

# BUSINESS KNOWLEDGE (FA3)

## CERTIFICATE IN FINANCIAL ACCOUNTING



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## **PREFACE**

### **INTRODUCTION**

The Institute noted a number of difficulties faced by students when preparing for the Institute's examinations. One of the difficulties has been the unavailability of study manuals specifically written for the Institute's examinations. In the past students have relied on text books which were not tailor-made for the Institute's examinations and the Malawian environment.

### **AIM OF THE MANUAL**

The manual has been developed in order to provide resources that will help the Institute's students attain the needed skills. The manual has been developed in such a way that even those who would like to study on their own can do that. It is therefore recommended that each student should have their own copy.

### **HOW TO USE THE MANUAL**

Students are being advised to read chapter by chapter since subsequent work often builds on topics covered earlier.

Students should also attempt questions at the end of the chapter to test their understanding. The manual will also be supported with a number of resources which students should keep checking on the ICAM website.

## TABLE OF CONTENTS

CHAPTER 1 WHAT IS PRODUCTION?.....	6
CHAPTER 2 RETAIL TRADE .....	13
CHAPTER 3 WHOLESALE TRADE .....	19
CHAPTER 4 INTERNATIONAL TRADE.....	22
CHAPTER 5 AIDS TO TRADE.....	30
CHAPTER 6 BUSINESS ORGANISATIONS.....	47
CHAPTER 7 FINANCIAL SERVICES SECTOR .....	66
CHAPTER 8 INTRODUCTION TO MALAWI LEGAL SYSTEM.....	78
CHAPTER 9 OUTLINE OF THE LAW OF CONTRACT.....	81
CHAPTER 10 CONTRACT FOR THE SALE OF GOODS.....	108
CHAPTER 11 HIRE PURCHASE.....	117
CHAPTER 12 NEGOTIABLE INSTRUMENTS.....	125
CHAPTER 13 CORPORATE GOVERNANCE .....	132

## **FA3: BUSINESS KNOWLEDGE**

### **AIM OF THE COURSE**

To provide candidates with an understanding of the operation of various business entities on the global market and how various business laws are applied to level the playing field of the participants in the global market.

On completion of the course, candidates will be able to:

- understand the various forms of trade and commerce;
- Differentiate the types of businesses units that operate in Malawi;
- Understand the law as it affects business operations;
- Understand the role of governance in the management of the business
- Express themselves about the topics discussed in the syllabus.

### **FORMAT AND STANDARD OF THE EXAMINATION PAPER**

The examination will be divided into two sections. Section A, will have three questions. Candidates will be required to answer any two questions from this section. Section B will have four questions; candidates will be required to answer any three. All questions will carry equal marks. Candidates will lose marks for failing to communicate clearly including grammatical errors.

### **SPECIFICATION GRID**

Areas of study in this syllabus have been given weightings which should guide the relative study time spent on each. Generally the marks available in the assessment are guided by the weighting bellow, notwithstanding that variations may occur in individual assessments to enable suitably rigorous questions to be set.

<b>Syllabus Area</b>	<b>Weighting (%)</b>
<b>Production and Trade</b>	30
<b>Business Organizations and Financial Services</b>	25
<b>Law</b>	20
<b>Hire Purchase, Law of Agency and Negotiable Instruments</b>	20
<b>Corporate governance</b>	5
	100

## 1. Production

Candidates will be able to identify the various industries that play a role in the production of goods and services.

- a. In the assessment, candidates may be required to:-define production
- b. explain the various factors of production
- c. describe the nature of industries and commerce
- d. explain how outsourcing is affecting industries and commerce
- e. state types of specialization, and its impact on countries.

## 2. Trade

Candidates will be able to identify the various types of traders who are involved for products to be consumed after production.

In the assessment, candidates may be required to:-

- a. explain the functions of a retailer
- b. identify various types of retail businesses, including mail order
- c. identify factors that affect retail trade
- d. explain the functions of a wholesaler
- e. state types of wholesalers
- f. identify alternative methods of distribution
- g. have an insight on the future of wholesalers.
- h. explain the reasons of having international trade, its advantages and disadvantages.
- i. understand imports and exports, and documents used to facilitate imports and exports
- j. identify the effect of globalization on trade

## 3. Aids to trade

Candidates will be able to discuss the importance, forms and characteristics of aids to trade.

In the assessment, candidates may be required to:-

- a. identify types of transport, their advantages and disadvantages
- b. state types of warehouses and why they are important in business
- c. identify types of advertising, and the role it plays in commerce
- d. identify terms in insurance, and the role it plays in business
- e. state what e-commerce is, and explain its advantages and disadvantages

## 4. Business organizations

Candidates will be able to explain the nature and structure, advantages and disadvantages of the various types of business organizations.

In the assessment, candidates may be required to:-

- a. identify the types of sole traders/proprietorships and partnerships, and to explain the advantages and disadvantages of these businesses
- b. state how the various types of companies are formed, regulated, dissolved and their legal personality.
- c. identify types of parastatals, cooperatives, and multinational companies, and show the respective advantages and disadvantages

## **5. Financial services sector**

Candidates will be able to identify the nature of the financial services sector in Malawi as an aid to trade,

In the assessment, candidates may be required to:-

- a. identify money and barter systems of exchange, nature and functions of money, and how inflation affects money
- b. identify types of banks and other financial institutions that have come into play because of money system
- c. discuss how electronic and internet banking is affecting the money system

## **6. Introduction to Malawi legal system**

Candidates will be able to explain the various sources of law in Malawi and the organisation of the courts in Malawi.

In the assessment, candidates may be required to:-

- a. state the sources of law, the establishment structure of the Judiciary, and powers of courts.

## **7. Outline of the law of contract**

Candidates will be able to explain the basic principles of the law of contract.

In the assessment, candidates may be required to:-

- a. recognize a legally binding contract and how it can be enforced
- b. identify issues leading to termination of contract, and possible remedies for breach of contract

## **8. The contract for sale of goods**

Candidates will be able to explain the law relating to sale of goods.

In the assessment, candidates may be required to:-

- a. state the meaning of goods, recognize a legally binding contract of sale, and the terms of such contracts
- b. identify when property passes and associated risks, and possible remedies for breach of contract

### **1. Hire purchase**

Candidates will be able to explain law relating to hire purchase.

In the assessment, candidates may be required to:-

- a. identify hire purchase agreement and differentiate it with a sale agreement

### **2. Outline of the law of agency**

Candidates will be able to explain the basic principles of the law of agency.

In the assessment, candidates may be required to:-

- a. identify the nature, types, and termination of agency, including the duties and rights of principal and agent

### **3. Negotiable instruments**

Candidates will be able to explain the law relating to negotiable instruments.

In the assessment, candidates may be required to:-

- a. identify negotiable instruments
- b. explain the Bill of Exchange as a negotiable instrument, and identify the parties involved
- c. state the rights of holders of, and liability of parties to, a bill of exchange, and how a bill of exchange is discharged

### **16. Corporate governance**

Candidates will be able to identify corporate governance issues.

In the assessment, candidates may be required to:-

- a. identify the importance of governance in the management of any business
- b. identify main players for an effective governance structure, and how ethics cement such a culture
- c. state meaning of money laundering, corruption, and fraud.

### **REFERENCE**

ICAM Business Knowledge Manual

## CHAPTER 1

### PRODUCTION

#### WHAT IS PRODUCTION?

Production can be defined as the creation of utilities to satisfy human wants/needs.

Utility can be in different form e.g.

- i. **Utility of Form:** In this case production involves changing the form of materials e.g. wood is made into furniture.
- ii. **Utility of Place:** Production here involves changing location of commodities e.g. transporting sugar from Nchalo to Blantyre.
- iii. **Utility of Time:** Production here involves storing goods until required. It is important, in a competitive environment, for a customer to physically obtain the chosen product as quickly as possible.
- iv. **Provision of services:** These are intangible tasks that cannot be "stored" or replicated exactly.

These human wants can range from the basic needs to the sociological needs.

Note that production can in short be defined as creation of goods and services.

Goods here means tangible things such as clothes, furniture, sugar, etc.

And services mean such things as health, defence, education, etc.

#### PRODUCTION FACILITIES

These are factors which help production to take place.

- i. **Land:** This includes land itself and all other gifts of nature e.g. soil, trees, mineral deposits etc. Land is the ultimate resource of all materials and natural forces, and provides space where production can be carried out.
- ii. **Labour:** Labor represents the human resources available to transform raw or national resources into consumer goods. This could be both physical and mental, which is available to engage in the production

of goods and services. Examples of labour as a factor of production is a managing director as well as a sweeper on the shop floor who both provide labour.

- iii. **Capital:** This term is used in many different ways today. However, capital as a factor of production refers to some stock of physical assets which have been there in the past and are still available for present use. It also includes human capital.
- iv **Entrepreneur:** This term is used to mean either:
  - (a) the owner of a business or
  - (b) the person who manages the business; or co-ordinates the factors of production.

## TYPES OF PRODUCTION/INDUSTRIES

### 1. PRIMARY INDUSTRIES/PRODUCERS

#### a **Extractive Industry**

This involves the obtaining of the gifts of nature, i.e. raw materials from nature through extracting process). Typical examples of extractive industries are: fishing, farming, mining, quarrying, lumbering and trapping. In Malawi, agriculture or farming is the most important extractive industry, followed by fishing. On mining, some deposits of minerals have been identified in some parts of Malawi. E.g. bauxite on Mulanje mountain, uranium at Kayerekera in Karonga, and coal at Kaziwiziwi in Rumphi.

Tea-picking in Thyolo and Mulanje districts is another example of extractive industry.

#### b. **Manufacturing Industry**

This deals with the converting of raw materials into finished goods, e.g. sugar, clothes, etc. These industries use inputs produced by extractive industries which they turn into manufactured or finished goods e.g. the manufacturing of sugar and clothes from both sugar canes and cotton respectively.

c. **Constructive Industry**

This deals with construction or building e.g. road building, construction of houses, bridges and roads just to mentioned a few.

2. **SECONDARY INDUSTRIES/PRODUCERS**

**Commerce/Commercial Services**

This sector involves all the activities which are necessary for a produced product to reach the consumer in good condition. It must be pointed out here that production is not complete until when the finished goods are in the hands of the consumer. This particular work is carried out by various kinds of trade such as banking and finance, transportation, insurance warehousing and advertising.

In Malawi such roles are played by such players as Reserve Bank of Malawi, commercial banks, micro-finance institutions, transport companies, and insurance companies.

3. **TERTIARY INDUSTRIES/DIRECT SERVICES/PRODUCERS**

This sector provides a social structure to enable production to take place smoothly e.g. health, education, defence, etc. These services are provided by both the public and private institutions. For example, health: Queen Elizabeth Central Hospital versus Mwaiwathu Hospital. This means that the other two sectors mentioned earlier on depend on this sector for their operations just as this sector too depends on the two mentioned sectors for its survival.

**DIRECT AND INDIRECT PRODUCTION**

**Direct Production**

It comes in where a person produces everything he/she needs to satisfy his own needs or wants. And in ordinary life this is impossible. We all depend on each other.

**Indirect Production**

This comes in when each producer specialises in one product and he/she produces the product in question more than he/she needs. The excess product is exchanged for other producers' products. This brings us then to the concept of specialization.

## OUTSOURCING

### DEFINITION:

Outsourcing is any task, operation, job or process that could be performed by employees within an organisation, but is instead contracted to a third party for a significant period of time.

### ADVANTAGES

1. Outsourcing allows an institution to concentrate on core business.
2. An outsourcing institution can bring better management skills to your company than what would otherwise be available.
3. Staffing flexibility – Outsourcing will allow operations that have seasonal or cyclical demands to bring in additional resources when you need them and release them when you are done.
4. Risk-sharing – Since the outsourced vendor is a specialist, they plan your risk-mitigating factors better.
5. The lower cost of operation and labour makes it attractive to outsource.

### DISAVANTAGES

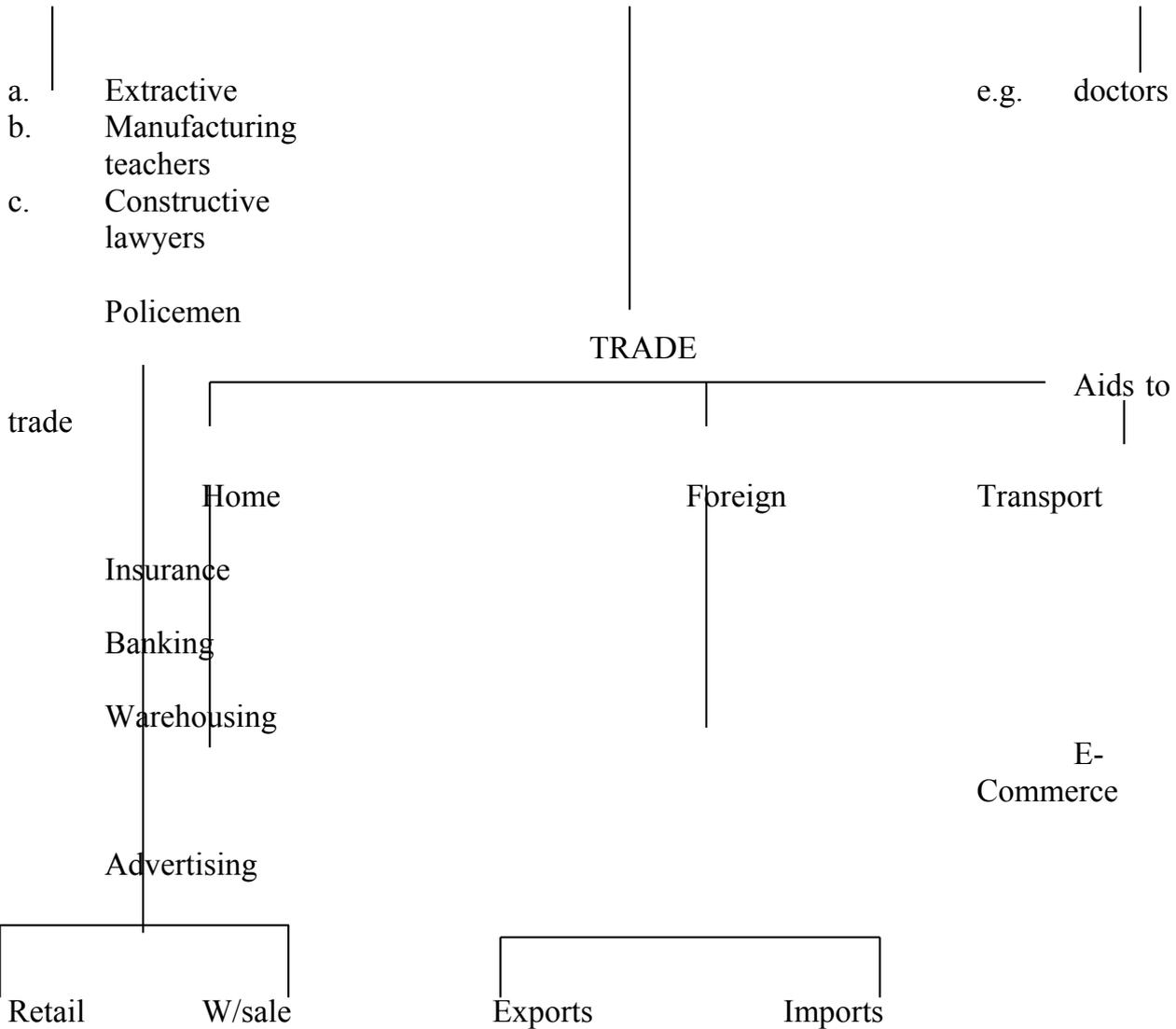
1. There is risk of exposing confidential data to a third party.
2. Losing management control of business functions mean that you may no longer be able to control operations and deliverables of activities that you outsource.
3. The outsourcing institution will be motivated by profit and might compromise on quality.
4. Lack of customer-focus: An outsourced vendor may be catering to the expertise needs of multiple organisations at a time. In such situations vendors may lack complete focus on your organisation's tasks.

## PRODUCTION

(PRIMARY)  
INDUSTRY  
SERVICES

(SECONDARY)  
COMMERCE

(TERTIARY)  
DIRECT



## Specialisation

By definition, specialization is the concentration of resources in production of narrow range of products (or one product) rather than a wide range of products. Specialization can also be defined as a situation in which resources are concentrated in the production of a relatively few types of commodities rather than a wider range of commodities.

## How Does Specialization Occur?

### 1. SPECIALISATION BY INDIVIDUALS

This means an individual concentrates on one activity or occupation.

But let us note that there are exceptions to this rule in that a person may not always be in an occupation he/she is best suited for because:

- i. The job that an individual could do best may not be available.
- ii. The individual may not wish to do the job for which he/she can expect the best economic reward, and
- iii. The individual may be a bad judge of what he/she is best at or he/she may simply be unaware of the opportunity.

### 2. SPECIALISATION BY REGIONS

This is a concentration of industry in a particular area. This may happen because:

- i. a trained labour force is available locally
- ii. raw materials are close at hand
- iii. sources of power are easily available; and
- iv. access to the market is relatively easy because either the product is sold locally or transport facilities are good.

### 3. SPECIALISATION IN COUNTRIES

Countries concentrate effort on producing goods and services they can produce more cheaply than other countries.

International specialisation can arise from:

- i. suitability of climate
- ii. availability of raw materials or resource endowment
- iii. readiness of market, and
- iv. skill of labour force

### SOME MERITS OF SPECIALISATION

It increases and sharpens skills – i.e. constant repetition of the same thing leads to excellent proficient of that particular operation.

responsible for only one part of the process become as skilled as they possibly can in that process without the distraction of learning other skills.

1. There is a saving of time in the training of factory workers. A worker can be trained quickly for the performance of a single operation.
2. There is saving of skill. Each worker can concentrate on what they are good at and build up their expertise.
3. It makes possible a much greater use of machinery. A complex operation of a machine is simplified when the complex operation is broken into a series of separate operations specialized by individuals.

### **SOME DEMERITS OF SPECIALISATION**

1. **Monotony** - repetitive operations make one dull or indeed bored, for the worker is not given a chance of self-initiative, creativity and responsibility.
2. **Losses of Craftsmanship** - basic skills are transferred from the hands of the worker to the machines.
3. Specialisation increases the risk of unemployment. Specialisation means the worker does not have the wide industrial training which would make him adaptable to changes in the techniques of production.
4. A specialized system of production increases the extent to which different sectors of the economy depend on one another.

## CHAPTER 2

### RETAIL TRADE

The word “RETAIL” originally meant ‘to cut a piece of tail off’ ‘to cut again’. A retailer is a businessman who sells things in small quantities.

Retailing is selling goods in smaller quantities to the final consumer. A manufacturer or a wholesaler who sells direct to the consumer is acting as a retailer. He/She adds retailing to his/her other activities. Whatever channel of distribution is used, the retailing function always exists.

#### FUNCTIONS OF THE RETAILER

A retailer provides services to those to whom he/she sells to and those from whom he/she buys. His functions include:

1. Anticipation of consumer’s demand. The retailer must anticipate demand. Consumers do not usually give their orders in advance.
2. Buying large and selling small. Retailer buys in fairly large quantities and sells in smaller quantities which are convenient for customers use.
3. He/she makes goods immediately available to customers.

Retailers provide goods where their customers want them. Consequently shops are in centres of population, the goods are taken to the consumers. Manufacturers can make goods in one place although they will be required in innumerable places.

4. Grading, packing and sorting.
5. Storage.

#### POSSIBLE PERSONAL SERVICES OF A RETAILER

1. Depending on the type of goods they sell, some retailers provide **advice** and **information** e.g. advice a chemist would give about medicines.
2. **A delivery Service** – Must be provided by some retailers e.g. those selling furniture.
3. **After – Sales Service** – This may be an undertaking which is to be given invariably by a retailer to repair faults which occur within a certain time in such goods as electrical appliances.

4. **Credit Facilities** – They provide informal credit to trustworthy customers (small scale retailers).

## **TYRES OF RETAILERS**

Retailers may be classified as follows:

1. Those who sell in shops and those who use other methods.
2. Small scale and large scale retailing.
3. Those who are solely retailers (traditional retailers) and those who combine retailing with manufacturing and/or wholesaling.

## **SMALL SCALL RETAILING**

Small-scale retail trade is one where a limited variety and also limited quantity of goods are sold within a local area.

In retail trade throughout the world the small firms are able to compete successfully with the large firms and they can work side by side with them. Some examples of small scale retailers are as follows:

### **1 Unit Shops/Independent Retailer**

This is the most common form of retail business in Malawi. It is usually owned by a sole proprietor or family.

### **2 Mobile Shops (The Itinerant Traders)**

These retailers sell goods from door to door.

### **3 Roadside Trader**

These traders rent a space in the market area and normally trade in groceries, craft, etc.

## **ADVANTAGES OF SMALL SCALE RETAILING**

- 1 It provides personal service to customers
- 2 It provides a convenient source of supply
- 3 It can sell in very small quantities if required

#### 4 Small scale shops often trade for long and irregular hours

Note that the main advantage is that the retailer is in personal touch with his customers and can have intimate knowledge of their wants. Again, he can not get the advantage of lower prices which are available for large purchasers from suppliers and his costs are greater when measured against the amount of his sale. Consequently his prices are higher than those charged by the large shops.

#### **WHY THEN DO THEY SURVIVE?**

Many of them do not.

Those who survive do so because they provide services which large shops do not. The “Little Corner Shop” still exists because it is close to its customers.

The small shop will often be open during odd hours when the large ones are not.

#### **DISADVANTAGES OF SMALL SCALE RETAILING**

- 1 It holds a small amount of stock and variety is limited
- 2 Costs and prices tend to be high
- 3 Such undertakings are often short of capital and that hinders progress

#### **LARGE SCALE RETAILING**

Over the years, there has been a considerable growth in large scale retailing.

#### **CONTRIBUTING FACTORS**

- 1 Development of cheap and adequate transport facilities, drawing customers from a wide area into a central shopping centre.
- 2 Growth of transport also means that people could move further away from the areas where they worked/lived.

#### **MULTIPLE SHOPS**

These are always operated by large companies, and the distinguishing feature is that they have numerous branches. They usually trade under the same style – making them easily recognizable e.g. a Peoples shop in one town will be similar to one in any other town.

All the branches are directed from the centre. Although each branch has a manager, all the buying is done at the Head Office (giving advantage of bulk buying). Normally these shops sell a narrow range of goods by efficient controlled and standardized methods.

## DEPARTMENTAL STORES

These are like many shops under one roof (and the same ownership).

The aim of such stores is to provide a complete range of shopping service under one roof.

To induce the customer to make as many purchases as possible within the store, shopping is made as pleasant as possible.

Services such as restaurants and hair dressing saloons are often available on the premises. Departmental stores have departments specializing in a particular line of commodities.

Each department is under the control of a buyer or manager responsible for making the department profitable.

Most departmental stores are often part of multiple shops.

## SUPERMARKETS

A supermarket is generally defined as a self-service shop with at least 186m<sup>2</sup> of floor space.

Many of them may be regarded as multiple shops as well. For they operate on a wide scale.

They concentrate on food and household goods and only stock goods which they know they can buy in bulk and sell quickly.

## SUPERSTORES AND HYPERSTORES

**Superstores** - have at least 2500m<sup>2</sup> of selling space

**Hyperstores** - these normally have over 5000m<sup>2</sup> of selling space

Both superstores and hyperstores tend to rely on self service and sell wide range of food and non-food items.

They are mainly in urban areas.

## MAIL ORDER FIRMS

There are three distinct types of mail order business:-

- 1 **Mail order – Specialist firms:** These promote a narrow range of goods by advertising in the press and occasionally in other media.

- 2 **Direct Mail Companies** : These normally advertise specific articles often in the specialist press.
- 3 **Catalogue Mail Order Companies:** These do dominate the mail order selling.

### **Advantages**

- i It does not need expensive high street premises
- ii The firm enjoys the usual economics associated with bulk buying.
- iii The availability of catalogue provides the firm with a permanent and enticing window shopping in many homes.

## **ADVANTAGES OF LARGE-SCALE RETAILING**

### **1 Economies of Scale**

The most important economies are the discounts obtained by buying in bulk. There are also considerable savings in labour for those retailers who use self service.

### **2 Specialisation**

The small retailer is responsible for the decisions that have to be taken e.g. what to sell, whether to advertise, or not etc. The large firm can afford to employ specialists to cover all these functions and more. Each specialist devotes his time to his job, therefore efficiency increases.

### **3 Time Saving**

Self-serving shopping is fast and the customer can buy almost everything he/she wants in one place.

### **4 Quick Turnover**

Because large sales, the large retailer can take a small profit on each sale thereby attracting customers with low prices. The sheer volume of sales will provide the retailer with a good total profit.

- 3 Only standard goods are stocked

A large retailer will stock only those items which are in regular demand. A shopper who requires any other item must search for a smaller retailer.

### **RECENT TRENDS IN RETAILING**

Retailing has developed towards large scale and most shops operate on a self-service basis. Factors affecting retail trade include:

- 1 Rising affluence among large sections of the population
- 2 High labour costs
- 3 Increasing use of branded goods or pre-packed goods
- 4 New advertising and sales promotion techniques
- 5 New materials for display and monitoring shoplifting
- 6 Greater mobility

## CHAPTER 3 WHOLESALE TRADE

This is the business of selling things in large amounts to other businesses rather than to individual customers.

The wholesalers form a link between producers and retailers.

### Functions of the Wholesaler

**1 Warehousing:** Some manufacturers and retailers do not have warehouses and they may not afford to have one. The wholesaler relieves them of this problem.

**2 Buying in Advance of Demand:**

A Wholesaler must anticipate what his customers will be buying in order to place orders.

**3 Preparation in Certain Cases:**

The wholesaler might be involved in grading, sorting and packing goods. He/She may sell under his/her own brand name.

**4 Finance**

Wholesalers help to finance trade by buying from manufacturers and so keeping their resources liquid and by giving trade credit to retailers.

**5 Information**

He/she passes information from retailers to manufacturers and vice versa e.g. about what criticisms people have against a product.

**6 Delivery**

Some wholesalers deliver goods to their customers/retailers.

Retailers would have to place innumerable small orders with manufacturers who would have to make up great numbers of packages to be delivered over long distances.

With the wholesalers, the retailer gets almost everything he/she needs in one place, and near to him.

## TYPES OF WHOLESALERS

The pattern of wholesaling in any particular trade depends on the number and size of production units, types of retail outlets and nature of commodity concerned.

If there is a great number of small and scattered producers and the product is one with many different grades and varieties there may be need for two wholesale stages:

### i **Primary Wholesaling**

The primary wholesaler will specialise in collecting together fairly small quantities from suppliers and will sell in bulk to secondary wholesalers.

### ii **Secondary Wholesaling**

These wholesalers sell to retailers.

### **General and Specialist Wholesalers**

General - These deal in wide range of non perishable goods.

Specialist - These deal in a narrow range of goods offering a wider selection over the narrow range.

### **National + Regional + Local wholesalers**

**National Wholesalers** - These are those who serve a certain region of a country.

**Local Wholesalers** - These supply retail shops in a particular town or country side.

### iii **Cash and Carry Wholesaling**

These enable retailers (Small-Scales to buy at low prices). No credit or other services are given. Here trade is largely confined to low priced quick-selling goods such as household items.

### iv **Agents and Other Intermediary Agents**

Manufacturers may employ agents who sell goods for them. Agents will obtain orders from wholesalers or from central purchasing office of large scale retailers.

Agents, although self employed, might sell in manufacturer's name. Others sell in their own names. Agents get commission on the business they handle.

v. **Factors**

These are agents who obtain legal possession of the goods they obtain from manufacturers and sell as if they are theirs, on their behalf invoicing customers directly.

**THE FUTURE OF WHOLESALE TRADE**

**The Wholesaler and the Large Scale Retailing**

Large scale retailers bypass the wholesalers. They buy directly, from the manufacturer. It has been estimated that by producing their own central wholesaling services, these retailers incur less costs than buying through an independent wholesaler. However, this does not mean that this is the beginning of the end of wholesaling trade.

NOT FOR SALE

## CHAPTER 4

### INTERNATIONAL TRADE

International trade is the exchange of capital, goods, and services across international borders or territories. [

A country cannot produce all it requires.

Just as individuals find they can enjoy higher standards of living by specialisation and exchanging the products of their specialisation, so countries can provide better living standards for their people by concentrating on the type of production for which their resources best suit them.

#### Why International Trade

- a Nature had distributed resources around the world differently. Exchange must take place.
- b Climate plays a large part in the production of natural products e.g. tobacco can be grown in Malawi but may not be grown in another country.
- c A country despite efficient production may have vast demands that she must supplement home production with imports e.g. Britain grows wheat efficiently but cannot support her entire needs.
- d A country might be able to produce all it needs but there may be reasons for not doing so e.g. to get cheaper things from elsewhere or to assist a certain country economically.
- e Trade also takes place when it is to the economic advantage of the nations concerned to specialise in particular activities.

#### Advantages Of International Trade

- a It enables nations to enjoy products which they could not produce within their own borders e.g. Malawi imports cars/car components.
- b It makes it possible for nations to obtain goods more cheaply than they could produce them themselves.
- c It provides a greater variety of commodities and gives a wider choice of designs and styles.
- d It permits countries to specialise in the production of goods and services for which their particular resources make them best suited.

## Disadvantages

- a If a country has highly specialised in the production of one commodity – fluctuations in demand and price may have devastating effects on its economy.
- b If a particular industry in a country is greatly dependent on exports that industry may suffer if demand for its products falls even though foreign trade benefits the country as a whole.
- C Producers in one country may use another country as ready market for excess produce which is sold at low prices (dumping), home industries may be damaged by such practices.

## Restrictions On Trade

In order to protect home industry most nations impose restrictions on trade with other countries. Such policies may be justified if they are used to protect growing industries which will be low-cost producers when they are fully developed or to prevent disastrous unemployment in home industry. In many cases, however, they merely serve to inhibit the growth of trade and to protect the home economy from necessary competition and change.

## Ways Of Restricting Trade

- 1 Import Duties - These are imposed in order to restrict imports by making them more expensive.
- 2 Quotas - These limit imports by restricting the total quantities of designated commodities that may be bought.
- 3 Subsidies - These allow home producers to offer goods at competitive prices by subsidising their costs.

## EXPORTING

### Methods of Selling Abroad

#### a Selling to buying Agents

An exporter can do all his selling by dealing with overseas buying agents. These are resident in the exporter's country buying on behalf of a foreign buyer.

**b Selling to Export Houses**

Export houses are usually owned by merchants who buy from the home manufacturers and then sell the goods to overseas buyers. The house finds the market and deals with exporting procedures.

**c Employing Foreign Agents**

An exporter may have agents permanently resident in foreign countries who obtain orders.

Normally they are nationals of the country concerned

**d Licensing Foreign Manufacturers**

Goods are not physically exported.

The manufacturer licences a foreign manufacturer to produce goods of the home manufacturer's design.

In return the foreign manufacturer pays a proportion of the sales income in the form of "royalties".

**e Running an Export Department**

A large exporter may have specialist staff which does all the work of exporting. It will find its own markets and will probably have a team of overseas salesmen.

**f Manufacturing Abroad**

The home manufacturer sets up a manufacturing plant in the foreign country.

**The Problems of Exporting**

A firm engaged in exports faces many more problems than one operating solely at home, for example:-

**a Extra Costs**

The exporter has to meet additional costs for transport. Goods have to be given extra protection, so cost of packing is higher.

**b Local Demand**

Requirements of the buyers may differ between countries. There is therefore a need for market research to be undertaken so that account is taken of buying characteristics.

c     **Social Standard**

The ability of buyers to pay for a product must be considered. Where wage levels are low there will obviously be little effective demand.

d     **Documentation**

In addition to the amount of paperwork involved in transporting goods abroad, there are some other documents required by the importing country.

e     **Receiving Payment**

The risk of non-payment is higher for exports than it is for home trading.

**The Documentation Involved in Exporting**

a     **The Bill of Lading**

This is a document of title to the goods

The holder may claim possession of the goods when they reach their destination port.

It contains details of goods to be shipped, names of sender and recipient, destination port and name of a ship.

It is made in three copies which are distributed as follows:

- (i)     kept by sender
- (ii)    attached to Bill of Exchange
- (iii)   signed by ship's master and returned to consignor

If the goods arrive at the shop damaged, the extent of the damage is indicated on the bill which is now called a DIRTY bill otherwise it is a CLEAN bill.

- b.     Import and export licence: An **import licence** is a document issued by a national government authorizing the importation of certain goods into its territory. Import licences are considered to be non-tariff barriers to trade when used as a way to discriminate against another country's goods in order to protect a domestic industry from foreign competition.

Each licence specifies the volume of imports allowed, and the total volume allowed should not exceed the quota.

An export is a document indicating that a government has granted a licencee the right to export specified goods to specified countries.

- c. Invoice: An **invoice** or **bill** is a commercial document issued by a seller to a buyer, indicating the products, quantities, and agreed prices for products or services the seller has provided the buyer. An invoice indicates the sale transaction only.
- d. Insurance certificate:  
A document issued by an insurance company/broker that is used to verify the existence of insurance coverage under specific conditions granted to listed individuals. More specifically, the document lists the effective date of the policy, the type of insurance coverage purchased, and the types and dollar amount of applicable liability.
- e. Certificate of origin: is a document used in international trade. It is a printed form, completed by the exporter or its agent and certified by an issuing body, attesting that the goods in a particular export shipment have been wholly produced, manufactured or processed in a particular country.
- f. Exchange control approval: This is the approval given by the Central Bank before making payment to a supplier in another country.
- g. Letter of credit: is a document issued by a financial institution, or a similar party, assuring payment to a seller of goods and/or services provided certain documents have been presented to the bank. These are documents that prove that the seller has performed the duties under an underlying contract (e.g., sale of goods contract) and the goods (or services) have been supplied as agreed. In return for these documents, the beneficiary receives payment from the financial institution that issued the letter of credit. The letter of credit serves as a guarantee to the seller that it will be paid regardless of whether the buyer ultimately fails to pay. In this way, the risk that the buyer will fail to pay is transferred from the seller to the letter of credit's issuer. The letter of credit can also be used to ensure that all the agreed upon standards and quality of goods are met by the supplier, provided that these requirements are reflected in the documents described in the letter of credit.
- h. An **import license** is a document issued by a national government authorizing the importation of certain goods into its territory. Import licenses are considered to be non-tariff barriers to trade when used as a way to discriminate against another country's goods in order to protect a domestic industry from foreign competition.

Each license specifies the volume of imports allowed, and the total volume allowed should not exceed the quota.

## Ways of obtaining Payment for Exports

### a Open Account Transactions

This method is only used when the exporter is selling to an established customer whom he/she trusts. It is possible where there is a branch of the exporter's bank in the importer's country. The importer pays the money into the local branch of the exporter's bank, from where it can be transferred to the exporter's account.

### b Bills of Exchange

These are used extensively for securing payment for goods which have been exported.

#### Definition

“A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed determinable future time, a sum certain in money to the order of a specified person bearer”.

The need for a bill arises in two sets of circumstances:-

- (i) Where the buyer needs a period of credit before paying so he/she can work upon goods he/she had bought and sell them but where the seller cannot afford to give credit.
- (ii) Where the distance between the supplier and the buyer is so large that there is a delay between the dispatch and the arrival of the goods.

### What Happens

The bill is sent to the importer who signs on it “accepted” to acknowledge his debt and to signify his agreement to the terms of the bill.

The importer will not accept the bill until he/she is sure that the goods are on their way to him. The bill is accompanied by a copy of the **bill of lading** (signed by the ship's master), which proves that the goods are on their way. A copy of the insurance policy is also attached. The bill of exchange is now known as a **documentary bill** (because of the shipping documents attached).

The exporter will not let the importer have these documents until he is certain that he will be paid.

Instead of sending the documents directly to the importer, the exporter instructs his bank to send the documents to a bank in the importer's country.

The bank in the importer's country will inform importer of the arrival of the documents.

Importer cannot obtain goods when they arrive unless he/she has the bill of lading.

To get the bill of lading, he/she will have to accept the bill of exchange.

The accepted bill will then be sent to the exporter's bank. The exporter will discount the bill with his bank, receiving an amount below the actual shown.

When the bill falls due, the importer will pay the exporter's bank the whole amount.

## **Importing**

### **Methods of Importing**

#### **1 Direct Importing**

A manufacturer who uses very large quantities of imported materials may find it convenient and economical to set up his/her own importing organisation/department.

Some well established multiple stores have their own import departments.

#### **2 Import Merchants**

They buy on their own account usually specialising in certain types of goods or in products of a particular country.

#### **3 Import Agent**

These usually specialise in particular products. They act on behalf of home manufacturer (buyers) wishing to obtain supplies of goods or raw materials from abroad or on behalf of foreign producers wishing to sell in this country. In either case they are paid a commission.

### **Dealing with the Customs and Excise Department**

Goods will not be released to the holder of a Bill of Lading until the Customs have been paid any duty which may be due.

## **Duties of the Customs and Excise Department**

- a To examine incoming goods and check them with the covering documents and to assess and collect any duty payable.
- b To ensure that the amount of certain imported goods does not exceed the limit of any relevant quota.
- c To produce statistics concerning imports and exports. These are compiled from import and export licences.
- d To control bonded warehouse\*
- e To prevent the import of prohibited goods (such as illegal drugs).

\***BONDED WAREHOUSES** – These store goods which have been imported into this country and on which duty has not been paid.

## **The Balance of Payments**

A country's balance of payments is the record of all the financial transactions between the country and the rest of the world.

It also means the difference between the total value of exports and the total value of imports. Exports like imports could take the form of goods or services.

**Visible Trade** - refers to trade in tangible things/goods. The value of goods crossing national boundaries is added together to give the "Balance of Trade" (The difference in value between the total exports and total imports of a nation during a specific period of time)..

**Invisible Trade** – Services a country sells abroad or buys from abroad constitute invisible trade.

## CHAPTER 5 AIDS TO TRADE

- a Transport
- b Warehousing
- c Advertising
- d Insurance

### A TRANSPORT

#### Place of Transport in Commerce

##### a Distribution of Goods

Raw materials have to be transported to places where they are needed.

Produced goods must be distributed from centres of production to sales outlets.

##### b Movement of People

People move with their goods from one place to another.

#### Transport Efficiency

A transport system must satisfy certain conditions

No one system is the best

Most efficient system is the one which meets the needs of the person requiring it.

#### General Requirements of an Efficient Transport System

- a **Economy** - The cost of transporting particular items must be as low as possible
- b **Speed** - The importance of speed should be balanced against the cost – consideration should also be given to the type of goods being sent.
- c **Convenience** - How conveniently placed are the terminals from the user of a system.
- d **Regularity** - The consignor is bound by the travel schedules – it is essential for transport to be frequent and punctual.

# The Transport Systems

## 1 Road Transport

### Advantages

**a Door-to-door-Service**

Goods are loaded at the departure point and off-loaded at the destination point-reducing the amount of breakages or pilferage.

**b Flexibility**

A lorry/car can be moved when necessary. Generally road transport does not depend on rigid scheduling of services.

**c Economy**

Strong competition among road transporters keeps the costs down.

The transport operator only pays for vehicle maintenance but the road is maintained by the government.

Staff costs – not very high

**d Regularity of Services**

Besides special journeys, road transporters provide regular services.

### Disadvantages

**a Diseconomies**

It is uneconomic to transport very heavy loads by road.

**b Travelling Time**

A lorry/truck would take longer to reach its destination than a train due to congestions on the road.

**c Social Costs**

Environmental losses due to pollution, etc.

## 2. Rail Transport

Rail Transport is another type of inland transport.

### **Advantages**

- a **Travelling Speed** is greater than it is in road transport because trains are not held up by traffic congestion.
- b **Transportation Costs** are lower than other forms of transport.
- c A train can carry heavier and bulkier loads than a truck/lorry.

### **Disadvantages**

- a **Transport Time** is often long because goods have to be taken to and collected from terminal points.
- b **Time-Tabling** imposes rigidity because goods and people can be moved only in accordance with railway schedules
- c **Operating Costs** are high because so many staff have to be employed and the cost of maintaining the track is high.

## 3. **Sea Transport**

Malawi relies, to a large extent, on sea transport when it imports goods from overseas. The advantages and disadvantages are similar to those of rail transport.

## 4. **Air Transport**

### **Advantages**

- a. The great advantage of air transport is speed.
- b. Goods move quickly and are not subject to poor weather conditions.
- c. Insurance costs are less than for sea transport because of the time it takes to transport goods.

### **Disadvantages**

- a. It is a relatively expensive method of transport
- b. It is not suitable for bulk products

## **The Choice of Transport Methods**

Where there is a choice between the methods of transport, the decision will depend on:

- (i) The nature of goods
- (ii) The priorities of speed cost, regularity, etc.

(In many instances there may be no choice)

Account must be taken of the following when choosing transport methods:

- a **True cost**  
What is the total cost of moving the goods? Air transport may be less expensive than it appears.
- b **Speed**  
How essential is quick delivery. If there is no urgency it will usually be best to send by the slowest method.
- c **Security**  
What are the risks of loss due to damage, deterioration and pilfering? In general the risks will be smaller the lesser the goods are handled.
- d **Reliability**  
How certain is it that goods will be delivered on time?

## B **WAREHOUSING (STORAGE)**

Warehousing is the provision of storage facility for goods.

The need for warehouses comes about because some goods are seasonal in supply e.g. agricultural products.

Warehouses are also needed because of the change over from production in response to direct orders to production in anticipation of demand.

Storage of goods is necessary if customer's needs are to be supplied immediately on demand. To meet the demand, there must be a store of goods and warehousing becomes a necessity in modern trade.

### **Types of Warehouses**

They are divided into two:

- (1) Private warehouses
- (2) Public warehouses

#### 1 **Private Warehouses**

Storage area or building secured for the exclusive use of a selling agent.

There are wholesale warehouses which are owned by merchants and are used by them as stores from which they supply retailers who buy from them.

Wholesalers hold their stocks in their own warehouses.

## 2 **Public Warehouses**

These are storage areas provided for public use on rental basis.

The term does not mean “owned by the government”.

Actually it means that the warehouse is open for use by members of the general public.

Public warehouses may be and very often are owned by private individuals, railway company, or an airline company.

These companies have a special business of offering warehousing facilities. They charge for their services

There are four types of public warehouses:

- (i) Those that store household goods and personal belongings
- (ii) Those that store general merchandise
- (iii) Those that provide cold storage
- (iv) Those that specialise in such commodities as maize, cotton, tobacco etc

Public warehouses may be used as reservoirs for surplus goods or as distribution centres in the marketing process.

### **Bonded Warehouses**

Some public warehouses are called bonded warehouses.

These are warehouses which store goods which have been imported into the country and on which duty has not been paid.

They are owned by private concerns but are strictly under supervision of customs officials.

The proprietors have to enter into a bond for the proper conduct of the warehouse so that there can be no fraud on the customs.

### **The importance of Warehousing in the Process of Distribution**

The need for warehouses comes about for many reasons which include the following:

a Seasonal supply of goods

Many goods are seasonal in supply e.g. agricultural products.

Storage facilities are needed to make the goods available to non-productive seasons.

b To meet consumers demand:

A store of goods is necessary to supply consumers' needs immediately on demand.

c Production in anticipation of demand:

Warehouses are needed because of the change over from production in response to direct orders to production in anticipation of demand.

d Saving in transportation costs:

Enables handling of bigger car loads hence transportation costs are reduced.

e Storage sometimes improves quality e.g. certain wines or tobacco.

f Warehousing prevents violent fluctuations in the supply of goods and consequent violent price fluctuations.

Price fluctuations are evened out because storage of goods enables the goods to be released into the economic system when they are needed.

### **Management of Warehouses**

Efficient management of warehouses requires the following:

a **Firm Stock Control**

Goods must be stored in an orderly manner so that any item can be found easily.

There must be an efficient system for checking in goods as they come into store and checking out goods as they are dispatched so that it is always known exactly how much there is of any one item.

b **Protection**

Goods must be stored in such a way that they do not deteriorate or become damaged. Goods must be safeguarded against theft, fire and pilferage.

c **Efficient distribution**

There must be efficient methods of dealing with sales (to customers or to branches) so that orders are dealt with quickly and accurately. There must be an efficient transport system so that few half-filled vehicles are sent out and no journeys are duplicated.

C **ADVERTISING**

**What is Advertising**

It is loosely defined as the spreading of information or awareness.

In business, the main aim of advertising is to increase or at least maintain the sales of a product or service.

**Aims or Functions of Advertising**

1 **To Increase Sales**

The main purpose of any business is to make profits. In general then, the more goods a firm sells, the higher are its profits.

2 **To Make New Products Known**

New products have to be introduced to the public if they have to be sold. Many new products fail to make it in the market simply because they do not immediately appeal to consumers, often because of poor advertising ways.

### **3 Information**

Information advertising announces a product and gives potential buyers the details they require. It also keeps consumers informed of changes in the nature of the products, goods available and where they can buy them.

### **4 Branded Goods**

Manufacturers' and retailer's branded goods are often advertised to keep the brand name in the public eye. Sometimes only the brand name is mentioned in the advert, and there is no reference to particular goods.

### **5 Retail Outlets**

Some adverts are restricted to the trade press, in an attempt to get more retailers to sell the product. Broadening the market in this way does result in higher sales.

### **6 Company's Image**

Businesses generally want to project a favourable image of themselves to the public. They like to be known for the reliability or high quality of their products for giving value for money, for putting the customer first and so on. Many adverts are not designed purely to project the desired image, but aim, in the short run or the long run, to increase the sales.

### **7 Quality**

The fact that a product has been widely advertised may compel a manufacturer to maintain high standards of quality.

### **8 Maintenance of Demand**

It is arguable that advertising is necessary to maintain demand at a sufficiently high level to provide full employment. The less the demand of a product the lower the production and the fewer the people needed for that work.

## **TYPES OF ADVERTISING**

Advertising is divided according to its approach or according to its medium.

### **1 Persuasive or Competitive Advertising**

This is mainly aimed at consumers, and commonly used on TV and radio. It tries to persuade consumers to buy the advertiser's product rather than that of his competitor, by assuring them that it is better than that of their competitor. This is the kind of advert which is considered as wasteful.

## 2 **Informative Advertising**

All advertising is informative to some extent, in that it is informing people that a product exists or an event is taking place. But the term informative advertising is normally reserved for the following goods and services:

- (i) technical and trade journals
- (ii) particular events
- (iii) employment opportunity

## 3 **Generic Advertising**

This is when all the producers in one industry combine to advertise the product in general rather than their own particular brands. We call the result generic advertising e.g. the kind of adverts which exhort you to drink more beer for example.

## **Advertising Media**

This is a means or vehicle for advertising. The following are examples of advertising media:

### 1 **Television and Radio**

Probably the best media for advertising consumer goods. In the case of TV, it has the advantage of combining sound and vision unlike the radio which relies only on sound. Similar to a radio, TV has a national coverage. Again adverts on TV can be shown at times suitable to the market for the goods. Others argue that adverts on TV have an advantage over others in that they address a relaxed and receptive audience.

#### **Disadvantages**

- (i) disturbing people's entertaining programmes
- (ii) quite expensive
- (iii) doubtful effectiveness due to lack of identifying strategic points as posters do (eye contact for long time).

### 2 **The National Press**

Since newspapers are published daily, they are very suitable for advertising a number of products in a country. Newspapers adverts can also be placed in suitable places in the newspapers. E.g. sports equipment can be placed on sports pages and dresses on the fashion pages.

## Disadvantages

- (a) advertiser's advert may be submerged in a large number of others unless he/she pays a higher rate for them to have them isolated.
- (b) Except in the coloured newspapers, the poor quality of the paper often prevents good reproduction of adverts.

### 3 **The Local Press**

Local papers are very important to local advertisers. Since local papers have a monopoly in their area, the advertiser can be sure of reaching almost every household. Again, even weekly papers are usually around the house for several days, so their adverts are more likely to be seen by potential customers.

### 4 **Posters**

#### **Advantages:**

- a Placed anywhere where newsletters, buses or cars do not reach.
- b Cheapest means of advertising
- c Have permanence
- d Act as a reminder as well as informing

#### **Disadvantages**

- a Rely on visual effect
- b Require a lot of paper to be used
- c Both the illiterate and the blind are isolated

### 5 **Window and Point of Sale Display**

You want to catch the consumer's eye to see your products. It is cheaper but can have a disadvantage in that consumer might not reach the shop and so cannot know what product is available.

### 6 **Exhibition and Trade Fairs**

These act like the window and point of sale displays

### 7 **Other Media**

- (i) advertising on sales van

- (ii) adverts on paper bags
- (iii) circulars delivered to houses
- (iv) methods used in sales promotion e.g. special offers.

### **Choice of Media**

The choice of an advertising medium depends on:

- (i) the nature of the product
- (ii) the cost of the medium
- (iii) social economic stand of your audience
- (iv) age group
- (v) geographical location of customers
- (vi) number of people covered by media

### **Advertising Agent**

These create the adverts on the basis of what you tell them as an advertiser. A seller may contact advertising agent to run a campaign for him.

### **Functions of an advertising Agent**

#### **(i) Creating the Advert**

This is done on the basis of the information provided by the seller to the agent about his product i.e. nature, strength and weakness of the product. This job is done by copywriters. These are the people who think how the advertisement should be produced once this is done the production department of the agency goes on to work on putting the copywriter into practice.

For example artists produce drafts of posters. The draft is then shown to the client for his/her approval and if he/she wants changes, amendments can be made.

#### **(ii) Placing the advertisement**

The agent normally books the advertising time on the radio or TV or indeed space in the press and then places his advert as necessary.

(iii) Here they deal with all the investigation of all factors influencing the distribution of the product from the producers to the final consumer. Its purpose is to provide producers with as much as information as possible about the market for their products.

(iv) The manufacturers may conduct such investigation for themselves or they may use their advertising agent.

#### **(v) Advice**

Agencies develop a sense of what will and will not sell a product and will normally be able to offer useful advice about e.g. the name of a new product or its packaging and the best media for advertising a product.

## **Advantages of Advertising**

- 1 It leads to higher sales which in turn lead to higher profits. These profits are shared with the consumers in the form of low prices.
- 2 Consumers know of new products through adverts
- 3 It helps producing better quality of products. A producer can only advertise if he/she knows that his products are of good quality. The producer wants to protect or maintain his reputation.
- 4 It informs consumers of what goods are available and their relative merits.
- 5 It improves people's living standards as new products are introduced to consumers.
- 6 Indirectly advertising keeps the price of newspapers relatively reasonable.
- 7 On a broader scale advertising may help to keep people employed. If a firm makes large profits through high sales it will produce more products and more people will be needed.

## **Disadvantages**

- 1 It can be very expensive.
- 2 It leads to higher prices if sales do not increase sufficiently to cover the cost of advertising
- 3 It uses scarce resources (artists) which could be better employed elsewhere.
- 4 Persuasive advertising may force people to buy things they do not want and cannot afford forcing them beyond their means.
- 5 It exploits people by suggesting e.g. that they would not be part of the world if they did not use a certain product.
- 6 Adverts in both the TV and the radio interrupt entertaining programmes sometimes.

## **D INSURANCE**

Insurance provides protection against the consequences of some events which would upset the plans of a business person.

Insurance is the “pooling of risks”, i.e. it provides a fund to which many persons who are a subject to a certain risk may contribute, and from what the few who actually suffer the loss may be compensated.

### **The Contract of Insurance**

A person wishing to be insured enters into an agreement with the organization giving the protection.

### **Some Important Insurance Terms**

- Insurer** - the organization giving the protection
- Insured** - the person wishing to be insured
- Proposal** - an application for insurance
- Policy** - the details of the contract of insurance
- Premiums** - the payments made by the insured into the commission Fund

### **Insurance and Non-Insurable Risks**

As an insurance company has to use statistics to assess the probability of a loss, it will not undertake a risk it cannot calculate. For example a businessman cannot insure against trading losses.

### **Insurance and Assurance**

- Insurance** - provides cover for events which may happen e.g. an accident may or may not occur
- Assurance** - relates to events which will definitely occur e.g. death.

### **The Principles of Insurance**

a

#### **Utmost Good Faith (Uberrima Fide)**

Each party to an insurance contract must make full disclosure of all material facts, otherwise the contract may be declared void or voidable. Facts must be disclosed to enable each party to make appropriate decisions.

b                    **Insurable Interest**

Insurance cannot be given unless the insured has an interest in whatever is being insured, so that if the loss insured against happens, he/she will suffer against financial consequences e.g. one cannot insure a neighbour's car.

c                    **Indemnity**

The basic purpose of insurance is to restore a person to the position he/she was immediately before the loss (with the exception of life assurance and personal accident insurances). Under indemnity there are two sub-principles.

i.    a            **Subrogation** -            The insured is entitled to full indemnity but is not entitled to make profit e.g. if the insured gets compensation for a car which has been written off he/she will not get the scrap as well.

ii.   B           **Contribution** -            Where the same item has been insured with two or more insurers, the insurers will contribute towards the compensation.

**Proximate Cause**

The doctrine of proximate cause states that a claim will be met only if the loss suffered was a direct consequence of the insured risk happening.

**Classes of Insurance**

A            **Life Assurance**

The aims of life assurance are different from those of insurance in that the issue of compensation does not really apply. There are the following types of policies.

(i)            **Whole Life Policies** -            these provide for a payment of a certain sum on the death of the insured person to his beneficiary.

(ii)           **Term Policies** -            these provide beneficiary only if

death occurs during a specified period

- (iii) **Endowment Policies-** Claims are paid on death of the insured or at the end of a stipulated period; whichever occurs earlier.

## **B**

### **Marine Insurance**

Marine Insurance policies provide cover for risk connected with the sea.

#### **(a) Hull Insurance**

This relates to the vessel itself including all its fixtures providing cover for loss at sea, or damaged by adverse weather conditions or other vessels. Hull policies may be divided into two categories.

- (i) **Time Policies** - give cover for a specified period e.g. one month.
- (ii) **Voyage Policies** - Provide cover for a particular journey.

#### **(b) Cargo Insurance**

This relates to loss of cargo while it is in transit. The beneficiary of the compensation will depend upon the terms of trade between the seller and the buyer.

#### **(c) Freight Insurance**

Freight is the charge levied by ship owner for carrying the goods. freight is usually paid in advance. If goods are not delivered, the ship owner may face a claim for repayment of the freight. The ship owner will be indemnified in such circumstances under freight insurance policies.

#### **(d) Accident Insurance**

- (i) **Personal Accident Insurance** - Cover the insured against partial or total disability arising from accidental causes. It provides for losses due to physical disability.

- (ii) **Property Insurance** - This relates to a wide range of risks to any form of property including accidental damage to vehicles and machinery; deliberate damage caused by burglary or vandalism, etc
- (iii) **Liability Insurance** - Provides cover for claims which may be made against the insured persons who are injured; a motorist may be liable to a “third party” he injures e.g. pedestrian (third party insurance is compulsory for all motorists).

### **Comprehensive Policies**

Cover accidental damage to property, injury to owner, and injury to other people or loss/damage with their property.

### **Fidelity Guarantee**

It provides compensation to employers if one of their employees has embezzled some funds.

### **E-Commerce**

Ecommerce or Electronic Commerce means buying and selling of goods and services using the Internet.

#### **Advantages**

**(i) Wider choice:** With the help of a well-developed computer networking system, business units can operate at the national as well as global level. The customers thus, have a wider choice of products and services. The businessmen also get a wider market for their products and services.

**(ii) Improved customer services:** Suppliers of goods and services can offer a wide range of services to the customers, before as well as after sales, such as information about products, guidance for use, responding to customers' queries about quality and usefulness of the product, etc.

**(iii) Quick response to customer needs:** In e-commerce business transactions take far less time as compared to the normal process of buying and selling. This is because the producers cut short the distribution channel and supply products and services directly to consumers.

**(iv) Cost saving and price reduction:** There is substantial cost saving in business transactions conducted through e-commerce. There is no need to display goods in showrooms or keep large stock in godowns (warehouses). The number of employees required to carry on the business is less. Thus,

the cost of operation naturally comes down. So the customers may get goods at a lower rate.

**(v) Market information:** Access to market information available through the internet enables business concerns to identify varied customer needs and produce new goods and better services accordingly.

#### Disadvantages

- i. **Security Concerns:** With hacking and identity theft on the rise, Internet banking customers have to place a certain amount of trust in the supplier that their account information and personal information are safe.
- ii. **Lack of personal contact** between the supplier and the customer.
- iii. **Accessibility:** If the Internet goes down in your area or the area, you will be unable to access your suppliers.

## CHAPTER 6

### BUSINESS ORGANISATIONS

There are many forms of business units. The following are the most common ones:

#### 1 Sole Proprietorships

A sole proprietorship is a business which is owned and run by one man who enjoys all the profits and bears all the risks alone.

The owner of a sole proprietorship is known as a sole proprietor or a sole trader.

#### Characteristics

The distinguishing features of sole proprietorships are as follows:

a **Ownership is by a single person** - that is, sole proprietorships occur where one person owns the business alone.

b **Management and Control** - day to day management and control of the business is usually by the owner. The owner runs and controls the business.

c **Finance** - the owner provides the capital (the money for starting the business)

Many people use their savings to start a business but frequently part of it is in the form of borrowed funds.

d **Size** - the business of the sole trader is usually small due to the amount of capital invested since the capital is usually small.

e **The business is not a separate legal entity from the owner** – which means that the owner is liable for the debts incurred by the business. However, the business is a separate accounting entity i.e. accounts are prepared for the business as an entity.

f **Ease of Entry** – it is easy to start a sole proprietorship since it does not require a large initial capital expenditure and there are no registration formalities unless a licence has to be obtained to operate the business (e.g. if selling liquor).

#### Advantages

a **Managerial Freedom** - decision-making can be effected quickly since the owner does not have to consult anyone. There is no board to convince and no committee to argue with and therefore decisions are reached quickly.

- b **Direct Responsibility** – any consequences of action are the sole responsibility of the owner. He/she gains all the profits from his/her efforts (if he/she makes mistakes he/she loses).
- c **Simplicity of Organisation** - (simple management structure)  
The difficulties of management often associated with large scale organizations are thus avoided.
- d **Personal Contact** – he/she is in close contact with his customers and can therefore have knowledge of their wants and can offer good personal services.
- e **No formal procedures** - are required to set up the business (except for types of business where a licence must be obtained e.g. retailing wines and spirits, operating taxi cab).
- f **Flexibility** - sole traders can react quickly to change or the sole trader can change the whole policy of his business in a very short time. He/she can make quick decisions.

### Disadvantages

- a **Unlimited Liability** – In the event of the business failing the owner is personally liable for the debts incurred by the business i.e. the owner of the business suffers personal liability in the case of bankruptcy.
- b **Limited amount of Capital** – the sole proprietor's capital is usually limited and he/she has difficulties in obtaining outside finance. This hinders expansion because it can only be done by ploughing back profits of the business.
- c **Lack of Continuity** – usually the business does not continue after the death of the proprietor.
- d **Limitation on Expertise** – the owner may not possess all the attributes required to run a business. An engineer, for instance, may have little financial acumen.
- e **Indispensability of the Owner** - the business has high dependence on the individual which can mean long working hours and difficulties during sickness. Absence of the owner will result in loss of personal direction during that time.
- f Disadvantages associated with **small size**, e.g. absence of economies of scale, problems of raising finance, lack of specialisation.

### 2 Partnerships

A partnership is a “relationship that submits between two or more people carrying on business with a common view to make profits”.

## Characteristics

- (i) A partnership isn't a separate legal entity from its owners which means that:
  - a a partnership cannot sue or be sued in its own name. anyone claiming against the firm must take action against any or all the partners as individuals.
  - b a contract cannot be entered into in the name of the firm. Contracts must be in names of the partners.
  - c there is no continuity – if any partner dies, withdraws from the firm or becomes bankrupt, the partnership dies.
- (ii) Each partner (like a sole trader), except the limited partner, has unlimited liability for the debts of the business.
- (iii) No account of the firm's activities has to be published.

## Formation of Partnership

A partnership may not have more than 20 members except in respect of certain professional firms such as accountants, doctors etc.

There are no registration formalities just like sole trader. Partners must draw an agreement – the **Partnership Agreement**.

A mere oral agreement is insufficient but it is better for the partners to have a written agreement.

A written partnership agreement is known as a **Partnership deed**.

## Contents of the Partnership Agreement

- a. The name of the firm and the names and addresses of the partners.
- b. The nature of the business
- c. The capital of the partnership and how much each partner is supposed to contribute.
- d. The role to be played by each partner in the business.

- e. The profit and loss sharing arrangements.
- f. The duration of the partnership and the conditions under which it may be brought to an end.

In the absence of an agreement or where there is ambiguity or where the agreement is silent, the provisions of the law, principally embodied in the **Partnership Act** will apply.

### Types of Partners

- Active Partners** - partners who take a full part in the running of the business.
- Dormant Partners** - these partners agree to contribute to capital and to receive their share of profits but to take no part in the running of the business.
- Limited Partners** - these are partners whose liabilities are limited to the amount of capital contributed to the business. Normally, these do not take an active part in the activities of the business. (note that limited partnerships do not exist in Malawi)

**Note:** In a partnership there must be at least one partner with an unlimited liability)

### Advantages of Partnership

- a **More Capital:** a number of people carrying on business together will obviously provide more capital than a single person.
- b **Specialisation:** since there are more people it is possible for them to divide work among themselves according to the capabilities possessed by each of them.
- c **Consultation:** the partners will from time to time consult each other to iron out business problems while the sole trader does not have anyone to share ideas with, which normally results in poor decisions.
- d **Shared Strain:** the partners share the worries of the business apart from sharing work.
- e **Personal Contact:** most partnerships still operate on a scale which is small enough to permit personal contact with customers and employees.

## Disadvantages

- a The liability of each of the partners (except limited partners) is unlimited.
- b The business is identified with its owners hence lack of continuity because any changes in the composition of the partnership will result in its dissolution.
- c Since any undertaking of one partner binds the others, it is important not to enter into a partnership with someone whose business judgment is dubious.
- d Since each partner is entitled to a say in the management of the firm, disagreements are very likely resulting into unnecessary delays.

## 3 Joint Stock Companies

A joint stock company may be defined as 'legal person created to engage in business, capable of owning productive assets, entering into contracts and employing labour in the same way as an individual.' Certain steps have to be taken for these companies to be incorporated (created). After incorporation they get corporate personality and legal identity.

### Methods of Incorporation

Companies can be incorporated by:

- a **Statute** : i.e. by Act of Parliament. These companies are known as Statutory Bodies. Examples include: Malawi Housing Corporation (MHC), Electricity Supply Corporation of Malawi (ESCOM), Agriculture Development, Marketing Corporation (ADMARC), Malawi Broadcasting Corporation (MBC), University of Malawi, etc.

- b **The Granting of Royal Charter:** These institutions are known as Chartered Companies; e.g. Chartered Association of Certified Accountants (ACCA), Chartered Institute of Bankers, Chartered Institute of Management Accountants (CIMA).

- c **Registration:** This is the commonest method of incorporation. After incorporation and the issue of a certificate of incorporation from the Registrar of Companies, the company comes into being.

Companies formed by registration are of three types. These are:

a **Unlimited Company**

These have corporate personality, but the liability of members is unlimited. This type is very rare.

b **Companies Limited by Guarantee**

Members of these companies undertake to be liable for the debts of the company up to a stated limit, i.e. they guarantee to pay a stated amount in circumstances where the company is unable to meet its debts.

c **Companies limited by Share**

The liability of the members is limited to the amount paid or agreed to be paid on the shares.

Companies Limited by Share are of two types, namely:

a Public Limited Companies

b Private Limited Companies

Differences between Private Limited Companies and Public Limited Companies:

- (i) Public Limited Companies can ask the public to buy shares in the company while Private Limited Companies cannot.
- (ii) At least two persons are required to form a company. A Private Limited Company cannot have more than fifty (50) members but there is no maximum number of members in the case of a Public Limited Company.
- (iii) The shares in a Public Limited Company can easily be transferred while those of a Private Limited Company can only be transferred upon the consent of the members.

### **General Characteristics of Companies Limited by Share**

1. **Profit Motive**

They operate with the aim of making profits

2. **Capital**

The capital is subscribed by the members who do so by buying shares in the company.

3. **Profit Sharing**  
The members share the profits of the company in the form of dividends.
4. **Limited Liability**  
The liability of the members is limited to the amount paid/payable on the shares.
5. **Legal Entity**  
The company is a separate legal entity from its owners i.e. it is regarded as a person created by law. It can sue or be sued. It can contract in its own name.
6. **Transferability of Membership**  
It is possible through the transfer of shares
7. **Continuity**  
The company has a continuous existence independent of its members.
8. **Separation of Ownership from Management**  
That is to say the managers of a company are different from the owners.
9. **Control**  
This is exercised by the shareholders through the appointment of a board of directors.

## **Regulation of Joint Companies**

### **(i) By Companies Act**

These are principal statutes relating to such things as:

Formation of company  
Keeping of proper accounting records  
Appointment of auditors  
Dissolution of company, etc

### **(ii) Company Powers**

The powers of a company are contained in the Memorandum of Association and the Articles of Association.

### **(iii) Investigation of Companies**

If the shareholders believe that the directors are not conducting the affairs of the company properly, they may ask the Department of Trade and Industry to appoint inspectors to investigate the concerned issue.

## Formalities of Registration

Limited companies must be registered with the Registrar of Companies. To comply with the Registrar's requirements which are laid down in the Companies Act, the promoters of the company must present the Memorandum of Association and the Article of Association.

## The Memorandum of Association

This governs the relationship of the company with the "outside world." Its main contents include:

- (i) The company's name which must contain the word 'LIMITED.' This is a warning to anyone dealing with the company that they cannot look beyond the company and its resources for the redress of any grievance (the concept of limited liability);
- (ii) The physical and postal addresses of the registered office of the company;
- (iii) The restrictions, if any, upon the business to be carried on by the company;
- (iv) A statement of the limited liability of members (for the benefit of potential creditors as well as shareholders).
- (v) The Authorised Share Capital of the company and its division into shares of a fixed amount (also the classes of shares of the company).

## Articles of Association

These control the internal running of the company. The Articles cover such things as:

- (i) The procedure of calling for a General Meeting;
- (ii) How directors are going to be appointed;
- (iii) The rights and obligations of the directors;
- (iv) The borrowing powers of the company;

After these two documents have been completed, they are sent to the Registrar who, after approving them, will issue a Certificate of Incorporation. The promoters of a public limited company can thereafter issue a prospectus inviting members of the public to subscribe to the capital of the company.

## The Capital of Limited Companies

Ways of raising capital including:

- (i) issue of shares
- (ii) long-term loans

- (iii) short-term loans e.g. overdrafts
- (iv) retained profits

## Share Capital

Promoters of a company limited by share attract contributions from all kinds of people and institutions by offering them shares in the business. Every person who buys a share in a company becomes a part-owner of the company.

The following terms should be noted:

- 1 **Nominal or Authorised Share Capital:** this is the maximum amount of money a company is allowed to raise by issuing shares.
- 2 **Issued Share Capital:** the company may not wish to issue the maximum number of shares at the outset. The nominal value of the shares issued is referred to as the Issued Capital
- 3 **Called-up Capital:** When the shares have been issued the company does not always need the full amount to be paid immediately. The proportion of issued share capital that the company asked the shareholders to pay is known as the Called-up Share Capital.
- 4 **Paid-up Capital:** This is the proportion of issued share capital that has been paid for. If the company fails, the holders of shares which are not paid up are required to pay the difference between the nominal value of issued share capital and the paid-up value of their shares.

## Types of Shares

The authorized shares of a company may be divided into many different types of shares, the common types are:

### a **Preference Shares**

Preference Shares carry a prior right to a share in the profits of a company. The holders of these shares must receive their dividends before holders of other types of shares. They rank after lenders of the company. The rate of return (dividends) on preference shares is a fixed percentage of their nominal value.

#### Types of Preference Shares

- (i) **Basic Preference Share-** holders of which receive a fixed dividend out of profits before anything is paid to ordinary shareholders.

- (ii) **Cumulative Preference Shares** if a dividend is missed in one year due to lack of distributable profits, the right to the dividend is carried forward to the next year.
- (iii) **Participating Preference Shares** - these do not only carry a fixed rate of dividend but also entitle their holders to a further share of the profits once they reach a certain level.

b. **Ordinary Shares**

The dividend on ordinary shares is not fixed and entirely depends on the profitability of the company and the policy of directors with regard to the amount of profit to be retained in the company. The dividend may be very high or zero. The ordinary share capital of a company is also known as the “Equity”.

**Loan Capital**

A company which is faced with the need for additional capital may choose to obtain it not by an issue of shares but by borrowing. A person who lends money to a company is a creditor not a shareholder. He/She is not a member of the company and if the company should fail, he/she will have the right to be paid before any distribution is made to the shareholders.

A company may borrow by issuing DEBENTURES. These are not shares. Debenture holders do not share in the membership of a company. A debenture is a written acknowledgement of a loan made to a company. It normally contains provisions for the payment of interest and the repayment of the loan. The rate of interest is fixed and it is paid before preference or ordinary shareholders receive their dividend. They are normally secured against property owned by the company so that in the event of the company’s failure, debenture holders are assured of getting their money. If debenture holders do not get their annual interest, they can force the company into liquidation.

**Dissolution of a company**

A company can stop existing in two main ways.

1 **Striking Off**

This is an informal way of ending a company due to non-compliance with regulatory framework.

The company stops trading and pays off its creditors. Its directors resign. This may occur when the Registrar of Companies wants an annual return and reports from the company, and gets no response. As a result he/she

will just strike off its name from his/her register hence the name **Striking Off**.

## 2 **Winding Up**

A company may wind up voluntarily or involuntarily

### a **Voluntary Winding Up**

A company may be wound up voluntarily:

- (i) When the period fixed for its duration expires;
- (ii) If an event occurs, on the occurrence of which the Memorandum or Articles provide that the company is to be dissolved.
- (iii) If the shareholders believe that the company is not going to continue a special resolution is passed to dissolve the company

The shareholders will appoint a Liquidator who will have the following functions:

- to sell all company property or assets
- to pay off all the creditors
- to distribute the balance among the shareholder, etc

### b **Involuntary/Compulsory Winding Up**

A company winds up involuntarily if it is forced to do so by a court order.

## **Advantages of Joint Stock Companies**

### a **Ability to Raise Capital**

These companies can raise a large amount of capital because it is subscribed by many members.

### b **Transferability of Membership**

This is possible by transferring shares.

c **Limited Liability**

The liability of the members is limited to the amount of capital subscribed or payable on the shares.

d **Economies of Scale**

Since they have a large amount of capital and they operate on a large scale they can exploit the economies of scale.

**Disadvantages**

a **Formal Procedures** are required to set up a business as a company hence it takes longer to start business as a company.

b **Publicity** the books of the company are open to the general public for inspection.

c **Divorce of Ownership from Management** i.e. day to day running of the business is done by people different from the owners.

d **Slow Decision Making** all members have to take part in the decision-making process of the company. This may result into unnecessary delays to reach a decision.

4. **STATUTORY CORPORATIONS OR PARASTATALS**

These are created by Acts of Parliament. Their powers and objectives are defined by those specific Acts of Parliament which created them. They deal with a broad range of activities. They are mainly concerned with public utilities like water, electricity, communication, etc. These are utilities or activities that provide the basic essential services to the nation which would otherwise be inefficiently or inequitably provided by the private sector.

Parastatals placing in particular sectors can be viewed as an arrangement whereby the government can maintain control over policy in a given area giving a means of access to a variety of skills and methods of operation not open to the civil services.

Some of these parastatals are seen to be:

1. Commercially viable
2. Others potentially viable

3. Others are surviving only with the continued support of a subvention from the state.

Parastatal organisations play a role on behalf of the government and most of them demonstrate and prove reasons for their existence. If not, they may be dissolved by the government.

Parastatal organisations may therefore, be seen as agents of economic and social development.

### **Categorical Grouping of Parastatals**

Parastatals in Malawi are grouped into three categories. Its functional grouping is by:

- a Commercial
- b Quasi-commercial (part-commercial)
- c Subvented

#### **(i) Commercial Category**

This group covers all those statutory corporations that are expected to show some return in terms of profit on the capital employed. They operate like ordinary private sector enterprises.

Examples in this category include:

Agriculture Development, Marketing Corporation (ADMARC)  
Malawi Housing Corporation (MHC)  
Electricity Supply Corporation of Malawi (ESCOM)  
BWB (Blantyre Water Board)  
LWB (Lilongwe Water Board)

#### **(ii) Quasi-Commercial Category (Part-Commercial/Semi-subvented)**

These are developmental by nature but are expected to be financially self-supporting after an initial start-up phase.

Examples include

STA (Smallholder Tea Authority)  
SCA (Smallholder Coffee Authority)  
SSA (Smallholder Sugar Authority)  
Malawi Tobacco Research Authority (MTRA)

### (iii) **Subvented Category**

This category is assumed to be permanently dependent on state or other support to fund the greater part of their activities.

Examples include:

- University of Malawi (UNIMA)
- Malawi Broadcasting Corporation (MBC)
- MANEB (Malawi National Examinations Board)
- Malawi College of Accountancy (MCA)
- Malawi Bureau of Standards (MBS)
- Malawi Institute of Education (MIE)
- Malawi Institute of Management (MIM)

### **Control of the Parastatal Sector**

The Government controls the parastatal sector through the following intermediary institutions:

- a The Department of Statutory Corporations in Office of the President and Cabinet (OPC)
- b The Treasury in the Ministry of Finance
- c The parent or technical ministries e.g. Ministry of Agriculture for ADMARC

The Department of Statutory Corporations in the OPC was created in 1982. It was charged with the following responsibilities:

- i. to monitor parastatal performance and planning
- ii. to monitor financial and personnel management of parastatals e.g. supervising staff establishments and terms of services.

The Treasury role is

- a to budget the financing of investments
- b to budget grants and subsidies

The relationship with parastatals is not generally formally instructed

### **Parastatal Boards**

In Malawi parastatals boards are appointed by the State President . The board normally constitutes:

- a. Representatives from Parent Ministries.

- b. The Department of Statutory Corporations
- c. The Treasury – ex-officio
- d. And a number of private individuals who have skills and experience.

Parastatal Chief Executives are also appointed by Government.

### **Board's Responsibilities**

- a To work on the formulation of policy recommended.
- b To execute good approved policies

### **Problem Areas**

Role definition  
Performance monitoring  
Policy direction  
Terms of employment  
Political interference/influence

There is no clear demarcation between commercial and development objectives and no standard procedures have been developed for addressing the situation.

Those with only development roles to play lack definition, and there is no accepted procedure for assessing the need for, or value of, individual annual subventions.

### 5. **Co-operative Societies**

The word Co-operative suffers from having two meanings.

In one sense it is as vague as working together or ready to help.

In the other sense it is a precise definition of particular kind of business organization.

A Co-operative Society is an association of persons, producers or consumers, who come together voluntarily to achieve some common purpose e.g. joint trading.

## **Main features of Co-operative Societies**

- a Open membership
- b Democratic control (one man, one vote)
- c Distribution of surplus
- d Political and religious neutrality
- e Cash trading
- f Promotion of education

## **Forms of Co-operative Societies**

There are many forms but most of them fall under the following major forms.

- a Consumers' Co-operatives
- b Producers' Co-operatives
- c The co-operative Credit (Credit Union)
- d Agricultural Co-operatives
- e Marketing Co-operatives
- f Co-operatives of Housing Societies

### **Consumers' Co-operatives**

The first successful co-operative society was found in 1844 by the Rockdale textile workers. The aim was to provide factory workers with cheaper food than they could buy in other shops. So the society was buying foodstuffs at wholesale prices and selling them to members across the counter at market prices.

The profits or surplus made are distributed among the members in proportion to the value of their purchases. Mainly the purpose of consumers' co-operative is not to make profit but to distribute reliable goods at a reasonable price.

### **Producers' Co-operative**

A producers' co-operative is a form of business unit owned by the workers. The members elect some of their members to manage it, the profits made are then distributed among the members as dividends on sales, with bonuses to employee.

Producers' co-operatives carry out an industrial or agricultural production process with the members sharing the work, profit and management.

That is, the member is a co-worker, co-partner and co-director. The society takes all the functions of the entrepreneur i.e. planning and

organization of production, buying raw materials, marketing finished products and fixing the remuneration to the worker.

## 6 **Credit Unions**

These are organizations whose members have other membership in common such as employees of a factory.

A credit union lends money to its members and borrows money from both its members and outside sources e.g. Malawi Union of Savings and Credit Cooperatives (MUSCCO).

### **Advantages of Co-operatives Societies**

- (i) Stability of trade which results from the loyalty of members who support the movement.
- (ii) It is democratically managed. The members elect the committee of management. One man one vote.
- (iii) There are no conflicts of interests since the customers and profit receivers are the same and one person.

### **Disadvantages**

- (i) Lack of business experience of many members of the committee. So the chief difficulty is to secure efficient management, for popular election is not the best method of securing the most effective managers.
- (ii) They compete unfairly against other retail traders, because their profits are exempted from corporation taxes which fall on the profits of other business undertakings.
- (iii) Some co-operative societies use some funds for political purposes.
- (iv) Method of promotion is set conducive to efficiency

## 7 **Building Societies**

These institutions are registered under the Building Societies Act.

- a Their main function is to assist people to purchase houses by installments

This they do by allowing suitable people to borrow the purchase price against a mortgage on the property.

Houses are expensive to buy but if payment is spread over a period of twenty years house purchase is like the payment of rent.

Building Societies accumulate funds in order to be able to lend money to their members for the purchase of houses, repayment of the loan being spread over a long period, during which the society holds a mortgage on the property.

- b They accept money from the public, pay interest on it, permit easy withdrawal, and generally provide a popular and convenient investment service.

## 8 **Multinational Companies**

These are very large companies which operate in several parts of the world. Although production and marketing take place in different countries direction remains at the centre. Each part may be merely a branch of the company but frequently there is a subsidiary company and local board of directors in each country. Examples of such companies are Toyota with Toyota Malawi as its subsidiary.

Multinational companies have developed due to:

- a a need to avoid tariffs which reduce markets for export.
- b a need to achieve greater efficiency by producing locally as compared with exporting.
- c need to reduce costs and competition by producing where raw materials and market are found.
- d a need to avoid losing business to licenced producers who might turn into competitors.

### **Advantages**

- a Multinational companies are able to transfer capital resources and managerial skills from developed countries to developing countries.
- b Multinational Companies also help to transfer technology from country to country.

- c they help to broaden economic opportunities within a host country by locating plants in depressed regions for example Lonrho's sugar producing plants in Nchalo and Dwangwa.
- d They create employment for the host country's people.
- e Multinational companies enable the production of goods which are directly suitable for local markets.

### **Disadvantages**

- a There are often conflicts between multinational companies goals and the host country's goals when the multinational company is seeking to maximize its profits while the host country is seeking to maximize the welfare of its citizens.
- b Multinational companies can avoid paying proper taxes by transferring funds through price mechanisms.
- c Multinational companies are often able to pay wages which may be much higher than those paid by local companies and government thereby creating dissatisfaction in the host country over wages.
- d Multinational companies are also responsible for transferring foreign culture some of which are not good and acceptable in certain host countries.

## CHAPTER 7 FINANCIAL SERVICES SECTOR

### MONEY AND BANKING

#### WHAT IS MONEY

It is anything which is generally accepted as a medium of exchange.

In fact money has several different functions.

#### Functions of Money in Detail

- a A medium of exchange
- b A store of value
- c A unit of account
- d A standard of deferred payment

#### 1 A Medium of Exchange

In the absence of money, exchange can take place only through barter; the exchange of one good for another.

Barter has many problems

##### (i) A double Coincidence of Wants

For exchange to take place a first person must offer what a second person wants, and the second person must offer what the first wants. For example, if I have a donkey to trade, I must search not only for someone who wants a donkey, but for someone who wants a donkey and has something that I would like to acquire.

##### (ii) Valuation of Commodities

The goods exchanged must be (approximately) equal in value. If a donkey is worthy 9 chickens and someone has only 6 chickens hardly can 6 chickens be exchanged with

2/3 of the donkey. Thus goods that are not readily divisible make poor subjects for barter transactions.

(iii) **Limits the Degree of Specialisation**

The difficulties of barter restrict the degree to which people can specialise in the production of a single commodity. Thus restricting ourselves to barter means that we would have to spend a great deal of time searching for satisfactory transactions. We would also have to be prepared to produce most of the things we need ourselves otherwise we could not be certain of obtaining all of our necessities.

The use of money as a medium of exchange removes these problems, as long as the money is readily accepted by everyone. One person sells something for an amount of money mutually agreeable to him and the buyer. The seller now takes the money and searches for someone who has the goods that he/she wishes to buy. So money facilitates the exchange of goods and services, i.e. it facilitates trade.

Therefore, money also promotes the division of labour and the greater productivity which it provides. Most of us sell our labour services, not for goods and services purchases from an employer, but in return for money income. The money income enables us to purchase from many other specialized producers a great variety of goods and services. Money, trade and specialisation together.

In addition to promoting the division of labour and greater productivity, money also permits great freedom of choice in the selection of goods to be consumed. Therefore, it contributes further to maximum satisfaction of human wants.

To serve as an efficient medium of exchange, money must have the following characteristics.

- 1 It must be readily accepted
- 2 It must have a high value for its weight
- 3 It must be divisible to accommodate transactions of small value
- 4 It must not be readily counterfeitable, for if money can be easily duplicated by individuals, it will lose its value.

2. **As a store of Value**

Money is a handy way to store purchasing power. A person can sell the goods and store the money until he/she will need it. This means that you have a claim on someone else's goods that you can

exercise at some future date. In this way money serves as a store of value i.e. if a person sells goods in exchange of money and does not spend it in a few days, weeks or months without loss of purchasing power. To hold money thus becomes one way of storing wealth. It acts as an asset. Money is a liquid store of wealth.

To be a satisfactory store of purchasing power, however, money must have a stable value. In inflationary times the purchasing power of money depreciates so that money does not perform well as a store of value, i.e. the rapid fluctuations of prices reduces the usefulness of money as a store of value.

3. **As a unit of Account**

Money may also be used purely for accounting purposes, without having any real physical existence of its own, e.g. students book allowances. You just go and buy books without taking real money but using the account which you have there.

Money is also used as a unit of account when the value is expressed as a money price. For example, here in Malawi these prices are expressed as Kwacha and Tambala.

Money does provide a unit in which prices may be expressed.

Money is a common unit of value measurement. That is how the value of goods and services is measured in monetary terms.

4. **As a Standard of Deferred Payment**

Payments that are to be made in the future, on account of debts, etc are reckoned in money terms.

Since goods and services are exchanged through money prices, loans and investments may also be expressed in this way. One person borrows a number of Kwachas. Another may acquire a mortgage for some quantity of Kwachas, another buys a bond – makes a loan – for N Kwachas.

When money is employed in a credit transaction, for example, a mortgage is negotiated for K20,000 to be repaid in 20 years, the borrower is given the use of K20,000 now and the lender expects it to be returned during the twenty years or at the end of the period. The expression of credit arrangements in money units involves the assumption that money will have the same purchasing power at the

end of 20 years as it has now. If it does, money has served well as a standard of deferred payment.

### The Attributes of Money

- a **Acceptability:** Money must be generally acceptable as a means of exchange.
- b **Uniformity or Homogeneity:** This means that each unit of Money ought to be the same.
- c **Divisibility:** This means money must be divisible into sufficiently small transactions
- d **Some Stability of Value:** To be a satisfactory store of purchasing power, money must have a stable value. In inflationary times the purchasing power of money depreciates so that money does not perform well as a store of value. That is the rapid fluctuations of prices reduce the usefulness of money as a store of value.
- e **Some Degree of Scarcity:** Money ought to have some degree of scarcity. This is why gold and silver used to be metals from which money was made, and nowadays, the government of a country controls the production of banknotes.
- f **Portability:** Money should be portable i.e. easy to carry. This is an attribute of banknotes, cheque books and credit cards.
- g **Durability:** This means that money should not disintegrate, evaporate or be easily destroyed.
- h **Recognisability:** Should be recognized internally and externally
- i **Non-counterfeitability:** It should not be easily counterfeitable.

**Inflation:** Is a rise in the general level of prices of goods and services in an economy over a period of time.

Inflation erodes the real value of money. Real value is best defined as 'the purchasing power' of money.

The effect of inflation is to reduce the purchasing power of money.

Inflation is generally measured by the Retail Price Index RPI (or Consumer Price Index CPI)

The RPI measures the percentage changes month by month in the average level of prices of the commodities and services purchased by the majority of households.

### **The Effect of Inflation on the Functions of Money**

Inflation prevents money from performing its functions effectively.

- 1 Money should be a store of wealth. In a period of inflation, although money retains its nominal value, it loses some of its purchasing power or real value. If people are worried about money's loss of value they will prefer to store their wealth in different assets which they do not expect to lose value.
- 2 Money should be a standard of deferred payment. However, in a period of inflation:

Someone who incurs debt will profit at the expense of the lender or creditor, because when the debt has to be repaid, its real value will have declined.
- 3 Money should be a stable unit of account, but during inflation, the relative value of different goods and services varies overtime, because individual products or services do not rise in price by the same percentage.
- 4 Money should be an acceptable means of exchange. When inflation is not excessive money will probably perform this function adequately. However, when inflation is very high (and there is hyperinflation) people might prefer not to use money. Instead, they might revert back to a barter economy, or use money alternatives or a foreign currency such as US Dollars.

## Banking

### Types of Banking

- a Central Bank
- b Clearing/Commercial Banks
- c Merchant Bank
- d Savings Banks

### A Central Bank

1. It acts as a banker and adviser to the government.

Some of the most important aspects of the work of a central bank are to conduct the nation's monetary policy, supervise and regulate banking institutions, and maintain the stability of the financial system..

It provides financial and economic advice to the Government.

2. It is the central note-issuing authority/issues legal tender currency.
3. It is the bankers' bank. The other banking institutions keep accounts at the Central Bank and use them to settle debts between themselves and the Central Bank. Thus, if one bank makes a payment to another bank it will do so by drawing a cheque on its account at the Central Bank.
4. It is a lender of last resort.
5. It is responsible for managing the national debt. The government's borrowing and lending is handled by the Reserve Bank which has the tasks of raising new loans by issuing government securities, arranging for the repayment of maturing securities and paying interest to the holders of existing securities.
6. It lends money to the government to meet temporary shortages of revenue.
7. The bank also, carries out the monetary policy of the country.

The monetary policy aims at

Influencing economic activity by acting on the total amount of spending in the economy through the following measures:

- a open market operations
- b special deposits
- c directives to commercial banks on lending policies
- d interest rates

## Other functions of Banks

1. Safeguarding customer's money  
A principal function of a bank is to accept and safeguard its customers' money.

Two types of accounts a customer may open with a bank are:

- i. **Deposit Account**

Such an account is usually used for saving money – money in a deposit account earns some income in the form of interest.

- ii. **Current Account**

This account is essential to all business cheques can be deposited into such an account at any time and more important, withdrawals can be made at any time without giving notice to the bank. The bank imposes charges for operating the account.

### Open and crossed cheques

These can be presented at the bank on which they are drawn and cash obtained across the counter.

If two parallel lines are drawn across the face of a cheque, it becomes a crossed cheque. The bank will not pay cash across the counter on a crossed cheque because the cheque must be paid into a bank account.

### Types of Crossing

**General Crossing** – A cheque crossed generally can be paid into any bank Account.

**Special Crossing** - Such a crossing on a cheque will mean that it can be paid only into the bank named in the crossing.

### Dishonoured Cheques

If a bank refuses to pay on a cheque the cheque is said to be “dishonoured.”

a “Refer to drawer” – insufficient money

b “Instructions not to pay” – drawer has “stopped” the cheque by telling the bank not to honour it.

- c “Words and figures differ”
- d It could be that the cheque is “stale” i.e. more than six months old.
- e Signature does not correspond with the specimen given to the bank at the time account was opened.

## 2. **Credit Transfer**

This is a method of payment by which a bank customer is able to pay several bills at once. He/she makes out a cheque for the total amount of the payments. The cheque and credit transfer form are handed to the bank. This saves postage and writing a number of cheques.

## 3. **Supply Cash to Customers**

If we are going to entrust our money to the bank we need to be sure that we can withdraw it when we want it. Thus the banks must always have money available for their customers.

The banks are also a means of getting new coins and notes into circulation. It is the function of the banks to withdraw soiled and mutilated notes from circulation when they are deposited.

## 4. **Transferring money**

This may be accomplished by cheques, credit transfers, standing orders, direct debits or by bank drafts.

### Cheques

A cheque is an order to the bank to pay a stated sum to the bearer of the cheque or to a named person.

Parties to a cheque:

- Drawer
- Drawee
- Payee
- (endorsee)

## Types of Cheques

### Bearer and Order Cheques

#### Bearer Cheques

These are written: pay bearer and anyone in possession of such a cheque can demand cash from the bank without even identifying himself.

#### i. **Order Cheques**

These require endorsement if passed on to someone other than the payee, and the bank will not honour such a cheque unless it has been endorsed by an original payee.

#### ii **Standing Order**

This is an extremely useful facility to those who have regular periodic payments to make such as rent, insurance premiums, professional subscriptions, pension contributions, etc. a simple form is completed telling the bank what sum to pay to whom and when; and the bank arranges payment according until the order expires.

#### iii. **Direct Debiting**

This is similar to a standing order. In direct debiting, however, you let the bank know how much is due. To do this you must give clear authority to your creditor and he/she must tell you that the amount is being charged before he/she demands the new sum.

#### iv **Banker's Draft**

A banker's draft is, in effect a cheque which a bank draws on itself on behalf of a customer. There can be instance when a creditor is not prepared to accept a cheque from his debtor. It may be because the amount is particularly large the creditor knows nothing about the debtor or payment is to be made in a foreign currency. If the bank agrees, it will send the creditor its draft for the amount and debit its customer's account.

Traveler's cheques are a more familiar kind of bank draft. If you are travelling abroad you may not want to carry along amounts of foreign currency with you. Instead you can buy traveler's cheques from a bank.

## 5 Lending Money

Another important role of the bank is to lend money to persons and businesses. A bank may allow one to borrow by means of:

### i An Overdraft

An informal way of borrowing from the bank for a short period, thus, if a trader's bills are greater than his cash and bank balance at a given moment, he/she may ask the bank manager to allow him/her to "overdraw his account for a few weeks to cover the difference."

### ii A Bank Loan

A person will have to fill an application form stating the amount he/she needs, the purpose of the loan, and the length of time for which it is required.

He/she is expected to pay it off in equal monthly installments.

### iii Personal Loans

Banks will lend to customers who are not in business.

## 6. Banks Assist in International Trade

They arrange for payments and transfer of documents between exporters and importers.

### i. Transfer of documents against acceptance:

Under this system the various documents referring to a consignment (Bill of Exchange of Lading, Certificate of Insurance) are transferred from the seller's bank to the importer's bank if instructed not to hand over the documents until the Bill has been accepted.

### ii Transfer of documents against payment. Exporters may demand that documents should not be handed over until payment has been made by the bank concerned

### iii Documentary Credit

Where an exporter wants an importer to pay for goods by means of a documentary credit, the procedure is as follows: the credit worthiness of an importer is substituted by the guaranty of a bank for a specific transaction. Under documentary credit arrangement (also called letter of credit arrangement) a bank (usually in the importer's country)

undertakes to pay for a shipment, provided the exporter submits the required documents (such as a clean bill of lading, certificate of insurance, certificate of origin) within a specified period.

## 7. **Collecting Money**

### i **Collection of Bills**

A bill is usually raised in trade circles when the seller of goods wants to obtain a definite undertaking of payment on the due date from the buyer. The seller can entrust his bankers with the collection of funds from the buyer on the due date and this process is known as “Collection of Bills.”

### ii **Discounting Bills**

The bank will buy a bill of exchange by giving the seller value less interest (discount) for the period between the date when the bill has been discounted to the due date. The bank will reimburse itself by debiting the account of the acceptor of the bill on the maturity date.

## 8. **Bankers Reference**

If a businessman is about to sign a large business contract with someone with whom he/she has not dealt before, he/she can ask his bank to find out about the other person’s financial standing

## 9. **Safe Custody of Valuables**

Customers may deposit documents (e.g. wills) and other valuables with the bank.

## 10. **Investment Advice**

If a person wants advice on how to invest his/ her savings, he/she can consult his/her bank manager on this issue.

## **Other Financial Institutions**

### 1 **Savings Banks**

These institutions are most familiar to the small saver. The savings of any one individual are limited in amount but they are many millions of accounts so that the total savings are very large.

The funds collected by these banks are invested in the securities issued by the government and other public authorities.

In Malawi an example of such a bank is the Malawi Savings Bank.

2. **Building Societies**

These are much specialised institutions in the sense that the savings which they collect are channeled almost exclusively towards the purchase of property (buildings). Building Societies make loans to house purchasers in the form of mortgages where by the society takes possession of the title deeds as a security for the loan.

3. **Insurance Companies**

Insurance companies provide cover for certain risks in return for regular payments which are known as premiums. Part of total annual premiums becomes available for investment in industry. Insurance companies hold share in several companies.

4. **Pension Funds**

Funds from public and private pension funds are an increasing element in the provision of capital for the private section securities and government securities.

5. **Investment Trusts**

These are really ordinary limited companies that use their capital to buy shares in other business in order to make profit to their shareholders.

6. **Unit Trusts**

These organizations are similar in function to investment trusts. Small savers are able to buy units in the fund. The managers of the trust then use the money to buy securities in particular sectors of industry to which the trust is committed (the deeds of the unit trusts indicate the areas to which funds will be applied).

## CHAPTER 8 INTRODUCTION TO MALAWI LEGAL SYSTEM

### The Malawi Legal System

Malawi law is basically *received law* having been adopted from English law.

#### Definition of law

- Law is a body of rules for the *guidance of human conduct* which is *imposed upon* and *enforced* among the members of a given state.
- The basic aim of law is the *attainment of justice* in society.

#### SOURCES OF LAW

*-The major sources of English law are:*

- a. Common law
- b. Equity
- c. Legislation
- d. Custom
- e. International law
- f. Academic writings

*-Other minor sources:*

- i. Cannon law
- ii. Law merchant

#### THE DOCTRINE OF JUDICIAL PRECEDENCE

-The doctrine of judicial precedent means that a judge is bound to apply a decision from an earlier case to the facts of the case before him provided, among other conditions that the material facts of the two cases are similar and the previous case was decided in a superior court.

#### Main branches of law

1. Public law
2. Private law

## **PUBLIC LAW**

- This is concerned with the legal structure of the state and the relationship between the state and individual members of the community.
- It also governs the relationship between one state and another.
- *It includes:*
  - a. Constitutional law
  - b. Administrative law
  - c. Criminal law

### **Constitutional law**

- *It is concerned with:*
  - The structure of the main institutions of government and their relationship to each other.
  - The relationship between central and local government.
  - The making of treaties with foreign states.
  - The status, function and powers of members of parliament, the judiciary, the civil service and the armed forces.

### **Administrative Law**

- It is a branch of constitutional law. It concerns the legal relationship between private citizens and various agencies of local and central government.

### **Criminal Law**

- It deals with crimes. A crime is a wrong against the state or the public (all of us). It is concerned with offences against the state, i.e. crimes such as murder, theft.
- The more serious criminal cases are dealt with by the high court presided over by a judge or jury. Less serious offences are dealt with by magistrates.
- The two parties in a criminal trial are:
  - a. The prosecutor and
  - b. The accused (defendant)
- The prosecution is conducted on behalf of the government by the Director of Public Prosecutions (DPP) and in most important cases by the Attorney General. The DPP may delegate to the police.
- 

### **PRIVATE LAW (Civil Law)**

- This governs the relationship between individuals.
- *Branches include:*
  - The law of contract
  - The law of torts
  - The law of trusts
  - The law of property

## **Establishment and Structure of the Judiciary**

### **The System of Courts**

- The judiciary is established by the constitution and consists of courts which are structured in a hierarchy:

#### ***The Supreme court of Appeal***

Followed by:

#### ***The High Court***

Then:

#### ***Subordinate Courts:***

Magistrate Courts

- i. The Industrial Relations Court
- ii. Traditional Local Courts

### **POWERS OF THE COURTS**

#### **The Supreme Court of Appeal**

- It has power to decide appeals against decisions of the High Court or other court or tribunal as may be specified by law.

#### **The High Court**

- It has unlimited power under the constitution to hear and determine any civil or criminal proceedings under any law, as well as the power to review any law, and any action or decision of the Government, for conformity with the Constitution.
- Within the High Court, there is Constitutional Court and Commercial Court.

#### **Subordinate Courts**

##### **1. Magistrate Court**

- It has the power to decide cases within specified limits set by Acts of Parliament e.g. presiding over minor criminal cases.

##### **2. The Industrial Relations Court**

- Has power over labor disputes and such other issues relating to employment.

##### **3. Child Justice Court**

- Deals with cases involving juveniles.

##### **4. The Traditional Court**

- Has power which is limited exclusively to civil cases at customary law and such minor common law and statutory civil cases as prescribed by an Act of Parliament.

## CHAPTER 9 OUTLINE OF THE LAW OF CONTRACT

### Definition of a Contract

- (i) A contract is a legally binding agreement formed by the mutual consent of two parties.
- (ii) A contract is an agreement which legally binds the parties.

The underlying theory is that a contract is the outcome of *consenting minds*.

However, parties are judged by what they have said, written or done, rather than by what they were actually thinking.

### The Essential Elements of a Contract

The three essential elements of a contract are:

- (i) Offer and Acceptance
- (ii) Consideration
- (iii) Intention to create legal relations

Note:

The Courts will usually look for evidence of three essential elements in any contract:

- (a) There must be an agreement usually made by offer and acceptance.
- (b) There must be consideration present, i.e. something of value given in exchange for a promise.
- (c) The parties must have an intention to create legal relations between themselves.

### Factors that may affect the validity of a contract

#### 1. Capacity

The parties must have legal capacity to contract otherwise a party without capacity may not be bound.

Some persons have restricted capacity to enter into contracts. For example, minors cannot enter in contracts for goods other than necessities nor do they have the capacity to contract for loans.

Those who lack mental capacity or who were intoxicated can avoid contracts if they can show that they did not understand the nature of their actions and the other party ought to have known about their disability. They still must pay a reasonable price for the goods received.

## 2. Form

For a contract to be enforceable it must be in its appropriate form. Thus, some contracts must be made in a particular form e.g. the sale of an interest in land must be in written form.

## 3. Content

In general, the parties may enter into a contract on whatever terms they choose. Some terms which the parties do express are overridden by statutory rules.

## 4. Genuine Consent

A mistake or representation made by one party may affect the validity of a contract. Parties may be induced to enter into a contract by undue influence or duress.

## 5. Legality

The courts will not enforce a contract which is deemed to be illegal or contrary to public policy.

A contract which does not satisfy the relevant tests may be either:

- (a) Void
- (b) Voidable
- (c) Unenforceable

### A void Contract

A *void contract* is not a contract at all. The parties are not bound by it and if they transfer property under it, they can sometimes recover their goods even from a third party.

### A Voidable Contract

Is a contract which one party may set aside. Property transferred before avoidable is usually irrecoverable from a third party.

### An unenforceable contract

Is a valid contract and property transferred under it cannot be recovered even from the party to the contract.

But if the other party refuses to perform or to complete their part of the performance of the contract, the other party cannot compel them to do so.

A contract is usually unenforceable when the required evidence of its terms, for example, written evidence of a contract relating land, is not available.

## **FORM OF CONTRACT**

A Contract may be made in any form. It may be *written, oral* or *inferred from the conduct of the parties*.

Writing is not usually necessary except in the following circumstances:

- (i) Some contracts must be by deed
- (ii) Some contracts must be in writing
- (iii) Some contracts must be evidenced in writing .

### **Contracts by deed**

A contract by deed must be in writing and *it must be signed*

These contracts must be by deed:

- (i) Leases for 3 years or more
- (ii) A conveyance or transfer of a legal estate in land
- (iii) A promise not supported by consideration, e.g. a covenant for example a promise to pay a regular sum to charity.

### **Contracts which must be in writing**

Some contracts are required to be in the form of a written document, usually signed by at least one of the parties.

### **Examples**

- (a) A transfer of shares in a limited company.
- (b) The sale of an interest in land
- (c) Bills of exchange and cheques
- (d) Consumer credit contracts

## Contracts which must be evidenced in writing

Certain contracts may be made orally, but are not enforceable in a court of law unless there is written evidence of their terms, for example, a contract of guarantee.

## ESSENTIALS OF A VALID CONTRACT

### 1. OFFER AND ACCEPTANCE

Definition:

An offer is a valid promise to be bound on specific terms. OR

An express or implied statement of terms on which the maker is prepared to be contractually bound if it is accepted unconditionally.

The offer may be made to one person, to a class of persons or to the world at large. Only the person or one of the persons to whom it is made may accept it.

Points to note:

An offer can be made to the world at large like in:

#### *Carlill v. Carbolic Smoke Ball Company 1893*

**Facts:** The respondent advertised to offer 100 British Pounds reward to any person who contracts influenza after having used the smoke ball as prescribed for two weeks. The claimant claimed the reward after having used the product as prescribed and contracted influenza.

**Held:** An offer to the public can be accepted so as to form a contract.

A statement which is vague cannot be an offer.

#### *Gunthing V. Lynn 1831*

**Facts:** the offeror offered to pay a further sum of money for the horse if it was lucky.

**Held:** The offer was too vague and no contract could be formed.

An offer must be distinguished from:

- (i) A statement which supplies information
- (ii) A statement of intention
- (iii) An invitation to treat.

## SUPPLY OF INFORMATION

A statement which sets out possible terms of a contract is not an offer unless this is clearly indicated.

### **Harvey V. Facey 1893**

**Facts:** The claimant telegraphed to the defendant “Will you sell us bumper hall pen? Telegraph lowest cash price”. The defendant telegraphed in reply “Lowest price for bumper hall pen 900 British Pounds”. The claimant telegraphed to accept what he regarded as an offer; the defendant made no further reply.

**Held:** The defendant’s telegraph was merely a statement of his minimum price if a sale were to be agreed. It was not an offer and no contract had been made.

### **A STATEMENT OF INTENTION**

Advertising that an event such as an auction will take place is not an offer to sell. Potential buyers may not sue the auctioneer if the auction does not take place.

### **AN INVITATION TO TREAT**

Definition:

- An invitation to treat is an indication that a person is prepared to receive offers with a view to entering into a binding contract.

### **Examples of invitation to treat include:**

- (a) Exhibition or display of goods for sale.
- (b) An auctioneers request for bids.
- (c) Advertisements.
- (d) An invitation for tenders.

### **Exhibition or display of goods for sale**

Displaying goods in a shop window or on the open shelves of a self-service shop is an invitation to treat.

### **Fisher V. Bell 1961**

**Facts:** A shopkeeper was prosecuted for offering for sale an offensive weapon by exhibiting a flick knife in his shop window.

**Held:** The display of an article with a price on it in a shop window is merely an invitation to treat.

### **An auctioneers request for bids**

An advertisement stating that an auction is to be held or a request for bids is an invitation to treat, and not an offer to sell to the highest bidder.

## Advertisements

An advertisement of goods for sale is usually an attempt to induce offers.

## An Invitation for Tenders

- A tender is an estimate submitted in response to a prior request.
- When a person tenders for a contract he/she is making an offer to the person who has advertised a contract as being available.
- An invitation for tenders does not generally amount to an offer to contract with the person quoting the lowest price, except where the person inviting tenders actually makes it clear that he/she is making an offer.

## TERMINATION OF AN OFFER

An offer may only be accepted while it is still open. In the absence of an acceptance, an offer may be terminated in any of the following ways:

- (a) Rejection
- (b) Counter-offer
- (c) Lapse of time
- (d) Revocation by the offeror
- (e) Failure of a condition to which the offer was subject.
- (f) Death of one of the parties.

### Rejection

Outright rejection terminates an offer.

### Counter-offer

- Acceptance must be unqualified agreement to the terms of the offer.
- A purported acceptance which introduces any new terms is a counter-offer.
- A counter-offer has the effect of terminating the original offer.

### Hyde V. Wrench 1840

**Facts:** The defendant offered to sell property to the claimant for \$1,000 on 6<sup>th</sup> June. Two days later, the claimant made a counter-offer of \$950 which the defendant rejected on 27<sup>th</sup> June. The claimant then informed the defendant on 29<sup>th</sup> June that he accepted the original offer of \$1,000.

**Held:** The original offer of \$1,000 had been terminated by the counter-offer of \$950.

### **Lapse of time**

An offer may be expressed to last for a specified time. If however, there is no express time set, it expires after a reasonable time.

### **Ramsgate Victoria Hotel Co V. Montefiore 1866**

**Facts:** The defendant applied to the company in June for shares and paid a deposit to the company's bank. At the end of November, the company sent him an acceptance by issue of a letter of allotment and requested payment of the balance due. The defendant contended that his offer had expired and could no longer be accepted.

**Held:** The offer was for a reasonable time only, so the offer had lapsed.

### **Revocation of an offer**

The offeror may revoke his offer at any time before acceptance. If he/she undertakes that his offer shall remain open for acceptance for a specified time he/she may none the less revoke it within that time, unless by a separate contract he/she has bound himself/herself to keep it open.

### **Routledge V. Grant 1828**

**Facts:** The defendant offered to buy the claimants house for a fixed sum, requiring acceptance within six weeks. Within the six weeks specified, he withdrew his offer.

**Held:** The defendant could revoke his offer at any time before acceptance, even though the time limit had not expired.

Points to note:

- Revocation may be an express statement or may be an act of the offeror.
- His revocation does not take effect until the revocation is communicated to the offeree.
- On communication, revocation of an offer may be communicated by any third party who is a sufficiently reliable informant.

Failure of a condition

- An offer may be conditional in that it is dependent on some event occurring or there being a change of circumstances.
- If the condition is not satisfied, the offer is not capable of acceptance.

### **Financings V. Stimson 1962**

**Facts:** The defendant wished to purchase a car, and on 16<sup>th</sup> March signed a Hire Purchase form. The form, issued by the claimants, stated that the agreement would be binding only upon signature by them. On 20<sup>th</sup> March the defendant, not satisfied with the car, returned it to the motor dealer. On 24<sup>th</sup> March, the car was stolen from the premises of the dealer, and was recovered badly damaged. On 25<sup>th</sup> March, the claimant signed the form. They sued the defendant for breach of contract.

**Held:** The defendant was not bound to take the car. His signing of the agreement was actually an offer to contract with the claimant. There was an implied condition in this offer that the car would be in substantially the same condition when the offer was accepted as when it was made.

### **Death of one of the parties**

- The death of the offeree terminates the offer.
- The offeror's death terminates the offer, unless the offeree accepts the offer in ignorance of the death, and the offer is not of a personal nature.

## **2. CONSIDERATION**

A promise is only legally binding if it is made in return for another promise or an act (either a positive act or something given up).

The rule of something for something.

### **Definition:**

- Consideration is the price at which a promise is bought.
- It could be some benefit accruing to one party or some detriment suffered by the other.

### **Types of consideration**

1. **Executed consideration**  
That which takes place at the present time. An act in return for a promise.
2. **Executory consideration**  
That which is to take place at some future date. A promise in return for a promise.

### **Past Consideration**

#### **Rule on past consideration:**

- Anything which has already been done before a promise in return is given is past consideration which as a general rule, is not sufficient to make a promise binding.

#### **Re McArdle 1951**

- **Facts:** Under a will the testator's children were entitled to a house after their mother's death. In the mother's lifetime one of the children and his wife lived in the house with the mother. The wife made improvements to the house. The children *later* agreed in writing to repay the wife in consideration for the improvements she made. But at the mother's death they refused to do so.

- **Held:** The work on the house had all been completed before the documents were signed. At the time of the promise the improvements were past consideration and so the promise was not binding.

### **Adequacy and sufficiency of consideration**

The long established rule is that consideration need not to be adequate but it must be sufficient.

#### **Adequacy**

- Consideration need not to be equal in value to the consideration received in return. There is no remedy at law for someone who simply makes a poor bargain.
- It is presumed that each party is capable of serving his own interests, and the court will not seek to weigh up comparative value of the promises or acts exchanged.  
**Thomas V. Thomas 1842**
- **Facts:** By his will the claimant's husband expressed the wish that his widow should have the use of his house during her life. The defendant's, his executor's, allowed the widow to occupy the house in accordance with her husband's wishes and in return for her undertaking to pay a rent of \$1 per annum. They later said that their promise to let her occupy the house was not supported by consideration.
- **Held:** Compliance with the husband wishes was not valuable consideration (no economic value attached to it), but the nominal rent was sufficient consideration.

#### **Sufficiency**

- Consideration must be sufficient. It must be capable in law of being regarded as consideration by the courts.
- Consideration is sufficient if it has some identifiable value.
- The law only requires an element of bargain, not necessarily that it should be a good bargain.

#### **Chappell & co. V. Nestle co 1960**

**Facts:** The defendants made a special offer, whereby if people collected three wrappers from Nestle bars of chocolate and then sent them in with a small sum of money, they could get a copy of the record called 'Rocking Shoes'. The case arose because the claimants owed the copyright to the music and the two parties were trying to calculate the amount of royalties payable to Chappell, on the basis of the value of the records. The argument hinged on whether the wrappers, which were merely thrown away on receipt by Nestle, constituted part of the consideration and therefore should be included in the royal calculation.

**Held:** The defendants had required that wrappers were sent in as part of the special offer, for obvious commercial reasons. It was held that the wrappers were part of the consideration as they had commercial value in the eyes of Nestle, one of the parties to the contract.

**Some acts, although arguably of some value, have been held to be no consideration:**

(a) **Performance of existing contractual duties**

Performance of an existing obligation imposed by statute is no consideration for a promise of reward.

**Collins V. Godefroy 1831**

**Facts:** The claimant had been subpoenaed (i.e. summoned to court) to give evidence on behalf of the defendant in another case. He alleged that the defendant had promised to pay him six guineas for appearing.

**Held:** There was no consideration for this promise, as the claimant was obliged to appear by law.

(b) A promise to do what the promise can already legally demand.

**Stilk V. Myrick (1809)**

**Facts:** Two members of the crew of a ship deserted in a foreign port. The master was unable recruit substitutes and promised the rest of the crew that they should share wages of the deserters if they would complete the voyage home short-handed. The ship owner however repudiated the promise.

**Held:** In performing the existing contractual duties the crew gave no consideration for the promise of extra pay and the promise was not binding. The lack of two crew members did not mean that the remaining crew was doing more than their existing duty.

(d) Payment on the day that a debt is due of less than the full amount of the debt is not consideration for a promise to release the balance

**PINNEL'S CASE- 1602**

**Facts:** Pinnel sued Cole, in an action of debt upon a bond, for the sum of £8 10s. The defendant, Cole, argued he had, at Pinnel's request, tendered £5 2s 6d before the debt was due, and the plaintiff had accepted in full satisfaction for the debt.

**Held:** payment of a lesser sum on the day in satisfaction of a greater, cannot be any satisfaction for the whole, because it appears to the Judges that by no possibility, a lesser sum can be a satisfaction to the plaintiff for a greater sum.

## PROMISSORY ESTOPPEL

The principle of promissory estoppel was developed in Central London

### Property Trust V. High Trees House 1947.

**Facts:** In September 1939, the claimants let a block of flats to the defendants at an annual rent of 2,500 British Pounds per annum. It was difficult to let the individual flats in war time, so in January 1940, the claimants agreed in writing to accept the reduced rent of 1,250 British Pounds per annum. No time limit was set on the arrangement but it was clearly related to wartime conditions. The reduced rent was paid from 1940 to 1945 and the defendants sublet flats during the war period on the basis of their expected liability to pay rent under the head lease at 1,250 British Pounds only. In 1945 the flats were fully let. The claimants demanded a full rent of 2,500 British Pounds per annum, both retrospectively and for the future. They tested this claim by suing for rent at the full rate for the last two quarters of 1945.

**Held:** The agreement of January 1940 was a temporary expedient only and had ceased to operate early in 1945. The claim was upheld. However, had the claimants sued for arrears for the period 1940-1945, the 1940 agreement would have served to defeat the claim.

It means that in some cases where someone has made a promise they can be prevented from retracting/denying/or going back on it.

The doctrine of promissory estoppel works as follows:

- If a creditor (Y) makes a promise (unsupported by consideration) to the debtor (X) that Y will not insist on the full discharge of the debt, and the promise is made with the intention that X should act on it and he/she does so, Y is estopped from retracting his promise, unless X can be restored to his/her original position.

#### Note:

- If the defendants in the High trees case had sued on the promise, they would have failed as they provided no consideration to the 1940 agreement. Therefore, the principle of promissory estoppel is a shield not a sword and cannot become a cause of action in its own right.

### Combe V. Combe 1951.

**Facts:** A wife obtained a divorce. Her ex-husband promised that he would make maintenance payments of 100 British Pounds per annum. The wife did not apply to the court for an order for maintenance, but this forbearance was not at the husband's request. No maintenance was paid and the wife sued on the promise. In

the High Court the wife obtained judgment on the basis of the principle of promissory estoppel. The ex-husband appealed.

**Held:** The Court of Appeal said that promissory estoppel ‘does not create new causes of action where none existed before. It only prevents a party from insisting on his strict legal rights when it would be unjust to allow him to enforce them’. The wife’s claim failed.

***The principle is subject to the following conditions:***

- (i) There must be an existing contract between the parties
- (ii) The claimants must voluntarily waive their rights under the contract.
- (iii) There must be an intention that the defendants should rely on the waiver
- (iv) The defendants must alter their legal position because of the waiver.

***Limitations of the principle of promissory estoppels***

- It is a shield not a sword, i.e. it is a defence not a cause of action.
- It may only have a suspensory effect, as shown in the High Trees case. (The claimant’s were suspended during World War II, but reinstated for the future once the war had finished.)
- The party seeking to use it as an equitable defence must also have acted fairly in their dealings with the claimants

### **3 INTENTION TO CREATE LEGAL RELATIONS**

An agreement will only become a legally binding contract if the parties intend this to be so. This will be strongly presumed in the case of business agreements but not presumed if the agreement is of a friendly, social or domestic nature.

**Presumptions:**

1. Social, domestic and family arrangements are not usually intended to be binding.
2. Commercial agreements are usually intended by the parties involved to be legally binding.

**Domestic Arrangements:**

**Husband and Wife**

A normal agreement within a stable marriage between a husband and wife does not create a binding contract.

### **Balfour V. Balfour 1919**

**Facts:** The husband was employed in Ceylon. He and his wife returned to the UK on leave but it was agreed that for health reason she would not return to Ceylon with him. He promised to pay her 30 British pounds a month as maintenance. Later the marriage ended in divorce and the wife sued for the monthly allowance which the husband no longer paid.

**Held:** An informal agreement of indefinite duration made between husband and wife (whose marriage had not then broken up) was not intended to be legally binding.

However, an agreement between a husband and wife as part of a separation process does create a binding contract.

### **Merritt V. Merritt 1970**

**Facts:** The husband had left matrimonial home, which was in the joint name of husband and wife, to live with another woman. The spouse met and held a discussion in the husband's car in the course of which he agreed to pay her 10 British pound a month out of which she agreed to keep up the mortgage payments on the house. The wife refused to leave the car until the husband signed a note of these agreed terms and an undertaking to transfer the house into her sole name when the mortgage has been paid off. The wife paid off the mortgage but the husband refused to transfer the house to her.

**Held:** In the circumstances, an intention to create legal relationship was to be inferred and the wife could sue for breach of contract.

### **PRIVITY OF CONTRACT**

- The common law doctrine of privities of contract states that no one can sue or be sued on a contract to which he/she is not a party.
- This principle was shown in the case of:

#### **Dunlop v. Selfridges Ltd. (1915)**

**Facts:** The claimant, a tyre manufacturer, supplied tyres to X, a distributor, on terms that X would not resale the tyres at less than the prescribed retail price. If X sold the tyres wholesale to trade customers, X must impose a similar condition on those buyers to observe minimum retail prices (such clauses were legal at the time though prohibited since 1964 by the Resale Prices Act). X resold tyres on these conditions to the defendant. Under the terms of the contract between X and Selfridges, Selfridges was to pay to the claimant a sum of 5 British Pound per tyre if it sold tyres to customers below the minimum retail price. They sold tyres to two customers at less than the minimum price. The claimant sued to recover 5 British Pound per tyre as liquidated damages.

Held: The claimant could not recover damages under a contract (between X and Selfridges) to which it was not a party.

**The general rule:**

Only a party to a contract:

- (i) Acquires rights and obligations under it.
- (ii) Can sue and be sued under it.

***Exceptions to the general rule:***

- (a) The Contracts (Rights of Third Parties) Act 1999 allows a person who is not a party to a contract to enforce it so long as the contract was for his benefit and he/she was expressly identified, by name or description.
- (b) Insurance law allows a third party to take the benefit of a contract of insurance
- (c) Trust law allows a beneficiary to enforce a trust.
- (d) Agency law allows an agent to make a contract between his principal and a third party, even though the third party may be unaware that he/she is acting as an agent.
- (e) An executor can enforce contracts made by the deceased for whom he/she is acting.

**Beswick V. Beswick 1967**

**Facts:** X transferred his business to the defendant, his nephew, in consideration for a pension of 6.10 British Pounds per week and, after his death, a weekly annuity to X's widow. Only one such annuity payment was made. The widow brought an action against the nephew, asking for an order of specific performance. She sued both as an administrator of her husband's estates and in her personal capacity as recipient.

Held: As her husband's representative, the widow was successful in enforcing the contract for a third party's (her own) benefit. In her personal capacity she could derive no right of action.

## TERMS OF CONTRACT

Statements made by parties may be classified as:

- (a) Terms or
- (b) Representations

Different remedies attach to breach of a term and to misrepresentation respectively.

### Representation

- A representation is something which induces the formation of a contract but which does not become a term of the contract.
- Breach of a representation would result in a lesser remedy than for breach of a term.

### Express terms

- An express term is a term expressly agreed by the parties to a contract to be a term of that contract.
- In examining a contract, the courts will look first at the terms expressly agreed by the parties.

### Implied terms

- Refers to a term deemed to form part of a contract even though not expressly mentioned.
- Terms may be implied:
  - i. By the courts
  - ii. By statute
  - iii. By custom

### Terms implied by custom

- The parties may enter into a contract subject to customs of their trade.
- Any express term overrides a term which might be implied by custom.

#### *Hutton V. Warren 1836*

**Facts:** A farm tenant claimed that it was the custom of the country that the landlord would give a reasonable allowance for seeds and labour to keep the land arable, and that he would leave manure should the landlord wish to purchase it.

Held: In favour of the farm tenant, that 'in commercial transactions, extrinsic evidence of custom and usage is admissible to annex incidents to written contracts matters with respect to which they are silent.'

### Terms Implied by Statute

- Some terms may be implied by statutes, for example the protection given by the Sale of Goods Act to a consumer who buys goods from a trader cannot be taken away from him.

### CONDITIONS AND WARRANTIES

Contract terms may be further categorized as:

- I. Conditions and
- II. Warranties

#### Condition

##### Definition:

- A condition is a vital term, going to the root of the contract, breach of which entitles the injured party to decide the contract as discharged and to claim damages.

##### *Poussard V. Spiers 1876*

- **Facts:** Poussard agreed to sing in an opera throughout a series of performances. Owing to illness she was unable to appear on the opening night and the next few days. The producer engaged a substitute who insisted that she should be engaged for the whole run. When Poussard recovered, the producer declined to accept her services for the remaining performances.
- **Held:** Failure to sing on the opening night was a breach of condition which entitled the producer to treat the contract for the remaining performances as discharged.

#### Warranty

##### ➤ Definition:

- A warranty is a minor/subsidiary term of a contract breach of which only entitles the injured party to claim damages.

##### *- Bettini V. Gye 1876*

**Facts:** An opera singer was engaged for a series of performances under a contract by which he had to be in London for rehearsals six days before the

opening performance. Owing to illness he did not arrive until the third day before the opening. The defendant refused to accept his services, treating the contract as discharged.

**Held:** The rehearsal clause was subsidiary to the main purpose of the contract breach of which was breach of a warranty and not breach of a condition as purported by the defendant.

## Innominate terms

### Definition:

- These are terms which cannot be classified as either a condition or warranty.
- As such they are treated as intermediate terms.
- You will have to wait for the consequences arising from the breach before you can treat such terms as conditions or warranties.
- If the consequence /result/impact of the breach is serious; the term is as a condition otherwise you treat the term as a warranty.

### *Hong kong shipping co. ltd V. Kawasaki ltd 1962*

**Facts:** The defendants chartered a ship from the claimants for a period of 24 months. A term in the contract stated that the claimants would provide a ship which was 'in every way fitted for ordinary cargo service'. They were in breach of this term since the ship required a competent engine room crew which they did not provide. Because of the engine's age and the crew's lack of competence, the ship's first voyage was delayed for 5 weeks and further repairs were required at the end of it, resulting in the loss of a further 15 weeks. The defendants purported to terminate the contract so the claimants sued for breach of contract on the grounds that the defendants had no right to terminate; the defendants claimed that the claimants were in breach of contractual obligation.

**Held:** The term was innominate and could not automatically be construed as either a condition or a warranty. The obligation of 'seaworthiness' embodied in many charter party agreements was too complex to be fitted into one of the two categories. The term would be construed in the light of the actual consequences of the actual breach. The ship was still available for 17 out of 24 months. The consequences of the breach were not so serious that the defendants could be justified in terminating the contract as a result. The defendants were in breach of contract for terminating it when they did.

- The so called contract is void.

## VITIATING FACTORS

These are factors that affect the validity of a contract.

These factors are:

- Mistake
- Misrepresentation
- Undue influence
- Duress
- Illegality

## MISTAKE

Mistake is an erroneous belief, at contracting, that certain facts are true

If one party enters into a contract as a result of mistake, the contract will be void.

### Common Law

The following types of mistake render the contract void, provided the mistake actually induces the contract:

- (i) Mistake as to the existence of the subject matter.
- (ii) Mistake as to the possibility of performing the contract.
- (iii) Mistake as to the identity of the subject matter.
- (iv) Mistake as to the identity of the other party.
- (v) Mistake as to the terms of the contract of which the other party is aware.

### Types of mistake:

#### a. Unilateral mistake

This occurs when one of the parties is mistaken about some fundamental fact and the other party knows or should know this.

#### b. Common (bilateral) mistake

This occurs when both parties make the same mistake. Usually this will be a mistake as to the existence of the subject matter.

### c. **Mutual mistake**

This occurs when the two parties mean different things. It will normally be as to the identity of the subject matter.

### **Equity**

Equity will, in limited situations, *relieve* a party from the effect of his mistake where common law would hold him to the contract.

### **Two equitable remedies:**

#### **1. Rescission**

To rescind a contract means to set it aside. In general, this remedy will only be granted if the party seeking to rescind was not at fault and provided justice can be done to the other party by imposing conditions.

#### **2. Rectification**

Equity will allow a written document to be rectified (made correct) in order to record the true intention of the parties at the time of forming the contract.

## **MISREPRESENTATION**

### **Definition:**

- This is a false statement of fact made by one party to the other in order to induce a contract.
- A misrepresentation will render a contract void.

### **Types of misrepresentation**

There are three types:

- (a) Innocent misrepresentation
- (b) Negligent misrepresentation
- (c) Fraudulent misrepresentation

### **Innocent misrepresentation**

This is a false statement which the maker honestly and reasonably believes to be true.

## **Remedies:**

### ***i. Rescission***

Setting the contract aside by restoring the parties to their pre-contact state of affairs.

### **ii. Damages in lieu (in place) of rescission**

This will be awarded if the court thinks it equitable to do so, e.g. if the misrepresentation is too trivial, it may be too drastic to rescind the contract.

## **Negligent misrepresentation**

Refers to a false statement made by a person who had no reasonable grounds for believing it to be true.

## **Remedies**

### **i. Rescission**

### **ii. Damages**

If the innocent party has suffered a loss.

## **Fraudulent misrepresentation**

A statement which is known to be false, or made without belief in its truth, or recklessly, not caring whether it is true or false.

## **Remedies**

**I.** Damages based on the tort of deceit.

**II.** The innocent party can also repudiate the contract.

**III.** The innocent party can also rescind the contract.

## **DURESS**

➤ If a person is coerced into making a contract by fear for the physical well being of himself or his immediate family or for safety of his goods or for his economic profits, this is called duress.

➤ The coercion may be either actual or threatened.

## **UNDUE INFLUENCE**

➤ This is where a contract is induced by unfair persuasion.

➤ Undue influence makes a contract voidable.

- The burden of proof of undue influence depend on the relationship between the parties :
- (a) If there is no special relationship, the party to avoid must prove that he/she was subjected to influence which excluded free consent.
- (b) Where a confidential relationship exists between the parties, it is for the party in whom confidence is placed to show that undue influence was not used. Example of such relationships:
  - i. Parent/child
  - ii. Doctor/patient

## DISCHARGE OF CONTRACT

There are four ways by which rights and obligations of the parties may come to an end:

- (i) By performance
- (ii) By agreement
- (iii) By frustration
- (iv) By breach

### Discharge by performance

The general rule is that a person who performs a contract in accordance with its terms is discharged from any further obligations.

### Exceptions to the general rule:

1. **Severable contracts:**  
Where a contract may be divided into several parts, payments for the parts that have been completed can be claimed.
2. Acceptance of part performance
3. Prevention of performance:  
Where one party is prevented by the other from completely performing the contract, he/she may bring a quantum meruit action to claim for the work done.

### Discharge by agreement

A contract will also come to an end through agreement.

There are four ways in which a contract can be discharged by agreement:

- (a) By release
- (b) By accord and satisfaction
- (c) By rescission
- (d) By some provision contained in the contract itself.

### **Discharge by frustration**

If an event occurs which is not the fault of either party, and could not reasonably have been foreseen, which so alters the whole character of the bargain as to make it a totally different thing from that intended; the contract is discharged by frustration.

The frustrating event must have the effect of making the whole contract impossible to perform.

### ***Frustration will occur in the following circumstances:***

- (i) If the whole basis of the contract is the continued existence of a specific thing which is destroyed.

#### **Taylor V. Caldwell – 1863**

**Facts:** A hall was let for a series of concerts on specified dates. Before the date of the first concert, the hall was destroyed by fire. The concert organizer sued the owner of the hall for damages for failure to let him have the use of the hall as agreed.

**Held:** Destruction of the subject matter rendered the contract impossible to perform and discharge the contract.

- (ii) If either party to a contract of service dies, becomes seriously ill, or is called up for military service.
- (iii) If the whole basis of the contract is the occurrence of an event which does not occur.

#### **Krell V. Henry- 1903**

**Facts:** A room overlooking the route of the coronation procession of Edward VII was let for the day of the coronation for the purpose of viewing the procession. The coronation was postponed owing to the illness of the King. The owner of the room sued for the agreed fee, which was payable on the day of the coronation.

**Held:** The contract was made for the sole purpose of viewing the procession. As that event did not occur the contract was frustrated.

- (iv) If the government prohibits performance of the contract for so long that to maintain it would impose on the parties fundamentally different obligations from those bargained for.

- (v) If performance of the main object of the contract subsequently becomes illegal.

***Limitations to the doctrine of frustration:***

- (i) A contract is not frustrated if it becomes unexpectedly expensive or burdensome to one of the parties.
- (ii) A party cannot rely on self induced frustration; that is due to his own conduct.
- (iii) Frustration will not apply where the parties have expressly provided for a contingency which has occurred.

***The effects of frustration:***

- The contract is automatically discharged as to the future but it is not made void from the beginning.
- Money paid after the frustrating event is recoverable and money payable before frustration ceases to be payable.

**Discharge by breach**

- A party is said to be in breach of contract where without lawful excuse, he/she does not perform his contractual obligations precisely.
- Breach occurs in the following circumstances:
  - i. If a party fails to perform one of his obligations under a contract.
  - ii. If a party before a date fixed for performance indicates that he will not perform on the date. ( anticipatory breach)

**Types of breach:**

1. Repudiatory breach
2. Anticipatory breach

**1. Repudiatory breach**

- A repudiatory breach occurs where a party indicates, either by words or by conduct that he/she does intend not to honor his/her contractual obligations.
- It usually occurs when performance is due.

***Types of repudiatory breach***

- a. Refusal to perform ( renunciation)
- b. Failure to perform an entire obligation.

- c. Incapacitation:  
Where a party prevents himself from performing his contractual obligations; he/she is treated as if he/she refused to perform them.
- d. Breach of condition.
- e. Breach of an innominate term which has the effect of depriving the injured party of substantially the whole benefit of the contract.

### **Anticipatory breach**

- This occurs when one party declares in advance that he/she will not perform his side of the contract when the time of performance arrives.
- The innocent party may treat the contract as discharged forthwith or continue with his/her obligations until actual breach occurs.
- His/her claim for damages will then depend upon what he/she has actually lost.

### **REMEDIES FOR BREACH OF CONTRACT**

1. Common law remedies
2. Equitable remedies

#### ***Common law remedies:***

- a. Damages
- b. An action for the agreed sum
- c. Quantum meruit claim

#### ***Damages (compensation for the loss suffered)***

Damages are a common law remedy intended to restore the party who has suffered loss to the same position he/she would have been if the contract had been performed.

The two tests applied to a claim for damages relate to :

- i. Remoteness of damage
- ii. Measure of damage

#### **Remoteness of damage**

- In a claim for damages, the first issue is to analyse the remoteness of damage.
- Here the courts consider how far down the sequence of cause and effect the consequence of breach should be traced before they should be ignored.
- Under the rule in **Hadley V. Baxendale-1854**, damages may only be awarded in respect of loss as follows:
  - a. (i) The loss must arise naturally from the breach.
  - (ii) The loss must arise in a manner which the parties may reasonably be supposed to have contemplated in making the contract as the probable result of the breach of it.

- b. A loss outside the natural cause of events will only be compensated if the exceptional circumstances are within the defendant's knowledge when he/she made the contract.

### **Measure of damages**

#### **General rule:**

- The amount awarded as damages is what is needed to put the claimant in the position he/she would have achieved if the contract had been performed.

#### **Market price rule**

- The measure of damages for breach of contract for the sale of goods is usually made in relation to the market price of the goods.

#### **Liquidated damages**

- Refers to a fixed or ascertainable sum agreed by the parties at the time of contracting payable in the event of a breach. For example an amount payable per day for failure to complete a building.

#### **Penalty Clause**

- A clause in a contract providing for a specified sum of money to be payable in the event of a subsequent breach.
- If its purpose is merely to create a difficulty on the other party; it will be held void and the court will proceed to assess unliquidated damages.

#### **Unliquidated damages**

- Refer to those damages assessed by the court at the time of breach.
- This is done when no provision for damages was made at the time of contract.

### **Other common law remedies:**

#### **a. Action for price**

- A simple action for the price to recover the agreed sum should be brought if the breach of contract is failure to pay the price.
- However, the property must have passed from seller to the buyer.

#### **b. Quantum meruit claim (how much it is worth)**

- A quantum meruit is a claim which is available as an alternative to damages.
- The injured party in a breach of a contract may claim the value of his work.

## Equitable Remedies:

### 1. *Specific performance*

- Refers to an order of the court directing a person to perform an obligation
- It is an equitable remedy awarded at the discretion of the court when damages would not be an adequate remedy.
- Its principle use is in the contract for the sale of land but may also be used to compel a sale of shares or debentures.
- It will never be used in the case of employments or other contracts involving personal service.

### 2. **Injunction**

It is a court order preventing a party to a contract from doing something in breach of a contract.

#### *Types of injunction:*

- (a) **Mandatory injunction**  
Orders a person to take action to undo breach of contract.
- (b) **Prohibitory injunction**  
An order of the court which prohibits a person from doing something.
- (c) **Mareva injunction**  
Orders a defendant not to remove specific assets from the jurisdiction of the court.
- (d) **Anton pillar injunction**  
Authorises the inspection/photographing, custody or removal of documents or property to preserve evidence if it is possible that the defendant will tamper with evidence.

### 3. **Rescission**

Rescinding a contract means that it is cancelled or rejected and the parties are restored to their pre-contract condition or position.

#### **Barriers to rescission:**

The remedy of rescission will not be available in the following situations:

- a. If the innocent party with full knowledge of his rights, affirms the contract.
- b. Lapse of time:
  - Where misrepresentation is innocent, lapse of time may bar rescission.
- c. If restoration to the pre-contract state of affairs is impossible, because for example a partnership's capital has been converted into shares in a limited company as in **Clarke V. Dickson-1858.**

- d. The intervention of third party rights.
  - Thus a person cannot rescind an allotment of shares in a company after the company has gone into liquidation, since at this point third party rights intervene because the assets of the company have to be collected to distribute among the company creditors.

#### **4. Rectification**

Means correcting a written document in order to record the true intention of the parties at the time of forming the contract.

## CHAPTER 10

### CONTRACT FOR THE SALE OF GOODS

#### Introduction:

- The law of sale of goods governs the sale and transfer of goods.
- The principle source of the law of the sale of goods is *The Sale of Goods Act 1979*.

#### *A contract for sale of goods*

##### Definition:

- A contract for the sale of goods is a contract where by a seller transfers or agrees to transfer *the property in the goods* (title) to the buyer for a monetary consideration called price.

#### *Description of goods under a contract of sale:*

##### **a. Existing goods**

Refers to goods which form a subject matter of a contract of sale, may be either existing goods owned or possessed by the seller or goods to be acquired or manufactured by the seller after the making of the contract. These are known as future goods.

##### **b. Ascertained Goods**

Refers to goods already identified by the parties.

##### **c. Unascertained Goods**

Goods which are usually in existence but have not been specifically identified as forming subject matter of the contract. When they have been identified they become ascertained goods.

##### **d. Specific Goods**

Refers to not only existing goods but also goods which have actually been agreed to be transferred under the contract.

#### *A sale and an agreement to sale*

##### **A sale**

- Refers to a contract of sale where the property in the goods is *transferred instantly* from the seller to the buyer.

### **An agreement to sale**

- Refers to a contract of sale where the transfer of property in the goods is to take place at a future time or subject to some conditions thereafter to be fulfilled.
- An agreement to sale becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

### **Note:**

**Property denotes ownership (title)** and not mere possession.

Therefore, a contract which does not pass ownership falls outside the definition of the contract of sale.

## **A CONTRACT OF SALE DISTINGUISHED FROM OTHER RELATED CONTRACTS**

### **1. Sale of goods distinguished from barter**

- The requirement is that the consideration for the sale of goods is supposed to be in monetary terms.
- Where the consideration is not in money, the contract is not one of the sale of goods.
- If the contract involves part-exchange plus monetary consideration; it is treated as a sale.

#### **Aldrige V. Johnson (1857)**

- A contract for the sale of 52 bulls valued at 6 pounds each against 100 packs of barley valued at 2 pounds per pack; the difference to be paid in cash was held without argument as a sale of goods as it involved some monetary consideration.

- The difference being that in barter trade there is no money consideration.

#### **Read V. Hutchnison**

- It was held that a party to a contract whereby some goods were exchanged for some other goods could not sue for the price of the goods because this was not a contract for sale.

### **2. A sale distinguished from promotional offer**

- Recalling from the law of contract, if no valuable consideration is given, an agreement to transfer the property in the goods is a gift and not a contract unless it's a contract under seal.
- But whether the contract is under seal or not, there can be no contract for the sale of goods where there is no monetary consideration.

### Dunlop V. Selfridge – 1915

- Where it was said that a promise without a promise is a gift; one made for consideration is a bargain or contract.
- The situation is more complicated where a trader offers extra goods to customers as inducement to buy other goods, for example. 2 free batteries for each camera bought or a free T-shirt for every ten liters of petrol.

### Esso Petroleum co. Ltd V. Customs and Excise Ltd- 1976

- The court held that in such a case there was no sale because the consideration for the free gift was not a monetary price as required by the Sale of Goods Act. The money paid was consideration for the main contract to buy petrol.

## 3. Distinguishing a sale from a contract for work and materials

- You look at the consideration coming from the other party and decide whether it has involved one's skill or not.
- A contract of sale is governed by the Sale of Goods Act while a contract of work and material is not, hence the need to distinguish the two.
- A contract of sale intends and results in the transfer of property in the goods. A contract for work and material, although it may result in transfer of goods also involves the supply of skill and labor or materials to produce the transferred goods.
- A contract of work and material focuses more on the exercise of skill, the transfer of the chattel being subsidiary as the chattel could only be transferred after or upon the exercise of skill.
- Thus if you contract an already completed material; it becomes a sale, but if you ask an artist to paint one; it is not a sale as you would pay him for the skill or materials over and above the portrait itself.

### Robinson V. Graves 1935

- G. commissioned R., an artist to paint a portrait for 250 guineas and R. supplied the canvass and other materials introducing a contract.
- It was now a contract of work and material and not of sale although the property in the chattel was transferred for a money consideration.

## 4. Distinguishing a sale and a hire

- A contract of hire is also known as a lease or a bailment.
- Bailment is a transaction under which goods are delivered by one party- the bailor to another- the bailee on terms which normally requires the bailee to hold the goods and ultimately re-deliver them to the bailor or in accordance with the bailor's instruction.
- The property in the goods is not intended to and does not pass on delivery. Because there is no transfer of property; it is not a sale.

## 5. Distinguishing a sale and a hire purchase

- Hire purchase is a hire with an option to purchase. In a sale property in the goods is transferred or is agreed to be transferred.

- Under a hire purchase agreement, the hirer is given possession of the goods together with an option to purchase them.
- Since one is not bound or compelled to purchase them; he/she has not agreed to buy them (the goods); it is not a sale and he/she is not a buyer. Only if he/she exercises the option to buy will it become a contract of sale.

**Helby V. Mathews - 1895**

- A person sold goods which he was holding on a hire purchase agreement. It was held that he had not bought the goods and had not agreed to buy them. The fact that he had an option to buy them did not entitle him to sell the goods. He would only be entitled to sell the goods after exercising the option to purchase.
- In a hire purchase agreement, the hirer acquires no title to the goods and cannot transfer title to third parties.

## **FORMATION OF A CONTRACT OF SALE**

The general principles of contract apply to the formation of the contract of sale of goods which means that there must be; offer, acceptance, intention to create legal relations, consideration, and capacity e.t.c.

### ***Capacity***

Capacity to buy and sale is regulated by the general law concerning capacity to contract and to transfer and acquire property.

Provided that where necessaries are sold and delivered to a minor or a person who by reason of mental incapacity or drunkenness is incompetent to contract; he/she must pay a reasonable price therefore.

### **Minor**

A minor is defined as an unmarried person under the age of 21 in Malawi.

### **Necessaries**

Refers to goods suitable to the condition in life of a minor or any other person and his actual requirements at the time of sale and delivery

## **FORMALITIES FOR MAKING A CONTRACT OF SALE**

A contract of sale can be made in writing with or without a seal (a kind of stamp to authenticate documents) or it can also be by word of mouth, by conduct of the parties; it may also be partly by word of mouth and partly in writing.

### ***The Price:***

Price refers to the consideration given by the buyer for the transfer of the property in the goods.

- Under the Sale of Goods Act, the price in a contract of sale may be fixed by the contract or it may be left to be fixed in a manner there by agreed.

- The price may also be determined by the course of dealing between the parties (previous transactions between the parties).
- Where the price is not determined in accordance with the forgoing provisions, then the buyer must pay a reasonable price and what is a reasonable price is a question of facts depending on the circumstances of each particular case.
- This means that the absence of agreement on the price does not render the contract void.

#### **Where the Price has to be fixed by valuation**

- If it so happens that the price is agreed to be fixed by valuation of a third party and the valuer cannot or does not do his job; the agreement shall be avoided.
- Where the third party is prevented to make a valuation due to the fault of a seller or a buyer; the party not in fault may maintain an action for damages against the party in fault. For example, turning away the valuer or consuming the goods before valuation.

#### **Clarke V. Westrope- 1857**

- In this case, the valuation was rendered impossible by the buyer who had consumed the goods before valuation.
- It was held that the plaintiff was entitled to damages because the valuation had failed due to the fault of the buyer.

## TERMS IMPLIED BY THE SALE OF GOODS (Statutory Implied Terms)

- These are terms which are implied into every contract of sale of goods where there was no express or clear agreement by the parties.

### *Implied terms as to title:*

#### Section 12(1)

- There is an *implied condition* on the part of the seller that in the case of a sale, he has a right to sell the goods, and in the case of an agreement to sell, he will have such a right at the time when the property is to pass.
- The seller can therefore not sell what he does not own (*the nemo dat quod habet rule*)
- Section 12(1) will be broken in two ways:
  - i. Where the seller lacks the right to pass property in the goods, that is, he is not the owner of the goods.
  - ii. Where the seller can be stopped by process of law from selling the goods.

#### *Niblett V. Confectioners Materials co. - 1921*

- A consignment of tinned milk to be shipped from New York to London was bought. The milk arrived, carrying the *label- nissy brand*. At the wish of a third party who claimed infringement of trademark; the consignment was seized by customs.
- It was held that S.12 (1) was breached as the seller did not have the right to sell.

#### Section 12(2)

- There is an *implied warranty* that the goods are free from any encumbrances (interference) not made known to the buyer.

#### *Microbeads A.G V. Vinhurst Road Markings Ltd- 1975*

- Goods were sold which were not at the time subject to any patents rights. Subsequently a patent specification was published a patent granted.
- The court of Appeal held that S.12 (1) was not breached but that the seller was in breach of S 12 (2).

## EFFECTS OF THE CONTRACT

### *Transfer of property as between seller and buyer*

#### Property passes when intended to pass

1. Where there is a contract for the sale of specific or ascertained goods; the property in them is transferred in them is transferred to the buyer at such a time as the parties to the contract intends it to be transferred.
2. For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

#### **Rules for ascertaining intention:**

- Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

##### **Rule 1**

- Where there is an unconditional contract for the sale of specific goods in a deliverable state; the property in the goods passes to the buyer when the contract is made and it is immaterial whether time of payment or time of delivery or both be postponed.

##### **Rule 2**

- Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state; the property does not pass until the thing is done and the buyer has notice that it has been done.

##### **Rule 3**

- Where there is a contract for the sale of specific goods in a deliverable state but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price; the property does not pass until the act or thing is done and the buyer has notice that it has been done.

##### **Rule 4**

- When goods are delivered to the buyer on approval or on sale or return basis or other similar terms, the property in the good passes to the buyer:
  - a. When he/she signifies his/her approval or acceptance to the seller or does any other act adopting the transaction.
  - b. If he/she does not signify his approval or acceptance to the seller but returns the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration

of that time; and if no time has been fixed, on he/she expiration of a reasonable time.

#### **Rule 5(1)**

- Where there is a contract for the sale of unascertained or future goods by description; the property passes when the goods of that description and in a deliverable state are unconditionally appropriated to the contract with the express or implied assent of the other.

#### **Rule 5(2)**

- A seller, who delivers goods to the buyer or a carrier for transmission, without reserving a right of disposal, is deemed to have unconditionally appropriated the goods to the contract.

#### ***Risk prima facie passes with property***

1. Unless otherwise agreed, the goods remain at the seller's risk until the property in them is transferred to the buyer; but when the property in them is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not.
2. But where delivery has been delayed through the fault of either buyer or seller; the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault.

#### ***Duties of seller and buyer***

- It is the duty of the seller to deliver the goods, and of the buyer to accept and pay for them in accordance with the terms of the agreement.

#### ***Rights of unpaid seller and buyer:***

#### **Unpaid seller's rights against the goods**

- Notwithstanding that the property in the goods may have passed to the buyer; the unpaid seller of goods has:
  - a. A lien on the goods or right to retain them for the price while he/she is in possession of them.
  - b. In the case of the insolvency of the buyer; a right of stopping the goods in transit after he/she has parted with possession of them.
  - c. A right of re-sale especially for goods which are perishables.
  - d. Repossession of goods
    - If the seller has reserved title to the goods until the contract price or any other debt owing to him/her by the buyer is paid; then he/she may re-possess the goods if the buyer, being a company, goes into liquidation or receivership.

#### **Aluminium Industries V. Romalpa-1976**

### **Seller's Lien**

- Subject to the Sale of Goods Act, the unpaid seller who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases:
  - a. Where the goods have been sold without any stipulation as to credit.
  - b. Where the goods have been sold on credit but the term of the credit has expired.
  - c. Where the buyer becomes insolvent.

### **Termination of lien**

- The unpaid seller of goods loses his lien or right of retention in respect of them:
  - a. When he/she delivers the goods to a carrier or custodian for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
  - b. Where the buyer or his agent lawfully obtains possession of the goods.
  - c. By waiver of the lien.

## **ACTION FOR BREACH OF THE CONTRACT**

### **Seller's remedies:**

1. An action for the contract price provided the property in the goods has passed to the buyer.
2. Damages for non-acceptance  
-Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may maintain an action against him for damages of non-acceptance.

### **Remedies of the buyer:**

#### **1. Damages for non-delivery**

- Where the seller wrongfully neglects or refuses to deliver the goods to the buyer; the buyer may maintain an action against the seller for damages of non-delivery.

#### **2. Specific performance**

- An equitable remedy which will normally be given when damages are an inadequate remedy.
- The goods will need to be specific or ascertained and not readily available elsewhere in the market. The remedy is appropriate for goods which have special value or which are unique, for example a classic car or a painting.

#### **3. Remedy for the breach of warranty**

- In respect of a breach of warranty:
  - i. Sue for damages.

Damages are measured by the difference between the cost of cover and the contract price, or measured by the difference between market price when the buyer learned of the breach and the contract price; and incidental and consequential damages.

## CHAPTER 11

### HIRE PURCHASE

**Definition:** A system by which a hirer (bailee) pays for a thing in regular installments while enjoying the use of it. During the repayment period, ownership (title) of the item does not pass to the hirer. The hirer has an option to purchase the good the end of the agreed period.

#### Parties Involved in a Hire Purchase

There are usually three parties to a hire purchase agreement. These are the hirer, the bailor and the financier. In some cases of hire purchase, the bailor may be the financier.

#### Basic features

- (a) The hirer has an option to purchase the good.
- (b) The hirer pays the price by means of installments.
- (c) The bailor can exercise the power to re-possess the item if there has been a default by the hirer.
- (d) The bailor must notify the hirer before the power to re-possess is exercised.

#### Termination of Hire-Purchase Agreement

The hire-purchase agreement can be terminated in any of the following ways: -

- i. **In terms of the agreement-** The hire-purchase agreement stipulates the circumstances in which the agreement can be terminated. The agreement is generally terminated by return of the goods by the hirer, notice of termination by the owner on account of hirer's breach of conditions or notice of termination by the hirer.
- ii. **By performance-** The hire-purchase agreement is terminated by performance on the exercise of the option to purchase the goods by the hirer.
- iii. **By renewal -** The parties to an agreement may enter into a fresh agreement terminating the hire-purchase agreement, which has not already been terminated.
- iv. **Notice by either party-** The hire-purchase agreement can be terminated by notice given by either party.
- v. **By acceptance of repudiation by other party-** An agreement is terminated, when a party to an agreement renounces his future obligations under the agreement or commits a breach of the agreement, which indicates that he/she does

not want to remain bound by its provisions, and the other party accepts the renunciation or breach as discharging the contract.

- vi. **By release-** Where one party to an agreement releases the other party from the performance of the obligations by him under the agreement, the agreement comes to an end.
- vii. **By frustration-** When performance of the agreement becomes impossible by reason of some act or event occurring subsequent to the formation of the agreement, comes to an end and the parties will be discharged from further obligations under the agreement e.g. when the goods are destroyed during the currency of hire-purchase agreement without negligence on the part of the hirer, the agreement comes to an end.
- viii. **By efflux (lapse) of time -** When the hirer is given time to exercise option to purchase the goods within a stated period and he/she does not exercise the option within the said period, the agreement comes to an end.

### **Sale agreement**

An agreement (or contract) in which property is transferred from the seller to the buyer for a fixed price in money (paid or agreed to be paid by the buyer).

## Agent

An agent is a person whose duty is to make a contract between the principal and a third party without himself becoming a party to the contract.

### General Categories of agents

All agents will fall into one of three general categories:

1. ***Special agents***  
An agent whose authority is limited to the performance of a specific act, for example, buying a car.
2. ***General agents***  
An agent with authority to perform any of the duties which are normally within the scope of business entrusted to him, for example a solicitor.
3. ***A universal agent***  
An agent with unlimited authority and perform any acts that his/her principal could have performed including the execution of a deed on his/.her behalf.

He/she is appointed by a deed known as **the power of attorney.**

### FORMATION/CREATION OF AN AGENCY

Agency may be created in the following **four ways:**

- (a) By express agreement
- (b) By implication
- (c) By necessity
- (d) By ratification

#### By express agreement

- This is where the agent is expressly appointed by the principal.
- This may be orally, or in writing.
- In most commercial situations, the appointment would be made in writing to ensure that everything was clear.
- An agent expressly appointed by the principal has actual authority.

### By implication

- An agency relationship between two people may be implied by their conduct/behavior or relationship.
- If an alleged agent is a partner in a firm, he/she will be held to be acting as the agent of his/her co-partners if the contract that he/she made is within the usual scope of the partnership business.
- **Cohabitation** (rather than marriage) raises a presumption that the woman has authority to pledge the man credit for necessities.
- An implied agency may arise **by estoppel**. Thus if a person by his words or conduct represents another as having authority to make contracts on his behalf; he/she will be bound on such contracts as if he/she had expressly authorized them. Thus he/she is estopped by his/her conduct from denying the existence of an agency.

### By necessity

- In some rare situations, it may be necessary for a person to take action in respect of someone else's goods in an emergency situation.
- That person can become an agent of necessity of the owner of the goods, as he/she takes steps in respect of the goods.
- Agency of necessity is formed by operation of the law (that is automatically).
- Thus the principal may be bound to a contract made on his/her behalf without authority and which he/she refuses to ratify.

### Three conditions must be satisfied:

- a. There must be an emergency, making it necessary for the agent to act as he/she did. (**Prager V. Blatspiel-1924**)
- b. It must be impossible to get instructions from the principal. (**Springer V. Great Western Railway-1921**)
- c. The agent must have acted in good faith, and in the interest of all the parties.

### **Great Northern Railway V. Swaffield-1874**

**Facts:** S delivered a horse to a railway company for transport to another station but failed to collect it on arrival as agreed. The railway company claimed from S the cost of feeding and stabling the horse arguing that if it had delivered the horse to a stable that would have been a contract made under agency of necessity and S would be bound to pay.

**Held:** The railway company's claim would be upheld for reasons given.

### **By ratification**

- Sometimes a person or an agent may act without the authority of the principal.
- If the principal agrees to the acts of the agent after the event, he/she may approve (ratify) the acts of the agent and make it as if they had been principal and agent at the time of the contract.

### ***The conditions for ratification are:***

- i. The principal must have existed at the time the contract was made by the agent.
- ii. The principal must have had legal capacity at the time the contract was made
- iii. The ratification must take place within a reasonable time.
- iv. The principal must have had full knowledge of all material facts or was prepared to ratify in any event.

### ***Authority of the agent***

- A contract made by the agent is binding on the principal and the party only if the agent was acting within the limits of his authority from his principal.
- Three distinct sources of authority can be identified:
  - a. Express authority
  - b. Implied authority
  - c. Ostensible authority

### ***Express authority***

- This is authority expressly given by the principal to the agent to perform particular tasks, along with the powers necessary to perform those tasks.
- If the agent contracts outside the scope of his express (actual) authority, he/she may be liable to the principal and the third party for breach of warrant of authority.

### ***Implied authority***

- Where there is no express authority, authority may be implied from the nature of the agent's activities or from what is usual or customary in the circumstances.

### ***Apparent/Ostensible authority***

- The ostensible (or apparent) authority of an agent is what a principle represents to other persons that he/she has given to the agent (authority by holding out)

### **The Duties of an agent**

1. He/she must be obedient in carrying out his/her principal's lawful instruction.
2. He/she must exercise reasonable care and skill in the performance of his/her duties
3. He/she must act in good faith and for the benefit of his/her principal.
  - i. *He/she must not let his/her own interest conflict with his duty to his/her principal.*

- ii. *He/she must not make a secret profit, thus he/she must not use his/her position to secure a benefit for himself/herself.*
- iii. He/she must not misuse confidential information regarding his/her principal's affairs.

### **Duties of the principal**

- a. He/she must pay the agent the commission or other remuneration that was agreed.
- b. He/she must indemnify the agent for losses and liabilities incurred by him in the course of the agency.

## **THE LAW OF AGENCY- Part B**

### **WHO CAN SUE AND BE SUED**

- The question of whether or not the agent can sue or be sued by the third party depends on the parties' intention.
- If their intention is not clear; the following rules apply:

#### ***If the agent names the principal***

- The agent generally incurs neither rights nor liabilities and drops out as soon as the contract is made.
- Only the principal can sue and be sued.

#### ***If the agent discloses the existence but not the name of the principal***

In the following exceptional cases the agent may be personally liable:

- a. If he/she signs his/her own name to a deed in which his/her principal is not named.
- b. If he/she signs a negotiable instrument in his/her own name without adding words indicating that he/she is signing as agent.
- c. If the custom of the trade makes him/her liable.
- d. If he/she agrees to be liable.

#### ***If the agent does not disclose the existence of the principal***

The agent may sue and be sued on the contract.

#### **Note:**

The undisclosed principal may also sue on the contract provided:

- i. The agent's authority to act for him/her existed at the date of the contract.
- ii. The terms of the contract are compatible with agency.

## ***Torts of the agent***

The principal is liable together with the agent for the torts committed within the scope of the agent's actual or apparent authority.

## ***Types of Agents***

### **1. Auctioneers**

- An auctioneer is an agent whose job is to sell goods at a public auction.
- He has authority to receive the purchase price and can sue for it in his own name.
- He/she has a lien (right of possession) on the goods for his/her charges.

### **2. Factors**

- A factor is an agent employed to sell goods consigned or delivered to him by his principal for compensation.
- Factors are also known as mercantile agents.

His powers are:

- To sell in his own name.
  - To give warranty, if it is usual in the course of business.
  - To receive payments for goods sold, give valid receipts, and grant reasonable credit.
  - To pledge the goods under the Factors Act.
- A factor has a lien on the goods for his/her charges and he/she has an insurable interest in the goods.

### **3. Brokers**

- An agent employed to make contracts in matters of trade, or commerce.
- An intermediary who arranges contract in return for commission.
- He/she rarely has possession of the goods and therefore has no lien on them.
- He/she does not buy or sell in his/her own name, unless there exists a trade custom enabling him to do so.

### **4. Del Credere Agent**

- An agent who guarantees to his/her principal that the buyers he/she finds will pay for the goods sold to them.
- Therefore if the buyer fails to pay; the agent will have to pay on their behalf.

## TERMINATION OF AGENCY

Agency is terminated by:

- a. Agreement
- b. Operation of the law

### *Termination by agreement:*

The parties may at any time mutually agree to terminate the agency.

### *Termination by operation of the law:*

An agency may also be terminated by operation of the law in the following circumstances:

- a. When the principal or agent dies.
- b. When the principal or agent becomes insane.
- c. When the principal becomes bankrupt.

NOT FOR SALE

NOT FOR SALE

## CHAPTER 12

### NEGOTIABLE INSTRUMENTS

Negotiable instruments are pieces of paper that represent property rights and are transferred from one person to another by delivery, or endorsement and delivery, such that the person in possession becomes the holder and has the right to sue on the.

#### Examples of Negotiable Instruments are:

- a bills of exchange
- b cheques
- c promissory notes
- d bank notes
- e dividend warrants
- f exchequer bills

#### Characteristic of Negotiable Instruments

Any document can be a negotiable instrument if it meets the following requirements

- a The holder of the instrument/document should be able to sue others using his/her own name
- b Title to the document should be able to be transferred from one person to another by
  - (i) delivery
  - (ii) endorsement and delivery
- c The holder in due course should be able to take the instrument or document free from defects of Title of his/her predecessors

#### What is a Bill of Exchange?

It is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person or to the bearer.

#### Characteristics of a Bill of Exchange

- a The order to pay on the bill must be unconditional (no condition must be imposed)
- b The instrument (bill of exchange) must be in form of an order e.g. pay Mr. X

- c The instrument (bill of exchange) must be in writing e.g. print or typewriting or pencil though open to fundamental alteration.
- d The instrument (bill of exchange) must be signed by a drawer or his agent
- e The instrument must be an order to pay (no any other should be ordered).
- f It must be to pay a sum certain in money or a certain sum plus interest.
- g Payment must be made on demand i.e. when the holder present it for payment (if no time is stated on the bill then it is payable on demand)
- h It may also be payable at a fixed or determinable future time e.g. “three months after date”
- i Payment may be made to bearer, i.e. whoever is the holder of the bill when it is duly presented for payment.
- j It may be payable to or to order of a named payee
  - o Drawee names the payee but payee can transfer payment to someone else if he/she endorses it to this effect

### **Requirements to be fulfilled by payee on the bill of Exchange**

- 1 A bill not payable to bearer must indicate payee with reasonable certainty
- 2 Where payee is fictitious or nonexistent, bill is treated as payable to bearer e.g. pay cash
- 3 A bill may be payable to two or more payees jointly or to one of them
- 4 A bill drawn in favour of the drawer himself is a valid bill e.g. cheque - pay cash or self.

### **Condition to be fulfilled by Drawee of Bill of Exchange**

Drawee is a person to whom the bill is addressed.

- 1 Where the drawer is a fictitious person or person not having capacity to contract, the holder should treat the bill as dishonoured
- 2 Where drawer and drawee are the same person, the bill is treated as bill of exchange or promissory note.

## Advantages of using Bill of Exchange in Trade Transactions

- 1 Bill of exchange is used by a debtor to settle his/her account with a supplier (creditor) – it's a payment instrument when drawee accepts or agrees to pay the bill. It is presented for payments on maturity.
- 2 By bill of exchange the supplier can send the debtor goods on credit (without checking credit worthiness of the debtor) after receiving bill of exchange before sending goods.
- 3 Bills of exchange are used in international trade and are drawn on bankers to facilitate exchange of goods on credit where debtor and supplier do not know each other.
- 4 There is a market for “discounting” bills so that the creditor/holder can receive immediate cash for a charge.

## ACCEPTANCE

**Acceptance** is the act of accepting the liability to pay the sum stated on the bill of exchange to payee when it is duly presented for payment.

It is not always necessary that a bill must be presented for acceptance. Holder of a bill of exchange may hold on to it unaccepted until maturity or negotiate to a third party.

## REQUIREMENT FOR VALID ACCEPTANCE

- 1 Acceptance, must be written on the bill and be signed by the drawee ‘accepted’ – the signature of drawee on the bill is sufficient
- 2 Acceptance must indicate that drawee will pay the money and not any other action
- 3 Acceptance is incomplete and revocable and does not bind acceptance until the bill has been delivered i.e. handed back to the person presenting it with signature of acceptance on it. (Baxendale V Bennet 1876)

## Dishonour by Non Acceptance

It is a situation where drawee rejects to accept liability on bill and return it to a holder with a note “Dishonour by Non acceptance.”

A bill of exchange is treated as dishonor by non acceptance when the

- the drawee is dead or bankrupt

- the drawee is a fictitious person
- the drawee is a person not having capacity to contract

### **Qualified Acceptance**

It is a situation where drawee is prepared to accept the bill subject to some modifications

### **Examples of qualified Acceptance**

- (a) **Partial Acceptance** – an acceptance to pay only part of the bill.
- (b) **Local Acceptance** – an acceptance to pay the bill at a certain place and nowhere else
- (c) **Conditional Acceptance**- acceptance to pay the bill only after fulfilling a certain condition e.g. on delivery of bill of lading
- (d) **Acceptance by Honour** – Where a bill dishonoured by acceptance, holder of the bill may allow another person to accept it in place of drawee

### **TRANSFER OF BILL OF EXCHANGE (NEGOTIATING BILLS OF EXCHANGE)**

What is Negotiation? It is the transfer of negotiable instruments e.g. Bills of exchange, cheques etc

- Bills of exchange, cheques etc are negotiated when transferred from one person to another
- the transferee becomes the holder of the bill

### **Method of Negotiating a Bill of Exchange**

- (a) **By delivery** – for bills payable to bearer
- (b) **By endorsement of holder and delivery** – for bills payable to order

## REQUIREMENT FOR VALID ENDORSEMENT

- (1) The endorsement must be written on the bill itself and be signed by endorser
- (2) The endorsement should always correspond with the drawing

**In Slingsby V District Bank Lts (1922)** it was held that a bill payable to “AB per X” must be endorsed “AB per X” and not X

- Where the endorsee name is incorrectly spelled the correct spelling should be endorsed.
- (3) The endorsement cannot split the bill.
  - (4) Where the bill is payable to two or more payee – all must join in the endorsement

## KINDS OF ENDORSEMENT

- 1 **Endorsement in Blank** – it occurs where no endorsee is specified. The bill becomes payable to bearer
- 2 **Special Endorsement** – endorsement specifies the person to whom the bill is payable or to whose order the bill is (if the payee wants to transfer the bill to another person, he/she must endorse it).
- 3 **Restrictive – endorsement** – endorsement which prohibits further condition of the bill
- 4 **Conditional endorsement** – the bill is only payable when certain specified conditions are met

## Holder in Due Course

Who is a holder in due course?

A holder in due course is a holder who has taken a bill, complete and regular on the face of it under the following conditions namely:

- (i) That he/she becomes the holder of it before it was overdue and without notice that it had been previously dishonoured. If such was the fact.
- (ii) That he/she took the bill in good faith and for value and that at the time the bill was negotiated to him/her he had no notice of any defect in the title of the person who negotiated it.

### **Rights of a holder in due course**

- 1 She/he should hold the bill free from prior defects – she/he inherits a perfect title.  
**Note:** If endorsement is forged no one taking the bill can be holder in due course.
- 2 She/he can pass on the perfect title to subsequent transferee
- 3 She/he can sue on the bill in her/his own name if the bill of exchange is dishonoured, the holder of the bill will see redness on his/her own name and without reference to prior partner.

### **What is endorsement?**

Endorsement is the act of approving instruction on the bill of exchange and is done by signing it at the back and delivering it to the third party.

### **Required characteristics of a holder in due course**

- 1 The holder must be the payee or bearer of endorsee of a bill who is in possession of it.
- 2 The person must take the bill when It is completed
- 3 The bill must be regular on the face and that all the endorsements must be there.
- 4 The person must take a bill of exchange before it is overdue and not after it matures
- 5 The person must take the bill in good faith and without notice that it had been previously dishonoured or had defects of title.
- 6 The person must have given consideration for the bill
- 7 In bill of exchange, note that past consideration is acceptable.

### **LIABILITIES OF PARTIES ON A BILL OF EXCHANGE**

There are three parties on a bill of exchange who are in a contract

- 1 Drawer  
A drawer is a person who makes the bill so that it should be payable to another person

2 Drawee

Is the person who accepts the bill and has a liability to pay the sum of money stated on it on the order of a specified person or bearer

3 Endorser

Is a person who gives approval to the statement that the bill should be payable to the third party or another person and he/she does this by signing at the back or on the face of it and delivering it to the third party.

**Liabilities of the Parties are**

- 1 Drawer of a bill, by drawing it, undertakes that on due presentation the bill shall be paid according to its tenor (normal way of paying the bill) and that if the bill is dishonoured he/she will compensate the holder or any endorser who is compelled to pay it.
- 2 The endorser of a bill, by endorsing undertakes that on due presentation it shall be accepted and paid according to tenor and if the bill is dishonoured he/she will compensate the holder or the endorser who is compelled to pay it.
  - 2 Acceptor or drawee of the bill, by accepting it be undertaker that he/she will pay the bill according to tenor of his/her acceptance.

## CHAPTER 13

### CORPORATE GOVERNANCE

Corporate governance: System by which companies are directed and controlled.

There are various stakeholders in companies. The Cadbury Report identified the following:

- i. Director: responsible for corporate governance
- ii. Shareholders: linked to the directors by the financial statements
- iii. Other relevant parties: such as employees, customers and suppliers.

#### *Importance of good corporate governance*

Help the shareholders who are not directors to gain knowledge on how their investment is being managed and whether their investment is subject to fraud.

#### **Voluntary codes**

Companies are different from each other, and globally, they operate in different legal systems, different institutions, frameworks and different traditions. It would be possible to construct one single way of operating companies that could be described as good practice for all.

#### *Advantages of voluntary codes*

If such codes are kept voluntary, they maintain their flexibility to suit all the different situations companies are in. In addition, where certain elements of codes do not seem relevant to certain companies (particularly smaller or owner managed companies), they can be left unapplied. This will also save companies unnecessary implementation costs.

#### *Disadvantages of voluntary codes*

There is a danger that some companies will not comply with the codes, and shareholders in those companies will be disadvantaged. It also adds to a lack of comparability in the market, if not all companies are meeting the same requirements, and makes it harder for shareholders to make investment decisions.

#### *Solutions*

To obtain the best of the advantages and avoid the worst disadvantages, Companies may take a hybrid approach and make some elements of the corporate governance mandatory and some voluntary e.g. the combined code which contains some mandatory elements for companies must have an audit committee.

## CODE OF BEST PRACTICE

### Principles of corporate governance (reference points)

- i. The corporate governance framework should protect shareholders' rights.
- ii. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
- iii. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
- iv. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.
- v. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

### Auditors

The principles state that an annual audit of financial statements by an independent auditor should be carried out.

There are three key issues in relation to auditors suggested by the principles

- i. *Annual audit:* all companies must have an annual independent audit of financial statements.
- ii. *High quality standards:* information should be disclosed and audited according to high quality standards to increase reliability and comparability of reporting, allowing investors to make better investment decisions.
- iii. *Other information:* shareholders will benefit if other information is subject checks by auditors e.g. financial and operating results of the company.

### Directors

Directors should set company policy, including risk policy, and are responsible for the company's systems and controls.

## *Policy*

Directors are responsible ultimately for managing the company, and this includes setting strategy, budgets, managing the company's people, maintaining company assets, and ensuring corporate governance rules are kept. An important element of setting strategies is determining and managing risks.

## *Systems, controls and monitoring*

Directors are responsible for the systems put in place to achieve the company policies and the controls put in place to mitigate risks.

They are also responsible for monitoring the effectiveness of systems and controls. Internal audits have an important role in this area.

## **Turnbull guidelines**

- i. Have a defined process for the effectiveness of internal control.
- ii. Review regular reports on internal control
- iii. Consider key risks and how they have been managed
- iv. Check the adequacy of action taken to remedy weaknesses and incidents
- v. Consider the adequacy of monitoring
- vi. Conduct an annual assessment of risks and the effectiveness of internal control
- vii. Make a statement on this process in the annual report

## **Non-executive directors**

An important recommendation of the principles is that boards contain some non-executive directors to ensure that the board exercises objective judgment.

Such non-executive directors may have a particular role in some sensitive areas such as company reporting, nomination of directors and remuneration of executive directors. Often companies will set up sub-committees of the board to deal with such issues e.g. audit committee

## **AUDIT COMMITTEES**

An audit committee can help a company maintain objectivity with regard to financial reporting and the audit of financial statements

## **Role and function of audit committees**

If they operate effectively, audit committees can bring significant benefits. In particular, they have the potential to:

- i. Improve the quality of financial reporting, by reviewing the financial statements on behalf of the board
- ii. Create a climate of discipline and control which will reduce the opportunity for fraud
- iii. Enable the non-executive directors to contribute an independent judgment and play a positive role
- iv. Help the finance director, by providing a forum in which he/she can raise issues of concern, and which he/she can use to get things done which might otherwise be difficult
- v. Strengthen the position of the external auditor, by providing a channel of communication and forum for issues of concern
- vi. Provide a framework within which the external auditor can assert his independence in the event of a dispute with management
- vii. Strengthen the position of the internal audit function, by providing a greater degree of independence from management
- viii. Increase public confidence in the credibility and objectivity of financial statements

#### *Advantages*

The key advantage to an auditor of having an audit committee is that a committee of independent non-executive directors provides the auditor with an independent point of reference other than the executive directors of the company, in the event of disagreement arising

Other advantages include:

- i. It will lead to increased confidence in credibility and objectivity of financial reports
- ii. By specializing in the problems of financial reporting and thus, to some extent, fulfilling the directors' responsibility in this area, it will allow the executive directors to devote their attention to management
- iii. In cases where the interests of the company, the executive directors and the employees conflict, the audit committee might provide an impartial body for the auditors to consult
- iv. The internal auditors will be able to report to the audit committee

Opponents of audit committees argue that:

- i. There may be difficulty selecting sufficient non-executive directors with the necessary competence in auditing matters for the committee to be really effective.
- ii. The establishment of such a formalized reporting procedure may dissuade the auditors from raising matters of judgment and limit them to reporting only on matters of fact.
- iii. Costs may be increased.

## **INTERNAL CONTROL EFFECTIVENESS**

Directors must ensure that a company's system of controls is effective.

### *Importance of internal controls and risk management*

Internal controls are essential to management as they contribute to:

- i. Safeguarding the company's assets
- ii. Helping to prevent and detect fraud
- iii. Therefore, safeguarding the shareholder's investment.

Good internal control helps the business to run effectively. A control system reduces identified risks to the business. It also helps to ensure reliability of reporting, and compliance with laws.

### *Director's responsibilities*

The ultimate responsibility for a company's system of internal controls lies with the board of directors.

- i. Should set procedures of internal control and regularly monitor that the system operates as it should
- ii. Assessing the risks facing the business, so that the system can be designed to ensure those risks are avoided
- iii. Reviewing a system of internal control regularly to ensure that it still meets its objectives.
- iv. Need to employ an internal audit function

- v. The combined code recommends that the board of directors report on their review of internal controls as part of their annual report.

#### *Auditors' responsibilities*

- i. Make appropriate enquiries and review the statement made by the board in the accounts and the supporting documentation.
- ii. Report on material weaknesses they may find.

### **MONEY LAUNDERING**

**Money laundering** is the process of changing money that has been gained through illegitimate means. Money evidently gained through crime is "dirty" money, and money that has been "laundered" to appear as if it came from a legitimate source is "clean" money. Money can be laundered by many methods, which vary in complexity and sophistication.

### **ETHICS**

Ethics can be defined as rules or standards governing the conduct of a person or the conduct of the members of a profession.

**Ethical codes** are adopted by organisations to assist members in understanding the difference between 'right' and 'wrong' and in applying that understanding to their decisions. An ethical code generally implies documents at three levels: codes of [business ethics](#), [codes of conduct](#) for employees, and codes of professional practice.

### **CORRUPT PRACTICES**

Corruption carries a wide range of definitions. There is no comprehensive, universally accepted definition of corruption. Generally corruption is referred to as the abuse of power for private gain. The Malawi Corrupt Practices Act defines corrupt practice as:

- a. the offering, giving, receiving, obtaining or soliciting of any advantage to influence the action of any public officer or any official or any other person in the discharge of the duties of that public officer, of official or other person;
- b. influence peddling;
- c. the extortion of any advantage.

It is a criminal offence. An institution or business needs to have awareness programmes to its employees on corruption.

Corruption must be distinguished from fraud. Fraud is a false representation of a matter of fact—whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed—that deceives and is intended to deceive another so that the individual will act upon it to her or his legal injury.

Fraud is commonly understood as dishonesty calculated for advantage. A person who is dishonest may be called a fraud.

Fraud is most common in the buying or selling of property, including real estate, Personal Property, and intangible property, such as stocks, bonds, and copyrights.

Fraud must be proved by showing that the defendant's actions involved five separate elements: (1) a false statement of a material fact, (2) knowledge on the part of the defendant that the statement is untrue, (3) intent on the part of the defendant to deceive the alleged victim, (4) justifiable reliance by the alleged victim on the statement, and (5) injury to the alleged victim as a result. These elements contain nuances that are not all easily proved.

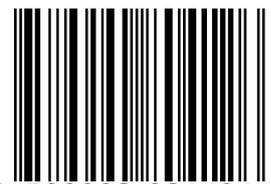
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