making sure that the rules of fair trading is observed on the stock exchange.*

(Any four answers are correct)

Having compared your answers with the information provided in the feedback above, you have assessed how well you have done. If you had problems answering the activity, review the text on self- regulation of the Lusaka Stock Exchange again. If you did well, congratulations! You can proceed and read the topic summary to review the main points covered in this topic.

You can proceed and read the topic summary to review what we have covered in this topic.

Topic 2: Summary

This topic focused on the last three outcomes of this unit. In the topic, you learnt the benefits of being a shareholder. We mentioned benefits that included earning dividends, bonus issue, capital gain and easy liquidity. On the other hand, we outlined the risks involved, one of which was the fall in share price. We said this would make shareholders suffer loses if they sold their shares during this period. We further deliberated on issues around the Securities and Exchange Commission. We defined it as an independent regulatory body that controls activities carried out on the stock exchange. We also identified principles that inform the activities of the Security and Exchange Commission. Finally, we investigated the regulatory process and principles of the stock market in general and with specific reference to the Lusaka Stock Exchange.

We have now come to the end of Unit 6. We hope that you enjoyed the discussion and that you have learnt a lot about the nature and activities of the stock exchange in your environment as represented by the Lusaka Stock Exchange. You can now proceed and read the unit summary to review on main points covered in this unit.

Unit Summary

Summary

In this unit you studied two topics. In Topic 1, we discussed the Lusaka Stock exchange. We looked at the reasons for its establishment. These included some of the following: to bring about cheaper long term capital for old and new companies, and also to encourage local and foreign private investments. In addition, we considered some of the objectives or purposes and functions of the Lusaka stock exchange. We also discussed the main players on the Lusaka Stock Exchange. These included the private and foreign investors, listed companies, stockbrokers, the government and the Securities and Exchange Commission. We further looked at the process and participation of buying and selling of shares on the Lusaka Stock Exchange

In Topic 2, we discussed the benefits of being a shareholder. We mentioned benefits that included: earning dividends, bonus issue, capital gains, pledging shares as collateral and easy liquidity. On the other hand, we outlined the risks involved in being a shareholder such as the fall in share price. This would make shareholders suffer loses if they sold their shares. We further examined the Securities and Exchange Commission. We said it is an independent regulatory body that controls activities carried out on the stock exchange. We also indentified its principles. Finally, we investigated the regulatory process and principles of the stock market in general and with specific reference to the Lusaka Stock Exchange.

We commend you for completing Unit 6 of Grade 11. We hope that you now have a broad understanding of the activities of the stock exchange in general as studied in Unit 5 and specific activities of the Lusaka Stock Exchange discussed in this unit.

Before you proceed to the next unit, we would like to encourage you to spend some time working on the Topic 2 Exercise to help you to assess your progress. This exercise is in the assignment section. Finally, you are also required to work on the tutor-marked assignment. The tutor-marked assignment will assist your tutor in assessing how well you have understood this unit.

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Assignment

Assignment

There are two topic exercises in this assignment. Each one of them should be written after you have completed a specific topic.

Topic 1 Exercise

This exercise should only be done after completing studying Topic 1.

There are two sections in this end of topic exercise. Answer all questions given. Make sure that you read the instructions carefully.

Section A

Fill in the blank spaces where numbers are indicated.

Zambia has a stock exchange called the ______1_______. It was established with specialised help from the World Bank in ___2____ It officially started operating in __ 3______ as a non-profit making limited company. The Zambian Government established this stock exchange in order to encourage _______4_________of the _______5_______. The intention of the Zambian Government was to see more ____6_______ create their own ________7_______ through this stock exchange.

Section B

Answer all the questions in this section.

1. Briefly explain the main purposes of the Lusaka Stock Exchange.
2. A. What is a listed company on the stock exchange?

   B. Outline three benefits of being a listed company on the stock exchange.
3. Ordinary members of the public are not allowed to trade directly on the Lusaka Stock Exchange. They are instead to use the stockbrokers. Explain the process of selling shares on the Lusaka Stock Exchange the investor would follow after an account has been open.

Topic 2 Exercise

This exercise should only be done after completing studying Topic 2.

There are two parts in this exercise. Answer both parts

PART A:

Multiple choice: Choose the *BEST* answer.

1. Like many other countries, Zambia has a regulatory body for the stock exchange. In which year was it established?

   A. 1993

   B. 1994

   C. 1995

   D. 1996

2. The highest body that controls trading on the stock exchange is ___________________________.

   A. The Lusaka Stock Exchange

   B. The Stockbrokers

   C. The Securities and Exchange Commission

   D. The Main Players

3. The highest regulatory body base its powers on some principles. Which of the following is not one of its principles?

   A. To help the securities market to operate in a free, orderly and safe stock exchange environment.

   B. Ensuring capital gain.

   C. All securities markets must be licensed by the highest regulatory body of the stock exchange.

   D. To register securities .

4. Self regulatory by the Lusaka Stock Exchange means __________

   A. Formulating trading rules.

   B. Creating its own rules besides those of the highest regulatory body of the stock exchange.

   C. To ensure company are licensed.

   D. Creation of company fund.

5. The rules and regulations of the Lusaka Stock Exchange are approved by _______________

   A. Itself.

   B. The Securities and Exchange Commission.

   C. The stockbrokers.

   D. Government.

PART B

Answer both questions

1. The Securities and Exchange Commission is Act of Parliament in Zambia. Explain the roles of this commission.
2. The Lusaka Stock Exchange bases its formulation of its regulatory powers on using certain guidelines. Identify and explain some of these guidelines.

Feedback

The following are the answers to the Topic 1 Exercise.

SECTION A

1. *Lusaka Stock Exchange*
2. *1993*
3. *1994*
4. *Participation*
5. *Private Sector*
6. *Citizens*
7. *Wealth*

SECTION B

1. *The following are the purposes of the Lusaka Stock Exchange:*
   - *One of the main purposes of stock exchange is to enable companies raise more capital. This is by allowing people to invest their money in these companies by means of buying securities. These investors benefit in the sense that they have a share in the profits of the company.*
   - *The other purpose of the stock exchange is to facilitate secondary trading for investors who bought securities the first time they were offered for sale by the company to the public.*
   - *Another purpose of the stock exchange is to determine share prices. It is at the stock exchange where the value and the price of securities are measured. The prices of securities can appreciate (go up) or depreciate (go down) in value basing on the principle of supply and demand. This means if more people wishes to buy shares in a particular company, then the share price may go up. If fewer people wish to buy shares then the share price may go down.*

2. *The benefits of a listed company on the stock exchange include:*
   - *The public gains confidence in the company and this*

enables it to raise funds from the public.

- *Increase of access of shares from the public will be enjoyed.*
- *The company's status and image is improved and this create a favourable relationship with government, financial institutions, suppliers and the public.*
- *There is proper market valuation of shares for a company.*

3. *The process the investor from the general public would follow when selling shares on the Lusaka Stock Exchange would be as follows:*

- *The seller of shares is expected to deposit the share certificate. Depositing the share certificate is similar to the way money is deposited in the bank account.*
- *The stockbroker verifies the share certificate to ensure that it is a true document.*
- *The shares certificate remains in the depository system of the Lusaka Stock Exchange up to the time the shares are sold.*
- *When shares are finally sold, the stockbroker must receive money from the buyer for the shares sold.*
- *Three days after selling the shares, the shares are transferred to the account of the new buyer. The shares cease to be stock of the seller.*
- *The stockbroker gets the agreed upon commission from the sale of the shares.*
- *The seller of the shares is then paid what is due to him by the stockbroker.*

The following are the answers to the Topic 2 Exercise.

PART A

1. *A*
2. *C*
3. *C*
4. *B*
5. *B*

PART B

1. The Securities and Exchange Commission is Act of Parliament in Zambia and it performs the following roles:

- *To establish the securities market. Like in Zambia, the* *commission had the duty to develop the Lusaka Stock Exchange.*

- *To help the securities market to operate in a free, orderly and safe stock exchange environment.*
- *To ensure that the securities market is well informed with necessary information. For example, changes in requirements for any company should be listed on the stock exchange.*
- *To register all securities of public limited companies.*
- *To issue and renew licenses to main players such as stock brokers and dealers as well on the stock market as well as the stock exchange.*
- *To protect investors by making sure that the rules of fair trading is observed on the stock exchange.*

2. *The Lusaka Stock Exchange bases the formulation of its regulatory powers on the following guidelines:*

- ***Membership** - There is a procedure followed to become a member of the Lusaka Stock Exchange and ordinary members of the general public are not allowed to deal with the stock exchange directly since they are not members. Stockbrokers should be licensed to be approved as a member of the stock exchange*
- ***Procedures for listing a company** - Companies to be listed on the stock exchange must be public companies and must produce financial records for the previous three years. This is to assess their performance in order know if the business of the company is doing well and as a way of protecting the shareholders to be.*
- ***Trading rules** - the Lusaka Stock Exchange has set trading hours and the process of transacting shares or other securities.*
- ***Disciplinary and problem solving procedure** - These procedures are clearly laid down so that anyone concerned would know where to start from to handle a problem or disciplinary issue.*

Assessment

Assessment

Tutor-Marked Assessment 3

This is a tutor-marked assignment and should be sent to the College for marking.

Answer all the questions given below.

1. Different securities are sold on the stock exchange. Define stock exchange and outline at least four (4) reasons why the Lusaka Stock Exchange was established.
2. There are different types of preference shares an investor can buy on the stock exchange. Identify any two types of preference shares and explain them.
3. Kayuma Musonda has just won an award as the best student at a university and was given an amount of Ten Million Zambian Kwacha (K10.000.000) and a job in a certain company. After the award ceremony, he comes to you for advice whether to keep this money in the bank or invest in some business. Having studied commerce and stock exchange in particular, you inspires him to invest in shares in a company that is listed on the Lusaka Stock Exchange. Kayuma Musonda is still not sure of what should be done to buy these shares. Explain to Kayuma Musonda the process of buying shares on the Lusaka Stock Exchange.
4. There are some risks involved in being a shareholder on the Lusaka Stock Exchange. Discuss the risks of being a shareholder.
5. Securities and Exchange Commission is an Act of Parliament and law whose regulatory powers is based on some princples. Briefly explain these principles.

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 7

Banking 1

Introduction

Welcome to Unit 7 of Grade 11 Commerce. This unit is about banking. It is the first of the two units on banking. In Unit 6 we discussed the Lusaka Stock exchange and the reasons for establishing it. We also looked at functions of the Lusaka stock exchange, the major one being the provision of a specialised market to Zambian companies that wish to raise additional capital through the sale of securities. In addition, we discussed the main players on the Lusaka Stock Exchange. We further looked at the Securities and Exchange Commission.

In this unit, we shall explore banking. Banking is not a new concept, you learned about it during your Junior Certificate Course in either Civics or Office Practice. In our introduction to commerce in Grade 10, we saw that banking is an aid to trade that plays a pivotal role in financial and monetary aspects in every area of business. Banks, like the stock exchange, play a vital role in helping individuals and companies raise the capital needed in financing their business activities. The stock exchange alone cannot provide the large amount of capital that businesses need to produce goods or services. Banks compliment the activities of the stock exchange by providing additional finance to individuals and companies. Moreover, for individuals and companies to buy or sell shares on the stock exchange, they may require certain services of banks as we shall learn later in this unit.

This unit is divided into three topics. In the first topic we will focus on banks and other financial institutions. In the second topic we shall look at commercial banks, their functions and services. In the third topic, we shall discuss the operations of different types of bank accounts. We shall also examine the advantages and disadvantages of individual bank accounts.

Let us start with the unit outcomes.

Outcomes

Upon completion of this unit you should be able to:

- *Define* banking.
- *List* financial institutions in banking.
- *Discuss* the functions of central bank.
- *Discuss* the services and functions of commercial banks.
- *Explain* the operations of different types of bank accounts.
- *Discuss* the advantages and disadvantages of different types of bank accounts.

Learning and Teaching Approaches

Tips

The following learning and teaching approaches will be used

- **Content based approach -** has been used to present the core content of the course. It is linked to the other two approaches mentioned below because it is the springboard for doing activities and solving problems. It encourages you to base your learning on the subject matter provided, read and follow instructions and improve your knowledge, skills and competencies on banking. All this is intended to help you learn effectively.

- **Problem based approach -** aims to make you responsible for your own learning in order to promote higher level learning skills like critical thinking on banking. Your study units are like a teacher in print form in that they facilitate your learning and assist you in solving problems rather than merely providing solutions.

- **Activity based approach -** should enable you to physically interact with people and content in order to acquire banking related skills and general learning skills by being actively involved in the discussions and activities within the unit. This will include among other activities visits to commercial banks and other financial institutions.

Time

You will need between 20 and 25 hours to study this unit. Do not worry if it takes you more or less time than this - we do not all work at the same pace. You will need about 10-12 hours to study each topic. This time includes the time you will spend studying, doing the activities and checking them against the feedback but does not include the time you will attend tutorials.

You are encouraged to spend between 2 hours and 3 hours to answer the tutor marked assessment.

Terminology

Credit transfer:	System of transferring money from one account to another.
Current account:	A bank account that enables a holder to withdraw money or make payments using a cheque and on which overdrafts are allowed.
Depositor:	A person who places money in a bank account to earn interest.
Expenditure:	Money spent or paid out.
Foreign Exchange controls:	Measures taken by a government on the sale or purchase of foreign currency as a way of controlling exchange rates.
Investment:	Planned activity in which someone devotes money in order to earn a profit for example depositing money in a bank account or buying securities.
Maturity date:	A date when an obligation is due.
Minimum balance:	The least amount that should be left in an account at any given time to keep it functioning.
Minimum lending rates:	The lowest percentage that the borrower pays to the bank.
National Debt:	The total amount of money borrowed by a country.
Unemployment:	A condition of being jobless.
Withdrawals:	Money taken out of a bank account.

Topic 1: Banks and other Financial Institutions

Introduction

Welcome to Topic 1 of Unit 7, on banks and other financial institutions. In our introduction to this unit, we saw that banks play a vital role in helping individuals and companies raise the capital needed in financing their business activities.

Finance therefore, is one reason why the stock exchange and banks exist. Finance is concerned with the provision of money to individuals, businesses and governments to empower them economically. For example, a limited company wishing to raise extra capital can sell its shares to the general public at the stock exchange. Alternatively, it can borrow from the public through debentures. Remember in Unit 5, we defined debentures as loans given to a company. A government can also raise money for projects by issuing bonds. Similarly, an individual company wishing to buy property such a tractor, machinery or a house can borrow money from a bank or building society.

From this discussion, we have seen that both banks and the stock exchange play a vital role in providing finance to individuals, companies (businesses) and the government. While banks offer intermediary financial services to those wishing to buy and sell shares on the stock exchange, the stock exchange provides a market for the securities, thereby promoting investment.

In this topic, we shall explain the meaning of banking. We shall also consider the different types of banks. We shall closely examine the central bank and its functions. We shall also discuss other financial institutions. The unit will address the first three unit outcomes.

Upon completion of this topic you will be able to:

Outcomes

- *Define* banking.
- *List* the financial institutions in banking.
- *Discuss* the functions of the central bank.

To get a clear understanding of banks and other financial institutions, we shall start by defining the term banking.

What is Banking?

Banking is the provision of financial services to individuals and businesses. The key financial services include accepting deposits by operating bank accounts, lending money and providing means of payments. What then is a bank?

Many people view a bank as a place where money is stored. But a bank is far much more than a money store. It is a financial institution (business) concerned with the collection and safeguarding of surplus finances (money) from the general public. Where the true owner does not require the money in the custody of the bank urgently, the bank lends it out with interest to others who may have urgent use for it. By lending surplus money to individuals or companies requiring it, banks finance them with the much needed capital to expand their existing businesses or set up new ones.

Now that we know that a bank is a financial institution, let us define financial institutions.

What are Financial Institutions?

Financial institutions are organisations which offer monetary services like accepting deposits, lending money, operating bank accounts and other investment activities. These include banks and all other institutions that handle money in one way or another. While some financial institutions offer a wide range of financial (monetary) services, others may specialise in one or two services, for example lending money to a given sector of the economy.

Having defined the term financial institutions, let us look at banks as financial institutions.

Banks as Financial Institutions

Have you ever been to a bank? We are sure that you have been there or seen other people going there. What did you go there for? You probably went there to deposit, borrow or withdraw some money. Banks accept deposits by operating bank accounts, lend money, deal in money transfers and perform other financial services. Banks are of different types. The type one chooses depends on the nature and range of services needed. The following are some of the banks:

- Merchant Banks
- Savings Banks
- Development Banks
- Commercial Banks
- Central Banks

Let us now take a brief look at each bank listed above.

Merchant Banks

Traditionally, **merchant banks** were banks that were formed to finance traders especially those involved in foreign trade. Today, merchant banks perform different functions.

Before you proceed, do the following activity and come up with at least three modern functions of merchant banks.

Activity 1

With the help of a friend or family member, list down at least three modern functions of a merchant bank in the space provided below:

Now check if your answers are similar to the ones provided below:

Feedback

The following are the modern functions of merchant banks:

- *They provide capital to firms in the form of shares rather than loans. Their main role is to help companies in selling shares to the general public. They even help in advertising the shares in newspapers and other media.*
- *They also help government to raise the capital needed to improve infrastructure like schools, hospitals, roads and many others.*
- *They may also perform underwriting functions.*

Congratulations if your list included at least two of the three modern functions of merchant banks. If not, find out more from your tutor at the study centre.

An example of a merchant bank in Zambia is Cavmont Merchant Bank.

Now that we have looked at merchant banks, let us proceed to savings banks and then development and commercial banks

Savings Banks

A **savings bank** is a financial institution owned and operated by the government. Savings banks were originally created to provide savings accounts to small savers, mainly to low income people in rural areas. In addition, they make payments on behalf of customers through stop order and offer basic financial services like small loans and insurance services.

In many countries, savings banks are operated from the Post Office. In Zambia, the National Savings and Credit Bank (NATSAVE) which was established in 1972 also operated from the post office as a savings bank. In 1997 it started offering full banking services and now operates as a commercial bank.

Development Banks

Where other banks are not willing to finance business ventures due to their risky nature, development banks may be able to help. A **development bank** is a bank formed by the government to provide long term finance to those in the agriculture and industrial sectors. Examples of development banks in Zambia are the Zambia Development Bank (DBZ) and the African Development Bank (AfDB). DBZ has invested significantly in agriculture, fisheries and manufacturing sectors.

Commercial Banks

Commercial banks are financial institutions offering a wide range of banking services. For this reason, many people consider commercial banks as major banks. We will learn more about banking services offered by commercial banks in Topic 2.

Although many people consider commercial banks as major banks, their activities are controlled by the central bank which is the principal bank in a country. We shall now discuss the central bank in detail.

Central Banks

The word central may have different meanings. It might mean the main part of something or having control over other parts. Both ideas apply to the central bank as it is the main or principal bank in a country which has control of the entire banking system in a given country. It monitors and controls the activities of all banks and financial institutions in a country. Its main customers are the government and commercial banks.

Ordinarily, accounts for individuals and companies cannot be opened with the central bank.

The central bank is often referred to as the nation's banker. Some countries refer to their central banks as reserve banks. A typical example is the United States Federal Reserve System.

Figure 1 below shows a picture of a central bank.

Figure 1: The Central Bank of Ireland, Dame Street, Dublin. © Copyright Hector Davie and licensed for reuse under this Creative Commons Licence.

It is important to note that:

Note it!

Every country has its central bank.

In Zambia, the central bank is the Bank of Zambia (B.O.Z). It was established by an Act of Parliament. The bank is run by a governor and board of directors appointed by the Republican President and ratified by Parliament. The Bank of Zambia is situated in Lusaka and has a branch in Ndola.

In all countries, the central bank is considered the most important financial institution as it coordinates the financial activities of all financial institutions in that country. To do this, it performs a number of functions, some of which we are now going to explore.

Functions of the Central Bank

The following are some of the functions of the central bank:

- **It issues bank notes and coins**

Every time you receive money, carefully examine it. You will discover that some of the bank notes and coins are brand new while others are old. Some of the old notes may even be too dirty to handle while others may be mutilated (torn). Have you ever imagined where the new bank notes and coins come from and where old dirty notes and coins go? You are probably aware that the new bank notes and coins come from the central bank (Bank of Zambia) for Zambia. It is the responsibility of the central bank to ensure that it prints bank notes and mints coins. In addition, the bank ensures that the bank notes and coins printed and minted go into circulation to replace old torn and dirty money. When bank notes and coins are dirty, the central bank removes them from circulation and destroys them.

Another important function of the central bank is that of managing or supervising the banking system.

- **It manages the banking system in the country**

As stated earlier, the central bank monitors and controls the financial activities of all commercial banks and other financial institutions. In carrying out this function, it sets rules and regulations to govern the way financial institutions should operate. Why should there be rules and regulations governing financial institutions? The rules are meant to bring stability in the banking system. Rules also help in preventing unfair competition among financial institutions. Licensing of financial institutions is also the baby of the central bank.

By monitoring loans and investments, the central bank helps in preventing banks and financial institutions from lending excessively at high interest rates so as to make huge profits.

Before you read on, do the following activity which encourages you to apply your prior knowledge of the dangers of excessive money lending and to discuss your views with your group or family members.

Activity 2

What in your opinion are the dangers of excessive lending at high interest rates by banks?

You may discuss with your group or family members and write down the points of the discussion in the space provided below:

If your answers included all the following dangers, well done! If not, consult your tutor at the study centre.

Feedback

If the borrowers fail to repay their loans (let alone interest), the bank makes losses because no money comes into the bank.

If many borrowers fail to repay, the bank will fail and eventually the whole banking system fails.

Therefore, it is the duty of the central bank to create guidelines on lending and to ensure they are followed by financial institutions in the country. For example, the central bank enforces the minimum lending rates set by government. The central bank may use the minimum lending rate to increase or reduce the amount of money in circulation. For example, an increase in the minimum lending rate reduces the amount of money in circulation as it makes borrowing expensive. Reducing the amount of money in circulation may lead to stagnation of the economy and unemployment. However, a reduction in the minimum lending rate makes borrowing cheap and increases the amount of money in circulation. This gives consumers more money in their pockets.

Reflection

Think of what you would do if you had more money in your pockets. Read the next section only after you have reflected on this issue so that you can assess your prior knowledge against our views and add any points we had left out.

Automatically, you would spend it on goods and services thereby increasing the amount of money in circulation. Too much money in circulation increases the prices of goods and services and causes inflation. **Inflation** is a situation where there is too much money chasing too few goods and services.

Many governments put in place measures to control inflation. It is the role of the central bank to provide advice to the government on how best inflation can be controlled. In addition, the bank provides financial advice on other issues like foreign exchange rates and tax. So, the central bank is the **chief financial adviser to government**.

- **It monitors and manages the country's foreign exchange rates and reserves**

It is the work of the central bank to ensure foreign exchange rates in a country are monitored and controlled to avoid artificial increases in the rates. In addition, the central bank may institute foreign exchange controls. This is done by controlling the amount of foreign currencies made available for the purchase of goods and services abroad. The central bank keeps much of the country's foreign currency in accounts abroad. These accounts are called foreign exchange reserves.

Now let us see if you know the other functions of the central bank in the following activity.

Activity 3

Other than the functions stated above, do you know any other functions of the central bank in your country? List at least five in the space provided below.

Feedback

Check whether your list is similar to the one given in the feedback below.

- *It is a bank for other banks (banker's bank).*
- *It maintains the government account.*
- *It lends money to commercial banks when they fail to obtain it from other sources.*
- *It pays the national debt on behalf of the*

government.

- *It acts as a clearing house.*

If your list included all of the functions above, well done! If not, find out more from a friend or relative if you are working alone or from your group members if you work as a group.

Now that we have identified the functions of a central bank, let us briefly discuss each function.

- **It is a bank for other banks (banker's bank)**

The central bank is a bank for all commercial banks in a country. It is a statutory requirement for all commercial banks to open bank accounts with the central bank. Why do you think banks are required to open bank accounts with the central bank? The main reason is to enable commercial banks keep their reserves in the bank which they use to offset interbank debts. The offsetting of debts is done by debiting the account of the bank owing and crediting the account of the bank receiving the amount owing. These debts arise from the clearing of cheques. The whole process of clearing cheques will be dealt with in Unit 9.

- **It maintains the government account (government's bank)**

The central bank looks after the government's money by maintaining an account for them. It is in this account that revenues collected by the government such as taxes and profits from parastatals are deposited. Expenses incurred by government departments are also paid from the same account. What are some of the expenses government departments incur? You probably have in mind expenses like rent, electricity, wages and salaries and many others.

- **It lends money to commercial banks when they fail to obtain it from other sources**

Where a commercial bank runs short of cash to carry out its day-to-day operations and fails to get it from another source, it may obtain help from the central bank.

Reflection

Consider a situation where a commercial bank lends out their customers' money to borrowers and they come to withdraw their money just to be told there is no money in the bank.

How do you think the bank will resolve this problem?

As you thought over the reflection activity, you may have thought of borrowing. The commercial bank will have no option but to borrow from the central bank. However, borrowing from the central bank is expensive.

By lending money to the commercial bank in need, the central bank acts as a **lender of last resort**.

- **It pays the national debt on behalf of the government**

Every year, different countries announce their budgets. You may have observed that the amount of expenditure in your national budget exceeds the amount of revenues. When this happens, a country may borrow money just like individuals and businesses do. The government may borrow money from the general public through the sale of government securities such as bonds. It may also borrow from other countries or international financial institutions like the World Bank or International Monetary Fund (IMF). The total debt owed by the government is called the **national or public debt**. Remember when the government borrows, it does so to benefit the general public. Hence the name public debt.

What is the role of the central bank in managing the national or public debt? Its role is to ensure that both local and foreign loans are repaid together with loan interest where applicable. In short, the bank looks after loan accounts.

- **It acts as a clearing house**

The central bank helps in the clearing of cheques drawn and paid into bank accounts of various commercial banks. The bank has a separate department responsible for cheque clearing. **Cheque clearing** is the process by which banks settle each others' debts resulting from the transactions of their customers. We will learn more about this process in Unit 8.

Now that we know the various banks and their functions, let us also look at other financial institutions.

Other Financial Institutions

Before you proceed, see if you can come up with some financial institutions other than banks in the following activity.

Activity 4

Do you know any financial institutions in your country other than banks? List them down in the space provided below

Feedback

Your list may have included the following financial institutions:

- *Building Societies*
- *Insurance Companies*
- *Micro Finance Institutions*
- *Credit unions*
- *Finance Houses*
- *Foreign Exchange Bureaus (Bureau De Changes)*

Well done if your list included all the financial institutions above. If however, you came up with more institutions than these, do not worry. The list may depend on what is operating in your area.

Let us now briefly discuss these financial institutions, starting with building societies.

Building Societies

A building society is a financial institution which lends money to those wishing to buy or build houses. A loan given to an individual for the purpose of building or buying a house is called a mortgage. Like commercial banks, they also accept deposits. An example of a building society in Zambia is the Zambia National Building Society (ZNBS).

Insurance Companies

Insurance companies are financial institutions specifically concerned with the protection of traders against financial losses caused by risks such as fire, theft, accident, burglary, floods and many more. To provide this protection, insurance companies compensate those traders who suffer losses. Where do insurance companies get the money for compensation? They get it from the central fund or pool. The central fund is created when each insured person contributes a small sum of money called a **premium** to this pool of funds.

Microfinance Institutions

Microfinance institutions are companies set up to lend money to the people with regular employment like nurses, doctors, teachers and all those employed by the government on the basis of their salary. Those employed by private companies are also considered as long as they provide their latest payslip and a letter from their employers. Examples of microfinance companies or institutions in Zambia are Bayport, Microfin now called Banc ABC, Capital solutions, Blue Financial Service and many others.

Credit Unions

Credit unions are financial organisations which provide loans to their members only at lower rates of interest.

Reflection

Take a few minutes and think about the sources of finance for the credit union.

Where does a credit union get the funds they lend to their members?

As you thought over the question in the above reflection activity, you may have thought of investments by members through the buying of shares. It is from this investment that credit unions give loans to members.

When a person buys shares from a credit union, they receive an annual dividend based on their investment. This means that the more money you invest, the higher the dividend. Any group of people with common interests like workers in a company, a church or a professional association can organise a credit union. People that cannot afford to get loans from banks because they do not have security, may find loans given by credit unions convenient as there is no security required.

Foreign Exchange Bureaux (Bureau De Changes)

These are financial institutions which help people to convert currencies. They are especially useful to those involved in foreign trade. Remember in Unit 1on foreign trade, we learnt that banks also convert currencies. This means that they provide foreign exchange services to traders and others.

Finance Houses

Finance houses are financial institutions that help individuals and businesses wanting to buy consumer durable goods like computers, machinery, vehicles, stoves and other similar goods on credit. Finance houses perform the following functions:

- They provide finance to individuals or organizations buying consumer durable goods on hire-purchase.
- They offer leasing services - **Leasing** involves hiring or renting an asset such as equipment for a specified period of time, for example five years. Finance houses normally buy costly assets and rent them out to other businesses.
- They also finance hire-purchase traders by paying them an amount slightly lower than the hire-purchase price. For example, if the item is invoiced at K20,000,000, the finance company pays

K19,000,000. When the finance house pays the hire-purchase amount to the trader, they buy the invoiced debt and this is called **factoring**. The finance house then becomes responsible for collecting the installments from the customer.

Now that you know some financial institutions and their functions, do the following activity to assess how much you have learnt.

Activity 5

Answer the following questions by filling in the blank spaces:

1. The business of providing financial services to individuals is called _______________.
2. Financial institutions concerned with the collection and safeguarding of surplus finances (money) from the general public are called ______________.
3. An example of a __________________ institution in Zambia is Capital Solutions.
4. ______________ offer finance to individuals or organizations buying consumer durable goods on hire-purchase.
5. _____________________ operated from the post office from 1972 to 1997.

Feedback

Now compare your answers with those in our feedback below:

1. *The business of providing financial services to individuals is called **banking**.*
2. *Financial institutions concerned with the collection and safeguarding of surplus finances (money) from the general public are called **banks**.*
3. *An example of a **microfinance** institution in Zambia is capital Solutions.*
4. ***Finance houses** offer finance to individuals or organizations buying consumer durable goods on hire-purchase.*
5. ***National Savings And Credit Bank** operated from the post office from 1972 to 1997.*

If you answered at least four of the questions correctly, congratulations! If not, read the topic once more.

Now proceed to the topic summary as we have come to the end of this topic.

Topic 1: Summary

In this topic we defined banking and financial institutions. We briefly discussed different types of financial institutions. Among those discussed were merchant, savings, development banks, building societies, credit unions, finance houses and central banks. The discussion included brief introductions to the functions and services provided by these institutions.

We hope you were able to do all the activities in this topic and that you did them correctly. If not, read through the topic again and make sure you understand the content before proceeding to the next topic.

Now take a short break and do the Topic 1 Exercise in the assignment section of this unit. Make sure you do this exercise before moving on to the next topic. The exercise is designed to help you review the topic. The answers to the Topic 1 Exercise are given just below the exercise. Remember, do not refer to our answers before providing your own.

In the next topic, we shall take a detailed look at commercial banks, their functions and services.

Topic 2: Commercial Banks, their Functions and Services

Introduction

Welcome to Topic 2 on commercial banks, their functions and services. In Topic 1, we looked at banks and other financial institutions. We defined banking as the provision of financial services to individuals and businesses, among them providing safe custody of money through bank accounts, lending money and dealing in money transfers. We also looked at banks such as merchant, central and development banks just to mention a few. Furthermore, we looked at other financial institutions like insurance companies, building societies and many others. You also had a chance to learn the various functions of central banks.

In this topic, we shall take a detailed look at commercial banks, their functions and services.

Before we proceed, let us look at the topic outcome:

Upon completion of this topic you should be able to:

Topic Outcomes

- *Discuss* the services and functions of commercial banks.

Time

You should spend at least 6.5 hours on this topic.

What is a Commercial Bank?

In Topic 1, we described commercial banks as financial institutions which offer a wide range of financial services. For this reason commercial banks are sometimes referred to as 'full service' financial institutions. While some commercial banks are publicly owned, the majority of are run by private individuals. Of all the banks that you may know, the majority are commercial banks.

Before you proceed, let us see if you know commercial banks very well.

Activity 6

Which of the following financial institutions in Zambia are commercial banks?

- Zambia National Commercial Bank
- Standard Chartered Bank (Z) Ltd
- Bank of Zambia (BOZ)
- Zambia National Building Society

- Stanbic Bank
- Indo Bank (Z) Ltd.
- National Savings and Credit Bank (NATSAVE)
- Finance Bank (Z) Ltd.
- Citi-Bank
- Barclays Bank (Z) Ltd.

Feedback

Well done! You may have observed that all except four financial institutions are commercial banks.

These include:

- *Zambia National Commercial Bank*
- *Standard Chartered Bank (Z) Ltd.*
- *Stanbic Bank*
- *Indo-bank (Z) Ltd.*
- *National Savings and Credit Bank (NATSAVE)*
- *Finance Bank (Z) Ltd.*
- *Citi-Bank*
- *Barclays Bank (Z) Ltd.*

If on your first attempt you included financial institutions that are not commercial banks, read Topic 1 once more.

Now that you have identified commercial banks, let us consider the functions and services of commercial banks.

Functions and Services of Commercial Banks

We have so far learnt that commercial banks offer a wide range of functions and services to their customers. We will start by looking at the key functions of commercial banks.

The following are the key functions of commercial banks:

Providing Safe Custody of Money (cash) and other Valuables

The primary function of commercial banks is to provide safe custody of money. Individuals and businesses with surplus money can take it to the bank for safe keeping. We may all be aware that keeping money at home or office is risky. What are the dangers of keeping money at home or at the office? It is a well known fact that keeping money at a business premise or home is very risky as the money may be stolen, destroyed by fire or natural disaster like a flood. Commercial banks exist to keep their customers money safely by opening bank accounts such as current, savings, fixed deposit and call accounts for them. We shall learn more on the operations of different bank accounts in Topic 3.

When a person or company keeps money with the bank, they earn interest, although certain bank accounts do not accrue interest as we shall learn later in this unit.

Commercial banks do not only provide safe custody of money, but valuables as well. What are some of the valuables that one can take to the bank for safe keeping? Valuables such as jewels, gold, diamonds and ornaments can be deposited with the bank just like cash. Similarly, valuable documents like share certificates, insurance policies, title deeds, wills and other similar documents can be kept safely by commercial banks.

Other than keeping money and valuables, banks also provide means of payments.

Providing Facilities for Making and Receiving Payments on Behalf of their Customers (Means of Payment)

Through current accounts, commercial banks make payments to suppliers by way of cheques, standing orders, credit transfers and other means of payment. Commercial banks do not just make payments but receive payments as well. For example, in foreign trade commercial banks receive payments on behalf of exporters through documentary credits, banker's drafts and cable transfers. It is important to note that credit transfers and standing orders may also be used to receive payments from customers on behalf of a business. You will find a full discussion of means of payments particularly in home trade in Unit 9. You know already the means of payments in foreign trade.

In addition to keeping money and valuables and providing means of payments, commercial banks also lend money.

Financing Individuals and Companies through Lending

Commercial banks finance individuals and companies requiring additional capital by lending them some money.

Reflection

Do you remember where commercial banks get the money they lend to their customers?

The money comes from depositors. Remember, when commercial banks collect and safeguard surplus finances (money) from the general public, whatever amounts are not needed by the true owners (depositors) are lent out with interest to those who may have urgent need for it.

There are two major ways used by banks to finance traders namely bank loans and overdrafts. You may have used both or one of the ways before. Better still, you may have seen or heard a friend or relative get a loan or overdraft.

We borrow money for different purposes. On the one hand, individuals borrow money to meet their daily expenses such as paying water, electricity and telephone bills. On the other hand, individuals borrow money to enable them meet their capital needs such as buying a vehicle or machinery. In this case, an individual is borrowing for a specific purpose. When an individual borrows money to meet daily expenses we call it an overdraft, but when they do it for a specific purpose we call it loan.

Before you proceed, let us see how much you already know about loans and overdrafts.

Activity 7

1. What do you think are the differences between a loan and overdraft? Use a table to show at least six differences.

Now check whether your differences are similar to those provided in our feedback.

Feedback

Loan	***Overdraft***
• *It is a long-term finance given to a customer for a specific period and purpose. For example, buying a capital item such as equipment or a building.*	• *It is a short-term finance given to a customer to enable her/him to meet day-to-day expenses. For example, buying stock and paying water and electricity bills.*

• *It can be given to anyone, be it a bank, customer or non-customer.*	• *It is given to good customers of the bank (current account holders with a good banking record).*
• *When a loan is granted, a separate loan account is opened.*	• *No separate loan account is opened.*
• *Interest is charged on the full amount.*	• *Interest is charged on the overdrawn amount.*
• *A loan requires collateral security.*	• *Does not require any collateral security.*
• *A loan is given as a fixed sum of money.*	• *An overdraft is not obtained as a fixed sum – the bank customer is only allowed to get more money than what is in their current account.*
• *A loan is repaid in regular fixed instalments.*	• *An overdraft is repaid when the bank customer deposits money in his current account.*
• *It is a formal and expensive way of borrowing.*	• *It is an informal and cheaper way of borrowing.*

Any six items are acceptable.

If you managed to indicate all the differences above, congratulations! If not, consult your group members if you are working in a group or a tutor at the study centre.

Note it!

Money put in a current account reduces an overdraft, but would have no effect on a loan account.

Before a loan or overdraft is granted, certain considerations should be made by the bank manager. Let us now look at some of the considerations which the bank manager should make.

Considerations by the Bank Manager

Reflection

Think of the things you would consider before lending a friend some money.

As you thought over the reflection activity, the following questions may have crossed your mind:

- Is my friend in a position to repay the loan?
- How much does he need?
- How long will he take to repay?
- If the amount is large, does he have any assets that can be sold in the event that he fails to repay?

Bank managers will have similar questions crossing their minds and will have to consider:

- **The Credit Worthiness of the Customer**

The bank manager will have to assess whether the customer is in a position to repay the loan or overdraft. Have you ever thought why banks always want to know whether the applicant got a loan or loans from other financial institutions and whether they have repaid the loans? This is one way of assessing the credit worthiness of the customer. Today, some banks have special departments that carry out thorough investigations. If through these investigations it is discovered that the applicant failed to repay some loan(s), the bank manager may not approve the loan.

- **The Amount Needed**

The bank manager will consider the amount required by the customer for a loan or overdraft. Remember, the bank depends on money deposited by customers, so if the applicant needs an amount beyond the bank's reach, it will not be granted.

- **The Period of Repayment**

This is the period in which the customer is required to repay the loan in full.

- **The Purpose of the Loan or Overdraft**

We stated earlier that people borrow money for different purposes. The purpose for which the loan or overdraft is required should be made known to the bank manager. Does the applicant need money to buy a capital item or to pay wages? Where the customer needs the money to buy some assets, the bank may require a quote.

- **The Type of Collateral Security Offered**

You may have observed that when one is borrowing from a bank, they are required to pledge any valuable asset against which a loan will be granted. These assets are called **collateral security**. Collateral security may be a house, farm, shop and any other immovable property. Assets such as share certificates and insurance policies may also be accepted as security.

- **Government Policy with Regards to Bank Lending**

The bank manger will be guided by government policy on lending. On one hand, the government may not allow financial institutions to lend money. Such a complete ban by the government on lending is called a **credit freeze**. On the other hand, the government may give a directive to financial institutions to reduce the amount they lend to their customers. This is called a **credit squeeze**.

The bank manager will also look at the profitability of the business to be undertaken.

Now you know the key functions of commercial banks and considerations by the bank manager before giving loans. We shall now consider other services offered by commercial banks.

Other Services Offered by Commercial Banks

Commercial banks provide the following services to both businesses and individuals:

- They accept and discount bills of exchange.
- Providing night safe facilities.
- Providing financial advice.
- Acting as stock brokers.
- Acting as executor and trustee.
- Issuing travellers' cheques to people travelling abroad.
- Providing ATM facilities.
- Providing credit and debit cards.

Let us now discuss the first five services in detail. The remaining services will be discussed in detail in Unit 9.

They accept and discount bills of exchange.

A bill of exchange is a method of payment used in foreign trade. It is usually drawn for a future date. This means that a bill is drawn now but is to be paid in future. An exporter who has received a bill of exchange will not have to wait for it to mature, but can discount the bill of exchange at a bank. This means that he can sell it to the bank for an amount slightly less than what is on the bill. For example if the amount on the bill is K1 000 000 and the bank discounts at a rate of 10%, the exporter will receive a payment of K900 000 instead of waiting for the bill to mature.

Providing night safe facilities

A night safe facility is a service provided by commercial banks which allows customers to deposit money after banks have closed, at night or during public holidays. Today, night safes are found in almost all the commercial banks. Does the picture in Figure 2 below look familiar?

Figure 2: A Midland Bank Witton Night Safe. © Copyright Roy Hughes and licensed for reuse under this Creative Commons Licence.

You may have seen something like this on the walls of some banks. This is a night safe fitting with a slot through which money can be dropped into the bank's night safe. Although, night safe fittings come in different shapes, the general appearance is the same.

Now that you know what a night safe facility is, see if you can come up with some businesses in your area that may find this service useful.

Activity 8

Think of the businesses in your area.

1. Are there any businesses that receive money after normal banking hours or at night? List them down in the space provided below:

2. In Zambia, what is the opening and closing time for commercial banks?

3. Why is it not advisable for any of the businesses mentioned above to keep money at home or business premises?

Feedback

1. *Businesses receiving money after normal banking hours and at night include:*
    - *Hotels*
    - *Filling Stations*
    - *Night clubs*
    - *Some supermarkets*
2. *In Zambia, most banks open at 08:15 hours. The closing time ranges between 14:30 hours to 16:00 hours.*
3. *If money is kept at home or business premises, it might be stolen.*

If you got everything right, well done! If not, consult your group members if you are working in a group or member of your family if you are working alone.

Now let us look at the procedure to be followed when using a night safe facility.

Procedure to be followed when using the night safe facility

The procedure is as shown in Figure 3 below.

1. The trader places the cash to be deposited together with a completed paying-in-slip in a lockable wallet or bag provided by the bank

2. The trader then drops the wallet or bag into the night safe through a slot (opening) on the bank walls

3. The next day, the bank staff either opens the wallet and deposit the money in the trader's account or they wait for the trader to collect the wallet and deposit the money in the usual way.

Figure 3: The procedure for using a night safe facility. Created by Commerce Team, ZACODE, 2010.

By allowing traders to deposit money in this way, banks reduce the risk of money being snatched from them by armed robbers. Remember, keeping money at home or business premises is risky.

Note it!

Always take precautions when taking money to the bank as thieves may attack you on the way. If possible, be accompanied by security personnel and do not always use the same route when taking money to the bank especially at night.

Providing financial advice on investments and other business matters

Commercial banks give advice to their customers on a variety of business matters such as insurance, taxation, investment opportunities, overseas trade information and many others.

Acting as stock brokers

You may recall from Unit 1 Topic 2, that a broker is an agent who buys and sells goods or services on behalf of the principal. A stock broker is an agent concerned with the buying and selling of stocks and shares on behalf of their customers. Also, in our introduction to this unit, we stated that for individuals or businesses to buy or sell shares on the stock exchange, they may require certain services of banks and this is one such service. People wanting to invest in limited companies may find this service useful.

Acting as executor and trustee

Who is an executor? An executor is a person named in a will to carry out the instructions contained in it. Some executors are appointed by a court. We know executors as administrators. As a bank customer, you can ask your bank to be the administrator of your property when you die. Why would you think of appointing a bank as executor? You would probably appoint a bank as executor because:

- The bank can carry out your instructions on a will without any disturbance. Unlike a human executor, a bank is never affected by ill health or death.
- Bank staff is more well-informed and qualified.
- They are fair in the way they deal with customers.
- The risk of fraud is reduced. Fraud is a crime of getting money or other benefits through cheating.

Besides carrying out instructions on a will, commercial banks may also take up the role of trustee. Who is a trustee? A trustee is a person given legal power to look after property on behalf of another. A bank may be appointed to act as trustee. This means that the bank may be requested to look after the property of a deceased person on behalf of the surviving children or child.

It is important to note that for all these services, commercial banks charge people.Why? We may be aware that any organisation or institution that charges for its services or goods is in business. Remember, the main aim of doing business is profit making. Therefore, commercial banks are profit making organisations. In short, they are in the banking business.

How do banks make their profits? Figure 4 below illustrates how banks make their profits.

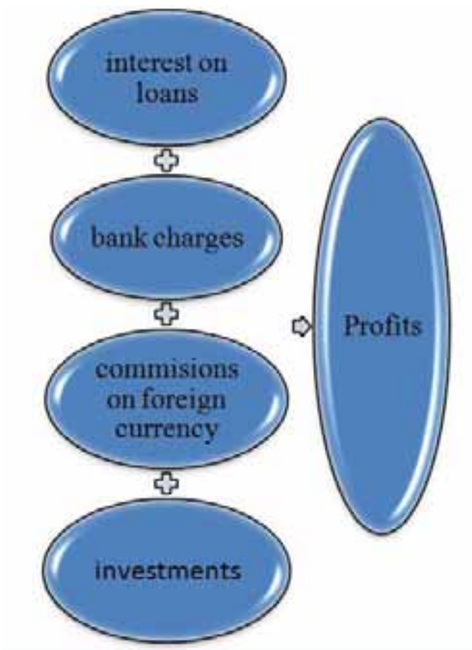

Figure 4: Showing how banks make their profits. Created by Commerce Team, ZACODE, 2010.

From the diagram, you can see that banks charge interest on loans granted to their customers. They also charge ledger fees (bank charges) and commission. For example, for operating a bank account the banks can charge you ledger fees and when buying currency they charge commission.

In addition, they make profits through investment activities. A bank may for example, buy shares in another company or set up a completely new company. You may recall that in Unit 3, you learnt that when an individual or company buys shares in another company, they become shareholders and share in the profits of that company. Again, when a company runs its own business they make profits.

Basically, these are the ways used by banks to make profits.

Now that you know the functions and services of commercial banks, do the following activity to assess your understanding of this topic.

Activity 9

1. Discuss the following functions and services of commercial banks:
   a) Providing safe custody of money (cash) and other valuables.
   b) Accepting and discounting bills of exchange.
   c) Providing financial advice on investments and other business matters.

2. Commercial banks are said to be profit seeking organisations. List at least three methods used by commercial banks to make profit.

Feedback

1. a) ***Providing safe custody of money (cash) and other valuables.***

The primary function of a commercial bank is to provide safe custody of money. Individuals and businesses with surplus money can take it to the bank for safe keeping. Commercial banks therefore keep their customer's money safe by opening bank accounts. When a person places money into a bank account, it earns interest. Also, they keep valuables such as jewels and ornaments made from it and important documents like share certificates, insurance policies and other similar documents.

b) Accepting and discounting bills of exchange.

Commercial banks accept and discount bills of exchange. A bill of exchange is a method of payment used in foreign trade. It is usually drawn for a future date. An exporter who has received a bill of exchange will not have to wait for it to mature, but can discount the bill of exchange at a bank. That means she can sell it to the bank for an amount slightly less than what is on the bill. For example, if the amount on the bill is K1 000 000 and the bank discounts at a rate of 10%, the exporter will receive a payment of K900 000 instead of waiting for the bill to mature.

c) Providing financial advice on investments and other business matters

Commercial banks give their customers advice on a variety of business matters such as insurance, taxation, investment *opportunities, overseas' trade information etc.*

2. *Three methods used by commercial banks to make profit include:*

   a) *Charging customers service or bank charges on services provided.*

   b) *Charging commission on sale of foreign currency.*

   c) *Charging interest on loans and*

   d) *Investing in other companies. Investments may also be made by setting up a completely new business.*

If you answered of all the questions correctly, well done! If not, review the topic.

Now proceed to the topic summary.

Topic 2: Summary

We have now concluded Topic 2. In this topic we took a detailed look at commercial banks, their functions and services.

We established that commercial banks are profit seeking organisations whose key functions include the provision of safe custody of money and valuables, provision of means of payment as well as lending money.

We further looked at services offered by commercial banks in addition to the key functions. The services offered included provision of night safe facilities, discounting bills of exchange and acting as executor and trustee.

We hope you were able to do all the activities in this topic correctly. If not, read through the topic again and make sure you understand the content before proceeding to the next topic.

You should also do the Topic 2 Exercise in the assignment section of this unit before proceeding on to the next topic. The exercise is designed to help you review the topic. The answers to the Topic 2 Exercise are given just below it. Avoid the temptation to refer to our answers before providing your own.

In the next topic, we shall examine the operations of different bank accounts. We shall also discuss advantages and disadvantages of different bank accounts.

Topic 3: Operations of Different Bank Accounts

Introduction

Welcome to Topic 3 on operations of bank accounts. In Topic 2, we discussed commercial banks, their functions and services. We learnt that commercial banks provide a wide range of services to their customers. Among the key functions discussed were providing safe custody of money (cash)/valuables and means of payment as well as lending of money.

We further looked at other services offered by commercial banks which included the provision of night safe facilities, discounting bills of exchange and acting as executor and trustee.

In this topic, we shall examine the operations of different bank accounts. The topic will also tackle the advantages and disadvantages of each type of bank account. It will address the last two outcomes of the unit.

Upon completion of this topic you should be able to:

Topic Outcomes

- *Explain* the operations of different types of bank accounts.
- *Discuss* the advantages and disadvantages of different types of bank accounts.

Time

You should spend at least 6.5 hours on this topic.

In Topic 2, we learnt that keeping money at business premises or at home is very risky as the money may be stolen, destroyed by a fire or a natural disaster like a flood. For this reason, commercial banks keep their customer's money safe by opening bank accounts for them.

Before we look at different bank accounts, it is important for us to understand the meaning of the phrase "bank account". What do you think is meant by this phrase? You probably know a **bank account** as a record of financial transactions between the account holder and the bank. According to the Macmillan English Dictionary for Advanced Learners (2002) a bank account is "an arrangement that you have with a bank that allows you to keep your money there and to pay money in and take money out". With this arrangement, bank customers can keep money in a bank or other financial institution and in exchange receive financial services. Remember, to keep money in a bank, the customer must open a bank account.

Do you know the procedure for opening a bank account? You probably have one already. In case you don't, the following is the procedure for opening a bank account:

Opening a Bank Account

Opening a bank account is easy, all one needs to do is:

- Fill in an application form giving personal details such as your name, occupation and address.
- Provide evidence of identity such as a national registration card. Passports and driving licences may also be accepted.
- Sign a signature card. On this card the signature is of great significance as it helps the bank verify the signature whenever withdrawals are being made.
- Provide references or recommendations from people that have known you for some time. For a savings account, a letter from your employer will do. A call account may only require a letter from you, the applicant.

In addition to the requirements above, some banks request that customers produce passport-sized photos.

Although we have different bank accounts, there is no big difference in the way these accounts are opened.

Once you provide the bank with everything they need and they are satisfied with the details on the application form and signature card, your account will be opened. The bank assigns a number to your newly opened account.

The banks provide several types of accounts to cater to all our needs. It is advisable for one to know the type of account they are about to open thoroughly and how it operates. Let us now examine different types of bank accounts available.

Types of Bank Accounts

As stated above, different bank accounts are available. The kind you open will depend on your reasons for opening it and the amount involved. Why open a bank account? One may open a bank account to save money and earn interest while another person may do it to keep money safe and at the same time have easy access to it.

Figure 5 shows three main types of bank accounts.

Figure 5 showing three main types of bank accounts. Created by Commerce Team, ZACODE, 2010.

Different banks may use different names to refer to these bank accounts. However, as you study this topic, you will realise that although different names are used by banks, the majority of bank accounts that we know are either current, savings or fixed deposit accounts. It is important to note that with the latest changes in banking, hybrid bank accounts now exist in the banking industry. A **hybrid account** refers to any account that combines features of two or more accounts. One such account is a NOW account which we shall discuss later in this topic.

Let us start with the current account.

Current Account

A **current account** is an account from which money can be accessed immediately by a bank customer. This means that as a current account holder, you can withdraw any amount of money at any time during the bank's working hours. There is no limit on the amount and number of withdrawals. You may recall that when the bank collects surplus funds from their customers, they keep it for them. In effect, the bank borrows from their customers and uses this money to lend to other people. For allowing the bank to use their money bank customers receive interest on their accounts.

However, a current account holder does not receive any interest. You may be wondering why this is so. The answer has already been given above. The reason is simply because the account holder does not give the bank a chance to use the money as they are allowed to withdraw any amount money at any time. So instead, charges are made by the bank for the services provided. These charges are called **ledger fees** or bank charges. There are some banks that offer a low rate of interest on money left in a current account.

Naturally, current accounts offer a wide range of services ranging from cheques to overdrafts. You may recall from Topic 2 that a current account customer may be allowed to withdraw more money than what is in their account up to an agreed limit. We called this kind of arrangement an overdraft

In addition, facilities like standing orders, direct debits, credit transfers and many others can also be enjoyed on this account.

Withdrawing money from this account requires the use of a cheque. This is the main reason why upon opening a current account, one is issued with a cheque book. A **cheque book** contains a number of cheques leaves. Customers issue a cheque leaf each time they want to pay someone or draw money from the bank.

How then is money deposited into this account? Well, a paying-in-slip is used. Like cheque leaves, paying-in-slips are taken from a book. This book is called a **paying-in-book**.

As a current account holder, you need to have a record of your banking activities. To provide this record, the bank issues a bank statement monthly or quarterly. In essence, a bank statement is a summary of the transactions that took place between you and them. We will learn more about cheques and bank statements in the next unit.

Current accounts are common among individuals and businesspersons. You may know them as checking or transactional accounts.

So far, you have seen that a current account does not earn interest. But, there are bank accounts that earn interest. A saving account is one such account.

Savings Account

What do you think when you hear the word saving? Depending on its usage, the word saving might mean:

- Rescuing something or someone from danger,
- Spending less on something or
- Setting aside money for future use.

In this context, we are using the word to mean setting aside money for future use. People set aside money for different purposes. One might save for their children's school fees. Yet another might set aside money to buy equipment. Irrespective of the purpose, money set aside for future use earns extra money at a given rate. This extra money is called interest.

A savings account is the most common bank account for personal savings. This type of bank account is suitable for individuals who want to save small amounts of money for future use and earn interest. While a current account does not require a minimum balance, a savings account requires a low minimum balance.

Since money set aside for future use should earn interest, some banks restrict the number of withdrawals and the amount to be withdrawn in a given period. This does not only give the bank an opportunity to use the money, but also helps the depositor to grow their money through interest.

However, with new developments in banking, the limit on withdrawals no longer holds. Money can be withdrawn from a savings account as often and as much as one likes through the **Automatic Teller Machine** (ATM). It is important to note that withdrawals from this account are not made by cheque. Instead, **withdrawal slips** are used. Equally, deposits are not made by paying-in-slips, but **deposit slips**.

When a person opens a savings account, they are issued with a savings or pass book which they must present to the bank when depositing or withdrawing money. As with a bank statement, a pass book records deposits, withdrawals and interest. In Zambia, pass books are slowly being phased out of the banking system. What is common nowadays, are bank cards bearing a customer's account number. Where pass books are not used, bank statements are issued to customers on request.

When a customer decides to have their money kept safely for a specific period of time, a fixed deposit account may be opened. Let us discuss this type of account.

Fixed Deposit Account

A fixed deposit account is an account where large sums of money not required immediately can be kept safely for a specific period like three months, six months or one year depending on the bank. In short, it has a long investment period. This means that money cannot be withdrawn from this account until the period comes to an end. The rate of interest paid on fixed deposits is usually higher than the other types of bank accounts. In addition to this, the interest paid on this account depends on the maturity period. The usual trend is that, the longer the maturity period, the higher is the rate of interest to be paid.

Nevertheless, if one decides to withdraw the money on demand, the bank charges a penalty fee. Some banks deliberately allow customers to withdraw money on demand as a way of making money through penalties.

Like a savings account, a fixed deposit account earns interest. On the contrary, interest rates on fixed deposit accounts are fixed for a period and higher than those for savings accounts. Remember, whenever interest is given by the bank, no bank charges or ledger fees are charged.

When the period comes to an end, the depositor is paid their money and interest in full. At this point, the account holder has a choice to either reinvest (re-deposit) the money for another period or to use it immediately. There are banks that allow their customers to withdraw the interest only leaving the investment capital in the account for another period. While you may know this account as a fixed deposit account, others call it a time deposit account. Yet others know it as term deposit.

You may be familiar with this type of account. You probably have one running already.

There are several benefits that one can get in operating these bank accounts. Figure 6 below gives the advantages of operating current, savings and fixed deposit accounts.

Advantages of operating current, savings and fixed deposit accounts

CURRENT ACCOUNT	SAVINGS ACCOUNT	FIXED DEPOSIT ACCOUNT
- Provides immediate access to funds. - Offers overdraft, standing orders, credit transfers, direct debits and other banking facilities. - Cheques are used to withdraw money or make payments and the same cheques provide evidence of payment. - Bank transfers through standing orders, direct debits saves the account holder's time and trouble of depositing cash or cheques by themselves. - No minimum balance is required. - Through bank statements, customers are kept informed about their banking activities. - Cash can be withdrawn throughout the country from branches and ATMs.	- Money can easily be accessed. - Interest is paid on this account. - Money can be withdrawn from an ATM and goods can be bought from traders with POS terminals. - It enables people to invest within their means as it carters for small savers. - It requires a low minimum balance. - Cash can be withdrawn throughout the country from branches and ATMs.	- It is a safe investment. - No ledger fees are charged. - It has a higher interest rate compared to savings accounts. - The customer knows in advance what their earnings will be at the end of the period. - The customer makes their own choice on how to use the interest. - A customer can choose an investment period of their choice to suit their financial needs.

Figure 6: The advantages of the current, savings and fixed deposit account. Created by Commerce Team, ZACODE, 2010.

Now re-examine the advantages of current, savings and fixed deposit accounts above and see if you can come up with disadvantages.

Activity 10

1. What do you think are the disadvantages of:
   a) Current accounts?
   b) Savings accounts?

   Write them down in the space provided below if you are working alone.

   If you are working in a group, identify the disadvantages, write them on a piece of paper and discuss them with members of your group.

Feedback

Well done! Your ideas may be similar to those provided in our feedback below

1. *You may have thought of the following disadvantages for a:*

   a) Current Account

   - *No interest is given. Instead, ledger fees are levied on this account. Ledger fees may be higher where quite a lot of transactions are made by the account holder.*
   - *Cheques are not legal tender. A creditor may refuse to be paid by cheque, especially personal ones.*
   - *Interest is charged on overdrawn amounts.*

   b) Savings Account

   - *A lower rate of interest is given compared to a fixed deposit account.*
   - *Cheque books are not provided to savings customers. This means that an account holder without an ATM card must physically go to the bank to withdraw cash whenever they need money to pay someone or buy something.*

You may have come up with other disadvantages not included in our feedback. As long as the information was obtained from a reliable source that is fine.

Like other bank accounts, a fixed deposit account has disadvantages. One of the major disadvantages of fixed deposit account is that the account holder is not allowed to withdraw money until the investment period is over. This means that even if the money is needed for an emergency it cannot be withdrawn. Even when the account holder is allowed to withdraw money before the maturity date (investment period) there is a penalty fee.

The other problem is that although the account earns a higher interest compared to other bank accounts, the earnings are far much less than those from other investments like securities. In addition, interest rates may be affected by inflation.

We have seen that one problem of a fixed deposit account is that as an account holder, you do not have access to your money until the investment period is over. You can overcome this problem by opening a

Premium Deposit Account or Call Account. These two accounts would provide you with a higher interest and immediate access to your money.

What is a Premium Deposit Account?

To get a clear understanding of what a premium deposit account is, we will start by defining the word 'premium'.

Activity 11

1. In your own words define the word 'premium' in the space provided below.

2. Now use a dictionary and compare your answers with what is in your dictionary.

Feedback

Your answers may have included any of the following:

1. *Money paid for insurance.*
2. *An amount of money paid in addition to a regular price, rate, wage or any other amount.*
3. *An amount beyond a nominal value at which something sells.*
4. *A reduction in price or a gift offered as an encouragement to buy another product or service.*

As you compared your answers with those in the dictionary, you may have come up with other answers, which is fine.

In this topic, we are using the word to refer to an additional amount of money paid as a top-up to a regular price, rate, wage or any other amount.

We can therefore define a **premium deposit account** as a type of deposit account in which money can be deposited to earn additional interest. In order for an individual to earn interest and avoid ledger fees, they must maintain a minimum balance.

Very high value personal account customers, associations or clubs may find this account convenient as they can get quick service just like current account customers.

A premium deposit account also gives the account holder immediate access to their money hence, they do not need to worry about penalty fees. There is also no limit on the amount and number of withdrawals per day; one can withdraw any amount as often as they desire.

As an account holder, you have several benefits to enjoy from a premium deposit account. Here are some of the advantages:

Advantages of a Premium Deposit Account

- Your account can yield an increase in interest annually at current rates.
- No ledger fees will be charged on this account.
- You have immediate access to your money at no extra cost.
- There is no limit on the amount and number of withdrawals you can make per day.
- You are assured of quick service just like current account holders.
- You can make cash withdrawals or deposits at any ATM and buy goods and services from traders with POS terminals.

On the other, a premium deposit account has the following disadvantages:

- It is restricted to high value customers, clubs and associations.
- Unless one maintains a minimum balance, no interest will be given.

Another account that provides an account holder with a higher interest and immediate access to their money is a call account.

What is a Call Account?

A call account is an investment account designed for people who want to deposit larger sums of money in order to earn a higher rate of interest. Any person with large sums of money not required immediately may find call accounts beneficial. The account is available to both business persons and individuals.

Normally, interest is paid on the monthly balance. Even if one has put money in the account for a short period of time, interest will still be paid on the monthly balance. Many banks pay tiered interest rates on the amount of deposit. Tiered interest rates are interest rates that depend on the size of deposit. This means that the more money one deposits, the higher the interest rate as illustrated in Figure 7 below.

***Figure 7: Illustrating the concept of tiered interest rates* Created by Commerce Team, ZACODE, 2010.**

You can see from Figure 7 that the more money one deposits in a call account, the higher the interest rates.

With this account, a business gets the benefit of having easy access to their money which can enable them to effectively manage their cash flow. This means that a business can withdraw money at any time without notice and be able to pay their daily business expenses. However, depending on the bank, some call accounts require at least two days notice of withdrawal.

As a call account holder you have benefits to enjoy. Firstly, you will not be required to pay ledger fees on this account. Secondly, you can arrange with the bank to transfer funds electronically from this account to your current account and vice versa. Lastly, you may also enjoy loan facilities whose security is the account itself. You may recall that in Topic 2, we saw that one of the requirements by the bank when granting a loan is collateral security. We defined collateral security as any valuable asset against which a loan will be granted for example a house, farm, shop or any immovable asset. With a call account, no such assets are pledged against a loan. The account itself acts as the asset.

We mentioned earlier in this topic that there are accounts that have a combination of features. An account we particularly mentioned was a Negotiable Order of Withdrawal (NOW) Account. We shall now examine this account.

Negotiable Order of Withdrawal (NOW) Account

You may have wondered why some people with what you perceive as savings accounts are able to draw cheques. In spite of these drawings, they still earn interest on their accounts. This is because their accounts serve as savings as well as current accounts. They are a hybrid between a savings and current account. In reality, a **Negotiable-Order-of-Withdrawal (NOW)** account "is an interest-bearing checking account that pays interest on the balance". (The Free Dictionary).

With this account, you can write negotiable orders of withdrawal to transfer money from your account to another. As long as a minimum balance is maintained on this account, the account holder will not face any penalties. Neither will they lose. The most important benefit of a NOW account is that the balance earns interest.

While an individual or business may open a bank account in their personal capacity, it is also possible for two or more individuals with common interests to open an account jointly. We shall now briefly discuss a joint account.

Joint Account

An account opened by two or more people is called a joint account. Joint accounts may be opened by people with common interests.

Reflection

Think of people in your area that may open a joint account.

Is a joint account for individuals or business persons?

You may have thought of family members such as husband and wife and others as well as partners in business. Thus, a joint account can be opened by both individuals and business persons.

People who operate joint accounts find them suitable as they enable each party to deposit or withdraw money on behalf of the other. This gives them full access to their money. A high degree of honesty is required from each party. For this reason, many banks require at least two signatories for joint accounts especially when withdrawing money. Why? This is done to ensure that no party withdraws money from the account without the knowledge of the other. More often than not, whichever party is depositing the money signs the deposit slip. It does not necessarily need to be signed by the two people.

Besides, when opening a joint account one must ensure that they are opening one with a person they trust. With husband and wife this may not be as serious as it may be with business partners. Where a business partner has no trust in the other, operating a joint account may become difficult, if not impossible.

You now have an idea on the operations of bank accounts. However, it is important to note that the operations may vary from bank to bank.

Now, read the following case study and answer the questions that follow.

Activity 12: Case Study

Gloria and her friend Faith wish to open bank accounts. Gloria gets a small regular income. However, she decides to open an account to enable her save for her daughter's school fees.

Her friend Faith is in business, she owns the biggest restaurant in town and has a big workforce. She intends to buy a truck to be used for deliveries. The funds she has so far made are not adequate to enable her buy the truck immediately. She hopes that in six months time, she should be able to raise enough funds. However, the amount she has is sufficient enough to enable her open two different bank accounts.

The two friends approach you for advice.

1. Which bank account would you advise Gloria to open?
   Give reasons for your answer.
2. Which document would Gloria use to withdraw money from her account?
3. Which bank accounts would you advise Faith to open? Give reasons for your answers.
4. If Faith is reluctant to open two bank accounts, which account would you advise her to open?
5. Why would you advise Faith to open the account in question 5 above?
6. What happens when a fixed deposit account holder withdraws money before the investment period comes to an end?
7. Why does the bank charge ledger fees on a current account?

Compare your answers with those provided in our feedback below.

Feedback

1. ***Savings account*** *because she is a small saver. By opening this account, Gloria will be able to save money for future use and earn interest. She will require a low opening and minimum balance.*
2. ***Withdrawal slip***
3. ***Current and fixed deposit accounts***

   Current account *because she needs easy access to her money. As a business person, she has to withdraw money at any time. When in financial need, she can agree with the bank to overdraw her account.*

   Fixed deposit account *because it has a long investment period and earns a higher rate of interest. When the investment period comes to an end, Faith can withdraw her money (capital) together with the interest and buy the truck.*
4. ***Call account***
5. *Because:*
   - *a) She will not be required to pay ledger fees on this account.*
   - *b) She can arrange with the bank to transfer funds electronically from her call account to her current account and vice versa.*
   - *c) She may also enjoy loan facilities whose security is the account itself.*
6. *They are charged penalty fees.*

Congratulations for doing such a great job! If you experienced any difficulties in doing this activity, review the topic before moving on to the topic summary.

Tips!

To obtain more information on this unit:

Where possible:

- Visit the central and commercial banks.
- Visit libraries to research on these business units.
- Attend tutorials at a study centre and discuss with other learners and tutors.

Topic 3: Summary

We have now come to the end of Topic 3 of this unit where we examined the operations of different bank accounts. This is the last topic in this unit. In this topic, we saw that for one to keep money safely in the bank, they must open a bank account. In this regard, we looked at what it takes to have a bank account opened. We also looked at different types of bank accounts available. Among them were current, savings, fixed and call deposit accounts. We futher examined the advantages and disadvantages of each type of bank account. We established that bank accounts like current, savings, call and premium deposit accounts provide immediate and easy access to cash and enable people to withdraw cash throughout the country through branches and ATM. We also saw that some bank accounts require a minimum balance, which in some cases may be high.

You had a chance to check your understanding through the activities given in this topic. We hope that you were able to do all of the activities in this topic and that did them correctly. If not, review the topic and make sure understand the concepts before proceeding to the Topic 3 Exercise.

Now go to the assignment section of this unit and do the Topic 3 Exercise. The exercise is there to help you review the topic. You will find the answers to the Topic 3 Exercise just below it. Avoid the temptation to refer to our answers before providing your own. If you experienced any difficulty in doing this exercise, review the topic once more.

Once you have completed the topic exercise, read the unit summary below to remind yourself of the contents of this unit.

Unit Summary

Unit Summary

In this unit you learnt what banking is.You also learnt about different types of banks and financial institutions and what they are involved in. The banks discussed ranged from savings to central banks. Financial institutions covered included building societies, insurance companies, credit unions, microfinance institutions and others.

The unit gave a detailed account of the central bank which is the principal bank in a country. You also learnt that in Zambia, the central bank is the Bank of Zambia and that it has offices in Lusaka and Ndola. Its functions include among others: the issuing of bank notes and coins, monitoring and controlling all the activities of banks and financial institutions in a country, being the bankers and government bank, acting as chief financial advisor and monitoring and managing the national debt.

The unit further enlightened you on the commercial banks and their functions. You now know that a commercial bank is a financial institution which offers a wide range of financial services and thus it is sometimes referred to as a 'full service' financial institution. The functions and services offered range from keeping money and other valuables safe to lending money and to providing debit and credit cards. You are now also familiar with what bank managers take into consideration before granting a loan.

In addition, you are more familiar with different types of bank accounts, their operations, advantages and disadvantages.

It is necessary that you compare or relate what you have learnt in the unit to your own situations in your area.

Now go back to the outcomes at the beginning of this unit and review them again. Have you achieved them all? If there are any outcomes that you are not sure about, refer to the relevant section or write to your tutor for clarification. If you have achieved all the outcomes, take a short break when you finish reading this summary.

We have come to the end of the unit and once you are ready, you can do the self-marked assignment given in the assignment section below. Remember, this is a self-marked assignment. A tutor-marked assignment will be given in Unit 9. After you have answered all questions, compare your answers to those provided in the feedback which you will find below the assignment. If your answers were correct, congratulations! You can proceed to the next unit. If some answers were not correct, you can review the unit and make sure you understand the relevant sections.

In the next unit: Banking 2, we shall examine documents used in the operations of bank accounts. We shall also explore the cheque as a means of payments.

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Assignment

Assignment

Topic 1 Exercise

1. State whether the following are true or false.
   a) Banking is a place where money is kept safely and withdrawn when needed.
   b) Financial institutions are organisations which offer monetary services.
   c) A savings bank is not a financial institution.
   d) National Savings and Credit Bank (NATSAVE) was established in 1972.
   e) The central bank controls all the activities of financial institutions in a country.

2. What do you understanding by the 'term' banking?
3. Discuss the functions of the Bank of Zambia.

Topic 2 Exercise

1. Use one word or phrase to describe the following:

   a) Financial institution offering a wide range of banking services.

   b) Money borrowed from a bank for the purpose of meeting capital needs such as buying machinery.

   c) Selling a bill of exchange to a bank for an amount slightly lower than what is on it.

   d) Bank service which allows customers to deposit money at night, after normal banking hours or holiday.

   e) Short term finance given to a customer to enable him to meet the day-to-day expenses e.g. buying stock, paying water and electricity bills.

2. State at least five considerations the bank manager would consider before granting a loan

Topic 3 Exercise

Answer all the questions:

1. Which bank account allows the holder to draw money using a cheque, but does not earn interest?

2. In which account is money kept for a fixed period at a fixed interest?

3. Using a table, distinguish between a current and fixed deposit account.

Feedback

The following are the answers to the Topic 1 Exercise:

1. *a) False*
   b) True
   c) False
   d) True
   e) True

2. *Functions of the central bank:*

   a) Issuing bank notes and coins
   The central bank is responsible for printing bank notes and minting coins. Minting is the making of coins from metal. In addition, the bank ensures that the bank notes and coins printed and minted go into circulation to replace old torn and dirty notes. When bank notes and coins are dirty, the central bank removes them from circulation and destroys them.

   b) Maintaining the government account
   The central bank looks after government's money by maintaining an account for them. It is in this account that revenues collected by government such as taxes and profits from parastatals are deposited. Expenses like rent, electricity, wages and salaries and many others incurred by government departments are also paid from the same account.

   c) It is a banker's bank
   The central bank is a bank for all commercial banks in a country. All commercial banks are required by law to open bank accounts with the central bank to enable them keep their reserves in the bank which they use offset interbank debts. The offsetting of debts is done by debiting the account of the bank owing and crediting the account of the bank receiving the amount owing. These debts arise from the clearing of cheques.

The following are the answers to the Topic 2 Exercise:

1. a) *Commercial Banks*
   b) Loan
   c) Discounting a bill
   d) Night safe facility
   e) Overdraft

2. ***Five considerations to be made by the bank manager before granting a loan:***

   a) The credit worthiness of the customer
   b) The amount needed
   c) The period of repayment
   d) The purpose of the loan or overdraft
   e) The type of collateral security offered
   f) The government policy with regards to bank lending
   g) The profitability of the business to be undertaken

   (Any five)

The following are the answers to the Topic 3 Exercise:

1. *Current account*
2. *Fixed deposit account*
3. *Differences between current and fixed deposit account:*

Cheques are used to withdraw money from the account.	Withdrawal slips are used to withdraw money while deposit slips are used for depositing money.
Money can easily be accessed.	Money can only be accessed after the investment period is over.
No penalty fee is charged if money is withdrawn on demand.	A penalty fee is charged if money is withdrawn on demand (before the end of the investment period).
No interest instead ledger fees are charge for operating a current account.	No ledger fees are charged, instead a higher rate of interest is given.
Allows a customer to overdraw (obtain an overdraft).	Customers are not allowed to overdraw.

Assessment

Self-Marked Assessment 4

The assignment has two parts A and B. You are required to answer all questions in both sections.

Part A: This part contains ten multiple choice questions.

Choose the *BEST* answer.

1. Two accounts that provide one with a higher interest and immediate access to your money are:
   A. Savings and current account.
   B. Current and fixed deposit account.
   C. Joint and premium deposit account.
   D. Call and premium deposit account.

2. A current account.............
   A. earns interest.
   B. does not earn interest.
   C. earns a high rate of interest.
   D. earns the highest rate of interest.

3. On which of the following accounts can an overdraft be allowed?
   A. Savings account
   B. Call account
   C. Fixed deposit account
   D. Current account

4. An arrangement with a bank that allows one to keep money, pay money and withdraw it is called a ....
   A. Bank account
   B. Credit transfer
   C. Bankers draft
   D. Standing order

5. Any valuable asset against which a loan can be granted is called: ....
   A. Property
   B. Loan asset
   C. Collateral security
   D. Overdraft

6. A credit freeze is ....
   A. a complete ban by government on lending
   B. a complete ban on banking
   C. a partial ban on lending
   D. a partial ban on banking

7. A directive by government to financial institutions to reduce amounts they lend to their customers is a: ....
   A. Debit freeze
   B. Credit freeze
   C. Credit squeeze
   D. Debit squeeze

8. A is a financial institution which lends money to those wishing to buy or build houses the provision of financial services to individuals and businesses.

   A. Credit union
   B. Commercial bank
   C. Central bank
   D. Building society

9. An executor is a ....
   A. Person or institution named in a will to carry out it instructions.
   B. Person that benefits from a will.
   C. Bank that benefits from a will.
   D. Person whose property is looked after by the bank.

10. Financial institutions which provide loans to their members only at lower rates of interest are called …………………..

   A. Building societies
   B. Development banks
   C. Credit union
   D. Micro-finance institutions

PART B: Answer all the questions

1. What do you understand by the term banking?
2. Name two valuable documents that can be kept by the bank on behalf of their customer.
3. What is meant by the term 'national debt'?
4. Name at least three valuable assets that may be used as collateral security.
5. Why do banks issue cheque books to current account holders?

Self-Assessment Feedback

Part A

1. D

2. B

3. D

4. A

5. C

6. A

7. C

8. D

9. A

10. D

Part B

1. *Banking is the process of providing financial services such as accepting deposits, lending money and providing means of payments to individuals and businesses.*
2. *Share certificate, title deed and or insurance policy.*
3. *The term 'national debt' means the total debt, that is, the total amount the government owes as a result of borrowing.*
4. *A house, farm, or shop.*
5. *Banks issue cheque books to current account customers to provide them with cheque leaves which can be used to withdraw money or pay people from their account*

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 8

Banking 2

Introduction

Welcome to Unit 8 of Grade 11 Comerce on banking. This is a continuation of Unit 7 which also dealt with banking. In Unit 7, we defined banking and discussed the different financial institutions like building societies, commercial banks, central bank etc. We further discussed the functions and services of commercial banks and the operations of different accounts.

In this unit, we are going to discuss the documents that are used for different accounts. These are the documents that are used in our everyday transactions with our different banks. We will also discuss the means of payment used in banking, but we will specifically discuss the cheque. The other means of payment will be discussed in Unit 9.

Banks are found in almost all of towns in Zambia. Some banks have even opened branches in the rural areas of our country. This is because business activities are on the rise in all areas of our land and our economy is growing. Business activities involve money. Therefore, they can only be easily done if there are documents that can be used for all the happenings or transactions that involve money in the bank.

In Unit 7 we said that in Zambia (just like in any other country in the world) banking is an aid to trade that plays a pivotal role in financial and monetary aspects in every area of business. You also learned about banking during your Junior Certificate course in Office Practice.

We are aware that cash amounts are not always used to make payments. There are many other safer ways of making payments and hence the need for us to learn about them.

This unit is divided into two topics. In the first topic we will discuss documents used for different accounts. The second topic will deal with means of payment, specifically: the cheque.

We trust that you will enjoy working through this unit.

Upon completion of this unit you will be able to:

Outcomes

- *Identify* the documents for different accounts.
- *Use* the documents.
- *Discuss* means of payment through the bank, specifically the cheque.

Timeframe

How long?

You will need between 16 and 20 hours to study this unit. This means that you will need between 8 and 10 hours to study each topic. This time includes reading and working through all the given activities. Do not worry if it takes you more or less time than this – we do not all work at the same pace.

Learning Resources

Tip

These materials are self-instructional and interactive. You will need to have a pencil to do the activities found in the unit. You will also need some financial resources to carry the following activities:

- Visit banks to research on documents used in banking.
- Attend tutorials at study centres and discuss with other learners.

Learning and Teaching Approach

Tip

There are different ways of learning and teaching, however, in this unit we will use the following approaches to learning and teaching.

- **Content based approach** - We want to encourage you to base your learning on the subject matter provided, to improve your skills and competencies in banking and to give you instructions to help in your learning.

- **Problem-based approach –**We want to encourage open-minded, reflective, critical and active learning. We also want to encourage the development of commercial thinking. The problem-based approach respects the fact that both you and the teacher have knowledge and understanding on banking. You will therefore be expected to use this knowledge and understanding in your interaction with the content and the activities in this unit.

- **Activity-based approach -**To help you develop skills and understanding of banking in the cognitive, psychomotor and affective domain and to develop general learning skills as you interact with people and content. The activities that you will find in this unit are meant to encourage such interaction. It is important to discuss these activities and the content of this unit with other learners and your tutor at the learning centre. These discussions will enable you to find immediate solutions to your study problems, broaden your knowledge and break the isolation you may experience as a distance learner.

Terminology

Standing order:	A service or facility for making fixed regular payments on particular or fixed dates.
Direct debit:	A service or facility for meeting varying payments at varying intervals.
Refer to drawer:	The cheque returned to the drawer by the payee because the bank has refused payment.
Drawee:	The bank on which the cheque is drawn.
Payee:	A person or firm that receives payment.
Negotiable instrument:	A document that can be transferred from one person to another by way of endorsing.
Dishonoured cheque:	A cheque which the bank refuses payment.

Topic 1: Documents for Different Accounts

Introduction

In this topic, we will discuss the documents used in the operation of different bank accounts.

These documents are all available in the bank to provide customers with an effective and efficient service. You are also aware that the banks provide their customers with different types of bank accounts that we discussed in Unit 7. Some examples of these bank accounts are: the saving account, fixed deposit account, current account and a lot more.

Let us begin by looking at the topic outcomes.

Outcomes

By the end of this topic you should be able to:

- *Identify* the documents for different accounts.
- *Use* the documents.

Time

You should spend at least 10 hours on this topic.

Documents Used in the Operation of Different Bank Accounts

There are a number of documents used in operating different bank accounts. Remember in Topic 1 of Unit 7, we learnt that banks provide a safe place for keeping money and can provide security. You will notice that each of the documents that we are going to discuss has been put in place by banks, for the purpose of providing security for their customers' money.

Activity 1

Do you know of any of these documents? List down your ideas in the space below:

Feedback

Your list of documents might have included the ones listed below:

- *Bank statement*
- *Passbook/savings card*
- *Withdrawal slip*
- *Deposit slip or credit slip*
- *Cheque*
- *Paying in slip*

Let us discuss them one after the other. We will start by looking at the bank statement.

Bank Statement

A bank statement is a document which gives a detailed list of transactions that take place between the customer and the bank. Current account holders receive bank statements from the bank regularly. The bank statement is usually sent together with cheques that have already been paid by the bank. It gives the following information:

- The opening balance.
- Cheques paid.
- Bank charges (if any).
- Credit transfers, standing orders and direct debits.
- The closing balance (the money remaining in the customer's account).

Let us look at an example of a bank statement below.

The bank statement was prepared using the following information: Mr. Maamba Chibwa operates a current account with BENG Bank and on 2nd June, 2009 he received a bank statement.

Bank Statement No. 0089

BENG BANK

Luanshya Branch

Date: *1st June, 2009*

Chibwa Magamba

Box 91010

Luanshya

For the period: *1st May – 31st May 2009*

Date	Details	Debit (Withdrawals)	Credit (Deposits)	Balance
		K	K	K
1/05/09	Balance b/f			1 500 000
01/05/09	CHQ No. 45013	1 600 000		100 000 O/D
05/05/09	Bank charges	100 000		200 000 O/D
06/05/09	Cash		4 500 000	4 300 000
15/05/09	Electricity company DD	300 000		4 000 000
28/05/09	Lions Club SO	200 000		3 800 000

This bank statement does not include transactions made after 31st May 2009

Abbreviations:

CHQ – Cheque, SO – Standing Order, DD – Direct Debit, CT – Credit Transfer

Figure 1: An example of a bank statement. Created by Commerce Team, ZACODE, 2010.

Let us go through the transactions on the statement together. The statement above indicates that on:

1st May 2009, there was K1 500 000 in Mr. Maamba's account. On the same date the bank paid John Lee, cheque no. 45013 for K1 600 000.

5th May, 2009 the Bank charged Mr. Maamba K100 000 for maintaining his account.

6th May, 2009 Mr. Maamba deposited K4 500 000 cash into his account.

15th May, 2009, a direct debit of K300 000 for electricity was paid to the electricity company by the bank.

28th May, 2009, a standing order of K200 000 for club subscriptions was paid to Lions Club by the bank.

You should take time to analyse the bank statement above and see how each entry was made and what effect it had on the balance.

On 1st and 5th May, the account was overdrawn. That is why there is an abbreviation O/D at the end. O/D stands for Overdraft. To overdraw means to get more money than what you have in your account. This can only be done by getting permission from the bank.

Note it!

Let us bear in mind that any customer who has an account with a bank, not only a current account holder, can request a bank statement from their bank. Do not worry about the terms standing order, direct debit and credit transfer that are written in the bank statement. We will discuss these in our next unit. However, we will look at the meaning of each of them below.

A **standing order** is a service that is used to make regular payments at fixed dates, for fixed amounts. **Direct debit** is a service used to make regular payments for varying amounts of money and at varying times. A **credit transfer** is a service which is provided to current account holders in order to allow them to make regular payments directly into the payee's account.

Now that we have discussed what a bank statement is and seen how entries appear on it, let us now discuss other documents. Specifically, the pass book or savings card and withdrawal slip.

Pass Book/Savings Card

A **pass book** is a document which is issued to a person who has a savings account at the bank or any other financial institution. Nowadays, pass books are rarely used. Instead, customers are issued savings cards. Where the pass book is issued, it is used for recording deposits, withdrawals and interest. It operates on the same principle as the bank statement. Where the savings card is used, deposits and withdrawals are recorded on a bank statement which is sent to the customer regularly.

Withdrawal Slip

A **withdrawal slip** is a document which is used when withdrawing money from a savings account. Withdrawal slips do not appear the same at all banks; they vary from bank to bank. Figure 2 below shows an example of an unfilled withdrawal slip from BENG Bank.

Withdrawal slip

BENG BANK

____________________________ Branch

Date _______________

Name of Account Holder____________________________________

____

Debit A/C No.

With the sum of _____________________________

____

K

Signature _____________________

Figure 2: A withdrawal slip. Created by Commerce Team, ZACODE, 2010.

To withdraw money from a savings account, one is required to fill in a withdrawal slip. Figure 3 is a picture of savings account holders withdrawing money at a bank.

The two ladies shown in the picture are bank customers and the two men are bank tellers.

Figure 3: Customers withdrawing money at a commercial bank. Created by Commerce Team, ZACODE, 2011.

You can now do the activity below before we proceed. It will help you assess your understanding of what you have learnt so far.

Activity 2

Imagine that you are the owner of Account No. 26758019 with a bank and you want to withdraw K200 000 from your account. Fill in a withdrawal slip like in Figure 2.

Feedback

The steps that you might have followed when filling in the withdrawal slip above may have been:

- *To enter the name of the town where your account is. For example, if your account is at BENG Bank in Luanshya, indicate on the provision as shown in the completed deposit slip below. If you stay in a big town like Lusaka, your bank may have a lot of branches in different areas of town. In this case, you have to be specific and indicate the exact area where the branch you have an account with is. For example, Cairo Road Branch (Cairo Road being the area).*
- *Indicate the date that you are making the withdrawal.*
- *Write down your name where it asks for the name of account holder.*
- *Write your account number in the boxes provided where it says debit account (A/C) number (No.).*
- *Write the amount you want to withdraw both in words and figures as shown below.*
- *Finally, write your signature in the space provided.*

Your completed withdrawal slip will appear as the one given below.

Withdrawal slip

BENG Bank

Luanshya Branch

Date *6 th February 2011*

Name of Account Holder *Enerst Mwalileni*

Debit A/C No.

2	6	7	5	8	0	1	9

With the sum of *Two Hundred thousand kwacha*

K*200 000*

Signature *E Mwalileni*

Figure 4: A completed withdrawal slip. Created by Commerce Team, ZACODE, 2011.

We have discussed the bank statement, pass book, savings card and withdrawal slips. Let us now proceed and look at other documents used in the operation of different bank accounts.

Deposit Slip or Credit Slip

This is a form used to deposit money into a savings or deposit account.

Cheque

This is a document used to withdraw money from a current account. It is defined as a written order to a bank to pay a named person a specified sum of money. Cheque books are issued by banks to a person who has opened a current account and they come in different sizes. We are going to discuss the cheque in detail in Topic 2.

Paying - in - Slip

This is a slip used to deposit money into a current account. The paying-in-slip is handed together with the cash and or cheques to the bank clerk over the counter. This slip is usually completed in duplicate. One copy is kept by the bank for their records and the other copy is handed back to the customer. Other banks may also use printed slips signed by both parties (the customer and the bank clerk).

Activity 3

Answer the following questions. These will help you to assess your understanding of what you have learnt so far.

1. Fill in the blank spaces:

   (a) A _____________ is used when withdrawing money from a savings account.

   ____________________.

   (b) A cheque is a document used to withdraw money from _______________ account.

   (c) A ___________________ is used for depositing money into a current account.

   (d) At the end of the month a current account holder receives a ____________________ to summarise the transactions between the bank and the customer.

   (e) A ________________ is a form used to deposit money into a savings or deposit account.

Feedback

a) *Withdrawal slip*

b) *Current*

c) *Pay-in-slip*

d) *Bank statement*

e) *Credit slip*

Having come to the end of Topic 1, you can now read the topic summary below.

Topic 1: Summary

We have come to the end of Topic 1, in which we discussed the bank statement, the pass book and savings card. We defined the bank statement as a detailed list of transactions that take place between the bank and the customer. We also discussed the withdrawal slip, deposit or credit slip, the cheque and pay-in-slip. We discussed and read the entries in the bank statement together. We also learned how to fill in the withdrawal slip.

In the next topic, we are going to discuss means of payment. We will however, focus our attention on the cheque. The other means of payment will be discussed in Unit 9.

You can now do the Topic 1 Exercise before you proceed to Topic 2. This will help you to see if you have understood the topic.

Topic 2: Means of Payment - Cheque

Introduction

In Topic 1, we looked at the documents used in the operation of bank accounts. The documents discussed included the bank statement, pass book/savings card, withdrawal slip, deposit or credit slip and the paying-in-slip. We also learned how to fill in the withdrawal slip and interpret the entries of the bank statement.

In this topic we shall discuss cheques. A cheque is a major means of payment especially in home trade. We shall further look at various types of cheques, parties to a cheque, requirements of a valid cheque and how a cheque is cleared. The advantages and disadvantages of using a cheque will also be discussed.

Cheques

Now that we have stated the topic outcome, we shall proceed and define a cheque.

Outcomes

By the end of this topic, you should be able to:

- *Discuss* means of payment through the bank – cheques.

In Topic 2 of Unit 7, under the functions of commercial banks we learnt that banks help business people to make payment for goods supplied. One way of making payment was by using cheques.

Let us look at the outcome that this topic will cover.

Activity 4

Have you ever come across a cheque? Do you know what it is? In your own words, define a cheque in the space provided below.

Feedback

You can compare your answer to the one given in the feedback below.

*A **cheque** is a written order by a drawer to their bank to pay a named person a specified sum of money.*

A cheque is obtained from a booklet that contains several cheque leaves. This booklet is called a **cheque book**. One can obtain a cheque book by requesting it from their bank. However, there is a charge for any cheque book issued by the bank to the person requesting it.

Let us look at Figure 5 below showing an example of a cheque.

Date 12th March, 2009

BENG BANK

L u a n s h y a B r a n c h

Pay ____________*Stone Chibwe*_____________ or order

The sum of *two million kwacha only*______ *K2, 000, 000*

Signature *Elephant Ndhlovu*

Cheque no. 001267 A/c No. 060000122484

Figure 5: An example of a cheque. Created by Commerce Team, ZACODE, 2010.

Now that we have defined and illustrated a cheque let us look at parties to a cheque. **Parties to a cheque** refer to the bank, individuals or organisations making and receiving payment. We will also be using the term drawn, which means written. We will also discuss other terms which are used to describe the various parties.

Parties to a Cheque

There are three parties to a cheque namely: drawee, payee and drawer.

- **Drawee**

  This is the bank on which the cheque is drawn or the bank that is ordered to pay. In the example, Figure 5 above BENG Bank is the drawee.

- **Payee**

  This is a person or firm that receives payment. In other words, the person or firm being paid. In the example above, the payee is Stone Chibwe.

- **Drawer**

The drawer is the person who writes the cheque and signs it or the owner of the account where the money will be withdrawn from. It is this person that orders the bank to pay a named person. In Figure 5 above, Elephant Ndhlovu is the drawer.

Now that you know the parties to a cheque, let us look at the parts of a cheque.

A cheque has two parts: the cheque counterfoil and cheque leaf. Figure 6 below shows the parts of the cheque.

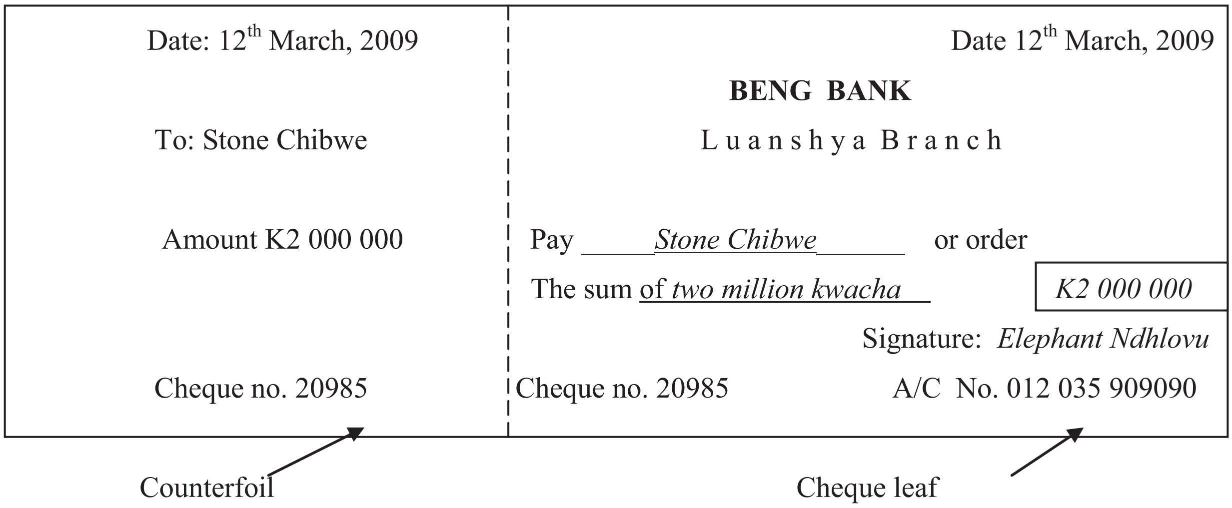


Figure 6: Showing Parts of the cheque. Created by Commerce Team, ZACODE, 2011.

We will now discuss the two parts of a cheque.

Cheque leaf

This is the main part of the cheque which is given to the payee. It contains the following details:

- Name of the bank and branch
- Date when the cheque is issued
- Name of the payee
- Amount to be paid, written both in words and figures
- Cheque number
- Drawer's account number

Counterfoil

The cheque counterfoil is the part that remains in the cheque book and is used by the drawer for his/her accounting records. It contains similar details like those on the cheque leaf. The differences between the two are that:

- The counterfoil does not contain the name of the bank because the whole cheque book belongs to a particular bank.

- In the counterfoil the amount payable is written only in figures.
- The drawers account number is not shown because the account number is written on the first page of the cheque book.

Having looked at the differences between a cheque counterfoil and the cheque leaf, it is important to proceed and state the requirements of a valid cheque. A **valid cheque** means a cheque that ought to be honoured by the bank or drawee. The word **valid** means usable until a fixed expiry date.

Requirements of a Valid Cheque

For a cheque to be valid, it must:

- Be written clearly in ink and not in pencil.
- Have a correct date.
- Have the name of the payee.
- Have the amount written in both words and figures.
- Be signed by the drawer.
- Not be stale.
- Have the drawer signing against any alteration made on it.

We have looked at the requirements of a valid cheque. We will now discuss the advantages of using a cheque but first, do the activity below to see how much you know about the advantages of using cheques.

Activity 5

What are the advantages of using cheques? Write your ideas in the space below. Afterwards, discuss your answer with a friend, family members or other learners before checking our feedback

Feedback

You can compare your answers to the ones provided in the feedback below.

The advantages of using a cheque are that it:

- *is easier to carry*
- *is safer*
- *acts as a receipt*
- *can be made out for any amount*
- *can be safely sent by post if crossed*
- *is generally acceptable as a means of payment.*

Did your discussion generate similar responses? Good! This has confirmed that you and other people close to you have a lot of knowledge that you can tap into to enhance your learning.

Now let us further explain the advantages of using a cheque given above.

Advantages of Using Cheques

- A cheque is easier to carry than cash. A person carrying a cheque worth One Hundred Million Kwacha (K100 000 000) for example, will find it easier to carry than a person carrying the same amount in cash.
- It is safer than cash because a cheque can be crossed and even when stolen or lost, the payment can easily be stopped (we will learn about cheque crossings later in the topic).
- It acts as a receipt. This means that a cheque provides proof of payment when it is cleared by the bank and comes back to the drawer. This clearly indicates that the drawee received their payment.
- It can be made out for any amount, especially large amounts.
- When crossed, a cheque can be safely sent by post to the drawee.

- A cheque is generally acceptable as a means of payment. It is also a negotiable instrument. A negotiable instrument is a document that can be transferred to another by way of endorsement or signing.

Using cheques also has disadvantages which we are now going to discuss.

Disadvantages of Using a Cheque

- It is not a legal tender. Not everyone can accept it as a means of payment because cheques may be dishonoured. To **dishonour** a cheque is to refuse payment, while **legal tender** is currency acceptable by law.
- It is not suitable for small amounts and for very large amounts. Where a cheque is used for very large amounts the creditor may demand a bank certified cheque. A **bank certified cheque** is a cheque drawn in the name of the bank after acknowledging that the drawer has money in the account.

  On the other hand a cheque is not suitable for small amounts because each cheque transaction carries a charge, therefore, it will be more costly to issue such a cheque than to make cash payment.
- A crossed cheque is not convenient to a person with no bank account. This is because a crossed cheque has to be deposited in the payee's bank account before it is paid out.
- It may be inconvenient to a payee who needs cash immediately.
- Banks charge people for issuing cheque books and may even charge for every transaction made by cheque.
- A cheque may be dishonoured if the drawer does not have enough money in the account. This is very inconveniencing on the part of the payee.
- The drawer's signature may be forged and if this happens, some money may be stolen from their account.

Having discussed the advantages and disadvantages of using a cheque, we will now look at the types of cheques.

Types of Cheques

There are different types of cheques available. You may be familiar with some while others will be new.

Now, here are some types of cheques:

Order Cheque

A cheque that has the words "Pay…………………… or order" written on its face is an order cheque. A cheque's face is the front part of the cheque where all its details are written .This type of cheque is made out to pay a named payee or any person to the payee's order. The payee's order is instructions given by the payee to the bank to pay a named person. This means that the payee can also instruct the bank to pay another person. This can happen if the payee wishes to transfer the cheque to another person whom he also owes money.

As we have already discussed, a cheque is a negotiable instrument that can be transferred from one person to another by endorsing it before cashing it or passing it on to another person. When presenting such a cheque to the bank, some form of identification is required. For example, a passport, a national registration card or a driving license. However, a crossed cheque is not transferable.

Let us now proceed and look at the different types of cheques.

Bearer Cheque

This is a cheque that has the words "Pay …………… or bearer" written on its face. This cheque is made payable to any person presenting it to the bank irrespective of whether their name is appearing on the cheque or not. This cheque does not require any endorsement. It is, therefore, not safe as any person in possession of it can cash it over the counter without any form of identification.

The other types of cheques we are going to look at are blank cheques, stale cheques, post-dated cheques and dishonoured cheques.

Blank Cheque

This is a cheque with the drawer's signature and other details but bears no amount. The amount is left to be filled in by the payee. To prevent the payee from getting more money than what has been agreed upon, the drawer limits the payee by indicating the amount to be withdrawn in the crossing. For example, under K500 000 which means the amount should be not more than K500 000.

Stale Cheque

A stale cheque is a cheque presented six months after date of issue. A cheque is valid for only six months. If it is presented to the bank after six months from date of issue, it becomes stale and cannot be honoured by the bank.

The word stale is used to mean different things. In the English language, it may mean something that does not smell good or pleasant, like food that has gone bad. In the commercial context it means a document not presented within a stipulated or given period time.

Post-Dated Cheque

This is a cheque bearing a future date or a cheque made payable on a later date than the present date. For example, the bank will not pay the payee if they present it to the bank before the date shown on the cheque.

Why would the drawer issue such a cheque? The drawer may not have enough money in their account by then, but may be sure that by the date stated on the cheque, the account would have enough money.

Dishonoured Cheque

A dishonoured cheque is a cheque which the bank refuses payment. A cheque that is refused payment is usually returned to the payee with the abbreviation R/D (Refer to Drawer) on it. **Refer to drawer** means that the payee should find out from the drawer why the cheque was dishonoured. What are some of the reasons why cheques may be dishonoured?

Let's now look at some of the reasons cheques may be dishonoured. A cheque may be dishonoured when the:

- Signature on the cheque differs with the specimen signature. A specimen signature is a sample of a customer's signature given to the bank during the process of opening an account.
- Cheque is stopped by the drawer. A cheque is stopped when the drawer instructs the bank not to honour it. This may happen when the cheque is stolen or lost.
- Cheque is post-dated.
- Cheque is stale.
- Cancellations on the cheque are not signed for by the drawer.
- Bank gets news that the drawer has died or is insane.
- Drawer's signature is missing.

We have so far defined a cheque and looked at the advantages and disadvantages of using a cheque. We further discussed different types of cheques. Before we proceed to look at other types of cheques, do the activity below in order to assess your understanding of the topic.

Activity 6

1. What is a cheque?

2. Explain three advantages and three disadvantages of using a cheque.

Feedback

You may have found the activity easy to do having studied what a cheque is as well as its advantages and disadvantages. That would be very good progress. Keep it up! Now, compare your answers to the ones provided in the feedback below.

1. *A cheque can be defined as a written order by a drawer to his/her bank to pay a named person a specified sum of money.*
2. a. *Advantages of using cheques:*

- *A cheque is easier to carry than cash. For example, A person carrying a K100 000 000 cheque will find it easier to carry than a person carrying K100 000 000 cash.*
- *It is safer than cash because a cheque can be crossed and even when it is stolen or lost, payment can easily be stopped (we will learn about cheque crossings later in the topic).*
- *It acts as a receipt, that is, a cheque provides proof of payment.*
- *It can be made out for any amount, especially large amounts.*
- *When crossed, a cheque can be safely sent by post.*
- *A cheque is generally acceptable as a means of payment. It is also a negotiable instrument. A negotiable instrument means a document that*

can be transferred from one person to another by way of endorsement or signing.

b. *Disadvantages of using a cheque:*

- *It is not a legal tender. Legal tender is currency acceptable by law. Not everyone can accept it as a means of payment because cheques may be dishonoured. To dishonour a cheque is to refuse payment.*
- *It is not suitable for small amounts or for very large amounts. Where a cheque is used for very large amounts the creditor may demand for a bank certified cheque. A bank certified cheque is a cheque drawn in the name of the bank after acknowledging that the drawer has money in the account.*

  On the other hand a cheque is not suitable for small amount because each cheque transaction carries a charge. Therefore, it will be more costly to issue a cheque than to make a cash payment.
- *A crossed cheque is not convenient to a person with no bank account.*
- *It may be inconvenient to a payee who needs cash immediately.*
- *Banks charge people for issuing cheque books and may even charge for every transaction made by cheque.*
- *A cheque may be dishonoured if the drawer does not have enough money in the account. This is very inconveniencing on the part of the payee.*
- *The drawer's signature may be forged and if this happens, some money may be stolen from their account.*

Any three advantages and any 3 disadvantages from the answers provided above are correct.

Having done the activity, we will now proceed with the remaining types of cheques.

Open Cheque

This is a cheque which is not crossed or a cheque without parallel lines drawn across its face. The reason why parallel lines are drawn across the face of a cheque is to make sure it is not cashed across the counter, but deposited into a bank account first. An open cheque can be cashed over the counter and therefore, it is not safe.

The reason why an open cheque is issued even if it is not safe is mainly because someone (payee) may not have a bank account with the drawer's bank in which the cheque can be deposited. In this case, they can withdraw money over the counter using an open cheque (without depositing).

Crossed Cheque

This is a cheque with two parallel lines drawn on its face. The benefits of such a cheque are that it cannot be cashed over the counter, but must be deposited into a bank account. This type of cheque is therefore a safe way of making payment. The payee's account is only credited when the cheque is cleared. To credit a payee's account means to transfer funds from the drawer's account to the payee account.

We have said that crossed cheques have parallel lines drawn across their face and have explained the reason why these lines are drawn. The parallel lines or crossings are of different types. We are now going to discuss the types of crossings.

Types of Cheque Crossings

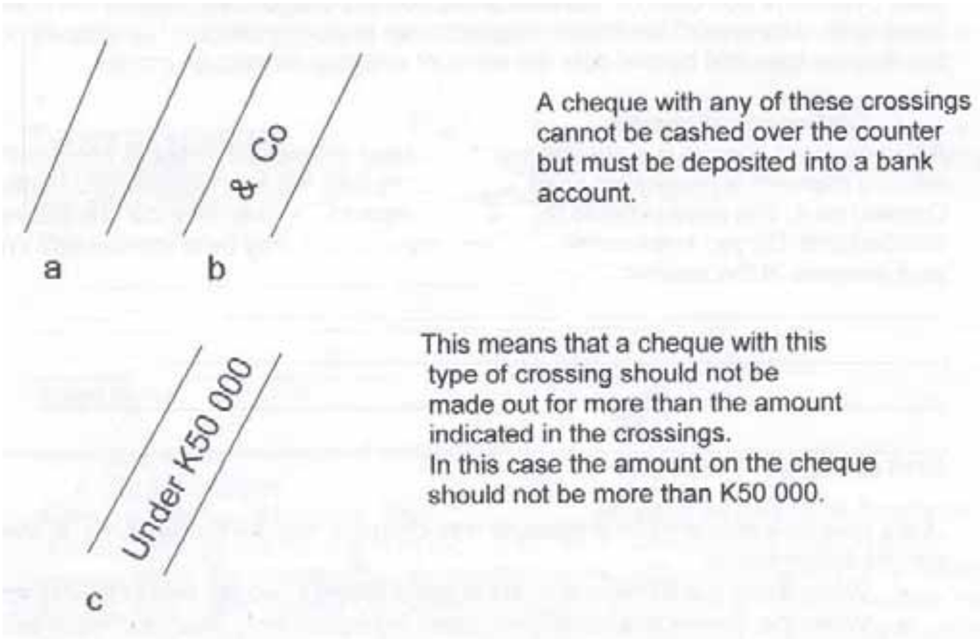
There are two types of crossings namely general and special crossings. We will start by looking at the general crossings and their effects and later look at special crossings.

General Crossings and their Effects

General crossings are two parallel lines drawn across the face of a cheque. These lines may have nothing written in between or may have the following phrases included:

- And company
- Under K50 000
- Account payee only
- Not negotiable

A cheque with such general crossings may be deposited in any drawer's bank account. Below are examples of how a generally crossed cheque may look. The sentences given beside the types of crossings below are the effect of the general crossings.



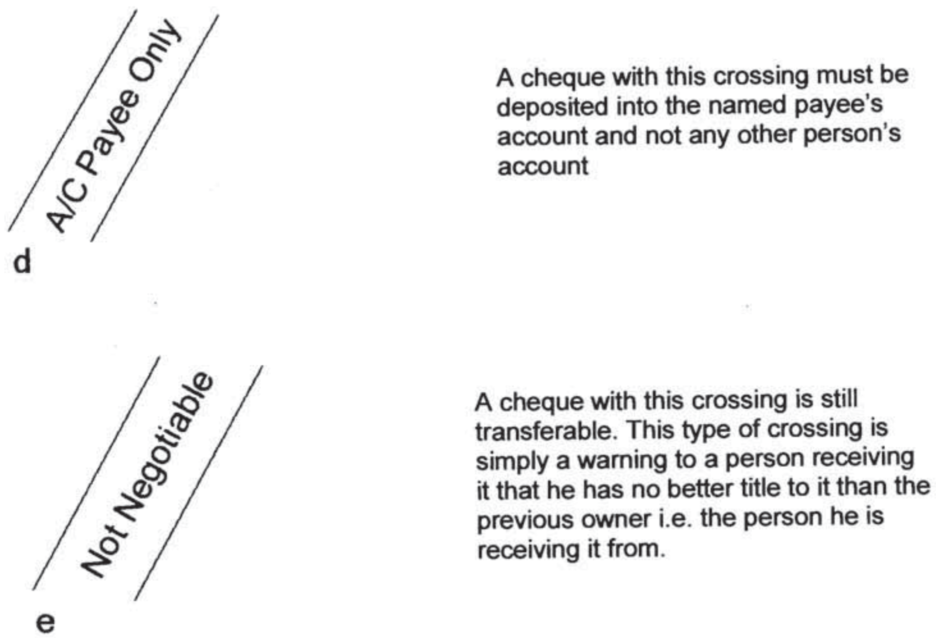


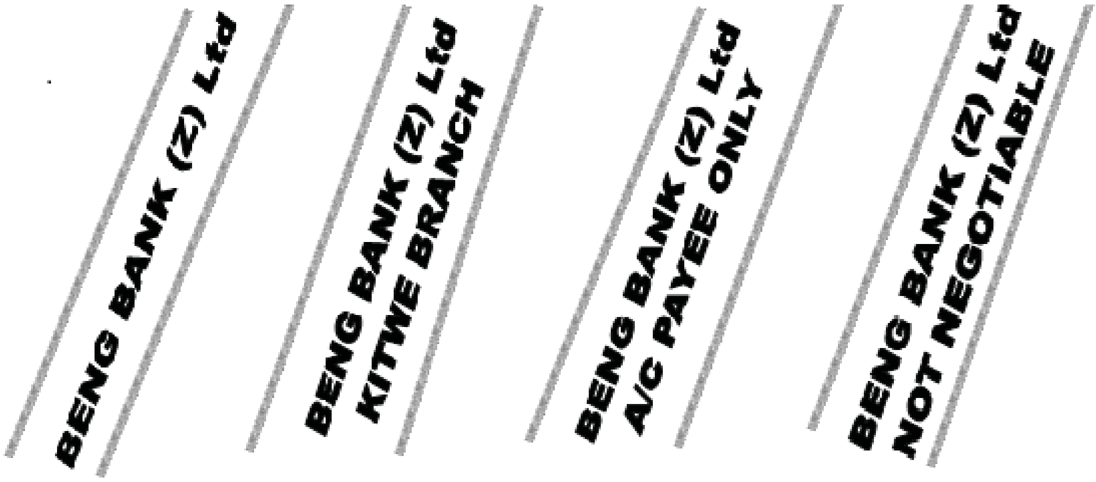
Figure 7: Types of general crossings (a – e). Created by Commerce Team, ZACODE, 2011.

Having stated and explained general crossings and their effects let us now look at the special crossings and their effects.

Special Crossings

These are two parallel lines drawn across the face of a cheque with a name of the bank written in between the crossings. A cheque with such crossings must be paid into the bank named between the crossings.

Examples of special crossings are given below:



a b c d

Figure 8: Special crossings. Created by Commerce Team, ZACODE, 2011.

The additional information in c and d above has the same effect as those discussed under general crossings.

The following phrases may be written in between the lines of a specially crossed cheque:

- Name of the bank, as in (a) above.
- Name of the bank and branch as in (b) above.
- Name of the bank and account payee only as in (c) above.
- Name of the bank and not negotiable as in (d) above.

We have discussed the open cheque, crossed cheque and we have discussed the types of crossings. We will now look at the cheque clearing process. We will define it and discuss this process in detail.

Cheque Clearing

Have you ever imagined what happens to a cheque from the time it is issued by the drawer to the time the payee gets his money? The cheque must undergo a clearing process before the payee gets their payment.

Cheque clearing is the process by which different banks settle amounts they owe each other arising from the business transactions of their customers. This process enables the payee's bank to collect money on behalf of the payee from the drawer's bank account. The process will vary according to whether the drawer and payee share the same bank or have different banks.

Remember, in Topic 1 when we were discussing the bank statement we said that the bank statement is sent to the current account holder together with all the cheques that have been paid out by the bank. These cheques sent to the current account holder are the cleared cheques, cleared using the cheque clearing system.

Let us start by looking at how cheque clearing is done when the drawer and payee belong to the same bank or when the two belong to different banks.

Where the drawer and payee:

- Have bank accounts at the same branch, a cheque is cleared within the branch. This is done by debiting the drawer's account and crediting the payee's account. This is called branch clearing. To debit the drawer's account means to deduct a stated sum of money from their account (drawer's account) as written on the payee's cheque.
- Have accounts at different branches of the same bank, a cheque is cleared at the bank's headquarters as shown in Figure 9 below.

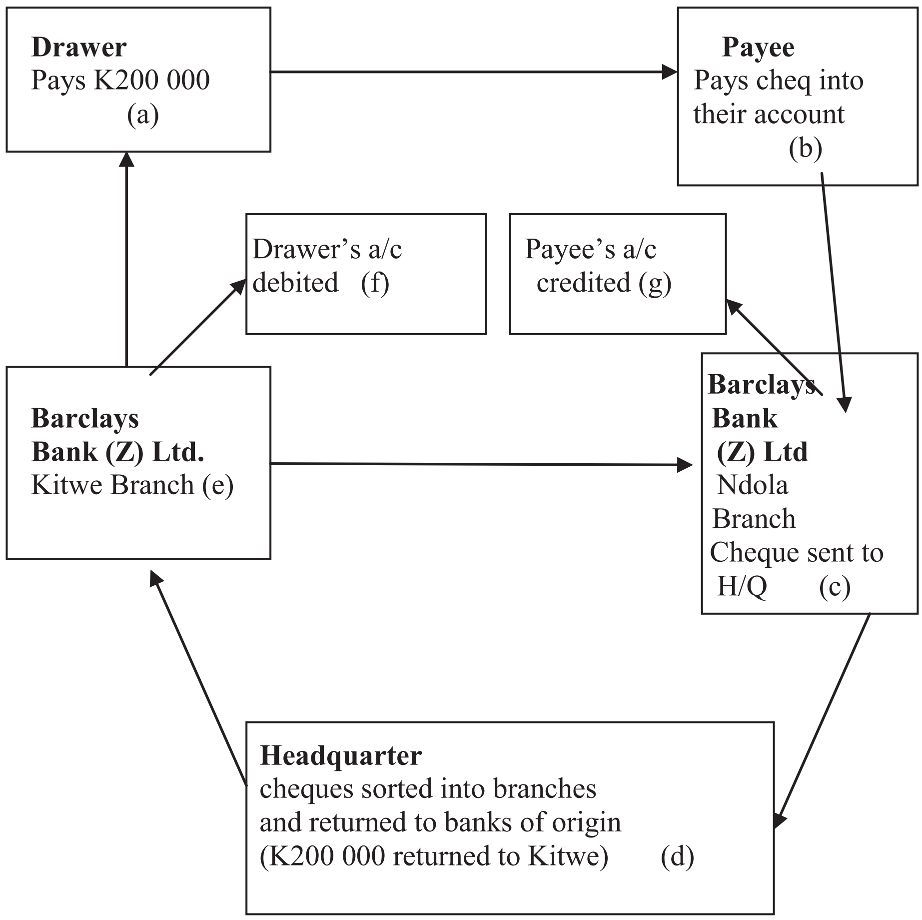


Figure 9: Clearing the cheque at headquarters. Created by Commerce Team, ZACODE, 2011.

The type of cheque clearing above is called internal clearing. The time a cheque takes to be cleared varies from bank to bank, usually between one and four days. Let us run through the above illustration together.

Step 1 (a): The drawer writes a cheque of K200 000 to the payee.

Step 2 (b): The payee deposits the cheque in their bank account.

Step 3 (c): The payee's bank sends the deposited cheque to its headquarters.

Step 4 (d): The headquarters sorts out the cheque among others and send it to the drawer's bank (bank of origin or bank where drawer has an account).

Step 5 (e): The drawer's bank receives the cheque from headquarters.

Step 6 (f): The drawer's account is debited (deducted) with the amount on the cheque by their bank.

Step 7 (g): The payee's account is credited with the amount written on the cheque by their bank. In other words, money worth the cheque's value is added (credited) to the payee's account at their branch.

Note it!

The arrow pointing from the drawer's bank (Barclays Bank, Kitwe branch) to the payee's bank (Barclays Bank, Ndola branch) indicates the communication between the two banks. The drawer's bank gives a go ahead to the payee's bank to pay the stated amount to the payee.

Let us now look at a situation where the drawer and payee have accounts at different banks in different towns.

Where the drawer and the payee have accounts at different banks in different towns, a cheque is cleared at the bankers' clearing house which is usually the central bank because all banks in the country have accounts with the central bank. This makes it easier for funds to be transferred from one account of a bank to another. This process is called **general clearing**.

The general clearing process is as follows:

- The payee deposits the cheque into his bank account.
- This cheque together with other cheques received that day by the payee's bank is sent to the bank's head office.
- At the head office of the payee's bank, cheques are sorted according to banks and sent to the clearing house.
- At the clearing house, cheques are exchanged between banks and amounts due between banks are settled.

- This cheque, together with other cheques belonging to the drawer's bank is sent to the head office of the drawer's bank.
- The head office of the drawer's bank sends this cheque back to the drawer's bank.
- The drawer's account is debited.
- The payee's bank credits the payee's account.
- With that done, the cheque has been cleared.

Note it!

In Figure 10 below, the arrow pointing from the drawer's bank to the payee's bank indicates the communication between the two banks. The drawer's bank gives the go ahead to the payee's bank to pay the stated amount to the payee.

The whole process can be summarized as shown in Figure 9 below.

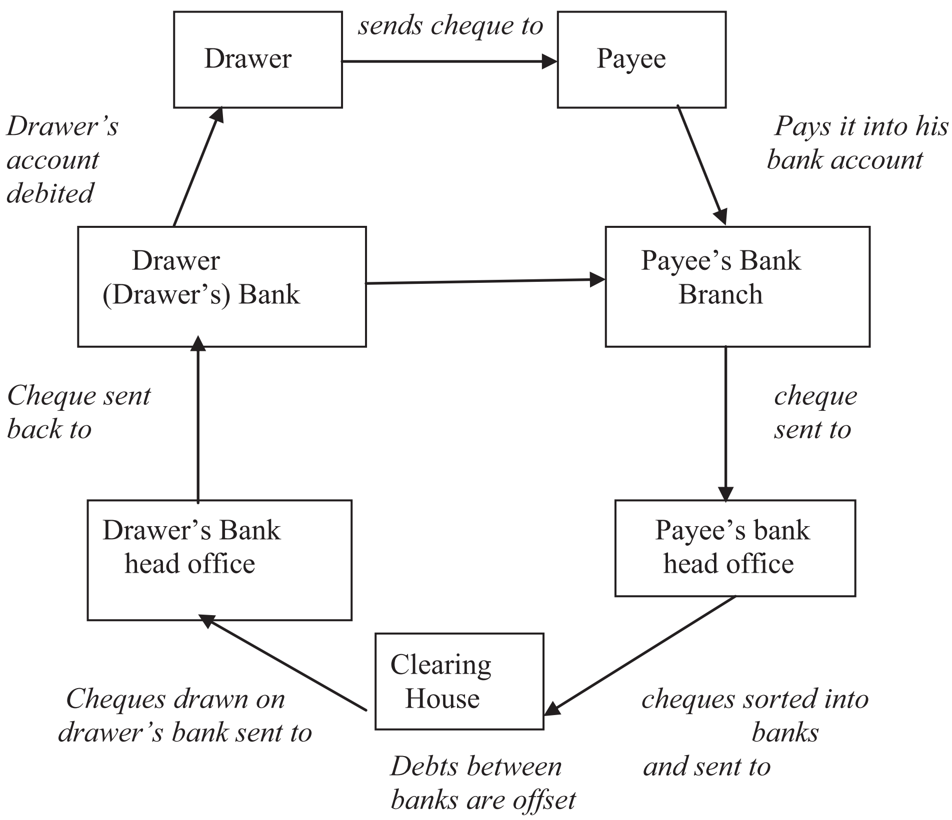


Figure 10: Showing the general clearing process. Created by Commerce Team, ZACODE, 2011.

Below is a practical example on cheque clearing:

Mrs. Mwamba pays Mr. Mwale K400 000 by cheque. Mrs Mwamba's account is at Barclays Bank, Livingstone and Mr. Mwale's bank is Standard Chartered Bank, Luanshya.

The following is the clearing process of this cheque:

- Mr. Mwale will deposit this cheque into his account at Standard Chartered Bank, Luanshya.
- This cheque together with other cheques received that day will be sent to Standard Chartered Bank Headquarters.
- At headquarters, cheques will be sorted according to banks and sent to the clearing house.
- At the clearing house, cheques are exchanged between banks and amounts due between banks settled.
- This cheque together with other cheques belonging to Barclays Livingstone Branch will be sent to Livingstone.
- Mrs. Mwamba's account will be debited.
- Standard Chartered Bank will credit Mr. Mwale's account.

Having discussed the cheque clearing system, you can now do the activity below to assess how much you have understood our discussion.

Activity 7

1. Define the following:
    - General crossings
    - Special crossings
2. With the aid of a diagram, describe how a cheque is cleared at headquarters (internal clearing).

Feedback

Compare your answers to the ones given in the feedback below. You may have found the activity easy to do having studied the content.

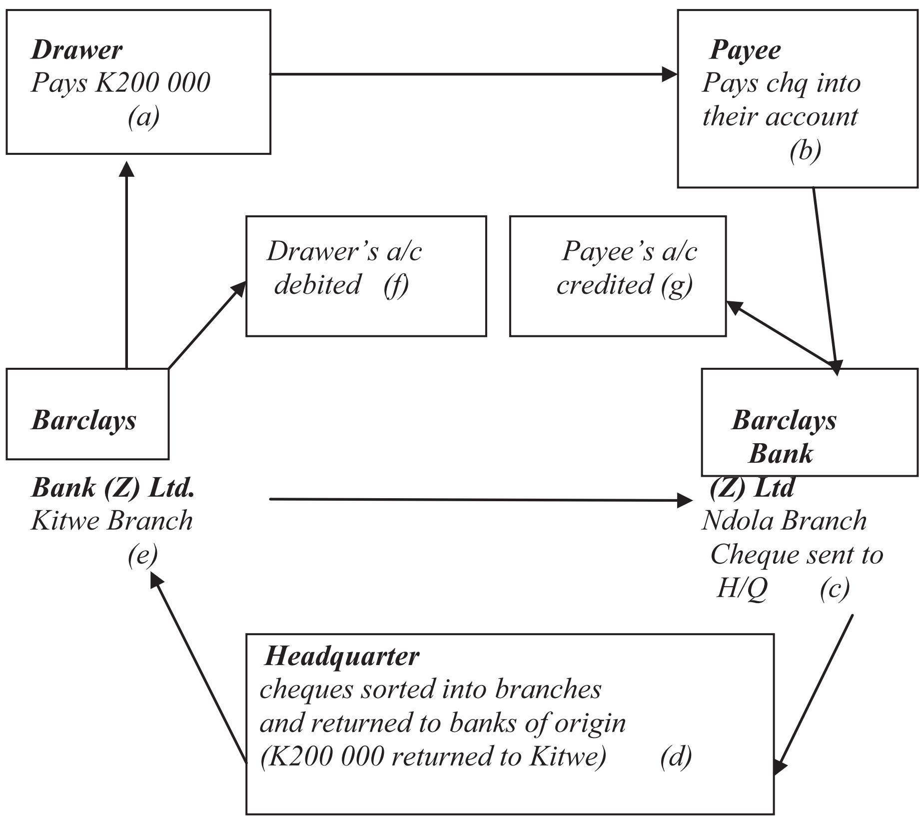
1. General crossings are two parallel lines drawn across the face of a cheque. These lines may have nothing written in between or may have the following phrases included:

- *And company*
- *Under K50 000*
- *Account payee only*
- *Not negotiable*

Special crossings

These are two parallel lines drawn across the face of a cheque with a name of the bank written in between the crossings. A cheque with such crossings must be paid into the bank named between the crossings.

2. Cheque clearing at headquarters.



Now that you have done the activity, let us recap the topic.

Topic 2: Summary

We have now come to the end of Topic 2 where we first defined a cheque and explained its parts. Among the parts explained were the cheque counterfoil and the cheque leaf. We learnt that a cheque is a written order to the bank to pay a named payee, the amount stated on the cheque. We also learned that a cheque counterfoil is the part of the cheque that remains with the drawer as part of the cheque book. It contains almost the same details as those on the cheque leaf.

We further explained the advantages and the disadvantages of using cheques and also identified different types of cheque crossings. These crossings are the general crossings and special crossings. We explained that general crossings are two parallel lines drawn across the face of the cheque without any bank named but has other features .This means that this cheque may be deposited in any bank of the named payee. Special crossings are also two parallel lines drawn on the face of a cheque with a named bank in between the lines and we learnt that this means that the said cheque should be deposited in the payee’s named bank.

Circumstances under which a cheque may be dishonoured were also discussed including the cheque clearing process. This included the headquarters and general clearing.

You can now do the Topic 2 Exercise before you read the unit summary. This is going to help you assess how much you have understood the content in the topic.

Unit Summary

Summary

We have come to the end of Unit 8 in which we discussed banking. Remember that it was a continuation from Unit 7.

In Topic 1, we learnt about the bank statement. We defined it as a detailed list of transactions that take place between the bank and the customer. We discussed and read the entries in the bank statement together. We also discussed the pass book and savings card, the withdrawal slip, the deposit or credit slip, the cheque and the pay-in-slip.

In Topic 2, we discussed means of payment. We focused our attention on the cheque. We mentioned that the other means of payment would be discussed in Unit 9.

We defined a cheque and explained its parts. Among the parts explained were the cheque counterfoil and the cheque leaf. We defined a cheque as a written order to the bank to pay a named payee, the amount stated on the cheque. We also learned that a cheque counterfoil is that part of the cheque that remains with the drawer. We explained the circumstances under which a cheque may be dishonoured.

We further explained the advantages and the disadvantages of using cheques. We also identified and explained two different types of cheque crossings: the general crossings and special crossings. We said that general crossings are two parallel lines drawn across the face of the cheque without any bank named but has other features .This means that this cheque may be deposited in any bank of the named payee. We defined special crossings as two parallel lines drawn on the face of a cheque with a named bank in between the lines and we learnt that this means that the said cheque should be deposited in the payee's named bank.

Finally, we discussed the cheque clearing process. This included the headquarters and general clearing.

In the next unit, we are going to continue discussing banking. We are going to look at the other means of payments used by commercial banks, apart from the cheque that we have already discussed in this unit.

Before we move on to the next unit, do the self-marked assessment which is given after the topic exercises.

References

Reading

Wokorach, J.B (2002) *Commerce – A Complete Course*. Mochudi: Salama

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Assignment

Assignment

Topic 1 Exercise

1. Differentiate between a withdrawal slip and a paying-in-slip.
2. Briefly write about the following in one paragraph:
   (a) Pass book/savings card
   (b) Deposit or credit slip
   (c) Cheque

Topic 2 Exercise

1. The cheque has two parts, the cheque counterfoil and the cheque leaf. State the details that each contain.
2. List four (4) reasons why a cheque can be dishonoured.

Feedback

Topic 1 Exercise

1. *A withdrawal slip is used when withdrawing money from a savings account, while a paying-in- slip is used to deposit money into a current account.*
2. *a. A pass book is issued to a person who has a savings account at the bank or any other financial institution. Nowadays, pass books are rarely used. Where the pass book is issued, it is used for recording deposits, withdrawals and interest.*

   b. Deposit slips or credit slips are a form used to deposit money into a savings or deposit account.

   c. A cheque is a document used to withdraw money from a current *account. It is defined as a written order to a bank to pay a named person a specified sum of money.*

Topic 2 Exercise

1. ***Cheque leaf***

This is the main part of the cheque which is given to the payee. It contains the following details:

- *Name of the bank and branch*
- *Date when the cheque is issued*
- *Name of the payee*
- *Amount to be paid, written both in words and figures*
- *Cheque number*
- *Drawer's account number*

Counterfoil

The cheque counterfoil is the part that remains in the cheque book and is used by the drawer for his accounting records. It contains similar details like those on the cheque leaf. The differences between the two are that:

- *The counterfoil does not contain the name of the bank because the whole cheque book belongs to a particular bank.*
- *In the counterfoil, the amount payable is written only in figures.*
- *The drawer's account number does not show because the account number is written on the first page of the cheque book.*

2. *A cheque may be dishonoured when the:*

- *Signature on the cheque differs with the specimen signature. A specimen signature is a sample of a customer's signature given to the bank during the process of opening an account.*
- *Cheque is stopped by the drawer. A cheque is stopped when the drawer instructs the bank not to honour it. This may happen when the cheque is stolen or lost.*
- *Cheque is post-dated.*
- *Cheque is stale.*
- *Cancellations on the cheque are not signed for by the drawer.*
- *Bank gets news that the drawer has died or is insane.*
- *Drawer's signature is missing.*

(Any four answers are correct)

Assessments

Self-marked Assessment 5

This is a self-marked assignment and not tutor-marked. It is aimed at assessing your understanding of the unit. You are encouraged to do it without referring to the unit content or feedback.

Part A

Answer all questions

1. Discuss the types of cheques.
2. Outline the requirements of a valid cheque.
3. Differentiate a standing order from direct debit.

Part B

Multiple choice questions

Choose the *BEST* answer.

1. A standing order is a facility that is used to make regular payment at fixed dates for:

a) subscriptions

b) fixed amounts

c) varying amounts

d) donations

2. A cheque is obtained from a booklet that contains:

a) several cheque leaves

b) the payee's name

c) account numbers

d) drawer's postal address

3. General crossings are two parallel lines drawn across the face of a:

a) bank book

b) withdrawal slip

c) deposit slip

d) cheque

4. A bank statement is a document which gives a detailed list of transactions that take place between:

a) banks

b) two organisations

c) the customer and the bank

d) people

5. A stale cheque is a cheque presented six months after:

a) cashing it

b) date of issue

c) depositing

d) signing it

Self-Assessment Feedback

Part A

Types of cheques:

Order cheque

A cheque that has the words "Pay…………………… or order" written on its face is an order cheque. This type of cheque is made out to pay a named payee or any person to the payee's order.

Bearer cheque

This is a cheque that has the words "Pay ……………. or bearer" written on its face. This cheque is made payable to any person presenting it to the bank irrespective of whether their name is appearing on the cheque or not. This cheque does not require any endorsement. It is not safe as any person in possession of it can cash it over the counter without any form of identification.

Blank cheque

This is a cheque with the drawer's signature and other details but bears no amount. The amount is left to be filled in by the payee. To prevent the payee from getting more money than what has been agreed upon, the drawer limits the payee by indicating the amount to be withdrawn in the crossing for example, under K500 000 which means the amount should be not more than K500 000.

Stale cheque

A stale cheque is a cheque presented six months after date of issue. A cheque is valid only for six months. If it is presented to the bank after six months from date of issue, it becomes stale and cannot be honoured by the bank.

Post-dated cheque

This is a cheque bearing a future date or a cheque made payable on a later date than the present date. For example, the bank will not pay the payee if they present it to the bank before the date shown on the cheque.

The drawer may issue such a cheque because they may not have enough money in their account by then, but may be sure that by the date stated on the cheque, the account would have enough money.

Dishonoured cheque

A dishonoured cheque is a cheque which the bank refuses payment. A cheque that is refused payment is usually returned to the payee with the abbreviation R/D (Refer to Drawer) on it. Refer to drawer means that the payee should find out from the drawer why the cheque was dishonoured.

A cheque may be dishonoured when the:

- *Signature on the cheque differs with the specimen signature. A specimen signature is a sample of a customer's signature given to the bank during the process of opening an account.*
- *Cheque is stopped by the drawer. A cheque is stopped when the drawer instructs the bank not to honour it. This may happen when the cheque is stolen or lost.*

- *Cheque is post-dated.*
- *Cheque is stale.*
- *Cancellations on the cheque are not signed for by the drawer.*
- *Bank gets news that the drawer has died or is insane.*
- *Drawer's signature is missing.*

Open cheque

This is a cheque which is not crossed or a cheque without parallel lines drawn across its face. The reason why parallel lines are drawn across the face of a cheque is to make sure it is not cashed across the counter, but deposited into a bank account first. An open cheque can be cashed over the counter and therefore, it is not safe.

The reason why an open is issued even if it is not safe is mainly because someone (payee), may not have a bank account with the drawer's bank in which the cheque can be deposited. In this case, they can withdraw money over the counter using an open cheque (without depositing).

Crossed cheque

This is a cheque with two parallel lines drawn on its face. The benefits of such a cheque are that it cannot be cashed over the counter, but must be deposited into a bank account. This type of cheque is therefore a safe way of making payment. The payee's account is only credited when the cheque is cleared. To credit a payee's account means to transfer funds from the drawer's account to the payee account.

1. ***Requirements of a valid cheque:***

For a cheque to be valid, it must:

- *be written clearly in ink and not in pencil*
- *have a correct date*
- *have the name of the payee*
- *have the amount written in both words and figures*
- *be signed by the drawer*
- *not be stale*
- *have the drawer signing against any alteration made on it*

2. ***Difference between standing order and direct debit:***

A standing order is a service that is used to make regular payments at fixed dates for fixed amounts, while direct debit is a service used to make regular payments for varying amounts of money and at varying times.

Part B

Multiple choice

1. *B*
2. *A*
3. *D*
4. *C*
5. *B*

COMMERCE

Grade 11

ZAMBIA COLLEGE OF DISTANCE EDUCATION
Social Sciences Department

Contents

Unit 9

Banking 3

Introduction

Congratulations for coming this far! You are now doing the final unit of this course, in which you are going to continue looking at banking. In Unit 8 we discussed cheques as means of payment. Whereas cheques are a major means of payment, banks still offer other means of payment to traders, both in local and foreign trade. This unit will take you on a tour of other means of payment used in home trade. We shall also look at modern trends in banking. Finally, we shall address issues of rights of customers in banking.

This unit has two topics. The first topic will explore other means of payments offered by commercial banks to local traders. The second topic will explore the trends in banking and the rights of customers in banking.

Let us begin with the unit outcomes.

Upon completion of this unit you will be able to:

Outcomes

- *Discuss* means of payments through the bank.
- *Discuss* the rights of the customer in banking.
- *Describe* the trends in banking.

Timeline

Time

You will need between 16 and 20 hours to study this unit. Do not worry if it takes you more or less time than this – we do not all work at the same pace. You will need about 8-10 hours to study each topic. This includes 7 hours for reading and doing the in-text activities and end of topic exercises and 2½ hours for doing the tutor-marked assignment

In addition to the work described above, you are expected to do an **end of course assignment**. You will have to do this assignment **at the study centre under the supervision of a tutor.** The time for this assignment will be specified by your tutor.

Learning Resources

Tips

These materials are self-instructional, but the resources given below will help you in your understanding of the unit.

- Computer, internet and mobile phones (where possible) for communication and research.
- Visits to libraries to research on banking (where possible).
- Attend tutorials at study centres and discuss with other learners and tutors.
- Visit banks and other financial institutions to get first-hand knowledge and experience of the means of payment discussed in this unit.

Teaching and Learning Approaches

Tips

The following teaching and learning approaches will be used:

- **Content based approach** - has been used to present the core content of the course. It is linked to the other two approaches mentioned below because it is the springboard for doing activities and solving problems. It encourages you to base your learning on the subject matter provided, read and follow instructions and improve your knowledge, skills and competencies on banking. All of this is intended to help you learn effectively.

- **Problem based approach** - aims to make you responsible for your own learning in order to promote higher level learning skills like critical thinking on banking. Your study units are like a teacher in print form in that they facilitate your learning and assist you in solving - problems rather than merely providing solutions.

- **Activity based approach** should enable you to physically interact with people and content in order to acquire banking related skills and general learning skills by being actively involved in the discussions and activities within the unit. This will include among other activities visits to commercial banks and other financial institutions.

Terminology

Authority:	Official permission to do something on someone's behalf.
Creditor:	Person or organisation owed money by another.
Credit Cardholder:	Person who has been issued with a credit card by the credit card issuer.
Credit Card Issuer:	The company/bank that issues the credit card.
Connectivity:	The ability a piece of hardware, software, system or an internet site has to link with another.
Debtor:	Person or organisation owing another person or company.
Electronically:	By means of electronic devices such as computers, facsimile etc.
Electronic Funds Transfer:	A computer-run program used for transferring money.
Fixed amounts:	Amounts that remain constant from time to time.
Internet Fraud:	Dishonest dealings on the internet.
Rights:	Legal freedoms and entitlements of individuals.

Topic 1: Other Means of Payment

Introduction

Welcome to Topic 1 of this Unit. In this topic we shall discuss other means of payments offered by commercial banks in addition to those you studied in Unit 8. Cheque payments are not always the answer to every money payment. As we saw in Unit 8, cheques (especially personal ones) may not always be acceptable. Where the buyer doubts the credit worthiness of the seller, a personal cheque may not be suitable. This calls for the use of other means of payments which this topic will address.

Upon completion of this topic you should be able to:

Outcomes

- *Discuss* different means of payments through the bank.

Time

You should spend at least 10 hours on this topic.

Several means of payment are available in both home and foreign trade. Before you proceed, do the following activity to see if you can come up with some means of payments.

Activity 1

1. Think of the means of payments that you already know and write them in the space below.

2. Do you know of any means of payment other than those mentioned in 1 above? List them down in the space provided below.

Feedback

1. *As you thought over this activity, you may have remembered the means of payment in foreign trade which we covered in Unit 2 of this course. You could have also remembered cash and cheques as a means of payment that are very common. Remember, in foreign trade documentary credits, cable transfers/telegraphic*

transfers, bank drafts and bills of exchange may be used.

2. *Your list of other means of payment may have included the following*:
   a) *Credit transfers*
   b) *Standing orders*
   c) *Direct debits*
   d) *Money orders*
   e) *Credit cards*
   f) *Debit cards and*
   g) *Travellers cheques*

If you were able to mention some of the above means of payment, that is good. This shows that you already have some prior knowledge of what we will be discussing in this unit.

Let us now take a detailed look at some of the means of payment identified in 2 above. You will notice that most of the means of payment identified above are used in home trade. However, it is important to note that some means of payment covered under foreign trade in Unit 2 like banker's drafts and telegraphic transfers may also be used in home trade. Therefore, we advise that you go back to Unit 2 and refresh your mind on these two means of payment. We will start by looking at credit transfers.

Credit Transfers

Banks provide means of payments that can enable a person to pay money directly into their creditor's account. A credit transfer is one such means of payment. You may know this means of paying as a bank giro credit system.

With this means is that funds are transferred from one account to another electronically via a facsimile or computer. To facilitate such money transfers, special software is installed on a customer's computer. **Software** is a program that enables a computer to do a given task, for example to transfer funds.

Besides, the computers many of us use nowadays have internet connectivity, making it fast and easy for funds to be transferred from one account to another. The system of paying bills and transferring funds through the internet is called **internet banking**. You will learn more about internet banking in Topic 2.

Other means of payment include standing orders and direct debits although these involve a direct transfer from one account to another. We shall discuss these two means of payments later in this topic.

In our discussion, we shall use the word **creditor** to refer to the person owed money. This is the person in whose account money is paid or transferred to. In short the payee. The word **debtor** will be used to mean the person owing the creditor money. This is the person paying the money or from whose account money is paid or transferred.

One can use a credit transfer to make only one payment to an individual creditor. For example, credit transfers are ideal for paying a supplier of goods or services instead of using cash or cheque. Remember, using a credit transfer overcomes certain problems associated with cheques and cash, which you already know from Unit 8. It is safer and cheaper than sending cash and cheques by post.

While credit transfers may be used to make single payments as seen in the paragraph above, they may also be used to make several payments to a number of creditors. For example, as a debtor you can use credit transfers to pay your staff or several suppliers. When paying several people, you will find credit transfers convenient to use because you will only need to prepare one cheque to pay several people. As a result, your paper work will be greatly reduced. You may also pay several people by depositing cash directly into their accounts. In addition to the benefits above, your time for paying several people will be saved as the need for writing several cheques or counting large sums of money is eliminated. It is also important to note that there is no limit on the number of creditors to be paid; one can pay as many creditors as they wish.

With the credit transfer system, it is possible for money to be transferred electronically from one account to another within the same branch or to accounts at another branch. Funds can also be transferred to accounts at different banks.

Any person wanting to pay by credit transfers must ensure that the creditor has a bank account. They may not have one themselves.

Let us now see how the credit transfer system works especially for paying several people.

How the Credit Transfer System Works

Here is the procedure for using the credit transfer system for several payments:

a. Prepare a list of workers with names of their individual banks, branches, account numbers, amounts to be paid to each worker and send it together with the cheque or cash for the total amount as shown in Figure 1 below. Figure1 below shows a list of employees to be paid by credit transfer.

S/N	NAME	BANK	ACCOUNT No.	BRANCH	AMOUNT (K)
1.	BANDA ROSE	BENG	100003451	LUANSHYA	500,000
2.	CHIPILA PEZO	BENG	100001234	LUANSHYA	1,509.205
3.	GEZA MELWE	BENG	10003456	LUANSHYA	2,000.500
4	ZULU LOTI	BENG	100001367	LUANSHYA	700,150
	TOTAL AMOUNT				4,709,855

Amount of cheque
or
cash to be prepared

Figure 1: A list of staff to be paid by the credit transfer system. Created by Commerce Team, ZACODE, 2010.

b. Once the list and money has been prepared, send it to the bank, instructing it to transfer individual amounts into the bank accounts of employees electronically.

c. The bank will then carry out your instructions electronically.

Remember, with this means of payment the creditor must have a bank account but the debtor may or may not have a bank account.

Before we proceed, do the following activity to assess your understanding of credit transfers.

Activity 2

1. From what you have just read on credit transfers, identify the advantages of credit transfers to you as a debtor and write them down in this space.

2. What are the advantages of a credit transfer to the creditor?

Check if your answers are similar to the ones given in our feedback below. If you included all of the points, congratulations! If not, review this part of the topic.

Feedback

1. Advantages of credit transfers to you as a debtor:

a) You will be able to pay money directly into your creditors account. You will also be able to pay as many creditors as you want as there is no limit on the number to be paid.

b) There will be no need for you to prepare individual cheques for *each and every creditor, so your time and money will be saved.*

c) You will find credit transfers more secure than cash and cheques.

d) You will not waste money on postage and there will be no need for you to deal with a lot of paperwork.

e) They provide you with a fast and easy means of transferring funds from one account to another.

2. As much as you will enjoy the benefits identified above, the creditor also has benefits to enjoy and these include:

a) The creditor will make an independent decision on the date of payment.

b) They will receive their payment immediately. There is no need to wait for the cheque to mature.

c) It will avoid bad debts and ensure a steady flow of cash for the creditor

Having looked at credit transfers, let us now turn our focus on standing orders.

Standing Order or Banker's Order

A **standing order** is a means of payment that you can use to pay fixed amounts at set intervals. A standing order therefore may be defined as written instructions from a bank customer to the bank to pay fixed amounts to a specified person or organisation at set intervals, for example the 31st of every month. Fixed amounts refer to amounts that will not change from time to time.

For example, if you join a club you may be required to pay a predetermined membership or subscription fee. Whatever amount the members agree to pay, the same will be paid every month; it will not change unless the members decided to change the membership fees. So, if the amount agreed upon is K100,000, the members will pay K100,000 per month. When subscriptions are paid yearly, direct debits may be used as we shall see later in this section.

Apart from subscription fees, you can use standing orders to pay rent, insurance premiums, loans, mortgages or hire purchase instalments. You may have noticed that these payments remain constant over a long period and it is very easy to set a date of payment for them.

You may be thinking: how is a standing order put into effect? Or do you already? Read the section below to either confirm your prior knowledge or learn how standing orders are set up.

How a Standing Order is Set Up

A standing order is not difficult to effect. What you need to do as an account holder (debtor) is to:

- Instruct your bank in writing to transfer money regularly from your account to your creditor's account. In your instruction include: the name of your creditor, the amount to be transferred, the account number and the date of payment.

- Once this is done, the bank will transfer from your account the amount indicated in the order to that of your creditor.

Note that:

Note it!

Once the instruction is given, it stands until you instruct the bank to stop paying. For this reason some financial institutions call them stop orders. Yet others call them banker's order.

Unlike credit transfers, both the debtor and creditor must have bank accounts.

Standing orders have advantages. Before you read on, do the following activity and see if you can come up with advantages of standing orders to both the debtor and creditor.

Activity 3

What are the advantages of standing orders:
a) to the debtor (owner of account paying)?

b) to the creditor (owner of account receiving payment)?

Feedback

You may have come up with the following advantages:

a) To the debtor:

- *Like a credit transfer, it is cheap and safer than cash and cheques.*
- *Payment will be made immediately so there is no need to wait for cheques to be cleared.*
- *No need to remember dates of payments.*

b) To the creditor:

- *Payments will be received immediately.*
- *No need to send reminders to debtor.*
- *Time will not be wasted on counting money and depositing cash into the bank.*

If you have included other advantages not found in our feedback, do not worry. As long as they were taken from a dependable source like a textbook or the internet, that is fine.

Another means of payment that requires both the debtor and creditor to have bank accounts are direct debits.

What are Direct Debits?

Direct debits are means of payment that one can use to make regular payments that vary in amount from time to time. However, as mentioned earlier direct debits may be used to pay small fixed annual payments for subscription fees, mortgages and other similar payments. It is also important to note that when subscription fees are paid on a monthly basis, standing orders are the best means of payment to use.

One can set up a direct debit to pay for a wide variety of services like insurance, telephone, gas and electricity. To ensure proper and effective management of direct debits you will need to understand how direct debits are used.

How Direct Debits are Arranged

To start paying by direct debits, the creditor instructs the debtor's bank to transfer money from the debtor's account to theirs. To do this, the creditor obtains permission from the debtor. Permission may be granted to the creditor through a debit form or telephone. Granting permission on telephone is quite risky and may only be used where the debtor personally knows the creditor.

Once the debit form is signed, the creditor sends it to the debtor's bank. Upon receipt of the signed debit form, the bank transfers money from the debtor's account to that of the creditor

Both the creditor and debtor can find direct debits safe and convenient to use. The creditor has the freedom to claim payment from the debtor's bank on dates decided by them, provided they get prior permission from the debtor. By claiming payments directly from the debtor's bank, the risk of bad debts may be reduced. In addition, the creditor does not need to wait because payment is received on time. The debtor does not need to remember dates on which to make payments. Payments are also made on time and paper work is greatly reduced as there is no need to change records whenever there is a decrease or increase in the amount to be paid. Similarly, the need to write cheques does not arise.

In spite of the advantages mentioned above, direct debits may not be safe. Some dishonest creditors may claim what is not due to them from the debtor's account. For this reason, many banks put safeguards in place. An example of such a safeguard is the use of a direct debit guarantee which protects the debtor in case anything going wrong. With it, the debtor's bank is required to refund the debtor without fail if any dubious payment is made.

Having discussed standing orders and direct debits, do the following activity to see whether you have understood this part of the section. Read the statement below and answer the questions that follow. You may have noticed that this is a group activity. We suggest that you discuss your answers with other learners at the study centre or with your friends.

Group Activity

1. "Bank customers as well as some bankers often confuse standing orders for direct debits".

   a) Why do you think some people confuse standing orders for direct debits?
   b) With the help of members of your group or a friend or relative, compare the two means of payments and come up with differences. Write down the differences in table form in the space provided below.

Feedback

Well done! We hope you enjoyed the discussion with your group, friend or relative.

1 (a) *You may have realised that the confusion arises from the fact that both means are used for paying regular amounts. Furthermore, both methods may be used to pay small fixed annual payments. However, the major distinguishing feature of a standing order is that it is used to pay regular fixed amounts at set intervals. On the contrary, a direct debit is used to make regular payments that vary in amount from time to time.*

(b) Your differences may have included some or all of the following. If you provided similar answers to the ones given in the feedback below. If your answers do not match our answers re-do the activity.

Standing Order	***Direct debit***
It is used for paying regular fixed amounts payable at set intervals.	*It is for making payments that vary in amount from time to time.*
The debtor asks their bank to pay the creditor.	*The creditor claims money from the debtor's bank with permission from the debtor.*

Whenever there is an increase or decrease in the amount to be paid, the debtor must give new instructions before changes can be effected.	*Whenever there is an increase or decrease in the amount to be paid automatically the creditor will claim the new amount, provided the debtor is informed.*
Payments are made on fixed dates.	*Payments are made on varying dates decided by the creditor*
Suitable for payments made over short intervals e.g. monthly payments such as hire purchase payments, insurance premiums and other similar payments.	*Suitable for payments made at varying dates and those made over long intervals, for example, yearly payments for mortgages, subscriptions fees etc.*

You now know the differences between standing orders and direct debits. Let us now look at money orders.

Money Orders

A money order is a means of payment that has been in existence for centuries and has not lost popularity. Many people still prefer using money orders to personal cheques. What then is a money order? A **money order** may be defined as a written order to a post office or bank to pay or transfer a sum of money to a named person. Anyone wanting to transfer money can buy money orders from the post office, grocery store or convenience shop.

You can see that money orders can be bought from different places. In Zambia, however, you can buy money orders mainly from the post office. To buy money orders, you pay for the orders in the amount preferred, plus a service fee. The amount on money orders is printed by the organization issuing them.

To send money using money orders, the sender fills in an application for money orders. On this application form, the sender indicates important details like the date, the name of the payee, post office of payment, purpose and method of payment. The sender should not forget to indicate their name and address. As a sender, you have a choice whether to send postal, telegraphic or electronic money orders. Whether you are sending postal, telegraphic or electronic money order, obtain a receipt as proof of sending money.

Before you read on do the following activity, to assess your understanding of postal and telegraphic money orders.

Activity 5

In your own words describe **postal money orders** and **telegraphic money orders**. Write your answers in the space provided below.

Feedback

You may have described postal orders as orders bought at the post office and sent to the payee through the post who then cashes them at the post office or bank. To cash a money order is to exchange it for cash at the post office or bank as we do with cheques. The charge for a postal money order depends on the amount of order bought. In addition, there is a small service charge made on each order.

A telegraphic money order, on the other hand, is a money order bought from a telegraph office and sent to the payee by telegraph (telex or fax). With telegraphic money orders, money can be transferred to another location within seconds. For this reason, telegraphic money orders are now widely used by traders in foreign trade.

The travelling public may also find telegraphic money orders helpful as they can get money easily and frequently when they run out of funds. All the traveller needs to do is to get in touch with someone back home and ask them to buy and send a telegraphic money order to them. The traveller then collects the money from a telegraphic office in the town or country they are currently.

We are now ready to discuss electronic money orders.

What are Electronic Money Orders (EMOs)?

An **electronic money order** is a new system of sending a money order by e-mail. It may be viewed as an improved version of the telegraphic money order.

With the introduction of electronic money orders, traders can now make payments for goods in foreign trade. So, if you are buying goods or services abroad, buy international money orders from your bank in the seller's currency and send them electronically.

What is an international money order? These are money orders used to transfer money abroad. International money orders are not any different from local money orders, except they are used to make payments abroad.

People travelling to other countries can also get money easily and frequently through money orders. Similarly, those with relatives and friends abroad can also receive money through this means of payment. You may have received money from abroad through this means or have seen a friend or relative receive money from abroad through Western Union Money Transfer for instance.

You will find international money orders more convenient and safer than cash. Why are international money orders safer than cash? To obtain answers to this question, do the following practical activity.

Activity 6

Visit a commercial bank, post office or any Western Union Agent in your area and ask them why international money orders are safe.

What in your opinion are the advantages of money orders in general?

You may find it helpful to discuss with friends or relatives, or members of your group.

Check if your answers are similar to ours in the feedback below.

Feedback

Well done! Your visit to the commercial bank, post office or western union agent may have improved your understanding of money orders. You now know that international money orders are safe because of the techniques they use in identifying the payee such as the test question which must be answered correctly before money is given. In addition, an identity card like a passport or national registration card should be produced by the payee.

Your advantages of using money orders may have included the following:

- *Payment is made immediately after the orders are received therefore there is no need to wait for clearing like for cheques.*
- *They do not become stale like cheques.*
- *They can be used even by people who do not have current/checking accounts.*
- *They can be bought by anyone; young and old.*
- *They are safe. If lost they can be replaced if it is established that they are not yet cashed.*
- *They guarantee payment since they are paid for in full at the time of buying.*

Although money orders have many advantages, there is a danger of counterfeiting. For this reason, banks and other institutions are not willing to accept them as a means of payment.

Note it!

Note that:

There are also express money orders that can be bought from other places like department stores and other stores. The American Express Money Order is a good example.

In some countries however, express money orders do not exist.

Besides money orders, people use cards like charge, credit and debit to pay for goods and services. We will now examine how these cards are used as means of payments starting with charge and credit cards.

Charge and Credit Cards

Charge cards are cards one can use to borrow money to pay for goods and services. A charge card is similar to a credit card except it is used to borrow money to pay for goods or services while a credit card allows one to buy goods and services on credit. This means that with a credit card one can obtain goods or services without paying cash for them at the time of purchase. Unlike credit cards, charge cards have no credit limit and interest charges on them. You will learn the meaning of credit limit shortly. Users of charge cards may be required to pay annual subscriptions. Examples of charge cards include the Diners and American Express.

Like charge cards, credit cards are a way of borrowing. They are plastic cards issued by credit card companies or issuers to their customers to enable them buy goods or services on credit. However, before a person is issued with a credit card, the issuer needs to establish whether or not that person has never had problems repaying debts. A credit card company or issuer may be a bank or business firm like a store or airline. You may have seen some stores issue credit cards for use in their shops or branches. This may be done to **promote custom** meaning to encourage customers to become regular customers.

Banks issue credit cards to holders to enable them to purchase goods or services on credit from shops and other businesses belonging to the scheme. One can even use a credit card to buy goods or services online or over the telephone. The same card can be used to take out cash from an ATM machine. However, using a credit card to take out cash from an ATM machine attracts a high rate of interest. This in reality is a cash advance because a credit card bill is normally paid at the end of a specified period, for example a month.

Examples of credit cards may include the Barclaycard, Master and Access cards.

Like other means of payments already discussed, credit cards are easy to use. You may be wondering how a credit card scheme works. The procedure below will give you an insight into how the credit card scheme works, especially if you have never used a credit card before.

How the Credit Card Scheme Works

The following is the procedure for using the credit card:

- The card holder obtains goods on credit upon presentation of a credit card to a trader in the scheme.
- The trader issues an invoice, makes card holder sign and sends a copy to the bank requesting them to pay for the goods or services supplied to their customer (card holder).
- Upon receipt of the invoice, the bank pays the trader in full on behalf of the card holder. They however, subtract their commission from the full amount paid. A bank statement is then sent to the card holder requesting payment within a specified period.

From the procedure above, you can see that although the card holder is allowed to have the goods, he does not pay for them immediately. It is the credit card issuer (bank) that makes the payment after receiving the invoice from the trader. At a later specified time, the card holder repays the bank for the debt that they settled. For this reason, banks may require that the card holder open a current account into which regular payments can be made to cover all the purchases they make using the credit card. What this means is that instead of waiting for the card holder to pay cash, the bank simply transfers money from this account to theirs. For the services offered, the bank charges the trader commission which they deduct from the amount they (the bank) pays.

People nowadays find it convenient to pay various expenses and bills using credit cards. For example, credit cards are now widely used to pay hotel, restaurant and fuel bills. However, the card holder is only allowed to spend up to an agreed credit limit. A credit limit is the maximum amount that the credit card holder can borrow on a credit card at any given time. The credit limit may be arrived at by assessing the credit worthiness of the customer. Credit worthiness is the customer's ability to repay the credit and monthly charges. Remember, this is done before a person is issued a credit card. If the holder does not repay within the agreed period, interest is charged. Therefore, it is always important for the cardholder to make full payments within the specified time to avoid interest or charges. It is important to note that credit cards are not usually connected to a bank account.

Credit cards have some benefits to the holder, trader and issuer. As a credit cardholder, you receive instant credit while the business you are buying from has a high turnover. You are also saved from carrying large sums of money around. In addition, you will find it convenient to use when buying goods or services online. The credit card issuer also makes a safe and worthwhile investment. However, as a credit cardholder you will have a limited choice of businesses to buy from because not all businesses accept credit cards. Besides, the temptation to overspend is quite high and failure to pay within a specified period attracts a charge or fine. Furthermore, there is sometimes an annual fee that must be paid for the card.

Activity 7

Now that you know the disadvantages of credit cards to the card holder, answer the following question in this activity.
What are the disadvantages of credit cards to the trader and the credit card issuer? Try to come up with at least one disadvantage to the trader and two to the credit card issuer (bank).

You may have come up with some or all the following disadvantages:

Feedback

- *The trader will not receive full payment because of the commission that credit card issuers charge.*
- *Credit card issuers have a lot of paper work to do. For example, the credit card issuer will have to handle invoices from the trader and issue bank statements every month.*
- *The credit card issuer (bank) may incur bad debts if the credit cardholder fails to pay.*

Having looked at charge and credit cards, let us now proceed to debit cards.

Debit Cards

A debit card according to Brown and Clow is "a plastic card used to pay for a purchase through EFT". EFT stands for Electronic Funds Transfer. We shall discuss Electronic Funds Transfers (EFTs) in detail in the next topic. One can even use a debit card to pay for online purchases just like a credit card. However, debit cards may also be used for withdrawing money as ATM cards as we shall see in the next topic. Debit cards provide bank customers with an alternative means of payment to cash and cheques. You may find debit cards far much better than cheques and credit cards as they enable the user to withdraw money directly from a bank account. For this reason, some people call them electronic cheques because they act as **cheque cards**. A cheque card is a plastic card issued by a bank to a bank customer with a current account. This card assures traders selling goods to the card holder that their cheques would not be dishonoured. When the bank issues this card, it guarantees payment up to a certain limit in amount.

Debit cards may not be new to you. Do you have one, or have you seen one? Figure 2 below shows the front and back view of a debit card.

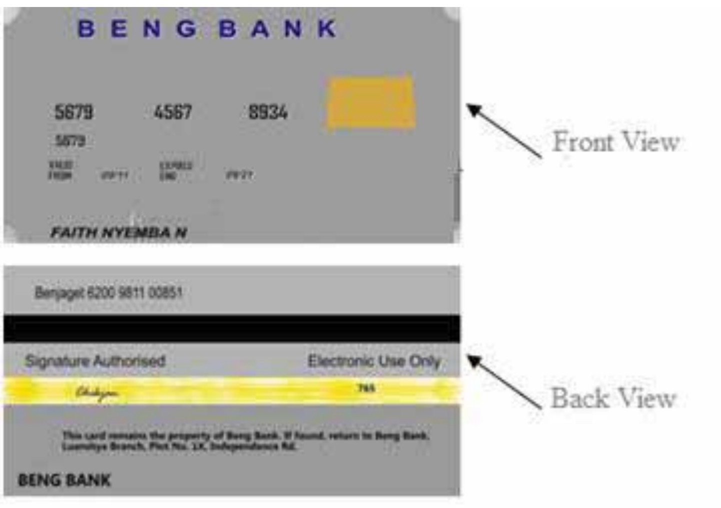

Figure 2: Debit card (front and back view). Created by Commerce Team, ZACODE, 2010.

You may not have seen this brand of debit card but basically most debit cards look similar to the one above.

We have seen that both a debit and credit card are plastic cards used to buy goods or withdraw money from a bank account. This has made it difficult for people to draw a clear distinction between a debit and credit card.

Figure 3 below summarises the differences between a debit and credit card.

DIFFERENCES BETWEEN A DEBIT AND CREDIT CARD

DEBIT CARD	CREDIT CARD
1. When one buys goods or withdraws cash using a debit card, money is taken out of the customer's current account immediately. This is because debit cards are directly connected to a bank account.	1. When one buys goods or withdraws cash using a credit card payment is made at a later date. This is why a credit card is considered as a form of short term credit.
2. No interest or annual fee is charged for using a debit card. However, if one overdraws their account, interest is charged at the end of each month. The rate of interest depends on whether there is an overdraft arrangement or not. The rate is much lower when there is an overdraft arrangement and higher when there is no such arrangement.	2. An annual fee is often paid on a credit card. In addition, a high rate of interest is charged every month on a credit card if one does not settle the bill on time or gets a cash advance.
3. The purchases one makes using debit cards are limited to the amount in the current account. Therefore, the temptation to overspend is avoided.	3. The purchases on a credit card are not limited to the amount in the account. This is because credit cards are not usually linked to bank accounts. This may cause the card holder to overspend, especially if they hold more than one credit card

Figure 3: Differences between debit and credit card

While some debit cards have one function, others have a dual-function. This means that they can be used as credit, as well as debit cards. With a dual-function card, a holder can withdraw cash instantly whether or not they have enough funds in their account. You can see that such cards enable holders to obtain cash instantly when money is available in the account and to borrow when funds are not available. An example of such a dual-function debit card with is the American Express.

In today's business world, debit cards have become more popular than credit cards due to the following advantages which we are now going to look at.

Advantages of Debit Cards

- When buying goods or withdrawing cash using a debit card, there is no need to worry about bills and interest rates as the payment is taken out of a current account immediately.
- No interest or annual fee is charged on a debit card.
- Where an overdraft arrangement exists, interest rates are low.
- Where purchases are limited to the amount in the account, people exercise financial discipline. This means that they are careful in their spending.
- Paper work is reduced as the writing of personal cheques, which may be dishonoured, is eliminated.

Although debit cards are popularly used in today's business world, they have disadvantages. One such disadvantage of a debit card is that purchases or cash withdrawals are limited by what is in the account. Where one needs more money, they must overdraw their account and if the account is overdrawn without prior arrangement, the rate of interest is quite high. Where a debit card has a daily purchase limit, the card holder will fail to buy as many goods as they want. Moreover, if there is anything wrong with the purchase, there is a high possibility that the seller would have already gotten the money by the time the cardholder (buyer) realizes. Again, if someone gets ahold of the card number or debit card, they can illegally withdraw money instantly from your account.

Travellers Cheque

Traveller's cheques are cheques that are acceptable globally. Traveller's cheques can be exchanged in any country for cash or goods. People on business trips as well as tourists may find this means of payment a suitable way of carrying money when going out of their country. One can buy traveller's cheques in local or foreign currency. As a traveller, you need to sign the travellers cheque twice:

- Once in the presence of the issuing bank official and
- Again when exchanging it for cash, goods or services in the presence of another bank official or retailer in the foreign country.

Not until they are countersigned by the person to whom they were issued, traveller's cheques are valueless. This makes them safer to carry than cash.

Topic 1: Summary

We have come to the end of Topic 1. In this topic we explored other means of payment. We focused mainly on means of payment in home trade. We particularly looked at credit transfers, standing orders, direct debits, credit cards and traveller's cheques. We also saw how these means of payments may be used and some of the benefits and disadvantages they have.

We hope you were able to do all the six activities in this topic and did them correctly. If not, read through the topic again and make sure you have understood before you go to the next topic.

Now take a break for five minutes, after which you can do the Topic 1 Exercise in the assignment section of this Unit. Make sure you do this exercise before moving on to the next topic. The exercise is designed to help you review the topic. The answers to the Topic 1 Exercise are given just below the exercises. Remember, do not refer to our answers before providing your own.

Topic 2: Trends and Rights of Customers in Banking

Introduction

In Topic 1, we discussed other means of payment in banking, particularly those used in home trade. The means of payments we discussed ranged from credit transfers to traveller's cheques. You had a chance to learn how the means of payments are used. We also looked at some advantages and disadvantages of these means of payment.

In this topic, we shall look at the trends in banking and rights of customers in banking. Almost throughout the world, the banking sector has undergone a lot of changes probably because of the new developments in technology such as the use of computers. Consumer rights have also become a big issue. This has affected the way banks operate today.

Before we proceed, let us look at the topic outcomes.

Upon completion of this topic you should be able to:

Outcomes

- *Describe* the trends in banking.
- *Discuss* the rights of the customer in banking.

Time

You should spend at least 10 hours on this topic.

Trends in Banking

The word trend is not a new concept, you covered it in Grade 10. Think of the topic of modern trends in retailing.

Reflection

- What do you remember about the word 'trend'?
- Do you remember any of the new developments or changes (modern trends) in retailing?

As you thought about the topic 'modern trends' in retailing, you may have remembered that a **trend** is a general gradual development of something new that eventually result in it becoming popular. In short, a trend is simply a new way of doing something. With reference to the topic in question, you are referring to new ways of retailing.

You may have recalled trends like branding, self service, electronic commerce, pre-packaging, voluntary chains and many others.

Like retailing, the banking sector has undergone a lot of new developments almost throughout the world. As stated in our introduction to this unit, these new developments may be as a result of improvements in technology and use of computers by businesses worldwide. Today, quicker and more efficient ways of withdrawing and transferring money exist. Before you read on do the following activity.

Activity 8

Think about the banking sector in your country today and compare it to the way it was 15 years ago.

Identify new ways employed by commercial banks in your country to conduct banking business and list them down in the space below.

If you were born after the period in question, you may not know all the trends in banking. We advise that you find out more from your friends and relatives who were there. You may also visit some banks to find out what changes have taken place. Then compare your ideas or those you learnt from banks and others to the ones provided in our feedback below.

Feedback

Well done if you did all the things suggested above! You may recall or may have learnt that the banking sector 15 years ago was characterised mainly by cheques, cash and written orders like credit transfers, standing orders etc. Today, the banking sector has undergone some transformations. Computers, telephones, mobile phones and other electronic devices are now widely used to carry out transfers of money from one account to the other and also to make inquiries on the account.

New ways of conducting banking business electronically are now used in banking. These include:

- *Electronic Funds transfer (EFT)*
- *Internet banking*
- *Telephone and mobile banking.*

You may have come up with different answers. Your answers may not have included all the ways above. On the other hand, you may have included other developments not mentioned above. Note that your new ways may be a reflection of what is occurring in your country.

Let us now take a detailed look at the trends in banking starting with Electronic Funds Transfer (EFT).

Electronic Funds Transfer (EFT)

Remember, we stated earlier that quicker and efficient ways of withdrawing and transferring money now exist. One such way is the Electronic Funds Transfer (EFT). This is a new way of transferring funds using an electronic operated device and computer-run program. With EFTs money can be withdrawn or transferred electronically within minutes. Three ways of withdrawing money using the EFT system exist. For example one can use an Automatic Teller Machine or Automated Teller Machine (ATM) as it may be called in some countries. Customers may find it convenient to pay for their purchases at point of sale using the EFT system instead of using a cheque or cash. A company may also prefer to use the EFT system for its payroll.

Let us begin by looking at Automatic Teller Machines

Automatic Teller Machine

Automatic Teller Machines (ATMs) are machines that operate in the same way bank tellers do. The only difference is that bank tellers are people, while ATMs are machines. As a bank customer, you can withdraw cash from your bank account without entering the bank building. ATMs are sometimes called cash dispensers. To dispense is to give out something. An automatic teller machine is called a dispenser because it gives out cash.

One can also transfer money from one account to another within the same bank. Some automatic teller machines may be used to deposit money into bank accounts. Others may even allow one to obtain a mini statement. Most likely you have seen one on the walls of a bank building, at shopping complexes or any other busy place. You may even have operated one. In case you have never seen or operated one, Figure 4 below shows an example of an automatic teller machine.

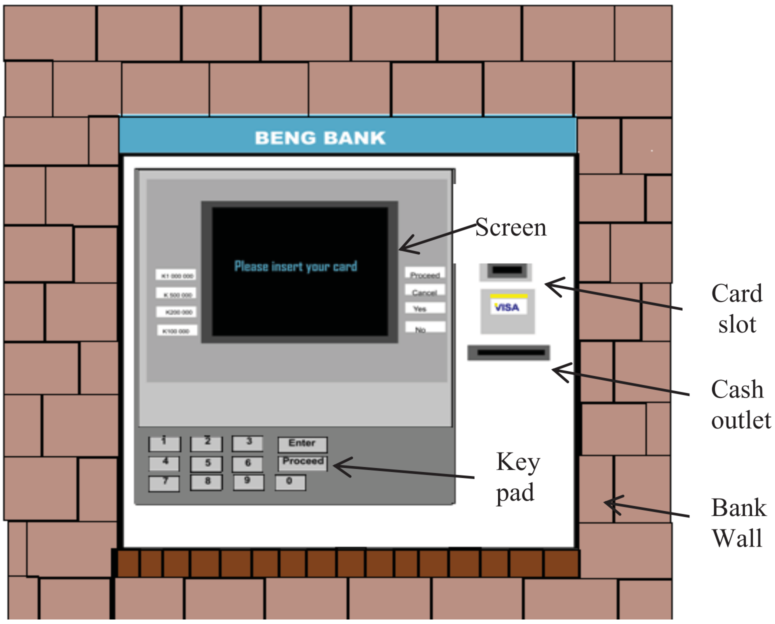

Figure 4: An AutomaticTeller Machine. Created by Commerce Team, ZACODE, 2010.

What is the procedure for withdrawing money from an Automatic Teller Machine? Withdrawing money from an Automatic Teller Machine is not a difficult task to do. All you need is to:

- Insert a special plastic card called an ATM or debit card in the **card slot** on the teller machine and follow the instructions given by the machine which will be displayed on the **screen**.

- Enter your Personal Identification Number (PIN) using the **keypad** on the machine.

- Indicate the amount you intend to withdraw. The machine will automatically determine whether you have sufficient funds in your account. If you do, it will automatically pay you the amount you requested through the **cash outlet** on the machine.

- The machine also provides you with a mini-bank statement. A mini-bank statement gives a summary of amount withdrawn and balance remaining in the account.

Tips

Do not disclose your PIN to other people for security reasons.

Benefits of using automatic teller machines are numerous. As we may have observed above, cash can be withdrawn from a bank account without one entering the bank building. This serves the customers time and energy. Moreover, an automatic teller machine is very easy to use as long as one is able to follow instructions. ATM cards are also easy to carry. ATM cards may be used as an Electronic Funds Transfer at Point of Sale or debit cards. You can also withdraw cash and obtain mini-bank statements even when banks are closed as the machine banking services are available 24 hours a day and 7 days a week. In addition, you have a wide range of places to withdraw money from as ATMs are found in a number of places including busy shopping centres.

On the other hand, the cost of maintaining Automatic Teller Machines are is far much less than maintaining human tellers. Remember, Automatic Teller Machines operate 24 hours a day and 7 days a week. Suppose a bank employed human tellers to work 24 hours a day and 7 days a week. What would the wage bill be? The wage bill would be quite high as the bank would be paying for double shifts or overtime.

Now that you know what an automatic teller machine is and how it operates, it is important to look at the disadvantages. Before you read on, do the following activity. See if you can come up with disadvantages from your own experience or what you have heard.

Activity 9

1. What in your opinion are the disadvantages of an automatic teller machine? Write your ideas in the space provided below.

2. Fill in the blank spaces

   (a)………………………… (ATMs) are machines that enable bank customers to (b)…………….. cash from their bank accounts without entering the inside the (c)………….. building. They are also called (d)………………... ATMs allow bank customers to access their money (e)…………. a day and seven days a week.

You may want to share your ideas with friends or relatives. They may surprise you with some ideas you had not thought about!

Feedback

1. *Through speaking with others, you may have discovered the following disadvantages of automatic teller machines:*

- *The mini statements that are provided by the automated teller machines are not very detailed as they may only show the amount withdrawn, date and the balance remaining in the account.*

- *There is a limit to the amount to be withdrawn on each day.*

This means that a customer who needs more money may have to get inside the bank. If the bank is closed, they have to wait for the next working day.

- *If someone picks the card and discovers the PIN code, the bank cannot know that the person withdrawing is not the owner of the account or money. It may be difficult to find out who stole the money from the account.*
- *When the ATM card is also used for buying goods, it makes individuals over-spend what they may have saved in their accounts.*

*2. **Filling in the blank spaces***

a) Automatic Teller Machines

b) Withdraw

c) Bank

d) Cash Dispensers/Automated Teller Machines

e) 24 hours

If you included all or at least four disadvantages above, well done! If not, go through this part of the topic to improve your understanding before you proceed. We also hope that your answers to question 2 are similar to the ones provided in the feedback above.

Having looked at the disadvantages of Automatic teller machines, let us proceed and see how else debit or ATM cards are used. We have just seen above that debit cards are used to withdraw money from an Automatic Teller Machine. We are now going to learn how debit cards can be used to purchase goods through Electronic Funds Transfer at a **point of sale**. A point of sale is a place in a store where a product or service is bought. Most points of sale have checkout systems that are computerized. At these points of sale, sales are recorded by scanning bar codes on the goods. The system does not only record sales, but also makes a printout of the purchases made by a customer and updates stocks in the store automatically.

Now that you know what a point of sale is, let us look at Electronic Funds Transfer at Point of Sale.

What is an Electronic Funds Transfer at Point of Sale (EFTPOS)?

An Electronic Funds Transfer at Point of Sale (EFTPOS) is a modern service offered by banks to enable people to buy goods or services without using any cash or cheques. You may have observed that some people in certain supermarkets do not use cash or cheques to pay for their purchases. Instead, they use a debit card to pay for goods and services in shops where banks have set up the EFTPOS terminals. You already know what these cards are; they were covered in Topic 1 of this unit. EFTPOS terminals are special machines installed in retail shops and in most cases at the check-out point. Some people call them swiping machines. Terminals may be connected to the computer system at the bank. You may have seen one in a shop. In Zambia, we find EFTPOS terminals in Shoprite outlets throughout the country as well as at some filling stations, supermarkets, department stores and hotels.

How to use the Electronic Funds Transfer at Point of Sale Service

When you enter a shop with an EFTPOS terminal (swiping machine):

- Collect the goods you would like to buy.
- Take the goods to the cashier at the check-out point and present your ATM or debit card.
- The cashier swipes the card in the terminal which sends a message to the bank electronically, asking for permission to deduct the amount for your purchase from your current account.
- Once permission has been granted, the amount for your purchase is taken out from your account and added to the retailer's account electronically.
- You will then be given a slip to sign for the transfer. It is important to note that the amount of transfer will also be reflected on a bank statement which will then be sent to the customer.

It is not unusual to use credit cards on these swiping machines. There are in fact some swiping machines where only credit cards are used.

Figure 5 below shows an example of a swiping machine.

Figure 5: An EFTPOS Terminal or swiping machine** accessed from **Wikimedia Creative Commons, 2010.

Remember, where one uses a credit card to buy goods or services, money will not be deducted from the customer's account immediately. Instead payment will be made at a later date, for example at the end of the month after the bank statement has been sent to the customer.

The Electronic Funds Transfer at Point of Sale Service has several advantages to both the customer as well as the trader. As a customer, you would enjoy using the service because you can get as many goods or services as you want. There is no limit as long as there is money in your account. You will also find it faster and easier to access. There is no need for you to carry large sums of cash or cheque books, all you need is an ATM or debit or credit card.

On the other hand, traders find this system more secure than cheques. There is no risk of bad debts and dishonoured cheques. The system is also simple to operate.

Stop for a while and read through the paragraph above again. You will notice that this paragraph gives the advantages of EFTPOS. Now, come up with some disadvantages in the following activity.

Activity 10

Disadvantages of EFTPOS.
Write your thoughts in the space provided below:

Feedback

Check to see if any of your thoughts are included in our disadvantages below. If all your thoughts are included, well done! If not, do not worry; just go through this part of the topic once more. You may come up with at least two more disadvantages which you can write down in your personal notebook.

Your disadvantages of EFTPOS may have included the following:

- *Like a credit card it encourages overspending, especially when the card holder has more money in their account..*
- *Obtaining permission may be delayed if the telephone line is engaged or if the whole system is down (not working). For example if there is a problem of connectivity.*
- *ATM debit cards or credit cards may be stolen and used by unauthorized people.*
- *When the funds in the customer's account are insufficient, the machine rejects the transaction. This implies that even if the customer wanted to get more goods they will not be allowed. Their purchase will be limited to the amount in the account.*

Having described EFTPOS, its advantages and disadvantages, we can now look at how EFTs are used for payrolls.

Electronic Funds Transfer for Payrolls

Many firms are changing the way they pay workers. As a firm, instead of using the credit transfer system or writing payroll cheques, you provide your bank with a computer tape containing details of your employees' salaries to be transferred to their accounts. When the bank puts the tape in their computer system, the balances in the employees' accounts are adjusted upwards. The employees get to know details of their salaries through pay slips. In Zambia, the EFT system is currently used to pay government workers. Paying workers through EFT is safer than cheques.

Money transfers may still be made through the internet. We shall now take you through a tour of internet banking.

What is Internet Banking?

Remember, in Topic 1 we defined internet banking as an electronic system of paying bills and transferring money from one account to another through the internet. With this system, customers can also view their account details.

Banks with internet banking facilities have created web sites on the internet where their customers can log in and access the banking service. To log in is to gain access to the computer system by entering the correct name or address of the web. It is important to note that the words 'log on' may be used to mean the same as 'log in'. A web site is a designed computer program that runs many interrelated parts of informational lines called network. A **network** may be defined as a system that links two or more computers and enables users to share information. On a network, files, printers and other resources can be shared. A network may be limited to a group of users in a local or global area.

With the information above in mind, the web sites created by banks are accessed only by the users allowed by them. Users should have entered into an agreement with their banks to access this facility.

For you to access the internet banking facility, you have to go to the bank, fill in an application form. As you fill in the form, you also provide your user name and the bank gives you a password that links you to your account. So, each time you want to access the internet banking service, use your username and password.

You may be familiar on how to access your account using the internet. In case you are not familiar, here is a summary of the process that should be followed:

- Log on the banks web site.
- When the web site opens, choose from the given options what you want. For example if you want internet banking, then click on it.
- A box will appear where to enter your user name and password and click on acknowledgement.

- The account then opens if the username and password are correct.
- You can buy airtime, goods and transfer money from your account to the person you want.
- When through with the transaction, the customer is expected to log out. To log out is to close the website so that no one would access your account information.

Using internet banking is as simple as explained above especially if the person has some skills in using the internet in general. Internet banking may have its own benefits to the customers. From what we have discussed, think of any advantages this service may have to the customer.

Activity 11

In your own opinion what are the advantages of internet banking. Write your ideas in the space provided below.

You may find it helpful to discuss with members of your group, if you work in groups. If you work alone, you may discuss with a friend or member of your family.

Feedback

Your discussion with others may have revealed the following advantages of internet banking to the customer:

- *Customers can access their accounts and carry out transfers from anywhere as long as there is an internet facility.*
- *Customers can monitor their accounts even before bank statements are issued.*
- *There is no need for customers to carry large amounts of money when buying goods and services.*
- *The service can be accessed 24 hours a day.*

If your list included all or at least three of the advantages, well done! However, do not worry if your list is longer than this, so long as you obtained the information from a trusted source that is fine. If on the other hand, your list is shorter than this, you may have to visit the nearest bank to find out more on internet banking and its benefits to the customer.

Internet banking does not only benefit the customer but the trader as well. The following are the advantages of internet banking to the trader:

- There will be less congestion in the bank as some customers use internet banking facility instead of going there physically.
- There is less paper work because communication is done electronically.

Though internet banking has the advantages outlined above, it also has some disadvantages that you as a bank customer should be aware of.

The following are some of them:

- You will not have access to your account if Internet connectivity fails.
- You may also be denied access to your account when there is power failure as computers mostly use electricity.
- Careless disclosure of account details may lead to internet fraud.
- There is a possibility of hackers. Hackers are individuals who use computers to get other people's information without their permission.

Having discussed internet banking, we will now move to tele-banking.

Tele-Banking

Tele-banking is one of the most recent ways of conducting banking business. Like internet banking, tele-banking uses a computer. In addition to a computer, tele-banking uses a telephone. Tele means operating at a distance and the phone is the tool used to make and receive calls. Telephones are of different types, there are land phones, mobile phone and touchtone phone depending on how the phone is made.

The most recent development in telephone technology is a cell phone or mobile phone as it is called in some quarters. A mobile phone is a portable telephone operated through wireless network. You probably own one. It is this kind of phone that is commonly used in Zambia to offer tele-banking. Since mobile phones are used, the system is sometimes referred to as mobile banking or sms banking. We believe mobile phones are used because of their ability to transfer messages right away and automatically by computer from one cell to another. The arrangement may be different in your country. In some countries touch-tone phones or other types of phones may be used.

Reflection

Apart from making and receiving calls from friends, relatives and business partners, what else do you use your mobile phone for?

Which feature on your mobile phone do you normally use?

You may have a wide range of answers like voice mail, internet, and text messages. In tele-banking it is the texting part that banks use in most cases.

To use the tele-banking service, you need to register with your nearest bank. But before you register, we advise that you acquire a mobile phone. On registration, the bank provides you with a pin code. Like the ATM PIN code, the tele-banking PIN code enables you to access your account. If you are opening a new account the bank will also provide you with an account number.

With these in place, you are ready to start using the tele-banking service. To get more information on tele-banking, we advise that you visit some banks in your area.

Activity 12

Visit commercial banks in your area and find out the types of transactions you can carry out using tele-banking.

List down the transactions in this space:

What benefits do you get from tele-banking?

If you work alone, write down the benefits of tele-banking and discuss them with a member of your family or a friend.

If you work in a group, write down the benefits of tele-banking and discuss them with your group.

Feedback

We hope your visit to a commercial bank or banks did not only expose you to tele-banking, but other banking services like those we discussed earlier. You now know that with tele-banking you can:

- *Check your account balance.*
- *Transfer a sum of money instantly from one account to another either within the same bank or to a different bank.*
- *Pay your water, electricity or telephone bills.*
- *Purchase goods of your choice.*
- *Top-up your mobile phones with the amount of air time needed.*
- *Have access to your account 24 hours a day.*

From the tele-banking services outlined above you can see that tele-banking makes banking enjoyable.

The gentleman in Figure 6 below is using his mobile phone to access banking services within the confines of his office. Review this figure and then complete Activity 10.

Figure 6: Shows a gentleman accessing banking services in his office using a mobile phone. Picture by Musonda Mathews ZACODE Science Team Member.

Activity 13

What in your opinion are the advantages of tele-banking? Write your ideas in the space provided below.

You may consider sharing your ideas with friends and family members or with members of your group to enrich your ideas.

Feedback

Well done! You may have come with the following advantages of tele-banking:

Advantages of tele-banking

- *The customer can make purchases without physically going to the bank to withdraw the money.*
- *It is relatively cheap.*
- *No need to carrying large sums of money to pay for bills.*
- *It saves time for the customer as they can do their transactions where ever they are like the gentleman in the picture making the transaction from his office.*
- *Customers can access their money 24 hours a day.*
- *Once it is activated you can use is as long as you have the account.*
- *It is a safe and simple mode of banking.*

While tele-banking is beneficial to both the bank and bank customer, it has disadvantages. Let us look at some of the disadvantages of this type of banking.

Disadvantages of Tele-banking

The following are some of the disadvantages of tele-banking:

- It encourages overspending.
- When money is transferred to a wrong account by mistake, it takes time to retrieve it and this may inconvenience the receiver of the money.
- When there is no telephone network, the customer cannot access the account.

Having a full knowledge of banking services may be meaningless if as a bank customer you don't know his or her rights. We shall now discuss the rights of a customer in banking.

Rights of a Customer in Banking

In simple terms, **rights** can be viewed as what an individual is allowed to do or have by law. It should however be noted that the term may be used differently by different groups of people as rights apply differently to right holders. For example, natural rights may not be applied in the same manner as legal rights.

Like in any other institution, customers in banking have rights. Many countries have come up with laws aimed at protecting consumers' interests in business including banking. Many governments have put in place laws to help protect the consumers' financial rights. Such laws control the activities of banks and other financial institutions.

You can now see that customers in banking have legal privileges. What is important is, knowing your rights as a bank customer. Do you know any of the rights of customers in banking? If you don't, the case study below will help you identify some of the rights. Take a few minutes to read through the case study and answer the questions that follow.

Activity 14: Case Study

1 Mr Spoon is a subsistence farmer of maize in Mkushi Farm Block. During the 2009/2010 farming season he had a bumper harvest. He decided to sell his produce to Armstrong Milling Company for which he received K100,000,000. He knew that keeping money at home is risky. So he decided to open two bank accounts on 31st April 2010 with BENG Bank, a savings account and current account. He deposited K10,000,000 in the savings account, the remainder was put in the current account. On 15th July he came to the bank with the intention of withdrawing some money from his savings account, but the bank refused to pay him. On 20th August 2010 Mr Spoon visited the bank again. When he checked the balance in his current account, he discovered that his account was closed. He seeks help from you.

Now answer the following questions;

a) Identify some of the mistakes the bank made in handling his banking activities. Write them in this space:

b) From the mistakes you identified, discuss with Mr. Spoon on his rights as a bank customer.

c) Write down points of your discussion with him.

Feedback

Well-done! You may have identified the following mistakes and rights:

1. Mistakes:

- *The bank denied him access to his money.*
- *The bank did not provide him with bank statements or account balance.*
- *The bank did not give him any notice about the closure of his account.*

2. His **rights** as a customer will include the following:

As a bank customer he has:

- *The right to be repaid his money on demand during normal banking hours.*
- *The right to be provided with a bank statement without unreasonable delay or account balance on request.*
- *The right to close his account.*
- *The right to receive interest on deposits.*
- *The right to be given reasonable notice of closure of his bank account.*

If you included other rights like the ones indicated below, that is fine.

- The right to order the bank to make payments on his behalf, provided the instructions are properly written especially for cheque payments.
- The right to secrecy of his account details. The bank should not reveal the account details to anyone unless it is compelled to do so by law or it is done in the interest of the public.
- The right to be informed of any forgery of his signature immediately the bank discovers that his signature has been forged

- The right to be assisted with safe and reliable banking services.
- The right not to be discriminated against when accessing bank products and services.
- The right to be provided with information on all services and products
- The right to be treated fairly in all dealings.

Topic 2: Summary

Well done! This is the last topic in this unit. In this topic you have learned new and different ways of transferring funds electronically from one account to another. Among them were: Automated Teller Machines, Electronic Funds Transfer at Point of Sale, internet banking and mobile and tele-banking. You also had a chance to discover your rights as a bank customer.

We hope the activities in this topic were done correctly. If not, go back and read through the topic again paying particular attention to those parts of the topic where you experienced some difficulties.

Before reading the unit summary, do the Topic 2 Exercise in the assignment section of this unit. The exercise will help you to get a clear understanding of the topic. The answers to the Topic 2 Exercise are given just below the exercises.

Unit Summary

Summary

Congratulations! You have now completed the last unit in this course. You deserve a pat on the back. In this unit, you have learned other means of payment especially those used by banks in home trade. You now know the different means of payments ranging from credit transfers to travellers cheques. You also learned the trends and rights of customers in banking. You are now familiar with new ways of transferring funds electronically like Automatic Teller Machines, Electronic Funds Transfer at Point of Sale, internet banking and tele-banking. You are also more familiar with the rights of customers in banking.

We hope you found all the in-text activities and topic exercises in this unit helpful. If you were not able to do the activities correctly, read through the unit again.

It is now time to do the tutor-marked assignment in the assessment section of this unit. When you have completed it, send it for marking to your tutor.

In addition to the work described above, you are expected to do an **end of course assignment.** You will have to do this assignment **at the study centre under the supervision of a tutor.** The time for this assignment will be specified by your tutor.

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Reading

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Assignment

Assignment

There are 3 exercises in this assignment, one for each topic. Each one of them should be written after you have completed a specific topic.

Topic 1 Exercise

1. Use one word to refer to the following.

   Means of payment used to:

a) To pay fixed amounts at set intervals.
b) Pay several creditors.
c) Pay annual fixed amounts.
d) Buy travellers like business persons and tourists.
e) Pay varying amounts from time to time.

2. Discuss credit transfers and how they can be used to pay several creditors.

Topic 2 Exercise

This exercise has two parts; A and B.

Part A.

This part is made up of five multiple choice questions. Choose the best answer and write the letter representing your answer in the box provided.

1. Which of the following can enable you to obtain goods in a store without using cheques or cash?
   - A. Automatic Teller Machine
   - B. Debit Card
   - C. Internet Banking
   - D. Tele-banking

2 In internet banking you access your account by:
   - A. entering the bank building
   - B. Inserting a debit card in the internet machine
   - C. Logging on to the banks web site
   - D. Visiting a shop

3 Automated Teller Machines operate in the same way as:
   - A. A computer
   - B. Human bank tellers
   - C. A telephone
   - D. A bank accountant

4. Tele-banking uses:
   - A. A telephone and computer
   - B. A bank and telephone
   - C. A bank and a computer
   - D. A sim card and computer

5. Bank customers have a right to:
   - A. give interest
   - B. dishonour cheques
   - C. be repaid their money on demand
   - D. to provide information on services offered by banks

PART B: Carefully examine the means of payments in picture A and B below.

A.

Customers withdrawing cash at a commercial bank.

B.

Automatic Teller Machine

Compare the benefits of the means of payment in B over A to the bank customer.

Feedback

Topic 1

Compare your answers to the ones provided in our feedback below:

1. Method of payment to be used

a) Standing order/bankers order
b) Credit Transfer/Bank Giro
c) Direct Debits
d) Travellers cheque
Direct debits

4 *Credit transfers are a means of payment that can enable a person to pay money directly into their creditor's account. A credit transfer is also known as a bank giro credit system. With this means, funds can be transferred from one account to another electronically via a facsimile or computer. To facilitate such money transfers, special software is installed on a customer's computer. Software is a program that enables a computer to do a given task, for example to transfer funds. Internet facilities may also be used to transfer funds from one account to another.*

One can use a credit transfer to make only one payment to an individual creditor. For example, credit transfers are ideal for paying a supplier of goods or services instead of using cash or cheque. While credit transfers may be used to make single payments, they may also be used to make several payments to a number of creditors. For example, as a debtor you can use credit transfers to pay your staff or several suppliers.

Credit transfers overcome certain problems associated with cheques and cash. They are also safer and cheaper than sending cash and cheques by post. When paying several people, they are convenient to use because only one cheque must be prepared to pay several people. As a result, paper work is greatly reduced. One may also pay several people by depositing cash directly into their accounts. In addition to the benefits above, time of paying several people is saved as the need for writing several cheques or counting large sums of money is eliminated. In addition, there is no limit on the number of creditors to be paid; one can pay as many creditors as they can.

When paying several people using credit transfers the following procedures are followed:

a) The debtor prepares a list of workers or suppliers with names of their individual banks and branches, account numbers, amounts to be paid to each worker and sends it together with the cheque or cash for the total amount.
b) Once the list and money is prepared, the debtor then instructs their bank to transfer individual amounts into the bank accounts of employees electronically.
c) The bank then carries out your instruction

With the credit transfer system, it is possible for money to be transferred electronically from one account to another within the *same branch or to accounts at another branch. Funds can also be transferred to accounts at different banks.*

Any person wishing to pay by credit transfers must ensure that the creditor has a bank account. They may not have one themselves.

Topic 2

Part A

1. *B*
2. *A*
3. *B*
4. *A*
5. *C*

Part B

1. *The benefits (advantages) of using Automatic Teller Machines include the following:*

- *It is easy to use as long as you are able to follow instructions.*
- *ATM cards are also easy to carry.*
- *ATM card may be used as an Electronic Funds Transfer at Point of Sale Card or debit card.*
- *Money can be withdrawn and mini-bank statements obtained even when banks are closed as automated teller machine banking services are available 24 hours a day and seven days a week.*
- *With this service you have a wide range of points to withdraw money from.*

Assessment

Assessment

Tutor-Marked Assessment 4

This is a tutor-marked assignment and should be sent to the College for marking.

The assignment has two parts A and B. You are required to answer all questions in both sections.

Part A

1. Read the following passage and fill in the blank spaces with suitable words or phrases.

Commercial banks give _____(a)______ and overdrafts to traders. An overdraft is usually given to a person with a ____(b)____ account. Anyone opening an account may be required to provide the bank with _____(c)_____ signatures. From a check or current account _____(d)______ can be ______(e)________ at any time and no ______(f)_____ is usually given. A ______(g)______ account is for small savers.

Besides giving loans and keeping people's money safely, banks also keep ____(h)_____ and _____(i)_____ safely. They also provide means of payments to their customers like ____(j)____ to enable them pay fixed amounts at set intervals.

Part B

1. Mr. Chota supplied sports equipment worth K500,000 to McMillan Jones. Mr. Jones prepared the cheque (check) below on 15th January 2011, to pay Mr. Chota. The cheque was presented to the bank the same day, the cheque dishonoured it. Carefully study the cheque and answer the questions that follow.

BENG BANK DN-090678543

Town Centre Branch

Date: 23rd April, 2011.

Pay Chota Pearce or order

the sum of five hundred and fifty kwacha only K500,000=00

Signature **J Mllan**

21 -1009-1234-098-001

c) Explain two reasons why this particular cheque was dishonoured.

d) Assuming that this cheque was only post dated, Mr. Chota would have two options: discounting it with a financial institution or waiting until it matures. What does it mean to discount a cheque or bill of exchange?

e) How can this cheque be made safe?

f) What does it mean to endorse a cheque?

g) State three other means of payment:

2. Briefly describe the following trends in banking;

a) Internet banking

b) Tele-banking/Mobile banking

c) Automated Teller Machines

d) Electronic Funds Transfer at Point of Sale (EFTPOs)