CHAPTER 8

OTHER MEANS OF PAYMENT

Objective

To teach students other means of payment like the bills of payment and treasury bills.

8.1 Bills of Exchange

Bills of exchange (b/e) are other means of settling debts both in domestic and international trade.

The use of bills of exchange in domestic business transactions has been overtaken by other means of payment which we discussed in the previous chapters. They are however, still prominent in international trade circles where they are used in form of documentary bills, i.e. bills to which shipping documents are attached. They became popular from the fifteenth century onwards in Britain where they were introduced by Italian merchants in the course of commercial transactions.

In West Africa, they were never popular in domestic trade but are used in international trade. The integrity of bills of exchange is as good as that of their acceptor and merchant banks of international repute find them a useful means of settling mutual indebtedness or cancelling out debts between banks.

8.1.1 Definition of Bills of Exchange

The Nigerian Bills of Exchange Act 1917 and Bills of Exchange Act 1964 are based on the original English Bills of Exchange Act 1882; all of which put the definition of a bill of exchange thus:

> *An unconditional order in writing, addressed by one person to another; it is signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determined future time, a certain sum of money to a specified person, or the bearer. This means that a Bill of Exchange as a means of payment does not originate from the debtor.*

8.1.2 Types of Bills of Exchange

The two types of Bills of Exchange are the inland bills and the foreign bills.

(i) *The Inland Bills of Exchange:* These are the bills used for setting commercial transactions in domestic (home) trade. They are used by traders within the same country, e.g. a trader in Calabar and a trader in Lagos. However, the importance of inland bills has been eclipsed by the use of cheques. Thus, in the domestic trade, bills of exchange are more of a relic than a modern form of payment.

₦200.00	P.O.Box 12481 Ilesha 2-6-89
Four months after date pay to me or my order the sum of two hundred Naira, value received.	
To:	
J.O. Desalu P.O.Box 390 Ijebu-Ode	J.A. Ayodele

Fig. 8.1: *A speciment of an inland bill of exchange*

(ii) *The Foreign Bills of Exchange:* These are bills for settling indebtedness between traders in different countries, e.g. between a trader in Accra (Ghana) and another trader in Lagos (Nigeria). The use of foreign bills eliminates the need for exchange of actual money in settlement of debts between two or more traders in two or more different countries. As a result, foreign bills have been tagged *â€˜the money of international tradeâ€™*. When they are used on mutual basis between two traders, they are merely referred to as *trade bills.* But if for lack of mutual trust, one of the traders requests that the other should process the bills through a bank (with international repute), then they are known as *bank bills.*

Since settlement of bills in respect of international trade is always accompanied with shipping documents such as the bill of lading, invoices, insurance policy and certificate of origin of goods, such bills of exchange are referred to as *documentary bills.*

₦250,000.00	P.O.Box 12481 Ilesha Oyo State Nigeria 2-6-81
Four months after date pay to me or my order the sum of two hundred and fifty thousand naira, value received.	
To:	
Mr. J. Davies 120 Queen Elizabeth Road Manchester England	J.A. Ayodele

Fig. 8.2: *A specimen of a foreign bill of exchange*

8.1.3 The Essential Features of a Bill of Exchange

Any draft of a bill of exchange must have the following features to make it valid.

(i) *An unconditional order:* A bill of exchange must be a strict order without any conditions attached to it, i.e. there must be no â€˜ifsâ€™, â€˜butsâ€™, etc.

(ii) *Order:* It is an order, not a request or wish. No begging or apology.

(iii) *In writing:* The bill must be in writing, not oral. It must not be just handwritten but either typed or printed or a combination of both. The amount of money due on the bill must be stated in both words and figures.

(iv) *Addressed to one person by another:* The bill must be drawn by the seller of the goods who would send the bill to the buyer. (Compare this with the cheque drawn by the buyer to the credit of the seller).

(v) *Certainty of amount:* The amount must be of specific figures; not â€˜about five hundred nairaâ€™.

(vi) *Certainty of time of payment:* A definite time of payment must be specified. â€˜Pay in four monthsâ€™, not â€˜Pay two months after your marriage.â€™

(vii) *Signatures:* It is imperative that the bill must be signed by the drawer or by his agent or his partner, if it is a firm. An unauthorized signature is a forgery and is therefore, unacceptable. However, an unauthorized signature could later on be regularized or ratified.

8.1.4 The Parties to a Bill of Exchange

Usually there are four main parties to a bill of exchange:

(i) *The drawer:* This is the creditor, the person owed the amount involved. He draws (hence the word â€˜drawerâ€™) up the bill for the amount owed to him by the debtor, to whom he sends the bill.

(ii) *The drawee:* This is the debtor on whom the bill is drawn. He is the customer who has to pay the drawer.

(iii) *The acceptor:* This is the person who accepts to pay the bill on the due date and at a nominated place (usually through his bank). The acceptor later on sends the bill back to the drawer for information about the acceptance.

(iv) *The payee:* This is usually the same as the drawer. The payee receives payment for the amount stated on the bill at the stated place and on the given date. The drawer could alternatively pass the bill to someone else; in which case, the drawer has negotiated the bill by endorsement (signing) it to another person in settlement of the debt. This other person then becomes *the payee* who receives cash from the *acceptor.*

(v) *A holder:* The person to whom the bill is endorsed is often referred to as *the holder.* He is however, not one of the main parties to the bill of exchange.

It would be observed in the main that, the four principal parties involve two main personalities - *the creditor and the debtor.* Theâ€™ drawerâ€™ and theâ€™ payeeâ€™ refer to the person of the creditor, that is J.A. Ayodele in our two specimens above; while the â€˜draweeâ€™ and the â€˜acceptorâ€™ are the same person as the debtor who pays off the amount stated on the bills, i.e. J.O.Desalu and J. Davies respectively.

8.1.5 Terms and Terminologies Used in Connection with a Bill of Exchange

(i) *A draft:* A bill of exchange is a mere draft when it is in the form shown in our two specimens 8.1 and 8.2. It is a draft when it is yet to be accepted, or yet to be sent off for an acceptance. At this stage, there is no liability to the bill by the drawee since nobody has accepted it yet.

(ii) *Tenor of the bill:* This is the period before the bills fall due, i.e. in our two examples above, *four months after dateâ€™.* Alternatively, if it is a bill *â€˜at sightâ€™,* â€˜once receivedâ€™ would be the tenor of the bill.

(iii) *Usance:* This is the time allowed before the bills fall due, i.e. the tenor that is customary in a given type of trade. For instance, if it is usual in a trade to give three or six months, this period is the *â€˜usanceâ€™* in that trade.

(iv) *Calendar months:* The months referred to in the bill are usually calendar months (30 days). The specimen bill given four months would be due for payment on 2-06-04.

(v) *Three days of grace:* This period was formerly allowed for the likelihood of delay in the postage system. This is a relic of a period of slow communication. In modern Britain, with her fast communication system, the *â€˜three days of grace*â€™ period has been abolished by the Banking and Financial Dealings Act 1971. In our specimens above, the bills fall due on 2-06-04. If three days of grace is granted, they would fall due on 5-06-04. If that date fell on a non-working day, then the bills would be due for payment on the next working day. When bills are payable *â€˜at sightâ€™,* no three days of grace is entertained.

(vi) *Acceptance:* Once a debtor - the drawee - signals his consent to the bill, he writes *â€˜Acceptedâ€™*across the face of the bill plus the draweeâ€™s signature. He may add the date and place of payment especially if the bill is payable not â€˜at sightâ€™, to give the bill a date of maturity. But usually, putting the â€˜signatureâ€™plus â€˜acceptedâ€™ is enough. See specimen 8.3. There are two types of acceptance viz:

(a) A *â€˜general acceptanceâ€™:* This is the acceptance of a bill of exchange as presented by the drawer (without any qualifications).

(b) A *â€˜qualified acceptanceâ€™:* This is acceptance after modifying the terms contained in the bill, e.g. varying the given period of payment. A drawer may not agree to a qualified acceptance in which case, he might treat the bill as dishonoured or as if acceptance has been refused.

₦250,000.00

P.O.Box 12481
Ilesha
Oyo State
Nigeria

Four months after date pay to me or
my order the sum of two hundred and
fifty thousand naira value received.

2-6-2004

To:

Mr. J. Davies
120 Queen Elizabeth Road
Manchester
England

ACCEPTED
J. DAVIES

J.A. Ayodele

Fig. 8.3: *A specimen of an â€˜acceptedâ€™ foreign bill of exchange*

N.B. The draft bill on page 99 has now become an accepted bill.

(vii) *Negotiation and Endorsement:* We have, in an earlier chapter, mentioned endorsement for Order chequesâ€™. The same points are relevant to a bill of exchange. An accepted bill of exchange could be negotiated with another person by the drawer in settlement of the drawerâ€™s debts. All the drawer has to do, as in the case of order cheque, is to sign or endorse the bill if it is payable to order as in the example above. But if it is a bearer bill, it is negotiated by mere delivery.

J. Davies
Owes J.A. Ayodele
₦250,000.00

Sends bill of exchange

J.A. Ayodele
Owes E. Uba

₦250,000.00

Sends endorsed bill

E. Uba

Makes final claim on the endorsed
bill in settlement of J.A. Ayodele's
debt of ₦250,000.00

2

Sends accepted bill

Fig. 8.4: *The process of endorsement*

N.B. *Davies owes Ayodele ₦250.000.00 and Ayodele owes E.Uba ₦250,000.00. By endorsement to E. Uba, Ayodele simply pays Uba.*

Types of Endorsement

(i) *Bank endorsement:* If the drawer simply adds his signature â€˜J.A. Ayodeleâ€™ as shown in the specimen, it is a bank endorsement; whoever it is endorsed to, can still endorse it to somebody else.

(ii) *Special endorsement:* Putting the name of the person to whom the bill is passed plus the drawerâ€™s signature i.e. â€˜Pay Mr. Etuk Ubaâ€™ and signed â€˜J.A. Ayodeleâ€™.Etuk Uba could still further endorse the bill to someone else.

(iii) *Restrictive endorsement:* With restrictive endorsement, there could be no further endorsement to anybody else, e.g. â€˜Pay Mr. Etuk Uba onlyâ€™.

(iv) *Gans recourse or without recourse to me:* If the endorser adds either of these two phrases to his signature, he would incur no liability on whatever happens to the bill later on.

(v) *Liability:* Whoever signs a bill of exchange becomes liable and is a party to the bill. When a bill is only in a â€˜draftâ€™, only the drawer is a party to the bill. The person who accepts the bill becomes a *second party* and is primarily â€˜liableâ€™ to the bill. Each endorser becomes liable in the order of signing.

(vi) *Discounting the bill of exchange:* The drawer could do any of the following with his â€˜acceptedâ€™ bill:

(a) Put it in the bank awaiting the date of maturity. This is an uneconomic use of financial resource.

(b) Endorse it in settlement of his indebtedness to others as discussed in (vii) above.

(c) â€˜Discountingâ€™ the bill - This is simply â€˜sellingâ€™ it to a bank at its face value without an interest.

It amounts to using the â€˜acceptedâ€™ bill as a security to borrow money. The accepted bill, in our example above, would not be due for payment until 2.10.04. But before then, J.A. Ayodele could lodge it with his bank in exchange for cash at a â€˜discountâ€™ or an interest payable.

* The longer the period between discounting and the date of maturity, the higher the interest payable, i.e., the shorter the period, the smaller the interest.

* Where the acceptor (or one of the endorsers, in the case of a bill that has been passed from hand to hand) is known to be of a good financial standing, the interest rate is relatively low.

(vii) *â€˜Retiringâ€™ a bill of exchange:* This is paying for a bill of exchange before its maturity, i.e., the bill is liquidated (paid for) before it is due for payment. The drawee or acceptor would earn a rebate or an allowance on the face value of the bill; that would amount to the â€˜discountâ€™ or interest rate he would have paid, if he had discounted the bill on the same date. Retiring a bill, therefore, is the *converse* of discounting a bill. Retiring a bill is like lending money to the drawer before the date of maturity. The rebate he would earn from the creditor depends, among other things, on the period between the date of retiring and date of maturity of bill. If the period and date of maturity of bill is short, his rebate would be small; but if the period is much, the rebate would be comparatively higher.

(viii) *â€˜Honouringâ€™ a bill:* This is when a bill is paid as at when due. The acceptor earns no rebate and pays no interest rate. He earns the credit, however, of being able to meet his obligations when and as due. This is goodwill in business transactions.

(ix) *Dishonoured bill:* A bill of exchange is dishonoured the moment it is refused acceptance; and if accepted; it is dishonoured if the acceptor or any of the endorsers cannot meet payment when and as due. However, those who cannot meet their obligations (the acceptor, or endorser) will only become liable if served with proper notice of dishonour. The service of notice of dishonour brought by means of *noting and protesting* as explained in (x) and (xi) below.

(x) *Noting:* This is a legal procedure that serves as a formal notice of dishonour, It is usually undertaken by a practising solicitor normally referred to as a *public notary.* He has the duty of representing the bill of exchange officially to the acceptor who, if he refuses to pay again, will be noted down as dishonouring the bill. The Public Notary will sign his name on such a report, note the reasons for dishonouring the bill, put the date, and indicate his charges (commission) for the â€˜notingâ€™ duty. This is in readiness for a possible court action against the acceptor for dishonouring the bill of exchange.

(xi) *Protesting:* This is a more formal declaration by the notary that dishonouring the bill of exchange is unacceptable to the drawer,who is keen on getting paid immediately. â€˜Notingâ€™ and â€˜protestingâ€™ are not usually necessary for inland bills of exchange; although â€˜notingâ€™ serves as a customary caution to the acceptor for dishonouring the bill of exchange. In foreign bills, â€˜protestingâ€™ is usually necessary while â€˜notingâ€™ is â€˜optionalâ€™ i.e., â€˜protestingâ€™ can take effect in foreign bills without â€˜notingâ€™ at all.

However, rather than standing the embarrassment of â€˜notingâ€™ and â€˜protestingâ€™ an acceptor who cannot meet the bill when and as due, can arrange to reschedule the date of maturity. This is buying more time; and the acceptor will have to pay more interest as this is an extended loan repayment period, if agreeable to the drawer of the bill.

(xii) *Stamp duty:* Up till 1961, stamp duty used to be paid on bills of exchange and promissory notes on their face values (ad valorem rate of duty). But as from 1961, the ad valorem rate was placed by a uniform rate of 2d (two pence). Again, as from 1970, payment of stamp duty was abolished completely on bills of exchange and promissory notes.

8.1.6 The Advantages of Bills of Exchange

(i) Abill of exchange is a written confirmation of debts owed to a creditor.

(ii) It indicates a definite date for settlement of such debts.

(iii) Except where they are â€˜sightâ€™, bills of exchange offer opportunities for a long period of credit, during which time the buyer (the drawee) can sell his goods and obtain funds for easy settlement of his debts.

(iv) Payment of bills of exchange obviates the payment of debts by carrying a large sum of money, with its associated risks and expense.

(v) If bills of exchange offer buyers long period credit facilities, the bills also ensure that sellers are not necessarily drained of ready funds because, the â€˜acceptedâ€™ bills can easily be â€˜discountedâ€™ (for cash) by the drawers or holders.

A drawer can also effect settlement of his indebtedness to his own creditors, given some mutual understanding, by mere transfers.

8.1.7 Comparison between a Cheque and a Bill of Exchange

The similarities between a cheque and a bill of exchange

(i) A cheque, like a bill of exchange, is an unconditional order. They are both worded *â€˜Pay ....or orderâ€™*.

(ii) A cheque is in writing - accepting handwriting â€˜as writtenâ€™ for this purpose.

(iii) A bill of exchange is addressed to a debtor (who has possession of the drawerâ€™s goods). A cheque is addressed to a bank who keeps the drawerâ€™s money (current accounts).

(iv) Like a bill of exchange, a cheque must be signed by the drawer.

(v) In both cases, the documents (b/e and cheque) are prepared by persons known as the drawerâ€™s.

(vi) The cheque, like the bill of exchange, may be made payable to the drawer, his order, or to the bearer.

The differences between a cheque and a bill of exchange

(i) The drawer of a cheque is a debtor ordering his banker to pay off his debts now to his creditor. The drawer of a bill of exchange is a creditor asking his debtor to accept responsibility for settlement of a debt either immediately or at a future date. Therefore, adopting a cheque and a bill of exchange as a means of payment are from two opposite directions.

(ii) A cheque is always drawn on a banker, and a bill of exchange in international trade is often drawn on a banker; but bills of exchange can be drawn on persons other than bankers.

(iii) While a bill of exchange is accepted by the drawee, a bank (the drawee in case of a cheque) does not have to accept the cheque.

8.2 Promissory Notes

While a bill of exchange is an â€˜orderâ€™ to pay, a promissory note is an undertaking (a promise) to pay.

8.2.1 Definition

Promissory note is defined in the bills of exchange act as, â€˜An unconditional promise in writing, made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time, a certain sum of money to, or to the order of a specified person or bearerâ€™.

8.2.2 The main features of promissory notes are as follows:

(i) The promise must be unconditional - no â€˜ifsâ€™ or â€˜butsâ€™.

(ii) The unconditional promise must be in writing.

(iii) The promise must be signed by the maker.

(iv) It does not need any â€˜acceptanceâ€™ since the promise is made by the person who has accepted the document, if it were a bill of exchange. In promissory notes, the drawer has technically accepted liability to pay the amount as promised.

(v) It is equally transferable by mere endorsement.

(vi) Nigerian bank notes before decimalization and the West African notes during the time of the West African currency board were promissory notes. However, such bank notes were promissory notes with a difference, since they were always payable to bearer on demand, and they were also legal tenders.

₦500,000.00

Plot 10
Eleventh Avenue
Oluyole Industrial Estate
Ring Road
Ibadan

14-6-04

Six months after date, I promise to pay to Ayo Asaolu or order, the sum of five hundred thousand naira, value received.

Payable at the Union Bank
Ibadan.

Ijosi Amafule

Fig. 8.5: *A specimen promissory note*

8.2.3 Parties to a Promissory Note:

These are two in the main:

(a) The maker: This is the debtor who makes the promise to pay the money.

(b) The payee: This is the creditor who will be paid eventually or to whom the promise to pay is made.

8.2.4 Comparison between a bill of exchange and a promissory notes

	Bill of Exchange	Promissory Note
(i)	This is an order of pay.	It is a promise to pay.
(ii)	An acceptance is required	No acceptance is required.
(iii)	Liability lies primarily with the acceptor	Liability lies squarely with one drawer.
(iv)	A bill of exchange is more reliable, since it contains the signature of both the drawer and the acceptor.	It contains only one signature and may not be all that reliable.
(v)	A protest is desirable, especially when bills are dishonoured foreign bills.	It does not warrant any protest.

The similarities between a bill of exchange and a promissory note are as follows:

(i) They are both negotiable instruments.

(ii) They are both transferable since they are endorsed for payments of debts; and the parties to a promissory note has the same rights as the parties to a bill of exchange.

Summary

Source: The Nigeria bills of exchange were born out of the Act of 1917 and 1964 respectively, which were also based on the English bills of exchange Act 1882. There are two types - inland bills - used within the country and foreign bills - for international trade.

Features: The features of bills of exchange are: unconditional order, in written form, from one person to another, certainty of amount and time of payment and signature.

Parties:

drawer - the creditor
drawee - the debtor
acceptor - accepting liability to pay
payee - usually the drawer or any other person so nominated.

Terms: Some of the terms in use are - draft, tenor, usance, calendar month, three days of grace; acceptance- general or qualified, negotiation and endorsement, honouring and dishonouring bill, noting and protesting.

Advantages: Certainty of terms, payment period and of amount.

Promissory Note

Parties: Two parties, i.e., the maker of promise - the debtor and the payee-the creditor.

Revision Questions

A. Essay Questions

1. Explain the following in connection with a bill of exchange terms:
   (a) a draft, an acceptance, â€˜usanceâ€™ and liability.
   (b) discounting the bill of exchange.

2. (a) What are the advantages of payments by bills of exchange?
   (b) Compare and contrast a bill of exchange with a cheque.

3. (a) Who are the parties to promissory note?
   (b) What are the similarities and differences between a bill of exchange and a promissory note?

4. (a) State six features of â€˜Bill of Exchangeâ€™. (2 marks)
   (b) What is NOTING and PROTESTING of a bill of exchange?

NECO 2000

5. (a) Define a bill of exchange.
   (b) State six essential features of a bill of exchange.
   (c) List the parties to a bill of exchange.

WASSCE 1998

B. Objective Questions

1. Which of the following does not originate from the debtor as a means of payment.
   A. Bank note
   B. Cheque
   C. Bill of exchange
   D. Promissory note

WASSCE 2000

2. Payments in international trade are made by means of
   A. Promissory notes and bills of exchange
   B. Letters of credit
   C. Cheques and bills of exchange
   D. Bank notes and coin

WASSCE 2002

3. Which of the following is not used to settle foreign indebtedness?
   A. Inland bill of exchange
   B. Letter of credit
   C. Domentary credit
   D. Bill of sight

WASSCE 2002

4. One of the following is NOT a feature of a promissory note.
   A. It must be qualified by â€˜ifsâ€™ or â€˜butsâ€™.
   B. It must be signed by the drawer.
   C. May be made payable to the drawer or his order.
   D. It must not be conditional.

5. Which of the following is not a means of payment in foreign trade?
   A. Telegraphic transfer
   B. Cheque
   C. Letter of credit
   D. Bill of exchange

WASSCE 2001

6. A bill of exchange paid before its due date at amount less than its face value is said to have been
   A. Accepted
   B. Rejected
   C. Discounted
   D. Dishonoured

7. Which of the following is the days of grace allowed to a bill of exchange on maturity?
   A. 3 days of grace
   B. 4 days of grace
   C. 5 days of grace
   D. 7 days of grace

8. When a bill of exchange matures, the extra days allowed before it is presented for payment is called
   A. days of acceptance
   B. days of grace
   C. days of discount

D. days of maturity

9. In which of the following is acceptance necessary before it can be valid?
   A. Promissory note
   B. Letter of credit
   C. Bill of exchange
   D. Bill of lading

10. Where a bill of exchange is not discounted, the drawer is also the
   A. Payee
   B. Drawee
   C. Endorser
   D. Acceptor

Project

Make specimen drawings of:

(i) An inland bill of exchange

(ii) A foreign bill of exchange (accepted)

(iii) A chain of link endorsement of a cheque for payment to three different people.

(iv) A promissory Note.