

COMMERCE

for

Senior
Secondary
Schools

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Secondary
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THEME 1

Basic information

Chapter 1

Introduction to commerce

1.1 Meaning of commerce

Commerce is the exchange and distribution of goods and services, an exchange involving buying and selling which, in a nutshell, is 'trading'. Commerce also means 'trade' but this definition narrows the meaning of commerce because commerce is more than 'trade.' Broadly, we can define commerce as consisting of all the activities involved in the distribution and exchange of goods and services. These activities are done with the help of transport, communication, warehouse, finance, advertising and insurance.

Through commerce, goods and services reach consumers at the appropriate places, at the desired condition, at the right time and in the desired quantity. Therefore, although buying and selling constitute the core of commerce, commerce is more pervasive than just mere buying and selling. It is the totality of services or activities that enable the distribution and exchange of goods and services to take place.

1.2 Scope of commerce

As fully discussed in a subsequent Chapter, productive activities in an economy can be classified into those taking place in the industrial sector, commerce and direct services sector. Activities in the industrial sector are either primary (as in farming and mining) or secondary (as in conversion of output of the primary activities into final goods, especially through manufacturing

and refining processes). Direct services, on the other hand, are those services that are rendered directly to the consumers or beneficiaries, and not on material things. Commerce, which is the third category, is, as just defined, the totality of services or activities that enable the distribution and exchange of goods and services to take place.

As shown in Figure 1.1, commerce, in turn, is about trade or buying and selling. But that is not all, as commerce also involves those other services that enable the distribution and exchange to take place. These other services are transport, communication, warehousing, advertising, banking and insurance. Therefore, the scope of commerce covers the areas discussed below.

1.2.1 Trade

As shown in the diagram above, trade (i.e., buying and selling), can be either domestic or foreign. The domestic trade comprises wholesaling and retailing; while foreign trade, in turn, consists of exporting, importing and entrepot trading, as explained in Chapter 5.

1.2.1 Supportive to ancillary services to trade

As also shown in Figure 1.1, there are six groups of activities that constitute supportive services to trade. These are as follows:

- i) Transport: This refers to movement of goods

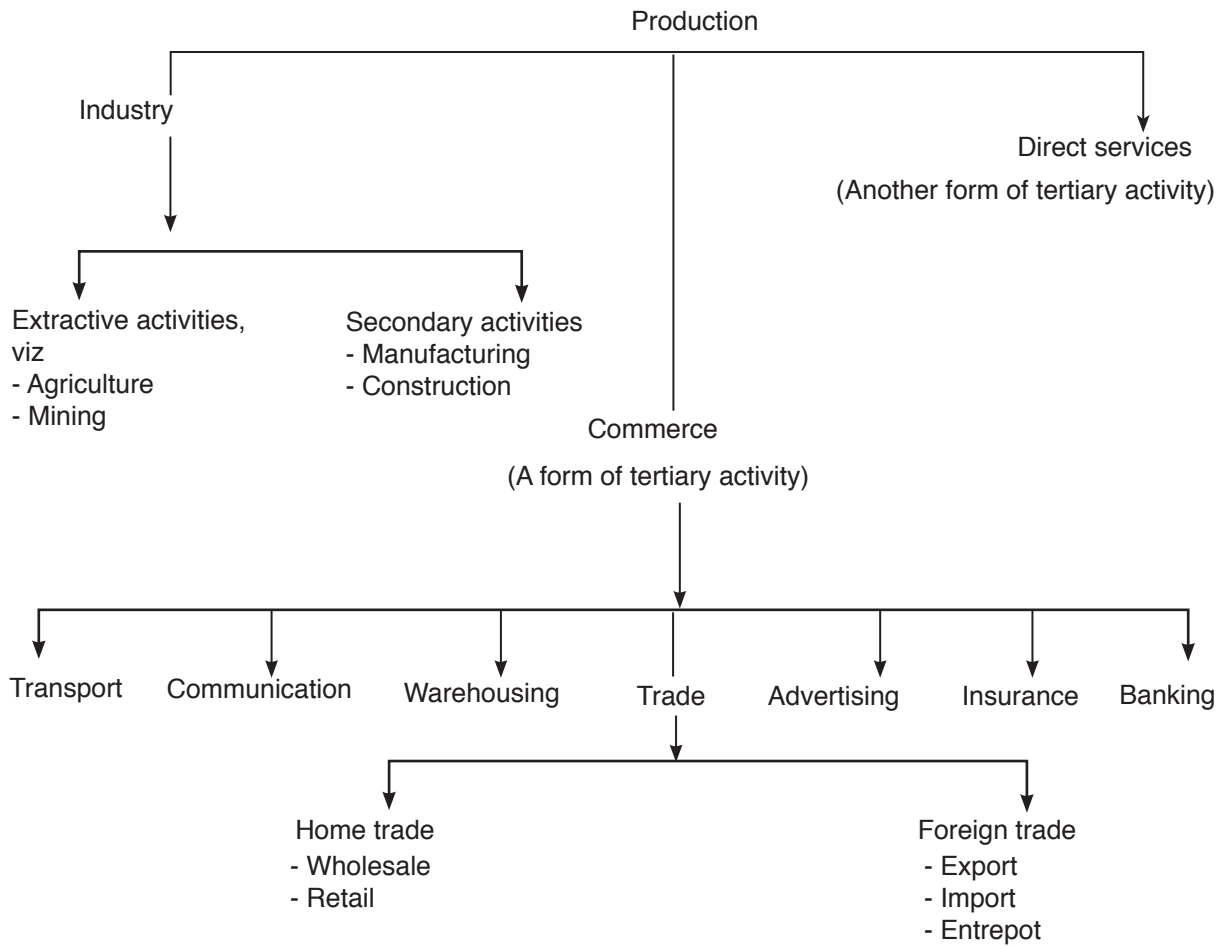


Fig. 1.1 Scope of commerce

and people from one place to another in the course of trading (and even non-trading

economic and social) activities.
ii) Communication: This is about sending



Fig. 1.2 Longman trucks about taking Longman books to customers

or dissemination of information from the sender to the recipients. Effective trading cannot take place without communication, particularly between the seller and the buyer. It is also essential for other economic activities (e.g., industrial activities) to take place.

iii) Warehousing: Goods produced by industries (manufacturers) normally have to be stored or warehoused before they are sold to consumers or users, in the same way that

raw materials from the extractive activities (agriculture and mining) have to be stored before they are used by industries (like food processing industries and mineral product refineries).

iv) Advertising: Communication of information about the existence, attributes and uses of produced goods and services to would-be buyers (who may also need to be cajoled into buying the products) facilitates trading.



Fig. 1.3 Longman warehouse



Fig.1.4 A billboard



Fig. 1.5 A banking hall

- v) Banking: Banking services, including custody of money as well as provision of credit facilities and payment mechanisms are needed for effective trading to take place.
- vi) Insurance: This is needed to underwrite or manage various risks (e.g., accidents, theft, destruction by fire, damage and loss of goods) associated with businesses, including trading. This enables traders to 'sleep with two eyes closed' about such risks and concentrate on actual trading.

1.3 Characteristics, functions and importance of commerce

1.3.1 Characteristics of commerce

The following are some of the characteristics or features of commerce:

- i) Productive activities consisting of rendering of (indirect) services as opposed to extraction or conversion of goods: Unlike

the extractive (primary) and secondary activities, commercial activities involve services that do not result in extraction of tangible, physical goods or conversion and transformation of such goods. Instead, they serve to change the location of such goods. Commercial services also are not rendered directly to consumers by bypassing goods, unlike direct services.

- ii) Linkage between primary and secondary producers with the users or consumers: As discussed above, commerce embodies all those processes that link primary and secondary producers with the consumers or buyers. It comprises all those activities that bring the goods from the place of origin (production) to the place of consumption. It is the only link between primary and secondary producers. It is also the only link between consumers and each of the primary and secondary producers – none of which can reach consumers unless through commerce.
- iii) Indispensability to other forms of production: Without commerce, other forms of production (primary production, secondary production and provision of direct services) cannot take place. This is particularly so with those commercial

activities that are aids to trade (transport, communication, warehousing, advertising, banking and insurance). Thus, these aids to trade are also aids to primary and secondary production as well as provision of direct services. However, the converse does not necessarily hold that primary and secondary production and direct services are indispensable or are strictly necessary before commercial activities (particularly, those activities that are aids to trade) can take place.

- iv) Relatively high requirements of short-term facilities and capital: As compared with primary and secondary production, commerce needs relatively less of permanent capital, fixed assets or facilities like machinery, tools, equipment, etc. Instead, it needs relatively much of inventory of goods and amount owed by debtors. Largely as a result of this, financial requirements to run commercial businesses too are relatively predominantly short-term in nature, like bank loans (which are typically short-term in nature), as opposed to debenture loans (which are inherently long-term in nature).
- v) Great diversity and broad base: Commerce is very diverse, covering many areas of productive activities like domestic buying and selling, import and export, transport, communication, warehousing, advertisement, banking and finance and insurance. Not only that, carrying out commercial activities requires a broad-based knowledge of other areas like marketing, commercial law, etc. as all covered in this Book and Books 2 and 3. None of direct services, primary production and secondary production is so diverse and broad-based and none requires such a diverse knowledge to carry out.
- vi) Greater interactions with the business environment: Related to the above are the great interactions between commercial and other activities. This follows from the fact that commerce provides a bridge or link between primary/secondary producers and the consumers, as it must relate or interact with these two groups. For instance, buying and selling requires interactions (in form of purchasing from) with primary and/or

secondary producers and with the customers or consumers while selling goods to them.

- vii) Greater contractual and legal relationships, with the attendant high degree of documentation: Following from a high degree of interactions involved is the great degree of contractual and legal relationships involved. These, in turn, entail a lot of documentation and paperwork more than in the case of primary/secondary production or direct services. Such documentation and paperwork include the several documents involved in domestic and foreign trades (ranging from invoices and letters of inquiry to the documents evidencing payments like letter of credit and receipts). No other economic activity involves so much documentation and paperwork.

1.3.2 Functions of commerce

The functions of commerce can be deduced from the scope of commerce, as we have just discussed. Based on this, we briefly outline the functions as follows:

- i) Trading: Commerce enables countries to buy from, and sell to, one another (through foreign trade). It also enables people in the domestic economy to buy from, and sell to, one another, as a result of home trade.
- ii) Transport: Commerce assists in transporting men and material to production points, and in conveying finished goods to where such goods are needed.
- iii) Communication: Similarly, it enables people to communicate with one another.
- iv) Warehousing: This provides time utility by bridging the period between production and consumption or usage of goods produced. Some goods (e.g., farm produce) are seasonal. In the absence of warehousing function, all that is produced or harvested will have to be consumed during the period while people starve when the harvest is over!
- v) Advertising: Through this, information about the existence, qualities, and uses of goods and services is communicated to the people.

- vi) Provision of credit and payment services: Commerce assists people in raising capital with which to embark on further production through the services of banks and other financial institutions, which also provide payment services..
- vii) Mitigating of risks through insurance: The risks of doing business is mitigated through provision of insurance facilities, which is an aspect of commerce.

1.3.3 Importance of commerce

Commerce is indispensable to modern economic activities in a number of ways. We shall outline here a few areas of importance of commerce to an economy but you would appreciate the special significance of commerce if you can imagine a world in which you have to produce all that you need!

- i) Enabling a country to have economic transactions with the rest of the world: Without international trade, a country would not only be able to import essential goods and services and dispose any surplus production above its domestic needs through exports, it would also be unable to borrow from or lend to the rest of the world. Its consumption at a point in time would strictly be limited to what it is able to produce at that point in time. It would also be unable to specialise in areas where it is relatively efficient to produce. Thus, commerce facilitates mass production of goods and services. People all over the world can then enjoy a variety of goods either produced locally or by the people in other parts of the world.
- ii) Enabling specialisation and division of labour to take place within the economy: Domestic trade permits individuals in an economy to focus or specialise in an area, sell the goods and services being produced and spend the proceeds on what goods and services that are desired.
- iii) Generating employment and income for people: Commerce offers employment to a large number of the populace. In Nigeria, for example, petty trading is competing

in popularity with agriculture in terms of employment while insurance, transport, advertising and banking also employ a large number of people. From these, they earn their living; that is, commerce generates income for the people.

1.4 E-commerce: Meaning, nature, origin, functions and importance

1.4.1 Meaning of e-commerce

E-commerce (which is an abbreviation of electronic commerce), in a very narrow sense, is sometimes defined as buying and selling online, i.e., through internet and other electronic media. However, as we have pointed out earlier, commerce is not just about trading or buying and selling alone. It also encompasses provision of ancillary services. Thus, this narrow conception of e-commerce is giving place in the literature to a more recent and wider conception. Based on this wider view, e-commerce can be defined as buying and selling of



Fig.1.6 Online work in e-commerce

products, exchanging of information, advertising, deployment of electronic means of warehousing, as well as banking and payments and doing insurance business through computer networks, including the Internet. In fact, some even regard e-commerce as doing commerce online, implying that all aspects of business, including business collaboration, holding business meeting through teleconference, etc are all aspects of e-commerce.

1.4.2 Origin of e-commerce

E-commerce applications started in the early 1970s through the emergence of electronic fund transfers (EFT), followed by electronic data interchange (EDI) that expanded financial transactions to other types of transaction processing and, hence, beyond financial institutions to other types of business like manufacturing and trading. EDI allows businesses to send commercial documents like purchase orders and invoices electronically. Specifically, EDI refers to the electronic communication of business transactions, such as orders, confirmations and invoices, between organisations, based on the computer-to-computer exchange of business documents between companies, thereby making EDI to replace the relatively expensive and time-consuming faxing

and mailing of paper documents. In the same manner that ETF permits financial institutions to send funds. Later applications were in the areas of stock market buying and selling, making travel reservations and buying of travel tickets online. Then, there was the advent in the 1980s of limited electronic banking (e-banking) in the form of electronic payment (e-payment) mechanisms through credit cards and automated teller machines (ATM) as well as telephone banking.

Later, in 1990, Tim Bernes-Lee invented the World Wide Web browser, which radically transformed and expanded the nature of e-commerce to what it is today. Following Internet shopping in the early 1990s, it has now become popular worldwide.

1.4.3 Facilities for e-commerce

Most e-commerce activities are now being carried out through the Internet. However, some e-commerce activities can also be conducted on private networks, such as local area networks (LAN), which refers to a computer network that is limited to the immediate area.

Network computing is the key infrastructure for e-commerce applications. Network computing is what connects multiple computers and other



Fig.1.7 Computers in use in business transactions

electronic devices that are located in various locations by telecommunications networks, including wireless ones. By this, users are able to access information stored in many different locations and are also able to communicate and collaborate with people that are in different geographical locations.

- i) The Internet: Although sometimes, people still use stand-alone computers that are not electronically linked with other computers, the majority use computers that are connected to a global network called the internet, which is accessible to every computer user with such additional devices like modems, servers and browsers.
- ii) The Intranet: Alternatively, or in addition to the Internet, there is an organisation-wide equivalent called the Intranet – which, although uses Internet tools like web browsers and Internet protocols, only connects different computers within a particular organisation that owns the intranet, but not with computers outside the organisation. The connection is through the LAN. This means that those outside the organisation would not be able to access the information on that particular Intranet.
- iii) Extranet: There is also what is called the Extranet, which is a network that uses the Internet to link Intranets of two or more organisations so that outsiders can access Intranets of such organisations (or, rather, selected portions of their Intranets that such organisations want outsiders to see).

Thus, the word online can refer to any of these three: Internet, Intranet and Extranet. But e-commerce is not limited to online transactions, as merely inserting money into an electronic vending machine and collecting the goods (with the change, if applicable) is also another form of e-commerce. However, the bulk of e-commerce is done online and, of the three online facilities just mentioned, the Internet is, by far, the most important. Also, the World Wide Web invented in 1990 is the best known way of accessing information over the Internet, to the extent that the Internet is often misunderstood to mean the World Wide Web, the protocols which constitute the totality of web servers. More about all these will be discussed in Book 2, under the chapter on

communication.

Therefore, in all cases, relevant computer hardware and software are needed to use e-commerce.

1.4.4 Scope of e-commerce applications

The areas of application of e-commerce are not only wide, they are also growing fast. Below, we briefly identify some of them.

- i) The electronic data interchange (EDI), which is already referred to above.
- (ii) Some aspects of e-banking, like e-payment mechanism through electronic funds transfer and the use of plastic cards like credit cards, debit cards, ATM cards and stored-value cards are also mentioned above.
- iii) Online travel ticketing and hotel reservations.
- iv) Electronic stock exchanges, through which brokers are able to trade in securities without having to go to the trading floors and through which investors can buy securities online without having to go to through brokers.
- (v) Online advertisement, as a result of which consumers learn about products online before buying at a 'real world' or physical location.
- (vi) Online buying and selling, with consumers learning online about the product, ordering for it online and/or receiving the good via traditional shipping or via the Internet. Thus, this can be a partial or complete e-commerce. If the consumer learns online about a product, orders for it online, and take online delivery of the goods (e.g., computer software or educational course materials downloaded in a correspondence education course programme as offered by an open university), then online trading is complete. But, if the goods are ordered for online but delivery has to be done physically, e-commerce is said to be partial. The partial one is the commonest.
- vii) Electronic tendering systems, whereby large buyers make their purchases through a

tendering or bidding process. This is related to (vi) above.

- viii) Online auctions, e.g., as made available on ebay.com and amazon.com and yahoo.com. This is also related to (vi) above.
- ix) Students participating in online education programmes to receive lectures and training.
- x) Students registering online for NECO and WAEC examinations, making payments electronically and learning of their examinations results on the websites of NECO and WAEC.
- xi) Holding virtual business meetings, including teleconferencing as well as the mutual and interactive sending of e-mail messages to members of a particular team for each member to express his views on items of agenda under discussion.
- xii) Electronic warehouse management through hi-tech machines that are linked to a computer, which is operated by a logistic automation software, with a computer program called Warehouse Management System (WMS) that is used for monitoring or tracking of the merchandise in the warehouse.
- xiii) Online advertising through e-mail messages to likely customers and information on the websites.

The above areas of application can also be categorised into whether participants in the electronic transactions are all businesses (or organisations) or consumers (i.e., individuals) or both. In this regard, we have what is called business-to-business (popularly called B2B) transactions, where all participants are businesses, e.g., when businesses purchase spare parts, fuel or services online. There are also business-to-consumer (B2C) transactions, like retail transactions with individual shoppers. To a lesser extent, there are also consumer-to-consumer (C2C) transactions whereby consumers sell directly to other consumers, e.g., online advertisement, classified ads (especially through the Intranet to invite other members of the organisation to buy) for the sale of residential properties or used cars or personal services. But the most important ones are the B2B and B2C.

1.4.5 Functions of e-commerce

E-commerce applications have been growing fast because of many functions of e-commerce, among which are the following:

- i) Sale and purchase of goods: E-commerce facilitates selling and buying of goods, often in a cheaper and faster way than through conventional trading. It is also a good supplement to augment (as opposed to replacement of) the conventional trading mechanism. Arrangements for electronic auctions and business tendering processes also exist to ensure competitiveness.
- ii) Advertisement: E-commerce includes online advertisement. This can be done through cost effective means like putting the advertisement on the organisation's website and through bulk e-mails, which are sometimes called spam.
- iii) Communication: The network (i.e., online) arrangement on which e-commerce is based means that communication and information-sharing are facilitated. Virtual meetings too can be held to discuss business matters either online or through teleconferences.
- iv) Payments or settlement of bills and raising of credit: Online banking facilitates credit transactions, including the use of credit cards, just as electronic funds transfer (ETF) and the use of plastic cards (credit cards, debit cards, stored-value cards and ATM cards) facilitate payments and bill settlements.
- v) Transportation: Online flight and other travel reservations and ticketing as well as online hotel reservations, coupled with online payments for such reservations, have facilitated transportation.
- vi) Warehouse management: Electronic management of warehouses, involving special computer hardware and software, have modernised warehousing.

1.4.6 Importance of e-commerce

E-commerce is important for businesses and the economy as a whole in many ways.

- i) **Efficiency in production:** E-commerce promotes business efficiency. Electronic or digital way of doing things, including commerce, is often precise and not prone to human factors and errors.
- ii) **Speed and accuracy:** E-commerce approach, in addition to being more precise, is faster than the 'manual' or orthodox commerce.
- iii) **Customer satisfaction and increased sales:** E-commerce is sometimes the only way to appeal to young customers, who are accustomed to modern ways of doing things. Such clientele group would rather prefer to click or press some buttons and get things done.
- iv) **Collaboration with business partners:** The networking philosophy underlying e-commerce makes it easy to collaborate with business partners.
- v) **Bringing the economy in line with global trend:** E-commerce brings the economy in line with the global trend, in the spirit of globalisation. To do business easily with the rest of the world or the international business community, a business and even the bulk of the whole economy has to go digital or electronic. A business that does not go e-commerce risks being isolated from its stakeholders, including customers and suppliers. So, without e-commerce, a business or the economy will become isolated and unable to compete in the global market.
- vi) **Promotion of competition:** E-commerce facilitates information dissemination that serves to reduce monopolistic tendencies and enhance competition. Examples are the online tendering systems or auction sites.
- ii) **Adaptation to changes:** Changing from the orthodox to e-commerce can bring some hassles, with some staff layoffs, retraining, etc.
- iii) **Ignorance of people about the technicalities, uses and capabilities of it:** Only very few people are yet aware of the capability, usefulness and, especially, how to use e-commerce. It is particularly too technical for people, except youths. Elderly people find it difficult to get accustomed to it.
- iv) **Lack of interpersonal relationship:** The usual interpersonal relationships among all the parties concerned (like suppliers and customers) are now largely lost under e-commerce, with its automated and mechanised process. Related to this is the loss of flexibility and use of human judgment, as computers and other facilities have now taken over human discretion and judgments.
- v) **Unemployment:** E-commerce is not labour-intensive but automated or mechanised way of conducting commerce. Thus, it would increase unemployment in an economy.
- vi) **Drain on foreign exchange:** The facilities for implementing e-commerce are capital goods that are not produced within a developing economy like Nigeria. So, they have to be imported, thereby draining the country's limited foreign reserves.

1.4.7 Disadvantages of e-commerce

Despite the importance and advantages of e-commerce, there are a number of disadvantages that a business may have to face. They include:

- i) **Costs of introducing and expanding e-commerce facilities:** As mentioned earlier, e-commerce requires computer hardware and software, including modems, servers, etc. The cost of these can be very high.

Revision questions

Essay questions

- 1 Explain the term 'commerce'. What are the functions of commerce?
- 2 By means of a schematic diagram, show the main divisions of production.
- 3 Explain any five branches of Commerce.
- 4 Explain any five characteristics of commerce.
- 5 What do you understand by e-commerce? List any six areas of application of e-commerce.
- 6 Discuss any five roles and three disadvantages of e-commerce.

Objective questions

- 1 Trade between different countries is known as
 - A retail trade.
 - B import trade.
 - C wholesale trade.
 - D foreign trade.
 - E home trade.
- 2 Buying and selling of goods and services over electronic systems are an aspect of what is called
 - A e-online.
 - B e-mail.
 - C e-commerce.
 - D Internet.
 - E e-payment.
- 3 Commerce belongs to
 - A primary occupation.
 - B secondary occupation.
 - C tertiary occupation.
 - D factory occupation.
 - E functionary occupation.
- 4 One of these is not commerce activity:
 - A Banking
 - B Advertising
 - C Mining
 - D Warehousing
 - E Communication
- 5 Exchange of goods and services for goods and services is known as:
 - A money economy.
 - B trade by barter.
 - C barter economy.
 - D money trade.
 - E exchange economy.

Chapter 2

History of commerce in Nigeria

2.1 A brief History of commerce in Nigeria

2.1.1 Introduction

Commercial activities have grown by leaps and bounds in Nigeria. The objective of this section of the Chapter is to examine the evolution of commerce in the country from the ancient period, when there was absence of trade or what is called autarky, till modern times, particularly the end of the first decade of the 21st century (2010). In doing this we have divided Nigerian economic or commercial history into four epochs. The first is the ancient time, before around 1000 AD, for which there exists little or no records of trading relationships of the tribal peoples in what is now Nigeria. The second is from about 1000 AD till around 1500AD, during which fragments of history exist for various ethnic groups as well as their trading relationships with outside their immediate communities. The third epoch is between around 1500 till the period of independence in 1960 when Nigerian communities had contacts with Arabs and Europeans, who eventually colonised and amalgamated Nigeria. The last period is the post-independence era, from 1960 to date.

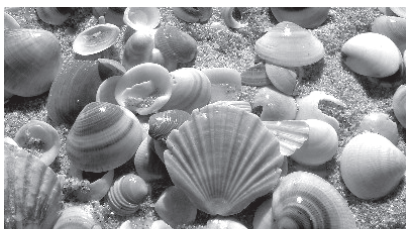


Fig. 2.1 Early currencies



Fig. 2.2 Trade by barter

2.1.2 Commerce in Nigeria before 1000 AD

- i) In the beginning, there was autarky or absence of trade: Little is known about the way of life of the communities that presently constitute Nigeria. However, it should be correct to speculate that those communities too would be living the primordial lifestyles that were similar to Stone Age lifestyles of their contemporaries in other parts of the world. Over time, such lifestyles involved pre-stone age styles that graduated to stone-age, to copper age, etc. The economic or 'commercial' arrangements that are characteristic of such primordial age are first, autarky, whereby no trade took place

so that every individual or family had to consume only what he or it produced.

- ii) Thereafter, trade by barter co-existed with and later replaced autarky: The next stage is the emergence of a crude form of trading but without the use of money, which is called trade by barter. The commercial situation where the forebears of almost all of Nigeria's present communities found themselves by 1000 AD was an admixture of autarky and trade by barter, with some barter system co-existing with autarky.

Over the years, prior to around 1000 AD, there was an increase in the importance of barter system of exchange vis-à-vis autarky. This also means that there must also have been some specialisation that started to increase over time. This practice of specialisation started from the time when man started to live a settled life instead of a nomadic life. When man ceased to be a hunter, he started to produce goods and services with the natural endowments which he found around the environment within which he lived. For instance, while those who found themselves near lakes and rivers became fishermen, those who settled on fertile land became farmers. The types of soil as well as the weather also decided the types of crops that the farmers planted. While some types of soil and weather favoured cultivation of root crops such as yam, cassava and potatoes, others favoured cultivation of grains such as beans, millet or rice. As a result of these differences in natural endowment, people from different localities produced different goods and exchanged some of what they produced for what they could not produce. The fisherman exchanged some of his fish for some yams of the farmer. The palm oil producer gave out some quantity of palm oil in exchange for some quantity of rice from the rice farmer. As pointed out above, this exchange of goods for goods was known as barter.

2.1.3 Commerce in Nigeria between 1000 AD and 1500 AD

- i) Use of foreign money for foreign and domestic trade later emerged, co-existing with and gradually displacing trade by barter: During this period, there were some commercial transactions with the outside world, including outside Africa, through the trans-Atlantic trade. By the end of the period, trading relationships had also started with Europe. The emergence of such commercial interactions with outside Africa led to the receipt of foreign currencies in return for the exports of Nigerian communities and the subsequent use of such currencies in making payments for their imports, because the trans-African trade was not always by barter. Later, such foreign currencies started to circulate domestically, within the communities, thereby making the use of money to co-exist with trade by barter at the domestic front.

With money as a medium of exchange, it became possible for people to sell some of what they produced and use the money realised to buy some other goods that they could not produce. With time, barter economy gradually gave way to money economy. The change to money economy was hastened by the advent of the Europeans, pioneered especially by the Portuguese sailors. With the arrival of the Portuguese sailors, the pattern of trade changed dramatically. The Europeans brought with them a large number of currencies and exchanged these currencies for slaves and local goods. Some of these early currencies included cowries from the Indian Ocean, horseshoe-shaped copper manilas, iron bars, etc. Some of these Europeans brought in 'Maria Theresa dollars' which were said to be especially manufactured for African markets. The Dutch also got heavily involved in trade with West Africa in the early times. For instance, they exported wax and pepper from Benin in Nigeria. These exported items were exchanged for guns,

cloth, gunpowder, brass rods, looking glass, beads, jack knives, casks of rum and fishing hooks. Other export commodities of Nigeria to European countries, including France and Britain, in the early days included the famous woven cloth, cotton and leather works from Kano.

- ii) There was also the trans-Saharan trade through which centres for bartering of goods evolved into markets: Export trade over long distances required traders who transported these goods to exchange them with goods of distant customers. These traders followed familiar paths and, as the paths moved from one locality to another, trade developed along the routes. Centres for bartering of goods developed into markets, villages and towns. This was how the ancient kingdom of Ghana became an important commercial centre for exports. The fall of Ghana shifted trade centres to Songhai, Kano and Hausa cities.

The kings of Bornu established important trade centres for exports to countries of North Africa. Firearms were first imported into Bornu from Egypt since Bornu at that time was the trade link between Lake Chad and the Nile. Bornu was also an important trade link between Kano and other countries of North Africa, as well as northern and southern Sudan. All trade with the south were channelled through Kano. Thus, Kano and other Hausa cities became important trade centres. Kano was an industrial city and its dyed cloth was exported to all over North and West Africa. Horses from Tripoli and kolanuts from West Africa were among the prominent trading commodities.

- iii) Organised domestic or inter-community trade too evolved and blossomed: Commercial activities also featured prominently along the Niger and Benue rivers. Important trade centres were established in Raba near Jebba on the River Niger and in the areas around Lokoja, the Niger-Benue confluence. In these centres, Hausa, Yoruba and Nupe traders met the Arabs, who had established business links with Kano, Sokoto, Bornu and other countries of North Africa. The Arabs were

the principal dealers in horses, red caps and raw silk from Tripoli. The principal commodities found along the Niger were onions, sweet potatoes, corn, ivory, leopard skins and slaves.

During this period, organised trade developed as goods were brought for barter to one of the villages in turn in successive days or weeks. This practice of shifting market day trading had taken root, with both barter system and the use of money co-existing in such markets. This practice entailed shifting of market days from one village or locality to another, a practice that still exists in the rural communities.

2.1.4 Commerce in Nigeria between 1500 AD and 1960

- i) Trans-Saharan trade declined but coastal trade with Europe increased in tempo: The rising tempo of commercial activities towards the end of 1500 AD continued into this new era. But the so-called discovery of the new world (America cum Caribbean continent) by Christopher Columbus just before the end of the sixteenth century (specifically, in 1592) changed the pattern and direction of Nigerian external trade, just as the wars of Northern Africa in the sixteenth century.

These wars affected the trans-Saharan trade and as a result, the West African trade shifted southwards to Europe. On the coasts of West Africa, slaves and agricultural products were the potential commodities. Slaves were needed in the new world 'discovered' by Columbus. European traders brought manufactured goods such as textile materials, guns, gunpowder, metal wares, distilled gin and tobacco and exchanged them for slaves. The Europeans either built trade forts or traded from their ships anchored in the river. The coastal chiefs and heads of families acted as middlemen between the Europeans and the people of the interior. These kings who constituted the landlords prevented the Europeans

from going into the interior to trade directly with the people. For instance, King Kosoko of Lagos prevented European entry into the interior by constantly interfering with direct trading between Lagos and Abeokuta. King Jaja of Opobo too resisted European entry into the interior. Except few ones like King Jaja who organised direct export to Europe, Nigerians only served as agents and middlemen in the early trade with Europeans. They performed the function of collecting the goods from the interior and exchanging them with the Europeans on the coast for foreign made goods.

- ii) Series of political developments influenced the direction, structure and volume of trade: Some decades before Nigeria got independence in 1960, the influence of Great Britain on Nigeria was growing. This started with the 1884/85 Berlin Conference in Germany, at which almost all the area now known as Nigeria was conceded to Britain by other European countries as a British colony. Almost simultaneously, in 1886, the British government granted a charter to the Royal Niger Company (RNC), an adventurous business organisation, to administer Nigeria before the charter was withdrawn in 1900. While the charter lasted, the RNC had a sort of monopoly to trade over almost all that now constitutes Nigeria and it used the political power and monopoly right to deprive France and Germany access to trade in Nigeria. The outcome of the Berlin Conference and the success of the RNC in fending off trading competition from other European business interests consolidated British influence on the polity, economy and external commerce of Nigeria, which was then being administered separately as Lagos Colony, Southern Protectorate and Northern Protectorate until the Colony and Protectorates were amalgamated in 1914 to constitute what is now called Nigeria. So, with these political developments, the pattern and, especially, direction of Nigeria's external trade tilted strongly in favour of Britain, away from earlier trading partners like France, Portugal and Spain. The political developments also led to increase in the volume of external and domestic trade.

- iii) The abolition of the above trade and development of various aids to trade also played a role in the evolution of domestic trade: With the abolition of inter-tribal wars towards the end of the 19th century and the earlier abolition of slave trade, external trade received a boost, just as the domestic trade. Another boost to trade occurred with the commencement in 1906 of construction of road and railway networks that linked Lagos with the hinterland. Although this was primarily motivated by the desire to facilitate movement of goods from the hinterland to the ports in Lagos so that they could be exported, the transport infrastructures also promoted development of domestic trade simultaneously.

Thus, before independence in 1960, domestic trade had taken root, with certain goods produced in the northern part moving to the southern parts to be sold and vice versa. The same holds for eastern-western movement of goods. Apart from road and rail networks, other ancillary services to trade started to emerge. First, the embryonic 'Central Bank', called the West African Currency Board, was established in 1912 to issue money that constituted legal tender in the British West African colonies, including Nigeria. Earlier, the first commercial bank, British Bank of West Africa (now known as First Bank of Nigeria) was established in 1894, followed in 1917 by the Barclays Bank (now known as Union Bank). In 1921, the first insurance company, Royal Exchange Assurance, was also established. All these started to impact positively on trade development.

2.1.5 Commerce in Nigeria since 1960

- i) The emergence of crude oil and gas changed the structure, direction and volume of trade: Initially after independence, there was no marked difference in the volume and pattern of trade, both domestically and externally, with the external trade still being dominated by Great Britain. But after the end of the civil war in 1970, there were

certain changes. First, crude petroleum resources started to dominate Nigeria's exports, particularly from 1973 onwards. This retarded the growth (and, indeed, caused a decline in the volume) of Nigeria's traditional exports. But, on the whole, it increased the overall volume of Nigeria's exports because petroleum exports more than compensated for the decline in the traditional exports.

The direction of external trade also changed, partly due to political independence from Britain and partly because of emergence of oil. Trading with Britain has since been declining because of decreasing political clout over Nigeria and because Britain does not need to buy oil from Nigeria since it was also producing (until recently) oil from its North Sea. It is the US that has been buying the bulk of Nigeria's oil. Also, the first decade of this 21st century has witnessed the rising profiles of China and India as important trading partners of African countries, including Nigeria. Concerning Nigeria's imports, they still continue to be consumer and capital goods. Domestic production of consumer goods has not been able to compete effectively with imports.

- ii) Rapid developments in aids to trade have also promoted trade: Also, the period since 1960 has witnessed some remarkable developments in ancillary services for trade. There are now many road networks, although the old railway networks have been in a state of disrepair and disuse, without being replaced by new ones. Concerning telecommunications infrastructure, Nigeria too is not left out of the global emergence and use of the new wireless or mobile telephony technology. Also, many types of banks and other financial institutions now exist in the country, as do many insurance companies. In addition, there are now many commercial warehouses. There are also many advertising companies or agencies.

2.2 Factors which have influenced the growth of commercial activities in Nigeria, and problems of commerce in Nigeria

2.2.1 Factors which have influenced the growth of commercial activities in Nigeria

The rapid growth in commercial activities over the past few decades can be attributed to a combination of factors. We shall discuss some of these factors.

- i) Monetisation of the economy: The use of commodity money such as cowrie shells, manilla, copper rods, etc., superseded trade by barter. Commodity money facilitated internal trade. However, commodity money is not a generally acceptable means of exchange. Therefore, trade with the outside world was still largely based on barter. For example, palm produce was exchanged for alcoholic drinks. Later, currencies facilitated foreign trade. The trend continued until 1912 when the West African Currency Board (WACB) was established. The WACB withdrew all foreign currencies from domestic circulation and issued a common currency for Nigeria, Ghana, Sierra Leone and Gambia. Nigeria's trade with the outside world was greatly enhanced because the WACB currency was easily convertible to the British pound sterling which was the most widely acceptable currency for international trade. Monetisation of the economy received a further boost with the establishment of the Central Bank of Nigeria on 1 July 1959.
- ii) Evolution of modern banking practice: In Nigeria, international trade and foreign trade have been enhanced with the establishment, in 1894, of the British Bank of West Africa, now known as First Bank of Nigeria. Subsequently, many other commercial

banks were established. The presence of these commercial banks has greatly accelerated trade and further reinforced the monetisation of the economy.

- iii) Growth of transport network: Early in the twentieth century, construction of road and rail networks commenced with vigour. Since then, there has been remarkable growth especially with the road networks. Massive growth has also been recorded in the sphere of air and water transport systems. The growth of all these transport networks has served as a great impetus to growth in commerce.
- iv) Growth of post and telecommunications system: The growth of post and telecommunications system has served as a great impetus to both domestic and foreign trade. The arrival of especially the gsm technology has served as an additional catalyst in this regard.
- v) Advances in technology: Advances in technology have aided commercial development in several ways. The arrival of information technology is particularly remarkable in this respect. Also, in general, technical progress has resulted in large-scale production, very much in excess of self-consumption. This demands increased specialisation and exchange which form the basis of commerce.
- vi) Warehousing development: Many warehouses have also sprung up, especially in cities like Lagos. Their growth has seemingly kept pace with requirements of volume of trade being handled.
- vii) Growth of insurance business: In 1921, the Royal Exchange Assurance established the first insurance company in Nigeria. By 1949, three other insurance companies were established. Today, the number of insurance companies is more than 80. This rapid growth in insurance business has promoted the growth of commerce.
- viii) Evolution of modern traders: With the overall development in the economy, a class of adventurous businessmen emerged. This class is ready and able to venture into commercial business.
- ix) Computer networking and the advent of e-commerce: The advent of computer

networking (including the Internet) in the early 1990s has revolutionised globally the e-commerce that was just emerging then. This global trend has impacted on similar developments in Nigeria, where e-commerce has also started to take root to complement the orthodox commerce.

- x) Digital information technology: Related to the above is the advent of the digital or information technology. This has placed buyers and sellers only a click away from each other through the Internet, including e-mails.
- xi) Political developments: Right from the pre-colonial period, political developments had been shaping the pattern and volume of Nigerian trade. Colonisation by European countries, the Berlin Conference of 1884/85 that conceded to Britain the areas forming the present Nigeria, granting by Britain of charter to the Royal Niger Company (a trading concern that was the precursor of the present UAC PLC) to administer Nigeria and the eventual revocation of that charter, the merging in 1914 of the Lagos Colony with the Southern and Northern Protectorates to form a single country, and the independence of Nigeria from Britain in 1960, are some of the political landmarks that shaped the trading pattern and volumes.
- xii) Population size: From a population of about 56 million in 1963, Nigeria's population has increased about three times since independence to over 150 million in 2010. The rising population also means rising volume of domestic and foreign trades.
- xiii) Steady, though slow, increase in income or affluence of an average Nigerian: The level of affluence of an average Nigeria (technically called per capita income in Economics) has been rising steadily, though slowly, over the past decades. This, just like the population size, has increased the purchasing power (or ability to buy goods and services) of people and, hence, the volume of trade.
- xiv) Emergence of crude petroleum oil and gas: The emergence of crude petroleum oil and gas has not only transformed the pattern of Nigeria's export to a monoculture type (whereby oil and gas now accounts for over 90 per cent of foreign trade), it has also

increased the overall volume of external trade.

2.2.2 Problems of commerce in Nigeria

Notwithstanding the growth witnessed by commerce over the years, commerce in Nigeria has faced many challenges or problems, which all served to moderate or reduce the growth below what it should have been. The problems facing commerce in Nigeria include the following:

- i) **Inadequate transport infrastructure:** Inadequate and poor networks of roads, rail, inland waterways, airports and seaports constitute a problem that has hampered commerce in Nigeria.
- ii) **Poor state of power supply:** This has raised the cost of carrying out commercial activities, which are often based on expensive stand-alone power generators.
- iii) **Bad state of communication facilities:** The national postal services do not operate as efficiently as they should, making commercial businesses resort to the expensive private courier services. Similarly, telecommunication system does not operate efficiently as they should, despite the advent of wireless telecommunications.
- iv) **Challenging legal environment:** Commercial activities thrive best when the legal environment operates efficiently and effectively. But in Nigeria, many of the pieces of commercial legislation are outdated; they date back to the colonial or pre-independence era despite post-independence developments that have necessitated amendments. Worse still, the extant laws are not properly enforced or executed. There are many instances of important commercial cases pending for over a decade within the judicial system, despite the dictum that justice delayed is justice denied!
- v) **Limited access to finance:** Many existing or would-be operators or owners of commercial enterprises do not have access to finance due to the capital market that is not deep enough and the unwillingness of banks and other financial institutions to liberally lend to such businesses – again, partly due to the challenging legal environment that would enable the lenders to recover their loans.
- vi) **Inadequate virile commercialists:** There are not enough determined commercialists, i.e., entrepreneurs that genuinely opt to go into commerce. Getting and executing government contracts and other related activities that are based on government patronage, by bringing ‘soft money’, poach and lure away prospective commercial entrepreneurs.
- vii) **Limited market size resulting from low income and, hence, purchasing power of people:** The market size is limited because people are generally poor. This limits their ability to patronise the goods and services offered by commercial enterprises.
- viii) **Low productivity or efficiency of workers:** Probably due to low education, low morale, low commitment or inappropriate orientation and attitude, the productivity of the workforce or workers in the commercial sector and activities (just as in most other activities) is lower than it should be.
- ix) **Inability to compete in foreign and domestic markets:** Due to problems like infrastructural deficiency, general low efficiency and over-valuation of the naira vis-à-vis foreign currencies, Nigerian goods find it difficult to penetrate foreign markets. This has reduced the growth of export trade in Nigeria. For the same reasons, foreign importers and exporters also do not find it economical to use Nigerian banking and insurance services when exporting to or importing from Nigeria. Also, for similar reasons, Nigerian importers and exporters would rather patronise the financial services of foreign banks and insurance companies to finance and insure their imports and exports. Bearing in mind that banking and insurance are a part of commerce, the growth of commerce has been hampered by all these.

2.3 The barter system

As pointed out earlier, trade by barter is the exchange of one good for another, without the

use of money. This is a primitive or primordial form of exchange. Under the system, each trader would exchange the surplus of what he produces in excess of his own requirements for another commodity that he needs to have.

In the context of evolution of commerce and exchange in Nigerian early communities, trade by barter led to crude exchange which, in turn, led to some degree of specialisation. When man ceased to be a hunter, he started to produce goods and services with the natural endowments which he found around the environment he lived in. (This has been discussed under 2.1.2 (ii). You are advised to read that section again.)

But the barter trade has several disadvantages over the use of money. First, it requires a double coincidence of wants whereby the person who has a surplus of commodity A to sell in exchange of commodity B that he needs will also locate another person that has a surplus of commodity B to exchange for commodity A that he has. Besides, it becomes difficult to measure the value of goods that are being exchanged in a standard unit. Also, borrowing and lending will be difficult under that system and that means that each individual will have to confine the value of his consumption during a period to the value of what he produces and vice versa.

Revision questions

Essay questions

- 1 Briefly outline the history of commerce in Nigeria.
- 2 Discuss the various factors which aided the growth of commercial activities in Nigeria.
- 3 Discuss any six problems facing commerce in Nigeria.
- 4 Explain five factors that facilitated the growth of commercial activities in West Africa (WAEC).

Objective questions

- 1 Which of the following was not used as a means of exchange in the early days of trade

in West Africa?

- A Cowries
- B Manilas
- C Pounds
- D Dollars (WAEC)

- 2 Which of the following was the chief means of transport during the trans-Saharan trade?

- A Aeroplanes
- B Motor lorries
- C Camels
- D Horses (WAEC)

- 3 Which of the following pioneered trade in West Africa?

- A Portuguese
- B Russians
- C Americans
- D Indians

- 4 The exchange of goods for goods is

- A entrepot trade.
- B barter trade.
- C multilateral trade.
- D foreign trade.

- 5 Which of the following has not been a major impediment to growth of commerce in Nigeria?

- A Large population size
- B Poor state of infrastructure
- C Poverty and low income
- D Non-conducive legal environment

Chapter 3

Occupation

3.1 Meaning and nature of occupation

Occupation is the work that people do for a living. Another name for it is the job that one does. Occupation is not the same thing as profession; profession is what people are trained for and certificated to do.

There are many bases or criteria for classifying occupations. First, we can classify it on the basis of the skill involved; that is, skilled and unskilled occupations. We can also classify it according to whether it involves paid employment or self-employment. Even within the category of paid employment, we can classify occupation according to the type of employers; whether in public sector or private sector paid employment. Also, we can categorise occupations according to the sector (viz: industry, commerce or direct services sectors) where the job is being performed. In our subsequent discussion in the Chapter, we shall adopt this last classification in the main, although occasional references will be made, where appropriate, to the earlier classifications.

3.2 An overview of types of occupation

The types of occupation we are focusing on here are based on the sector where the employment takes place. By sector we refer to industry, commerce and direct services sectors. As already discussed in Chapter 1 (see the schematic diagram in Figure 1.1 of that chapter), industry can be sub-divided into primary and secondary groups of activities, while commerce can be divided into trade and six categories of ancillary services to trade (transportation, communications, advertising, warehousing, banking and insurance). The third category is that of direct services. Refer to Figure 1.1.

However, what we have done below is to discuss employment opportunities and types of occupation in each of the three broad sectors of industry, commerce and direct services.

3.3 Occupations in the industrial sector

As has already been explained, the industrial sector comprises the primary and secondary groups of activities. While the primary group comprises the extractive activities of farming and mining, the secondary group is made up of manufacturing and construction. As will be more fully discussed in the next chapter, the secondary activities consist of transforming the output, that is, the raw materials received from the primary activities, into finished goods. The different categories of each of the primary and secondary groups of activities are as shown in the schematic diagram of Figure 3.1 below.

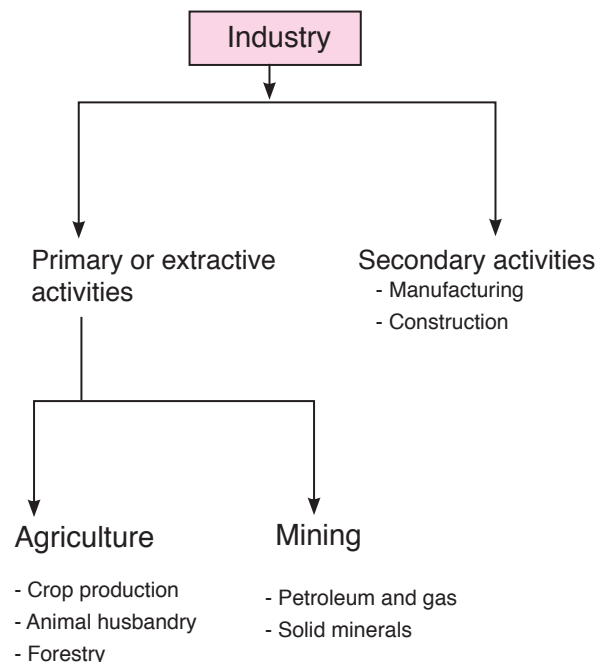


Fig. 3.1 Employment opportunities in industry

Let us now examine the types of occupation in each of these two categories of industrial activities.

3.3.1 Occupations in agriculture and mining

- i) Various divisions of agriculture and mining: As shown in the schematic diagram above, primary or extractive activities can be divided into agriculture and mining. Agriculture can be divided into crop production (where different crops are produced), animal husbandry (which consists of livestock, poultry, piggery, rabbitry, and so on – probably also including the latest trend of rearing of snails, grass cutters, etc), fishery and forestry (including lumbering and hunting). Each agricultural outfit or farm can be small-scale (as in peasant farming), or large-scale (which is sometimes called plantation). Mining, on the other hand, comprises extraction of crude petroleum (oil and gas) and of solid minerals, both metals and non-metals. Mining outfits are usually on a large-scale basis, when compared to agricultural farms.
- ii) Employment opportunities in each category and sub-category of agriculture and mining: Each of these long lists of activities sheds light on employment opportunities that exist therein for both paid employment and self-employment. To get employment in each of them, one only needs to look at the existing organisations (existing farms in the case of agriculture and existing mining outfits in the case of the mining sector) and apply for jobs that are suitable for one’s academic qualifications and working experience. Thus, with commerce education, one can be employed as a marketer (advertising officer, sales representative, etc), purchasing officer (for procuring raw materials, e.g., animal feed and fertilisers), etc.

3.3.2 Occupations in manufacturing and construction activities

As mentioned before, secondary activities comprise manufacturing and construction, both of which transform the raw materials got from the primary activities. Manufacturing is a modernised sector of the economy so that it offers opportunities for modern employment opportunities. The construction sector, on the other hand, can be sub-divided into property development and road infrastructure development sub-categories. The property development portion is in charge of building construction while the road infrastructure sub-category is in charge of construction of road networks, bridges, etc.

Each manufacturing and construction company would have positions for marketers, salesmen, purchasing officers, warehouse or store officers, etc that a commerce graduate can apply for. Obviously, procuring the supply of materials inputs used in an industrial activity and the sale of the resulting products are all commercial activities. Thus, knowledge of commerce would greatly enhance employment in industrial activities.

3.4 Occupations in the commercial sector

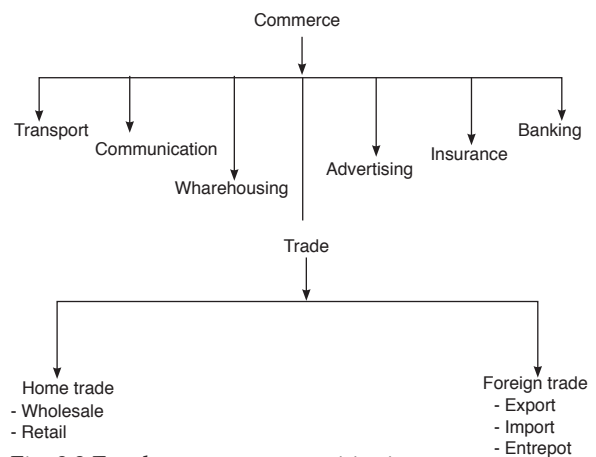


Fig. 3.2 Employment opportunities in commerce-related activities

Figure 3.2 above shows the various areas of commerce that were discussed in Chapter 1. Both self-employment and paid-employment jobs exist in these areas, as we now discuss below.

3.4.1 Self-employment

Self-employment is the surest way of getting employed, and our previous discussion has shown the following as some commercial activities which an individual can embark upon.

- i) *Transport*: An individual can operate transport business which would provide passenger services, for example, taxi transport services and/or haulage services.
- ii) *Communication*: The only apparent communication business that can be engaged in by individuals is the operation of courier services, i.e. mail delivery (which will be discussed in detail later).
- iii) *Warehousing*: Private individuals can own warehouses (i.e., depots) which they can lease to users.
- iv) *Banking*: This does not offer much scope for self-employment as a bank is a large limited liability company that is not easy to set up.
- v) *Advertising*: Advertising agencies can be set up for the patronage and consultation of businesses that want to get their products advertised.
- vi) *Insurance*: While it is not easy to set up an insurance company, it is relatively easy to be an insurance broker or any other form of independent insurance agent.
- vii) *Trade*: One can become a self-employed trader of various types - a retailer, a wholesale trader, an importer and an exporter. As compared with other forms of self-employment, trading appears to be the one that is least risky and which brings quickest returns (i.e., profits) at the same time.

3.4.2 Paid-employment career opportunities in commerce

- i) *Personal selling*: Personal selling is an important and most labour-intensive

aspect of marketing. As a result, it is the most prominent area where people with an educational background in commerce have a good prospect of getting paid-employment. Personal selling concerns face-to-face interactions between the seller (or seller's representative) and the potential buyer. The scope of personal selling jobs is wide. They are found in various organisations – manufacturing, farming and trading firms as well as service-oriented organisations and financial institutions (e.g., insurance companies). The jobs embrace a wide range of positions and titles ranging from very low positions to top management positions.

- ii) *Purchasing*: One could work with a manufacturing, agricultural or trading concern as a purchasing staff; either as a purchasing clerk, purchasing officer or purchasing manager depending on one's level of education and experience.
- iii) *Warehousing*: Similarly, there is a scope to work with a manufacturing or trading firm as a stores clerk, stores officer, etc. The main duties in warehousing involve the receipt of goods bought, taking custody of the goods, and issuing them when they are to be processed or sold as the case may be.
- iv) *Government departments*: There exist some job opportunities in government departments in the purchasing, storage, and other sections.

3.5 Occupations in the direct services sector

As will be explained further in the next chapter, direct services are those services rendered to, and final consumers. As shown in the schematic diagram of Figure 3.3 below, direct services are provided by both the formal professionals and relatively informal professionals. The formal professionals comprise registered members of legal, medical and advisory professionals, i.e. the practitioners are lawyers, medical doctors, professional advisers, teachers, and so on. The relatively informal professionals, on the other hand, comprise artisans like beauticians, hairdressers and barbers, tailors, photographers, caterers, and so on.

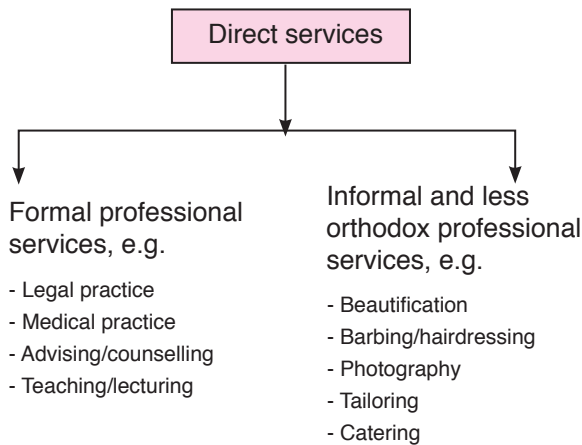


Fig. 3.3 Employment opportunities in direct services activities

An obvious job opportunity for a commerce graduate (i.e., with a good knowledge of commerce) that readily comes to mind here is teaching of commerce-related courses in secondary schools as well as in higher educational institutions, depending on one's academic qualifications.

3.6 Factors determining the choice of, and eligibility for, different types of employment and occupation

3.6.1 Factors to consider in choosing an occupational career

An important stage in career selection is the survey of all the available job opportunities. From these, the ones that are commerce-oriented (i.e. commercial activities) should be identified by the student of commerce. Each commercial activity should then be analysed in order to understand what is required to perform it successfully or being employed in the job. From the list of those commerce-related careers whose requirements have been met, a choice should be made; and the

career that is so chosen should be the one that fits the preference of the career seeker most.

This career analysis is illustrated in Figure 3.4, with the rectangle representing all the commerce-related career opportunities. Circle A represents those career opportunities that are available to the career seeker on the basis of his educational qualifications, experience, acquired talents, in-born traits (i.e., aptitudes or innate qualities), etc. Circle B represents those commerce-related activities that are of interest to the career seeker but whose requirements he may not satisfy; while those commerce-related jobs that interest him and the requirements of which he has also satisfied are contained in the segment C. This is obvious from the fact that segment C is common to the two circles, i.e., it is the intersection of the circles A and B. Therefore, the career seeker should make his choice from segment C.

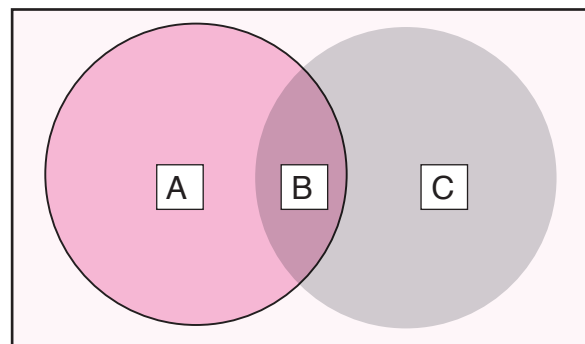


Fig. 3.4 Occupations - Availability, eligibility and preference

We shall now examine the factors that may influence the size of circle A, i.e., those commercial jobs that an individual is eligible to do, and the factors that may influence the size of circle B, i.e., those commercial jobs that an individual would like to take up.

3.6.2 Factors that may determine eligibility for a commerce-related career

Some factors that make an individual have either strong or weak points in relation to a career include:

- i) *Experience*: Some jobs require a lengthy

period of experience in which case an inexperienced job seeker becomes unsuitable. Other jobs do not require much experience.

- ii) *Education*: Some career opportunities require a relatively high level of education – sometimes on applied aspects and sometimes on theoretical aspects or even both.
- iii) *Finance*: This becomes important in the case of self-employment. Small-scale commercial ventures normally require less finance than large-scale ones.
- iv) *Natural talent*: Some occupations require a lot of aptitude or in-born skills.
- v) *People-orientation*: Some jobs are people-oriented, that is, rapport and good human relations are required, while others are ‘things-oriented’, that is, little or no dealing with other people is required in the process of job performance.
- vi) *Challenges*: Some jobs are very challenging and rigorous - often in order to meet deadlines. Other jobs are just the opposite. Only smart and energetic people will do well in the former case.
- vii) *Initiative*: Some jobs require a lot of initiative and foresight as in the case of self-employment, while others entail close supervision.
- viii) *Flare for risks*: Some careers require capacity to venture and undertake risks (e.g., being self-employed) more than others (e.g., being employed in the civil service).

3.6.3 Factors that may determine preference for a commerce-related job

The main factors that determine the occupational career or job that a person prefers are: What are individual wants in life, what is important to him and what he aspires to become. These factors may be broken down into the following:

- i) *Financial reward*: Everyone is interested, to an extent, in the financial reward they may get from employment, but those who are too concerned with financial reward may, for example, choose self-employment.

- ii) *Risk-aversion*: Those that are averse to risk do not usually venture into self-employment. Public sector paid employment may be their surest bet.
- iii) *Social prestige*: White-collar jobs, for example, appear to carry greater social prestige than most other jobs.
- iv) *Independence and personal integrity*: People who prefer to be independent like to be self-employed. In the same vein, those who cherish self-respect usually dislike jobs (like personal selling) that entail persuasion of potential customers – with likely insults from such potential customers.
- v) *Power and influence*: Some people may prefer jobs or careers that entail more power and influence to other jobs in which lesser power is needed.
- vi) *Quiet life*: Paid-employment appears to afford more quiet life than self-employment.
- vii) *Climate and physical environment*: Some jobs may have to be performed under relatively comfortable and attractive physical environments, e.g., in air-conditioned and well furnished offices. Such facilities and comforts are often lacking in most field jobs.
- viii) *Rural versus urban area*: Some jobs are rural based while others are urban-based and young people tend to choose the latter.
- ix) *Family life*: Those jobs that involve frequent transfers, out-of-station travels, longer working hours, and night duties are not very conducive to a settled family life. The importance attached by an individual to family life in relation to an occupational career would affect preferences. This factor is especially important for married women.
- x) *Stereotype or rigid working hours*: Some jobs, like civil service, entail rigid working hours while others, like self-employment, have very flexible working periods.

3.6.4 Implications of the analysis to seekers of career opportunities

In the present day in which there is scarcity of job opportunities, an individual seeking a career should strive to widen the scope of jobs from

which he can make a choice. In other words, segment C in Figure 3.4 should be made as wide as possible. This can be accomplished in two ways as follows:

- i) *By increasing one's own eligibility:* An individual can, for instance, enhance his eligibility for many careers through acquiring more education. This would increase the area of circle A in Figure 3.4 and, hence, the segment C.
- ii) *By being more accommodating:* An individual can be more accommodating and flexible concerning the range of preferences that he is ready to tolerate. This will increase the area of circle B in Figure 3.4 and, hence, the segment C. This can be accomplished by not insisting on white-collar jobs, high financial reward, etc. In particular, the tendency towards risk-aversion should be reduced so that the career seeker can venture into self-employment career opportunities.

- 3 Industrial products are
 - A crude oil and gas.
 - B tubers of yam.
 - C minerals.
 - D loaves of bread.
 - E bunches of banana.
- 4 Occupations in the construction industry include the following *except*
 - A surveying.
 - B civil engineering.
 - C medical practice.
 - D architecture.
 - D electrical engineering.
- 5 Commercial occupations belong to
 - A secondary occupation.
 - B tertiary occupation.
 - C formal occupation.
 - D primary occupation.
 - E functional occupation.

Revision questions

Essay questions

- 1 With concrete examples, explain any four primary occupations you know.
- 2 What are the areas of employment in commercial occupation?
- 3 What factors determine the types of occupation in Nigeria?

Objective questions

- 1 Primary occupation excludes
 - A farming.
 - B mining.
 - C fishing.
 - D banking.
 - E hunting.
- 2 Mining products do not include
 - A stone.
 - B coal.
 - C petroleum oil.
 - D zinc.
 - E diamond.

Chapter 4

Production, division of labour, specialisation and exchange

4.1 The concept of production

Production is the act of creating value, utility or want. Creation of utility or want means that the value of the affected commodity has been enhanced in the sense that the commodity is now more cherished than before the act of production.

Thus, you may cherish this textbook on commerce more than you cherish ordinary wood-pulp although the textbook has been brought about through several stages of production involving the wood-pulp. Some of these stages of production are:

- production of papers in the industry from wood-pulp;
- fashioning of the manuscript by the authors;
- activities of the publisher and printer;
- distribution of the books to bookshops from where you can purchase your own copy.

In each of the four broad stages, something is added to the original wood-pulp until it is transformed into our textbook on commerce.

4.2 Factors of production

Factors of production are those things used in producing goods and services. Normally, several things are used in producing a commodity. These things can be classified into *land*, *capital*, *labour* and *entrepreneurship*. Each of these four factors will now be examined further.

4.2.1 Land

Land comprises all factors of production provided

by nature. For this reason, land is sometimes referred to as *natural resources*. Land refers to such resources as soil, land surface, rivers, oceans, lakes, vegetation, forest, climate, as well as mineral deposits like crude oil and gas, iron ore, and gold. The main characteristics of land include the following:

- i) It is not possible to move land from one location to another.
- ii) Land is a gift of nature. However, with the passage of time, some persons have arrogated portions of land to themselves and now collect *rent* from those who wish to make use of the land. In other words, *rent* is the reward paid to landowners for the use of their land.
- iii) The quantity of land in an economy can hardly be increased since land is not provided by human actions or human efforts but by nature.

4.2.2 Capital

Capital is the wealth which has been set aside to assist in the production of goods and services. It is an accumulation of goods produced in the past for further production of goods.

There are two major characteristics of capital. First, capital is man-made, i.e., it is produced by man. As a result, the stock of capital available in an economy is capable of changing from time to time. Second, capital can be moved from one place to another.

The reward accruing to owners of capital is called *interest*. In economics, capital can be grouped into *fixed social capital*, *fixed private capital*, *circulating or non-fixed capital*, and *human capital*, as explained below.

- i) *Fixed social capital*: This is the capital held by the government on behalf of the society. Examples include roads, railways, seaports,

airports, dams, power generating plants and distribution facilities and other similar physical infrastructures.

- ii) *Fixed private capital*: This is privately owned, particularly by business firms. Examples include buildings, plant and machinery, tools, and equipment.
- iii) *Circulating or non-fixed capital*: This is the type of capital that is not permanent in nature but typically has a short-term lifespan. Examples include inventory of goods and financial capital. In accounting, circulating capital is referred to as current assets or, rather, *net* current assets called *working capital*, which is defined as the gross current assets less current liabilities (i.e., less short-term indebtedness).
- iv) *Human capital*: This refers to investment in human education and human health for the purpose of increasing human productivity or efficiency in production. Thus, an organisation that trains its workforce is said to invest in human capital.

4.2.3 Labour

Labour is human effort exerted in production. It involves the exploitation of the intelligence and physical strength of human beings.

Basically, there are two broad types of labour: *skilled* and *unskilled*. Skilled labour requires special training for the acquisition of the special skills. Doctors, engineers, lawyers, accountants, technicians, teachers, and administrators must have all gone through special training before they acquire the skills to become what they are. Unskilled labour, on the other hand, does not require much rigorous and intensive training. The jobs performed by unskilled labour are such that can be done by any person who is physically fit. Examples include jobs being performed by cleaners, gatemen, etc.

There are two major characteristics of labour. First, labour is a human factor of production. For this reason, it is very difficult to separate labour from the owners of labour services. Second, the quantity and quality of labour services are influenced by the moods and emotions of workers. Thus, labour matters should be handled as delicate matters.

The reward to workers or owners of labour is called wages, which can take the form of ordinary wages, salaries, bonuses, overtime allowances, etc.

4.2.4 Entrepreneurship

The owners of a business are called *entrepreneurs*. Thus, entrepreneurship is a human factor of production, just like labour. The entrepreneur bears all the risk pertaining to the business. An entrepreneur takes the final decision on the type and quantity of goods to be produced, the quality of the goods, combination of capital, labour and land to use in producing them, etc. Thus, an entrepreneur organises all the other factors of production in order to produce a commodity.

An entrepreneur is the sole proprietor of a sole proprietorship business, a partner in the case of a partnership business organisation, and shareholder in the case of a limited liability company. The reward for entrepreneurship is called *profit*.

The duties of entrepreneurship include the following:

- i) Provision of initial financial resources for the commencement of the business as well as any subsequent finance for business operations and expansion.
- ii) Bearing of risks inherent in a business. In other words, while entrepreneurs can shift insurable risks to insurance companies, they must bear the uninsurable risks such as changes in technology or massive loss of patronage.
- iii) Organisation of the other factors of production to produce a commodity.
- iv) Taking of decisions on which commodities to produce and the methods of producing them.
- v) Innovation by introducing new products into the market as well as new methods of producing existing products.

4.3 Specialisation

Specialisation is the concentration of all factors of production on certain lines of production.

Specialisation can occur when there is concentration of a particular factor of production on a line of production. For example, labour employed to work only in industry, or an entrepreneur who sells only textbooks.

Specialisation also occurs when there is concentration of the resources of a region on a particular line of production. For example, people who live along the riverine areas of Nigeria specialise in fishing, while people who live in the savanna areas are mainly preoccupied with the rearing of cattle. Most people in urban areas of Nigeria specialise in commerce while those in the rural areas of Nigeria specialise in agriculture. As a nation, Nigeria specialises in primary production, while developed countries, such as Japan and Germany, specialise in secondary production.

4.3.1 Advantages of specialisation

Specialisation has its advantages and these are outlined as follows:

- i) Specialisation increases production by allowing individuals and nations to focus their attention on those lines of production for which they have a comparative advantage. Let us illustrate comparative advantage with a woman who is a legal practitioner and also a trained typist. It is usually economically sensible for such a woman to concentrate on her legal practice while she employs the services of a competent typist.
- ii) Specialisation enhances learning. This is referred to as 'learning-by-doing advantage of specialisation. This advantage is brought about by increased skill resulting from specialisation.
- iii) With specialisation, there is no duplication of overhead costs or fixed costs. Duplication of fixed costs is inevitable when an individual, region or country is engaged in all aspects of production.
- iv) Specialisation encourages friendly relationship among individuals, regions, and countries. This is so because specialisation naturally gives room for exchange of goods or for trade in goods.

- v) Concentration on a single activity or a few activities promotes new ideas which may give rise to inventions and innovations.

4.3.2 Disadvantages of specialisation

Specialisation has its disadvantages and these are outlined as follows:

- i) Specialisation may give rise to undesirable dependence. This would be the case when individuals, regions, or countries rely heavily on one another in respect of certain needs. For instance, if Nigeria relies on Japan for all her automobile needs, then Nigeria's need for automobile would be prone to any disruptive repercussions within Japan.
- ii) Specialisation by a nation may jeopardise the security of that nation. For example, those countries which specialise in agriculture are prone to military attacks by those countries which specialise in production of armament.

4.4 Division of labour

In essence, division of labour is the allocation of various productive activities to different workers. Division of labour is a clear reference to specialisation of labour. Division of labour is accomplished by allocating different jobs to different workers. This is done in such a way that a worker can commence and complete the production of a commodity. This is what occupational distribution of labour is all about. In this sense, some people are farmers, some are lawyers, some are doctors, etc.

However, modern mass production has extended the scope of division of labour beyond mere broad occupational distribution of labour. The extension is such that each occupation is now broken further into small processes, each process being manned by a worker. For example, in the farming occupation, some workers may be ploughing, some may be planting, while others may be harvesting. In fact, in the manufacturing industry, division of labour has been firmly entrenched such that most workers play a minute



Fig. 4.1 Employment opportunities in commerce-related activities

role in the production process. The division of labour is such that most workers cannot identify the final product which they played a role in its production.

4.4.1 Advantages of division of labour

Division of labour raises the level of output. This point was recognised a few centuries ago by Adam Smith in his survey of the new world

of industry and commerce. According to him, in the absence of division of labour, a worker could produce only very few pins per day, but with the introduction of division of labour, several dozens of pins were now being produced per day.

We can now outline the various advantages of division of labour as follows:

- i) Each worker is able to specialise in a productive activity for which the worker is inherently talented. In other words, the worker specialises in his area of comparative advantage.
- ii) Division of labour enhances learning-by-doing because much skill will be acquired through repetitive practice on a job.
- iii) It saves time which would otherwise have been used in moving workers from one job to another job.
- iv) It saves time which would have been used in acquiring new skills.
- v) It facilitates the use of machinery and it is the only means by which mechanisation and automation can be applied to our modern mass production processes.
- vi) It removes excessive duplication of working tools and equipment. With division of labour, each worker needs only those tools and equipment necessary for a particular task.
- vii) It promotes friendly relationship within a society because it leads to exchange of goods or trade in goods.
- viii) It can promote discoveries and inventions because the thinking and attention of workers are focused on only a particular task.

4.4.2 Disadvantages of division of labour

Despite its advantages, division of labour has its disadvantages and these are outlined below.

- i) Division of labour dehumanises workers because it takes away discretion from workers, thus making them mere tenders of machines. In other words, by facilitating the use of machinery, division of labour strips workers of their initiative and transfers and confers same on machines.

- ii) It encourages monotony as a result of repetitive performance of a job. Monotony, as we know, kills incentives while variety, they say, is the spice of life.
- iii) It leads to loss in craftsmanship because the worker is no longer in a position to carry out a task from inception to completion. As a result, quality is compromised.
- iv) It encourages the use of machines as substitutes for workers and this obviously increases unemployment.
- v) It exposes workers to the risk of being immobile among different jobs both within and outside the organisation. This is because of the narrow area in which workers have specialised. This immobility can lead to unemployment when workers are retrenched and they cannot fit into any of the other available jobs elsewhere.
- vi) It can lead to unpleasant interdependence, to the extent that tasks may not be accomplished unless certain workers are available. In this case, the absence of a single worker may paralyse an entire production line since there may be no other worker to perform the duty of the absentee worker.

4.4.3 Limitations of division of labour

A number of factors are capable of limiting the scope of division of labour. These factors are discussed as follows.

- i) *Size of market:* The smaller the size of market for the commodities to be produced, the smaller the scope for division of labour. Since the market outlet is small, there would be less need for mass production and even lesser need for division of labour.
- ii) *Production method:* If the method of production is not repetitive, or cannot be subdivided into various parts, the scope of division of labour would be limited.
- iii) *Nature of commodities:* Production of tailor-made goods and direct services does not lend itself to extensive division of labour. Tailor-made goods are those goods designed to suit the specific need and taste of an

individual. For example, a carved calabash with the name HAJIYA AISHA is a tailor-made calabash for Hajiya Aisha.

4.5 Exchange

4.5.1 Meaning and reasons for exchange

Exchange refers to giving out something by one party to a transaction in return for a more desired thing. Another name for exchange is swap. An exchange occurs when there is a transaction or trade between at least two parties. Let us assume the two parties to a transaction are Mr A and Mr B. An exchange or transaction is said to occur if Mr A gives out something (say, Y) to Mr B in return for something (say, X) that Mr A desires more. This means that Mr B desires what he gets from Mr A (i.e., Y) more than what he gives out to Mr A (i.e., X). So, at the end of the transaction, both parties would be better off, as they both get something more cherished by parting with what is less cherished. There is no point exchanging one thing for the other unless one desires what is received more than what is being parted with.

An absence of exchange is called autarky, or self-sufficiency. This means that every person or family consumes what he (or it) produces. Nowadays, there is nothing like autarky again. It only existed in the early history of man and, presently, it exists only among animals.

4.5.2 Two types of exchange - Barter and use of money

The earliest exchange or trade is by barter, which refers to a swap of one thing for another without the use of money as a medium, intermediary or go between. Thus, in our example above, there would be trade by barter if none of Y and X is money but, instead, both are commodities that Mr A and Mr B desire as an end in themselves, e.g., for consumption. Trade by barter, as will be discussed in a later chapter on Money, has several disadvantages over the use of money. One of these problems of barter is the need for what is

called *double coincidence of wants*, whereby Mr A that has Y and wants to give it out in return for X has to look out for Mr B, who has X and wants to exchange this for Y. This is not to talk of how to agree on how many units of X to be exchanged for a given unit of Y, including the need to give a change if an odd fraction of X is involved. Money, as a unit of account, would have solved this problem. In addition, Mr A will often desire X at the same time that Mr B will desire Y because, if Mr A buys X and keeps it until needed, X may deteriorate in value. Money, as a store of value, would have removed this problem.

The above problems of barter exchange gave rise to the use of money as a medium of exchange, to solve them. This is called *money exchange*, i.e., an exchange system based on the use of money, defined as whatever is generally accepted as a medium of exchange. Unlike under a barter system where all the parties to a transaction are buyers and sellers at the same time, with the use of money, a party to a transaction can only be a buyer or a seller, but not both. The one giving out money is the buyer while the one receiving money is the seller. Sellers accept money not as

an end in itself, e.g. not for consumption. Instead, sellers accept money so that they too can use it to buy (whether immediately or later) something else that they need (or will need). This also means that buyers part with money that they too must have received sometime in the past by parting with something they had in exchange for it. Also, unlike under a barter system, at least one of the two things involved in an exchange (i.e., X and Y in our above example) has to be money. If X is the one assumed to be money, then Mr A is the seller (that accepts X in return for giving away Y) while Mr B is the buyer (i.e., by giving away X in exchange for Y).

4.5.3 Advantages and disadvantages of exchange

As the role of exchange is to permit the existence of specialisation, its advantages and disadvantages are the same as the advantages and disadvantages of specialisation as already discussed earlier in the chapter.

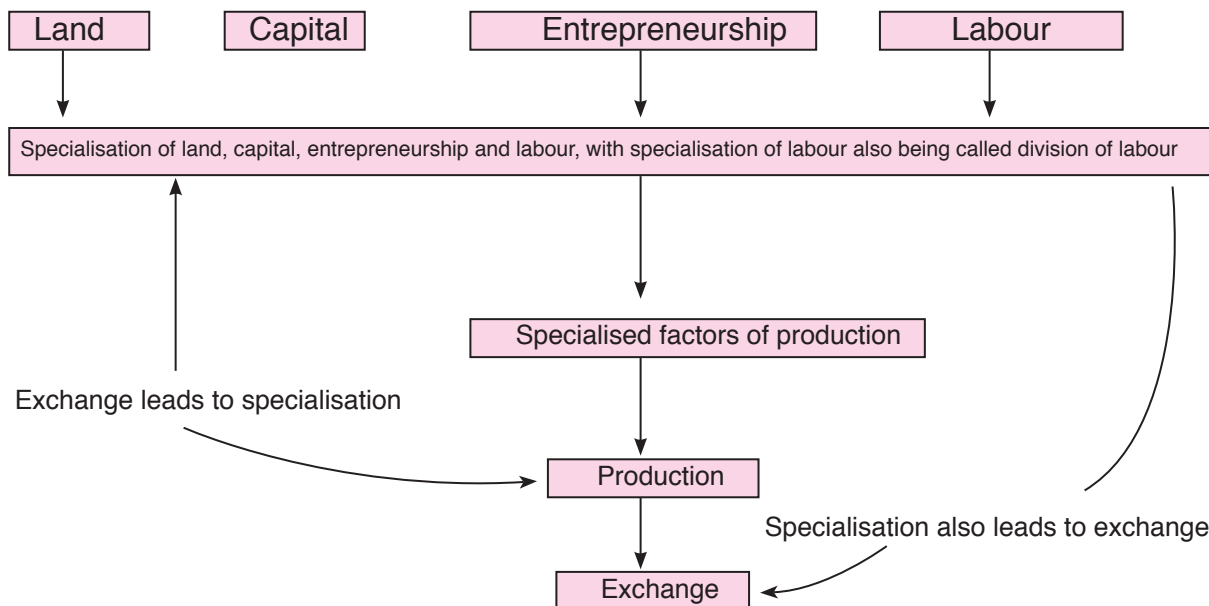


Fig. 4.2 Interrelationships among production, division of labour, specialisation and exchange

4.6 Interrelationships among production, division of labour, specialisation and exchange

The interrelationships among production, specialisation, division of labour and exchange are as depicted in Figure 4.2. As can be seen from the diagram, the starting point is the factors of production (viz: labour, capital, land and entrepreneurship), without which production cannot take place.

The efficiency and effectiveness of the factors of production in producing goods and services are due to their specialisation. This is because of the various advantages of specialisation discussed earlier. It would also be recalled that division of labour is a special case of specialisation, as it is the term used to connote specialisation of just one factor of production, viz: labour.

The specialised factors of production then combine (thanks to the entrepreneur, who does the combination) to produce goods and services. At least a part (if not all) of the produced goods

and services will have to be exchanged or sold for other goods and services under a barter system or for money (or money equivalents) under a monetised system.

As also shown in the diagram, this exchange arises as a result of specialisation of factors of production (including division of labour), without which there will be no need for exchange – i.e., if everybody produces all the things they need. The diagram also shows that specialisation itself arises as a result of the possibility of exchange. This is because, if there is no possibility of exchange, one has to produce all that one needs, thereby eliminating possibility of exchange. Thus, there is a mutual dependence of the existence of exchange and specialisation, that is, each depends on the other to exist.

4.7 Main divisions of production

Production can be divided into various broad categories, with each category being sub-divided in turn. The tree diagram of Figure 1.1 of Chapter 1 that shows the various divisions, sub-divisions, etc of occupation or productive activities, is reproduced below in Figure 4.3.

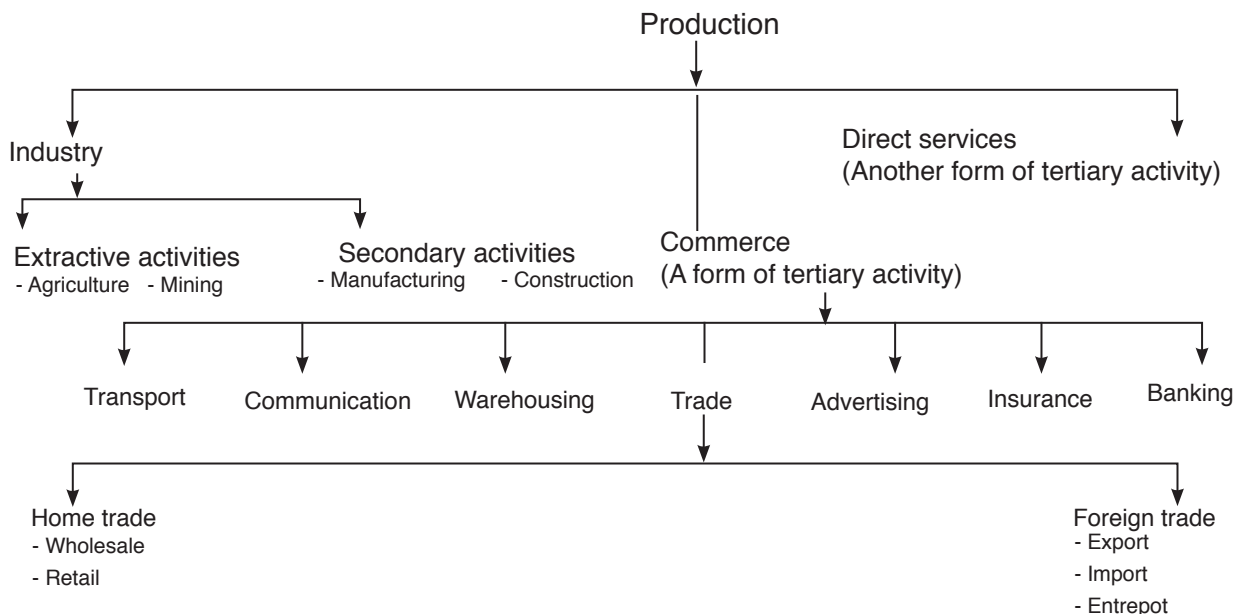


Fig. 4.3 Scope of commerce

We shall now examine each division and subdivision depicted in the tree diagram.

4.7.1 Industry

This consists of the activities of either obtaining the crude (raw) materials or changing the shape or form of such raw materials into a more cherished form. Let us use furniture-making as our example. The industry aspect covers lumbering of timbers, production of planks by the sawmill, changing the shape of the planks into chairs, tables, etc as well as the use of the planks in the building of houses.

Conventionally, it is this group of occupation, which we now refer to as industry, that is often wrongly understood as production or productive activities. However, as the diagram shows, industry is just one aspect of production. Industry can, in turn, be divided into three main activities as follows:

i) *Extraction or primary activities:* These are the activities that first obtain or extract the materials from nature. The major extractive occupations are agriculture (that is, crop production, fishing, animal husbandry and forestry), and the mining of petroleum and gas and solid mineral deposits (e.g., iron, gold, bauxite and sulphur) from the bowels of the earth.

In our example of furniture-making, the act of growing trees and cutting the trees into timbers constitute primary activities, that is forestry activities. This is because the activities lead to the output of materials that are in their natural and unprocessed form.

ii) *Secondary activities:* As shown in the diagram, secondary activities are those that transform the output of primary activities into final or more usable goods. They comprise manufacturing and construction activities.

a) *Manufacturing activities:* These are called secondary activities because they must be preceded by the primary activities, which provided the raw materials for them. Manufacturing activities relate to the conversion of the primary products and secondary products into either the final goods to be consumed, or the intermediate goods to be worked upon before they become

final consumer goods. Manufacturing includes processing of goods.

Thus, the sawmill in our furniture-making example is a manufacturing stage in the production of furniture as sawmilling converts the primary products (timbers) into the secondary or intermediate products (planks). In the same vein, the furniture industry, or carpentry, is a secondary production process in the sense that it converts the intermediate product in the form of planks into more refined furniture products such as tables and chairs.

In Nigeria, other manufacturing activities include production of soft drinks, beer, cement, textiles, footwear, paints, soap and detergents, sugar, printing and publishing.

b) *Construction activities:* These are secondary production just like manufacturing. A basic feature of construction activities is the production of geographically immovable or immobile goods, that is, goods that cannot be moved from one place to another. Examples of the products of construction activities are buildings and transport network such as roads, rails, airports, and seaports. Using our example above, the use of planks to build a house is a construction activity.

4.7.2 Commerce

Commerce is an aspect of production. Commerce deals with the various activities which enable the producers to secure the raw materials and other capital goods required in the production processes. In addition, commerce enables the final products to get to the consumers. Thus, commerce creates utility or value on a commodity by serving to change the location of the commodity. It also creates utility by reconciling quantities of goods offered by the industry with the quantities needed by the users either for further production or for final consumption.

As depicted in our tree diagram, commerce is a group of tertiary activities in the sense that it does not often lead to the conversion of goods from one physical state to another. Commerce is only a package of services which makes the goods emanating from the primary production and

secondary production to suit the tastes of specific users. Let us now consider the various branches of commerce.

- i) *Transport*: This is the medium by which goods are conveyed from one location to another. In our sawmilling example, the equipment needed by sawyers in producing the timbers would have to be conveyed to the forest. The timbers would have to be conveyed to the carpentry workshop and building site; and furniture would have to be conveyed to the consumers. In this process, the transport media could be by road (using vehicles, bicycles, pedestrian carriers, etc); or by rail (using the trains); or by water (using ships, canoes, etc); or by air (using aeroplanes).
- ii) *Communication*: This is the aspect of production which enables producers at different production stages to get in touch with one another without the necessity for physical contacts. Communication enables producers and consumers to interact in a non-physical form. Communication consists of postal and courier services, telephone, telegraph, telex, radio, television, etc.
- iii) *Trade*: This consists of buying and selling. In the language of the layman, trade is referred to as commerce. Buying and selling can be related to internal trade or to foreign trade or even to re-exporting or entrepot trade (as explained in the next chapter). Thus, in our sawmill example, the act of selling sawing equipment to the lumberman; buying the timber from lumbermen; getting timber sold to sawmillers; buying planks from the sawmillers; getting planks sold to the carpenters; buying tables, chairs, etc and getting these sold to consumers, are all various aspects of trading. If the buying and selling is confined to within the country, it is called internal trade. On the other hand, external trade is involved if, for example, some of the timber is sold outside the country. It would be entrepot trade if the imported goods are exported in the same form (i.e., without further processing) to another country.
- iv) *Warehousing*: Raw materials, intermediate products, and final consumer goods will often need to be stored until they are

needed for either further processing or final consumption. Warehousing is all about storage and it enables production to proceed conveniently as required. In our furniture example, the planks may need to be stored until the carpenters, builders, etc need them. In the same way, the tables, chairs, etc may need to be kept at some depots until consumers buy them.

- v) *Banking*: The various producers will often need credit or loans to carry on their activities. Banking enables producers to secure such credit. The commercial function also requires banking credit. Most importantly, banking facilitates payments.
- vi) *Advertising*: Advertising serves to inform potential buyers about the existence and nature of goods. Thus, our furniture dealer who displays the tables, chairs, etc in the showroom is advertising the products.
- vii) *Insurance*: Various risks are connected with all aspects of production. For example, goods may be lost in transit or destroyed during accidents. The warehouse may collapse or be gutted by fire. Armed robbers may raid a bank and cart away cash from the vaults. Insurance underwrites such risks. In other words, insurance undertakes to make good any loss in return for certain (generally, non-refundable) payments called premium.

4.7.3 Direct activities

Direct services constitute tertiary production. Direct services are rendered to consumers. For this reason, direct services are sometimes called personal services. Examples of direct services are those rendered by teachers, lawyers, medical doctors, entertainers, soldiers, police, etc. Other examples are less formal professionals that are called artisans, like hairdressers and barbers, tailors, photographers, and caterers.

4.8 Meaning and concept of goods, services and commodities

4.8.1 Meaning of goods

The term goods refer to tangible physical commodities. Goods can be intermediate, that is, those to be used in the eventual production of consumable commodity. Such intermediate goods are in the form of raw materials and durable capital goods. Alternatively, goods can be final goods, that is, those to be consumed instead of being used for further production. In many cases, some goods are used as intermediate goods and also as final consumer goods. Goods are often stored and there is usually a time lag between production and consumption of goods.

The production of goods results from several activities in the form of services. Services rendered in the process of producing goods are called indirect services. Thus, to get the tables and desks produced, various indirect services are rendered by sawyers, sawmill owners and workers, carpenters, distributors, and many others engaged in the commercial aspect of production. Such services are called indirect services because they have been rendered indirectly to the ultimate consumer of the product. In fact, ultimate consumers normally do not know those who have rendered such services. Thus, goods constitute a series of indirect services rendered while combining and changing some natural resources into cherished forms.

4.8.2 Meaning of services

By services in this context, we are simply referring to direct services, as already explained. Examples of services are medical, educational, legal, entertainment and defence.

Thus, services, unlike goods, have no physical or tangible existence. Services are only final commodities. This means that services are not in the form of intermediate commodities since services must be rendered directly to the ultimate

consumer. The consequence of this is that services can hardly be preserved or stored.

As a further clarification of direct and indirect services as well as goods and services, we can use the example of a medical doctor (physician) and a veterinary doctor. A medical doctor renders direct services to consumers (human patients). Thus, a medical doctor is said to provide direct services and to produce services as opposed to goods. On the other hand, a veterinary doctor renders services to animal patients. The veterinary doctor is said to provide indirect services and to have produced goods (healthier animals) as opposed to direct services. In the same vein, the authors of this book are providing you indirect services while your Commerce teacher provides you direct services.

4.8.3 Commodities

This is often used as a collective or generic name for goods and services. Thus, the word commodity can connote any goods or any services.

However, in some cases, the word goods can be used to mean commodity. This is in line with the use of the word man. Man can sometimes be used as a representative word for human beings irrespective of sex. At other times, it may be used to mean only the male human beings so that the female human beings are now distinguished by the word woman. Such usages may sometimes be confusing but they have to be tolerated and coped with by paying attention to the contexts in which they are being used.

Revision questions

Essay questions

- 1 Explain your understanding of 'specialisation' and 'division of labour' and discuss the factors that can limit the scope of division of labour.
- 2 Why is 'specialisation' desirable? Mention any shortcomings in 'specialisation.'
- 3 Discuss the advantages and disadvantages of 'division of labour.'
- 4 By means of a schematic diagram, show the

main divisions of production.

- 5 a) What is production?
b) Explain the factors of production.
(WAEC, May/June 2010)
- 6 State and explain the factors limiting the application of division of labour.

Objective questions

- 1 Production ends when goods and services
A are used by the consumer.
B are packed and labelled.
C are sold in the market.
D are advertised to the consumer.
- 2 Exchange developed as a result of
A specialisation.
B competition.
C barter.
D advertising.
- 3 Division of labour is limited by
A non-availability of special skills.
B the problem of mass production.
C non-availability of money.
D the size of the market.
- 4 Which of the following is *not* the function of an entrepreneur?
A Provision of initial capital
B Bearing of risks
C Deciding on the amount of tax to pay
D Organising other factors of production
- 5 Which of the following enables people to consume a variety of goods and services?
A Labour
B Capital
C Land
D Exchange

THEME 2

Trade and business organisations

Chapter 5

Trade – Types and their relationships

5.1 Trade and types of trade

Trade refers to buying and selling of goods and services. There are three types of trade—home trade, foreign trade and entrepot trade. Home trade is at one extreme, foreign trade is at another extreme while entrepot trade is in-between or mid-way between the two extremes. These are explained below.

5.2 Home trade

Home trade (which is also called internal trade or domestic trade) refers to buying and selling in the markets that are within the borders of a country. An example would be buying and selling in Nigerian markets.

5.3 Foreign trade

Foreign trade (which is also called external trade or international trade) refers to buying and selling across the borders of a country, i.e., trade between buyers and sellers from at least two different countries. An example would be buying by a Nigerian resident from a seller that is resident in Ghana.

Foreign trade can be either export or import. Export refers to selling of goods or services abroad, i.e., the seller is resident in the country while the buyer is resident in another country. Import, on the other hand, refers to buying of goods or

services from abroad, i.e., the buyer is resident in the country while the seller is resident in another country. An example is a Nigerian company (an exporter) selling crude oil to a Chinese company (an importer).

5.4 Key differences between home trade and foreign trade

Domestic and foreign types of trade differ in a number of respects, including the following:

- i) Means of payments could differ: In domestic trade, payments are normally made in domestic currency, as opposed to foreign trade, payments are made, in many cases, in foreign currency, which can be the currency of the home country of the seller or, alternatively, an internationally accepted currency like the US dollar or British pound. For example, if a buyer from Nigeria wants to pay the seller of a commodity in Ghana, the Nigerian naira can be used in making the payment if this is agreeable to the Ghanaian seller. Otherwise, the Nigerian buyer would have to pay in Ghanaian cedi or an internationally accepted currency like the US dollar.
- ii) Legal and regulatory requirements often differ: In home trade, the technical qualities of the traded goods and services are supposed to meet only the domestic laws, rules and regulations. For instance, goods traded within Nigeria are supposed

to meet only regulations prescribed by the Standards Organisation of Nigeria (SON) and the NAFDAC, among others – but not laws of another country. But in foreign trade, the technical qualities of the commodities are supposed to meet not just the domestic laws, rules and regulations. They are also to meet foreign ones too. For instance, commodities bought in Nigeria from China would often have to meet not only the Chinese specifications, but also the Nigerian regulatory requirements – including those required by NAFDAC, SON and Nigerian Customs authority.

- iii) Trade barriers exist in international trade, unlike in home trade: In home trade, barriers or restrictions such as customs duties, exchange restrictions, fixed quotas, or embargoes do not exist since the goods only move within the country. In foreign trade, such restrictions do exist, serving to restrict movement of specific goods to specified countries. Also, while international trade may be a product of bilateral agreements (between two countries) or multilateral agreements made by a comity of nations, no such agreements exist in domestic trade. There is also nothing like a trading bloc (e.g., customs union like the ECOWAS) in domestic trade.
- iv) Units of measurements may not be the same between trading partner countries: Related to the above is that the units of measurement may differ across the countries involved in foreign trade relationship. While one may measure distance in metres and weight in grams, the other may use feet to measure distance and pound to measure weight.
- v) Cultural, including linguistic, differences may be greater between trading partner countries: Similarly, cultural differences are often more pronounced between different countries than within a particular country. Such cultural differences pertain to language, religion, attitudes, etc. The same applies to physical outlook, including the height as well as the colour of the skin and texture of the hair. All these affect the types of goods and services required by the would-be buyers and the sellers have to take these into consideration. In the same manner, the

diversity of languages is greater in foreign than in domestic trade. While in Nigeria, there are over 200 languages, this is nothing compared with thousands of languages spoken all over the world. This has some implications for foreign trade, as documents used (e.g., invoices) may have to be prepared by the seller in different languages required by importers from various countries to suit the regulatory requirements in importing countries.

- vi) Greater distances are also often involved in international trade: Distance is yet another area of difference. In most cases, commodities traded across borders have to be transported or shipped over longer distances than the distances involved in home trade. This would be so when the two countries involved are not close to each other. For instance, the longest distance in Nigeria is between Lagos area and Maiduguri area or between Calabar area and Sokoto. Yet, this is nothing when compared with the distances between Nigeria and China or the USA.
- vii) More complicated types of documents and documentation are involved in foreign trade: The types of documents involved in foreign trade (e.g., certificates of origin, packing lists) are greater than those involved in home trade. Also, the relatively few documents used in home trade are comparatively simple and easy to understand and follow than the various sets of documents which must be filled in every instance of foreign trade.
- viii) Volumes involved in foreign trade are often greater: While most of the sales and purchases made in foreign trade are in large bulks, sometimes taking a whole ship to carry, most of the sales and purchases made in domestic trade are in small lots, with just a lorry (or, at most, a truck or trailer) used to carry them.
- ix) Many traders are not resident in the country where they trade internationally, leading to a high degree of inequality in access to market information: In domestic trade, all traders are resident in the country where they do business, i.e., the same country where they buy and sell the goods. Both sellers and

buyers are resident and do business in the same country. In foreign trade, importers are not normally resident in the countries they import from (i.e., where supplies come from), just as exporters are not normally resident in the countries they sell to. Importers and exporters are normally not resident in the same country. As a result, importers' knowledge would likely be less than that of the exporters' about the market situations in the supplying or exporting countries, just as exporters' knowledge too would likely be less than that of the importers about the market situations and payment systems prevailing in the importers' countries. This highly skewed information can make the party to the transaction that is less informed exploited, and taken undue advantage of, by the other party that has greater information. In domestic trade, such inequality is less between buyers and sellers in access to information that is pertinent to carrying out the trade.

- x) Greater risks exist in foreign trade: Political and diplomatic risks (e.g., a sudden development of hostility and war between the erstwhile trading partner countries) exist in foreign trade. Also, should there be a disagreement between importers and exporters, the governments (and probably, the judiciary too) would likely take sides with who, between the disputing traders, are resident in their respective countries, instead of being fair-minded umpires.
- xi) Insurance is compulsory against foreign cargoes: While it is normally optional for domestic traders to insure consignments or cargoes, shipments or consignments of goods across borders are required to be insured.
- xii) Payments for international trade are mostly made through the international banking system: In most cases, foreign trade is preceded by payment or promises of payment (also called *Letters of Credit*) made by importers' banks to the exporters. In domestic trade, payments are often made after the trade is executed, sometimes without any preceding promise to pay. Letters of credit, and the like, are not normally used in making domestic payments.

5.5 Similarities between home trade and foreign trade

Despite the above differences, there are a number of similarities between home trade and foreign trade. The important areas of similarity are as follows:

- i) Both need ancillary services: As they are both trade, they need ancillary services, namely transport, communication, warehousing, advertisement, banking and insurance. For instance, goods have to be transported in both home and foreign trade.
- ii) Both need substantial documents and documentation: Although the requirements for documentation and documents are higher for foreign trade, both need a lot of these more than most other forms of productive activities.
- iii) High labour intensity and low capital intensity: Both are labour-intensive to carry out and they are less automated or capital-intensive, especially when compared with primary and secondary production activities like mining and manufacturing.
- iv) In common, they need less of permanent (or long-term) finance and more of short-term finance: Buying and selling, whether in foreign or domestic trade, traditionally need mainly to finance their working capital (particularly, holding of inventory before they are sold and provision of financial accommodation to customers in the form of what is called *trade debtors*). This calls for only short-term financing that banks are suited to provide. This is in contrast to long-term or relatively permanent debts like issuing of debentures in order to raise borrowed finance, which is more needed in other productive activities like mining, agriculture and manufacturing.
- v) Some diversity, distance to cover and political risks are present in both domestic and foreign trade: While the cultural and linguistic diversities, distance to travel and degree of political risks are greater in international trade, they are nevertheless present to some extent in domestic trade

too. In other words, both have all these in common, although they are more pronounced in foreign trade.

5.6 Entrepot trade

Entrepot trade (which is also called re-export) refers to importing of goods into a country and exporting them in virtually the same conditions to yet another country. An example would be if a Ghanaian resident imports electronics from the UK to Ghana and then exports it to Nigeria (in practically the same state, i.e., without processing the goods further before exporting them to Nigeria).

A major reason for the entrepot trade is to take advantage of tariff differences and also differences in other trade barriers between members of a trading bloc (like Nigeria and Ghana that are members of ECOWAS) that goods from third party countries (like the UK) are subjected to. For example, if electronics from the UK are subjected to a 50% import tariff when coming directly to Nigeria but subject to only a 10% tariff in order to enter Ghana, it would pay a Ghanaian trader to import electronics to Ghana first and pay only 10% import duty and then re-export the electronics to Nigerian market, knowing that movement of goods and services between Nigeria and Ghana is duty-free because they are both members of ECOWAS. By this, the Ghanaian trader would be able to out-compete a Nigerian trader that imports the electronics from UK directly to Nigeria market, after paying the 50% import duty. The same could apply if import of electronics from the UK to Nigeria is subject to a binding quota or is totally prohibited, while they could be imported from the UK to Ghana with little or no restriction. Through entrepot trade, Ghanaian traders could then take advantage of this to first bring the goods from the UK to Ghana and then divert them to Nigerian markets.

Thus, entrepot trade can be regarded as trade that is seeking to take advantage of differences between members of a trading bloc (like ECOWAS) in the barriers that goods from non-member-countries (e.g., the UK) are subjected through importation from the non-member-countries to the member-countries (e.g., Ghana) with smaller trade barriers, and then diverting

or 're-exporting' such goods barrier-free to the member-countries (e.g., Nigeria) that have greater trade barriers against the non-member-countries.

In Nigeria, as in most other countries, the import duty already paid is refunded by the government to the importer if the goods are later re-exported, i.e., if the earlier importation is for entrepot trade. The common name for such customs duty refund is called customs drawback, the precise nature of which (in the Nigerian context, where it is the Manufacture-in-bond scheme, MIBS) is discussed in Chapter 7 under Foreign Trade.

5.7 Relationship between home, foreign and entrepot trade

Concerning the relationship between home and foreign trade, most of the commodities traded in the domestic markets are imports, i.e., they originate from abroad. Once the imports enter the country, they are traded in the domestic markets just like other goods produced in the country. Thus, the distinction is thin between imports and other domestically traded goods. In the same vein, the export commodities are produced in the country and are often first traded in the domestic market like any other domestically produced commodities. It is only when they get to the borders of the country or ports of shipment that they acquire the distinguishing features of export trade. The only exception, however, relates to goods produced in what is called an Export Processing Zone, as such goods are specifically produced for export only. Except for this, the distinction is thin between export goods and other domestically traded goods.

Similarly, there is a high relationship between entrepot and foreign trade. This is because goods involved in entrepot trade are imported goods initially and become export goods later. That is, entrepot trade is also foreign trade – import and export trade.

Revision questions

Essay questions

- 1 Explain each of
 - a) Home trade
 - b) Foreign trade, and
 - c) Entrepot trade.Highlight the relationships between them.
- 2 Discuss six key differences and three similarities between home trade and foreign trade.

Objective questions

- 1 Home trade refers to
 - A trade taking place at home. within members of a family.
 - B trade taking place within an economy.
 - C buying and selling of homes or houses.
 - D A and B.
 - E B and C.
- 2 Foreign trade refers to
 - A trade taking place in foreign lands.
 - B trade conducted by foreigners.
 - C buying of goods and services from abroad and selling of goods and services abroad.
 - D A and B.
 - E A and C.
3. Foreign trade comprises
 - A imports and exports.
 - B wholesale and retail.
 - C imports and retail.
 - D exports and wholesale.
 - E exports and retail.
4. Likely differences between foreign trade and domestic trade include the fact that
 - A volumes involved in foreign trade are often greater.
 - B greater distances are often involved in international trade.
 - C units of measurements may

- not be the same between trading partner countries.
- D all of the above apply.
 - E none of the above applies.
5. A likely similarity between home trade and foreign trade is that
 - A both need ancillary services.
 - B about the same distance is normally involved in both cases.
 - C volumes of trade involved are generally the same in both cases.
 - D A and B apply.
 - E B and C apply.

Chapter 6

Home trade

6.0 Introduction

Home trade refers to the buying and selling of goods within the geographical boundary of a country. For instance, in Nigeria, people could move from Kano to Lagos, or from Enugu to Maiduguri, to buy and sell goods. Often, home trade is referred to as internal trade or domestic trade.

6.1 Nature of middlemen

Middlemen are independent business enterprises which constitute a link between producers, on one hand, and consumers, other middlemen or industrial users, on the other hand. Middlemen may also be referred to as intermediaries. The word *producers* is used here to connote any of the primary producers and secondary producers. In other words, tertiary producers are not included. Secondly, the expression *industrial users* conventionally refers to all those users for the purpose other than final consumption and also other than buying and reselling by the middlemen.

6.2 Types of middlemen

The schematic diagram in Figure 6.1 below shows the types of middlemen institutions.

6.2.1 Merchant middlemen

Merchant middlemen have title to the goods which they are marketing. This means that merchant middlemen own the goods somewhere along the distribution channel before passing the title to their customers. As a result of this, merchant middlemen bear risks of ownership of goods. Such risks could be in the form of loss, obsolescence, damage, etc. There are two types of merchant middlemen: the retailers and the wholesalers.

- i) *Retailers*: Retailers are those businesses which sell mainly to the final consumers. This means that selling to either the industrial users or to the middlemen is incidental to a retail business. The word *dealer* is technically synonymous with retailer. However, in the Nigerian business context, a dealer is sometimes regarded as a wholesaler. This may be due to the excessively lengthy nature of the distribution channel.

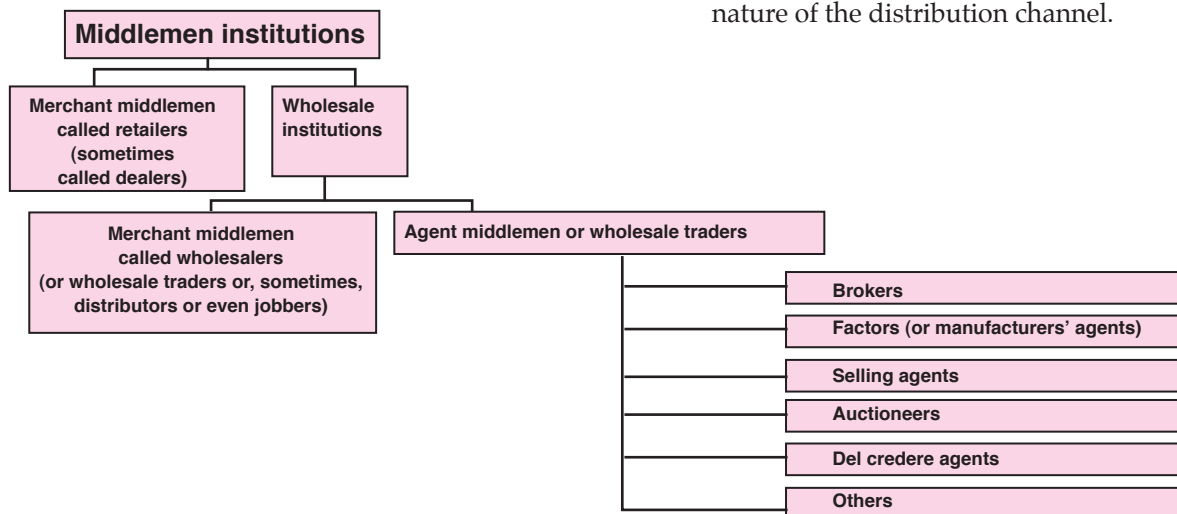


Fig. 6.1 Types of middlemen

- ii) *Wholesalers*: Wholesalers are merchant middlemen who sell mainly to buyers, except the final consumers. This means that a wholesaler sells to some other middlemen or industrial users. Any sale to the consumer is incidental to the wholesaling business. The word *distributor* is synonymous with wholesaler. In some countries such as the USA, distributors are also referred to as *jobbers*.

6.2.2 Agent middlemen and how they differ from conventional wholesalers

Agent middlemen are institutions which do not take title to goods that they handle. Agent middlemen merely constitute the conduit pipe through which ownership passes from the sellers to the buyers. Sometimes, agent middlemen may be in physical possession of the goods, as in the case of *factors*, or may not be in physical possession at all, as in the case of *brokers*. It should be noted that to be in possession of something is not the same as to have ownership of that same thing. For example, a textbook borrowed from your friend is in your possession, that is, in your custody, but the ownership belongs to your friend.

Usually, all agent middlemen are wholesaling middlemen, although they are not wholesalers. That is, the expression *wholesaling middlemen* is wider and more embracing than the word *wholesalers*. Wholesaling middlemen include wholesalers and agent middlemen. This is because they all sell to customers who are not final consumers. In other words, they all participate in wholesaling or wholesale trade. However, the agent middlemen or wholesale traders perform narrower range of tasks than the wholesalers. This is because wholesale traders never own the goods, the distribution of which they are assisting. From the discussion in this paragraph, the types of wholesale trade are as illustrated with the tree diagram in Figure 6.1.

6.3 Types of agent middlemen

An agent is a person employed for the purpose of establishing a contractual relationship between the principal (who is the person employing the agent) and someone else. In the field of commerce, an agent refers to a person employed for the purpose of selling goods on behalf of the principal. The person employing the agent is either the producer, foreign supplier, or some larger-scale domestic wholesale trader. As shown in the schematic diagram in Figure 6.1 above, there are six types of agent middlemen. These are discussed below.

6.3.1 Brokers

These are agents employed to bring into contact intending sellers and buyers. Unlike other agents, brokers are never in possession of goods and do not sell goods in their own name. If they sell good at all, they would normally indicate that the action is on behalf of someone else, the principal. As a result, they do not have any authority to fix prices. In addition, brokers do not contract to work on a continuing basis with any principal. They can, therefore, act for several principals at the same time. Brokers merely negotiate the sale of goods with a buyer and inform the seller about the bargain. It is then up to the seller to accept or reject the bargain.

6.3.2 Factors or manufacturers' agents

Factors are commercial agents who have the authority to sell goods and who keep custody of the goods until the goods are sold. They sell goods under own name. Factors are independent in the sense that they are not employees of any manufacturer. However, factors do not control pricing policy. Most often, they are required to comply with the prices, and other terms of sale, prescribed by the manufacturer or the producer. Unlike brokers, factors have a continuing relationship with their principals. They normally represent several non-competing manufacturers.

They facilitate the wide circulation of the goods of manufacturers especially to those markets where the sales force of the manufacturers have been unable to reach. Although factors are generally called manufacturers' agent or manufacturers' representatives, nothing prevents them from being agents of other wholesale traders.

6.3.3 Selling agents

These agents perform the complete range of marketing functions for manufacturers. In other words, selling agents perform the fullness and widest range of marketing functions for the manufacturers. They render the marketing departments of manufacturers more or less redundant and superfluous. Agents of this type are peculiar to advanced countries, such as the USA, and are not yet widely embraced in Nigeria.

6.3.4 Del credere agents

Del credere agents are employed to sell goods on the understanding that they would take full responsibility for any defaults on credit sales. This means that Del credere agents undertake that the buyers would pay, failing which the agents become liable.

6.3.5 Auctioneers

Auctioneers are agents whose duty it is to sell goods at public auctions.

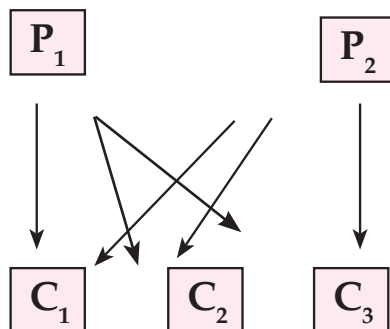


Fig. 6.2 (a) Number of contacts in the absence of a middleman

6.3.6 Others

Other types of agents that do not fit perfectly into any of the above-mentioned five categories can also exist, depending on the agreement existing between the manufacturer and such agents.

6.4 Contractual function of middlemen

Middlemen of all categories usually perform some functions. One important function that is common to them all is called the *contractual function*. This particular function reduces the number of contacts between buyers and sellers. It also reduces transport costs. The benefits of contractual function are sometimes called *transaction economies*. This function is explained in the next paragraph with the aid of Figures 6.2(a) and 6.2(b).

Assume there are two producers, P₁ and P₂, and three consumers, C₁, C₂ and C₃. In the absence of middlemen, the number of contacts would be 6. Let us now assume that there exists a middleman, M. The maximum number of contacts would reduce to 5. A reduction in the number of contacts is followed by a reduction in the distance and, hence, a reduction in transport costs.

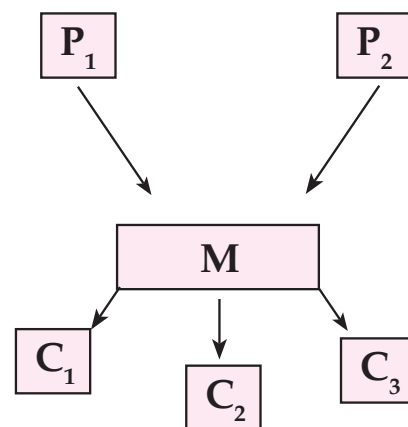


Fig. 6.2 (b) Number of contacts with the presence of a middleman

Generally, if there are C consumers and P producers, the number of contacts could be as much as $C \times P$. In our illustration, this is $3 \times 2 = 6$. With the introduction of a middleman, the number of contacts would be reduced to $C + P$. In our illustration, this is $3 + 2 = 5$.

6.5 Types of channels of distribution for consumer goods

Channels of distribution refer to the various stages which goods pass through, from the point of production to either the final consumer or the industrial user. The channel through which the products get to the final consumer is often called the consumer channel while the industrial channel is the route or course taken for the products to reach the industrial user.

There are, in principle, eight types of distribution channels for consumer goods. In most cases, there may be several layers of middlemen. This is especially so in the Nigerian context. In the distribution channel for consumer goods, the agent could be a broker, a factor, etc (as shown in Figure 6.1).

We shall now briefly examine each of these channels.

a) **Producer → Agent → Wholesaler →
Retailer → Consumer channel**

This is the most complete channel of distribution. All categories of the intermediaries are involved.

b) **Producer → Wholesaler →
Retailer → Consumer channel**

This is another complete channel of distribution. However, this time, the producer dispenses with the services of the agent.

c) **Producer → Agent →
Wholesaler → Consumer channel**

In this channel, the wholesaler sells directly to the consumer, thus dispensing with the services of the retailer. An example of this channel is self-servicing wholesaling.

d) **Producer → Wholesaler →
Consumer channel**

In this channel, the producer dispenses with the services of the agent. Dispensing with retailers and agents has its advantages. These are as follows:

- i) The retailing profit now largely accrues to either the consumer in the form of reduced prices or to the wholesaler or to both.
- ii) There is a reduction in the time taken for the goods to reach the consumer. This is particularly desirable in the case of perishable goods, and fashion goods which are vulnerable to obsolescence within a short period.

e) **Producer → Agent → Retailer →
Consumer channel**

In this channel, the producer dispenses with the wholesaler and deals directly with the retailer. The functions of the wholesaler are now being performed by the agent, or the retailer.

f) **Producer → Retailer → Consumer channel**

In this channel, the producer chooses to deal directly with the retailer and so bypasses the agent and the wholesaler whose roles are now to be performed by the producer or the retailer.

We can now outline the methods by which the producer can dispense with the services of the wholesaler and the agent as follows:

- i) By appointing sales representatives who will maintain constant personal contacts with retailers.
- ii) By appointing agents with exclusive rights to sell the products within defined geographical areas.
- iii) By establishing sales offices with each office managed by a sale force.
- iv) By establishing sales branches with each branch managed by a sales force.
- v) By establishing selling departments within the producing firm or by establishing a separate company for the purpose of marketing the products.
- vi) Through house-to-house selling or mail-order selling.

Certain conditions encourage producers and agents to bypass wholesalers. These conditions include:

- i) When the goods are perishable so that the goods need to get to the consumers quickly.
- ii) When the goods are expensive.
- iii) When the goods have been made popular with the retailer through advertisements.
- iv) When the goods are tailor-made, that is, customer-made.
- v) When the goods are highly technical.
- vi) When there are large-scale retailers.

There are advantages in bypassing the wholesaler. These include:

- i) The profit of the wholesaler now largely accrues to either the producer, agent or the retailer.
- ii) The time taken for the product to reach the consumer is reduced. This becomes especially important with perishable goods and fashion goods.
- iii) Retailers now have direct access to producers, or their agents. In this way, retailers can directly relay market information as well as consumer preferences, to the producers or agents. In the same vein, the producers, or agents, can directly pass technical information about the products to the retailers.

g) Producer → Agent → Consumer channel

In this channel, the agent dispenses with all forms of intermediaries and deals directly with the consumer. Dealing directly with consumers has its advantages.

- i) The profit of middlemen is now cut off and accrues to the producer and the consumer.
- ii) There is a reduction in the time lag for the product to reach the consumer.
- iii) Consumers' preferences and complaints would easily be known by the producer. In the same vein, technical information about the products could easily be conveyed to the consumer.
- iv) The producer's recommended price can easily be enforced.

h) Producer → Consumer channel

This is the shortest channel. Here, the producer bypasses all types of middlemen and deals directly with the consumer. Online sales are sometimes done in this manner, whereby consumers order directly from the manufacturer. Also, small-scale manufacturers may find this convenient and cost-effective, particularly if getting customers to buy the goods is not a problem. The channel is also the only one available in the case of direct services, which the producer must render or administer directly to the consumer. In addition, it has those advantages that are discussed in (g) above.

There are other miscellaneous channels which include direct purchase from producers by the wholesale cooperative societies for eventual sale to the individuals through retail cooperative societies and government bulk purchase of scarce commodities from the producers for eventual resale to consumers.

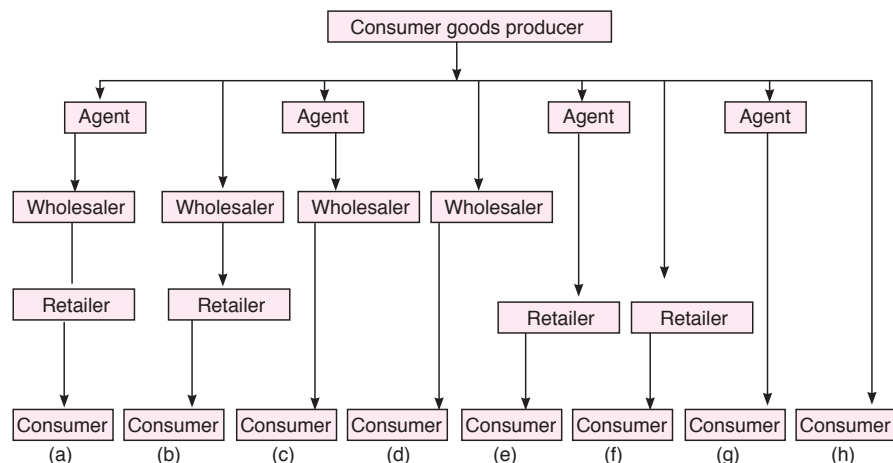


Fig. 6.3 Channels of distribution of consumer goods

6.6 Types of distribution channel for industrial goods

Retailers are not normally involved in the distribution of industrial goods. Therefore, the distribution channel for industrial goods is shorter than the distribution channel for consumer goods. Let us illustrate a typical distribution channel for industrial goods as shown below in Figure 6.4.

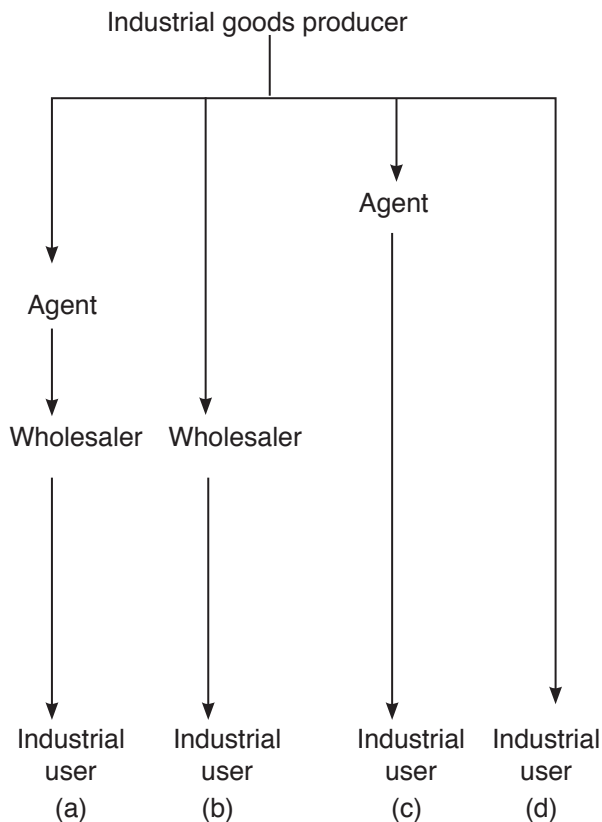


Fig. 6.4 Distribution channels for industrial goods

NOTE: Channels (a), (b), (c) and (d) respectively correspond to channels (c), (d), (g) and (h) identified for consumer goods.

6.7 Factors to consider in choosing a distribution channel

Three factors need to be considered in choosing a distribution channel. These factors are market situation, features of product and circumstances of the producer.

6.7.1 Market situations

Three market situations can be considered; the number of potential customers, the geographical concentration of the customers, and order size.

- i) *Number of potential customers*: If the number of potential customers is small, the tendency would be to dispense with all categories of middlemen. The converse holds true when the number of customers is large.
- ii) *Geographical concentration of customers*: If the customers are concentrated in a particular locality, the tendency would be to eliminate some or all of the middlemen categories.
- iii) *Order size*: If the users buy largely in bulk, the tendency would be to eliminate some or all of the middlemen categories.

6.7.2 Features of a product

The features of a product affect the choice of distribution channel. We shall now discuss the three features, which are *value*, *perishability* and *technicality*.

- i) *Value*: The more expensive the product, the shorter the channel is likely to be.
- ii) *Perishability*: The higher the degree of perishability, the shorter is the desirable distribution channel.
- iii) *Technicality*: The more technical and complex the good, the shorter the distribution channel is likely to be. This is because the producer is normally best suited to provide pre-sale and after-sale services.

6.7.3 Circumstances of the producer

The circumstances of a producer may affect the length of the distribution channel. We shall consider three circumstances: financial resources, managerial resources and distribution.

- i) *Financial resources*: The stronger the producer is financially, the less the need for middlemen and, hence, the shorter the distribution channel.
- ii) *Managerial resources*: This affects the distribution channel in the same way as financial resources.
- iii) *Distribution*: A producer who intends to control the prices and distribution of goods would prefer a short channel.

6.8 Advantages of home trade

Home trade has some obvious advantages and these are outlined as follows:

- i) There is hardly any language barrier since buyers and sellers are close to each other.
- ii) There is no foreign exchange problem since buyers and sellers use the same currency.
- iii) There is no difference in the weights and measures used by both the buyers and the sellers since both groups are subject to the same laws.
- iv) The distance over which goods are to be moved is shorter, on average, than in foreign trade.
- v) In addition to less language barrier, there are also fewer cultural barriers in general. So, it is easier for producers to take the cultural characteristics of would-be customers into account in designing the features of his products.
- vi) The political and legal systems too are less heterogeneous than in the case of foreign trade. In most cases, only a single legal system and a single political system prevails in a country.

6.9 Functions of retailers

With respect to the distribution of goods, the retailer has a number of functions and these are outlined as follows:

- i) *Breaking the bulk*: A retailer buys in relatively large quantities from the wholesaler and resells in small quantities to the consumers.
- ii) *Ensuring availability of goods*: The retailer keeps stock of a variety of goods within easy reach of potential customers. Thus, consumers can obtain the goods required without necessarily going beyond the neighbourhood.
- iii) *Warehousing*: A retailer stores and preserves goods in anticipation of sales.
- iv) *Offer of credit facilities*: A retailer may accept part payment from consumers while balance is paid at an agreed future date.
- v) *Provision of after-sales services*: Most retailers provide after-sales services. This is particularly common for consumer durable products such as wristwatches, motor cars, radio, television, and bicycles.
- vi) *Provision of guarantee*: A retailer may guarantee a product for a period of time, say six months. During this period, the retailer undertakes to repair any faults that the product may develop. Guarantees are normally provided for such products as radios, televisions, typewriters, and cars.
- vii) *Risk-bearing*: Along the distribution channel, retailers assume the risks of loss, theft, damage, deterioration, and obsolescence, because goods now belong to them.
- viii) *Transport and delivery services*: Sometimes, retailers undertake to deliver the goods to the places where they are actually needed.
- ix) *Advertisement*: The retailers often advertise and promote the goods. This is particularly the case with the hawkers, stallholders, etc.
- x) *Product preparation, branding, labelling and packaging*: Certain goods may need to be measured and packaged before they are sold to the consumers. An example is the sale of meat. The retailer normally buys a whole animal which may be a goat or a cow. The retailer slaughters the animal, dismembers it and then packages the various pieces ready for sale to the consumers. The retailer may brand and label the packages.

- xi) *Provision of technical advice*: The retailer gives advice to consumers on the most effective way to use certain products. For instance, a radio retailer gives advice to the consumer on how best to operate and use the radio.
- xii) *Provision of market information to wholesalers*: Retailers are in a direct position to know the preferences and complaints of consumers. Retailers convey such information to the wholesalers for onward transmission to the producers. In the absence of wholesalers, retailers can convey such information directly to the producers.
- xiii) *Contractual function to consumers*: Like all middlemen, a retailer reduces the number of contacts, thus enhancing transaction economies.

6.10 Factors necessary in setting up a retail trade

The purpose of establishing a retail business, or any business for that matter, is to make profit. That being the case, several factors that enhance profit should be considered when planning to set up a retail trade. Let us consider the following factors as factors that are necessary in the setting up of retail trade.

6.10.1 Site or location of the shop

In deciding on the location of the shop, consideration should be given to the following:

- i) *Proximity to the customers*: This becomes especially important in the case of non-expensive items.
- ii) *Proximity to the source of supply*: This curtails expenditure on transportation of raw materials.
- iii) *Proximity to competitors*: This is an advantage in the sense that such a place can be the focus for customers. Proximity to competitors may, however, lead to an inevitable cut-throat competition among retailers.
- iv) *Rental cost of shops*: In the centre of a city, the rental cost of a shop is often high when

compared with shops on the outskirts of the city.

- v) *Availability of good roads*: This is important so that customers can have easy access to the shop.

6.10.2 Capital

This refers to the finance with which to set up and nurture the trade. Capital can be sourced from the private savings of the trader, monetary gifts from friends and relations, loan from banks and private money lenders.

6.10.3 Pricing policy

If consumers' demand for a certain commodity is *inelastic* – that is, the quantities bought do not respond much to prices changes – then it is advisable to raise prices. On the other hand, demand for a certain commodity might be sensitive or responsive to price changes. In this case, it is prudent to lower prices in order to boost sales. In some cases, it may be advisable to sell some commodities at a loss because more customers are likely to be attracted and such customers are likely to buy other items, the sale of which may be sufficiently profitable as to compensate for the loss sustained in the sale of the other commodity. Such goods that are sold at a loss in order to derive sufficient profit repercussions on the sale of the other items are called *loss leaders*.

6.10.4 Labour

If the scale of operation is really small, or if proprietorial (i.e., owner's) attention to customers is essential, then the owner might also be the shopkeeper. In this case, also, the owner may deploy the services of members of his household. However, if the scale of operation is really large, it becomes inevitable for the shop owner to employ the services of paid shop attendants.

6.10.5 Retail outlets

A decision on the choice of retail outlet must be firm. Such an outlet may be a market stall, a shop, a supermarket, etc.

6.10.6 Inventory holding

The items to hold in stock and the quantity of each item should be considered. Different varieties and large quantities of items tend to boost sales.

6.10.7 Source of supply

The source of supply must be clear to the retailer. Supply could be direct from the manufacturer or through a wholesaler.

6.10.8 Publicity and advertisement

The retailer must ensure that potential customers are aware of goods in stock. Publicity can be through the radio or the newspapers, whichever commands a wider audience.

6.11 Retailing and retail outlets

Retailing is the business of selling goods to customers, for the use of customers and not for resale. Retail outlets refer to the various methods by which retailers get in touch with their customers. Many types of retail outlets exist. A diagrammatic representation of retail outlets is shown below.

From this diagrammatic representation, it is evident that there are two major retail outlets: the small-scale retail outlets and the large-scale retail outlets. We shall now discuss each of the two major retail outlets.

6.12 Small-scale retail outlets

Small-scale retail outlets are sometimes referred to as *independent* retailing or *unit* retailing. Small-scale retail outlets consist of hawking, stall holding, single shops, mobile shops, and market trading.

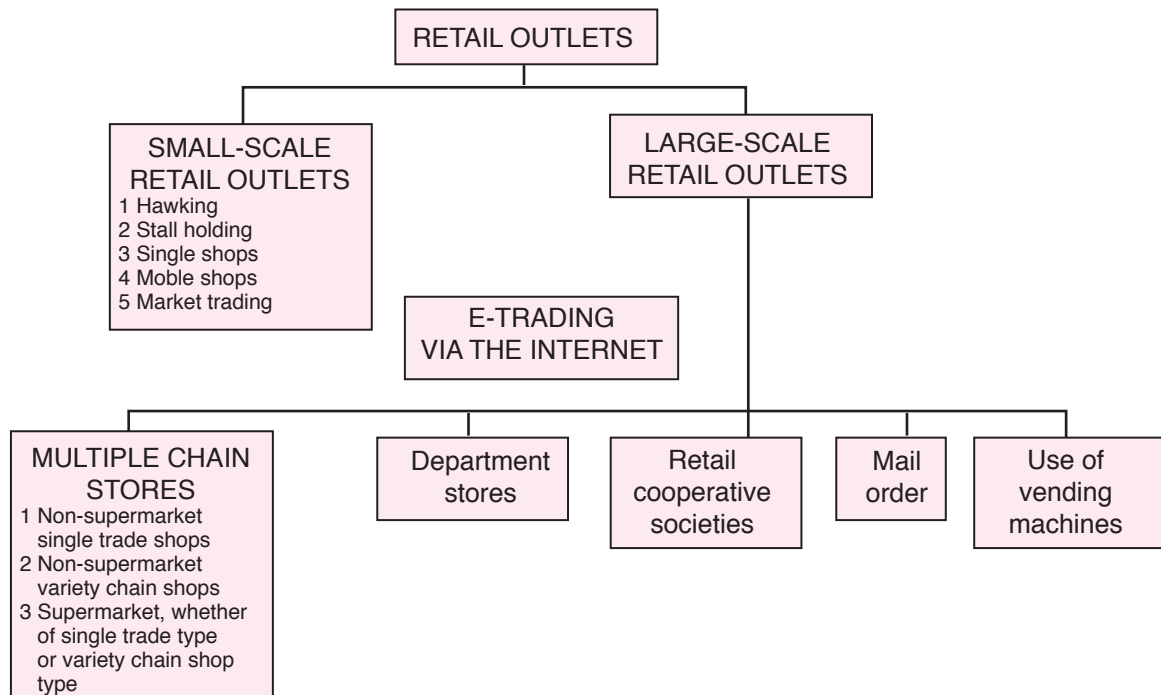


Fig. 6.5 Retail outlets

6.12.1 Distinguishing features of small-scale trading

Nearly all small-scale trading have the following distinguishing features:

- i) Only a small amount of capital is employed.
- ii) Only a few workers are engaged. In many instances, the services of the owner and the services of family members are adequate.
- iii) The methods of retailing and the retailing facilities are often simple and crude.
- iv) Selling prices are often arrived at through haggling.
- v) Small-scale trading is generally labour-intensive. In other words, the ratio of labour services to capital services is high.
- vi) Small-scale trading businesses are usually not incorporated and, in most cases, are mere sole proprietorships.

6.12.2 Advantages of small-scale trading

Despite the crude method of retailing and the poor retailing facilities, small-scale trading has some important advantages and these are outlined as follows:

- i) Personal relationship with customers is enhanced through individual attention to every customer.
- ii) There is flexibility in decision making.
- iii) Decisions are quick and prompt because there is hardly any need for extensive consultations and meetings.
- iv) There is usually a tax advantage in the sense that the proportion of profit paid as tax is usually small. Many are not even registered with the government to enable the tax authorities to know of their existence and tax them; that is, many do not pay any tax on their profits.
- v) Small-scale trading provides convenient and local sources of supply to customers because small-scale traders are found in every nook and cranny of our towns and villages.
- vi) A little amount of capital will suffice to commence retail trade.

- vii) Small-scale trading requires minimum labour, probably that of the owner of the business and family members.
- viii) Trading can go on for as long as the owner wishes. In other words, there may be no strict working hours.
- ix) Small-scale trading is good training ground for those aspiring to undertake large-scale trading.

6.12.3 Disadvantages of small-scale trading

Small-scale trading suffers some typical disadvantages and these are outlined below.

- i) Small-scale traders cannot buy in bulk and are, therefore, unable to enjoy discounts and cheaper transport costs.
- ii) Small-scale traders suffer from unlimited liability, as many of them are just sole proprietorships and not incorporated as limited liability companies.
- iii) It is difficult for small-scale traders to raise finance with which to expand their businesses.
- iv) Small-scale traders can hardly hold adequate inventory. In other words, they cannot stock a variety of products.
- v) Operational method of the small-scale trader is often crude and archaic.
- vi) Haggling is common among small-scale traders and this wastes the time of the consumers.

6.13 Types of small-scale retail outlets

We shall now discuss the main features, advantages and disadvantages of each type of small-scale retail outlet.

6.13.1 Hawkers or itinerant traders

Hawkers or itinerant traders carry their wares from place to place in search of customers. Usually, hawkers do not have any permanent place of



Fig. 6.6 Hawkers

business, but move from street to street in search of customers. In our big cities, such as Lagos, Enugu, Kaduna, Ibadan and Kano, hawkers sell their wares to motorists along the road. Hawking requires very small capital to commence.

There are advantages of itinerant trading. These include:

- i) Itinerant form of retailing spares customers the time and cost of travelling in order to make minor purchases.
- ii) For the hawkers, there is no rent to pay since they do not maintain any permanent shop.
- iii) Very often, defective items cannot be returned to hawkers since they are always on the move.

However, itinerant trading has a number of disadvantages, which include the following.

- i) It is inconveniencing and hazardous to be carrying wares from place to place.
- ii) The hawker can only carry a small quantity of wares at any particular time.
- iii) Hawking is unsuitable for the sale of bulky items such as bags of cement.

- iv) Defective items cannot be returned to the itinerant trader and this may facilitate deliberate sale of such goods.

6.13.2 Stallholders

Generally, stallholders are traders who display their goods in stalls. The stalls may be built by the stallholders themselves or by the local government. If the stalls have been built by the local government, then the stallholders are required by law to pay a token rent to the local government.

Stallholding has advantages, which include the following:

- i) Market stalls in any community reduce the number of times consumers might need to travel to the cities.
- ii) Stalls are not expensive to construct or to rent.

However, there are disadvantages of trading in stalls. These include:

- i) Stallholders are prone to fixing arbitrary prices for their commodities.
- ii) Stock is restricted to those items needed by the local residents.
- iii) Customers can change their minds and return some items.

6.13.3 Single or unit shops

In Nigeria, unit shops are located almost everywhere in the cities, towns and villages. Depending on the type of business, a unit shop may be located in a residential building or in any other place convenient to prospective customers. Most single shops are owned by individuals. However, some single shops are owned by a family or by partners in business. It should be noted that the difference between single shops and stalls is in degree and not in kind.

Advantages of unit shops are as follows:

- i) They minimise the need for advertisements.
- ii) They reduce transport costs to customers.

Disadvantages of unit shops include the following:

- i) Expansion of business is difficult because capital is small.

- ii) Customers are personally known to shop-owners and refusal to grant credit may lead to loss of patronage.

6.13.4 Mobile shops

Mobile shops are special forms of hawking operated with motor vehicles. Mobile shops display fairly large quantities and varieties of goods.

Mobile shops do have advantages. These include:

- i) Mobile shops can reach many customers.
- ii) Mobile shops can stock variety of goods in popular demand.
- iii) Owners of mobile shops can look for customers wherever they can be found.
- iv) Customers cannot easily return goods.

Mobile shops also have disadvantages which include:

- i) Cost of maintaining the vehicles can cripple the business.
- ii) A breakdown of vehicles might be the end of a day's business.
- iii) Cash from sales may be lost to thieves.

6.13.5 Market trading

In many towns and villages in Nigeria, some open places are designated as market places. Some markets in Nigeria specialise in the sale of certain items, and operate on special days, at 4-days or 8-days intervals depending on the location. However, there are many markets in Nigeria which operate on a more or less daily basis. A typical example of this type of market is the Onitsha main market which is reputed to be the largest in West Africa. In major marketplaces, hawkers, stallholders, unit shop owners and mobile shop operators can be found.

Advantages of market trading include the following:

- i) A wide variety of goods are available.
- ii) It saves time for consumers since they do not need to move from one marketplace to another to get what they need.
- iii) For each item, there are many dealers, giving rise to competition and reducing the chances of any buyer paying arbitrary prices.
- iv) Marketplaces attract customers from both far and near places.



Fig. 6.7 A busy market

Disadvantages of market trading include the following:

- i) Marketplaces cannot be found in every nook and cranny of our towns and villages.
- ii) Marketplaces do not serve the needs of the small buyers.

6.14 Why small-scale retailing still thrives

Here, we shall give reasons to justify the continued survival of small-scale retailing despite the emergence of multiple shops in many big cities of Nigeria. The reasons are as follows:

- i) There is no protocol with the buying and selling.
- ii) Many retail trades require direct personal services best catered for by small-scale retailers.
- iii) Only a small capital is required to commence a small-scale retail trade.
- iv) There is no need to acquire a lot of managerial skills.
- v) Profit is for the owner of the business alone.
- vi) Many small-scale retailers do not pay tax on profit.
- vii) Small-scale retailers operate any time and are not restricted by public holidays declared by the government.
- viii) There is no need to keep books of account.

16.15 Trading on the Internet or online retailing

Before discussing the conventional large-scale retail outlets, electronic retailing (or e-retailing or e-tailing) is discussed first in line with the schematic diagram in Figure 6.5, where it can be seen that online retailing is usually not a stand-alone outlet but what can supplement some other retail outlets. E-trade is a modern way of selling. It is only large-scale retailers, especially multiple chain stores and department stores, that could have facilities for e-trade. Manufacturers and wholesalers too use e-trading to reach consumers

directly and bypass other middlemen.

E-trading entails goods being ordered via the Internet and paid for through one of the e-payment arrangements. The risk there is that customers may not have the opportunity of carrying out physical inspection, which may be an important factor for non-standardised items. There is also the risk of Internet fraud, whereby fraudsters would order and take delivery of goods without paying.

The advantages of online trading, like speed, precision, etc have been discussed in Chapter 1, just as the disadvantages like the cost of putting in place the requisite networking facilities and loss of personal relationship with customers.

6.16 Large-scale retail outlets

6.16.1 Multiple chain stores

In this sub-section, we shall start to examine each type of large-scale retail outlets and also outline the advantages and disadvantages of each type. Let us start with the multiple chain stores. We shall discuss other types subsequently.

Multiple chain stores consist of several shops located in different places but are all centrally controlled by a single retailing organisation. Such a retailing organisation is usually a limited liability company. Each of the several retailing shops constitutes a branch. Normally, purchasing is centralised and it is the responsibility of the head office. The head office then distributes supplies to the various branches. Each branch has a branch manager who, as a rule, cannot even fix selling prices. The branch manager makes periodical returns of sales, cash receipts, expenditure and stock available to the head office. Multiple chain stores have standard, unique and easily identifiable shop fronts in the various branches. Usually, multiple shops are located in populous streets within the city, and the shop fronts portray the name, logo and any other symbol of identity.

Advantages of multiple chain stores include the following:

- i) Chain stores have easily identifiable shop fronts.

- ii) Chain stores make it possible for the manufacturer to retail its own products.
- iii) Staff can be transferred from one shop to another shop.
- iv) Middlemen may be eliminated if the manufacturer chooses to retail its own products.

Disadvantages of multiple chain stores are as follows:

- i) Goods must reach the branch through the head office instead of from the source of supply. Thus, transport costs are escalated because goods cannot move straight to the branches from the source of supply.
- ii) Branch managers are mere figure heads and cannot take any executive decision without reference to the head office.
- iii) Personal services are lacking and this can scare away some customers.

We shall now discuss the three main types of multiple chain stores.

- a) **Multiple or single-trade shops**
These are called single-trade shops because they have a well-defined stock, instead of varieties or assorted items. Usually, multiple shops are confined to one line of business, for example electrical appliances, textbooks, or shoes.
- b) **Variety chain shops**
These stock a wide range of products.

Some of the products are produced by the manufacturers exclusively for a particular chain shop.

Variety chain shops are not a common feature in Nigeria but Bhojsons and Chellarams are known to stock products bearing their trade names. Branches of variety shops can be found in the big cities. For instance, Bhojsons and Chellarams have branches across Nigeria. A noticeable feature of variety chain shops is that they have identical shop fronts.

c) **Supermarket**

These are multiple chain shops with self-service facilities. A supermarket is a very large shop with self-service facility. A supermarket may occupy a large surface area of about 200 square metres. The large area enables customers to move about freely in order to make selection of goods they need. A supermarket can deal in a narrow range of products or in a single product. A major characteristic feature of supermarkets is that they specialise mainly in household goods and food items. More often, a supermarket deals in a variety of goods. In Nigeria, every small shop is tagged a 'supermarket' by the owners. This is erroneous.

In many advanced countries, some supermarkets have become very large and



Fig. 6.8 Goods on display in a supermarket

they have been given special names such as *hyper-markets*, *superstores*, or even *super-super-markets*.

6.16.2 Department stores

A department store is a retail outlet with several shops under the same roof. Each of the several shops constitutes an autonomous unit called a department. A department is headed by a manager who has the authority to secure supplies for the department. Depending on the line of products, food items may constitute a department, electronics may constitute another department, wearing apparels may be yet another department, etc.

Commonly, a department store has four main divisions, namely merchandising, administration, accounts, and stores. The merchandising division is responsible for the sale of goods. The administrative division is responsible for staff matters. As usual, the accounts division is responsible for all accounting functions while the stores division takes custody of all the goods. A typical organisation of a department store is shown in Fig. 6.9 below.

Only the merchandising division is accessible to the potential customers. Other divisions are located in places within the building that may not be as distinct.

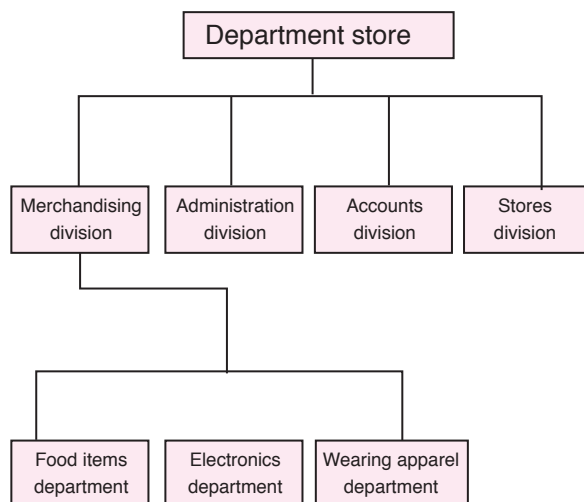


Fig. 6.9 Typical organisation of a department store

Thus, it can be seen that the major difference between a department store and a multiple chain store is that all branches in the multiple chain stores are controlled from the head office, and branch managers do not have authority to procure supplies. On the other hand, a departmental manager in a department store has authority to procure supplies. Another difference between a department store and a multiple chain store lies in the location of the shops. In a department store, all the shops are located within the same building, but for a multiple chain store, the various shops are located in different premises, cities, or towns.

Another difference is that personal service is emphasised in a department store while self-service is emphasised in a multiple chain store. Most department stores provide café-restaurants unlike multiple chain stores.

Historically, it is interesting to note that department stores had their origin in France. The very first department store, called Bon Marché, was established in 1852.

a) Advantages of department stores

- i) Department stores provide pleasant surroundings to cater for the comfort of customers.
- ii) The various needs of customers are satisfied since the different shops are located in a single building.
- iii) Trained staff are available to brief customers on the proper use and maintenance of specialised products such as videos and televisions.
- iv) Staff can easily direct customers from one department to another.
- v) Departmental managers can identify and satisfy market needs without reference to the head office. This would surely enhance turnover.
- vi) The wholesaler is eliminated because department stores can make direct purchases from the manufacturer.

b) Disadvantages of department stores

- i) Department stores are located in big cities and, therefore, do not benefit country dwellers.
- ii) Since luxurious facilities are provided, the cost of operation is high and, as a result, selling prices are high.

comfortably examine the goods in their own home before deciding on whether or not to purchase them. If the goods do not meet the stated requirements of the customer, they are returned to the seller for replacement.

- iv) A mail order business does not need to be located in an expensive centre of the city. Instead, a low-rent area will serve the purpose.
- v) Time and travelling expenses are saved by the customers.

b) **Disadvantages of mail order business**

- i) The cost on advertisement is very high, involving colourful and descriptive catalogues.
- ii) Postal expenditure is high for the retailer and the buyer.
- iii) Time is wasted while waiting for the goods. In Nigeria, this waiting period can be agonising because of the poor postal system.
- iv) There is absence of personalised service.
- v) The pictures and descriptions in the catalogue may be misleading, as a result of which customers often get disappointed on receiving the goods. Consequently, such goods are returned to the sellers.



Fig. 6.10 Purchase at a Coke vending machine

6.16.5 Vending machines

In many countries, sales can be effected with the aid of automatic machines specially designed for the purpose. These machines are referred to as *vending machines*. For most vending machines, the customer drops an appropriate amount of coins into the machine and then presses a button for the goods required. The vending machine will automatically supply the goods required by the customer.

The main goods retailed through vending machines include chocolate drinks, sweets, chewing gums, cigarettes, milk and even a complete meal.

By the use of vending machines, the seller need not be present to deal with the customer and the customer can make purchases at any

convenient time. However, vending machines, like any other machines, are susceptible to mechanical faults. Some unscrupulous customers may even vandalise the machines. Vending machines are very capital-intensive and therefore an uncommon method of retailing goods in Nigeria.

6.17 Modern trends in retailing

Any place designated for the sale of goods is a retail outlet. For this reason, petrol stations, market gardens, selling plants, restaurants, etc are all retail outlets. Developments in retailing are a continuous exercise. We shall discuss the latest developments.

6.17.1 Self-service

This is a practice which enables customers to serve themselves. The practice reduces the need for many sales assistants. Before the introduction of self-service, one shop assistant attended to one customer. In a self-service shop, the customer has the right to handle and examine the goods. When the customer decides to buy, the check-out counter is approached where payment is made for the goods.

The main characteristics of self-service are as follows:

- i) Most of the functions customarily performed by the sales staff are now performed by the customers. An example is the selection of goods from the shelves. The main function still performed by the sales staff is the replacement of the goods on the shelves and to collect money from customers at the check-out points.
- ii) The goods on sale must be properly branded, labelled and affixed with price tags.
- iii) Self-service facilitates the sale of 'loss leaders.' These are goods whose prices have been substantially reduced in order to attract people into the shop. Such people may be tempted into buying other goods being sold at a profit.
- iv) In operation are special procedures for the purpose of monitoring and caring for perishable goods.
- v) Since the possibility of pilfering is high, store detectives are usually employed. A further security measure is to place small items, which can easily be pocketed, at the check-out points.
- vi) Trolleys and baskets are provided and these enable customers to move selected goods to the check-out points where payments are made for the goods.
- vii) There is adequate space which allows for free movement of customers and facilitates adequate display of goods.

Self-service has the following advantages:

- i) It speeds up the process of retailing.
- ii) It cuts costs.
- iii) It allows customers a great deal of freedom of choice.
- iv) It facilitates the sale of 'loss leaders.'

However, self-service also has some disadvantages, which are as follows:

- i) It breeds shoplifting.
- ii) Personalised service is absent.
- iii) Handling of goods by customers hastens deterioration of stock.
- iv) The need for space may prove expensive.
- v) It entails hiring of detectives, or the installation of other devices so as to reduce shoplifting.

6.17.2 Branding

A brand is a class of goods which is the product of a particular company or producer. Branding refers to the affixing of a producer's identity on own products. The identity can be in the form of a name in which case it is referred to as a *brand name*. Alternatively, branding can be in the form of a peculiar symbol, design, or colour in which case it is called a *brand mark*. Through advertisements, such goods become recognised by the buyers.

Branding can be done by the producers or by the middlemen. We shall now examine branding by producers and branding by middlemen.

Branding by producers

Many large-scale producers brand their products. Such producers normally have effective distribution channels. Branding by producers enables such producers to have total control over the marketing of the products. Small-scale middlemen are encouraged to patronise the producers. However, branding by producers will scare away large-scale middlemen. This is so because many large-scale middlemen prefer to market some products under their own brand names.

Branding by middlemen

Many wholesale traders and large-scale retailers prefer to market some products under their own brand names. In this way, these middlemen monopolise the market for these products with their own brand names.

We shall now consider the advantages and disadvantages of branding, whether by producers or by middlemen.

Advantages of branding

- i) Branding facilitates recommended prices to be indicated on the products.
- ii) It obliges manufacturers to maintain the quality of goods and the middlemen to sell only quality goods in order to maintain established goodwill.
- iii) Branding facilitates self-service retailing because the customer can easily identify the product.
- iv) Branding facilitates the standardisation of the goods. This means that all units of a particular brand are alike. For example, all the tablets of a particular standardised brand of soap would be alike irrespective of who is the retailer. Branding therefore facilitates buying and selling of goods.

Disadvantages of branding

- i) The retailers are compelled to keep an inventory of each brand for the sake of customers who patronise the different brands. The implication of this is that the total inventory of wares held by a retailer is high and this entails a corresponding high cost of inventory holding.
- ii) Branding entails intensive advertisement and is therefore costly to the manufacturer or the middleman.
- iii) Costs incurred from advertisements are passed on to the consumers in the form of high shelf-prices.

6.17.3 Pre-packaging

Stock that is continuously handled can be protected through packaging, wrapping, or containerisation. Pre-packaging allows for ease of handling and an attractive packet is a good selling point. Much of pre-packaging is done by the manufacturer but many supermarkets now pre-package perishable goods such as meat and vegetables. Since each packet contains a known weight of the goods, pre-packaging saves time as the customer merely selects the weight of the goods required. It is important for us to note that packaging is now a major industry and that when we pay for any packaged goods, we are also paying for the containers, whether such containers are bottles, tins, jars, boxes or Cellophane.

Let us now consider the advantages and disadvantages of pre-packaging.

Advantages of pre-packaging

- i) If pre-packaging is done by the producer, the middleman is relieved of the burden.
- ii) Pre-packaging by the producer or by the wholesaler helps to eliminate false weighing and false measuring by unscrupulous retailers.
- iii) Pre-packaging helps to ensure that retailers do not tamper with the quality of the goods.
- iv) Since the packaged goods are standardised, self-service retailing is facilitated.
- v) Branding and labelling are possible only when goods are pre-packaged.
- vi) Pre-packaging protects the product as they are moved from the seller to the buyer, or even in the process of the product being used by the buyer. This can be in the form of prevention of deterioration, evaporation, loss, etc.
- vii) For corrosive goods, pre-packaging protects both the buyer and the seller.

Disadvantages of pre-packaging

- i) Pre-packaging is expensive and the cost of packaging is often passed on to the consumer.
- ii) Pre-packaging prevents actual inspection of the goods by the buyer, thereby compelling buyers to rely on the information stated on the package.
- iv) End-users of pre-packaged goods often litter the streets with wrappers and empty containers. This breeds filth and our government spends a lot of money clearing such filth.

6.17.4 Labelling

Labelling refers to the written information about products. Labelling can be in the form of a tag which is attached to products. In many instances, however, labelling is often part of the package. This implies a close relationship between labelling and packaging. There is a similar close relationship between labelling and branding in the sense that the brand may simply be written information.

6.17.5 Discount houses and cash-and-carry stores

One feature of selling consumer durables is the offer of discounts. Some business houses specialise in this style of trading and are called discount houses (this should not be confused with firms that discount financial instruments like treasury bills, which are also called discount houses). Many discount houses limit their stock to a particular line such as television sets, refrigerators and washing machines.

In cash-and-carry stores, credit sales are not allowed. But prices are cut to the 'bone' to compensate the customer for paying in cash and removing the goods immediately. Many traders do business on the principle of cash-and-carry.

6.18 Why retail businesses may thrive or fail

Retail businesses have strengths in some areas while they are also vulnerable in others. Their strengths constitute the reasons why they survive and thrive while their weaknesses are the factors that often cause their downfall. Both of these are examined below.

6.18.1 Why retail businesses thrive

The following are reasons why retail business thrives:

- i) *Lack of separation of ownership from control:* Because the size of a retail business is generally small when compared with the wholesale business, there is generally no separation of ownership from control. This means that the proprietor (owner) often doubles as the manager of the business. Therefore, there is always an incentive for the manager to do his best to maximise profit for the business. But in the case where there is a separation of ownership from control, the management may be pursuing interests (e.g., maximising remunerations

to themselves) and objectives that are often at variance with the profit-maximising interest of the absentee proprietor (or shareholders).

- ii) *Owners' managerial capacity may not be overstretched:* Also, because of the relative smallness of size, management of a retail business may be simple, thereby not overstressing the managerial capacity of the owner-manager.
- iii) *Flexibility:* A big business can be compared with a truck which, though very strong and rugged, may not be able to move fast, manoeuvre narrow roads, or make quick turns, should the situation so demand. A small business, on the other hand, is like a small car or even a motorbike which, though fragile, can move fast, maneuver quickly and make quick turning even if the available space is not much. This analogy means that a retail business, by virtue of its relatively small size, is flexible and adapts or adjusts quickly and easily in line with the changes in business environment and other circumstances.
- iv) *Decision-making is fast, with minimum bureaucracy:* Related to the above is the fact that decision-making and implementation are fast. There is not much bureaucracy, red tape, excessive paper work, protracted consultations and approval process, etc.
- v) *Informality means escaping many government regulations and controls:* Mainly because most retail businesses are small in size, they operate in the informal sector of the economy. One major feature of the informal economy is the general absence of government control on the activities there, as the government hardly has a record of their existence since they may not even be registered with the government in the first place. Thus, they generally do not pay profit tax, value-added tax or payroll tax for their employees. They also often do not comply with minimum wage legislation in paying their staff or comply with price controls when such exist. The same applies to many other government regulations.

6.18.2 Why retail businesses fail

- i) *Finance*: Because of the generally small size, retail businesses do not have ample opportunities to obtain finance. Reliance is often placed on the generally meagre financial resources of the proprietor, including retained profits. Banks and other financial institutions do not often give loans to small borrowers, who are also disadvantaged in accessing the capital market or stock exchanges to raise funds.
- ii) *Limited managerial and professional capacity*: Management and professional services are often limited to whatever the proprietors themselves can provide. The smallness in size does not often permit competent managers and skilled professionals to be engaged.
- iii) *Simplistic and non-modern modes of operation*: Again, because of the usually small size, the mode of operation or technique of doing business is often too simplistic to meet modern day business requirements. For instance, adequate financial and accounting records are sometimes not kept. Also, information technology (computer terminals and networking, electronic trading, etc) is not often used. All these may affect the competitiveness of the business.
- iv) *Lack of diversification*: Because of the small size, retailers may not be able to diversify into many areas of merchandising, which would require much money and management capability. The resulting narrow range of products dealt in would make the business vulnerable to the risk of unfavourable changes in market conditions; for example, a fall in the demand for a particular product, could easily result in business collapse.
- v) *Limited government attention*: Government attention is more focused on larger enterprises that are often regarded as 'too big to fail' because of the wider effects that a failure would have on society. This is not the case with small enterprises, including most retail businesses, whose failure would only have localised, and rather unnoticeable effect, from the government perspective.

That many retail businesses are operating in the informal sector of the economy, and hence, without being registered with the government, means they do not exist in government records and this makes it difficult for government to assist them, even if it wants to.

- vi) *Unfavourable market conditions and retail business environment*: Both favourable and unfavourable market conditions and retail business environments are different, and rather inevitable, phases of the cycle that retail businesses, like other businesses, are supposed to pass through over time, depending on the general macroeconomic and political situations that affect demand and operating costs facing the business community. But, because of their generally small size, many retail businesses are unable to weather the storm when the unfavourable phase comes, and it is then that many of them collapse.
- vii) *Aggressive competition and incursions from wholesalers, manufacturers, etc*: Wholesalers and manufacturers generally have more muscles to out-compete the relatively small retailers, with some of them by-passing retailers to sell directly to the consumer. The advent of Internet trading makes the matter worse, as it allows the manufacturer to sell directly to the online customer, as no retail outlets are needed.

6.19 Wholesalers

Wholesalers are those traders who buy goods in large quantities from manufacturers and sell such goods in small quantities to retailers or to industrial users. Wholesalers are therefore intermediaries between the manufacturer and the retailer.

Wholesalers do not deal with the general public but with accredited retailers or industrial users, who must open accounts with the wholesalers. Wholesalers stock goods from many manufacturers and are therefore in a position to offer a wide range of alternative goods. Wholesalers have large capital which enables them to buy and stock large quantities of goods. Most wholesalers pay cash to the manufacturers but

sell on credit to retailers whose financial resources are very low. By this special service, wholesalers help the manufacturers to maintain production and the retailers to remain in business.

6.19.1 Channels of distribution

The available channels of distribution for wholesale institutions are as earlier discussed in Figure 6.3 on page 46. As can be seen from there, all except two out of the available options involve wholesale institutions in one form or another. This means that at least one of the wholesalers and the agents feature in six out of the eight possible channels identified there, while wholesalers alone feature in four.

6.19.2 Functions of wholesalers to producers

- i) Wholesalers simplify distribution by making available to the retailers a wide range of both local and foreign goods.
- ii) They provide market information to the producer. This is possible because wholesalers are in closer touch with retailers and consumers than with producers.
- iii) They sometimes indirectly finance producers by making advance deposits for goods still in production.
- iv) They purchase in bulk, relieving the producer of the burden of carrying many stocks. Wholesalers are able to do this because they have large warehousing facilities.
- v) They stimulate demand for products through branding, packaging, labelling, advertisement and many other sales promotion gimmicks.
- vi) They stockpile goods when demand falls and release goods into the market when demand rises. By so doing, wholesalers ensure a smooth flow of goods into the market thereby reducing sporadic gluts and shortages together with attendant price fluctuations.
- vii) They receive from manufacturers bulky goods which are now split into smaller packages by the wholesaler. The smaller packages are now convenient for the retailer

and consumer. Breaking of bulky goods into handy units facilitates transportation from the wholesaler to the retailer.

- viii) Somewhere along the distribution channel, wholesalers perform entrepreneurial role of risk-bearing.
- ix) They perform the contractual function described earlier, thereby permitting the realisation of transaction economies.

6.19.3 Functions of wholesalers to retailers

- i) Wholesalers sometimes pre-pack, brand and grade goods for retailers.
- ii) They stimulate demand for goods through various sales promotion efforts and gimmicks.
- iii) They often offer credit facilities to retailers.
- iv) They provide retailers with technical information and advice on new products.
- v) For the convenience of retailers wholesalers carry inventory of assorted goods procured from different manufacturers. From the inventory, retailers can select the goods needed.
- vi) When retailers buy good from wholesalers, wholesalers arrange for a suitable means of transport to carry the goods to retailers' outlets. Sometimes, wholesalers bear the cost of transport but in many instances, retailers bear the transport cost.

6.19.4 Arguments for and against the elimination of wholesalers

We have already noted the useful functions of wholesalers to producers, retailers and consumers alike. However, it is believed that wholesalers are responsible for artificial scarcity and the attendant rise in price. For this reason, many people now think that wholesalers should be eliminated in the distribution channel.

Wholesalers are regarded as unproductive. This is not strictly true since many wholesalers are as productive as manufacturers.

However, an important point is that

wholesalers constitute an uncomfortable addition to the distribution channel. Many of these wholesalers hardly perform any function and yet they take huge profits.

Bearing in mind the functions of wholesalers, it appears that they cannot be eliminated from the distribution chain without adding unnecessarily to the burden of producers and retailers. All benefits which producers and retailers derive from wholesalers would be lost if wholesalers are eliminated from the chain. Perhaps, a reduction in the number of wholesalers would be ideal.

This is not to suggest that wholesalers should not be completely eliminated in certain instances. For instance, it is better for manufacturers of technical goods to deal directly with consumers than reaching consumers through any wholesaler. In this way, manufacturers will advise the consumers on how best to use and maintain the technical goods. Again, manufacturers whose goods are in frequent demand by consumers do not have any need for wholesalers. The Nigerian Bottling Company, manufacturers of the popular soft-drink Coca-Cola, distributes its products directly to consumers using heavy-duty trucks.

6.19.5 Wholesale cooperative societies

Wholesale cooperative societies are formed along those lines which we have already outlined for the formation of the retail cooperative societies. The only major difference is that members of wholesale cooperative societies are not individuals but the various retail cooperatives. In other words, a wholesale cooperative is a federation of some retail cooperatives. But the general principles of a cooperative are still intact especially in relation to management and profit-sharing. Wholesale cooperative societies own many factories which supply the retail cooperative societies with the majority of the goods stocked in their retail shops.

6.19.6 Survival process of wholesalers

Wholesalers, like most other businesses, compete with each other for customers, this time, retailers

and final consumers. So, it is survival of the fittest for them and they have to put in place adequate survival strategies. Some of such strategies included the following:

- i) *Expansion for large-scale production so as to reap economies of scale:* Some of them expand so as to do business on a large-scale basis and reap the benefit of reduced distribution cost per unit, which is technically called economies of large-scale production or, simply, *economies of scale*. The means of growth include merger with, or taking over of, other businesses.
- ii) *Diversification into trading in more than one product:* Instead of dealing with a single product line or narrow range of products thereby putting all eggs in one basket, some wholesalers diversify into two or more product lines so that, if some lines are not moving fast, this would be compensated for by others that are likely to be moving fast. Diversification builds stability into the business activity.
- iii) *Production of the merchandise:* Some wholesalers produce in-house the merchandise being dealt in. This ensures regularity of supply.
- iv) *Pricing strategy:* Some wholesalers price their goods low if the nature of the goods is such that buyers are highly responsive to price inducement or adopt high-price strategy if buyers are not easily deterred by high prices. Pricing policy is an important element of survival strategy package.
- v) *Non-price competitive policy:* This includes all-out advertising, sales promotion, branding, packaging, labelling, etc.
- vi) *Distribution channel adopted:* Whether to sell to retailers only, to by-pass retailers and sell directly to consumers, or do both, can affect the competitive and survival position of a wholesaler.
- vii) *Electronic trading:* A wholesaler can boost sales through e-trading, but this has to be compared with the cost of putting in place e-trading facilities.

6.20 Functions of the producer

The following are the functions of the producer:

- i) *Production of goods:* It is the producer that combines the factors of production (labour, capital and land) to produce the goods. The producer is the entrepreneur.
- ii) *Financing of wholesaler:* By selling to the wholesaler on credit, the producer is financing the wholesaler.
- iii) *Provision of technical information to wholesaler:* The producer has more knowledge of the goods being produced than any middleman. He passes this information on to middlemen to guide them and to enable them to pass this on to consumers.
- iv) *Pre-packing, branding, grading, etc:* The producer has the primary responsibility for these, more than the middleman.
- v) *Advertisement:* The producer too does sales promotion and advertisement.
- vi) *Transport:* Some producers handle the transport responsibility of taking the goods to the middlemen.
- vii) *Inventory holding:* Manufacturers hold inventory until the goods are released to middlemen.
- viii) *Risk-bearing:* Manufacturers bear the risks associated with the products, including the risk of the goods not being accepted by the

consumers as well as the risk of damage or of being stolen while still in their custody.

6.21 Types of warehouse

Warehouses can be divided into three categories, with the third category sub-divided into two. These are the bonded, *government-owned*, and privately-operated warehouses. The privately-operated warehouse can be either a private warehouse or a public warehouse. These categories are discussed below.

6.21.1 Bonded warehouse

A bonded warehouse is the one where imported goods are stored pending the time that import duties on them are paid. It is a warehouse authorised by customs authorities for the storage of goods on which payment of duties is deferred until the goods are collected.

After imports arrive, it may take a while before the importer pays the amount of duty due on the goods to the customs authorities. During this interim period, the imported items have to be kept in a special warehouse called bonded warehouse, from where the goods will be released after the payment of the assessed customs duty. While the goods are in the bonded warehouse, the importer is not free to deal with them as they



Fig. 6.11 A warehouse

are under the surveillance of customs officials, who have to be present before the warehouse can be opened. This lack of freedom to deal with the goods, which are also referred to as *bonded goods*, is probably the reason why it is called bonded warehouse, that is, the goods in the warehouse are in 'bondage'. Another reason for its being referred to as 'bonded' relates to the fact that the operator of a bonded warehouse is required to provide bond security (i.e., pledging of money as collateral) in respect of the warehoused goods (which, in Nigeria, should not be less than 15% of the duty payable), in addition to the general bond which the operator must execute with any of the customs duty collecting banks.

In principle, a bonded warehouse can be owned by either the government or by private organisations. If privately owned, standing arrangements with customs authority would be necessary to ensure that there is no unauthorised removal of goods before payment of duties on them. However, in Nigeria, many bonded warehouses are government-owned, that is, they are owned by Nigerian Ports Authority, which, in turn, is owned by the Federal Government, just as a good number are owned by the private sector. They exist at the principal ports of entry into Nigeria.

6.21.2 Government-owned warehouse

This is owned by Federal, State or Local Government directly or indirectly through a government agency or parastatal. The owner-government also doubles as operator of the warehouse. But its use is not restricted to the government, as any interested private business entity can make use of it at a fee.

6.21.3 Privately-operated warehouse: Private *versus* public warehouses

A privately-operated warehouse is the one that is owned and operated by a private organisation or business entity. There are two broad types, depending on whether or not it is available to

members of the public for use on payment of the prescribe rent.

- i) *Private warehouse*: The private warehouse is the one that the owner-operator operates for its own use alone. Naturally, both the location and design are likely to be tailor-made to suit the convenience of the operator, as it is not shared with any other user.
- ii) *Public warehouse*: On the other hand, the public warehouse is the one that the operator operates for the use of members of the public for a prescribed rent or fee.

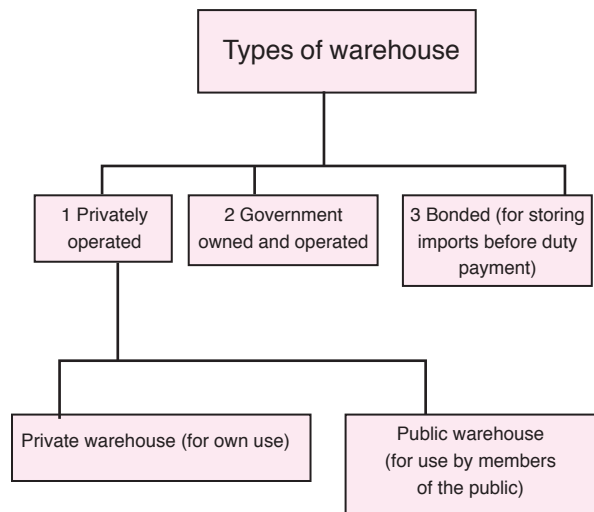


Fig. 6.12 Types of warehouse

6.22 Documents used in home trade

Different types of documents are used in domestic trade. Important ones among these are discussed below.

6.22.1 Trade journals

A trade journal is a booklet that contains articles or write-ups as well as advertisements in respect of some trades. Thus, it provides information to new and potential buyers on various items. It also keeps existing customers informed of new developments in the trade. Trade journals often serve as the starting point from which a buyer makes further enquiries about a particular good.

6.22.2 Letter of enquiry and request for price quotation

Following the preliminary information from the trade journal or any other source, it is common for a buyer to send a letter of enquiry to the seller instead of paying a visit or making an inquiry by telephone. This letter simply asks the seller to supply more information about the goods to augment the knowledge that the buyer has acquired from the trade journal or other sources. At the same time, the letter may request for a price quotation.

6.22.3 Response to letter of inquiry: Price quotation and catalogue or price list

As part of the response to the letter of inquiry would be a catalogue or price list. A separate price quotation may also be sent, particularly to update the prices contained in the catalogue or price list.

A catalogue is simply the list of goods that a seller deals in. Usually, the catalogue contains the photographs or illustrations and descriptions of goods as to the size, colour and other measures or indications of quantity and quality. It is also possible to indicate prices in catalogues. Alternatively, it may be more appropriate to list the goods against their respective prices in a separate document or booklet called price list.

6.22.4 Purchase order

Following from the information in the catalogue or price list (as well as the price quotation) in response to the letter of inquiry, a decision could be made to buy from a particular seller. This would result in the would-be buyer placing a purchase order. This is done by completing and submitting an order form prescribed by the seller; sending own order form; or simply writing to that effect.

6.22.5 Reference letter

A reference letter, or simply a trade reference, is the written reference given by a third party to the would-be supplier regarding the creditworthiness of the intending buyer. This would be desirable as the purchase order is unlikely to be accompanied with cash and the would-be customer is yet to have a long-standing relationship with the supplier to enable the buyer to establish and prove his creditworthiness. Such references can be sought from suppliers that the would-be buyer has been doing business with, the buyer's bank, or any other reliable third party. The seller would write any of such referees, whose written response constitute what is called *Reference letter*. On the basis of the seller's evaluation of the reference letter, he may decide whether or not to sell to the buyer on credit.

6.22.6 Pro forma invoice

A pro forma invoice is a special invoice presented by an intending seller to the would-be buyer for payment for goods prior to their dispatch. This method of invoicing is to ensure payment is received before goods are sent and is often the case when the buyer has not been buying from, or has not earned good credit records with, the seller. It is also issued when goods are sent to the customer for the customer's inspection. It looks very much like an ordinary invoice, except that it has 'Pro Forma' written across its face to distinguish it from an ordinary invoice.

6.22.7 Invoice

Following the seller's decision to supply the goods, he issues an invoice to the buyer. An invoice is a document, or a bill, issued by the seller, indicating to the recipient (i.e., the buyer) the amount of money owed to that seller for goods and/or services being supplied. It contains, among other things, names and addresses of the seller and buyer, seller's signature, date of sale, particulars of the goods as to the type, quantity and price, and terms of the sale, including any trade and cash discounts.

6.22.8 Advice note

This is the document issued by the seller's warehouse, to be received by the warehouse of the customer for record purposes. In effect, it is a warehouse-to-warehouse document. Sometimes, a copy of the invoice can serve as the advice note. Otherwise, a separate advice note would be prepared in a less elaborate form than an invoice, as only the type and quantity of the goods dispatched now need to be indicated (with price, terms of sale, etc being omitted, quite unlike the case of an invoice). It is to inform or advise the customer that goods are being sent separately or are already on their way, to enable the customer to anticipate or expect ahead of time the arrival of the goods.

6.22.9 Delivery note

This document is usually packed with the goods, and used by the seller's carrier or deliveryman to obtain the signature of the buyer, attesting to the fact that a certain quantity of the goods has been received in the stipulated condition. Thus, a delivery note (as opposed to a consignment note) normally applies when goods are delivered to the buyer by the seller or seller's carrier. Also, a copy of the invoice can serve as the delivery note. Otherwise, a separate delivery note would be prepared, which would not need to contain all the detailed information (e.g., price and terms of sale) that an invoice contains as it would still serve its purpose by simply indicating the quantity and type of goods. It is normally a substitute for the advice note – which is the one sent to notify the buyer that the goods are being sent separately or are on their way.

6.22.10 Consignment note or waybill

A consignment note or waybill is a contract of domestic affreightment (or carriage of goods). In this regard, it is the evidence of the carriage of goods contract between the carrier and the seller dispatching the goods to the buyer. It also constitutes an acknowledgement by the carrier

that the goods have been received from the sender (or seller) in a particular condition stated in that document.

A consignment note is used when an independent carrier or transporter (whether by rail, road, air or water) is used, unlike a delivery note that normally applies when the seller uses its own transport facilities to deliver the goods. Thus, it is the carrier that issues the consignment note, unlike a delivery note that is issued by the seller.

6.22.11 Receipt issued by the seller in acknowledgement of money received

When a customer makes a payment other than through a cheque, he will often require to be issued a receipt by the seller in acknowledgement (i.e., as evidence) of the payment. In the case of payment by cheque, the legal view is that, unless the payer so insists, a receipt may not be necessary, particularly as the cheque itself and the bank records provide a sufficient trail of evidence that the payment did take place.

6.22.12 Credit note

A credit note, just like an invoice, is issued by the seller to the buyer, acknowledging or notifying cancellation of a part or whole of the amount contained in the original invoice associated with the sale of the goods. The amount contained in the invoice must have been debited into the buyer's account in the seller's accounting records. The credit note is so called because it is used in notifying the buyer that the seller has reversed the earlier debit entry as per invoice by an offsetting credit entry.

A credit note is issued when the seller is acknowledging the receipts of goods returned by the buyer due to defects or any other cause, when the seller is acknowledging the realisation that the buyer had earlier been over-charged as per original invoice, or when the seller is acknowledging the receipt from the buyer of packing cases or containers the cost of which had

earlier been charged against the buyer.

If the invoice has been paid for prior to the return of the goods, the credit note will then entitle the holder to alternative goods (or sometimes cash refunds) at the original value.

6.22.13 Debit note

A debit note can be issued by either the buyer or the seller, depending on the circumstance. It is issued by the seller to notify the buyer that the buyer had been under-charged as per original invoice and this is being corrected by debiting the customer's account in the seller's accounting record with the extra amount stated in the debit note. Thus, this type of debit note can be regarded as a *supplementary invoice* – it has the same effect as the original invoice.

It can also be issued by the buyer either to inform the seller that goods earlier bought are being returned due to the reasons stated on the debit note or that the seller's containers used in packing the goods, the cost of which had been charged against the buyer, have now been returned to the seller. This form of debit note can be regarded as the *reverse credit note*. It may be issued by the buyer when the seller delays issuing the credit note from his own side, or the buyer is simply impatient to wait for the arrival of the credit note.

6.22.14 Statement of account

A statement of account is regularly sent by a seller to the customer, usually at the end of every month, to inform the customer of his or her transactions and outstanding balance as contained in the seller's records. Thus, it informs the buyer of the balance that the seller is claiming to be owed to him or her (the seller) and, if applicable, to call on the buyer to make necessary payments to settle the outstanding balance.

6.22.15 Receipt

When a customer makes a payment other than by cheque, he or she will often require to be issued a receipt by the seller in acknowledgment (i.e., as evidence) of the payment. But if the customer pays by issuing a cheque, the Cheque Act of 1957,

enacted in the United Kingdom and inherited by Nigeria, makes it unnecessary for the seller to issue a receipt unless the customer insists on getting one. In most cases, a customer is not likely to insist on this as the cheque issued constitutes a receipt or evidence of payment as long as it has been stamped *Paid* by the banker.

Sequence of documents used in domestic trade

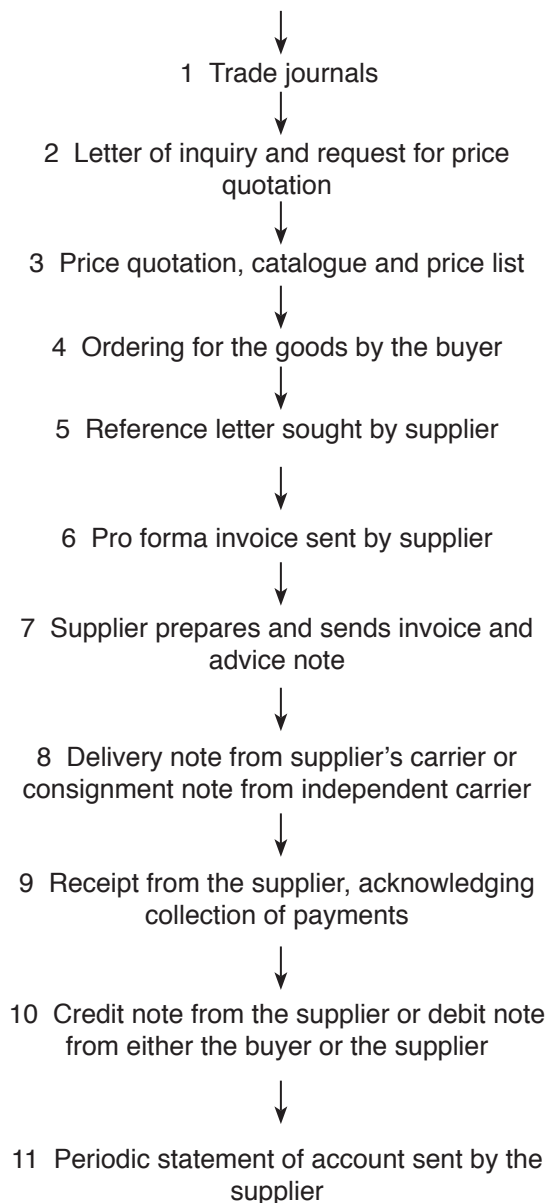


Fig. 6.13 Sequence of documents used in domestic trade

Revision questions

Essay questions

- 1 What is home trade? What are its advantages?
- 2 Outline and discuss the functions of retailers.
- 3 What factors would you consider before setting up a retail trade?
- 4 Outline the advantages and disadvantages of small-scale trading.
- 5 What do you understand by the term 'itinerant trading'? Outline the disadvantages of itinerant trading.
- 6 What is a multiple-chain store? What are the advantages of multiple chain stores?
- 7 What is a department store? Outline the advantages and disadvantages of department stores.
- 8 What is a mail-order business? What are the advantages and disadvantages of mail-order business.
- 9 Outline the use of vending machines, and discuss other modern trends in retailing.
- 10 Explain the term 'branding'. What are the advantages and disadvantages of branding?

Objective questions

- 1 Which of the following is not a small retail outlet?
 - A Hawking
 - B Stallholding
 - C Supermarket
 - D Mobile shop
 - E Market trading
- 2 Possible reasons why small retail businesses fail include
 - A lack of access to finance.
 - B limited managerial and professional capacity of the proprietors.
 - C inadequate diversification of the activities.
 - D all of the above.
 - E none of the above.
- 3 Which of the following is not a function of the producer?
 - A Breaking the bulk
 - B Production of the goods
 - C Financing of the wholesaler
 - D Provision of technical information about the product to the wholesaler
 - D Advertisement
- 4 Modern trends in retailing include:
 - A mail order.
 - B wholesale.
 - C use of vending machines.
 - D A and B.
 - E A and C.
- 5 Unlike a department store, a supermarket
 - A has several shops under the same roof.
 - B operates on a self-service basis.
 - C specialises mainly in household goods and food items.
 - D is A and B.
 - E is B and C.

Chapter 7

Foreign trade

7.0 Introduction

Foreign trade refers to the buying and selling of goods between residents of two or more countries. It also involves exchange of services between two or more countries. Foreign trade is often referred to as international trade or external trade.

Foreign trade has assumed a significant dimension for two important reasons. First, there is inequality in the distribution of natural resources among the nations of the world. This condition has made it necessary for some countries to depend on some others for the supply of certain goods and services. Secondly, nations differ in efficiency and technology in the use of natural resources for the production of goods. It is desirable, therefore, for nations to export those goods which they can produce with greater relative efficiency in exchange for those goods which they cannot produce efficiently.

7.1 Advantages and disadvantages of foreign trade

7.1.1 Advantages

Every country engaged in international trade derives some measures of benefits. We shall outline below a few of the advantages of foreign trade.

- i) Foreign trade enhances the frequency with which goods are exchanged between countries, and this results in a higher standard of living for the inhabitants of the countries concerned.
- ii) Foreign trade enables a country to enjoy those goods which cannot be produced within the country. Let us give an example with Nigeria and the rest of the world. Nigeria imports aircraft from the rest of the world for her air transport services, while

she exports cocoa to other countries of the world. Through foreign trade, each country has access to those goods which cannot be produced locally.

- iii) Foreign trade has made many countries to come under one economic unit. As a result, there is peace among nations since such nations are economically interrelated and interdependent.
- iv) Foreign trade has necessitated improvements in transport, whether by road, sea or air.
- v) Foreign trade has boosted employment opportunities for the inhabitants of those countries engaged in foreign trade.
- vi) Foreign trade has greatly promoted goodwill among nations and among mercantile agencies across the world.
- vii) Foreign trade assists a country to even (or spread) out consumption in order to match domestic production over time. During a period of severe domestic recession, hardship can be minimised through importation of goods, on credit, from other countries. These goods supplement the inadequate domestic production. During boom periods, the country can now export goods in payment for the goods earlier imported on credit during the period of recession.
- viii) Foreign trade enables many developing countries to acquire technical knowledge. For example, our contact with some technical goods, such as automobiles and electronics, has made it possible for many Nigerians to learn how to service, repair and even assemble most of these machines.
- ix) Foreign trade can put in check adverse domestic monopolies. For example, if a few monopolies decide to hold the nation to ransom with the type of goods such monopolies produce, the action of these monopolies can be checked through importation of similar goods from other countries.

- x) Foreign trade provides a vent for surplus, or excess, natural resources. In the absence of foreign trade, such natural resources will either be wasted or merely lie dormant and unutilised. In Nigeria, for example, crude petroleum is abundant but Nigerians only need a small fraction of it for refining and domestic use. In the absence of foreign trade, much of Nigeria's crude petroleum would lie untapped within the bowels of the earth.

7.1.2 Disadvantages

Despite the above-mentioned advantages, foreign trade has a number of disadvantages.

- i) Foreign trade can lead to depletion in the natural resources of a nation. For instance, if the rate of exploration of crude oil is not controlled, the crude oil deposit in Nigeria may dry up any day.
- ii) Foreign trade breeds unhealthy rivalry between home producers and foreign producers of more or less similar goods.
- iii) If unrestricted, foreign trade can lead to the import and export of all manner of goods.
- iv) The gains from foreign trade may be unequally and unfairly distributed between the trading partner-countries. This would be so if what is called the terms of trade, defined as the price of exports in relation to the price of imports, is persistently moving against a country and in favour of the other country. This means that the first country (i.e., with unfavourable terms of trade movement) would need to be exporting an increasing volume of goods in order to buy a given volume of imports.

7.2 Barriers to foreign trade

There are many barriers in the way of foreign trade. We shall now enumerate some of these barriers.

- i) There exists a difference between the domestic currency and the currencies of other countries. Importing of commodities

therefore requires the conversion of domestic currency into the currencies of countries from which the goods are to be imported. It is common for the proceeds of exports to be received in currencies other than the domestic currency. In such a case, the foreign currencies are converted, one way or another, into the domestic currency before the exporter can use the proceeds for domestic transactions.

- ii) Factors of production are less mobile between nations. Thus, importers and exporters cannot travel freely across borders but have to subject themselves to travel regulations, including that of entry visa.
- iii) Artificial barriers such as tariffs, quotas, and exchange controls, serve to restrict movement of goods across the borders of trading nations.
- iv) Natural barriers such as differences in language and customs, serve to restrict the movement of goods across the borders of trading nations. Although language and customs barriers also exist in domestic trade, these barriers are more pronounced with foreign trade.
- v) The distance between nations is a clear barrier to foreign trade. The greater the distance between nations, the greater the cost of transport. This results in added costs in distribution of goods within the importer's country.
- vi) Transport, postal and telecommunications facilities often pose problems for foreign trade. This is so because information flow is restricted between the traders in different countries.
- vii) Political differences between nations can, and do, affect trade between nations. For instance, some decades ago, Nigeria did not trade with South Africa because of the Apartheid policy of the government in South Africa at that time.
- viii) There is also a greater difference in the legal systems, including pieces of legislation or laws that affect buying and selling.
- ix) Units of measurements do often vary from one country to another. These units of measurements include weight, length, volume, etc. Since buyers and sellers do not use the same types of weights and

measures, inaccuracies are likely to arise in the quantities of goods supplied.

- x) Domestic traders have more knowledge of the political, economic and market conditions of the country where they trade (since they are resident there) than importers or exporters have of the country where the trading partner is based. This increases the risk of doing business with the trading partner, which is a hindrance to trade.
- xi) Domestic traders have more political clout, influence, weight or connection in the country where they trade than exporters and importers have in the foreign countries where the trading partners are based. This becomes an important issue when there is the need to lobby policy makers, regulatory authorities, legislators, and even the judiciary when there are disputes between the buyers and sellers. In foreign trade, policy makers, regulatory authorities, legislators and even judiciary would normally take sides with the traders (exporters or importers) that are their 'own' (i.e., that are resident in their country) while such a thing does not apply in domestic trade.

7.3 Division of trade: Imports, exports and entrepot

Goods brought into Nigeria for sale are called imports. Goods dispatched from Nigeria for sale in other countries are called exports.

Imports and exports may be visible or invisible items. Visible items indicate tangible goods which move between countries. For instance, cars and electronics move into Nigeria from other countries while crude petroleum, palm oil and cocoa move out of Nigeria into other countries. Invisible items are mere services which require payment of money. For instance, Nigeria pays for services rendered in Nigeria by non-Nigerians. In the same vein, Nigeria receives payment for services rendered by Nigerians in other countries. Services rendered by Nigerians, or to Nigeria, could be educational, cultural, commercial, etc, as discussed in detail under the section on balance of payments.

There is also a third category of foreign trade called entrepot trade or re-export. As explained earlier, in Chapter 5, entrepot trade occurs when a member of a trading bloc (like the ECOWAS), charges lower tariffs to countries outside the trading bloc to win trade and then re-exports the same goods tariff-free within the trading bloc (i.e., to other members of the trading bloc). It involves export without further transformation or processing, i.e., in the same state as the goods had earlier been imported from outside the trading bloc.

7.4 Bilateral and multilateral foreign trade

7.1.1 Bilateral trade

Bilateral trade, which is also called *reciprocal trade* or *countertrade*, is trade between two countries whereby exports to and imports from each other are made to be equal; that is, imports from one country are offset by exports to that country. By this, the use of foreign currency to pay for import and receipt of foreign exchange from export become redundant (unnecessary) or even inapplicable. Bilateral trade is always a product of bilateral trade negotiations and agreements at the political level, unlike multilateral trade that often takes place on the decisions of importers and exporters, in response to market signals. Different forms that bilateral trade can take are as follows:

- i) Simple trade by barter: This entails direct exchange of physical goods and services of equivalent values between the two trading partners.
- ii) Switch-trading: Under this form of bilateral trading, the exporter in country A that sells goods (say, computers) to an importer in country B would have his payment lodged in a bank account (opened in his name) in country B on the understanding that the proceeds could only be used for buying other goods from country B at a later date. It would then be left to that exporter from country A to find any unrelated commodity to buy from country B with the export receipts

domiciled in the bank account in country B. Alternatively, he can find an interested trader (referred to as a switch trader) in country A that wants to use the proceeds to import (say, textiles) from country B and sell the bank balance to that trader at a mutually agreed discount. Alternatively also, some form of multilateral clearance of bilateral trade imbalances may be involved whereby a specialised countertrade firm will buy (at a discount) from country A the value of its bilateral trade surplus with country B, and sell it at full value to country C, which has a bilateral trade deficit with country A.

- iii) Buy-back or compensation: This involves an exporter of capital goods or other production facilities (e.g., tractors) in country A selling the goods to a producer (e.g., plantation farmer) in country B on the understanding that the payment would be made in the future through buying back specified units of the goods produced (e.g., particular units of farm produce) with the facilities earlier supplied.
- iv) Offset: Under this, the exporter agrees to use goods produced in the importer's country or the production technology from the importing country as an input into the production of the export goods. That is, products being sold to the importing country would require the exporter to offset in one form or another and this could include requirement to use goods from the importing country as an input or to transfer the technology of production (including a co-production arrangement based on the transfer of production technology to the importing country), or to meet any other condition specified by the importing country.
- (v) Counter-purchase: Under the counter purchase form of bilateral trade, the exporter (or a third party arranged by the exporter) in country A undertakes to buy goods of equivalent value (whether related or not) from the importer from country B (or from a company nominated by the importer) within a specific period. Both parties pay for their purchases in cash but undertake, through signed agreements, to fulfil the counter purchase obligation.

7.4.2 Multilateral trade

Multilateral trade is foreign trade whereby the exports to and imports from a particular trading partner do not have to be related, as exporters are not required to reciprocate by also importing from the buying country. This means that trade between any two trading partners would not normally balance and the one (say, country A) would have a surplus (excess of export over import) with the other (say, country B), who would therefore be in deficit. This also implies that the use of foreign currency (a generally accepted currency for carrying out international transactions) is inevitable, whereby export proceeds are to be received in the foreign currency while import bills are to be similarly paid for in a foreign currency, and not necessarily in the currency of any of the trading partners. With the use of a foreign currency, the country in deficit (i.e., country B) would pay the trading partner with bilateral surplus (i.e., country A) more foreign currency than it has received from it. The deficit country B might have received the extra foreign currency by maintaining a trade surplus with yet another trading partner, say country C. In the same manner, the surplus country A might need to use the extra foreign currency received from country B in offsetting a deficit with another trading partner, say country D. In other words, the deficit with a particular trading partner is often paid for with a surplus with other trading partners (specifically, the rest of the world) while a surplus with a particular trading partner may be counterbalanced by a corresponding deficit with other trading partners combined (often referred to as the rest of the world). But there is also the possibility that a part of the deficit is financed by borrowing from that particular trading partner or even from the rest of the world, in the same manner that a part of the surplus can be used in lending to the specific trading partner or even the rest of the world. This is an aspect of the beauty of multilateral trade and this follows from the fact that multilateral trade is more liberal and less restrictive than bilateral trade.

The diagrams in Figure 7.1 illustrate the distinction between bilateral and multilateral trade between two countries, country A and country B. Figure 7.1(a) illustrates the case of

a bilateral trade situation. The flows of goods between the two countries are equal. The value of export from country A to country B is \$5 billion, which is also the value of export from country B to country A.

Figure 7.1(b), on the other hand, shows the multilateral trading relationship between country A and country B on one hand and between the two countries and other countries like country C and country D and even with the rest of the world. While country A exports ₦5 billion worth of goods to country B, the latter only exports only ₦1 billion worth of goods to country A. This means that country A has a bilateral surplus and country B, a bilateral deficit of ₦4 billion in their trading relationship during the period under consideration. Therefore, in the absence of bilateral borrowing between the two countries, country A would be receiving from country B a net amount of ₦4 billion (by paying ₦1 billion to, and receiving ₦5 billion from country B). But, in

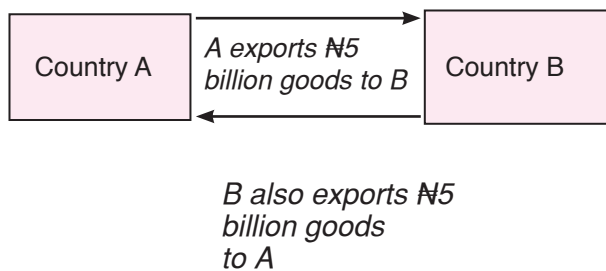


Fig. 7.1 (a) Bilateral trade between countries A and B. (Arrows show direction of flow of goods)

turn, country B has a trade surplus with country C, to which it exports goods without importing anything from there. In the same vein, country A has a trade deficit with country D, from which it imports without exporting anything to it in return. Countries A and B also export to and import from the rest of the world, although it is not indicated in the diagram as to the values of exports and imports involved and, hence, whether there is a deficit or surplus with the rest of the world.

7.5 Procedures for international trade

In this section, we shall explain the methods of international trade and the functions of each method. For a Nigerian exporter seeking foreign customers, there are many methods of reaching the prospective customers. We shall consider a few of the main methods.

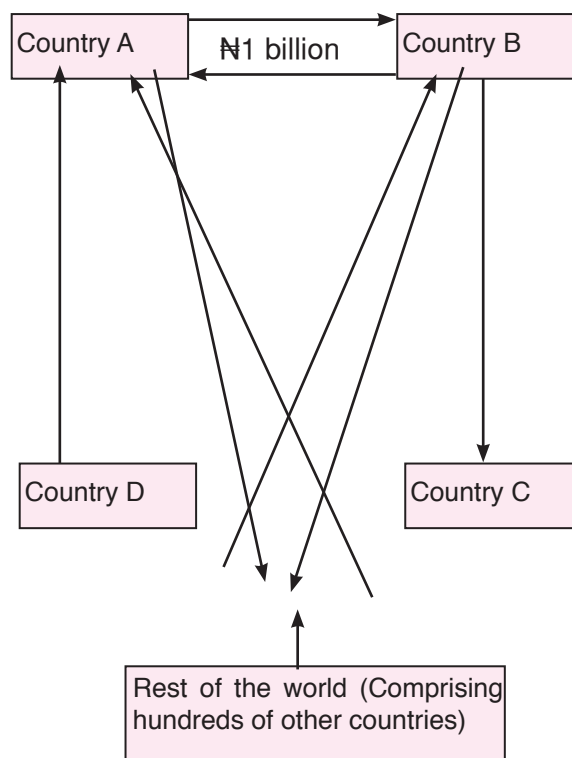


Fig. 7.1 (b) Multilateral trade, showing relationships between countries A and B and also with the rest of the world. (Arrows show direction of flow of goods)

7.5.1 Advertisement and circulars

Goods can be advertised in the trade journals which circulate in countries of the potential importers. Similarly, circulars and catalogues can be dispatched to the potential customers.

7.5.2 Representatives

Nigerian exporters employ representatives or agents in countries which hold potential for customers. The duty of such representatives would be to establish contacts with foreigners interested in Nigerian goods.

In the same way, representatives of foreign organisations can be asked to visit Nigeria in order to see for themselves Nigerian export items. The representatives can then make selection from the available items.

7.5.3 Opening of depots abroad

Nigerian exporters can open depots abroad. Such depots serve as showrooms for prospective customers. Foreign organisations interested in opening a trading link with Nigeria may similarly open depots in Nigeria as outlets for their goods.

7.5.4 Trade fairs and exhibitions

By attending trade fairs and exhibitions in other countries, Nigerian exporters can get their goods exposed to potential foreign buyers. Also, by organising international trade fairs within Nigeria, Nigerian exportable items are exposed to potential foreign buyers.

7.6 Agents employed in foreign trade

We have already discussed the many barriers to international trade. In order to minimise the

problems created by these barriers, different types of agents are employed in foreign trade. We shall discuss a few of these agents.

7.6.1 Import merchants

Import merchants procure imports from the supplying countries. Essentially, import merchants are middlemen between importers and exporters. It is the duty of import merchants to convey the goods from the ports of entry into the warehouse, and then to effect distribution of such goods.

7.6.2 Import agents

Foreign suppliers often appoint selling agents in other countries. It is the responsibility of the foreign suppliers to convey the goods into Nigeria. In this transaction, the foreign suppliers are known as principals.

The role of the import agents in Nigeria is to sell the goods and remit the net proceeds to the principals. An import agent has an insurable interest in the goods, can give credit and receive payments.

7.6.3 Import brokers

An import broker is an agent whose role is to get foreign buyers for Nigerian exportable goods. The import broker also links the Nigerian exporter with foreign buyers. Many import brokers do not specialise in any particular line of product but merely take advantage of favourable market conditions.

7.6.4 Del credere

These are foreign trade agents who receive additional commission, called Del credere, if they can guarantee immediate payment for any consignment dispatched to an importer.

7.7 Destination inspection: Procedures and requirements

7.7.1 Background, nature and purpose of destination inspection

With effect from January 2006, the Federal Government of Nigeria abolished the pre-shipment inspection scheme whereby imports to Nigeria were to be screened from the countries of origin to guard against overloading or underloading of invoices, adulterated or expired food items or drugs, used equipment at the stated prices of new ones, general falsification of import documents, foreign exchange claims on goods not imported or services actually not rendered, and overpricing of government projects in order to keep the excess gains abroad in foreign exchange. In its place was introduced, with effect from the same date (i.e., January 2006), the destination inspection scheme whereby all the afore-mentioned malpractices were to be checked when the goods arrive in Nigeria. In other words, the inspection would now be carried out in Nigeria, at the various ports or points of entry into the country. The outcome of the inspection was evidenced by prescribed documents.

Under this new scheme, the Nigerian Customs Service (NCS), on the advice of the risk management service providers, was now responsible for carrying out the inspection. The risk management service providers are responsible for advising the NCS through the risk assessment report (RAR) that they issue on the basis of the information provided by the importer in the single goods declaration (SGD) and Form M. The RAR is to guide the NCS as to the channel a particular consignment should be made to pass through – i.e., whether green, yellow or red channel, in ascending order of the risk adjudged to be involved.

If it is green, it means the container does not need either scanning or physical examination but should be released. For the yellow channel, it means the consignment should be scanned,

while if routed to red, the consignment would be subjected to 100 per cent physical examination.

Sophisticated modern technology, including x-ray cargo scanning equipment provided and operated by the risk management service providers, are being employed. The essence of the x-ray scans of a consignment is to highlight whether the contents of the consignment agree with what is contained in the documents like the invoice and packing list and whether it contains contraband (i.e., unlawful merchandise). The outcome of this exercise would determine whether the consignment should be subject to physical examination in order to confirm what the x-ray scan suggests.

In addition to the use of scanners, the NCS also employs a high-technology risk management database called the Automated System of Customs Data (ASYCUDA), a computer software package made available by the UN agency called UNCTAD.

Three companies were engaged as risk management service providers to kick-start the process and also develop the capacity of, and transfer the technology to, the NCS for the NCS to understudy and take over the entire process when the initial seven-year contracts with the risk management service providers expire in 2013. The three risk management service providers engaged by the Federal Government are the SGS, Global Scan and Cotecna. The ports and other points of entry of the country are divided among the three, such that each has its own point of entry jurisdiction where it operates.

The additional documents that this new arrangement entails, like the single goods declaration (SGD) and the RAR, are explained later. It should be noted that the replacement of the pre-shipment inspection with the destination inspection has changed the import procedures and requirements. Therefore, we review below these new changes.

7.7.2 Import guidelines under the destination inspection

- i) Any person intending to import physical goods into Nigeria shall, in the first instance, process the Form M through any authorised

dealer bank, irrespective of the value and whether or not payment is involved. The Form M is to be obtained from a commercial bank for completion and return for processing through the same commercial bank. Four copies of the Form M are to be submitted with the relevant Proforma Invoice and both shall carry a proper description of the goods to be imported to facilitate price verification, as pointed out in the sub-sections where Form M and Pro forma Invoice are discussed.

In addition, the Form M shall be submitted together with the following information:

- Detailed description of the goods, including commercial name for each item, make, whether new, used or refurbished and the standards adopted.
 - Quantities and/or their measurements.
 - Unit cost of the goods.
 - Total cost of the goods.
 - Freight cost.
 - Mode of transport (whether by sea, air or road).
 - Details of shipment, whether full container load, low container load, bulk, loose, etc.
 - Other charges reflected on Form M, if any.
 - Country of origin.
 - Country of supply.
 - Pro forma invoice with details of physical address and telephone and/or fax number of the supplier and e-mail (where applicable).
 - Other documents (such as certificate of registration with NAFDAC, where applicable).
- ii) The authorised dealer bank, after making sure that the submission is in order, shall make necessary endorsement on the Form M, retain the original copy and forward three copies to the relevant scanning and risk service management provider in Lagos.
- iii) The scanning and risk service management provider, on the basis of its preliminary review of the application, shall accept or reject the Form M within one day. If rejected,

the documents would be returned to the importer through his authorised dealer bank, for necessary corrections to be made. If accepted, the scanning and risk service management provider shall retain one of the three copies of Form M, forward one copy to the Customs Area Command where the port of clearance of the goods is located and send the last copy to the Headquarters of the Nigerian Customs Service (NCS) in Abuja.

- iv) The importer shall then procure the foreign exchange through his bank, if it is a letter of credit transaction and also advise the supplier to arrange for shipment of the goods.
- v) On consignment of goods for shipment, the overseas supplier shall make available three sets each of the original combined certificate of value and origin (CCVO), transport documents (i.e., bill of lading or waybill, as applicable) and the packing list to the relevant bank. In addition, for transactions valid for foreign exchange or involving supplier's credit, he should forward two sets of the documents in (i) above (viz: generic product name, mark or brand name, model name, description of the quality, as well as quantity and packing) through his banker to the relevant correspondent bank of the authorised dealer bank of the importer that opened the Form M and send the third copy directly to the authorised dealer bank. But, in the case of not-valid-for-foreign exchange transactions, only two copies are to be produced and these should be sent directly to the authorised dealer bank. Finally, in the case of dutiable personal effects, the two sets should be sent to the authorised dealer bank. But if they are not dutiable (i.e., if they are just normal personal effects), the two copies should be sent directly to the appropriate scanning and risk service management provider.
- vi) Upon receipt of the third copy mentioned in (v) above, the authorised dealer bank should forward photocopies, with a cover letter, to the scanning and risk service management provider to enable the latter to issue its risk assessment report (RAR). The shipping line (or air or road carrier, as applicable) is also

to make available electronically an advance summary of the manifest of the cargo to the scanning and risk service management provider within a few days after shipment to facilitate the generation of the RAR. For transactions involving foreign exchange transfer, the assessed value on the RAR shall be the amount payable. Where there has been excess remittance (in iv above), such must be repatriated.

- vii) On the arrival of cargo, payment of import duty and other charges to the NCS follows before clearance of the goods. First, an administrative charge of 1% on the FOB value of the goods is paid. Second, import duty of applicable rate on the CIF value of the goods is paid also. The authorised dealer bank is to issue the draft on behalf of its importer customer and the draft is to be paid into the NCS account with a designated bank (which may also be the authorised dealer bank, if it happens to be among the NCS-designated banks). The designated bank will issue a receipt to acknowledge the payment before it transfers the funds to the CBN.
- viii) Clearance of the goods with the NCS follows. First, the importer is to complete the single goods declaration (SGD) form. The importer may need to refer to a copy of the RAR (obtained from his authorised dealer bank) in completing the SGD form. He is then to attach with the SGD form all the necessary and supporting documents, like the final invoice, CCVO, pro forma invoice, bill of lading, insurance certificate, payment receipts for import duties and other charges, RAR, copy of the Form M and submit everything to the designated customs officers (called Face Vet Officer).
- ix) Based on the review of the documents, particularly the RAR, the NCS would decide whether or not the goods are to be scanned, subjected to physical inspection or exempted from scanning and physical inspection. On the basis of the RAR, NCS clears cargo through the green lane, yellow lane and red lane, depending on the degree of risk perception by NCS – with the red lane meant for the highest risk class.

7.7.3 Document requirements for import payment under the destination inspection scheme

- i) Approved Form M.
- ii) CCVO.
- iii) Manufacturer's certificate with standards adopted stated thereon.
- iv) Clean/shipped on board bill of lading/airway bill/road waybill.
- v) Packing list.
- vi) Letter of credit instrument (for confirmed letters of credit transaction only).
- vii) RAR with the Form M number.
- viii) Single goods declaration (SGD) form, signed by the importer or his agent.
- ix) Import duty payment receipt.
- x) Laboratory test certificate for chemicals, food, beverages, etc.
- xi) Certificate of insurance (for bills for collection transactions only).
- xii) Bill history/bill of exchange (for bills for collection transactions only).
- xiii) Tally sheet/gate pass (for bills for collection transactions only).

7.7.4 Documents to accompany imports into Nigeria under destination inspection

Documents in respect of each import transaction shall carry the name of the product, country of origin, specifications, date of manufacture, batch or lot number, and standards to which the goods have been produced (e.g., whether Nigerian standard, British standard, or whatever). They shall all be clearly marked 'Valid for forex' or 'Not valid for forex', depending on whether or not foreign exchange remittance would be involved. The documents explicitly mentioned include the following:

- i) CCVO
- ii) Packing list
- iii) Clean/shipped on board bill of lading/airway bill, waybill, road waybill.

- iv) Manufacturer's certificate of production, which shall state standards and, where it is not applicable, the phytosanitary certificate or chemical analysis report.
- v) Laboratory test certificate for chemicals, foods, beverages, pharmaceuticals, electrical appliances and other regulated products, where applicable.

7.7.5 Other requirements for goods to be imported to Nigeria under destination inspection

- i) All goods shall be labelled in English (alone or together with any other language).
- ii) Where import items like foods, drinks, cosmetics, drugs, medical devices, chemicals, etc are regulated for health or environmental reasons, they shall carry expiry dates or the shelf life and specify the active ingredients, where applicable.
- iii) Electrical appliances (fluorescent lamps, electric bulbs, electric irons, etc) shall carry information on live performance while cables shall carry information on the ratings.
- iv) All electronic equipment and instruments shall carry instruction manual, safety information and/or safety signs, and a guarantee/warranty of not less than six months.
- v) All computer hardware, software, operating and embedded systems shall continue to be Year 2000 compliant.

7.7.6 ECOWAS Trade Liberalisation Scheme (ETLS)

This subject matter is not specific to the destination inspection as such. Nevertheless, it also fits into the trade requirements and procedure that are being discussed in this section.

As will be discussed in Book 3, ECOWAS (Economic Community of West African States) is a 15-country customs union, within which movements of goods and services are supposed

to be duty-free and also free of non-tariff barriers like quotas and embargoes. To give effect to this, there is the ECOWAS Trade Liberalisation Scheme (ETLS) that cover the following groups of goods:

- i) Unprocessed goods, viz: raw agricultural products and mineral products;
- ii) Traditional handicraft products; and
- iii) Industrial products originating from member-countries.

Movements of these three groups of goods between member-countries are granted the concessions of total exemption from import duties and taxes and exemption from any quantitative restriction.

To benefit from these concessions, the importer must be resident in an ECOWAS member-country and the goods must originate in ECOWAS member-countries and accompanied by a certificate of origin (as also explained in this Chapter) as well as completed export declaration form. Also, the goods shall be covered by the inter-state road transit declaration that shall be duly signed and either be typewritten or hand-written in ink.

7.8 Main documents (other than transport documents) used in foreign trade

Many documents are in use in foreign trade. However, we shall consider only the major documents. The sequence of relevance or applicability of the documents, which is the one followed in discussing them below, is also shown in the schematic diagram of Figure 7.2 on pages 85-86.

7.8.1 Preliminary documents - Trade journals, catalogues and quotations

As in the case of domestic trade, the would-be importer might have come across the foreign supplier through trade journals, magazines, visits to trade fairs and exhibitions or any other similar sources. Following this, the would-be importer may write a letter of inquiry to ask for specific

information as well as general information by requesting for the catalogue. A request for price quotation can be included in the letter of inquiry, just as a free sample.

7.8.2 Indent – Foreign trade equivalent of a purchase order

If satisfied with the outcome of the letter of inquiry, the would-be importer can send a purchase order which, in the context of foreign trade, is referred to as an *indent*. In order to import goods from abroad, a Nigerian importer often needs an agent based abroad. The document on which the instruction is given to such an agent by the importer is called an indent. In effect, an indent is the foreign trade equivalent of a purchase order in domestic trade.

Indents are of two types – an open indent and a closed indent. An open indent does not state the name of any particular supplier. The agent is merely requested to procure certain goods and supervise shipment. But a closed indent states the name of a particular supplier and the agent is bound to procure goods from that particular supplier and to supervise shipment

7.8.3 Pro forma invoice

In domestic trade, a proforma invoice is issued when the supplier to accompany a free sample to the would-be customer or when the supplier does not want to sell to him before payment but, at the same time, wants to acquaint him with how the actual invoice would look like (including the gross price, trade discount, cash discount, etc) upon payment for the goods. In foreign trade, such reasons may also apply. But, in addition, a proforma invoice may be a requirement for the importer to comply with regulatory requirements prior to importation of the goods. For instance, in Nigeria, a pro forma invoice (with a validity period of three months) has to be included with other documents that must accompany the submission of the completed Form M to the authorised dealer bank. Like under domestic trade, it can be regarded as the interim or temporary version of the invoice. But, unlike in domestic trade, the

contents of a proforma invoice to be issued by the supplier should also be tailor-made, to suit the regulatory requirements in the importer's country, e.g. as required by the customs authority and the foreign exchange authority (i.e., the central bank). The invoice normally states the prices of goods dispatched and the contents are normally written in the language of the exporter. In Nigeria, the contents of a pro forma invoice to accompany the submission of Form M, just like the Form M itself, must shall carry a proper description of the goods to be imported to facilitate price verification.

7.8.4 Form M

As has already been pointed out, any person intending to import physical goods into Nigeria shall, in the first instance, process a Form M through any authorised dealer bank, irrespective of the value and whether or not payment is involved. The use of Form M dates back to 1979. The Form M can be obtained from a commercial bank, completed and returned for further processing through the same commercial bank, which will forward the same to the CBN, to whom the Form M application is directed. Apart from its use for statistical and routine record-keeping purpose, it is also used by the customs authority and the risk management service providers to determine the import duty to charge and by the central bank in deciding foreign exchange allocation.

Four copies of the completed Form M are to be submitted, together with several accompanying documents (including the proforma invoice), to the authorised dealer bank, with each copy marked 'BA', if in respect of goods subject to destination inspection, and 'CB', if not subject to destination inspection. Form M shall contain, among others, the following information.

- i) Generic product name, i.e., product type or category.
- ii) Mark or brand name of the product, where applicable.
- iii) Model name and/or model or reference number, where applicable.
- iv) Description of the quality, grade, specification, capacity, size, performance, etc.
- v) Quantity and packaging and/or packing.

The Form is valid for six months for all imports except for plants and machinery imports when it is valid for one year.

7.8.5 Letter of hypothecation

A letter of hypothecation is a written agreement, which authorises a bank or lender to repossess and sell the item pledged in the event of default. In international trade, it enables any of the banks that provide credits (e.g., the bank that accepts bills of exchange, the one that discounts it, or the one that pays at sight the bill of exchange) to sell the shipment in case of the buyer's non-payment of the bill previously discounted or if the buyer defaults in making funds available to the bank for accepting or paying (as appropriate) the bill of exchange. While shipping the goods, the exporter often draws a bill on the importer. To get immediate payment, the exporter may discount the bill with his banker for less than the bill's face value. But, to safeguard its own interest against risk of non-honour of the bill on maturity by the importer, the banker may require the exporter to issue a letter of hypothecation to the bank, which would authorise the bank to sell the goods and recover the money. The letter normally applies when the bank is unable to obtain the goods by themselves, without such a letter.

7.8.6 Commercial invoice and consular invoice

i) Commercial invoice: This is the equivalent of what is simply called invoice in domestic trade, except that the contents differ somewhat. It is an accounting document (bill), prepared by the seller, through which the seller claims payment from, or charges the buyer for the value of the goods and/or services supplied. Like the invoice used in domestic trade, a commercial invoice contains an itemised list of goods dispatched to a buyer. It normally contains the same information as the proforma invoice that precedes it. It can be regarded as the final version of the pro forma invoice. Apart from serving as a bill charged to the customer, a commercial invoice is also often used by

the customs authority to determine the true value of goods, as a basis for assessment of the applicable customs duties. In this case, the government of the country of import specifies the form, content, number of copies, language and other characteristics of the invoice to be drawn up.

ii) Consular invoice: A consular invoice is a special type of invoice issued by an exporter to an importer. It contains all the particulars of a normal invoice. In addition, the exporter would need to swear to the accuracy of the export value stated on the invoice. The swearing is normally done before the Consul of the country of destination of the goods. For example, if a Nigerian imports goods from the UK, the UK exporter would have to swear to the accuracy of the value stated on a consular invoice before the Nigerian Consul or High Commissioner in the UK. The Consul would then certify the invoice and receive a fee called the *consulage*. Several copies of the consular invoice would be made out. The importer, the exporter, and the Consul would retain one copy each. In addition, a copy is forwarded directly by the Consul to the customs authority in Nigeria. Consular invoice is normally used when a country imposes ad valorem duties, those duties based on the actual naira value of the imports as against sheer physical units. Before the introduction of consular invoice, it was common among exporters and importers to collude and understate the value of imports.

7.8.7 Packing list

A packing list is the document, issued by the exporter, that provides detailed information about the cargo, beyond what is contained in the commercial invoice. In this regard, it can be regarded as an extended invoice. It lists seller, buyer, shipper, invoice number, date of shipment, mode of transport and carrier. It also itemises quantity, description, the type of package, such as a box, crate, drum, or carton, the quantity of packages, total net and gross weight (in kilograms), package marks, and dimensions, if appropriate. Freight forwarders carry standard

packing list forms for importers to complete.

Concerning its purposes or uses, the exporter or his agent (*viz*: the customs broker or the freight forwarder) reserves the shipping space on the basis of the gross weight or the measurement shown in the packing list. Also, the customs authority uses the packing list as a checklist to verify the outgoing cargo (in the exporting country) and the incoming cargo (in the importing country). The importer too uses the packing list to inventory the incoming consignment.

7.8.8 Certificate of origin

A certificate of origin is a document that attests that goods in a particular export shipment are wholly produced in a particular country called the country of origin. In other words, it indicates the country from which the import originates. The country of origin and country of supply or export are not always the same thing. For example, most imports to Nigeria from Dubai in the United Arab Emirates (UAE) do not originate (*i.e.*, are not produced) in the UAE but in Asian countries.

The certificate of origin is usually issued by the exporter and confirmed or validated by another party in the exporting country, like notary public (a firm of solicitors that render the service of attesting to documents), a chamber of commerce or the local consulate of the destination country. In most countries, chambers of commerce perform a central role in the delivery of the certificate of origin, although other industry groups too can perform some role in this regard.

There are two types of certificate of origin. One is the preferential type that attests to the fact that the country of origin of the goods entitles the importer to some concessions. These concessions include import duty and quantitative restriction granted because the country of origin qualifies for such waivers, based on the existing bilateral or multilateral trade agreements. The other type is the ordinary certificate of origin which does not qualify the goods to any concession in the importing country.

The certificate of origin is used for classifying the goods in the customs regulations of the importing country so as to enable the customs authority to determine how much duty is to be paid on the goods. This is often necessary because

imports which originate from friendly countries are usually given preferential or concessionary rates of import duties. Also, the certificate of origin can be used for import quota purpose as goods from certain countries may be subjected to quotas or even outright embargo either because of political considerations or because of health and related concerns. In addition, the certificate of origin provides statistical and record-keeping information regarding the geographical sources of imports into the country. Thus, a certificate of origin may be needed by the exporter in order to comply with the letters of credit, foreign customs requirements or buyer's request.

In some cases, the certificate of origin may be incorporated into the commercial invoice. This is the case in Nigeria, where the combined certificate of value and origin (CCVO) is in use. The CCVO, as the name suggests, combines information in both the invoice (particularly, the pro forma invoice) and the certificate of origin.

7.8.9 Combined certificate of value and origin (CCVO)

The CCVO is a certificate issued by a third (or independent) party in the exporter's country upon the exporter's request. It is the exporter that sends it to the importer. As the name suggests, it provides a neutral third party evidence on the value and origin of the goods. Information about the value is already contained in the proforma invoice while the standard certificate of origin already contains information about the country of origin and country of supply of the goods. So, the CCVO, which is supposedly independently prepared by a third party, is supposed to confirm these other sources. The customs authority uses it in assessing the value of the goods for import duty levy and the foreign exchange authority, *i.e.*, the CBN, in the Nigerian context, also uses it in assessing the total value of import to qualify for foreign exchange allocation.

The CCVO is required to contain the following information:

- i) The information on the pro forma invoice
- ii) Form M number
- iii) Adequate description of the goods

- iv) Port of destination (e.g., whether Tin Can Island, Apapa, Kano, Onne, Abuja, etc)
- v) Shipment identification, date of shipment, etc
- vi) Country of origin
- vii) Country of supply

It is the duty of the importer to bring this requirement to the notice of the exporter.

7.8.10 Certificates independently issued on the quality and fitness of the imports

- i) Certificate of analysis: This applies to regulated products like foods, drugs, electrical equipment appliances, etc. The certificate is issued to the exporter by an independent third party that has been appointed by regulatory bodies in Nigeria, especially the NAFDAC and Standards Organisation of Nigeria (SON), to report on the quality and fitness of the regulated products for use.
- ii) Certificate of chemical analysis report: This applies to drugs and related products and it is issued broadly in the same manner as the certificate of analysis.
- iii) Laboratory test certificate: This applies to chemicals, foods, beverages, pharmaceuticals, electrical appliances and other regulated products. It is issued broadly in the same manner as the certificate of analysis.
- iv) Phytosanitary certificate: This is an official document issued by the plant protection organisation of the exporting country to the plant protection organisation of the importing country, certifying that the plants or plant products covered by the certificate have been inspected according to appropriate procedures and are considered to be practically free from injurious pests, and that they are considered to conform to the current phytosanitary regulations of the importing country.

7.8.11 Certificate of marine insurance/certificate of insurance

Goods in transit are subject to many risks. Since exporters are aware of these risks, they take out a policy to cover the goods until delivery. Such a policy is normally in the form of certificate of marine insurance. It is only when the exporter's quotation covers cost, insurance and freight (CIF) that the exporter needs to take up a certificate of marine insurance if the cargo is shipped by sea. However, the more general name that applies whether the cargo is transported by sea, air, road or rail is the certificate of insurance.

7.8.12 Export shipping cargo instruction (ESCI)

The ESCI is the written instruction from the exporter to the freight forwarder (i.e., forwarding agent) or carrier (whether shipping line, airline, road hauler, or whosoever to facilitate the movement of goods to the intended destination. It contains information on nature of the goods, the route to the destination of the goods (including shipping, forwarding and transport), transport requirements, customs matters (including customs clearance and payment of any duties and taxes), who should receive which documents, allocation of costs or charges (i.e., freight and operational charges) and any special matters (e.g., insurance, dangerous goods, etc). Most freight forwarders and transport companies have standard ESCI documents that exporters can complete.

The use of ESCI is not a requirement, but acknowledged good practice due to its important roles. In particular, it is a very helpful checklist at the planning stage. It enables all parties to be clear about the precise details on how the goods should be handled along the transport chain. It also provides a written record of the exporter's instructions on how the consignment should be handled, which makes it a source of dispute resolution and document of reference in the event of any subsequent disagreement over procedures, documentation or charges.

Given the role of export forwarders or

forwarding agents in connection with the ESCI, it would be in order to explain here the roles they play in facilitating exportation. An export forwarder is an independent service company which specialises in providing services for facilitating export shipments on behalf of the exporter. Such services include preparing the shipping documentation, advising the exporter when applying for trade financing, booking and arranging space for shipments as well as cargo insurance, advising the shipper on overseas requirements on packaging and labelling, and so on.

7.8.13 Risk assessment report (RAR)

On the arrival of the consignment, the applicable risk management service provider issues the risk assessment report (RAR) based on the information provided by the importer in the single goods declaration (SGD) and Form M. In the RAR, the risk management service provider advises the Nigerian Customs Service (NCS) on which channel to route a particular consignment: the green channel means the container does not need either scanning or physical examination, and should be released; the yellow channel means the consignment should be scanned (i.e., x-rayed by the x-ray equipment); for the red channel, the consignment should be subjected to a 100 per cent physical examination. It should be noted, however, that the RAR is only advisory; the NCS, may use its discretion to ignore the advice if it considers it appropriate so to do.

7.8.14 Single goods declaration (SGD) form

This is the form that an importer (or importer's agent) fills in order in the process of clearing the goods from the customs. As pointed out earlier in this chapter while discussing the import procedure, the importer may need to refer to a copy of the RAR (obtained from his authorised dealer bank) in completing the SGD form. He is then to attach with the SGD form all the necessary and supporting documents, like the final invoice,

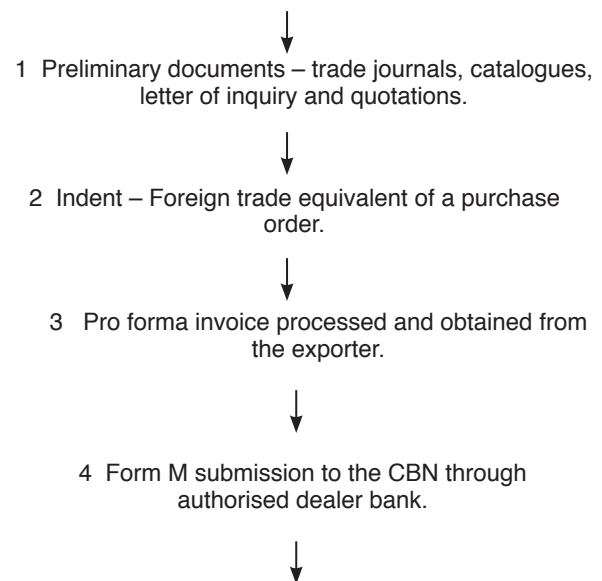
CCVO, pro forma invoice, bill of lading, insurance certificate, payment receipts for import duties and other charges, RAR, a copy of the Form M and submit everything to the designated customs officer (called the Face Vet Officer).

It is the contents of the SGD form that guides the Nigerian Customs Service in deciding whether or not to subject the cargo to physical examination. The automated system of customs data (ASYCUDA), a special purpose computer software of the NCS, selects the submitted SGD forms that go for scanning, with a pre-determined percentage of the SGD forms being subjected to such screening.

7.8.15 Customs declaration form

Customs officials are based at all ports of entry into Nigeria. Part of the duties performed by customs men include controlling the flow of dutiable goods into Nigeria. All persons entering Nigeria must complete a customs declaration form indicating the nature of goods which are being brought into the country. Similarly, exporters have to complete export declaration forms that are prescribed for exports.

Sequence of documents used in foreign trade



5 Agreeing payment mechanism with the authorised dealer bank, which should also double as the Issuing bank, including writing of letter of hypothecation by the exporter to the bank to enable the bank to possess any pledged asset, especially the consignment, in the event of a default by the importer.



6 Preparation by, and receipt from, exporter of various documents that should accompany the import consignment, like the commercial invoice or consular invoice, certificate of origin, combined certificate of value and origin (CCVO), packing list, pythosanitary certificate or any other similar third party certificate from exporting country, insurance certificate, shipping or transportation documents like the bill of lading or waybill.



7 Export shipping cargo instruction to be prepared by exporter to guide freight forwarder and transport owner while about to ship the consignment. This stage, however, does not concern the importer as it is the affair of only the exporter and transport company.



8 Risk assessment report issued by the risk assessment service provider.



9 Completion and submission of single goods declaration (SGD) form and, if applicable, the customs declaration form.

Fig. 7.2 Likely sequence of documents used in foreign trade

7.9 Transport documents used in foreign trade

The various forms of transport documents used in foreign trade are discussed below.

7.9.1 Dock receipt

This is the receipt issued and signed by an import broker or a receiving clerk at the dock or container terminal as proof of delivery of the goods to the dock under the conditions stated therein. It is issued in advance of the bill of lading. One copy is returned to the freight forwarder or the shipper as proof of delivery. The dock receipt can

be *clean* or *foul*, depending on whether the goods are received in good or in defective condition. If clean, the bill of lading issued in due course would be clean also. It is the contents of the dock receipt that would be subsequently reflected in the bill of lading.

7.9.2 Mate's receipt

This is the receipt issued by the shipowner (specifically, the captain of the ship, who is referred to as the mate) after the goods have been loaded into the ship to acknowledge receipt of the goods. It acknowledges that the goods have been received under the conditions stated therein. It is issued as a temporary receipt pending the time when the bill of lading would be ready when the shipper (i.e., exporter) would have to surrender the mate's receipt in exchange for the bill of lading. However, unlike the bill of lading, it is not a document of title, not to talk of being a negotiable document. Nevertheless, it constitutes a contract of carriage between the shipper and the shipowner, just as it provides an indication of the conditions under which the goods are received from the shipper. If on board the goods have no defects, a clean Mate's receipt would be issued. Otherwise, a qualified or 'dirty' Mate's receipt would be issued, just as in the case of a bill of lading, if the goods have defects. The Mate's receipt is similar to the dock receipt; it can be regarded as the counterpart of dock receipt that is used in the chartering trade (i.e., when a ship is chartered).

7.9.3 Bill of lading

A bill of lading has been legally defined as an acknowledgment in writing, signed by the captain or master of a ship or other vessel, that he has received in good order (or under the conditions stated therein), on board of his ship or vessel, therein named, at the place therein mentioned, certain goods therein specified, which he promises to deliver in like good order, at the place therein appointed for the delivery of same, to the consignee therein named or to his assigns, he or they paying freight for same.

A bill of lading is really a contract between

an exporter and a shipowner. The contract is for the carriage of goods to their destination. A bill of lading is signed by the shipowner. It ought to contain the following:

- i) the name of the consignor
- ii) the name of the consignee
- iii) the name of the master of the vessel
- iv) the place of departure and destination
- v) the name of the vessel
- vi) the price of the freight
- vii) the marks and numbers of the goods shipped

More importantly, the terms on which the goods have been delivered to, and received by, the shipowner must be stated in the bill of lading.

When the goods are loaded onto the ship, they are checked for any damage or any defect. If the goods are free of any defect, a clean bill of lading would be issued by the shipowner. However, if the goods are found to be defective, or damaged, the defects would be indicated on the bill which now becomes a 'dirty' or 'foul' bill of lading.

At least, three originals or parts of a bill of lading are usually prepared. One of these is to be sent to the consignee with the goods on board; another is to be sent to him by mail or by some other means; the third is to be retained by the merchant or shipper. The shipowner too should take care to have another part (the fourth) for his own use or record. When the ship arrives the port of destination, the importer presents his own copy of the bill of lading to the master of the ship. The master of the ship then releases the goods to the importer.

There are three types of bill of lading. These are: the straight bill, the order bill (that is endorsed to facilitate transfers), and the bearer bill. The straight bill of lading indicates that the goods are consigned to a specified person. Although it qualifies as a document of title, it is not negotiable; it is free from existing encumbrances. And so any endorsee acquires no better right or title than that held by the endorser. A straight bill of lading has a space for the shipper to insert the name of the consignee; all that the shipper does to produce a straight bill of lading is to insert the name of the consignee therein in such a way that prohibits the ability of the consignee to endorse the bill to another person. The shipper does this by simply omitting to put the expression, *or order* or, alternatively, *or assigns* after the name of the

consignee.

An order bill, on the other hand, permits endorsement to another party and this is accomplished simply by putting the expression, or order after the name of the consignee, for example, *pay XY or order* or *pay XY or assigns*.

The third type of bill of lading is the bearer bill. It is the bill of lading which indicates that delivery shall be made to whosoever holds the bill. Such bill may be created explicitly or an order bill can be converted into it by making the order bill to fail to indicate the consignee whether in its original form or through its subsequent endorsement in blank. Ordinary physical delivery is what is required to negotiate a bearer bill. Thus, for practical purposes, both the order bill and bearer bill are treated as negotiable instruments, although legally, they are not fully negotiable, but only quasi- or semi-negotiable. This is because the legal definition of negotiability includes some other features that bills of lading, even the bearer bills, do not fully possess.

The bill of lading is important in three major respects. Firstly, it constitutes a receipt for the goods shipped; it also contains the terms on which the goods have been received from the consignor. Secondly, it is a document of contract in respect of carriage of goods by sea. Thirdly, it is a document of title in respect of the consigned goods, and not even the straight bill is an exception in this regard. Thus, possession of the bill of lading is an entitlement to the goods. This means that, in the case of the quasi-negotiable bills (viz order bills and bearer bills), an importer can sell the goods while still at sea. The importer can do this simply by transferring the bill of lading to a willing buyer after proper endorsement at the back of the bill. The willing buyer can now claim the goods by presenting the bill of lading to the master of the ship when the consignment arrives at the port.

7.9.4 Liner waybill or sea waybill

Liner waybills are also referred to as the *data freight receipts*, issued by shipowners, just as bills of lading. Other names are *sea waybills* and *ocean waybills*. Liner waybills are issued in acknowledgment of the goods received from the consignor.

7.9.5 Charterparty

Unlike the bills of lading which are almost fully negotiable, liner waybills are not negotiable at all. Unlike the bill of lading, it is not a document of title; it bears the name of the consignee (without the option for the consignee to endorse it to a third party) who must identify himself in order to take delivery of cargo. Also, the details of the terms of contract of affreightment (hiring of the vessel) are not contained in a liner waybill, unlike a bill of lading on the reverse of which the details of the terms are stated. The liner waybill may only refer to the terms of affreightment contract as contained in the bill of lading issued by the shipowner. That is, a liner waybill will contain a statement which merely refers to the details of the terms of contract of carriage by sea as contained in the accompanying bill of lading. Thus, a liner waybill is not often issued in isolation as it is not a substitute but a complement to the bill of lading. A major purpose of the liner waybill is to avoid the delays that cargoes often undergo when bills of lading are late in arriving at the destination port. Liner waybills are generally faster to prepare and obtain than bills of lading.

A liner waybill alone can, sometimes, be adequate especially if only the shipper, the shipowner and the consignee are involved in the transaction. This means that the consignee has no intention of transferring the title or ownership of the goods to somebody else before taking physical delivery of the consignment from the shipowner. It also means that the consignee does not intend to pledge the goods as security to a lending bank. However, if the consignee, before the physical delivery of the consignment, either wants to sell the goods or pledge the goods as security with a bank, a liner waybill ceases to be sufficient as only a bill of lading can serve this purpose. This is because, a transfer by the consignee of the (quasi-negotiable form of) bill of lading to either the repurchaser or a bank automatically makes the repurchaser or the bank to be owner of the goods as against the consignee. This is so despite the fact that the goods are still in marine transit. A similar transfer of liner waybill does not entitle its new holder to the consignment which is still in marine transit. This is because a bill of lading is half-negotiable or quasi-negotiable while a liner waybill is not negotiable.

A charterparty can be defined as a written contract of affreightment by which the owner of a ship or other vessel lets the whole ship or vessel to a charterer (merchant) or any other person for the conveyance of goods, on a particular voyage or for a period of time, in consideration of the payment of freight, and with all terms, conditions and exceptions being stated in the contract or incorporated by reference. A charterparty should contain the following:

- i) the name and tonnage of the vessel.
- ii) the name of the captain.
- iii) the names of the freighter.
- iv) the price of the freight.
- v) the place and time agreed upon for the loading and discharge.
- vi) the demurrage or indemnity in case of delay.
- vii) any other conditions that the parties may mutually agree upon.

There are two types of charter, the time charter and the voyage charter. In the time charter, the charterer takes over the vessel for a certain amount of time, i.e., the vessel is hired for a specific period of time. Although the owner still manages the vessel, it is the charterer that gives orders for the employment of the vessel, and he may even sub-charter the vessel to another party. In the voyage charter, on the other hand, the charterer hires the vessel for a single voyage while it is the vessel's owner that provides the master, crew, bunkers and supplies.

It can thus be seen that, when compared with a bill of lading which applies when the consignor or shipper uses merely a space in the ship, a charterparty is a contract of hire of the entire ship or vessel. So, the shipper, and not the shipowner, is responsible for transporting the goods. A charterparty is not a contract of shipment of goods but a contract for hiring of the ship that is to be used for carrying the goods. Therefore, unlike a bill of lading, a charterparty is not a contract that states the conditions under which the goods are received or that can be negotiated by being transferred or endorsed to another party. As an illustration, the nature of contract or agreement to hire a truck to carry goods from Abuja to Lagos should differ materially from the agreement to

carry goods in just one of the compartments of the truck from Abuja to Lagos.

7.9.6 Air waybill or air consignment note

The air waybill (AWB) or air consignment note (ACN) is the contract document issued by an airline (or its agent) for carriage of goods or cargo from a specified airport to another. A cargo agent or the airline itself draws up and signs the contract by issuing an air waybill in line with the standard format that is approved by the International Air Transport Association (IATA). The AWBs show the carrier's name, its head office address, its logo and the pre-printed eleven-digit AWB number. It is also possible to complete an AWB through a computerised system.

The conditions of the contract are printed on the reverse side of the AWB originals. AWB is either issued by the air carrier itself or an IATA cargo agent that acts as an agent of that air carrier. AWBs are issued in sets of different colours. The first three copies constitute the originals. The first original is blue in colour and it is the shipper's copy; the second, also coloured blue, is to be retained by the issuing carrier; while the third, which is orange in colour, is the consignee's copy. A yellow copy is used as the delivery receipt, or proof of delivery. Other copies, which are all white, serve various and miscellaneous purposes.

The AWB has several functions and serves many purposes in international transport. Specifically,

- i) It is a confirmation of the transport contract between the shipper and the carrier. Accordingly, it defines the limits of the carrier's liability. At the reverse of every original of the AWB are conditions of contract for carriage.
- ii) It is a confirmation that goods have been accepted for transportation as air freight. It is evidence of the acceptance of goods and the proof that the shipment was handed over in good order and condition (or in the order and condition stated therein).
- iii) It is an important document for customs, banking and other transactions. Although customs authorities and the foreign

exchange authority (i.e., the central bank) require various documents like a commercial invoice, packing list, etc, the AWB too is proof of the freight amount billed for the goods carried and may be needed to be presented for customs clearance and in applying to the central bank for foreign exchange permission or allocation.

- iv) It is also a receipt for payment of air cargo.
- v) It may constitute a bill or invoice together with supporting documents. This is because it indicates charges to be paid by the consignee to the agent or the carrier. An original copy of the air waybill is used for the carrier's accounting purpose.
- vi) It also serves as the shipper's proof of ownership under Article 12 of the Warsaw Convention.
- vii) It conveys to airline personnel the shipper's instructions, as contained in the shipper's instruction letter or export cargo shipping instruction, concerning the routing and the handling during loading and storage.
- viii) It may also serve as a certificate of insurance if the carrier is in a position to insure the shipment and has been requested to do so by the shipper.

However, unlike a bill of lading, an AWB cannot be transferred from one party to another in order to convey the title to the underlying merchandise, i.e. it is not negotiable and neither is it a *document of title* to the goods.

7.9.7 Waybill or consignment note in general

We have discussed above the air waybill or air consignment note and the sea waybill, which is also called liner waybill. But waybills are not peculiar to air or sea transport. Each of the other modes of transport, whether by road or by rail, also has its own waybill or consignment note. Thus, in addition to air waybill and sea waybill, we also have road waybill (issued by road haulage companies) and rail waybill (issued by rail operators). We singled out air waybill and sea waybill for separate discussion above simply because of convenience. This is particularly so in the case of air waybill, in view of its minor difference when compared with the road and

rail waybills. An air waybill contains additional items like airport of destination, flight number and time, a feature that is often absent from other forms of waybill. In addition, the air waybill is more standardised, partly due to the uniformity adopted by the IATA. Meanwhile, it should be noted that, while the word waybill is commonly used in the US and a few other countries that adopt the US terms, the expression consignment note is commonly used in other countries, particularly in Europe. Both of them mean the same thing. In our discussion here, we adopt and use the two terms.

So, in general, a waybill or consignment note can be defined as a written contract issued and signed by a *carrier* giving details and instructions relating to the *shipment* of a *consignment* of goods. A waybill typically shows the names of the *consignor* and *consignee*, the point of origin of the consignment, its destination, *route*, and method of shipment, and the amount charged for carriage. In advanced countries, the digital waybill, which is an electronic version of a waybill, is increasingly becoming very common as many shipments are ordered through the Internet.

Compared with a bill of lading, a sea waybill has some limitation, viz it is not negotiable; neither does it constitute a document of title. In view of this limitation, the question arises as to why a sea waybill may be adopted instead of a bill of lading. In this regard, it should be noted that the sea waybill is most commonly used in the container trade, particularly in a situation where the shipper does not insist on separate bills for every item of cargo carried, as would be the case if the cargo is one of a series of loads being delivered to the same consignee. All that the consignee has to do is to identify himself in order to take delivery of the cargo. The use of sea waybill is also customary in transactions where the shipper and consignee are the same person in law, making the rigid production of documents of title to be unnecessary.

A waybill, just like the air waybill and sea waybill serves many purposes. Particularly, it is

- i) a confirmation of the transport contract between the shipper and the carrier. Accordingly, it defines the limits of the carrier's liability.
- ii) proof of receipt of the goods for transport.
- iii) a receipt for payment of air cargo.

- iv) evidence of the contract of carriage.
- v) an invoice for the freight, reflecting the shipper, the consignee and the goods being shipped, as well as the full freight amount.
- vi) a guide to the road hauler for the handling, dispatch and delivery of the consignment.
- vii) a means of clearing the goods through customs.

However, just as in the case of air waybill, a waybill is not negotiable; neither is it a document of title - the goods are released to the consignee (usually the importer) on application and on providing proof of identity.

7.9.8 Postal receipts

When a parcel or consignment is sent through NIPOST or a courier service, the postal outfit acknowledges this by issuing a receipt, which spells out the terms and conditions of carriage of the parcel or consignment and defines the limit of liability of the postal outfit. This receipt serves broadly the same purpose as a waybill and has broadly similar legal implications. Also, they are both non-negotiable and are not documents of title, as the addressee or consignee has to identify himself in order to take delivery of the parcel or consignment.

7.9.9 Tickets

A travel or transport ticket is a voucher or commercial document that indicates that the ticket owner has paid for the right to board a flight, train or road vehicle which the ticket relates to. It also permits the owner to carry luggage, including what is called personal effects, on board. It is also possible to use the ticket to send small luggage, without the owner accompanying it. So, there is the airline ticket issued by an airline or travel agent for travel and sending of luggage by air; the train ticket issued by a railway operator that enables the owner to travel and send luggage by rail; and the bus ticket issued by the bus operators for road commuters to travel and send luggage by road. A travel or transport ticket serves the following purposes:

- i) It serves as a receipt for payment made to travel or send luggage.

- ii) It is a contract document for the travel or sending of luggage between the transport operator and the traveller or sender of luggage. It usually contains the terms and conditions of the carriage of persons and things (e.g., at the back of the ticket) by reference to an existing contract document.
- iii) In the case of transport of goods, it may serve as an acknowledgment of receipt of goods under the conditions stated on the ticket.

But unlike a bill of lading, a ticket is not a document of title. It resembles waybills in many respects. However, unlike waybills, the contents of such tickets are not standardised. The wordings vary from carrier to carrier. Also, there can be bearer travel tickets, which is the one that does

not contain the name of the owner so that it can be transferred from the original owner to another person (without any endorsement). This is the case with most train tickets for intra-city travels.

7.9.10 Manifest

This is a document that contains a full list of a ship's cargo. The information on the manifest is extracted from the bills of lading. A copy called the *outward manifest* is lodged with the customs authorities at the port of origin while another copy, called the *inward manifest*, is lodged at the port of destination. There is also a separate manifest for passengers, which lists the names of all those travelling on a particular flight, ship, train or bus.

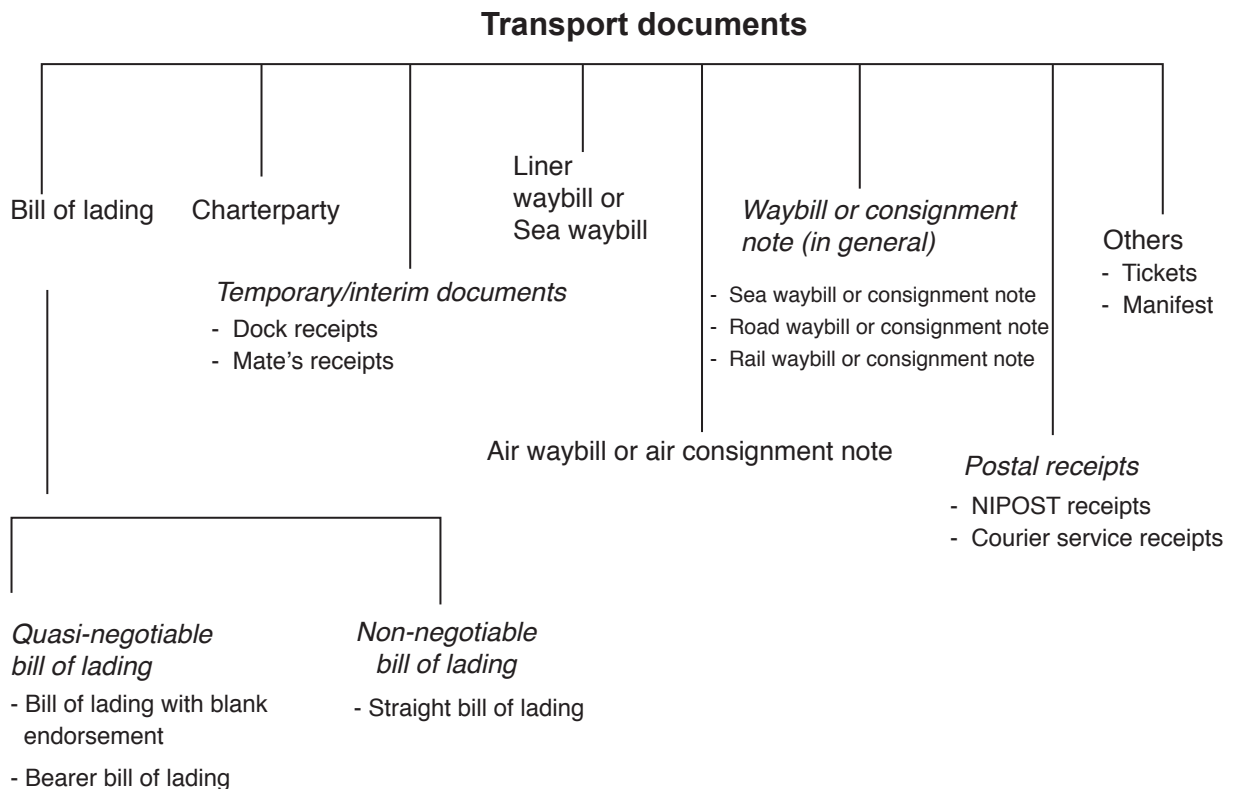


Fig. 7.3 Transport documents

7.10 Methods of payment in foreign trade

It would be unwise, even senseless, for any exporter to dispatch goods when there are no satisfactory payment arrangements. Payment may be arranged through a bank which will normally have overseas correspondents. In this section we shall mention and describe the various methods available for payment in foreign trade.

7.10.1 Telegraphic transfer

Telegraphic transfer is a means of wiring funds from one location to another. Originally, telegraphic transfers made use of the *telegraph* or cable as a means of transferring money between the source bank and the destination bank, which may or may not be in the same country. However, today, the process of transferring money between two parties is no longer through the cable or telegraph, but the use of the term is still retained in several countries. Thus, to make a foreign payment by telegraphic transfer, a sum of money could be transferred from a bank in Nigeria to a bank in another country. When telegraphic transfer is used, the local bank making payment on behalf of the importer, cannot dispatch a specimen signature. Therefore, private codes are used in place of signatures. These private codes are previously arranged between the banks. Telegraphic transfer is the fastest and safest method of transferring funds abroad. Expectedly, it is the most costly method of remittance.

7.10.2 Mail transfer

This is a form of remittance which is communicated by telegram, telex or fax machine. In the context of foreign payment, it is an order to make payment issued by a local bank to its overseas correspondents. The foreign creditor is normally paid by means of a letter or airmail.

7.10.3 Bank draft

A bank draft for international payment is a special type of cheque normally drawn on the

debtor's bank. The bank draft is usually issued by a commercial bank on approval by the Central Bank of Nigeria.

7.10.4 Traveller's cheque

The traveller's cheque is another means of making foreign payments (e.g., to pay hotel and restaurant bills or taxicab operators). It is a special cheque issued by a bank to its customers to enable them to make payments while outside the country. It is a pre-printed, fixed-amount cheque that the person signing it uses to make payment to someone else as a result of having paid the issuer for the privilege. Traveller's cheques are available in several currencies, for example US dollar, British pound, the Euro, and Japanese Yen. They are sold in pads of 10 or 5 cheque leaflets. Unlike ordinary cheques that become stale six months after being drawn, traveller's cheques do not get stale.

The organisation that produces traveller's cheques is called the issuer or the drawee. Thomas Cook Group is the most renowned issuer in the world. The banks or other places that sell it to users are the agents; the purchaser is the traveller that wants to use it to make payment; while the person or organisation to whom the purchaser writes the cheque is the payee. The traveller, while purchasing the traveller's cheque, should immediately write his signature on each leaflet. When making a purchase (e.g., paying hotel bills), he should, in the presence of the payee, date and countersign (i.e., sign again) the cheque to enable the payee to compare this with the earlier signature as an assurance against forgery.

7.10.5 Wiring of funds, particularly through SWIFT

- i) Meaning and nature of wire transfer: Bank wire transfer is a form of credit transfer whereby money is transferred from one person's or an organisation's bank account to another's bank account. The transfer can be domestic (between banks in a particular country) or international (between banks in different countries).

ii) Nature of SWIFT, as the most widely used form of international wire transfer: Most international transfers are executed through what is called the SWIFT, which is a sort of co-operative arrangement or society (with its headquarters in Belgium) that has a membership of well over 7,000 banks in virtually all countries of the world. It operates a global network to promote the transfer of financial messages. With the use of these messages, banks can exchange data or information for funds transfer among themselves.

As the SWIFT money transfer mechanism is the most widely used form of international wire transfer, it is the one that is discussed below. Other forms of wire transfer are not materially different from the SWIFT, so that the SWIFT mechanism is illustrative of others too. The process and mechanism entailed in effecting a SWIFT money transfer are as provided below.

iii) Information to be provided a bank to effect a SWIFT wire transfer: The transferor of funds gives his bank the instruction to make the transfer from his account to the bank account of the transferee and provides the particulars of the transferee's or recipient's account. The particulars should include the name of the recipient of the funds, his bank account number, the bank branch where the account is maintained, and the Bank Identifier Code (BIC) or SWIFT Code of the recipient's bank (as each bank has its own SWIFT Code). For transfers involving European banks, the International Bank Account Number, or IBAN (which each European bank has), also has to be supplied.

iv) How banks actually effect the transfers among themselves: The sending bank transmits a message, via a secure system, to the receiving bank, asking it to effect payment according to the instructions given. The instruction would give details of the amount that should be posted and the particulars of the account involved. Either the banks involved must hold a reciprocal account with each other, or the payment must be sent to a bank with such an account, a correspondent bank, for further benefit to the ultimate recipient. Thus, if money

is to be sent from Nigeria (i.e., through a Nigerian bank) to, say, a recipient in the US, the sending bank in Nigeria may need the services of its correspondent bank in the US to transfer the funds to the recipient's bank account. The actual transfer is not often immediate, particularly as it may have to be routed through correspondent banks which act as go-between the sender's bank and the recipient's bank. Funds may take several hours or even days to move from the sender's account to the receiver's account.

v) An appraisal of costs and benefits of wire transfer mechanism: Bank-to-bank transfer mechanism is very secure and safe. It is considered the safest international payment method. Information contained in wires is transmitted securely through encrypted (or specially coded) communications methods. However, it is relatively expensive. Banks collect payment for the service from the sender as well as from the recipient, before whatever remains as the proceeds are credited to the recipient's bank account. As a result, recipients are often bewildered when less money is received than expected. The sending bank typically collects its own fee, separate from the funds being transferred. On the other hand, the receiving bank and go-between (i.e., correspondent) banks through which the transfer travels deduct fees from the money being transferred, thereby making the recipient to receive less than what the sender sent. It is to be noted that these correspondent banks that handle the transaction take the liberty to unilaterally take their fees directly from the money being transferred without the knowledge or consent of the sender or recipient, so that there is little check against abuse.

7.10.6 Foreign bills of exchange and documentary credit

A foreign bill of exchange is a promise to pay a given sum of money at an agreed future date. An exporter first prepares the bill and sends it to the importer for immediate payment (in the case of a demand bill) or otherwise for his signature to

signify his acceptance of the bill. Alternatively, it is for the importer to arrange more credible acceptor or acceptance house to accept the bill. On the receipt of the bill signed by the importer, the exporter can discount the bill (i.e., sell the bill for less than its face value) with a bank. By so doing, the exporter gets immediate payment. At the agreed future date, the bank that discounts the bill collects payment (amounting to the face value of the bill) from the importer.

Foreign bills of exchange consist of clean bills, documentary bills and documentary credit.

Clean bill

This refers to a bill of exchange sent by an exporter to an importer for either acceptance or immediate payment without the bill being accompanied by such other documents as the bill of lading, insurance certificate, etc. These other documents are sent to the importer separately from the bill of exchange. A clean bill is normally used when the exporter has no doubt about the integrity of the importer; otherwise there would be the fear that the importer may refuse payment or acceptance especially if he has taken delivery of the goods with such documents of titles as the bill of lading.

Documentary bill

A bill is referred to as a documentary bill when it is presented to the importer for payment or acceptance simultaneously with documents of title like the bill of lading, insurance certificates, etc. On the one hand, this arrangement assures the importer that he is either paying or accepting the bill (or liability) in respect of goods which have been duly insured and which he is now entitled to collect. On the other hand, it assures the seller that the property in (or ownership of) the goods is being given to an importer who has either paid or accepted to pay for the goods. Thus, a documentary bill is used when there is little mutual trust between the exporter and the importer. This method is also called collection arrangement. Banks in the importer's country are normally instructed to present the bill for the importer's payment or acceptance and most banks of the world follow these international rules.

A documentary bill can be either a D/A bill or a D/P bill. A D/A documentary bill is the one

that is presented to the drawee (or importer) for acceptance while a D/P documentary bill is the one that is presented to the importer for payment as in the case of a Demand Bill (i.e., payable on demand).

Documentary credit

This is another method of making foreign payments. This method operates exclusively through banks. Under the method, which applies only if the exporter and the importer opt for it in their contract, the importer (say, a Nigerian importer) instructs the bank in his own country, which now becomes the issuing bank, to open a credit with the bank in the supplier's (say, a UK exporter's) country in favour of the supplier. The bank in the supplier's country would normally be the correspondent bank of the issuing bank. This correspondent bank then becomes the advising bank, as its primary role is to liaise with the exporter by advising or providing information to the exporter. It is through it that documents pass to the exporter and from exporter to the issuing bank in the importer's country. If the documentary credit is a confirmed type, the advising bank is usually the one to also confirm the credit, i.e., undertake to pay the exporter whether or not the issuing bank or the importer pays. In that case, the advising bank doubles as the confirming bank also. The instructions given to the correspondent bank, which are contained in what is called a Letter of Credit, would also specify the document that the supplier needs to present (e.g., bill of lading and insurance certificate) before the supplier gets paid by the correspondent bank. Briefly, the procedure involved is as follows:

A Nigerian importer approaches his own bank in Nigeria, the issuing bank, with a view of getting the bank to open a credit in his favour. The issuing bank then writes a letter of credit to the UK exporter through the correspondent bank. In the letter, the issuing bank instructs the correspondent bank to provide finance to the supplier on presentation of stipulated documents like the bill of lading. The method by which the finance is provided the supplier would also be stated in the letter of credit. Three such methods are common. The first method consists of the supplier being paid directly (by the correspondent), in which case the bill of exchange is not involved at

all. Under the second method, the correspondent bank only accepts the bill of exchange drawn by the supplier so as to enable the supplier to get the bill discounted easily and cheaply. The third method is for the correspondent bank to discount the bill by providing cash to the exporter before maturity, at less than the face value of the bill.

Documentary credit can be of three types as follows:

i) Simple or revocable documentary credit: Under this arrangement the issuing bank (usually on the advice of the importer) can countermand, i.e., revoke the payment instruction contained in the letter of credit at any time before the finance is made available to the supplier. In other words, the issuing bank can give a counter-instruction to the correspondent bank that the finance should not be provided to the exporter any longer and the correspondent bank must obey accordingly.

An importer would normally prefer this arrangement as it gives him the time to inspect the goods, with the opportunity to countermand payment if the goods are found to be defective. On the other hand, the method exposes the supplier to the risk of a dishonest and unscrupulous importer countermanding payment after receiving the goods.

ii) Irrevocable (but unconfirmed) documentary credit: This is the type under which the correspondent bank must not obey any instruction from the issuing bank to countermand payment. That is, the issuing bank now becomes unable to revoke the letter of credit and the supplier has some assurance that the correspondent bank would provide him the finance. However, this assurance is not absolute as the correspondent bank may not provide the finance unless the issuing bank has made the required funds available to it (the correspondent bank). This, in turn, may depend on whether the importer has made the funds available to the issuing bank.

iii) Irrevocable and confirmed documentary credit: This is an irrevocable type of credit to which the correspondent bank has added its own confirmation, i.e., the correspondent bank has undertaken to provide the finance,

come what may, so that the correspondent bank, or whichever bank provides the confirmation, now becomes the confirming bank. Thus, a confirmed documentary credit constitutes a firm undertaking by the correspondent bank to pay the supplier provided the supplier presents the stipulated documents. The supplier is thus assured of getting paid because the correspondent bank is a reliable 'paymaster' vis-à-vis the issuing bank (located in a foreign country). Confirmed credit is, therefore, presumed to be irrevocable.

7.11 Balance of trade and balance of payments (BOP)

a) Three broad components of the balance of payments records: The balance of payments (BOP) is a statement which summarises all economic and financial transactions between a country and the rest of the world during a period of time. It is where the summary of the country's transactions with the rest of the world (i.e., collectivity of other countries of the world) is contained. The transactions are often summarised into three broad categories, namely

i) flow of goods and services to and from the rest of the world (recorded in the current account component);

ii) borrowing from and lending, including inflow and outflow of equity finance like foreign direct investment (recorded in the capital account component); and

iii) flow of foreign currencies and other types of foreign reserves (recorded in the monetary capital account component).

b) Use of the double entry principle in the recording: Under each component, double entry principle of bookkeeping is adhered to by entering each transaction twice, crediting one account and debiting another. The rule applied requires that transactions that can lead to receipt of foreign exchange are to be entered in the credit column, with the

offsetting debit entry recorded in the other account. In the same manner, transactions that can lead to payment of foreign exchange are entered in the debit column, with the offsetting credit entry entered into another account.

- c) Meaning of favourable and unfavourable balances: Periodically (say, at the end of each month or quarter), the difference between the credit column total and debit column total is taken in order to determine whether there is a favourable or unfavourable balance in each component and, hence, in the overall balance of payments position. A favourable or surplus balance exists in respect of each of the first two components (namely, current account and capital account) if the total of the credit column exceeds the total of the debit column (i.e., credit balance) while, in the case of the third component (i.e., flow of foreign reserves account), a favourable balance exists when the total of the debit column exceeds that of the credit column (i.e., a debit balance). An unfavourable balance exists if the inequality is reversed in each case.
- d) Arithmetical implication of the use of double entry bookkeeping: The principle of double entry ensures that the addition of balances in the first two components, in the absence of errors or omissions, must be equal and opposite to the balance in the third component. This means that the third component is a mirror image of the sum total of the first two components. It also means that if the balances in all the three components are added together, the result would be zero. These three categories or components are discussed below under 7.11.1, 7.11.2 and 7.11.3.
- e) Residence, and not nationality, is what counts: It should be noted that, in the context of BOP record, it is the residence (that roughly means a place of normal abode for roughly one year) of those carrying out the transaction that counts, and not their nationality. Thus, transactions of a non-Nigerian, in terms of nationality, but who has been living in Nigeria for more than a year, are regarded as transactions by a Nigerian while transactions by a Nigerian

who has been living abroad for over a year would count as transactions by a foreigner.

7.11.1 International trade in goods and services component

- i) Merchandise trade and the balance of trade: In the first part of this component are recorded exports and imports of tangible or physical goods, called merchandise or visible trade. Exports are credit items, as they can lead to receipt of foreign exchange, while imports are debit items, as they can give rise to payment in foreign exchange. The difference between the total of credit entries (i.e., exports) and debit entries (i.e., imports) is called *balance of trade*. The balance of trade is favourable or in surplus, to the extent of the difference, if the total of exports exceeds the total of imports for the period under consideration, while it is unfavourable or in deficit if the inequality is reversed.
- ii) Invisible trade: In the latter part of this component are recorded what is called invisible trade or trade in services. Export of services constitutes credit items while their import constitutes debit items. There are three sub-divisions of items called services. The first is called *factor services incomes*, these being incomes received by a country's residents for making their factors of production available for productive activities taking place in another country that is not their residence. Rewards to factors of production include wages (for labour), interest (for capital or finance), rent (for land or property) and profit or dividend (for entrepreneurship). So, wages earned by Nigerian residents who work abroad for less than a year before returning to Nigeria constitute export of services abroad in the same way that payments to foreigners for coming to work, e.g., as consultants, in Nigeria for less than a year constitute import of services to Nigeria. Similarly, interest income received by Nigerian investors who buy bonds issued abroad would constitute a credit item or export of services while

interest being paid to the foreign lenders by Nigerian government on its foreign debts amounts to import of services by Nigeria. The same applies to rents being received by Nigerians on their landed properties offshore, which would be export of services, while rent being paid on properties on Nigerian soil but owned by non-residents is an import item. Finally, the dividends (or share of profits) that accrue to Nigerian entrepreneurs from equity investments (whether foreign direct investment or not) in businesses located abroad, constitute export of services item while payments of dividends to foreign investors in Nigerian companies constitute import of services item.

The second is called non-factor services incomes, which are those conventional services that do not directly relate to factors of production. These items include income received through usage of services provided by Nigerian-owned transport facilities (ships, airlines, etc) for the use of importers and exporters from Nigeria's trading partners in connection with foreign trade, provision by Nigerian banks and insurance companies of services for such importers and exporters, etc. Also included are the payments received in Nigeria (e.g., hotel bills and travels while in Nigeria) from tourists from abroad when they visit the country. All these are regarded as export of services. Import of services is the payments by Nigerian importers and exporters for using the transport facilities, banking and insurance services that are provided by foreigners.

The third sub-division is what is called *unrequited transfers*, which refer to donations between residents of two countries. Often, the Nigerian government receives donations or gifts from abroad. Individual Nigerians also very often receive donations or gifts from abroad. These donations and gifts are recorded under the credit column of the unrequited transfer account.

It does happen also that the Nigerian government gives grants to other countries, and that individual Nigerians could make donations abroad. In such instances,

these grants and donations are treated as payments abroad and are entered under the debit column of unrequited transfer account. If credit entries exceed debit entries, then there is a surplus or favourable balance in unrequited transfer account. If debit entries exceed credit entries, then there is a deficit or an unfavourable balance in unrequited transfer account.

- iii) Current account balance: The addition of the balance of trade (i.e., difference between merchandise exports and imports) and the balance on services account (i.e., excess of export of conventional services and unrequited transfers received over and above import of services and unrequited transfer payments) is what is called the current account balance. This current account balance is sometimes considered as the balance of payments itself, because of its significance. A country may have a surplus balance of trade but may still have a deficit current account balance if the deficit in the services account is more than offsetting to the balance of trade surplus.

7.11.2 Non-monetary capital component: International lending and commercial capital flows

This is also simply called capital component or capital account. The deemed export of finance capital is recorded under the credit column, for instance, borrowings by the Nigerian government from international finance institutions or borrowings by private individuals from international capital markets. Inflows of foreign direct investments are similarly recorded as a credit item. The deemed import of finance capital is recorded under the debit column, for instance, lending by the Nigerian government to other countries or purchase by Nigerians of foreign debt instruments. Outflows from Nigeria of foreign direct investments are similarly debited into the account. If the credit entries exceed the debit entries, then there is a surplus or favourable

capital account balance. If the debit entries exceed the credit entries, then there is a deficit or an unfavourable capital account balance.

7.11.3 Monetary capital or reserves component

- i) Items comprising foreign reserve flows: This component records movement of foreign reserves. The sole largest component of foreign reserve is the foreign exchange or the currencies of other countries. Other components of foreign reserve include Special Drawing Rights (SDR) which is the virtual money created by the International Monetary Fund (IMF), reserves position with the IMF, etc. An outflow of foreign reserve is entered under the credit column while an inflow is entered under the debit column of the monetary capital account. The balance in this account is often referred to as the overall balance of payments position of a country. Without errors or omissions in compiling the records, this balance must be equal and opposite to the sum of the current account and capital account balances.
- ii) Meaning of unfavourable overall BOP position: A favourable or surplus balance of payments position results if the inflow of reserves exceeds the outflow of reserves during the period and this means that the country is gaining or accumulating foreign reserves. An unfavourable or deficit balance of payments results if the outflow of reserves exceeds the inflow. Obviously, this means that such a country is losing previously accumulated reserves to some other countries.

The overall balance of payments position is sometimes loosely referred to as the 'balance of payments.' This means that the term 'balance of payments' can have two meanings: the first is as we explained at the beginning of this sub-heading, and the second is the loose meaning just mentioned.
- iii) Distinction between the accounting and economics meanings of BOP position: In an accounting sense, the balance of payments

must always balance because the total amount of the credit entries must be equal to the total amount of the debit entries; that is, the debit column and the credit column must always be equal. This is what is meant by the statement: 'balance of payments must balance'. But, in an economics sense, the balance of payments hardly balances as the outflows of foreign reserves are not normally equal to the inflows of foreign reserves. This is another way of saying that the sum of export of goods, services and non-monetary capital inflows is not normally equal to the sum of import of goods, services and non-monetary capital outflows. If the sum of export of goods, services and non-monetary capital inflows is the greater, that means the inflow of net foreign reserves generated would exceed the foreign reserves outflow and there would be an favourable balance in economics sense. Otherwise, there would be an unfavourable balance.

7.11.4 Arithmetical illustration of balance of payments

The following is the balance of payments of a hypothetical country for the year ended 31 December, 20-5. We can use the figures in illustrating the computations for the balances of the various components of a balance of payments.

- i) Balance of trade surplus: This is given by $2,560 \text{ minus } 1,410 = 1150$.
- ii) Deficit balance in the services account: This is given by $(550 + 100 + 320 + 70 + 85) \text{ minus } (900 + 250 + 360 + 80 + 220) = 1,125 \text{ minus } 1,810 = -685$.

The total export of services is equal to $550 + 100 + 320 + 70 + 85$ or $1,125$, while the total import of services is equal to $900 + 250 + 360 + 80 + 220$ or $1,810$. Thus, the deficit is the excess of $1,810$ over $1,125$, that is, 685 .
- iii) Surplus balance in unrequited transfer account: This is given by $150 - 125 = 25$.
- iv) Current account surplus: This is given by $1,150 \text{ minus } 685 \text{ plus } 25 = 490$. It should be noted that the current account balance is the sum of balance of trade, services account

Balance of payments of a hypothetical country for the year ended 31 December 20-5.

	Credit (Cr) ₹ Million	Debit (Dr) ₹ Million
Merchandise goods	2,560	1,410
Shipment	550	900
Other transportation	100	250
Travel	320	360
Other non-factor services	70	80
Factor services	85	220
Unrequited transfers	150	125
Long-term capital	1,145	990
Short-term capital	755	815
Reserves movement	240	825
	<u>5,975</u>	<u>5,975</u>

balance, and unrequited transfers account balance with any deficit taking a minus sign.

- v) Capital account surplus: This is given by $(1,145 + 755) \text{ minus } (990 + 815) = 1,900 \text{ minus } 1,805 = 95$. The total capital inflow of 1,900 is the sum of long-term and short-term capital inflows of 1,145 and 755, respectively. Similarly, the total capital outflow of 1,805 is the sum of long-term and short-term capital outflow of 990 and 815, respectively. The capital account surplus is the excess of inflows over the outflows.
- vi) Monetary capital account surplus: This is given by $825 \text{ minus } 240 = 585$. Thus, the overall balance of payments position is in surplus to the tune of 585 because the inflow of reserves (825) exceeds the outflow of reserves (240) by 585. Another method of computing the overall balance of payments position is to add the current balance of 490 to the capital account balance of 95. The result is 585.

That the balance of payments must always balance in an accounting sense is evident from the fact that the sum total of the credit column is 5,975 and this is exactly equal to the sum total of the debit column.

7.11.5 Methods of correcting balance of payments

The following are measures that a country having a balance of payments deficit can take to correct or reverse the situation:

- i) Borrowing from international financial markets, governments of friendly countries or inter-governmental organisations like the International Monetary Fund (IMF) and the World Bank.
- ii) Increase in tariff rate, that is, an increase in import duties or imposition of quantitative restrictions on imports, possibly an embargo on some import items.
- iii) Tight monetary policies such as a reduction in money supply, curtailing of banks in the economy, and an increase in the domestic rate of interest.
- iv) Tight fiscal policies in the form of reduction in government expenditure, or an increase in taxation.
- v) Exchange control measures.
- vi) Export promotion through various policies that are discussed in this chapter.
- vii) Encouragement of capital inflows especially through foreign direct investments, controls on capital repatriations, and remittances of profits made abroad.
- viii) Exchange rate policies which must include

depreciation of the naira, the domestic currency. This would reduce imports by making them more costly to buy and would also simultaneously increase non-oil exports as more naira would be realised when exporters convert a given quantum of foreign currency into Naira. That is, the lower the worth of the naira, the more costly it is for Nigerians to buy goods and services from overseas, and the cheaper it is for foreigners to buy Nigerian goods and services. Devaluation, in this way, is expected to correct the balance of payments deficit through reduction in imports and a corresponding increase in exports.

7.12 Tariff and reasons why a country may impose it

7.12.1 Nature of tariff

Import tariff (or, simply, tariff), which is also called import duty, is the tax levied on goods imported into the country. The tax is expressed either as a percentage (i.e., fraction) of the value of an imported good or per unit of it. When expressed as a fraction of the value of the good, it is called an ad valorem import tax. An example is an import duty of 10% of value of imported cars, so that import duty of ₦200,000 would be paid on a car costing ₦2 million. When expressed on per unit basis, it is called a specific import duty. An example is a ₦250,000 import duty on a car, so that import duty of ₦500,000 would be paid on two cars, irrespective of their values. In other words, while an ad valorem duty is calculated on the monetary value of the imported goods, a specific duty is calculated on the weight or quantity of imported goods, irrespective of their monetary value or market price.

Import duties are assessed and collected in Nigeria by the customs authority called the Nigerian Customs Service (NCS).

7.12.2 Reasons why tariffs may be imposed

There are many reasons why government may impose duties on imports. Notable among these are as discussed below.

- i) Revenue generation: Tariff revenue is a major component of government total revenue. In Nigeria, it comes only after the government revenue derived from petroleum activities.
- ii) Protection of domestic economic activities from foreign competition: The higher the tariff rate, the higher would also be landing cost of imported goods and, hence, the price of imported goods in the market. This would give the domestically produced equivalents a price advantage and encourage more of the goods to be produced locally, thereby generating more income and employment.
- iii) Infant industry protection: There may be some economic activities or industries that are just emerging in a country. The country may have a great potential and bright prospect to excel in them but they may be operating below international standards of efficiency due to their start-up or *infancy* nature. Such economic activities or industries are referred to as infant industries. On this basis such industries have to be protected against unfair competition from abroad. Imposition of tariffs on imports coming from such foreign competitors is a way of accomplishing this. This rationale is related to, and may be seen as a special case of, the reason for tariff imposition mentioned immediately above.
- iv) As an anti-dumping policy: Sometimes foreign suppliers deliberately sell imports at very low prices, even if this means they would be making a loss by so doing. Their home governments too may subsidise them to enable them to sell cheaply in other countries. The rationale is to displace domestic competitors, which are unlikely to afford to sell at such low prices. After driving out such competitors, the foreign suppliers would then be selling at high prices. This practice is called *predatory dumping*. Imposition of tariffs can prevent from occurring or, at least, from achieving

its objective. A countervailing duty is the one imposed by a country on imported goods, to counter subsidies granted to the exporters of the goods by their domestic governments.

- v) Discouragement of undesirable goods: From the social point of view, some goods are considered less desirable or even undesirable. Policy makers would therefore want to reduce consumption of such goods. Imposition of high tariff rate is a way of accomplishing this. Examples of such goods are tobacco and alcoholic drinks.
- vi) Improvement in balance of payments position and conservation of foreign reserves: Tariffs can be used to discourage importation so as to improve the balance of payments position of the country. This, in turn, would conserve the scarce foreign reserves that would have been used in financing the imports and make the reserves available for other uses, including re-payment of external debts.
- vii) Protection of domestic currency against depreciation: Similarly, a reduction in the volume of imports, due to tariff imposition or for whatever reasons, would reduce the pressure on the exchange rate or value of the naira in terms of other currencies and thereby prevent it from falling (i.e., depreciating) or reduce its extent of depreciation.
- viii) Retaliation against tariff imposition by trading partners as an instrument of trade negotiation: When a country imposes tariffs on its imports, the trading partners where affected products are being produced would naturally frown at, and be uncomfortable with it. At a point, some or all of such adversely affected countries too may decide to impose retaliatory tariffs on the goods they buy from the particular country that started it all. This probably may lead to escalation of mutual tariffs or tariff wars, until all parties eventually reason together at a trade negotiation 'round-table' to agree to remove or reduce the tariffs.
- ix) A change in income distribution pattern: Import duty by encouraging domestic production of the goods whose importation is reduced as a result of the duty, would enhance incomes accruing to the factors of

production used in producing such goods locally. By this, income distribution pattern would move in favour of the owners of such factors of production. For example, if the duty is introduced or increased on food imports, income distribution would move in favour of domestic farmers.

- x) A tool for settling political score: Tariffs may be imposed on goods emanating from countries perceived to be unfriendly.

7.13 Tools or instruments of trade restriction, and export promotion

7.13.1 Nature of, and rationale for, trade restriction

Trade restriction refers to the imposition of constraints in one form or another on free flow of trade between the country that imposes it and other countries or, sometimes, another country. Trade restriction sometimes refers to the restriction of exports, particularly if the export items are considered to be essential for the country and enough of them are not yet being produced to meet domestic needs. But in most cases, trade restrictions pertain to just imports. This is because of the prevailing perception and sentiment that, when goods are sold abroad or exported, it is beneficial to the exporting country while the reverse is the case for the importing country. So, our focus below will be more on the tools for import restriction.

As has just been pointed out concerning the reasons for restricting exports, it is just to ensure availability of the essential goods (especially, food items) for domestic use, especially if their export would lead to a high rise in their prices far beyond the reach of vulnerable or low-income buyers. While this may be against the interest of domestic producers, it favours the domestic users or consumers. A second reason is to disallow export of commodities that are considered to be against the cherished social values and norms of the society to export. Examples are artifacts and antiquities and wildlife animals classified as endangered species that are in the export

prohibition list in Nigeria. Another possible reason is to settle a political score. Exports to unfriendly countries may make such a country uncomfortable and thereby cause disaffection of the people against the government of the country. The disaffection may precipitate factors that may lead to an eventual removal of that government. For instance, there was once a suggestion in Nigeria that the government should restrict crude petroleum export to some countries that were then perceived as not being friendly with Nigerian government.

In case of import restriction, the reasons are many and the main ones have already been discussed above in connection with the reasons for imposition of import tariffs.

7.13.2 Tools for import restriction

There are many instruments or tools for preventing a free flow of imports into the country. The main ones are discussed below.

- i) **Import tariff:** This has already been discussed on page 100 under 7.12.2: Reasons why tariffs may be imposed.
- ii) **Quota or quantitative restriction:** This occurs when there is an upper limit to the quantity that can be imported of a particular good. For example a regulation that not more than 5,000 cars of a particular brand can be brought into the country is a form of import quota. The quota can be general (by applying to the import of that good from the rest of the world) or it can apply to only a particular importing country or group of countries (e.g., only European countries). To implement the quota, the government normally gives import licences to importers, specifying the maximum unit of the good each importer is permitted to import so as to make sure all importers combined would not be able to import more than the quota.
- iii) **Embargo:** This refers to an outright ban on the importation of a good. It is a special case of the quota, as the quota now is simply zero! Obviously, illegal products (e.g., narcotics) are normally embargoed in any country of the world. But it is not only illegal products that can be embargoed. There are other reasons, beside illegality, for this as discussed under the reasons for tariff imposition (except revenue generation



Fig. 7.4 Customs men at a border

to the government that is obviously not applicable here).

- iv) **Qualitative barriers:** These refer to various impediments and inhibitions that are put in place regarding the quality attributes and specification that some goods must possess for them to be permitted to be imported into the country. This is sometimes to protect the consumers of the imported goods and this is often the stated objective of imposing the qualitative restrictions. But in most cases, the actual objective is simply to discourage importation of the products as not many foreign suppliers would find it feasible or cost effective to meet such a restrictive set of quality attributes.
- v) **Exchange rate depreciation:** A reduction in the value of the domestic currency vis-à-vis foreign currencies (i.e., depreciation or devaluation of the currency), by making imports to be more costly, would restrict or reduce the volume of imports.
- vi) **Bilateral trade agreements:** As explained earlier, counter trade (which is just a euphemism for trade by barter) and other forms of bilateral trade agreements restrict importation by requiring the exporting countries to import from the country equivalent values of goods and services. It requires some sort of double coincidence of wants for importers from the country to locate foreign suppliers that would simultaneously be interested in becoming a customer.
- vii) **Subsidy to domestic producers:** If the government subsidises domestic producers of the goods that are also being imported, it would give domestic producers a cost advantage that would make them out-compete foreign suppliers in the domestic market. By this, the volume of import of the goods will be reduced and, arguably, restricted.
- viii) **Domestic propaganda appealing to patriotic sentiments:** Sometimes, a country may mount propaganda that appeal to the patriotic sentiment to patronise domestically produced goods, instead of imported equivalents.

7.13.3 Tools for export restriction

As it is not very common to restrict exports, fewer instruments or tools have been used. Such instruments are as discussed below.

- i) **Export tariff:** Tariff or export duty (also called export tax) can similarly be imposed on exports. So technically, tariffs too can apply to export, although, if not explicitly qualified as export tariff, the word tariff is normally understood to refer to only import tariff.
- ii) **Export quota:** This refers to quantitative restriction whereby only certain quantity of the goods can be exported.
- iii) **Embargo:** This refers to outright ban on exportation. In Nigeria, goods like maize, timber, raw hides and skin, scrap metals, unprocessed rubber latex, artifacts and antiquities, and wildlife animals classified as endangered species, are in the export prohibition list or embargo.
- iv) **Qualitative barriers:** This refers to specifying the quality attributes that goods have to meet before they can be exported from the country, as NAFDAC currently does in respect of foods and drugs for export.
- v) **Exchange rate appreciation or revaluation:** An appreciation or revaluation of the domestic currency in terms of foreign currencies is a disincentive to exports as the worth of a given quantum of foreign currency receipts would be reduced when converted into the domestic currency.
- vi) **Taxation on domestic producer:** Taxation of activities of domestic producers of export goods would reduce the incentive to produce and export the goods.

7.13.4 Tools for export promotion

While it is unusual for imports to be encouraged, countries try to encourage exports so as to earn foreign exchange and generate balance of payments surplus, increase domestic income and generate employment for the people. Main tools

or instruments of export promotion are discussed below.

i) Tax concessions: Tax exemptions and concessions are often given to export industries and activities, as an incentive to produce more. It is a form of what is called fiscal incentives. For instance, in Nigeria, there is what is called Manufacture-in-Bond Scheme (MIBS) under which manufacturers of non-oil export commodities are entitled to import duty-free raw materials and intermediate inputs, whether prohibited or not, for the production of goods for export. This is the revised equivalent of what used to be referred to as import duty drawback arrangement. (Customs drawback refers to a refund of a duty paid on imported merchandise at the time of re-exportation, whether the exported goods have the same form or a different form vis-à-vis the form at the time of import. An in-bond industry, on the other hand, is defined as an industry which specialises in the processing of imported raw materials and components that are allowed to enter the country free of duty, provided that they will be re-exported).

Instead of collecting the incentive in form of cash, the manufacturer can collect (presumably, on a faster basis than outright cash) what is called the Negotiable Duty Credit Certificate (NDCC), the face value of which would equal the cash payment. This NDCC can be used for the benefit of the owner or be negotiated with interested parties on mutually agreed terms.

ii) Grants, subsidies and loans: This is another form of fiscal incentive. Under this, the government gives grants or subsidies to export industries to assist them. Credit facilities are also sometimes provided on much more concessionary terms (in terms of interest rates, maturity, collateral requirements, etc), when compared with loans from banks. It may also facilitate access to bank loans by guaranteeing such loans, thereby making it unnecessary for the lending bank to insist on loan collateral. For instance, in Nigeria, there is what is called Export Expansion Grant (EEG) whereby the Federal Government gives grants to non-oil

exporting industries, graduated according to the nature of the industries and the extent to which they are dependent on local material input and generate local employment. Also, the Federal Government-owned Nigerian Export-Import (NEXIM) Bank maintains a foreign exchange revolving fund for lending to exporters who need to import input to facilitate export production.

iii) Underwriting of risks associated with exports: Because exporters operate in less familiar grounds of foreign countries, they face certain peculiar risks, including the risks of non-payment by foreign customers. Thus, governments all over the world underwrite or guarantee some types of such risks. For instance, the Federal Government-owned NEXIM Bank provides credit guarantee or insurance against political and commercial risks in the event of default by foreign buyers of Nigerian non-oil exports.

iv) Provision of information on export potential and opportunities: The government often enlightens industrialists and entrepreneurs on the opportunities and potential that exist in exporting certain products to specific countries. It also organises seminars and workshops to enlighten exporters on new developments in certain foreign markets.

v) Export development: The government often assist exporters to enhance the quality of their products to make them meet international standards and thereby competitive, quality wise, in world markets. In this context, the Nigerian Export Promotion Council (NEPC) advises manufacturers on packaging, product design and adaptation, quality standards, suitable strategies (including sales promotion and publicity strategies) to adopt to penetrate target export markets, and pricing and costing for exports.

vi) Infrastructural development: The government assists export industries by improving on the infrastructures (like power supply, transport networks, water supply, availability of industrial estates) for such industries. However, because it may be difficult to target only export industries and that provision for the entire economy may overstretch the capability of the government, the government often creates an enclave for

export industries, called Export Processing Zone, as discussed below, where such things can be provided exclusively for export activities alone.

- vii) Diplomatic measures, including bilateral and multilateral trade negotiations: The government promotes export by entering into bilateral trade agreements with several countries. Whenever the president or top leader of a country goes on an official trip abroad to meet his counterparts, trade negotiation is normally a key item in the agenda for discussion. Also, a key responsibility of a country's embassies in other countries is to explore export opportunities there and such embassies are supposed to organise trade exhibitions and trade fairs to market the country's products in those countries. At the multilateral level, each country tries to bargain, lobby and canvass for multilateral agreements that are most favourable to its exporters. Such multilateral fora include the World Trade Organisation (WTO), among others.
- viii) Belonging to trading blocs, like a customs union: Membership of a trading bloc like a Customs Union (e.g., ECOWAS) is to enable each member-country to enjoy the privilege of free access of its exports to all other member-countries, while non-member-countries' access are restricted by tariff and non-tariff barriers.
- ix) Conducive exchange rate policy that does not lead to over-valuation of domestic currency: Depreciation or devaluation of the value of the domestic currency makes the country's export to be competitive in the world markets and thereby promote exports. Over-valuation (i.e., appreciation or insufficient depreciation) of the domestic currency has the opposite effect of making exports to be uncompetitive and reducing them.
- x) Permission of retention by exporters of foreign currency receipts: Requiring exporters to surrender their export earnings (in exchange for local currency equivalents that are often converted at exchange rates that are disadvantageous to the exporters) to the central bank is a disincentive to exporters while permitting them to hold on

to the proceeds is an incentive. In Nigeria, exporters are allowed to open domiciliary (i.e., foreign currency-denominated, as opposed to Naira-denominated) accounts with commercial banks to enable them to retain export proceeds and use them as they deem fit.

- xi) Establishment of export processing zone (EPZ): An EPZ is an enclave earmarked exclusively for export industries and activities to enable the government provide amenities, facilities, concessions and other indulgencies to such industries in an exclusive manner. Many countries provide EPZs. In Nigeria, there are also EPZs (e.g., Onne Free Zone) where Nigerian taxes, levies and foreign exchange regulations will not apply; repatriation of foreign investment as well as foreign remittance of dividends earned by foreign investors are exempt from extant government regulations; no import or export licences are required; enterprises there are not required to comply with expatriate quota regulations in employing foreign staff and members of the management; and foreign investors' 100% ownership of enterprises there is allowed. Thus, the EPZ serves not only to promote exports, it also attracts foreign investment to the Zones.

7.14 Functions of selected government agencies involved in Nigerian foreign trade

7.14.1 Nigerian Customs Service (NCS)

The Customs & Excise Management Act (CEMA) Cap 45, Law of the Federation of Nigeria, 2004 vests legal authority in the Nigerian Customs Service (NCS) to act on behalf of the Federal Government of Nigeria in all customs matters, which are as follows:

- i) Control and management of the administration of the customs and excise laws in general.
- ii) Collection of revenues of customs and

- excise and accounting for same to the government.
- iii) Enforcement of import and export restriction and prohibition. This includes carrying out anti-smuggling operations at the ports and borders in order to forestall importation and exportation of contrabands and goods injurious to the health and security of the country. In particular, Customs supports the combat of: infraction to intellectual property rights; illegal commercial activities and illicit goods (e.g., import of fake and sub-standard goods); traffic in illicit drugs; illegal trade in arms and ammunitions; importation of pornographic materials; money laundering; and illegal trade in cultural artifacts and heritage.
 - iv) Provision of useful inter-agency cooperation with other agencies of government such as the Nigeria Police, NDLEA, NAFDAC, and SON.
 - v) Trade facilitation.
 - vi) Handling trade procedures and documentation. In this regard, it collects accurate import and export data for economic statistical usage and planning.
 - vii) Engaging in research, planning and enforcement of revenue generation policies of the Government.

7.14.2 Nigerian Export Promotion Council (NEPC)

The Nigerian Export Promotion Council (NEPC) was established through the Nigerian Export Promotion Decree No. 26 of 1976. It was set up with the following mandate:

- a) To promote the development and diversification of Nigeria's export trade.
- b) To assist in promoting the development of export-related industries in Nigeria.
- c) To spearhead the creation of appropriate export incentives.
- d) To articulate and promote the implementation of export policies and programmes of the Nigerian government.

The NEPC implements its mandate by performing the following four broad functions:

- i) Export development: The NEPC seeks to diversify the export base of the economy by identifying potential products for development for export. It also advises exporters on:
 - a) packaging, product design and adaptation.
 - b) quality standards.
 - c) appropriate strategy to adopt to penetrate target markets.
 - d) pricing and costing for export.

In addition, it assists companies financially to undertake market research and to undertake suitable publicity in target markets. It also plans and organises Nigeria's participation in international fairs and exhibitions.

- ii) Export financing and incentives: The NEPC facilitates effective administration and prompt payment of incentives to qualified exporters, in addition to reviewing existing incentives and articulating new ones.
- iii) Capacity development of export activity operators: It organises general seminars and workshops to enlighten exporters on new development as well as export fora to discuss latest developments in the export sector. It also undertakes demand-driven enterprise-level training for the staff of export industries.
- iv) Coordination of and cooperation with multilateral institutions: It cooperates with trade promotion organisations of other countries and also liaises with multilateral trade organisations like the International Trade Centre (ITC), World Bank and the United Nations Development Programme (UNDP) for the purpose of maximising the benefits accruable to Nigeria on trade matters.

7.14.3 Nigerian Export-Import Bank (NEXIM)

The Nigerian Export-Import Bank (NEXIM) was established by Act 38 of 1991 as an export credit agency, whose share capital is jointly owned by the Federal Government of Nigeria and the Central Bank of Nigeria. The Bank, which replaced the Nigerian Export Credit Guarantee & Insurance Corporation earlier set up under Act 15 of 1988,

has the following main statutory functions:

- i) Provision of export credit guarantee and export credit insurance facilities to its clients. Accordingly, the Bank provides credit insurance against political and commercial risks in the event of non-payment by foreign buyers. The Bank is also the government's national guarantor under the ECOWAS inter-state road transit programme.
- ii) Provision of credit in local currency to its clients in support of exports. In this regard, the Bank provides short- and medium-term loans to Nigerian exporters. It also provides short-term guarantees for loans granted by Nigerian banks to exporters, so as to encourage banks to lend to exporters without demand for collaterals since NEXIM Bank's guarantee is as good as any collateral.
- iii) Establishment and management of funds connected with exports.
- iv) Maintenance of a foreign exchange revolving fund for lending to exporters who need to import foreign inputs to facilitate export production.
- v) Maintenance of a trade information system in support of export business.
- vi) Provision of domestic credit insurance where such a facility is likely to assist exports.

7.14.4 Federal Airports Authority of Nigeria (FAAN)

The Federal Airports Authority of Nigeria (FAAN), which replaced the Nigerian Airports Authority, was created by the FAAN Act of 1996. It was entrusted with certain statutory functions which include the following:

- i) Development, provision and maintenance of necessary services and facilities for air transport.
- ii) Provision of adequate conditions under which passengers and goods may be carried by air and under which aircraft may be used for other gainful purposes.
- iii) Provision of accommodation and other facilities for the effective handling of passengers and freight.

- iv) Development and provision of facilities for surface transportation within airports.
- v) Carrying out at the airports, either directly or indirectly through some agents, economic and commercial activities, whether or not such activities are relevant to air transport.
- vi) Provision of adequate facilities and personnel for effective security at all airports.
- vii) Creating, in a general sense, conditions for the development of air transport and services connected with it.

7.14.5 Nigerian Ports Authority (NPA)

The Nigerian Ports Authority was charged with the following statutory duties and functions:

- i) Development, ownership and operation of ports and harbours.
- ii) Provision of safe and navigable channels.
- iii) Offering of cargo handling and storage services.
- iv) Maintenance of port facilities and equipment.
- v) Ensuring safety and security.
- vi) Development and ownership of property.

However, some of the above functions have since been ceded to the private sector under a public-private partnership agreement. Those ceded to the private sector are cargo handling, stevedoring, warehousing and delivery, acquisition of cargo handling and operations-related equipment, development and maintenance of ports' superstructure, and maintenance of safety and security within the terminal. But despite ceding some functions to the private sector, the NPA is still responsible for service delivery in such areas.

Revision questions

Essay questions

- 1 An erstwhile domestic trader has just ventured into foreign trade. Outline the barriers which the trader is likely to encounter.

- 2 What advantages does Nigeria derive from international trade?
- 3 What measures can a country embark upon in order to correct a deficit balance of payments.
- 4 With respect to foreign trade, explain the role of the following documents:
 - a) Consular invoice
 - b) Certificate of marine insurance
 - c) Certificate of origin
- 5 What is a bill of lading? Discuss the contents, purpose and mechanism of operation of the bill of lading. Distinguish between a 'clean' bill of lading and a 'dirty' bill of lading.
- 6 Write brief notes on the following:
 - a) Mate's receipt
 - b) Air consignment note
- 7 What is the major difference between a bill of lading and charterparty?
- 8 Discuss the following
 - a) Telegraphic transfer
 - b) Mail transfers
 - c) Banker's draft
- 9 Explain the term 'balance of trade.' What is the difference between balance of trade and balance of payments?
- 10 Presented below is the balance of payments of a country for a given year:

Figures in millions of domestic currency

	Credit (Cr)	Debit (Dr)
Merchandise	950	820
Shipping, travel, Insurance, etc	122	400
Investment incomes	78	250
Other factor incomes	40	60
Unrequited transfers	84	96
Long-term capital	210	180
Short-term capital	55	52

You are required to calculate the balances in each of the following accounts and indicate whether they are in surplus or in deficit:

- a) Merchandise account
- b) Services account
- c) Unrequited transfers
- d) Current account
- e) Capital account
- f) Overall balance of payments account

Objective questions

- 1 Which of the following is not true of bilateral trade?
 - A It is trade between two countries.
 - B It is normally a product of bilateral agreement.
 - C It normally involves the use of foreign currency.
 - D A and B.
 - E All of the above.
- 2 Any person intending to import into Nigeria shall first process the Form M and submit it to the Central Bank through his commercial bank together with the
 - A bill of lading.
 - B commercial invoice.
 - C proforma invoice.
 - D air waybill.
 - E sea waybill.
- 3 Documents to accompany imports into Nigeria under the Designation Inspection arrangement does not include
 - A Combined Certificate of Value and Origin (CCVO).
 - B Packing List.
 - C Shipped (clean on board) bill of lading or waybill.
 - D Form M.
 - E C and D.
- 4 Which of the following is not a normal reason for imposing import tariff?
 - A Revenue generation for the government
 - B Reduction of domestic inflation
 - C Protection of domestic economic activities against foreign competition
 - D Discouragement of import of undesirable goods
 - E Retaliation against tariff imposition by trading partners
- 5 Which of the following is *not* a function of the Nigerian Export Promotion Council?
 - A Export development
 - B Export financing and provision of export incentives

- C Capacity development of export activity operators
- D Provision of technical advice to Nigerian exporters
- E Prevention of importation of illegal goods into Nigeria

Chapter 8

Commodity exchange

8.1 Meaning of commodity exchange

A commodity exchange is an organisation that provides arrangements and facilities for buying and selling of tradable commodities. The arrangements and facilities include:

- i) physical infrastructures like the trading floors, support facilities such as phones and price-reporting and dissemination systems, etc;
- ii) electronic networking arrangements that enable remote electronic trading to take place;
- iii) organisational framework for human networking arrangements that enable commodity traders, warehouse keepers, clearing house members, etc to coordinate and get in touch with each other for carrying out commodity trading; and
- iv) an elaborate set of rules, regulations, by-laws, etc that guide and facilitate commodity trading in an organised manner, including orderly pricing, grading, measurement, standardisation, warehousing, clearing and delivery of traded commodities.

The exchange does not determine the price or trade in commodities for itself.

8.2 Meaning, attributes and types of commodity

8.2.1 Meaning of commodity

In Economics, commodity refers to goods and services. But here, the meaning is different. It now means those things that can be traded in a commodity exchange. It refers to raw or unprocessed physical goods that are homogeneous

and, hence, can be easily standardised. Such goods, traditionally, have been agricultural or farm produce (maize, rice, soya beans, meat, etc), crude metals or metallic minerals, and crude petroleum and gas. It also includes contracts or financial instruments, called *derivatives*, in the form of futures, options and swaps. The values of derivatives, in turn, derive from the values of the underlying commodities (farm produce, crude metals, crude petroleum products, etc) as well as foreign currencies (like dollars or Euro), debts, and equity indices (like All Share Index of Nigerian Stock Exchange).

The definition of commodity here excludes services because they are not normally tradable in an exchange. It also excludes most types of physical goods, especially processed or manufactured goods, simply because they cannot be traded in an exchange. But it includes financial instruments or contracts (called derivatives), which are obviously not commodities in pure economics parlance.

8.2.2 Attributes of a tradable commodity

For anything to be tradable and, hence, listed in a commodity exchange, it must have certain attributes. It is non-possession of such attributes that excludes commodities like services and processed or manufactured goods in the definition while the possession of the attributes explains inclusion of derivatives in the definition. Notable among such attributes are the following:

- i) Homogeneity: The item to be traded must be homogeneous, a quality that is indispensable to standardisation. By this, the exact qualities of the items can be defined on paper to such an extent that an intending buyer would not find physical inspection necessary before entering into an agreement to buy. The identity of the producer can affect the quality of a product or, even if it does

not affect the product's intrinsic quality, it can affect it due to various measures that differentiate products in the eyes of the buyers through packaging, branding, etc. Manufactured products therefore do not meet this condition. That is why wheat is a tradable commodity, but not flour; cassava of a specified variety should be tradable, but not cassava grains (called gari) made from the same variety, etc.

- ii) Long shelf-life: Perishable items must have adequate shelf-life. This is because delivery (i.e., physical transfer of goods to the buyer) on a futures contract takes some time and the items should not deteriorate or perish during such an interval of time.
- iii) Price fluctuation: The price of the item in question must fluctuate enough so as to create an incentive for it to be traded. The whole essence of trading in a commodity is for the hedgers to protect themselves against price fluctuation and for speculators to gamble on prices. This means that the need for commodity trading would not arise if the price is naturally (and anticipated to be) perfectly stable.

8.2.3 Types of tradable assets or commodities

In view of the above tradability requirements and the definition of a commodity, the list of categories of commodity and assets that are tradable, and have been traded, in the commodity exchange includes the following:

- i) Unprocessed agricultural produce like grains, fibre, cassava, livestock, meat, etc.
- ii) Energies, particularly crude petroleum oil and gas.
- iii) Solid minerals, especially basic metals like gold, zinc, silver, platinum, iron, etc.
- iv) Foreign currencies like US\$, British £, and Euro.
- v) Equity securities, like individual shares.
- vi) Interest rates and stock indices (e.g., AllShare Index of the Nigerian Stock Exchange).
- vii) Bonds and other debt instruments – particularly those issued by the central government, including money market instruments like the treasury bills.

In a narrow sense, it is only items (i) to (iii) above that are referred to as commodities. But a broad concept or definition of commodity would include all the items (i) to (vii). These are illustrated in Figure 8.1.

8.2.4 Tangible and intangible commodities or assets

Sometimes a distinction is made between tangible and intangible assets. Tangible assets are those belonging to categories (i) to (iii) above, i.e., the narrow definition of *commodities*. The intangible ones, on the other hand, are those belonging to categories (iv) to (vii) above, namely foreign currencies, stock indices, shares as well as bonds and other debt instruments. Unlike tangible commodities, they are financial instruments that do not have direct utility or benefits until they are exchanged into goods and services.

As will be explained later, tangible commodities can be transformed into intangible ones through commodity market contracts like forward, futures and options contracts – through which the tangible commodities now only become the underlying assets of the contract. This means that it is these contracts that would now be traded in the commodity exchange and not the underlying tangible commodities they represent and derive their values from. Conversely, intangible assets too can be transformed into tangible ones, as when buyers of the forward, futures or options contracts (intangible) take delivery of the underlying commodities when the contracts expire.

8.3 Evolution, organisation and regulation of commodity trading and exchange

8.3.1 History of commodity exchange

Globally, the evolution of modern commodity exchange (particularly, forward and futures

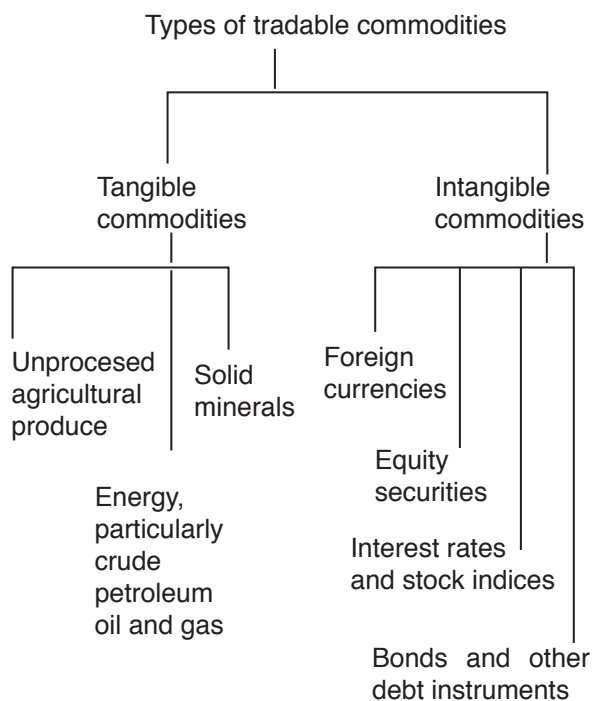


Fig. 8.1 Types of tradable commodities

contracts) can be traced to the 1840s, when the Chicago Exchange (called Chicago Board of Trade) in the US started. Commodity exchange has since spread worldwide.

In Nigeria, while anybody or group of persons (with a capital of N0.5 million) can apply to the Securities and Exchange Commission (SEC) for a licence to set up a commodity exchange, the only commodity exchange so far is the Abuja Securities and Commodity Exchange (ASCE) PLC, which was incorporated as a stock exchange (i.e., Abuja Stock Exchange, ASE) in 1998 as a public limited liability company owned jointly by the Federal Government and private sector stakeholders (like commodity brokers, etc). It already started electronic trading in securities in May 2001. But the Nigerian Stock Exchange (NSE), not wanting a competitor or rival securities exchange, protested to the Government against proliferation of stock exchanges. This led the Government to change ASE to a securities and commodity exchange, thereby diversifying the scope of its mandate to include commodity trading. Since then, it has focused on only commodity trading, leaving securities trading to only the Nigerian Stock Exchange (NSE).

The conversion to a commodity exchange, in

addition to the protest by the NSE, was based on the government's desire to provide an alternative arrangement to manage the effects of fluctuations in agricultural produce prices on the farmers, following the abolition in 1986 of commodity board arrangement that used to stabilise produce prices.

The ASCE was designed to start only spot trading. It plans to evolve through inclusion of forward trading, then futures trading and finally options trade.

8.3.2 Organisation of a commodity exchange

A modern commodity exchange typically has a hierarchy of authority comprising a board, a council, a number of standing committees to be constituted by the board, and a chief executive officer (CEO) to be appointed by and reporting to the Board.

The ASCE is not an exception in this regard. Specifically, it has a board of directors, constituted by the Federal Government, which determines broad policy matters. In this regard, is responsible for organising, maintaining, controlling, managing, regulating and facilitating the operations of the exchange and of transactions in contracts by the members of the exchange. It appoints a council to which it delegates operating, market-related decisions and the membership of which includes representatives of various commodity exchange players and stakeholders like commodity brokers, warehouse keepers and clearing banks. In this regard, the council is vested with the power to manage the business affairs of the exchange and the establishment and administration of the policies of the exchange. The council, in turn, operates through four standing committees as follows:

- i) Membership and Finance Committee that is responsible for applications and applicants for membership.
- ii) Clearing House Committee that sees to the manner in which contracts in commodities are cleared, registered and settled by the Clearing House.
- iii) Trading Committee that oversees rules and regulations governing conduct of trade on the exchange.



Fig. 8.2 Abuja Securities and Commodity Exchange Commission

- iv) Arbitration and Vigilance Committee that is in charge of issues on which there are disputes among/between different parties.

Finally, there is a Federal Government-appointed managing director, who is the chief executive officer and is therefore responsible for the day-to-day running of the exchange.

8.3.3 Regulatory authority of a commodity exchange

The ASCE is a self-regulatory organisation (SRO) in the sense that, on its own, it establishes rules and regulations for the purpose of regulating trading in the exchange. Nevertheless, it still has to be regulated by relevant government agencies. Accordingly, it is put under the broad supervisory authority of the Ministry of Commerce, to which it reports on administrative matters. But the effective regulation of operating or professional aspect of its work is from the Securities and Exchange Commission (SEC) which, in turn, has the Federal Ministry of Finance as its supervising ministry.

8.4 Major players in a commodity exchange

8.4.1 Commodity market operators and members

Membership of an exchange entitles the members to certain privileges that facilitate carrying out trades. However, membership is not required to buy or sell through commodity brokers, as any merchant, farmer, speculator, etc (whether a member or not) can get this done through their respective commodity brokers.

In the case of the ASCE, it has three categories of members, as follows:

- i) Ordinary members: Individuals or corporate citizens can, on application, be registered under this category. Members in this category have all rights and privileges of other types of members except that they cannot trade directly on the exchange but have to go through ordinary trading members (as their commodity brokers), in order to trade. In other words, they are not eligible to be commodity brokers. This category of membership would suit speculators.

- ii) Ordinary trading members: Those registered as ordinary trading members can trade on their own accounts, i.e., they do not have to go through any other commodity broker if they want to trade for themselves. They can also trade on the accounts of their clients, meaning that they can act as commodity brokers to those who want to buy or sell through the exchange. They are, in effect, the commodity brokers. Only stockbroking or commodity broking firms, with qualified professionals in top positions of their firms, are qualified to apply for this category of membership.
- iii) Institutional trading members: Those registered as institutional trading members can trade on their own account only. They cannot execute trade for other members or customers and clients that are not members. Such members are typically financial institutions, merchants and processors (e.g., flour mills, food processing companies and oil mills) and merchants who want to use commodity trading for hedging, instead of speculation.

8.4.2 Commodity brokerage firms, floor brokers and floor traders

A commodity broker or brokerage firm is an individual or firm that is licensed by a commodity exchange to buy and sell in the exchange on his or its own account or on behalf of his or its clients (also called customers or constituents) for a fee called commission. Thus, they can initiate trades (i.e. trade on own account) and solicit trades from their constituents – customers or clients with whom they have constituent agreements in return for the commission they get from the customers. In effect, they are equivalent to the ones referred to above as the ordinary trading members. The more popular name is commodity broker, commodity brokerage house or commodity brokerage firm.

Under the open outcry method of trading, as opposed to electronic trading (both of which are fully explained later), a distinction is sometimes made between a commodity broker and a floor broker. A floor broker serves as a 'broker' to the

commodity brokers by buying and selling on the floor of the exchange on behalf of the commodity brokers, who are not eligible to trade on the floor of the exchange. In other words, commodity brokers can execute trades for their customers only by going through the floor brokers, who are the ones to actually execute the trade. But the exchange rules do not allow floor brokers to take customer orders or solicit trade from the public – they can only take orders from commodity brokers.

Also, under this same open outcry method, a distinction is sometimes made between floor brokers and (independent) floor traders. While a floor broker executes trade on the floor of exchange for clients of commodity broking houses (and, sometimes, on his own account also), an independent commodity trader (sometimes called locals) too executes trade on the floor of exchange but only on his own account – not for anybody else.

In principle, neither floor brokers nor independent floor traders exist under electronic trading system, as trading floors are not used in the first place. Brokerage firms would be able to execute orders for their clients directly through the computer terminals in the manner described later. In the same manner, most services of brokerage firms themselves could, in principle, be dispensed with as buyers and sellers are able to trade online in commodities, without the need to go through brokers, in the manner discussed later.

8.4.3 Other operators or intermediaries in the commodity exchange

There are other players or operators in the commodity exchange, notable among which are:

- i) Warehouse and warehouse keepers: As discussed in greater detail later, commodities to be sold may first have to be deposited with the warehouse keeper for custody under a spot contract or (in the forward, futures or options contract) just prior to expiration of the contract. The warehouse keeper would put the commodities in the warehouse and issue warehouse receipts as evidence of his

custody of the commodities. The ASCE, in line with good practices in the commodity exchanges in other countries, has accredited a number of warehouses and warehouse keepers for this purpose. In addition, it has registered or *accredited assayers* to be in charge of other warehouses that it has not accredited and where commodities to be traded can also be deposited. (To assay means to examine and determine quality and quantity of a product as to weight, measure, grade, etc.)

ii) Clearing house and clearing house members: As also discussed later in greater detail, the clearing house is a facility for clearing, registering and settling payments in respect of traded commodities. Those who formally register as members under this arrangement are the clearing house members. In the ASCE, a Department there constitutes the clearing house while ordinary trading members and institutional trading members are eligible to be members.

Types of members of commodity exchange

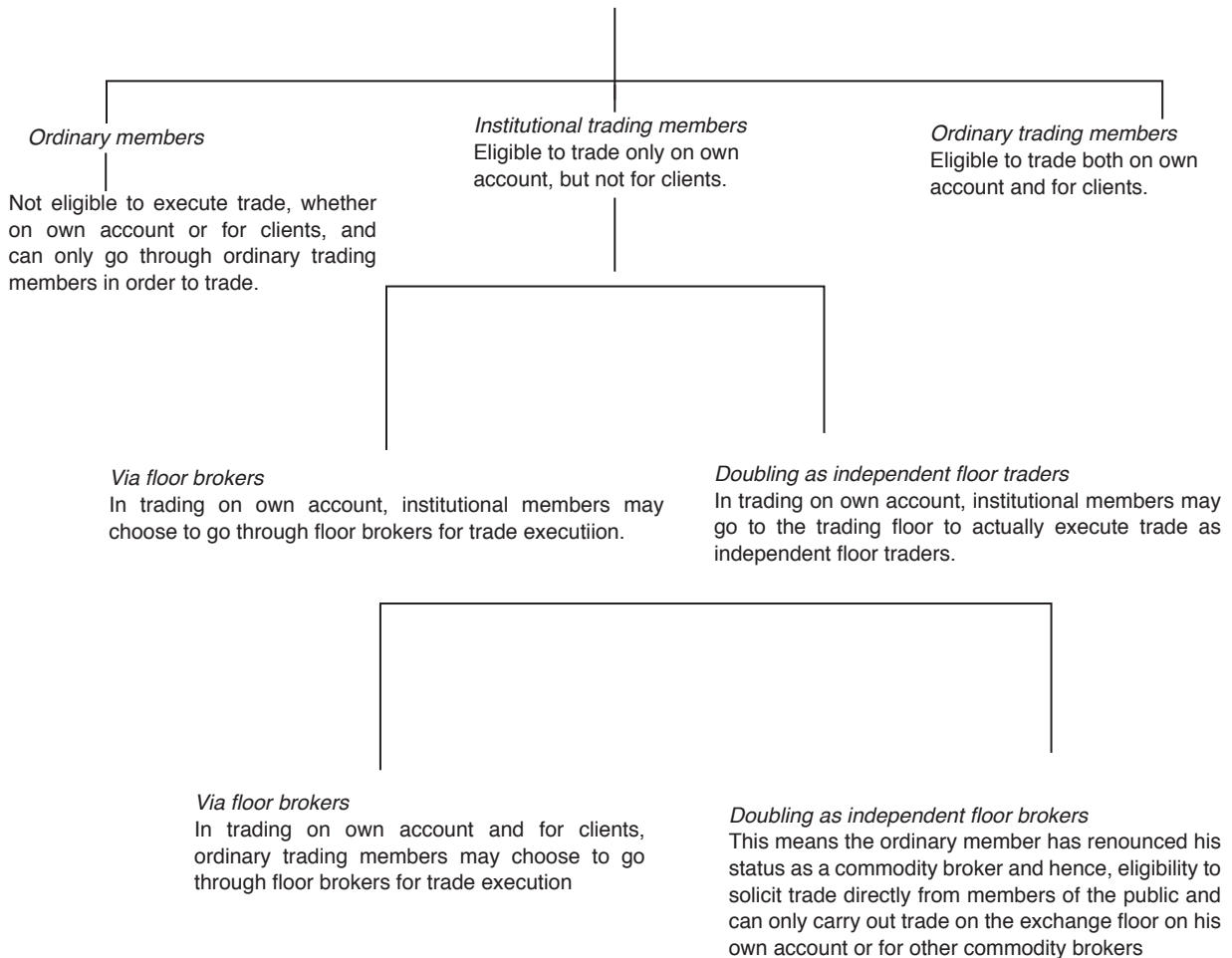


Fig. 8.3 Categories of a commodity exchange membership

8.4.4 Buyers and sellers in a commodity exchange: Long and short positions

In the spot segment of the market, the sellers and buyers (i.e., traders) are broadly similar to what we have in a conventional market. This is because a conventional market is also a spot market, except that it is less organised. Traders choose to patronise the exchange due to other advantages, like standardisation and elaborate rules and regulation, which the exchange offers. But in the forward, futures and options segments, there are additional benefits to be derived and these have given rise to the categories of sellers and buyers that can be identified as follows:

- i) Sellers: Technically, these are said to be taking a *short* position. There are two broad categories of sellers or short position takers. The first category comprises farmers or farm produce merchants as well as merchants of solid minerals and energy products, who want to hedge against possible fall in the raw materials prices before the goods are harvested or extracted from the ground and, hence, are available for delivery to buyers. The other main category comprises speculators, who anticipate that future prices would be lower than the current market prices at which they can sell now and thereby decide to sell now, with the possibility of buying back the commodity at the lower prices and thereby make a profit by so doing. Speculators are the ones assuming the risks that hedgers run away from.
- ii) Buyers: Technically, these are said to be taking a *long* position. Here too, there are two broad categories of long position takers. The first consists of processors of agricultural and other raw materials, who want to hedge against possible increase in the raw materials prices before the time they are to be bought from the market. The second category consists of speculators, who anticipate that future prices would be higher than the current market prices at

which they can buy now and thereby decide to buy now, with the possibility of re-selling the commodity at higher prices and thereby make a profit by so doing. They assume the risks that hedgers run away from.

8.4.5 Motives for trading in commodities: Hedging, speculating and arbitraging

There are two major motives for trading, these being hedging and speculation. To this, one can add a third, but relatively unimportant, motive of arbitraging. Those traders with the motive of hedging are called *hedgers*; those with speculating motive are referred to as *speculators*; while those having arbitraging motive are *arbitrageurs*. These are discussed further below.

- i) Hedging motive and the hedgers: Hedging refers to seeking protection or insurance against the risk of adverse future price movement in the commodity that one plans to either sell or buy. So, hedgers are risk averters. Producers of crude energies (petroleum oil and gas), miners of minerals and farmers who want to sell their products in the market in future would be concerned about the risk that the prices of their products may decline (or, more precisely, may be below what they ordinarily anticipate or expect them to be) then. This would be a disappointment to them. Of course, there is still the possibility of the future prices being higher than they anticipate, thereby producing a pleasant surprise. But as risk averters, they cherish less the possibility of a future pleasant surprise than they fear an equal possibility of a disappointment of the same magnitude. That is, they like certainty in the future prices that their commodities would fetch. This feature may therefore make them seek protection against the risk of disappointment in future price movement, despite the possibility of pleasant surprise in the price movement. So, such producers would prefer to sell their commodities at a ('reasonable' or 'fair') price that is fixed upfront, ahead of the delivery and payment

time. By this, they would be able to sleep well and avoid high blood pressure as well as face their farming or mining activities during the day.

In the same vein, processors or refiners of the crude products would be concerned about the risk that the prices of these raw materials they need for their factories may increase (or, more precisely, may be above their expectation) when they need them in future, thereby resulting in disappointment for them. They would, therefore, seek protection against such a risk by buying the raw commodities at a ('fair') price that is predetermined ahead of the delivery and payment date. This would give them price assurance, making them have rest of mind and focus on their normal processing or refining activities.

So, commodity market hedgers are those trading in the commodity market at predetermined prices for the motive of self-protection against the risk of future prices of the raw commodities they produce or own for future sale, or raw materials they would need in future for processing being unfavourable vis-à-vis their present expectation. So, it is the motive of trading that distinguishes hedgers from other traders.

- ii) Speculating motive and the speculators: Speculating refers to the risk-taking practice of trying to buy low and sell higher for profit. It has to do with guessing about future price movement so as to buy now if it is guessed that future price would be higher or sell now if it is felt or speculated that future price would fall, thereby making profit from the transaction if the guess happens to be correct, or sustain a loss if the guess is wrong. Speculating relates to gambling.

So, commodity market speculators are those trading in the commodity market at predetermined prices for the motive of gambling on or assuming the risk of future prices of the raw commodities they speculate on being unfavourable vis-à-vis what they guess them to be. Because they are generally sophisticated in the analysis of future market situation, they are likely to guess future market conditions more

correctly than other traders in the market and thereby outperform the market and make more profits than losses incurred through wrong guesses. Bulls or bullish speculators are those expecting prices to rise (i.e., are optimistic about future prices) while bear or bearish ones are those with pessimistic perception about futures prices. So, bullish speculators would buy now and sell in future, while bearish speculators would do the opposite – sell now and buy in future.

As compared with hedgers who are risk shy, speculators are inherently risk lovers. They often take positions that are opposite to those of the hedgers, so that they often constitute the counterparty of the trading contracts of the hedgers. That is, they often buy what the hedgers sell and sell what hedgers buy. By this, they often provide the insurance or risk underwriting that hedgers seek. Thus, in the *options contract* (as explained later), they are the ones that sell the options or risk underwriting while hedgers are the buyers of such options, in most cases. In addition to this role of insurance provision, they also provide liquidity in the market. In the absence of speculators, trades in many commodities would be too thin to be viable. Speculators do not need the underlying assets or commodities they buy, as they are not processors or refiners of such commodities. Their interest is just to sell them off as soon as the market offers such opportunity. So, when they buy derivatives (i.e., those contracts, like futures contracts, that derive their values from the underlying assets, as explained below), they normally do not wait till the expiration of the derivatives contract when they would be able to take delivery of the underlying assets before they close their *long* (i.e., buy) *position* through an offsetting sale of the derivatives. Similarly, they do not often have the underlying assets or commodities they sell, as they are not miners, farmers or produce merchants. Their interest is just to buy such commodities as soon as the market provides such opportunity to enable them to deliver what they earlier sold for a subsequent delivery. So, when

they sell derivatives, they normally do not wait till the expiration of the contract when they would have to deliver the underlying assets before they close their *short* (i.e., sell) *position* through an offsetting purchase of the derivatives. Thus, unlike hedgers, they do not often take a long (i.e., buy) or short (i.e., sell) position on a long-term or 'permanent' basis.

- iii) Arbitrating motive and the arbitrageurs: Arbitrating refers to movement of commodities from one market to another in a risk-free manner in order to take advantage of mis-pricing in both (or one of the) markets, until and as a result of which the mis-pricing becomes eliminated. Specifically, arbitrage entails buying of a commodity from the market where the price is low (thereby tending to raise the price there because of the increase in demand) and selling it where it is high (thereby depressing the price there due to increase in supply), until (and resulting in) equalisation of price in the two markets. Thus, arbitrage process is often transient and fleeting, as it would stop after the mis-pricing is corrected. Arbitrage can occur between markets that are spatially or geographically separated (e.g. Lagos and Ibadan markets) and this is what is called geographical arbitrage. It can also occur between the spot market and the market for the derivatives contracts (like futures contracts). Thus, if there is a mis-pricing between the futures contract and the commodity or asset underlying the contract, it is arbitrage process that would remove the mis-pricing, thereby equalising the prevailing market price of the futures contract with that of the spot price of the underlying asset.

Arbitrageurs do not assume any risk in their activities and neither do they try to insure against any risk. They are simply eliminating mis-pricing or discrepancies between markets. However, their importance is much less when compared with hedgers and speculators in driving the volume of activities in the market.

8.5 Spot, forward and derivatives segments of the market

It would be easier to follow subsequent explanation by first being able to differentiate between traded items called derivatives and those that are non-derivatives. A derivative is simply a contract, i.e. formal paper agreement, which is based on an underlying physical asset or commodity, whereby the value of the contract is always the same as the value of the underlying asset so that its value increases or falls as the value of the underlying asset too increases or falls. It is called a derivative because its value derives from (i.e., is based on) the value of the underlying asset. Because of this one-to-one linkage in its value with that of the underlying asset, it has been found convenient to be trading with third parties in such contracts or paper agreement instead of the original commodities or assets from which their values are derived, as this, among others, prevents the need for physical movements of commodities to and from the warehouse, transport costs, etc. Trading in it is done by entering into another (i.e., *second-layer*) contract based on the initial contract. This also means that the value of the second-layer contract would be the same as the value of the first contract and, by implication, the value of the original underlying commodity.

As an example, let us assume that on March 1, a speculator enters into a three-month futures contract (explained below) to buy 500 kg of maize from a farmer at a (futures) price of ₦50,000 per 500 kg. Due to various factors – political or economic – the futures price prevailing in the market for maize would be moving up or down, often on a daily basis (usually, in sympathy with the price of maize in the spot market). The speculator may actually not be interested in taking a physical delivery of maize, come June 1 (i.e., when the three-month contract would expire). He may therefore wish to sell off the maize, say, to a maize food processor or manufacturer before it is ready for delivery and this could be done simply by writing a second-layer contract based on the paper contract with the farmer. The value of this second-round contract would be the same as that of the first contract, which, in turn, would be the same as the ever-changing futures price of maize.

The new buyer would not need to see or inspect the maize physically because all the attributes of the maize (weight, colour, warehouse where it is located, June 1 date of delivery, etc) would have been specified in the contract document.

Obviously, derivatives would not be applicable to spot transactions since payment and delivery are supposed to be immediate, marking an end to such contracts. In respect of the forward contract, some regard it as a form of derivative because its value too derives from the physical commodities that underlie the contract. However, because it is not common or easy to trade in a forward contract because of its tailor-made or specific nature, some do not regard it as a form of derivative contract. For our purpose here, we rather treat it as being half-way between a derivative and a non-derivative contract. But there are three other contracts that are obviously derivatives and these are futures contract, options contract, and swaps contract. Thus, on the whole, we have five types of contract – *spot*, *forward*, *futures*, *options* and *swaps* contracts. All these are explained below.

8.5.1 Spot market

The spot market is the segment of the exchange for contracts for immediate payment (in cash or equivalent) and delivery (i.e., making the commodity available to the buyer). As a result of the immediate delivery, the contract is also sometimes referred to as ready delivery contract. Although in practice, the payment and delivery may be delayed by some days in order to sort out technical and logistic reasons in the exchange, this does not detract from the principle of immediate payment and delivery underlying the transaction. The spot contract is also effected at the spot price, which is the price prevailing (i.e., the conventional current market price) at the time the contract is made. It can thus be seen that most transactions are in the form of spot contracts, including those everyday transactions we are very familiar with outside a commodity exchange - purchase transactions through the supermarkets, department stores, etc. The only difference is that such transactions are not done through commodity exchanges.

8.5.2 Forward market

The forward market is the segment of the exchange for contracts that are made at a price agreed upon now but with payment and delivery shifted 'forward' till a later date, i.e., in future. The price agreed upon ahead of the payment and delivery date is called the forward price. This *forward* price may differ from the spot price at the time the forward contract is made, just as it may also differ from the spot price at the date of payment and delivery. Both the seller and the buyer of the forward contract are said to be *locked in* to the forward price agreed upon, making them to be certain of the price at which the payment and delivery would take place when the contract expires. For instance, a three-month forward contract can be entered into at a price mutually agreed upon by both parties on July 1, which would therefore expire on September 1, when payment and delivery would take place. Irrespective of the current market (i.e., spot) price prevailing on July 1 or September 1, the payment and delivery have to take place at the price earlier agreed upon as in the contract.

Thus, a commodity seller (say, a farmer) who enters into a short forward contract (contract to sell forward) that would expire during the harvesting period would know with certainty the price that the harvest would fetch when delivered, irrespective of the prevailing (spot) market price during the harvesting period. By this, the farmer would be 'insuring' or guaranteeing against an *unanticipated* fall in produce price. In the same manner, a food processor or manufacturer who enters into a *long forward contract* that would expire some time in the future (when the raw material would be needed in the factory) would know with certainty the price it will have to pay for the raw material when it is needed and thereby be able to plan ahead with minimum uncertainty. By this, the manufacturer would be 'insuring' or guaranteeing against any possible rise above anticipation or fall below expectation in raw material price at the future time when the raw material would be needed.

8.5.3 Futures contracts and how they differ from forward contracts

Like the forward market, a futures market is the segment of the exchange for contracts that are made at a price agreed upon now but with payment and delivery shifted 'forward' till a *future* date. The price agreed upon ahead of the payment and delivery date is called the *futures price*, which may differ from the spot price at the time the forward contract is made, just as it may also differ from the spot price at the date of payment and delivery. Both the seller and the buyer of the futures contract are said to be locked in to the futures price agreed upon, making them to be certain of the price at which the payment and delivery would take place when the contract expires. For instance, a three-month futures contract can be entered into at a price mutually agreed upon by both parties on July 1, which would therefore expire on September 1, when payment and delivery would take place. Irrespective of the current market (i.e., spot) price prevailing on July 1 or September 1, the payment and delivery have to take place at the price earlier agreed upon as in the contract.

So far, futures contracts have the same features as forward contracts, as we only need to substitute the word *future* for its synonym, *forward*. But the similarities end here, as they are different in many respects. The basis of their differences essentially arises from the fact that futures contracts are standardised (with a one-size-fits-all attribute) whereas forward contracts are flexible, tailor-made in nature, to suit the peculiar needs of buyers and sellers in the contract. From these basic differences stem a number of other differences that are identified in Table 8.1.

i) Contract size: As indicated in Table 8.1, one area of difference is in the contract size, which is standardised for futures contract (e.g., 500 kg of maize) while it is flexible in forward contracts – it is left for the counterparties (i.e., parties to the contract, which are the sellers and buyers) to mutually agree upon. This means that, for a seller that wants to sell, say, 700 kg of maize, he would find the futures contract somewhat inconvenient as

only 500 kg or multiples of 500 kg (like 1,000 kg, 1,500 kg, etc) can be traded there, and not a fraction of 500 kg. But the flexibility inherent in forward contracts would enable 700 kg maize to be negotiated with the intending buyer.

- ii) Maturity date: Another area of difference is delivery date of the contract, which is standardised for futures contract (e.g., three months) while this is flexible for forward contracts. This means that, for a seller that intends to harvest and deliver perishable farm produce about five months from now, he would find a futures contract inconvenient as only a three-month contract is available, whereas a forward contract can accommodate this if a buyer can be found to take delivery five months from now.
- iii) Location and timing of trade: A third area of difference relates to the location and timing of trading. Futures contracts are done on the regular floors of the organised commodity exchange and only during the prescribed trading hours. On the other hand, forward contracts take place in the less formal arm of the commodity exchange called over-the-counter (OTC) market, which refers to informal bilateral contacts between commodity brokers and other players in the market. Because of this informality, contacts and contracts can be made any time of the day, instead of during predetermined trading hours.
- iv) Delivery of commodity on maturity: In the forward contract, sellers often deliver the commodity to the buyer. In the futures contract, on the other hand, speculators (who, in the first place, are not common in the forward market) typically prefer not to settle the contract through physical delivery of the underlying commodity to the buyer but, instead, prefer, prior to the maturity date, to make reverse or offsetting operations (whereby a buyer would enter into a sell contract or a seller would enter into a buy contract in respect of the same quality and quantity of the particular commodity). Alternatively, as discussed later, on maturity of the contract, cash compensation can be given by the seller to the buyer or by the buyer to the seller, as appropriate.

- v) **Anonymity of counterparties:** The counterparties (viz: buyers and sellers) often need to be in contact with (and, hence, know) each other while negotiating a forward contract. But, since all the terms of the futures contract are market-determined, the counterparties do not have to know each other.
- vi) **Guarantee:** In a futures contract, the buyer would have to deposit a certain fraction (say 5%) of the contract value, called margin (a sort of performance bond), as security against the possibility that he would abandon or renege on the contract if the contract price in the spot market on maturity date falls 5% below the initial contract value, as there would be no incentive (other than just personal integrity) to hold on to the contract because the contract can be got for a smaller price in the market. Similarly, the seller would have to deposit a *margin requirement*, as security against the possibility that he would abandon or renege on the contract if the futures contract price in the spot market rises above a certain percentage above the contract value. But in forward contracts, there is often no margin requirement and this partly explains why defaults are more prevalent in the forward market.
- vii) **Speculators as traders:** As speculators want to enter and exit the market with great ease, the lack of liquidity or tradability in forward contracts means that speculators hardly patronise forward markets – which is mainly for hedgers. On the other hand, speculators are prevalent in the futures market because of ease of entry into and exit from futures contract.
- viii) **Liquidity or tradability of contracts:** First, the tailor-made nature of a forward contract makes it very difficult to find a counterparty for the contract, i.e., an intending seller may not easily find a willing buyer for the specific size, maturity date, etc of the contract, in the same manner that an intending buyer may not find an intending seller. In other words, a double coincidence of want for the specific attribute is often difficult to come by and some sorts of compromise or give-and-take may be resorted to in order to find a counterparty. Similarly, after the forward

contract is sealed, it is often a very difficult task to trade in the contract – i.e., to find a counterparty for another (the second-layer) contract the value of which would derive from the earlier contract in the manner explained earlier. This means that a forward contract is not liquid or tradable (i.e., cannot easily be bought or sold). This is unlike a futures contract, whose standardisation attributes make it tradable and liquid.

The comparison of the features of forward and futures contracts done here applies mainly to the matured commodity markets. In the emerging markets and, especially, frontier markets like we have in Nigeria, the distinctions are less applicable. For instance, at the ASCE, there are no futures contracts as yet so that the forward contracts there share some of the characteristics (like being traded in the central exchange instead of the OTC) that are peculiar to futures contracts in the mature markets.

8.5.4 Options contracts

- i) **Options and its two variants - call and put options:** Options can be said to be a right (but not an obligation) given by one party (called *seller* or *writer* of the option) to another party (called buyer of the option), which is valid for a particular period, for a 'fee' called *premium* to be paid by the option buyer to the option seller. The option or opportunity, in turn, can be what is called a *call* option, which gives the right to the option buyer to buy from the option seller a particular item or asset at a particular price (called *strike price*) on or before a specified future date. Alternatively, it can be what is called a *put* option, which gives the right to the option buyer to sell to the option seller, on a particular date or anytime during a particular period, a given item or asset at a particular price (i.e., strike price). As shown in Figure 8.4, each of the call options and put options has both the seller (who is often a speculator) and a buyer (who is often a hedger). Before the expiration of the options contract, it would be left to the option holder or buyer to decide whether or not to

exercise the right or option, depending on what the prevailing spot price of the item is at the time.

An extended explanation is desirable here to avoid the inherent confusion between selling of sell option, buying of buy option, etc. This confusion can be avoided by bearing in mind that the one buying an option (whether a sell or buy option) is buying now a right to compel the other party (i.e., the seller of that option, whether a buy or a sell option) to do something on or

before a particular future date. In the same manner, the seller of the option (whether it is buy or sell option), who is also said to be the writer of the option, is presently giving somebody else (i.e., the option buyer) the right to make or compel him to do something on or before a particular future date. Thus, the option is beneficial to the buyer but costly to the seller and that is why the buyer has to compensate the seller by paying the seller a premium, which is usually a small

Table 8.1 Differences between forward and futures contracts

Feature	Futures contract	Forward contract
1 Size	The size is standardised.	Negotiated. The size is as the buyers and sellers want it.
2 Maturity / delivery date	The date is standardised.	Negotiated. The date is as the buyers and sellers want it.
3 Location and timing of trading	Organised commodity exchange and also at prescribed trading hours.	Over-the-counter (OTC) or less formal arm of the commodity market and negotiations are done round the clock.
4 Commodity delivery on maturity date	Hardly done. Compensating settlement through reverse operations.	Delivery of commodity is usual.
5 Anonymity of counterparties	Counterparties are often not known to each other – buyers do not need to know sellers and sellers do not need to know buyers.	Counterparties are in touch with each other.
6 Guarantee	Guarantee deposit (called margin) required to prevent default.	Guarantee deposit absent, making default risk high.
7 Liquidity or tradability	Highly liquid.	Not liquid – difficult to find a counterparty and subsequent buyers or sellers prior to maturity date.
8 Speculators as traders	Dominate.	Few or hardly exist.

fraction of the contract price. Normally, the buyer of an option is a hedger (like farmers, food processors, etc) seeking to insure against the risk of unfavourable future price movements – hedgers like farmers would seek to buy a sell or put option to protect against future decline in produce prices while hedgers like food or raw materials processors would seek to buy a call or buy option to underwrite the risks of future rise in raw material prices. On the other hand, the writer or seller of options is usually a speculator seeking to gamble by assuming the risks the hedgers are trying to avoid.

- ii) Items or assets on which an options contract can be written and why futures contract is often the preferred asset on which an options contract is written: The item or physical asset on which the option is granted varies. It can be a financial asset like 1,000 units of ordinary stocks (called stock option) of, say, Nigerian Brewery or 1,000 units of Federal Government bond of a particular maturity, just as it can be foreign currency like 1,000 US dollars. In principle, it can also be a physical commodity like 500 kg of maize of a particular grade. But in practice, instead of the physical commodity, it is more convenient for traders to buy or sell a futures contract whose underlying asset is the same physical commodity (i.e., 500 kg of maize) since, as explained earlier, the market value of the physical commodity would always be the same as the market value of the futures contract based on it and there is the added advantage that the inconvenience of physical delivery would be avoided upon expiration of the futures contract.

So, for most options contracts in the commodity exchange, the underlying asset of options contracts are futures contracts whose underlying assets, in turn, are the physical commodities – farm produce, solid metals, crude energy products, etc. That is, an option's price tracks and moves in tandem with the price of its underlying futures contract which, in turn, tracks the ever-changing price of the underlying asset in the spot market. This type of options contract (i.e., written on futures contract) is

called *futures option*.

- iii) An illustration of a put options contract: As an illustration, a farmer, fearing the occurrence of an unfavourable (downward) price movement three months ahead when his products (say, 500 kg of maize) may be harvested and brought to the market, can buy a put option (option to sell to the writer of the option), at a specified price (say, ₦10,000 per 500 kg) and for a three-month period, a futures contract (of 500 kg size) for a given premium to be paid to the writer of the option. On the expiration of the three-month period, the farmer stands to gain if the market price of the commodity (i.e. 500 kg of maize) and, hence, the futures contract exceeds the strike price of ₦10,000 as all that the farmer would do is simply refrain from exercising the right to force the writer of the option to buy the just-harvested 500 kg of maize as a higher price would be fetched by selling in the open or spot market. However, if the price of the 500 kg of maize (and, hence, the futures contract based on it) falls below ₦10,000 (say, ₦8,000), it would pay the farmer to exercise his right by asking the seller of the option to buy the futures contract from him at the guaranteed ₦10,000, the proceeds of which the farmer would keep. To get the futures contract to deliver, the farmer only needs to sell his 500 kg of maize for ₦8,000 and use the proceeds to buy one futures contract of 500 kg maize with it. In effect, the farmer has been able to lock in his anticipated harvest of 500 kg of maize at a price of ₦10,000 – which, because of the insurance provided by the options contract, is the worst case scenario of the adverse price movement that could confront the farmer.
- iv) An illustration of a call options contract: As another illustration, a food processor (say, a flour mill operator), fearing the occurrence of an upward movement in the price of the needed basic raw material (say, wheat) three months ahead, when it would need 500 kg of wheat in the flour mill, can buy a call option (i.e., option to buy from the writer of the option), at a specified price (say, ₦50,000 per 500 kg of wheat) and for a three-month period, a futures contract of 500 kg of maize

for a given premium to be paid to the writer of the option. On the expiration of the three month period, the flour mill operator stands to gain if the market price of this raw material (and, hence, futures contract based on it) is below the strike price of ₦50,000 as all that the farmer would do is to simply not exercise the option to make the seller or writer of the option to sell the futures contract to him for ₦50,000 since a lower price is available in the spot market. But if the price is higher than the ₦50,000 strike price, it would pay the flour mill operator to exercise the option by requiring the option seller to sell the futures contract (and, by implication, the underlying 500 kg of wheat) to him at ₦50,000.

8.5.5 Swaps

To swap means to exchange. So, a swap contract is a financial transaction in which the parties agree to exchange streams of payments over time on the basis of a predetermined rule. Swaps transactions are typically made in exchanging foreign exchange inflows and also in exchanging cashflows in respect of fixed interest debts for

those relating to variable interest debts. Swap transactions do not normally apply to commodity trading that is of interest here and, hence, the topic is not discussed further.

8.6 Commodity standardisation, grading and pricing

8.6.1 Commodity standardisation

Standardisation refers to establishment of uniformity or homogeneity in the attributes of the commodities and contracts traded in the exchange. The four characteristics or features affected are the quantity (contract size), quality, duration (time for delivery – whether three months, six months, etc), and place of contract delivery. The quantity and quality of the commodities are to be measured, ascertained or confirmed by the accredited warehouse keepers (or independent assayers, in the case of warehouses that are not accredited by the exchange) as these have to be indicated in the warehouse receipts (or quality certificates, in the case of independent assayers) to be issued.

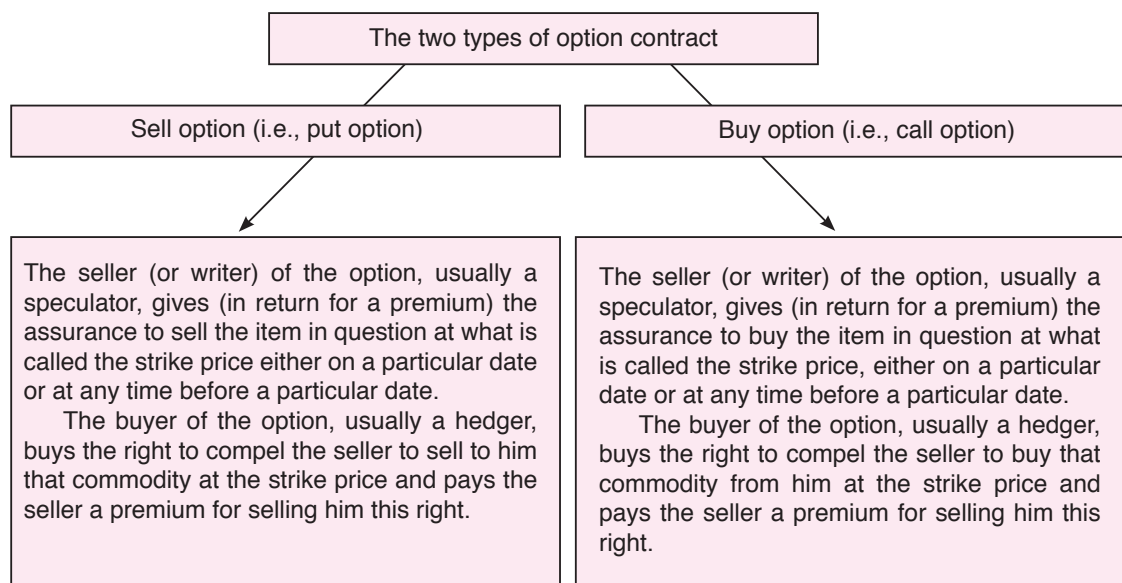


Fig. 8.4 Illustration of option to buy and option to sell, each of which has its own buyer (hedger) and seller/writer (speculator)

- i) Quantity or contract size: Each exchange prescribes the contract units to be traded. An example is the contract size of 5,000 bushels of wheat in many commodity exchanges in the US, meaning that only multiples of 5,000 bushels of wheat (10,000, 15,000, 20,000, etc) can be traded there. In Nigeria, the ASCE prescribes 500 kg as contract size for any commodity to be traded there.
- i) Quality: For a particular commodity, there may be many grades (Grade A, Grade B, Grade C, etc). For instance, there may be yellow maize and white maize, making two grades.
- iii) Duration of contract or timing of contract expiration: Each exchange prescribes the duration of contracts for each type of commodity. This can be over three or six months or longer.
- iv) Place of contract delivery: The contract usually indicates delivery warehouses where the buyers can collect the commodities when the contracts expire. The exchange typically has a list of warehouses that are designated as delivery warehouses.

Standardisation is to facilitate trade, as all that the buyers and sellers need to negotiate is limited mainly to the price. But it also has a cost of being inflexible – a sort of ‘one size fits all’ thing. Thus, in the over-the-counter (OTC) segment of exchange (where forward contracts are mostly traded), standardisation is less pronounced.

8.6.2 Grading of commodities

Grading or ascertaining the quality of a commodity is to identify the category that the commodity belongs to – whether inferior or superior category. It affects the tradability of a commodity in the exchange as a commodity that is below a predetermined quality threshold may not be listed for trading in the exchange. The grade also affects the pricing of the commodity. As just pointed out, grading is done by the accredited warehouse keeper before issuing the warehouse receipt on which the grade has to be indicated (or by the independent assayer before issuing quality certificate, when the goods are stored with a warehouse that is not exchange-accredited).

8.6.3 Pricing of commodities and contracts

In the main, the prices are determined by the market forces of supply and demand, and not by the exchange itself. The price in the spot market, which typically fluctuates on a daily basis, would reflect the degree of scarcity and need for the commodity, as well as other economic factors and political and psychological ones. This means that the market price for the forward, futures or options contracts also fluctuates on a daily basis, as it should be the same as the spot price of the underlying asset or commodity. This is unlike the fixed contract price at which the underlying asset is to be delivered, at the contract expiration date. Comparing this fixed contract price with the ever-changing contract market price creates a profitable buy or sell opportunity for the speculators.

Concerning the fixed contract price at which the underlying commodity is to be delivered at the expiration date, the ‘fair’ or mutually agreeable price would be based on what the two parties anticipate or expect the spot market price of the underlying asset to be when the contract expires. The spot price when the contract is initiated is not relevant as such.

8.7 Methods of trading – Electronic trading, open and online trading

8.7.1 Commodity exchange as a counterparty to contracts

An important principle underlying trading in the exchange is that the exchange is a third counterparty to every contract, with the other counterparties being the buyer and the seller. By this, the exchange, through its clearing house, is the buyer to the seller and simultaneously the seller to the buyer. This is to engender confidence in the exchange since, if the buyer defaults by refusing to take delivery when the contract

expires, the seller would be insulated from this as the default would affect only the exchange (which constitutes the 'intermediate' seller). Similarly, if the seller defaults by not making payment when the contract expires, this would affect only the exchange (which is the 'intermediate' buyer). It is not conceivable that the exchange would default and it is therefore a 'default' absorber that guarantees both the seller and the buyer against default risks.

8.7.2 Eligibility to trade

As discussed earlier, those trading on the floor of an exchange are required to be members of the exchange. In the ASCE, they are either ordinary trading members (commodity brokerage firms whose representatives must be professionally qualified commodity traders) or institutional trading members, but not the third category called ordinary members. These members support the exchange by dues and assessments. Ordinary members and non-members trade through commodity brokerage firms whose officers or partners hold memberships.

8.7.3 Trading procedure

Following standard practice in mature commodity exchanges the world over, trading procedure at the ASCE requires ordinary members and other customers or clients to first approach (via the telephone, Internet or physical visit) ordinary trading members (commodity brokers licensed to trade at the Exchange) and request to buy or sell, as appropriate, through the broker, in the exchange. The instruction can be in the form of specifying a price limit (maximum price to buy or minimum price to sell). The intending seller is required to have deposited the commodity in any of the exchange's accredited warehouses or in any warehouse of his choice and tender, through his broker, the warehouse receipt or quality certificate to the ASCE. The brokers for both the seller and the buyer are also to deposit, as guarantee, a certain minimum percentage (which is 5%) of the contract price in their accounts with the clearing banks. This constitutes the margin, which serves as a performance bond. The broker

representing the seller and that representing the buyer would then try to find each other out to match the trades and arrive at a bargain, through any of the mechanisms discussed below.

8.7.4 Trading mechanisms - Electronic trading, open outcry, call over and online methods

There are two broad mechanisms through which an intending seller's broker and a buyer's broker are able to locate each other and strike a deal. These are the *open outcry* (of which the *call over* mechanism is a special category), and *electronic* mechanisms, which are as explained below.

i) Open outcry mechanism: This is a method that uses 'face-to-face' verbal bids (intention to buy) and offers (intention to sell) in the trading pits – a part or arena of the trading floor that is specially constructed to suit open outcry trading, with each commodity or group of commodities having a separate pit where buyers and sellers face each other. The name open outcry derives from crying out, screaming or yelling by the floor brokers or floor traders (with many of them wearing uniform-like coloured jackets), running in the pit as well as hand gestures and other signals that are also used by the floor brokers to communicate with each other. These hand signals vary and each of them is understood by all the floor traders. For instance, palms in means 'I am a buyer' while palms out means 'I am a seller'. Hand gestures are used to communicate price bids (prices the buyers are ready to pay) and price offers or asking prices (prices sellers are asking), quantity bid and offered, and other terms and conditions of the transaction.

To trade under this system, the one who intends to trade would call his broker with instruction to buy or sell (as appropriate). The commodity broker would then approach floor brokers, who are the ones that are eligible to run round in the pit to carry out trades either on their own accounts or for the commodity brokerage firms who unlike commodity brokerage firms, are not

eligible to directly take customers' orders from the public customers. They constitute their own 'auctioneers' in the pits, where the floor brokers that want to buy are crying out (or, sometimes, gesturing with hands) the quantity and price of their bids and the floor brokers that want to sell on the other side of the pits are also yelling (or hand gesturing) the quantity and price of their offers. According to commodity exchange rules, no one can bid below a higher bid or offer above a lower asking price. This means that, at any point in time, only the highest bid and lowest offer are allowed to come forward while all others are silenced. If a floor broker is willing to pay the highest price offered, he would yell it out and all other (lower) bids would have to disappear. When the floor brokers representing the commodity brokerage firms for the buyer and seller meet and execute the trade, they would also often cry out 'Sold' or 'Done' or 'Take it'. Thereafter, the floor brokers would relay the information that the trades have been executed to the brokerage firms, which, in turn, would notify their customers accordingly. The arrangement ensures that the identity of the customers on behalf of whom the floor brokers are making the bids and offers remains undisclosed.

- ii) Call over system: This is a special case of the open outcry method just described above, which is adapted to suit the situations in emerging commodity exchanges. Under this, there is a chairperson whose duty is to preside over the transactions and allocate traded commodities among buyers. But, in the main, it retains the essence of the open outcry, particularly as both of them are manual-based and can be described as old-fashioned.
- iii) Electronic trading mechanism: This involves trading through computer terminals. The commodity broker would enter a customer's buy or sell order into the online terminal. The order would then find its match automatically through the online channel – that is, a buy order would seek to match a sell order and vice versa. If it does not find a match instantaneously, it will be stored online until a similar and opposite order

matches it or the order expires – if the order is valid for only a limited period. The trade will be executed when a matching opposite order is found. The exchange's trading engine matches the *trade on price-time priority basis*. Completed trade would be notified electronically to the commodity broking firm, which, in turn, would notify this to the customer concerned. Because the physical trading floor is now dispensed with, floor brokers are bypassed and, arguably, cease to be relevant.

- iv) Let us now draw a comparison between open outcry (including call over) and electronic trading mechanisms. The open outcry mechanism is an old (and, more or less manual) method of trading that has since been generally abandoned in mature commodity exchanges and stock exchanges, which have now shifted to the modern, electronic trading mechanism: The only exceptions are the commodity and stock exchanges in the US, which still adhere, largely, to this traditional method, just as commodity exchanges in some developing countries. But even in the US exchanges, they have in place after-hours electronic trading systems that operate when the trading floors are already closed and some exchanges are even already adopting the electronic trading during regular hours. (By definition, OTC markets are only electronic-based, even in the US). This is likely due to a number of obvious advantages of the automated, electronic trading system. In particular, the system is faster, cheaper and more efficient. It is also less prone to manipulation by dealers and brokers. It is deemed to be more transparent as trade execution is based on first-come, first-served priority. Nevertheless, the open outcry also has its own advantages, which include the fact that the face-to-face contact among brokers enables them to read each other's mood and speculate on the motives for the trade. Particularly, the grapevine and other informal sources of information that are made available on the trading floor often deepen their knowledge of the prevailing market situation.
- v) What is the situation with the ASCE? In

Nigeria, the call over system being used in the ASCE (and, until recently, the NSE) is a variant of the open outcry system that is adapted to suit the emerging nature of the Nigerian exchanges. In the ASCE, in particular, there is a trading floor defined as not only the floor space but also as including systems and networks for trading. In addition, provision is made for remote negotiated trading, which refers to trading initiated outside the trading floor but to which the ASCE is counterparty.

- vi) Online trading in commodities: A recent development in the commodity market is the emergence of online trading, which is a further extension of electronic trading discussed above. Through online trading, traders can trade directly (by bypassing commodity brokers) from their computer terminals and get the trade routed directly to the trading floor of the commodity exchange, where the order would be executed immediately, with payments also made online. In this manner, the calling of commodity brokers on telephone or visiting them is eliminated and the services of brokers to the clients are greatly reduced, if not eliminated.

8.7.5 Over-the-counter (OTC) market

The open outcry and electronic trading mechanisms just described apply to the organised commodity exchange, and not to the less formal (often called unorganised) exchange called over-the-counter (OTC) market. OTC trading takes place through direct contact between buyer and seller, who contact each other through the telephone, electronic media and/or (possibly) visits that lead to face-to-face interaction. Although commodity brokers can facilitate the meeting of buyer and seller, the relationship is more or less bilateral (between the counterparty, i.e., buyer and seller) and, hence, the commodity exchange is not counterparty to the OTC contracts. Not all the elaborate rules and regulations of the organised exchange apply to the OTC market. Although there are sometimes performance contracts (including margin requirements) in one form or

the other so as to discourage defaults, default risk is higher there. In mature markets, OTC markets are very active as all forward contracts, most of options contracts and all swaps contracts, take place there. In Nigeria, the OTC market has yet to emerge in the ASCE.

8.8 Warehousing, assaying and warehouse receipts

Warehouses are buildings which may be publicly or privately owned and/or managed, for storage of commodities such as manufactured goods and farm produce. A commodity exchange has a list of the accredited or certified warehouses, which are independent commercial warehouses authorised by the exchange or by law to accept commodities for storage and issue certified warehouse receipts (a document of title) on behalf of the beneficial owners, as an evidence or proof of the quality and quantity of the stored commodities. Such a warehouse is to be operated by a certified warehouse keeper, whose duty is to measure, grade and certify the commodities in his custody. He has the right to issue, honour, extinguish and re-issue certified warehouse receipts under the authority of the exchange.

To avoid a conflict of interest, he is not eligible to be a member of the exchange and, hence, trade on the exchange. The contents of warehouse receipts include information about the quantity, quality, mode of packaging, and grade of the commodity.

In Nigeria, sellers can elect to use warehouses other than those accredited by the ASCE. In respect of such unaccredited warehouses, certified independent assayers (those accredited by the ASCE to grade and certify commodities deposited in the unaccredited warehouses) can also issue quality certificates in respect of commodities deposited there. Such quality certificates have the same reliability as those issued by keepers of accredited warehouses so that trade is to be conducted on the quality certificates as if they are receipts issued by accredited warehouse keepers. The assayers would issue such certificates after duly assaying (inspecting and grading) the commodities.

Buyers of commodity contracts are deemed to have fulfilled their contractual obligations in respect of delivery of commodities through delivery of the certified warehouse receipts. Certified warehouse receipts are negotiable instruments as this feature is necessary in commodity futures contract. This means that, like a cheque or any other bill of exchange, upon its endorsement (signing at its back) by the holder and handing it to another person, the new holder becomes its legal owner. That is why its delivery by the buyer to the seller constitutes a transfer of value to the seller. In addition, warehouse receipts can be financed, meaning that it can be pledged as collateral for loans from banks and other lenders. By this, it would enable holders to have access to bank loans and at lower interest rate than otherwise.

8.9 Trade clearing, registering, settlement and the clearing house

8.9.1 Meaning of clearing, registering and settlement

Clearing is a process of scrutinising by the clearing house, partly for the purpose of ensuring the authenticity and financial integrity of the contracts recorded in its books. This is needed so as to enable the clearing house, on behalf of the exchange, to become a 'central counterparty' by being the buyer to each seller and seller to each buyer and thereby protect buyers and sellers from any loss arising from defaults by the traders. Registering, on the other hand, refers to entry or recording of the transactions in the books or records of the clearing house while settlement refers to payment to the seller and delivery of the commodity to the seller on expiration of a contract.

8.9.2 Nature and functions of the clearing house

The above roles of clearing, recording and settling are performed by the clearing house, a section of the exchange through which contracts executed on the exchange are matched, settled and guaranteed. It is where the claims and liabilities of members and registered non-members are received, cleared and settled in respect of executed contracts in listed commodities transacted on the exchange. It ensures timely settlement, registers trade and provides consequent follow-up. It provides contract enforcement mechanism. The clearing house also ensures proper conduct of the exchange's delivery procedures and adequacy of financing of trade through collection of margins. In this regard, it ensures delivery of the commodity to the buyer and simultaneous payment to the seller. Clearing house members share default costs (by contributing to a guaranteeing fund) with the intent of insulating traders from such risks, thereby enabling the clearing house to settle funds in non-delivery cases. In Nigeria, all contracts executed on the ASCE shall be cleared, registered, and settled by the clearing house whose functions are being carried out by the clearing and settlement department of the exchange.

8.9.3 Membership and procedure of a clearing house

Membership of the clearing house is open exclusively to members of the exchange, including commodity brokers or ordinary trading members (but not ordinary members) and only members have the privilege of being eligible to clear, register and settle their trade, or trade of their clients, directly through the clearing house. Commodity brokers that are not members would have to go through members of the house for the services for themselves or their clients. Thus, in Nigeria, only the trading members and institutional trading members of the ASCE are qualified to obtain directly the clearing, registering, settlement and guaranteeing services of the clearing house of

the ASCE. The *constituents* (defined as ordinary members of the ASCE that are clients of the trading member or any other client and customers of the trading member) are required to have *constituent agreements* with the trading member (commodity broker) for clearing their executed transactions. They are presumed to remain constituents of the trading member until the agreements are terminated.

8.9.4 Clearing banks

Following worldwide good practice, in Nigeria, the ASCE appoints a number of commercial banks as clearing banks. The banks are appointed as funds settling agencies for collecting settlements for all deals entered into through the ASCE and for any other funds movement between members and the ASCE as well as between members. All trading members are required to open their clearing accounts exclusively for settlement purposes. The banks are electronically linked to the ASCE to permit funds to be transferred for pay-in and pay-out under the instruction of the clearing house.

8.10 Delivery

8.10.1 Meaning of delivery

Delivery refers to the tender and receipt of certified warehouse receipts (or equivalents in the form of quality certificates, as appropriate) in settlement of commodity contracts upon expiration of the contracts. It is neither necessary nor usual to tender the physical commodities themselves since tendering only the warehouse receipts is enough to change ownership in the commodities and entitle the recipients to use the warehouse receipts to collect the underlying commodities at the designated delivery warehouses.

8.10.2 Closing or taking an offsetting position before the contract expiration date

It is not in all cases that a contract would remain open or unclosed until the expiration date when

it has to be settled. The price of the derivative (whether futures or options) moves in tandem or in sympathy with the spot market price of the underlying commodity. As time passes, the spot price would be moving up or down and the price of the futures or options contract too would be mimicking this movements so that the contract's prevailing market price would be changing relative to the fixed price at which the contract was originally executed. Traders, particularly speculators, often close the trade (by taking an offsetting position) before this date by seizing the opportunity offered by the prevailing market price of the contract. Closure means the holder of a long position (the buyer) would assume a short position (sell an equivalent commodity or contract) to liquidate the earlier one. This often happens if a profitable opportunity occurs – that is, if a rise in the price prevailing in the futures or options market where the selling is to be done. The original holder of the short position, independent of what the other party is doing, may also choose to close his position by taking a long or buying position should a profitable opportunity present itself before the contract expires, that is, if a rise in the futures or options market price occurs before the contract expires. The buyer and the seller can, separately and independently of each other, eliminate their obligations by taking offsetting positions in the spot market in this manner before the contract expires. Speculators monitor the ever-changing futures or options price, which usually move in tandem with the spot price for the underlying commodity, and compare this with the fixed price at which the futures or options contract was initiated. In the case of those holding buy position, they would be alert to seize the opportunity to sell to offset the earlier buy contract if the prevailing price rises sufficiently higher than the fixed contract price. In the case of those holding sell position, they would watch for when prevailing market price falls sufficiently below the fixed contract price to take a buy position to liquidate the existing sell position.

8.10.3 Delivery process through exchange of the underlying asset

If an offsetting position is not taken before the contract is about to expire, the commodity broker often would inform or remind a customer with an open buy position to either close out the position or be ready to take delivery and pay the full value for the underlying contract. Similarly, the brokerage firm for a holder of an open sell position would notify him to either close out the position or prepare to deliver the underlying commodity by tendering the warehouse receipts and related documents.

If the buyer chooses not to close his position (as many hedgers, but not many speculators, often prefer), he would hand over to the clearing house, through his brokerage firm, the payment (or cheque) some days ahead of the contract expiration date. In Nigeria, this is to be done by paying the cheque into the clearing house's account with one of the clearing banks. Then, he would collect warehouse receipts and any other prescribed documents (which is the delivery order in the specific case of the ASCE) from the clearing house, also through his brokerage firm, and tender them at the stipulated delivery warehouse in order to collect the underlying commodity. In the same manner, if the seller chooses not to close out his position, he would (some days ahead of the contract expiration date) hand over the warehouse receipts and any other prescribed documents (which is the delivery note in the specific case of the ASCE) to the clearing house, through his broker. Then, he would collect the payment (cheque) from the clearing house, through the broker.

8.10.4 Delivery process through exchange of cash

However, even if the seller and the buyer elect not to close their position and decide to wait till the contract expiration date, they may still wish to settle the contract by merely exchanging cash, instead of the underlying commodity, in such a

way that the settlement price at the expiration date reflects the underlying value of the commodity at the spot market. Exchanging cash in this manner simply means one party would pay the other the difference between the fixed price at which the contract was executed and the spot market price on the day the contract expires. If the spot price is higher than the fixed contract price, it is the seller that would pay the buyer the difference because this is what the buyer is losing by not taking physical delivery. He could have taken physical delivery for instantaneous sale in the spot market at the high price while giving a cheque to the seller in settlement of the lower, predetermined contract price. In the same manner, it is the buyer that would pay the difference to the seller if the spot price is lower, because it is this difference that the seller is sacrificing for keeping or not delivering physical commodity. He could still hold on to the commodity in the warehouse and immediately buy the equivalent at the lower price prevailing in the spot market for the purpose of delivery to the buyer in exchange for the cheque of a higher value that the buyer is obligated to pay.

For example, let us suppose there is a three-month futures contract for 500 kg maize contract of ₦10,000 that expires on June 1 and the spot price on June 1 is ₦12,000. In this case, it is the seller that would pay ₦2,000 to the buyer if both elect against physical delivery. This is because it is the buyer that is sacrificing by not taking delivery of the 500 kg maize in exchange for ₦10,000 cheque payment and immediately selling the maize at ₦12,000 in the spot market. If, on the other hand, the spot price on June 1 is only ₦7,000, it is the buyer that will have to compensate the seller for the ₦3,000 difference because, without tampering with the 500 kg maize in the warehouse, the seller has the option of taking ₦10,000 cheque payment from the buyer in exchange for 500 kg of maize that could be bought instantaneously from the market for just ₦7,000.

8.11 Contract enforcement through margin, guarantee fund and arbitration mechanism

As the price of a forward, futures or options contract changes when compared with the fixed price at which the contract was initially executed, either the buyer or the seller loses money, thereby creating a temptation for the loser to avoid performance. A rise in the prevailing spot price of the underlying asset at the expiration date of the contract above the fixed price at which the forward, futures or options contract was initially executed creates an incentive for the seller not to deliver on that date by reneging on his obligation and selling the commodity in the spot market at that higher price, instead of delivering it at the pre-determined lower contract price. Conversely, a fall in the spot price on the expiration date below the price at which the forward, futures or options contract was initially made is an incentive for the buyer not to take delivery and make payment, since it pays to buy the underlying commodity at the lower price in the spot market. Even if some traders want to perform on their contracts despite such an incentive not to, they may be unable to get resources to do so.

The clearing house and, hence, the commodity exchange, as a counterparty to each contract whereby it is a seller to the buyer and buyer to the seller, is liable to absorb the loss (at its own expense) arising from default of either the buyer or the seller. This is to protect the buyer and the seller and thereby enhance confidence in the commodity exchange. This means the commodity exchange would have to devise means of enforcing contracts to which it is a counterparty so as to guard against absorption of losses arising from defaults. One way of accomplishing this is through resorting to third party enforcement mechanisms, particularly by seeking legal remedies in the court of law. But this is often not very effective, as it takes a long time and is also expensive. Three other major devices that are often relied upon by the exchange, as

supplements to disciplinary and court processes, are the use of margin; establishment of guarantee funds; and an exchange-established arbitration mechanism that may lead to sanctions, including the possibility of expulsion of the party that is found to have breached the exchange regulation. These are as discussed below.

8.11.1 Margin requirement and how it works

Margin refers to a sort of performance bond or 'good faith' deposit that each member of the clearing house has to lodge with the clearing house (in Nigeria, at a clearing bank appointed by the ASCE). It is expressed as a certain percentage of the contract's fixed value. This is to assure the commodity exchange that the clearing member has sufficient funds to handle maximum losses (under a worst case scenario) that could potentially happen to the contract, assuming a most adverse price movement occurs against the contract. In turn, it is the clients of the clearing house member that normally would have made the money available to the clearing house member and, hence, the clients are the ultimate payer of the margin. In principle, the margin is normally the amount that the exchange deems sufficient to cover any one-day adverse price fluctuation. In Nigeria, the ASCE has pegged the daily margin to be posted by the clearing house member at 5% of the initial contract price.

8.11.2 Establishment of guarantee funds

Not only buyers and sellers can default and thereby cause losses to the exchange; even exchange members (including commodity brokers) and other players can default or do some other things that can bring losses to the exchange. So, as an additional safeguard, the clearing members of an exchange often establish a guarantee fund into which they would all contribute a certain percentage of their revenues. This fund is to be used to absorb any losses arising from defaults or similar actions of the members and other players for which the exchange becomes ultimately liable.

In Nigeria, the ASCE's equivalent is its Settlement Guarantee Fund to which all trading members contribute. An ordinary or institutional trading member may make voluntary contributions to the guarantee fund from time to time in addition to the compulsory appropriation made by the exchange from the clearing fees charged from the trading member. It is a safeguard against default as well as a guarantee for traders' objection cases, like replacement of any bad delivery or payment of the equivalent in lieu of replacement.

8.11.3 Arbitration

A commodity exchange usually establishes an in-house or private arbitration mechanism to settle disputes and perform some quasi-judicial functions. In Nigeria, the ASCE has its own arbitration and vigilance committee, which adjudicates on disputes that may arise over trading and clearing of contracts; ensures orderly functioning of the exchange in accordance with the laid-down procedures; and carries out investigations into violation by any member of the exchange of any provision of the rules and regulations of the exchange. Those found to have breached the rules and regulations of the exchange, including misconduct, misinformation, indifference and wilful negligence and failure to pay any dues would be liable to sanctions of varying severity, including expulsion from membership of the exchange.

8.12 Similarities and differences between commodities and stocks

8.12.1 Similarities between commodities and stocks

i) They are both traded in very similar markets or exchanges: Stocks represent ownership of a certain fraction of a limited liability company, so that those trading, buying or selling stocks are buying or selling the

ownership interest. Stocks are similar to commodities in the sense that both are traded (i.e., bought or sold) through exchanges or markets that have many similarities. Stocks are traded in the stock exchange while commodities are traded in the commodity exchange, both of which resemble each other. They are both most competitive markets in an economy. They have broadly similar rules and regulations, market operators, etc.

- ii) Stocks are intangible assets, just as contracts deriving their values from tangible underlying commodities: Also, like stocks, some commodities (like forward, futures and options contracts) are intangible, though their underlying assets may be tangibles – following definitions of tangibles and intangibles given earlier.
- iii) Trading in both can be risky due to high price fluctuations: Trading in commodities and stocks too can both be risky, suggesting desirability of limited exposure to each of them. They are not very safe assets to hold (unlike, say, bonds) because their prices are volatile.

8.12.2 Differences between commodities and stocks

- i) Stocks represent part-ownership of a company, not ownership of a commodity: As just pointed out, stocks represent ownership of a certain fraction of a limited liability company, and not ownership of a certain quantity of a commodity (or any other underlying asset) that commodity trading entails.
- ii) Duration - stock ownership potentially has an infinite lifespan, and not for a short period: While the stock owner can elect to sell in the stock exchange, he can also decide to hold on to the stock for ever (or until the company ceases to exist). But commodity contracts are for very short periods (usually, a few months) when the contracts would expire and delivery would take place.
- iii) Streams of dividends can be earned from stocks, but not from commodity contracts: In most cases, the profit made by the company

whose stock is held is divided among the shareholders in the form of dividends. There is no stream of income that is derivable from commodity contracts.

- iv) Commodity prices are generally more volatile: While stock prices are volatile, commodity prices are more volatile as the prices are highly sensitive to over- or under-production (arising from, say, crop failure), political instability, consumer appetite, etc.
- v) Opportunities for risk containment and speculation are better offered through commodity trading: Commodity trading (through trading in forward, futures and options contracts) can be used by farmers, miners, etc and those who need the commodities as raw materials to contain the risk of future adverse price movements, which is what hedging is all about. In the same manner, commodity trading offers opportunity for speculating on future price movements. The opportunities to speculate or, particularly hedge through stock trading are less.
- vi) Spot market for stock transactions, but not necessarily so for commodity transactions: Stocks can be bought in the primary segment of the stock exchange from the companies seeking to raise funds or in the secondary segment from the previous holders. In either case, spot transactions are involved, meaning that buyers will pay immediately and sellers too will transfer ownership immediately. On the other hand, spot transactions in the commodity exchange are limited as most of the transactions are in the form of forward contracts and the derivatives (especially, futures and options contracts), none of which requires immediate payment by the buyers except for brokerage commission and, possibly, the margin. The implication of this is that an intending buyer of stocks must have enough resources to pay upfront in the spot market, unlike an intending buyer of contracts in the commodity market. In the same manner, a seller of stocks gets immediate payment or liquidity while only deferred payments exist outside the spot market of the commodity exchange. Thus, commodity markets are hardly suitable for raising funds for immediate needs.

8.13 Benefits of commodity exchange

A commodity exchange provides many benefits to those who trade there and to the economy as a whole. These benefits are as discussed below.

8.13.1 Benefits to producers

Producers of the traded commodities include farmers, solid minerals miners and explorers/exploiters of crude petroleum oil and gas. To them, a commodity exchange can provide the following specific benefits:

- i) Opportunity to contain risks of future adverse movements in price: Producers have the opportunity to hedge against the risk that future prices would be lower than they expect. By this, they would be able to focus and concentrate on what they are specialised in doing, which is production, instead of dissipating their efforts in sleepless nights of worry about price movements and how to deal with the situation – which should be a job for professional speculators. By this, the exchange serves to separate production from managing risks of price movement. The hedging facility also facilitates efficient production planning, which requires knowledge of future prices with certainty. Through all these, the volume of production is likely to increase.
- ii) Price discovery: Price discovery refers to accessibility to and finding out price information. Through the centralised information made available in the commodity market, producers of the commodities have better and easier access to information, thereby enhancing proper pricing and reducing their vulnerability to cheating by the middlemen and buyers. Wasting of time and resources in haggling is also avoided.
- iii) Assurance of regular, undisrupted product demand: The irrevocable contracts entered into with potential buyers (with the enforcement mechanisms that the exchange provides) means that the commodity producers are assured that demand is

already waiting for their products at a pre-determined date. It also eliminates or reduces the need for farmers and other producers to sell at harvest and other periods when lowest prices prevail.

- iv) Easier access to finance: Selling farm produce and other commodities forward would facilitate pledging what is sold forward as collateral for bank loans. For instance, warehouse receipts issued as evidence of ownership of goods stored in the warehouse can be pledged as loan collateral, while the commodity producer is waiting for the delivery time when the contract expires.
- v) Enhanced storage facilities and practices: Commodity trading encourages expansion of, and improvement in, warehousing which, in turn, would enable the producers to better preserve their products before sale.

8.13.2 Benefits to users

Buyers of the commodities for use as raw materials include food processing industrialists, refiners of crude petroleum and gas and industrialists who work on solid mineral products. To them, a commodity exchange can provide the following specific benefits:

- i) Opportunity to contain risks of future adverse movements in price: Processors of traded commodities have the opportunity to hedge against the risk that future prices would be higher than they expect. By this, they would be able to focus and concentrate on what they are specialised in doing, which is processing of the raw materials, instead of dissipating their efforts in sleepless nights of worry about price movements and how to deal with the situation – which should be a job for professional speculators. By this, the exchange serves to separate raw materials processing from managing risk of price movement. The hedging facility also facilitates efficient production planning, which requires knowledge of future prices of raw materials with certainty. Through all these, the volume of raw materials processed may increase.
- ii) Price discovery: Through the centralised

information made available in the commodity exchange, processors of the raw commodities have better and easier access to information, thereby enhancing proper pricing and reducing their vulnerability to being over-invoiced. Wasting of time and resources in haggling is also avoided.

- iii) Assurance of regular, undisrupted raw materials supply: The irrevocable contracts entered into with the potential suppliers (with the enforcement mechanisms that the exchange provides) means that the buyers or raw materials processors only need to sign many contracts whose expiry dates would be staggered so as to ensure raw material deliveries that match their requirements for processing.
- iv) Quality product assurance: The measurement and grading for product standardisation facilitate a high quality of raw materials for industrial use.

8.13.3 Benefits to the whole economy

- i) Expansion in the relative size of formal economy: Substitution of trading in the commodity exchange for trading in the traditional markets (especially, markets for farm produce) means that the size of the informal or traditional segment of the economy is shrinking while that of the modern, formal segment is increasing. One of several benefits of a rising share of modern economy is that the tax base (i.e., those things on which government taxation can be based or levied) would increase.
- ii) Creation of employment and income: Commodity exchange transactions provide employment opportunities for many people, who now become brokers, warehouse operators, assayers, speculators, market regulators, etc. Increased employment opportunity also leads to increase in income.
- iii) Access of commodities to international markets: The modernisation of commodity trading, by leading to improvement in product quality to a world class

standard, would enhance access to, and competitiveness in, international markets of such commodities.

- iv) Overall economic growth: Due the above benefits to buyers and sellers in the exchange, economic growth of the country would be enhanced.

8.14 Constraints to commodity trading

Despite the several benefits of commodity trading to producers, buyers and the whole economy as discussed above, it has not been expanding as it should in many developing countries, including Nigeria. In Nigeria, it took several years for the only commodity exchange, the ASCE, to take off; even after taking off eventually, it has still been struggling to find its feet. The reasons for this are that these are many constraints inhibiting commodity trading, notable among which are those discussed below.

8.14.1 Inadequate volumes of trade

The patronage of the market is very low in commodity markets like the ASCE, resulting in inadequate trading and, hence, absence of liquidity. Many listed commodities are not being traded at all. Thus, sellers are not sure of getting their commodities to sell and buyers are not sure of getting the right commodities to buy. The end-result is that traders are further discouraged from patronising the market.

8.14.2 Inadequate infrastructural and trading facilities, including warehouses

Upcoming or upstart exchanges like the ASCE do not yet have adequate trading facilities, including computer networks that would link many places. Warehouses too do not seem to be adequate.

8.14.3 Low awareness of the benefits derivable from commodity trading

Probably as a result of the generally high level of illiteracy in countries like Nigeria, many would-be traders, especially farmers, are not aware of the benefits they can derive from commodity trading. So, there is no known incentive for them to trade. That the commodity exchange is just taking off in such countries also means that the commodity trading culture would take a while to be nurtured.

8.14.4 Inadequate knowledge of the working of commodity trading

Similar to the above is that in countries like Nigeria, people are not conversant with the workings of a commodity exchange, when compared with the level of their knowledge about how a stock exchange works. This also serves to adversely affect patronage of commodity exchanges.

8.14.5 Unfavourable ethics, values and beliefs

As speculation in the commodity markets is often likened to gambling or betting, many with ethics, values and beliefs that are against gambling and betting regard speculation, and even commodity trading as a whole, as being immoral and, therefore, discourage it.

8.14.6 Unfavourable legal environment

Commodity trading thrives when the legal environment is conducive to contract enforcement through the judicial process. This is because the essence of commodity trading is contracts and their enforcement. But in many countries like Nigeria, the legal framework is weak on contract matters and even the weak framework is difficult to enforce as the judicial process often takes too long to be meaningful.

Revision questions

Essay questions

- 1 Explain what you understand by *tradable commodity* and discuss main attributes that it should possess.
- 2 Distinguish between tangible and intangible tradable assets and give a list of each type.
- 3 In relation to the Abuja Securities and Commodity Exchange (ASCE), distinguish between the ordinary members, ordinary trading members and institutional trading members.
- 4 Distinguish between commodity brokerage firms, floor brokers and floor traders of a commodity exchange.
- 5 Explain any three of the following and highlight their functions:
 - a) Warehouse
 - b) Warehouse keepers
 - c) Assayer
 - d) Warehouse receipts
- 6 In connection with the Abuja Securities and Commodity Exchange (ASCE), discuss briefly the clearing house, its membership and its functions.
- 7 By highlighting the motivation behind each, distinguish between speculation, hedging and arbitrage in the commodity exchange.
- 8 Distinguish between spot and forward contracts in commodity trading.
- 9 Discuss the similarities and differences between a forward contract and a futures contract in commodity trading.
- 10 Explain, in connection with commodity trading, the term *option* and differentiate between the call and put options.
- 11 In connection with commodity trading, write short notes on:
 - (a) Taking a short and long position
 - (b) Commodity standardisation
- 12 Explain the open outcry and electronic mechanisms of commodity trading and discuss the advantages and disadvantages of the former over the latter.
- 13 Explain the following:
 - a) Delivery of a commodity exchange contract through

- taking an offsetting position before the contract's expiration date.
 - b) Delivery of a commodity exchange contract through exchange of cash at the contract's expiration date.
- 14 Discuss the use of
 - a) margin, and
 - b) guarantee fund, as ways of contract enforcement in a commodity trading.
 - 15 Discuss the similarities and differences between commodities and stocks.
 - 16 Discuss three possible benefits of a commodity exchange to each of:
 - a) Producers of the raw materials being traded.
 - b) Users or buyers of the raw materials being traded.
 - c) The whole economy.
 - 17 Discuss five problems militating against the growth and prosperity of commodity trading in Nigeria.

Objective questions

- 1 Which of the following is an intangible commodity.
 - A Unprocessed agricultural product
 - B Foreign currencies
 - C Bonds
 - D A and B
 - E B and C
- 2 Which of the following is *not* a feature of tradability of a commodity?
 - A High degree of homogeneity
 - B Long shelf life
 - C Very stable price
 - D All of the above
 - E None of the above
- 3 The Abuja Securities and Commodity Exchange was converted from the Abuja Stock Exchange that was established in
 - A 1988.
 - B 1998.
 - C 2000.
 - D 2008.
 - E 2010.
- 4 The one that sells commodities in anticipation of a likely fall in price and buys

in anticipation of a likely rise in price is called

- A a hedger.
- B an arbitrageur.
- C an investor.
- D a speculator.
- E a commodity broker.

5 Ordinary members of the Abuja Securities and Commodity Exchange (ASCE)

- A can buy commodities on the exchange on their own account.
- B can buy commodities on their own account and for their clients.
- C can buy commodities only by going through the ordinary trading members.
- D can buy commodities only by going through the institutional trading members.
- E can buy commodities only for certain categories of clients.

Chapter 9

Sole proprietorship

Introduction

In order to deal with internal and external trade, we need a vast number of business units. These business units are organised in a complicated pattern which ranges in size from the sole proprietorship, or sole trader, to many multi-million naira organisations such as the United Africa Company of Nigeria Limited, John Holt Limited, G.B. Ollivant (Nigeria) Limited, Guinness Nigeria Limited, Dunlop Nigeria Industries Limited, Leventis Nigeria Limited, and so many more.

Many of the multi-million naira organisations in Nigeria actually began as sole proprietorships. Indeed, Leventis Nigeria Limited was once owned by Mr A.G. Leventis. Over the years, it has grown into a gigantic business organisation, and is no longer controlled by just one man.

9.1 Meaning of sole proprietorship

The sole proprietorship is a business unit which is owned by an individual. The owner is called the sole proprietor. A sole proprietor may control one shop or many shops and could be a printer, publisher or may own just a small manufacturing business.

In Nigeria, a sole proprietor is likely to be the local shopkeeper, a restaurant owner, a photographer, a mechanic workshop owner, a bookseller, a patent medicine dealer, a beauty salon owner, etc.

The sole proprietorship is the earliest, simplest and commonest form of business in Nigeria. The success, or failure, of a sole proprietorship depends largely on the ability of the sole proprietor to render services, or sell goods, which other people need and at prices which the people can afford. A sole proprietor is responsible to nobody and is probably assisted by close relations or hired professionals.

9.2 Sources of capital for the sole proprietor

There are two main ways through which a sole proprietor can raise money for the business. The first is through fund provided by the proprietor and the second is through external sources.

Funds provided by the proprietor are called adjusted capital fund. Adjusted capital fund consists of:

- i) the finance provided directly by the proprietor since commencement of business and this includes the value of personal property transferred to the business; and
- ii) the retained earnings or plough-back profits which, in essence, is the profit less withdrawals by the proprietor since commencement of the business.

It is not easy for a sole proprietors to obtain an outside source of finance. This is because most lenders doubt the ability of the sole proprietor to repay money so borrowed. However, the sole proprietor can obtain meagre amounts from the following outside sources:

- i) non-institutional loans consisting of borrowings from friends and relatives.
- ii) loans from financial institutions especially thrift and cooperative societies and banks – whether regular loans or overdrafts.
- iii) traders' finance and suppliers' credit which mainly refer to purchases of goods on credit, called *trade creditors*, and purchases of services on credit, called *accrued expenses*.

Source (iii) above is normally the only short-term finance, that is, current liabilities of a sole proprietorship.

9.3 Utilisation of funds by a sole proprietorship

A sole proprietorship can utilise available funds for the acquisition of fixed assets or for the acquisition of current assets. Fixed assets and current assets are both called *business assets*, that is, those things owned by a business. The benefits from fixed assets last for a relatively long period of time. Examples of fixed assets are land, building, plants, machinery, motor vehicles, furniture, fixtures and fittings.

Current assets, also called *circulating assets*, may be raw cash held for the purpose of running the business. Current assets may also be assets purposely held for conversion into cash within a short period. Examples of current assets are the stock or inventory of goods to be sold, trade debtors (that is, amount owed by customers), payments in advance for goods not yet delivered and services not yet rendered, cash kept in bank, and cash in hand or in till.

9.4 Balance sheet of a sole proprietorship

The balance sheet of a business is a statement of the sources of finance of that business and how these sources have been utilised or represented. In other words, the balance sheet shows, in detail, the net worth, and external sources of finance and the manner in which these funds have been represented in the form of fixed assets and current assets.

As a result of the bookkeeping principle that underlies accounting records from which financial statements (including the balance sheet) are prepared, a combination of net worth and external sources of finance must always be equal to the combined fixed assets and current assets. This is because the fixed and current assets of the business must be financed by a combination of net worth and external credit. That being so, the relationship below applies.

Net worth + External finance = Fixed assets + Current assets

9.4.1 Concept of liabilities

The liabilities of a business are made up of the total indebtedness of the business. For this purpose, the business is treated as separate from even its proprietor! This means that the business can even be indebted to its proprietor.

Secondly, the business can owe outsiders; that is, it can be indebted to those that are not its proprietor. This is a form of external credit, or external finance. Thus, the liabilities of a business consist of all sources of finance. This is what accountants refer to when they say that assets and liabilities must always be equal, since all sources of finance must be utilised on acquisition of assets.

However, net worth is sometimes excluded from the liabilities of a business. In this case, liabilities would refer to external finance only. If this is the situation, accountants would say that *assets must equal net worth plus liabilities*. In a way, the term 'liabilities' may connote either all categories of financial sources (including net worth) or just external finance alone.

9.4.2 Working capital

The working capital of a business is the excess of current assets over the current liabilities. In our hypothetical balance sheet which is shown below, the working capital is equal to ₦70,000 minus ₦30,000 which is ₦40,000.

9.4.3 Capital employed

This has various meanings, the commonest of which is the net worth of the business. This networth is also called net asset. In our hypothetical balance sheet, the capital employed, or net asset, is equal to ₦150,000

9.5 Presentation of the balance sheet of a sole proprietorship

The simplest and most usual presentation is to have the sources of funds on the left-hand side with the assets on the right-hand side.

Typical format of the balance sheet of a sole proprietorship as at the end of a period

Capital (or Net worth)	₦	₦	Fixed assets	₦	₦
Opening capital (plus addition during the period)	140,000		Land & buildings	130,000	
			Plants & Machinery	10,000	
			Equipment	6,000	
Add net profit	30,000		Motor vehicles	25,000	
	<u>170,000</u>		Furniture & Fixtures	9,000	
				<u>180,000</u>	180,000
Less drawings	20,000				
Closing capital	150,000	150,000			
Liabilities			Current assets		
a) Long-term liabilities			Stock (or Inventory)	19,000	
Bank loans	16,000		Trade debtors	21,000	
Loans from a cooperative society	54,000		Pre-payments	5,000	
	<u>70,000</u>	70,000	Cash in bank	18,000	
			Cash in hand	7,000	
				<u>70,000</u>	70,000
b) Current liabilities					
Trade creditors	20,000				
Accrued expenses	10,000				
	<u>30,000</u>	30,000			
		<u>250,000</u>			<u>250,000</u>

The left-hand side will indicate the total as well as the components of both the net worth and the liabilities. In particular, liabilities would be divided into long-term liabilities and current liabilities, the latter consisting mainly of traders' credit and suppliers' finance. Current liabilities can be termed short-term liabilities and are those debts with relatively short maturity periods. In other words, the indebtedness must be repaid within a short-time.

The right-hand side shows the details of each of the fixed assets and the current assets. The right-hand side and the left-hand side must be equal at all times.

We have already explained each item in the

balance sheet. Out of the ₦250,000 total assets, ₦150,000 of the amount has been financed through the proprietor's own financial resources. The remaining amount of ₦100,000 has been financed to the tune of ₦70,000 by long-term borrowings while the balance of ₦30,000 has been financed through a financial accommodation of ₦22,000 provided by a supplier of goods as well as services rendered on credit to the tune of ₦8,000.

9.6 Advantages and disadvantages of sole proprietorships

9.6.1 Advantages

- i) It is cheap and easy to set up.
- ii) Prompt decisions can be taken by the proprietor who need not be bothered with consultations and meetings.
- iii) There is complete absence of bureaucracy and, as such, business operations easily adjust to changing circumstances.
- iv) There is cordial and intimate relationship between the proprietor on one hand and the employees, customers, and suppliers on the other hand. This helps to promote the business.
- v) There is absolute freedom which the proprietor can use to make the business successful and efficient.
- vi) There is tax advantage in the sense that the tax payable on the profit of the business would often be less than the tax payable on the same amount of profit made by any other form of business unit.
- vii) There is privacy in the affairs of the business because sole proprietorships are not required by law to prepare financial statements which would have divulged its privacy not only to business rivals but also to members of the public.
- viii) There exists motivation for hard work since the proprietor alone enjoys the profits of the business and suffers alone any business losses.
- ix) Sole proprietorship is free from many forms of legal restrictions.
- x) The small nature of the business enables the sole proprietor to supervise every aspect of the business.

9.6.2 Disadvantages

- i) Sole proprietorships lack adequate capital and this hinders expansion, thus limiting the ability of the business to expand.
- ii) Sole proprietorships suffer from managerial

problems, especially when the business has grown beyond the managerial ability of the proprietor.

- iii) The proprietor is personally liable for all debts incurred by the business.
- iv) The death of the proprietor may mean the end of the business because there may be no child or wife willing and able to carry on the business. In other words, there is lack of continuity.
- v) Unwise and rash decisions may often be taken. This is because the proprietor is not required to consult anybody before taking a decision.
- vi) It is difficult for a sole proprietorship to obtain loans from banks. This is because the assets and security of the sole proprietor are limited. Sole proprietorships are very vulnerable. Many are known to have gone bankrupt due to inability to obtain credit to bail them out of liquidity problems.

Revision questions

Essay questions

- 1 Discuss the term 'sole proprietorship.' What are the major sources of finance for a sole proprietor?
- 2 Outline the advantages and disadvantages of sole proprietorship.
- 3 It is said that in Nigeria, the number of sole proprietors continues to increase every year. Why do you think this is so?
- 4 The balance sheet of Mr Akowe's business as at the end of the year is presented on page 143.

<i>Capital</i>	₦	₦	<i>Fixed assets</i>	₦	₦
Opening capital and addition during the year	18,000		Land & buildings	8,500	
Add net profit	3,200		Furniture & fittings	3,900	12,400
	<hr/>			<hr/>	
	21,200				
Less drawings	2,300	18,900			
<i>Long-term liabilities</i>			<i>Current assets</i>		
Loans from traditional Money lenders	2,500		Stock	5,500	
Loans from cooperative society	4,600	7,100	Trade debtors	6,100	
	<hr/>		Cash in hand	8,000	19,600
<i>Current liabilities</i>					
Trade creditors	4,000				
Bank overdraft	2,000	6,000			
	<hr/>				
		32,000			32,000
		<hr/> <hr/>			<hr/> <hr/>

You are required to

- indicate the net assets or capital employed.
- calculate the working capital.
- calculate the (i) internal and (ii) external sources of finance.
- discuss how the total assets of ₦32,000 have been financed.
- discuss how the total financial resources of ₦32,000 have been utilised.

Objective questions

- A sole proprietorship is
 - owned by one individual.
 - is characterised by limited liability.
 - is an incorporated business.
 - A and B.
 - A and C.
- Which of the following is *not* a source of borrowed finance for a sole proprietorship?
 - Trade creditors
 - Loans from a cooperative society
 - Debentures
 - Bank overdraft
 - Loans from traditional money lenders
- Which of the following is an advantage enjoyed by sole proprietorship?
 - The proprietor is personally liable for all debts incurred by the business.
 - It is cheap and easy to set up
 - There may be lack of continuity in the life of the business, following the death or incapacitation of the owner.
 - A and B.
 - A and C.

- 4 Disadvantages suffered by sole proprietorship include
- A that the proprietor is personally liable for all debts incurred by the business.
 - B that it is cheap and easy to set up.
 - C that there may be lack of continuity in the life of the business, following the death or incapacitation of the owner.
 - D A and B.
 - E A and C.
- 5 (I) A sole proprietorship is subjected to more legal restrictions than other forms of business.
- (II) Sole proprietorships are generally smaller than other forms of business units.
- (III) Sole proprietorships can raise finance by issuing shares.
- Which of the above three statements is/are true?
- A I only
 - B II only
 - C III only
 - D I and II only
 - E I, II and III

Chapter 10

Partnership

10.1 Meaning of partnership

The United Kingdom Partnership Act of 1890, which also applies in Nigeria, defines a partnership as the relation which subsists between persons carrying on business in common with a view of profit. An equivalent and a rather simpler way of defining partnership is to express it as an unincorporated profit-making business unit that is owned by not less than two persons. The owners of a partnership are called 'partners' and they are the entrepreneurs of the business. According to the Companies Act, 1948, a partnership may not consist of more than 20 persons. However, in Nigeria, it would be very unusual to find a partnership with as many as 20 partners. A partnership can only conduct business under the name of the partners. If any other name is to be used, then such a name must be registered with the Registrar of Business Names, and the real names of the partners indicated on the letterheaded paper used by the partnership. This is a very sensible precaution aimed at protecting the public who are entitled to know the identity of the partners.

10.2 Types of partnership

There are two main types of partnership. These are the ordinary partnerships and limited partnerships. In an ordinary partnership, all partners have equal responsibilities and equal powers. Each partner in an ordinary partnership may participate in the management of the business but all partners are equally responsible for debts of the partnership. In a limited partnership, the liability of some partners are limited to the capital invested in the business.

Whether in an ordinary partnership or in a limited partnership, each partner in a partnership is classified in accordance with the contributions made into the business. Such contributions may be in the form of capital, knowledge, skill or

expertise. On this basis, we have the following kinds of partners.

10.2.1 Active partner

An active partner takes part in the general management of the business. An active partner has unlimited liability for all debts of the firm.

10.2.2 Special partner

A special partner does not take part in the management of the firm. The liability of a special partner is limited to the capital invested in the business. The death, bankruptcy or mental disorder of a special partner does not lead to the dissolution of the partnership. The consent of a special partner is not required in order to introduce a new member into the partnership.

10.2.3 Dormant partner

As the name implies, a dormant partner does not take an active part in the business or may have retired from active participation in the affairs of the business. A dormant partner, in spite of the dormancy, is liable for the debts of the business. In other words, dormancy does not mitigate liability.

10.2.4 Nominal partner

The name of this partner is used to boost the ego of the business. A nominal partner does not take part in the management of the business and also does not share in the profit.

10.2.5 Secret partner

This partner takes active part in the management

and organisation of the business. However, a secret partner is not known to the public as a partner in the business.

10.2.6 Silent partner

A silent partner does not take an active part in the management of the business, but his partnership is not a secret.

10.3 Deed of partnership and partnership law

Partnership agreement may be made orally or in writing. The agreement may also be implied from the conducts of the parties involved. However, contracts are best made in writing to serve as safeguards in the event of a disagreement. A formal written agreement for a partnership is called a partnership deed.

10.3.1 Contents of a deed of partnership

- i) The names of the partners.
- ii) The nature of the business.
- iii) The amount of capital each partner should contribute to the business.
- iv) The manner of sharing profit and loss among partners.
- v) The percentage interest to be allowed on capital.
- vi) The limit of drawings and the percentage interest to be paid on drawings.
- vii) The basis for the valuation of goodwill in the event of retirement or death of a partner.
- viii) The salaries for partners who render special service to the partnership.
- ix) The procedure for resolving disputes among partners before resorting to the court of law.
- (x) The duration of the partnership.

10.3.2 Partnership Act

We have already mentioned the UK Partnership

Act of 1890. We stated that most provisions of that Act equally apply in Nigeria. The UK Partnership Act provides for most issues which may arise in connection with partnerships. However, a partnership agreement, whether oral or written, supersedes the provisions of the Partnership Act. If a partnership agreement is silent on any issue, the Partnership Act applies.

10.3.3 Relationship between partners and persons dealing with the partnership

Every partner is an agent of the partnership. As an agent of the partnership, every action of each partner is binding on the partnership. A partner has the authority to bind the firm through

- i) selling the goods of the firm.
- ii) purchasing goods on behalf of the firm.
- iii) receiving payments on behalf of the firm.
- iv) employing workers on behalf of the firm.

For any of the actions in (i) – (iv) above, the partner is binding the partnership. Thus, anybody wishing to go into partnership must be careful in the choice of partners. Incompetent or fraudulent persons must be avoided in the choice of partners for a partnership.

10.3.4 Relationship between partners in a partnership

The relationship between partners in a partnership is governed by the deed of partnership. We shall now examine the rights and duties of partners as provided in the Partnership Act, 1890.

10.3.5 Rights of partners

- i) All partners are to participate equally in the sharing of profit and loss.
- ii) There should be no interest on contributed capital.
- iii) There should be no remunerations for serving the partnership.

- iv) Each member may participate in the running of the business.
- v) No new partner may be admitted unless by agreement of all the partners. In other words, one partner can forestall the admission of a new partner.
- vi) Any disagreement on non-fundamental matters may be decided through a simple majority by the partners. However, a decision on a fundamental issue will need the support of all the partners.
- vii) No partner can be expelled by the other partners.
- viii) A partner is entitled to be indemnified in respect of expenses incurred on behalf of the partnership.
- ix) A partner who provides a loan to the partnership is entitled to an interest on that loan at the rate of 5% per annum.
- x) The partnership records should normally be kept at the place of the business of the firm and such records must be accessible to all the partners.

10.3.6 Duties of partners

- i) Each partner must render accurate accounts and give accurate information on matters which affect the partnership.
- ii) Each partner must account to the partnership for any benefit received in connection with the partnership affairs.
- iii) Each partner must not compete with the firm through the setting up of a competing business.

10.4 Financing a partnership

The sources of funds with which a partnership is financed are similar to the sources of funds for a sole proprietorship. Loans and net worth, however, constitute the two exceptions.

10.4.1 Loans

In addition to the loans and other external sources of credit, individual partners can also lend to the partnership. We have already noted that the

interest on such loans is 5% per annum except otherwise stated in the deed of partnership.

10.4.2 Net worth

The net worth of a partnership often consists of two parts. The first part is the fixed capital usually called the *capital account balances*. Each partner is required to contribute to the fixed capital either in cash or in kind. The second part is the fluctuating part of net worth which is the accumulated share of profits for individual partners less respective accumulated drawings. This second part is called *current account balances*.

Sometimes however, the capital account balances and current account balances of each partner are merged into what is called *fluctuating capital account balance*. In other words, there are two meanings to capital account balance. In the first meaning, the stipulated fixed amount is separate from, and supported by, current account balances. In the second meaning, the stipulated fixed capital is rendered fluctuating as a result of profit sharing and withdrawals.

10.5 Balance sheet of a partnership

The assets side, that is, the right-hand side, of a partnership balance is essentially the same as that of a sole proprietor. On the liability side, that is, the left-hand side, loans of the partners will have to be displayed as a long-term liability. Under the net worth portion, the capital account balances as well as any current account balances of each partner will have to be displayed. In other aspects, the balance sheet structure of a partnership is like that of a sole proprietorship. A typical format of the balance sheet of the partnership of Mr A and Mr B is presented as follows:

Balance sheet of the partnership of Mr A and Mr B as at the end of a period

Capital (or Net worth)	₦	₦	Fixed assets	₦	₦
Mr A: Capital account	80,000		Land & buildings	130,000	
Current account	35,000		Plants & equipment	40,000	
	<u>115,000</u>	115,000		<u>170,000</u>	170,000
Mr B: Capital account	60,000		Current assets		
Current account	40,000		Stock	38,000	
	<u>100,000</u>	<u>100,000</u>	Trade debtors	42,000	
		215,000	Cash in hand	<u>70,000</u>	
				<u>150,000</u>	150,000
Liabilities					
Long-term liabilities					
Loans from Mr B	25,000				
Loans from the bank	50,000				
	<u>75,000</u>	75,000			
Current liabilities					
Trade creditors	14,000				
Bank overdraft	16,000				
	<u>30,000</u>	<u>30,000</u>			
		<u>320,000</u>			<u>320,000</u>

Let us now note some important points in connection with the balance sheet which we have just displayed.

- 1 The net worth contributed by Mr A is ₦115,000 which is made up of ₦80,000 fixed or stated capital to be contributed and ₦35,000 of accumulated shares of profits less the accumulated withdrawals. An alternative way of showing this net worth is to display just the combined figure of ₦115,000 without showing its breakdown. What has been said about Mr A can also be extended to the combined ₦100,000 net worth of Mr B. The total partnership net worth is therefore ₦215,000.
- 2 Loans provided by Mr B have been

distinguished and stated separately from the net worth.

- 3 Banking overdraft is normally treated as a current liability in any balance sheet, not in partnership balance sheet alone.

10.6 Dissolution of a partnership

Dissolution of a partnership means the termination of the life of the partnership. A partnership can be dissolved with or without a court order.

10.6.1 Dissolution of a partnership without a court order

Unless the partnership agreement stipulates otherwise, a partnership can be dissolved without a court order under the circumstances which follow.

- i) At the end of the term fixed for the partnership.
- ii) The termination of the venture for which the partnership was originally formed.
- iii) If partnership had been entered into for an undefined term, the partnership stands dissolved if a partner gives notice of intention to dissolve the partnership.
- iv) The death or bankruptcy of one of the partners.
- v) If a partner uses a part of contributed capital to settle personal debts.
- vi) If as a result of new legislation, the business of the partnership becomes illegal.

10.6.2 Dissolution of partnership with court order

On application by a partner, the court may order the dissolution of partnership under the circumstances which follow.

- i) When a partner, by reason of mental disorder, is incapable of administering own personal affairs.
- ii) When a partner is incapable of performing the duties of a partner.
- iii) When a partner has been found guilty of gross misconduct either in the partner's business or private life.
- iv) When a partner wilfully and persistently breaches the partnership agreement, or makes it impossible for the other partners to carry on the business of the partnership.
- v) When the partnership is unable to break even.
- vi) When a court of law thinks it just and equitable to dissolve a partnership.

10.6.3 Application of the partnership assets on dissolution

When a partnership is dissolved, some of the assets are normally sold for cash whilst others are taken over by interested partners at values mutually agreed upon. The proceeds from the disposal of these assets are applied in the order which follows:

- i) Payment of debts and liabilities to outsiders.
- ii) Payment of loans granted to the partnership.
- iii) Payment of the capital contributed by partners.
- iv) Any amount left is distributed among the partners in accordance with the profit sharing ratio agreed upon during the formation of the partnership.

If the revenue realised from the sale of the partnership assets is insufficient to settle the indebtedness of the partnership, the outstanding amount is made up from current account balances which represent the accumulated retained profit from the previous years. If the accumulated retained profit is insufficient to settle the outstanding amount, the stipulated fixed capital of the partners would be utilised. After this, any outstanding amount will be made good through individual contributions by the partners, normally in accordance with the profit-sharing ratio agreed upon at the formation of the partnership.

10.7 Advantages and disadvantages of partnership

10.7.1 Advantages

- i) It is easy to set up and no legal fees are involved.
- ii) There would be no need for formal board meetings, annual general meetings and, as a result, decisions are quick to take.
- iii) Tax is low on profit made by a partnership.

- iv) There is privacy in the sense that financial statements of the partnership are not made public.
- v) It is easy to raise capital since each partner brings own monetary resources into the business.
- vi) There is room for division of labour and each partner could concentrate on a specialist area.
- vii) There is no scope for unwise and rash decisions because partners must consult before decisions are taken.

- v) All partners are bound by the action of one partner.
- vi) Success of a partnership depends on the ability of partners to work as a team. Any serious disagreement among partners may lead to the dissolution of the partnership.
- vii) Consent of all partners is necessary before a new partner can be admitted. This means that one partner can effectively veto the admission of a new, useful partner.

10.7.2 Disadvantages of partnership

- i) Partners suffer unlimited liability except for a limited partner.
- ii) Unless the partnership agreement provides otherwise, the death, retirement, insanity or bankruptcy of a partner will lead to the dissolution of the partnership.
- iii) Capital cannot be raised from members of the public through issuance of debentures.
- iv) The growth of the firm is limited to the managerial abilities of the partners.

Revision questions

Essay questions

- 1 Define the term 'partnership'. Name the various kinds of partners and write brief notes on three of them.
- 2 What is a 'deed of partnership'? Enumerate the contents of a deed of partnership.
- 3 Outline the rights and duties of partners in a partnership.
- 4 The balance sheet of the partnership of Mr Sam and Mr Madu as at the end of a year is as presented below.

Capital	N	N	Fixed Assets	N	N
<i>Capital account</i>					
Mr Sam		40,000		Land & building	25,000
Mr Madu		30,000	70,000	Plant & machinery	<u>26,000</u> 51,000
<i>Long-term liabilities</i>					
Loans from Mr Sam		12,000		<i>Current assets</i>	
Bank loans		<u>8,000</u>	20,000	Inventory	22,000
<i>Short-term liabilities</i>					
Trade creditors		9,000		Trade debtors	15,000
Accrued expenses		<u>4,000</u>	<u>13,000</u>	Cash in bank	6,000
			<u>103,000</u>	Cash in hand	8,500
				Prepayments	<u>500</u> <u>52,000</u>
					<u>103,000</u>

You are required to

- a) indicate the net worth or capital employed.
 - b) calculate the working capital.
 - c) calculate the (i) internal, and (ii) external sources of funds.
 - d) explain how the total assets of ₦103,000 have been financed.
 - e) explain how the finance of ₦103,000 has been represented.
- 5 Under what circumstances can a partnership be dissolved without a court order?
 - 6 Under what circumstances can a court order the dissolution of a partnership?
 - 7 Outline the advantages and disadvantages of a partnership.

Objective questions

- 1 A dormant partner
 - A does not take an active part in the business.
 - B is not liable for the debt of the partnership.
 - C does not share in the profit of the partnership.
 - D refers to A and B.
 - E refers to A and C.
- 2 According to the extant partnership law, in the absence of the deed of partnership providing otherwise
 - A all partners are to participate equally in the sharing of profit and loss.
 - B there shall be 10 per cent annual interest on contributed capital.
 - C remunerations for serving the partnership should be fair and just.
 - D a partner can only be expelled by a majority vote of other partners.
 - E participating in the running of the partnership business is only a privilege and not a right.
- 3 Which of the following is *not* a source of borrowed finance for a partnership?
 - A Trade creditors
 - B Loans from individual partners
 - C Debentures
 - D Bank overdraft
 - E Loans from banks

- 4 Which of the following is an advantage enjoyed by a partnership over a sole proprietorship?
 - A The partners are not personally liable for all debts incurred by the business.
 - B It is cheaper and easier to set up than a sole proprietorship.
 - C There is room for specialisation and for mutual consultations among partners.
 - D A and B.
 - E A and C.
- 5 Unless the partnership agreement stipulates otherwise, a partnership can be dissolved without a court order
 - A at the end of the term fixed for the partnership.
 - B due to death or bankruptcy of one of the partners.
 - C when the partnership is unable to break even.
 - D owing to A and B.
 - E owing to A and C.
- 6 On dissolution of a partnership, the proceeds from the disposal of partnership assets are applied in the following order:
 - A Payment of debts to outsiders, followed by payment of the capital contributed by partners, and then payment of loans granted by partners to the partnership.
 - B Payment of debts to outsiders, followed by payment of loans granted by partners to the partnership, and then payment of capital contributed by partners.
 - C Payment of the capital contributed by partners, followed by payment of loans granted by partners to the partnership, and then payment of debts to outsiders.
 - D Payment of loans granted by partners to the partnership, followed by payment of the capital contributed by partners, and then payment of debts to outsiders.
 - E None of the above.

Chapter 11

Money

11.1 Meaning of money

Money is anything that serves as a medium of exchange for goods and services. Money may be in the form of tokens with the value established by the government of a country. The tokens are usually minted pieces of metal or promissory notes in the form of Central Bank of Nigeria notes. Indeed, money can be anything that is locally accepted, and this may be in the form of commodity money like beads, cowries, cows, goats, etc.

11.2 Evolution of money in Nigeria

For a long time, the barter system was the only method of exchange. Later, the use of commodity money co-existed with the barter system. Eventually, the barter system gave way to commodity money. Such commodity money includes cowrie shells, manilla, iron rods, etc.

Before the colonisation of Nigeria by Britain, the currencies of European countries such as Portugal, Spain, France and Britain, were in circulation in what is now Nigeria.

In 1894, a branch of the British Bank of West Africa (BBWA) was established in Nigeria. The use of cheques was introduced with the establishment of the BBWA. However, the use of cheques was not popular then, and has never been very popular in Nigeria.

In 1912, the British colonialists established the West African Currency Board. The Board's area of jurisdiction included Nigeria, Ghana, Sierra-Leone, and The Gambia. The West African Currency Board withdrew from circulation the currencies of other countries and, in their place, issued its own currency. We can say, therefore, that the existence of legal tender actually began in Nigeria in 1912.

On 1 July 1959, the Central Bank of Nigeria

began operations. Nigeria, therefore, withdrew from the West African Currency Board and the Central Bank of Nigeria began to issue currencies which constituted legal tender in Nigeria.

11.3 Forms of non-electronic money

There are various forms of money. These include commodity money, legal tender, and demand deposits.

11.3.1 Commodity money

Demerits of the barter system necessitated the introduction of commodity money which is useful for purposes other than as a means of payment. For this reason, commodity money is said to have a high intrinsic value. Examples of commodity money include cows, common salt, cowrie shells, gold, silver, etc. The use of commodity money is wasteful because commodities that could have been directly consumed are now being used as money.

11.3.2 Legal tender

Legal tender is anything decreed by law to be used as money. In other words, the acceptability of a legal tender derives from the law of a country. For this reason, legal tender is also referred to as fiat money. One consequence of legal tender is that a creditor who refuses to be paid with forfeits the right to be paid in any other form.

In Nigeria, legal tender now consists of currency issued by the Central Bank of Nigeria. This currency, in turn, comprises bank notes such as ₦100, ₦200, ₦500 and ₦1,000. Coins are also legal tender and these are minted in digits of 50k,



Fig. 11.1 Nigerian bank notes—part of legal tender in the country

₦1, etc. Bank notes are legal tender up to any amount. Coins are legal tender only up to certain limits. For example, if you decide to settle a debt of ₦60,000 with only 50k coins, your creditor may refuse to accept the money, which, for that particular amount, is no longer legal tender.

Coins constitute a form of commodity money up to some extent. This is because coins are still used for some other purposes, especially as ornaments. Bank notes cannot be used for any other purpose except as a medium of exchange. Bank notes are without any commodity content and are often referred to as token money.

11.3.3 Demand deposits or bank money

This is the type of money kept in the current account of a commercial bank and, to a lesser extent, microfinance banks and merchant banks. The withdrawal of bank money or demand deposit from the current account is made on demand, that is, without any previous notice to the bank by writing a cheque to that effect.

It should be noted that the actual money in this sense is the demand deposits and not the cheques. Cheques are just a withdrawal or transfer mechanism through which the bank money is

transferred from one bank to another, or from bank money to raw cash, that is, the currency.

Unlike bank notes issued by the Central Bank, bank money or demand deposits are issued by commercial banks, and to a lesser extent, the microfinance and merchant banks. Unlike bank notes, cheques are not legal tender. But both constitute paper money.

11.3.4 Scrip

A scrip is a certificate whose value is recognised by the payer and payee and, though not a currency or legal tender, is a substitute for currency and can easily be converted into a currency. It can also refer to either company money that could only be used at the company store or a certificate exchangeable for cash before a specified date, after which it may have no value. It also sometimes refers to paper money (but still not legal tender) issued by a government for a specific purpose or issued by a merchant or other body for local circulation.

11.3.5 Private currency

A private currency is a currency issued by a private organisation. It is often contrasted with fiat currency, i.e., legal tender, issued by

governments. Such private currency can take different forms that include local paper money, computerised systems of credits and debits, as well as electronic currencies in circulation, such as digital gold currency. In many countries, the issue of private paper currencies is severely restricted or even outrightly prohibited by law.

11.4 Forms of electronic money or e-money

Electronic money (or e-money), which is also variously called e-currency, e-cash, digital money, digital cash, refers to money or scrip which is exchanged only electronically or digitally. The mode of, or device for, such electronic exchange of money can be through digital stored-value systems, i.e., 'stored value' or pre-paid payment mechanisms for making payments via point-of-sale (POS) terminals (e.g., the amount of money loaded into a stored-value card or amount of money pre-paid for a pre-paid debit card). It can also be through direct transfers between two devices or over computer networks such as the Internet. Two specific forms of electronic money, stored-value card and Internet-based e-cash, are discussed below.

11.4.1 Stored-value card

This is a credit-card-sized plastic card that is implanted with a computer chip that is encoded with monetary value on a magnetic strip. It is a substitute for cash and is particularly suited for low-value retail purchases. Unlike a pre-paid card in respect of which money is on deposit with the issuer and a debit card with an externally recorded account, the monetary value in a stored-value card is embedded in it. A stored-value card is also used as an electronic purse.

There are two main categories of stored-value card. The first type is a single-purpose or closed-loop type. It is used in purchasing one type of goods or service from one vendor; it is also used by a merchant or vendor to issue spending limit credit to its customers by giving a magnetic strip card in exchange for money received, with each purchase amount deducted from the card. It is in the form of a disposable card in the sense that,

after exhausting the monetary value through purchases, it cannot be re-loaded with monetary value again. Examples of this are merchant gift cards, transit system fare cards, and pre-paid telephone cards.

The second type is a multipurpose or open-loop card, which can be used for a variety of purchases from several vendors and even for banking purposes, such as receipt of direct deposits and withdrawal of cash from ATMs. This can be in the form of a disposable card, which cannot be reloaded after exhausting the monetary value initially stored in it. It can also be in a form that can be reloaded with additional value, so that it can be re-used by transferring monetary value to it from an ATM or any other suitable device.



Fig. 11.2 Cash dispensing at an ATM

In terms of the degree of sophistication, there are also two types: the simple and the sophisticated ones. A simple stored-value card is purchased with a certain amount of money already stored or encoded there, like a prepaid phone card. The card can then be used to make

payments until the amount stored in it is used up (or about to be used up), after which it can be reloaded to enable it to be usable for further payments. A more sophisticated stored-value card is the one based on smart cards. A smart card can be loaded with digital cash from the owner's bank account through ATMs, personal computers with a smart card reader, or a special form of cell phones.

Stored-value card mechanism has a particular advantage to those that lack access to conventional current or savings accounts with banks.

11.4.2 Internet-based electronic cash (or e-cash)

E-cash is used in making payment for goods and services purchased through the Internet. The e-cash facility user first has to open an account with a bank that has links to the Internet and then gets the e-cash transferred to his personal computer. While ordering for goods through the Internet by clicking the 'buy' option for a particular item on the Web store, the e-cash facility would automatically transfer from his computer to the computer of the seller of the goods. The seller would then get the funds transferred into his own bank account from the buyer's bank account, before sending the goods to the buyer.

11.5 Qualities and functions of money

11.5.1 Qualities of money

For money to be effective, it must have certain attributes. Let us now itemise a few of such attributes.

- i) Money must command general acceptability.
- ii) Money must be durable if it can serve as store of value.
- iii) Money must be scarce. In other words, money must be limited in availability.
- iv) Money must have stable purchasing power if it can serve as a good unit of account.
- v) Money of the same denomination must

be homogeneous. In other words, every denomination of money having the same value must look alike. For example, all ₦500 notes in Nigeria look alike. This prevents confusion.

- vi) Money of different denominations must be heterogeneous. In other words, different denominations of money should not look alike. For example, ₦500 notes and ₦1,000 notes should not look alike.
- vii) Money must be divisible. In other words, money should consist of different denominations such as ₦50, ₦100, ₦500, etc. This makes money useful in transactions of high values and low values.
- viii) Money must be portable. In other words, money must be easy and convenient to carry about.

11.5.2 Functions of money

- i) Money is a medium of exchange. This is the major function of money. Being a medium of exchange, money saves us time and enables us to purchase a wide range of goods. Money therefore facilitates specialisation and exchange.
- ii) Money serves as a store of value. This means that wealth can be held in the form of money.
- iii) Money acts as a measure of value. This means that money can be used to measure the worth of goods and services. Money therefore acts as a unit of account.
- iv) Money acts as a standard for deferred payments. This means that money facilitates lending and borrowing, as well as buying and selling on credit.

Revision questions

Essay questions

- 1 What is money? Write briefly on
 - i) commodity money
 - ii) fiat money
 - iii) bank money
- 2 Briefly discuss the evolution of money in Nigeria.

- 3 Enumerate the characteristics of money.
- 4 What are the functions of money?
- 5 Explain how the credit card system works in Nigeria.

Objective questions

- 1 Which of the following is *not* a form of commodity money?
 - A Cowrie shells
 - B Salt
 - C Gold
 - D Silver
 - E Naira notes
- 2 Which of the following is not legal tender?
 - A Fiat money
 - B Scrip
 - C Bank notes
 - D Coins up to a certain limit in terms of value
 - E None of the above
- 3 Electronic money includes
 - A Internet-based e-cash.
 - B stored-value cards.
 - C scrip.
 - D A and B.
 - E B and C.
- 4 Which of the following is *not* a quality of money?
 - A General acceptability
 - B Durability
 - C Plenty and easy to get
 - D Stable purchasing power
 - E Easy recognition
- 5 Functions of money include
 - A medium of exchange.
 - B store of value.
 - C measure of value.
 - D all of the above.
 - E none of the above.

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