DEFINITIONS OF MONEY:

(i) *"Money may be defined as anything that is generally acceptable as a means of exchange and at the same time acts as a measure and as a store of value".*

(Crowther)

(ii) *"Money is anything which is habitually and widely used as a measure of payment, and is generally acceptable in settlement of debts".*

(Cole)

QUALITIES OF GOOD MONEY

The following are the general qualities or characteristics, which a good money commodity should possess:

(1) Utility and Value:

Since money has to be exchanged for valuable goods, it should itself possess value and it must, therefore, have utility as the basis of value. No one would like to receive a worthless substance. All the different commodities like tobacco, cowry shells, corn, iron, copper, gold, and silver possess value and utility. Hence they have been used as money.

(2) Portability:

It means easy to carry or move. Money should have more value but less weight. For example, copper is more portable than iron, gold is more portable than silver and diamond is more portable than gold. For a money commodity, portability is an essential characteristic. Money has to be handled, delivered and transported. If the money commodity is not portable, it will be difficult to send it to long distances and there will be much hindrance in trade and commerce.

(3) Indestructibility:

A money commodity should not be subject to easy perishability. If it is so, it cannot be preserved. Consequently there will be much hindrance in the growth of capital and wealth. So a good money material should be such that it may not lose its original form and shape due to any mishandling or change in weather conditions.

(4) Homogeneity:

It means that all portions of the substance used as money should be homogeneous, that is, of the same quality so that equal weight will have exactly the same value. This is an important characteristic of a money commodity. If any commodity lacks homogeneity, it will not be easy to divide and sub-divide it. It will also be difficult to value correctly the each portion of the commodity.

(5) **Divisibility:**

Divisibility not only means that a commodity is capable of being divided and sub-divide but it also means that after division, the commodity should not lose its value and if all the parts of the commodity are put together their value is exactly the same as the value of the whole commodity. Gold and silver are divisible.

(6) **Stability of Value:**

It is very necessary that the money commodity should not be subject to wide fluctuations in value. If it is so, then people will suffer a great deal. It means the commodity used as money should have the characteristic of stability in value so that people may use it for the settlement of transactions.

(7) **Cognizability:**

It means the capacity of a substance that it may be easily distinguished from other substance. Money has to pass from hand to hand, so it should be such that it may be easily recognized by anyone. It is not easy to judge whether a particular metal is good or bad unless it is scrutinized, weighed and tested. Cognizability of gold is better than silver, because silver is sometimes confused with lead.

(8) **Malleability:**

The money material should be malleable. It should be capable of being melted, remolded and given shapes so that it may be stamped. Paper currency is also malleable in a sense that it can recycled to produce new notes.

(9) **Elasticity:**

A good money is that which possess the quality of elasticity. So money should be such which can be expanded or contracted according to the needs of nation and requirements of the economy.

(10) **Economy:**

The issuances of good money should always be economical. There should be no unnecessary expenditure on its use. It must be cheap according to the requirements of people.

(11) **Scarcity:**

Scarcity is one of the essential features of good money. One can get it after efficient work and reasonable effort or struggle. To maintain or stabilize the value and to build the confidence of the people, money in circulation should be limited. The importance of money is realized when demand is more and it is less in supply.

(12) **Government Support:**

A good money material must be supported or backed by the government. The people accept even fiat money (money issued without keeping any metallic reserve) due to government support. The government's backing to money creates a sense of confidence.

FORMS OF MONEY

Historical evidences show that money has evolved indigenously in response to the economic needs of the people. The money is generally classified under following six heads on the basis of its course of evolution, nature and characteristics:

(1) COMMODITY MONEY:

In the earliest stage of human civilization, different commodities or species were used as money or medium of exchange. The most popular commodities or species were leather, animal skins, salt, wheat and rice etc.

(2) METALLIC MONEY:

Metallic money consists of coins made of gold, silver or nickel. Metallic money varies in weight, fineness and value. All metallic coins are stamped with a die in order to avoid chopping and abrasion against clipping or filing. In our country coins of rupee five, two and one are metallic money.

Metallic money cannot be eliminated from the economy. It is playing its role in one shape or the other. Metallic money is of following kinds:

(i) Full Bodied Money:

It consists of those coins the metallic value of which is equal to their face value. They are also called *"standard money or natural money"*. These are made from standard metals like gold and silver according to mint rules and regulations. The gold and silver coins are considered as full-bodied money. Now such money is not used anywhere in the world.

(ii) Token Money:

The coins whose face value is higher than their intrinsic value are called token money. They are usually made of sliver, copper or nickel. They are of small denominations and used for small payments. All metallic money, which circulates in present days, is token money.

(3) PAPER MONEY:

Money made of paper is called paper money. It consists of notes issued by the government or its Central Bank. Paper money is also called folding money. It is accepted in payment of goods or services, taxes and all public and private debts. The use of paper money has become very wide due to its many conveniences as a medium of exchange.

Paper money is generally classified under following three heads:

(i) Representative Paper Money:

Representative paper money is that money which is fully backed by equivalent metallic or other reserves. It means the holder of such paper money or currency note can easily get it converted into gold or other metallic money on demand.

(ii) Convertible Paper Money:

Paper money which can be converted into gold or metallic money on demand but all the notes issued are not fully backed by gold is called convertible paper money. The state or the public authority which issues convertible paper currency does not keep an equal value of metallic reserves behind it because she knows that all the notes are not generally presented for conversion at the same time.

(iii) Inconvertible Paper Money:

Inconvertible paper money is that form of paper money which is not convertible into gold or silver on demand. It is acceptable because it has been declared legal tender by the issuing authority and has general acceptance as medium of exchange. Generally, inconvertible paper money is termed as "Fiat Money".

(4) NEAR MONEY:

Numbers of assets, which are liquid in nature but cannot be used directly as a medium of exchange, are considered as near money. For example time deposits, shares, government bonds and securities. Near money can be easily converted into cash without any delay and loss in value.

(5) CREDIT / BANK MONEY:

Bank money occupies a very predominant position as a medium of exchange in the advanced countries of the world today. Nearly 90% of all transactions take place by cheques. The term bank money applies to that near money, which consists of cheques, bills of exchanges and drafts.

(i) Cheque:

A cheque is merely an order on a bank by its client to pay specified sum of money to him or to a third party on demand.

(ii) Bills of Exchange:

An instrument in writing, containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money, only to or to the order of a certain person, or to the bearer of the instrument.

(iii) Draft:

A draft is a cheque drawn by a bank on its own branch at a different place requesting it to pay on demand a specified amount to the person named in it. It is one of the cheapest methods of sending money both inside or outside the country.

(iv) Plastic Money:

Plastic money means the credit cards, debit or smart cards, which have silicon chips and a specially printed set of characters. These cards are used for making payments for the purchase of goods or services locally and internationally.

(6) LEGAL TENDER MONEY:

The money which creditors must accept in settlement of their claims by law is called legal tender money. If we offer such money in discharge of a debt, no one can refuse to take it as government guarantees it. It has following two types:

(i) Limited Tender Money:

It can be accepted only up to a specific limit. It Pakistan, coins of small denomination value up to Rs. 1, 2 and 5 are limited legal tender money because coins are token money which are used in small payments.

(ii) Unlimited Tender Money:

These can be paid upto any amount to the creditors for the settlement of claims or dues. Notes of Rs. 10, Rs. 20, Rs. 50, Rs. 100, Rs. 500, Rs. 1000 and Rs. 5000 are unlimited legal tender in Pakistan..

(7) MONEY OF ACCOUNT:

It means the unit of money by which the value of goods or services is expressed. Money of account in Pakistan is rupee because all people count their money in rupees. In be same way, price of all goods or services is also expressed in rupees. Every country has its own money of account. For example, England has Pound, Germany has Mark, America has Dollar and Saudi Arabia has Rial etc.

QUESTION NO. 3

INFLATION:

"Inflation is a state in which the value of money is falling and prices are rising".

DEFLATION:

"Deflation is a state in which the value of money is rising and prices are falling".

INFLATION	DEFLATION
(1) Price Level:	
During inflation the price level increases.	During deflation the price level decreases.
(2) Value of Money:	
Due to rise in price level, the value of money decreases.	Due to fall in price level, the value of money increases.
(3) Purchasing Power:	
Due to decrease in the value of money, the purchasing power of the people also decreases.	Due to increase in the value of money, the purchasing power of the people also increases.
(4) Effect on Savings:	
The people suffers loss on the savings during inflation due decrease in value of money.	People try to maximize their savings during deflation due to increase in the value of money.
(5) Demand for Goods:	
During inflation, the price level of goods increases which reduces the demand for goods at national and international level.	During deflation, lower price level makes the goods cheaper which increases the demand for goods at national and international level.

(6) Effect on Consumers:

Inflation	Deflation
Increase in price level also increases the cost of living. Due to this the consumers suffer loss.	During deflation, the purchasing power of people increases and the consumers buy more goods with their income.

(7) Effect on Government:

Inflation	Deflation
Inflation increases the government expenditures which results in economic crises and political unrest.	During deflation, the investment, price and employment level fall which creates problems for government in the formulation of economic policies.

(8) Salariés and Wages:

Inflation	Deflation
During inflation, salaries and wages do not increase in the same proportion as that of prices.	During deflation, the purchasing power of money increases which provides benefit to the people to some extent.

(9) Effect on Business:

Inflation	Deflation
During inflation, producers, wholesalers and retailers earn more profits due to increase in price level.	During deflation the businessmen suffer loss due to fall in price level.

(10) Effect on Debtors:

Inflation	Deflation
When prices increase and the value of money decrease, the debtors get benefit from the situation.	In case of deflation the debtors are not benefited.

(11) Effects on Creditors:

Inflation	Deflation
Creditors suffer loss during inflation.	Creditors get benefit during deflation.

(12) Effect on Agriculturists:

Inflation	Deflation
During inflation, the prices of agricultural products increase and farmers get higher profits.	During deflation, the farmers are less benefited as the prices of their output decrease.

(13) Effect on Taxpayers:

Inflation	Deflation
In inflation the taxpayers gain benefit as they pay tax having low value due to high prices.	During deflation the taxpayers suffer loss as they pay high value due to low prices.

(14) Level of Investment:

Inflation	Deflation
When prices are rising the business and economic activities increase which stimulates investment.	During deflation, the price level falls which reduces the profit margin and level of investment falls.

(15) Central Bank Policy:

Inflation	Deflation
During inflation, the central bank adopts credit contraction policy.	Credit expansion policy is adopted by the central bank during deflation.

QUESTION NO. 4

State Bank of Pakistan is a Central Bank of Pakistan and being a Central Bank it performs the following functions:

FUNCTIONS OF CENTRAL BANK

The functions of central bank, as mentioned by banking experts, are performed in the following capacities:

(1) SOLE RIGHT OF NOTE ISSUE:

In every country, central bank has sole right or monopoly of note issue. This authority has been given to central bank for:

(a) Uniformity in the notes.

(b) To check undue expansion of notes.

(c) To regulate currency according to its demand.

(d) To make sure that notes issued are the liability of the bank and get full support of state.

There are following three main methods of note issue.

(i) Fixed fiduciary system

(ii) Proportional reserve system

(iii) Minimum reserve system

(2) BANKER TO THE GOVERNMENT:

The functions of the central bank as banker to government can be described as follows:

(i) Keeping the Deposits:

The central bank keeps the deposits of the central and provincial governments. It makes payments on the behalf of government. However, it does not pay interest on government deposits.

(ii) Advances Loans:

As a fiscal agent, the central bank provides loans to the government and makes investments in Treasury Bills and Long-term Government securities.

(iii) Foreign Loans:

Central bank makes arrangements to get foreign loans on the demand of government.

(iv) Transfer of Capital:

Central bank transfers the capital of central and provincial governments from one place to another.

(v) Financial Advisor:

The central bank also advises the government on economic matters such as controlling inflation or deflation, devaluation or revaluation of the currency and balance of payments etc.

(vi) **Keeping of Accounts:**

The central bank keeps the accounts of different departments of govt. It does not charge any fee or commission for said service.

(vii) **Govt. Securities:**

Central bank is not only the custodian of government securities, but also works for their sale and purchase.

(3) **BANKER'S BANK:**

As a banker for the commercial banks, the central bank performs the following functions:

(i) **Custodian of Cash Reserves:**

The commercial banks are required by law to keep reserves equal to a certain percentage of both time and demand deposit with the central bank.

(ii) **Clearing House:**

As a banker's bank, the central bank acts as a clearing- house for the settlement of mutual claims of commercial banks. Since the central bank holds reserves of commercial banks, it transfers funds from one bank to the other banks to facilitate the clearing of the cheques by making entries on the principles of bookkeeping without using cash.

(iii) **Lender of Last Resort:**

The central bank acts as the lender of last resort for the commercial banks. The central bank lends to the member or scheduled banks in times of stress to save their financial structure.

(iv) **Re-discounting:**

The member commercial banks can re-discount their bills from central bank in the time of need.

(v) **Opening of New Bank:**

A new bank or a branch of an existing bank cannot be established without the prior permission of central bank.

(vi) **Advance Policy:**

Central bank regulates the policies of advancing loans for commercial banks and fixes the rate of interest to be charged.

(vii) **Growth of Banks:**

It is the duty of the central bank to promote the growth of the banking system on sound footing.

(4) **LEADER OF CAPITAL MARKET:**

Central bank is considered as the leader or guardian of capital market, because it works for its establishment and growth. It also makes policies and takes decisions to avoid undue expansion or contraction of credit and to stable the credit or money system in the country. The steps taken or methods adopted by central bank in this regard are called monetary policy.

(5) CONTROLLER OF FOREIGN EXCHANGE:

The Central Bank is responsible for the management of foreign exchange and maintenance of the external value of the home currency. Moreover, foreign exchange reserves are also kept with the central bank. It prepares the balance of payments accounts of the country, and helps the government to keep the balance favourable.

(6) CUSTODIAN OF METALLIC RESERVE:

The central bank is a supervisor or custodian of metallic reserves (gold and silver etc.) of its country. It keeps them with great care and safety. The metallic reserve of commercial banks and other institutions are also kept with central bank.

(7) EXCHANGE RATE STABILITY:

The central bank fixes the exchange rates of the domestic currency in terms of foreign currencies. It holds these rates within narrow limits in keeping with its obligations as a member of the International Monetary Fund and tries to bring stability in foreign exchange rates.

(8) REPRESENTATIVE OF FOREIGN TRADE:

Central bank acts as the representative of government in international trade. Besides, making investment in international market, it also provides foreign exchange to importers and exporters of the country.

(9) MISCELLANEOUS FUNCTIONS:

(i) Staff Training:

Central bank not only provides modern training of banking to staff, but also establishes training institutes in this regard. (e.g.) Institute of Bankers etc.

(ii) Growth to Saving:

Central bank makes plans and adopts various methods to promote the habit of saving among the people of country.

(iii) Industrial & Agricultural Development:

Central bank extends loans of different kinds to develop the industrial and agriculture sectors of the country.

(iv) Representation in International Institutions:

Central bank acts as the representative of government for International institutions like IMF etc.

(v) Membership Fee:

If the government wants to become the member of international institutions, then central bank pays membership fee (e.g.) SAARC and Security Council etc.

(vi) Financial Reports:

Central bank publishes periodical reports relating to different aspects of monetary and economic policies.

QUESTION NO. 5

DEFINITIONS:

(i) ***"Monetary policy refers to the measures which the central bank of a country takes in controlling the money and credit supply in the country with a view to achieve certain specific economic objectives".***

(ii) ***"Monetary policy is mainly concerned with deciding how much money the community shall have or perhaps more correctly deciding whether to increase or decrease the volume of purchasing power".***

(Hanson)

(OBJECTIVES)

(1) Full Employment:

The main object of monetary policy is not only to maintain the conditions of employment in the country but also to create more opportunities of employment in less developed countries.

(2) Price Stability:

Maintenance of price stability does not mean to keep the prices fixed but to avoid inflation and deflation. The monetary policy is directed towards controlling inflation by decreasing the total amount of credit or containing its expansion with a desired limit and curing deflation by increasing it.

(3) Exchange Stability:

This means maintaining relative stability in the exchange rate i.e. external value of the country's currency. It also means the maintenance of balance of payment in equilibrium or at least improves its position.

(4) Equitable Distribution of Credit:

This is necessary for social justice because it helps lessening inequality of wealth and income, which increases the standard of living of people. Thus the credit policy should be formulated in a way, which ensures increased flow of credit to backward areas and small borrowers.

(5) Foreign Value of Currency:

Monetary policy helps in consolidating the, external value of local currency which leads to growth in trade.

METHODS OF CREDIT CONTROL

There are following two methods of credit control.

QUANTITATIVE METHODS

This method is used to control the total quantity of money supply and bank credit. They are selective in nature. This method can be divided into following five sub-methods.

(1) Interest Rate Policy:

It means the rate of interest at which the commercial banks grant loans against first class securities according to the instructions of central bank.

In case of inflation, the bank interest rate is raised which discourages borrowings, as a result credit contracts. On the other hand if there is deflation, the bank interest rate is lowered which encourages the borrowings as a result credit expands.

(2) Open Market Operation:

It means purchase and sale of securities by central bank in open market. If there is more quantity of money, the central bank sells securities in open market. Buyers make cash payments through commercial banks, so as a result credit contracts. On the other hand, if central bank wants to increase the quantity of money in a country, then he buys securities and makes payment in cash, as a result credit expands.

(3) Change in Reserve Ratio:

Every member bank is required to keep a certain amount of its total deposits as cash reserve with central bank. If there is more quantity of money in the country, the ratio is raised which reduces the credit base of banks and credit contracts. On the other hand, if there is less quantity of money then the ratio is reduced which increases the credit base of banks and credit expands.

(4) Credit Rationing:

The central bank puts limits for the grant of credit. The credit is rationed for each bank during financial crises. If the central bank adopts expansionary monetary policy the rationing limit of loans increases. On the other hand if the central bank adopts the contractionary monetary policy the rationing limit of loans decreases.

(5) Bank / Discount Rate Policy:

This policy refers to the varying of the rate at which the central bank re-discounts the first class bills of exchange of scheduled banks or advances loans to them against approved securities. In case of inflation, the central bank increases the bank rate and vice versa.

QUALITATIVE METHODS

These methods are used to restrict bank advances for certain specific purposes. There are general in nature. The detail of these methods is as under.

(1) Moral Pursuation:

Sometimes the central bank advises the commercial banks to avoid malpractices and makes them to adopt right ways. So that country could achieve its objects easily. Generally, following instructions are given to commercial banks in this regard.

(i) Avoid economic activities against the interest of country.

(ii) Issuance of loans only for investment and productive purposes.

(2) Publicity:

Central bank keeps the nation well informed about economic conditions through newspapers, radio and television etc. which enables the people to understand the economic condition of the country. Publicity throws a light on the following points.

(i) Policies of business concerns, their production and production targets.

(ii) Deposits of capital, quantity of loans, interest rate of banks and level of inflation or deflation.

(3) Direct Action:

When the central bank realizes the fact that its policies regarding credit control are not being implemented then he takes following direct actions:

(i) Does not provide the facility of clearing house.

(ii) Declares the scheduled banks as non-scheduled banks and takes the facilities back.

(iii) Increases the ratio of Cash Reserve which limits the advancing ability of banks.

(iv) Refuses to re-discount the bills of exchange of scheduled banks.

(4) Change in Margin:

Margin means the difference between the amount of loan and the value of security. The minimum margin requirement on securities may be relaxed to encourage the borrowings and can be imposed to discourage the borrowings.

(5) Restriction on Advances:

In severe economic problems, the central bank may impose restriction on commercial banks to grant loans. The central bank tries its level best to avoid this tool of credit control policy.

(6) Selective Control:

In this method, the credit controlled by increasing or decreasing the buying power of consumers. If there is inflation, the grant of credit for consumption goods may be banned and in case of deflation a lenient policy about the consumer credit is adopted and supply of money expands. Central bank usually restricts consumer's credit, so that more funds are available to the industry, agriculture and other sectors.

QUESTION NO. 6

PRIVATIZATION OF BANKS

After the nationalization of banks, it was hoped that it would increase the public confidence over banks. However in spite of showing any remarkable sign of development, there was large-scale corruption and unbalanced distribution of credit. So the Govt. of Pakistan started a privatization policy in 1990. A Privatization Commission was set up on February 22,1990. It has transferred two banks (MCB and ABL) to the private sector.

MERITS OF PRIVATIZATION

(1) Elimination of Corruption:

The privatization was considered necessary to eliminate red-tapism and bureaucratic structure that have developed in all sectors of the economy after nationalization.

(2) Improves Efficiency:

One of the major benefits of privatization is that it improves efficiency of the bank. The policy was made at raising standard of performance and quality of work in banks.

(3) Capital Market:

Another major merit of privatization is that it developed capital market because normally private sector attracts more investment.

(4) Better Services to the Customer:

Another benefit of privatization is that it provides better services to the customers. It also provides modern baking system to the customers.

(5) Proper Incentives:

In private sector all the employees get proper reward for their valuable services and they are encouraged by giving different incentives and in this way efficiency improves.

(6) Quick Hiring and Firing:

As in the private sector the policy of quick hiring and firing is adopted, so the employees try their level best to improve the efficiency to stay at job.

(7) Accountability:

The element of accountability or check and balance can be strictly observed in case of privatization, which keeps the working of bank remarkable.

(8) Eliminates Political Interference:

Another major merit of privatization is that is eliminates political interference. The banks advance and recover loans without any discrimination.

DEMERITS OF PRIVATIZATION

Following are the disadvantages of Privatization.

(1) Unequal Distribution of Wealth:

As there was not power distribution of loans, so privatization also encourages unequal distribution of wealth.

(2) Unequal Distribution of Loans:

As there is no govt. interference so there are more chances of unequal distribution of loans.

(3) Ineffective Control of Central Bank:

Although commercial banks were working under the State Bank of Pakistan but they did not cooperative for the effective implementation of monetary and other banking policies.

(4) Favoritism:

The small business sector and agriculture sector along with new comers in industrial sector will suffer because the banks will advance loans to the financially sound parties.

(5) Exploitation of Employees:

Under privatization banks exploited their employees in different ways. For example, only those persons were given jobs in the banks who were able to bring heavy deposits to them.

QUESTION NO. 7

DEBT / BORROWED FINANCING

When the owners are not in the position to meet financial need of business from their own resources, the deficiency of capital can be met by taking loan. The loans can be obtained from different individuals or financial institutions. The finance thus obtained is called debt or borrowed finance.

[MERITS OF DEBT FINANCE]

(i) Urgent Current Expenses:

The business concern can take overdraft and short-term loans from commercial banks and from other sources for meeting the urgent expenses during the peak operations of a business.

(ii) Business Expansion:

The business can be expanded with the use of borrowed funds. The economies of large-scale production can thus be achieved.

(iii) No interference of Creditors:

The creditors does not interfere in the affairs of the business and the owners are independent to take any step.

(iv) Low Interest:

The interest charged on debts is lower than the rate of return paid to shareholders in form of dividend.

(v) Large Scale Business:

For large-scale business where huge capital is required, the businessmen can take help of borrowed money for their business.

(vi) Tax Savings:

As the interest on borrowed funds is an expense and is deductible from income, which results in low profit. So, the owners have to pay less tax.

(vii) Flexible Financing Policy:

Debt financing enables the management to frame a flexible financing policy. Whenever they want to expand business they can raise funds.

(viii) Quick and High Return:

Debt financing makes finance policy flexible. The reason is that a firm will get debt finance when the season starts and repays it as soon as the season is over. Whereas equity finance remains idle during off-season.

(ix) Checking of Invoice and Goods:

If purchases are made on credit, it is more convenient and easier to check the invoice and goods before paying the bill than paying cash on delivery.

(x) Winding Up:

When the business is closed due to any reason, the owners have the claims for refund of capital after the creditors have been paid. So the whole loss goes to owner's accounts.

[DEMERITS OF DEBT FINANcE]

(i) Depression:

The funds supplied by creditors are not available in the times of depression because they are not ready to take risk.

(ii) Risk of Heavy Losses:

The business depending upon borrowed money possesses less potential to face any loss. Once it suffers loss it becomes cumulative in nature.

(iii) Payment of Principal Amount:

The main drawback of the use of creditor fund is the risk to the owners investment from the inability to meet the creditor claims in respect of principal amount when due.

(iv) Higher Rate o. Interest:

It may happen true that the rate of interest charged by the lenders is high than other types of payments. Credit financing may be costly due to various economic and business factors.

(v) Frequent Maturities:

Short-term credits become mature frequently. In case of delay or default, the business can suffer, but this situation may not arise in owners finance due to absence of maturity.

(vi) Restlessness and Exploitation:

Sometimes the firm used its profit in the business to clear the borrowed funds, it then creates restlessness and sense of exploitation among partners or owners.

(vii) Chance of Sue:

The interest due on the borrowed funds and the principal amount must be paid on maturity date. If it is not so, the creditors can legally force the firm for repayment.

(viii) Low Returns:

The amount of interest is paid to the creditors out of the profit, which reduces the income of business. As a result, the return to the owners remains low.

(ix) Discouragement of Investment:

In the period of depression when firm would be giving a lower return as compared to interest on borrowed funds, the new investors will not contribute their funds in business sector.

QUESTION NO. 8

(a) TYPES OF BANK ACCOUNTS

(i) Current Account:

It is the most popular form of bank accounts. Majority of customers particularly business class, government departments, public bodies keep their money in current accounts. In this account money can be deposited and withdrawn from bank at any time during banking hours. Generally interest is not paid on this account and bank deducts its service charges from the account.

(ii) Saving Account:

Persons with little savings (low income or salaried persons), deposit their money in the saving account. Saving deposits can be withdrawn on demand up to a certain limit. Banks also pay interest on these accounts.

(iii) Fixed Deposit Account:

In this account, money is deposited for a fixed period of time. High rate of interest is paid on this deposit. The period is fixed at the time of opening a bank account. Within this period, the account holders are not entitled to withdraw money from the accounts.

(iv) Foreign Currency Account:

This account is opened in foreign currency instead of local currency. In Pakistan, this account can only be opened in nominated branches of commercial banks. Foreign currency account can be opened in form of Saving, Fixed and Current accounts. This account is exempt from Zakat & Tax.

(b) SOURCES OF SHORT TERM BUSINESS FINANCE

The borrowing or lending of funds for the period of one year or less is known as short-term finance. Main features of short-term finance are:

(a) Available at low rate of interest.

(b) Seasonal requirements of business can be met easily.

(c) No need to keep heavy cash balance.

(d) It is considered blessing for unforeseen expenditures.

SOURCES OF EQUITY FINANCE

(i) Loan by Owner:

Sometimes the owner or partner of the business concern provides short-term loan to business in the hour of need from his personal sources in addition to contributed capital.

(ii) Advance Payment by Owner:

If the owner wants to buy the goods, produced by his own business, for domestic or personal use then he can provide short-term finance to business by making total or partial payment in advance.

SOURCES OF DEBT FINANCE

(i) Commercial Banks:

These banks receive the savings of public as deposits and lend them to the businessmen for short period. These loans are granted in shape of overdraft and cash credit (Running Finance).

(ii) Friends & Relatives:

A number of persons obtain loan from friends or relatives in the time of need, but it is limited and indefinite.

(iii) Indigenous Bankers:

This type of source includes, small moneylenders i.e., Sahukar, Mahajan, Zamindar, who grant loans on high rate of interest.

(iv) Public Deposits:

Some commercial units receive deposits from the public for short period on very favourable terms. Thus they are in the position to utilize these funds for their business requirements.

(v) Co-operative Societies:

These societies render valuable services in providing loans to rural businessmen against the security of land.

(vi) Trade Creditors:

Trade creditors include wholesalers, retailers and manufacturers who supply goods on credit basis to the traders.

(vii) Customers:

Sometimes customers provide short-term funds by making advance payment of goods before their delivery.

(viii) Factors:

They grant credit on the security of account receivables. Thus they take over the risk of bad debt losses.