Ethiopian TVET-System

Basic Account Works
Level-II

Based on August 2012GC Occupational standard

Module Title: Developing Understanding of Debt and Consumer Credit

TTLM Code: EIS BAW2 TTLM 0919v1

This module includes the following Learning Guides

LG37: Identify and discuss the role of credit in society
LG Code: EIS BAW2 M07 LO1-LG-37

LG38: Identify and discuss the range of credit options available
LG Code: EIS BAW2 M07 LO2-LG-38

LG39: Identify and discuss costs of using credit
LG Code: EIS BAW2 M07 LO3-LG-39

LG40: Analyze and discuss the effective use of consumer credit
LG Code: EIS BAW2 M07 LO4-LG-40

LG41: Manage personal credit rating and history
LG Code: EIS BAW2 M07 LO5-LG-41

Instruction Sheet	LG37: Identify and discuss the role of credit in society

INTRODUCTION

Welcome to the module "Develop Understanding of Debt and Consumer Credit". This learner's guide was prepared to help you achieve the required competence in "Basic Account Works Level- II". This will be the source of information for you to acquire knowledge attitude and skills in this particular occupation with minimum supervision or help from your trainer

This guide will also assist you to attain the learning outcome stated in the cover page. Specifically, upon completion of this Learning Guide, you will be able to:

Learning Instructions:

1. Read the specific objectives of this Learning Guide.
2. Follow the instructions described
3. Read the information written in the "Information Sheet". Try to understand what are being discussed. Ask you teacher for assistance if you have hard time understanding them.
4. Accomplish the "Self-checks" .
5. Ask from your teacher the key to correction (key answers) or you can request your teacher to correct your work. (You are to get the key answer only after you finished answering the Self-check).
6. Submit your accomplished Self-check. This will form part of your training portfolio.
   Ask from your teacher the key to correction (key answers) or you can request your teacher to correct your work. (You are to get the key answer only after you finished answering the Self-check 2).

1.1 The concepts and terminology of credit provided by a financial institute and debt incurred by a borrower are analyzed and discussed

Concept of credit

The word credit originates in the latin "credere" verb, and means believing. The Latin noun is "credititus". From there than something credited somewhat credible. For example when we say "his words are worthy of credit" or "the titles that has give credit their knowledge of the subject", or "its punctuality makes it to earn the credit of confidence".

Meaning of credit

A loan is a sum of money that is given to a person is a form of a loan, the institution which gives it u offers in full right to make it. Banks are usually the entities that grant credits, with the purpose that the person does some investment, engaging with the institution to cancel it in a stipulated time and under the rules and conditions that this imposes, in general, consist of a fixed rate of financing which is established as a Commission. For the Bank, the credit is a product, since in addition to offering it to the public, this generates dividends which in turn stimulate the growth and development of the Bank as a company and collaborate simultaneously with the evolution of society.

Meanwhile credit cards, are also products of banks, which make the times of continuous credits to the person, i.e., with a credit card Ana can buy the portfolio that you both like, although it does not have money in their accounts, the credit card offers you a limit of available money that she can then pay. This type of instrument offers the customer convenience and economic freedom preferentially. The difference between credit and loan basically is that the loan is a fixed amount, paid established fees and interest according to the contract, credit is a term account for pay, it complies with the same conditions as a loan since the final credit is a loan, but this can vary according to the condition of payment or availability of the account which the creditor puts at your disposal.

In general_Credit Is defined as

- A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some later date. When a consumer purchases something using a credit card, they are buying on credit receiving the item at time, and paying back the credit card to the company according to the agreement between the creditor and debitor. Any time when an individual finances something with a loan (such as an automobile or a house), they are using credit in that situation as well.
- The borrowing capacity of an individual or company.
- A journal entry recording an increase in assets. With cash basis accounting, credits are recorded when income is received. With accrual basis accounting, credits are recorded and recognized when income is earned. Let us now review the synonyms the term in question boasts: financing, down payment, mortgage, advancement, loan; guarantee, solvency, renown, fame, reputation, prestige; confidence, acceptance.

What Is Debt?

Debt is simply defined as an amount of cash borrowed by a person from another person, a financial institution, or the government. For instance, if you go to a bank and borrow birr 50,000, this will be considered a debt – you will owe the bank the birr 50,000 plus the interest accrued thereof.

Debt is used by both individuals and corporations as a way of making big purchases which they cannot afford under ordinary circumstances – purchases they can't finance upfront. A debt agreement, also called debt arrangement, is the document used to give you the authorization to borrow the cash and the conditions under which you will repay the money at a future date, and often with interest.

Consumer debt refers to debts that arise from purchase of goods that do not appreciate in value and/or are consumable. Possessing some level of consumer debt pays off if the debt was incurred to purchase an asset needed to boost one's earnings. For example, borrowing to finance a car is a wise decision if you need it to travel to work at a higher paying job. However, high level of consumer debt is not good because it puts too much strain on your income. If unchecked, consumer debt can lead one into the debt spiral and/or bankruptcy.

The Difference between Debt and Credit

In general speaking, debt and credit are used interchangeably, but in strict financial terms, they have distinct interpretations.

Credit is a financial device that businesses and individuals try to obtain from financial institutions. So, financial institutions don't offer debt, they offer credit. For instance, banks, credit unions, and credit card companies offer different type of credit to their customers. These include: Mortgage loans, Payday loans, Credit cards and Automobile loans and more.

1.2 The Historical and Current Role of Consumer Credit

What Is Consumer Credit?

Consumer credit is personal debt taken on to purchase goods and services. A credit card is one form of consumer credit.

Although any type of personal loan could be labeled consumer credit, the term is usually used to describe unsecured debt that is taken on to buy everyday goods and services. It is not usually used to describe the purchase of a house, for example, which is considered a long-term investment and is usually purchased with a secured mortgage loan.

Understanding Consumer Credit

Consumer credit is extended by banks, retailers, and others to enable consumers to purchase goods immediately and pay off the cost over time with interest. It is broadly divided into two classifications: installment credit and revolving credit.

Installment Credit

Installment credit is used for a specific purpose and is issued at a defined amount for a set period of time. Payments are usually made monthly in equal installments. Installment credit is used for big-ticket purchases such as major appliances, cars, and furniture. Installment credit usually offers lower interest rates than revolving credit as an incentive to the consumer. The item purchased serves as collateral in case the consumer defaults.

Revolving Credit

Revolving credit, which includes credit cards, may be used for any purchase. The credit is "revolving" in the sense that the line of credit remains open and can be used up to the maximum limit repeatedly, as long as the borrower keeps paying a minimum monthly payment on time. Revolving credit is available at a high interest rate because it is not secured by collateral.

Special Considerations

Consumer credit use reflects the portion of a family or individual's spending that goes to goods and services that depreciate quickly. It includes necessities such as food and discretionary purchases such as cosmetics or dry cleaning services.

Consumer credit use from month to month is closely measured by economists because it is considered an indicator of economic growth or contraction. If consumers overall are willing to borrow and confident they can repay their debts on time, the economy gets a boost. If consumers cut back on their spending, they are indicating concerns about their own financial stability in the near future. The economy will contract.

Advantages of Consumer Credit

Consumer credit allows consumers to get an advance on income to buy products and services. In an emergency, such as a car breakdown, that can be a lifesaver. Because credit cards are relatively safe to carry, America is increasingly becoming a cashless society in which people routinely rely on credit for purchases large and small.

Revolving consumer credit is a highly lucrative industry. Banks and financial institutions, department stores, and many other businesses offer consumer credit.

Disadvantages of Consumer Credit

The main disadvantage of using revolving consumer credit is the cost to consumers who fail to pay off their entire balances every month and continue to accrue additional interest charges from month to month.

The History of Consumer Credit

Consumer credit may seem like a fairly new invention – but it's actually been around for more than 5,000 years!

In fact, many millennia before the credit score became ubiquitous, there is historical evidence that cultures around the world were borrowing for various reasons. From the writings in Hammurabi's Code to the exchanges documented by the Ancient Romans, we know that credit was used for purposes such as getting enough silver to buy a property or for agricultural loans made to farmers.

Examples of the Ancient Credit

1. **3,500 BC – Sumer.** Sumer was the first urban civilization

2. 1,800 BC – Babylon

3. 50 BC – The Roman Republic

4. 1500 – The Age of Discovery

The Modern Consumer Credit

The Information Age has enabled a new era in consumer credit and assessing risk – and today, credit reports are used to inform decisions about housing, employment, insurance, and the cost of utilities.

The Current Role of Consumer Credit

Consumers, along with businesses, are the driving force of the economy. When they spend, businesses reap the profit and consumers get a quality product or service that will in some way enhance their lives. Consumers play an important role in society from the methods they use to research and review products to their decisions on which brands to use and where to make purchases.

A) Initiator

Consumers determine the products and services they need, whether they are shopping for themselves, friends, family members or business clients. The media help to persuade, inform and remind them about products and services that are available for consumption. Once a consumer becomes interested in a product or service, regardless of the brand name associated with it, he begins to gather information to determine if making the purchase is a reasonable, wise-buying decision.

B) Influencer

Consumers undoubtedly look to family, friends and colleagues for opinions when they're making a purchase. A referral for a business or a personal experience with a product holds more weight with a consumer than a well-orchestra print advertisement or commercial. In fact, Business Wire reports that women often look to blogs and social networks to research products before they make a decision to buy. Companies offer customers an opportunity to review their services and products online, and consumers use this information to gauge quality, service, features, benefits and pricing.

C) Decider

Children, for example, may initiate the idea of a purchase by mentioning a new cereal to a parent. The parent decides whether or not to make the purchase after researching the cereal to determine its price, its availability and how healthy it is. Consumers who assume the role of a decider have the financial authority to decide whether a good or service can be purchased.

D) Buyer

Consumers purchase products and services with their money, a spouse's money, or by using a company credit card. Whether they visit a store in person, make a purchase online or place an order over the phone, the buyer gives a payment and receives a good or service in exchange.

E) User

Consumers typically use the products they buy, unless they make the purchase for a family member, friend or colleague. Regardless of who makes the purchase, the user is the person who ultimately consumes the good or service that's purchased by the buyer.

The Sources of Consumer Credit

A) **Commercial Banks**

Commercial banks make loans to borrowers who have the capacity to repay them. Loans are the sale of the use of money by those who have it (banks) to those who want it (borrowers) and are willing to pay a price (interest) for it. Banks make several types of loans, including consumer loans, housing loans and credit card loans.

B) Savings and Loan Associations (S&Ls)

Savings and loan associations used to specialize in long-term mortgage loans on houses and other real estate. Today, S&Ls offer personal installment loans, home improvement loans, second mortgages, education loans and loans secured by savings accounts. S&Ls lend to creditworthy people, and usually, collateral may be required. The loan rates on S&Ls vary depending on the amount borrowed the payment period, and the collateral. The interest charges of S&Ls are generally lower than those of some other types of lenders because S&Ls lend depositors' money, which is a relatively inexpensive source of funds.

C) Credit Unions (CUs)

Credit Unions are nonprofit cooperatives organized to serve people who have some type of common bond. The nonprofit status and lower costs of credit unions usually allow them to provide better terms on loans and savings than commercial institutions. The costs of the credit union may be lower because sponsoring firms provide staff and office space, and because some firms agree to deduct loan payments and savings installments from members' paychecks and apply them to credit union accounts.

Credit unions often offer good value in personal loans and savings accounts. CUs usually require less stringent qualifications and provide faster service on loans than do banks or S&Ls.

D) Consumer Finance Companies (CFCs)

Consumer finance companies specialize in personal installment loans and second mortgages. Consumers without an established credit history can often borrow from CFCs without collateral. CFCs are often willing to lend money to consumers who are having difficulty in obtaining credit somewhere else, but because the risk is higher, so is the interest rate. The interest rate varies according to the size of the loan balance and the repayment schedule. CFCs process loan applications quickly, usually on the same day that the application is made, and design repayment schedules to fit the borrower's income.

E) Sales Finance Companies (SFCs)

If you have bought a car, you have probably encountered the opportunity to finance the purchase via the manufacturer's financing company. These SFCs let you pay for big-ticket items, such as an automobile, major appliances, furniture, computers and stereo equipment, over a longer period of time.

You don't deal directly with the SFC, but you are generally informed by the dealer that your installment note has been sold to a sales finance company. You then make your monthly payments to the SFC rather than to the dealer where you bought the merchandise.

F) Life Insurance Companies

Insurance companies will usually allow you to borrow up to 80 percent of the accumulated cash value of a whole life (or straight life) insurance policy. Loans against some policies do not have to be repaid, but the loan balance remaining upon your death is subtracted from the amount your beneficiaries receive.

Repayment of at least the interest portion is important, as compounding interest works against you. Life insurance companies charge lower interest rates than some other lenders because they take no risks and pay no collections costs. The loans are secured by the cash value of the policy.

G) Pawnbrokers

Recently made famous by reality shows, pawnbrokers are unconventional, but common, sources of secured loans. They hold your property and lend you a portion of its value. If you repay the loan and the interest on time, you get your property back. If you don't, the pawnbroker sells it, although an extension can be arranged. Pawnbrokers charge higher interest rates than other lenders, but you don't have to apply or wait for approval. Pawnbrokers' chief appeal? They rarely ask questions.

H) Loan Sharks

These usurious lenders have no state license to engage in the lending business. They charge excessive rates for refinancing, repossession or late payments, and they allow only a very short time for repayment. They're infamous for using collection methods that involve violence or other criminal conduct. Steer clear of them. They are illegal, after all.

I) Family and Friends

Your relatives can sometimes be your best source of credit. However, all such transactions should be treated in a businesslike manner; otherwise, misunderstandings may develop that can ruin family ties and friendships.

1.3 The Impact of Consumer Debt on the National Economy

How Consumer Debt Affects the Economy Most people these days are more than a little familiar with consumer debt. This is the type of debt that is held by individuals just like you. Sometimes it seems like living a normal, modern life isn't even possible without taking on debt to make it happen. Of course, consumer debt doesn't just accumulate without any effect on the economy. Here is some information on various aspects of consumer debt, and how it can affect an economy. The Multiplier Effect One way that consumer debt affects the economy is by creating a multiplier effect, where the theory goes that an increase in economic activity can create a chain reaction of activity that results in more than the original increase. Basically when people borrow money and then spend that money, business revenues increase which can result in more jobs being created which results in even more spending, and so on. What Are the Interest Rates? The state of interest rates is one factor that will always influence borrowing and any subsequent effect on the economy. If the economy is in a slow-moving state and things haven't been moving well, governments will sometimes lower interest rates to make borrowing easier and more manageable for consumers. Most consumers seem to focus on how much their monthly payments are and not really how much they've just borrowed. Lower interest rates increase the level of borrowing and the level of spending, which will ultimately give the economy a boost, while at the same time increasing consumer debt. What Kind of Debt Is It? Even though increased consumer debt helps grow the economy, many experts naturally become concerned about how much it can expand before the system caves in on itself. The type of debt that is incurred by consumers is also a factor in whether the debt is good or bad. With unsecured debts like credit cards, the money is used to make purchases and stimulate the economy, but the individual debt load just continues to increase with nothing really to show for it. With purchases like a home, the consumer has taken on debt, but has also purchased an appreciating asset. As these debts are paid down and home values rise, consumer wealth also rises. With an asset like a home and increases in consumer wealth, the likelihood of defaulting on loans decreases because there is always that home equity to fall back on if necessary. Of course, with any type of household debt the effect on the economy is at least partially dependent on future interest rates, unemployment rates and any unforeseen shocks to the economy.

1.4 The Advantage and Disadvantage of Credit

All businesses exist in a competitive environment. Although it would be nice to make all sales on a cash basis, it's not always possible. If your competitors are giving their customers credit terms, you will need to offer something similar to get their business. Selling to customers on credit has advantages and disadvantages. A business owner must consider the effects on his company before venturing into the potential minefield of taking credit risks with customers.

Advantage:

A) Meet the Competition

When your competitors are making sales on credit to your customers, you will need to do the same just to stay competitive. If you want to offer more favorable terms, you might consider giving discounts for prompt payment. For example, instead of just providing 30-days terms, offer 2/10/30. This means that the customers can take a 2-percent discount if he pays within 10 days instead of waiting for the full 30 days to pay.

B) Increase in Sales

An increase in sales may or may not happen when you start selling on credit. If your competitors are not offering credit terms, then you will gain sales by offering credit terms, because your customers will buy from you instead of having to pay cash from your competitors.

C) Better Customer Loyalty

Offering credit to customers indicates that you respect and trust them to pay their bills before their due dates. Customers will reward these gestures of confidence by continuing to buy from you. They will feel a degree of loyalty, and they like to do business with someone who trusts them.

Disadvantage:

A) Negative Impact on Cash Flow

When you begin selling to customers on credit, your cash flow will be immediately affected. For example, if you begin to offer credit terms for 30 days, the cash that you would normally receive during this time will disappear. You will not have this cash to pay your bills, employee and suppliers.

B) Need to Fund Accounts Receivable

Since giving credit terms to customers will directly affect your cash flow, you must calculate how much your accounts receivable will increase and then figure out how you will finance this increase. You may need to use a line of credit with a bank or ask your suppliers to extend better credit terms to your company.

C) Taking a Credit Risk with Customers

The creditworthiness of each customer must be investigated. This will require checking the customers' credit references and obtaining a business credit report, such as Dun & Bradstreet.

D) Keeping Up With Accounts Receivable

Someone needs to keep up with the status of your accounts receivable. The reality is that customers don't always pay on time, and somebody needs to make calls or to send out past due notices. If there isn't already an employee in the office who can do this, you may need to hire a new employee.

E) Potential for Bad Debts

No matter how well you check a customer's credit rating and references, eventually, there will be someone who doesn't pay. When that happens, if you turn over the account to a collection agency, you will incur fees. If collection efforts don't work, then you will need to write off the receivable as a bad debt.

Offering credit to customers is a necessary evil to remain competitive in the marketplace. If your competitors are offering credit terms, you must do the same. Otherwise, your customers will abandon you.

OPERATION SHEET 1: Identify concepts and terminology of credit

Directions: Answer all the questions listed below. Use the Answer sheet provided in the Next page

Self-Check 1	Written Test

1. Define the following terms:

Consumer____

Credit ____

Debit____

2. Write Difference between Debt and Credit

____

Note: **Satisfactory rating - 3 and 5 points Unsatisfactory - below 3 and 5 points**

You can ask you teacher for the copy of the correct answers.

Answer Sheet

Score = ___________

Rating: ____________

Name: _________________________ Date: _______________

Instruction Sheet	LG38:Identify and discuss the range of credit options available

Information sheet-2	Identify and discuss the range of credit options available

What Is a Credit Facility?

A credit facility is a type of loan facility given to your business by a bank, which provides capital that you can draw on any time you need it. Credit facility is an agreement with bank that enables a person or organization to be taken credit or borrow money when it is needed.

The concept of Loan

A loan is a type of debt. Like all debt instruments, a loan entails the redistribution of financial assets over time, between the lender and the borrower.. in a loan, the borrower initially receives or borrows an amount of money, called the principal, from the lender, and is obligated to pay back or repay an equal amount of money to the lender at a later time. Typically, the money is paid back in regular installments, or partial repayments; in an annuity, each installment is the same amount.

What's the Difference Between a Credit Facility and a Loan?

When you negotiate a bank loan, you agree to borrow a fixed amount of money for a fixed period of, say, five or 10 years. When the loan closes, the full amount of the loan goes directly into your bank account. It doesn't matter whether you use all of the money: you still have to pay the entire amount back with interest at the agreed rate.

Another difference worth emphasizing is that you only pay interest on the amount you withdraw, rather than on the entire credit facility you have been granted. So, the interest starts to accrue from the day you borrow the money, so you'd be paying interest on the first withdrawal of birr. Interest rates vary widely and depend on the usual range of factors, such as the company's creditworthiness and risk profile. Overall, you should expect to pay a higher rate than you would for a regular bank loan. That said, since you're only withdrawing essential amounts for a few months or weeks, the cost of borrowing could work out cheaper in real terms.

Why Do Businesses Use Credit Facilities?

Imagine that your main customer is late in paying your invoice and you were relying on that money to pay your rent or payroll expenses. Now imagine that a key piece of machinery breaks down and you need to fix it fast before production grinds to a halt. A credit facility offers an instant solution to these and other setbacks that a business might face concerning its cash flow and expenses. In many ways, it acts as a revenue back up or financial insurance policy to the business.

Of all the types of bank facilities, a credit facility is perhaps the most flexible. Growing businesses find it especially helpful to be able to dip in and out of an overdraft-style pot whenever they need some additional support. And drawing funds is just about the fastest way to access capital aside from accessing your own bank account. Since you're not being forced to borrow a predetermined amount, there's much less risk of over-borrowing and paying interest charges or early-payment penalties on money that you didn't need.

What's more, credit lines don't generally require collateral or business valuations. The bank will put you through an application process, and you probably will need to supply some financial information and annual revenue projections. But once the credit line is set up, you can borrow from it over and over as long as your outstanding balance allows.

The Various Types of Credit Facilities

Some of the commonly used credit facilities in Singapore today are as below;

A) Credit Card

With a good credit history and steady income, you may qualify for credit cards at the bank. The card issuer will usually assess your repayment ability before deciding whether to accept your application and what credit limit to be set. Also, your credit card can be used to purchase items in most places. Different credit cards have different interest rates for different types of activities, like purchases, cash advances or balance transfers, so do remember to read the fine print.

B) Personal Loan

Personal loans are mostly unsecured in nature. They do not require collateral such as a car or house in order for a loan to be extended to you. Their unsecured nature makes personal loans attractive to those who require finances to meet short term personal and business needs.

C) Bridging Loan

If you do need assistance on the initial cash down payment of your property purchase, a Bridging Loan can be extended to you while you are still in the process of selling your Housing and Development Board (HDB) flat or private property. For example, let say You can borrow up to 15% of the purchase price or fair market value (whichever is lower) at 6.5% p.a. (1% above prime rate*) and the maximum tenor of the Bridging Loan is six months.

During the tenor of the loan, you can choose to service the interest only and repay the principal amount once you receive the cash proceeds from the sale of your existing property.

D) Motor Vehicle Loan

The bank supplies a definite sum of money, intended for the purchase of a suitable vehicle, to an individual who qualifies against a list of requirements that establish the said individual's financial history and repaying capacity. Car loans in Singapore can be deemed as secured loans that involve the purchased vehicle as the collateral. The process of acquiring a car loan in Singapore is easy enough, and it majorly depends on your compliance with the minimum age requirement, nationality, gross family income, clean credit history and employment stability that equates to a dependable source of income.

E) Bank Overdraft

Overdrafts are an extension of credit from a bank when an account reaches zero. An overdraft allows the individual to continue withdrawing money even if the account has no funds in it. You can arrange a bank overdraft on the account your salary is paid into. This means your account can be overdrawn. The interest rate is much higher than the prime interest rate. You do not have to repay the overdraft within a fixed time, but the bank will review it at least once a year, and choose to withdraw it at any point of time.

F) Restructured Loan

Restructured loans are overdue loans where a bank has negotiated for a change in repayment terms with the borrower and payments are still being made in accordance with the repayment terms.

G) Housing and Development Board (HDB) Loan

HDB loans are offered by HDB or the banks and they provide tenures of up to 25 years if you pay a minimum 20% down payment (at least 5% in cash), and use your CPF to pay off 15% or more for the balance down payment depending on the loan amount that you want. You will have the option to extend your loan tenure to 30 years if you are going for a 60% loan or less (capped at age 70). These loans are well suited for individuals who can afford to place a large down payment and take a smaller home loan.

H) Renovation Loan

Purchasing a house is one of the most important financial decisions you will ever take in your life. Everyone deserves to live in a home of their choice, complete with the furnishings and appliances they would want. Renovation loans help home owners renovate their new homes, be it to make repairs to the roof, plumbing, walls, paint, and fixtures.

I) Education Loan

If you are planning to study locally or overseas, there are various flexible study loans offered by banks and financial institutions to finance your studies. With an education loan, you can finance your tuition fees, focus on studying and do better in the classroom.

J) Medical Loan

Medical loans are available to help ease the financial stress away and offer you peace of mind. They will ensure your family member gets the medical care they require, while the loan takes care of the ensuing medical bill. The loans are structured according to your financial situation and repayment ability regardless of the medical emergency.

2.2 The Differences between Unsecured and Secured Loans

What is a secured loan? Definition and examples

A **secured loan** or **secured debt** is when the borrower has committed to give the lender certain assets, such as a real estate property or a car, if he or she defaults, i.e. fails to make payments. The lender has recourse to seize the asset and sell it to recoup the money lent.

The asset the borrower puts up as security is called the *'collateral'* on the loan. The practice of pledging an asset as collateral on a loan is known as hypothecation.

When a homebuyer takes out a mortgage, the house being bought is put up as collateral, making it a secured loan. If the mortgagor (borrower) defaults, the lender will take possession of the house and sell it in order to recoup its money – this is known as foreclosure.

If after selling the collateral there is not enough money to pay off the debt, the lender may try to obtain a deficiency judgment against the borrower for the remainder. With non-recourse secured loan the collateral is the only claim the creditor has against the borrower.

A secured loan is the opposite of an unsecured loan, as occurs with most credit card purchases when the issuer lends the card holder money and no collateral is involved.

As the risk is lower for the lender, secured loans tend to charge lower interest rates compared to unsecured debt. Other factors will also determine how much interest the lender will charge, including the borrower's employment status, credit history, age, and ability to repay.

Examples, let's say that you want to take a house. So, you go out and contact a bank and ask for a housing loan. The bank says that they will give you the housing loan without any issue, but there's only one condition. The condition is you need to keep the house as collateral to the bank until the loan amount and the interest charges are paid off in full. Bank also says that as you're accepting their offer, they will also offer you a reduced interest rate that is much lower than an unsecured loan. You happily agree and go for the housing loan and buy your dream house. This is how it works

Advantages of a secured loan

A. With this type of loan the lender is relieved of much of the risk, which permits the second advantage.
B. The borrower is more likely to get better terms than what would be available with an unsecured loan. He or she can probably borrow more and pay back over a longer period. In many cases, without putting up collateral the borrower might not be able to get the loan he or she wants.
C. For individuals with a poor credit rating, this may be the only way they can borrow money.
D. A secured loan is a good way to improve your credit rating (as long as you pay on time).

What is a unsecured loan? Definition and examples

Unsecured loans are loans that are approved without the need for collateral. Instead of pledging assets, borrowers qualify based on their credit history and income. Lenders do not have the right to take physical assets (such as a home or vehicle) if borrowers stop making payments on unsecured loans.These loans are also known as "signature loans" because your signature on the loan agreement is all that you bring to the table. You promise to repay, but you don't back up that promise by pledging collateral.

Example, let's say that you have been doing a job for few years after graduation. Now you feel that it is the right time to go ahead and get an MBA degree. You have some savings, but that's not enough to study in top-notch MBA institute. So you go to a bank and talk to them about an education loan. They tell you that up to a certain extent, the bank will offer you a loan which doesn't need any collateral. But if you take more amount than that you would need to keep collateral against the educational loan that you would want to take.

You talk to your parents and they tell you that they will offer you a portion of the money. And after computing, you find out that you can take an unsecured loan from the bank and the rest of the amount you can pay from your savings and from your parents' savings.

Types of Unsecured Loans

Unsecured debt comes in several forms.

- **Credit cards** are a common form of unsecured loan. Even though you might not think of them as "loans," you borrow money when you spend with a credit card.
- **Student loans** are often unsecured. Although some people take cash out of their homes to pay for school, pure student loans through the Department of Education are typically unsecured.
- **"Personal" loans**, available from banks, credit unions, and online lenders are unsecured loans you can use for any purpose you want.

2.3 The Personal Loans Credit Cards, Store Cards and Overdraft

A **credit card loan** or **credit card debt** is money you borrow when you use your credit card. Credit cards allow us to buy things when we either don't have cash or don't want to use cash. People may also prefer to pay by credit card because it offers convenience, security, and easy tracking.

When you buy something using your card, the issuer loans you the money to make the purchase. You will have to pay back the loan at a later date. After a 'grace period,' you will also have to pay interest on that loan

What is ***store card?***

a credit card issued by a large department store, which can only be used for purchases in that store. Store credit cards often aren't worth it compared to regular, or general use, credit cards branded with a major processing network. store credit cards can only be used in a specific store or family of stores. They're just like any other credit card, but purchases made in the affiliated store will typically earn higher rewards or other benefits

Characteristics *of* store card

A) Limited Use

B) Higher Interest Rates-Store credit cards often have higher interest rates than regular credit cards

C) Restrictions on Rewards-With store credit cards, rewards are relatively difficult to earn and have limited options for redemption. Most every store credit card only rewards you on purchases you make in that store

D) Credit Limits

Store credit cards usually have low credit limits,
Refer:: http://www.investorwords.com/11218/store_card.html#ixzz60XFSQMRJ

The concept of Overdraft

An overdraft is a service provided by a bank which allows a customer to continue to make payments or withdrawals from an account even when there is not enough money in the account to cover them. In effect, an overdraft is a form of credit, which attracts interest charges for as long as you are overdrawn.

Are there different kinds overdrafts?

Yes, there are **authorized** and **unauthorized** overdrafts.

An **authorized** overdraft is one where your bank has agreed that you can have an overdraft, which exists for you to take advantage of at any time within an agreed period, up to an agreed amount. It costs you nothing in interest charges if you do not use it. On the other hand if your account goes overdrawn without the bank's permission or you exceed the limits set in an authorized overdraft, then this is an **unauthorized overdraft**. The bank is not obliged to give you an unauthorized overdraft. As a general rule, when you do not have an authorized overdraft in place, then any cheques or withdrawals for a sum higher than the amount available in your account can be 'bounced'. This mean the bank may not honor them and may make a charge for returning the item.

How do I apply for an overdraft?

If you believe that there are likely to be times when the funds available in your account will not meet your expected outgoings for a short period, then you should contact your bank and discuss whether it would be possible to have an overdraft facility

3.1 ***Fees and costs*** associated with different types of credit options are ***analyzed and compared***
3.2 The features and associated risks of fixed versus variable interest rates are analyzed and compared
3.3 ***Ways to compare advertised interest rates*** and the effects of fees and charges are analyzed and discussed

Information Sheet	***credit facilities***

Fees and costs **associated with different credit options may include**

- account servicing fees
- credit purchase fees
- late payment fees
- loan establishment fees

withdrawing from a foreign Automatic Teller Machine (i.e. the ATM of a lending institution other than your own).

Fees and costs may be ***analyzed and compared*** using:

- manually, comparing fees and costs drawn from tables and charts provided by financial institutions and analyzed using a calculator
- online, web-based, calculation tools

software applications such as spreadsheets

Process documents relating to goods and services received

Procurement

Procurement is the acquisition of goods or services. It is favorable that the goods/services are appropriate and that they are procured at the best possible cost to meet the needs of the purchaser in terms of quality and quantity, time, and location(Weele 2010) . Corporations and public bodies often define processes intended to promote fair and open competition for their business while minimizing exposure to fraud and collusion.

Overview

Almost all purchasing decisions include factors such as delivery and handling, marginal benefit, and price fluctuations. Procurement generally involves making buying decisions under conditions of scarcity. If good data is available, it is good practice to make use of economic analysis methods such as cost-benefit analysis or cost-utility analysis.

An important distinction is made between analyses without risk and those with risk. Where risk is involved, either in the costs or the benefits, the concept of expected value may be employed.

<table>
<tr><th colspan="5">Direct procurement and indirect procurement</th></tr>
<tr><td colspan="2" rowspan="3"></td><th colspan="3">TYPES</th></tr>
<tr><th>Direct procurement</th><th>Indirect procurement</th><th></th></tr>
<tr><th>Raw material and production goods</th><th>Maintenance, repair, and operating supplies</th><th>Capital goods and services</th></tr>
<tr><th rowspan="5">FEATURES</th><th>Quantity</th><td>Large</td><td>Low</td><td>Low</td></tr>
<tr><th>Frequency</th><td>High</td><td>Relatively high</td><td>Low</td></tr>
<tr><th>Value</th><td>Industry specific</td><td>Low</td><td>High</td></tr>
<tr><th>Nature</th><td>Operational</td><td>Tactical</td><td>Strategic</td></tr>
<tr><th>Examples</th><td>Crude oil in petroleum industry</td><td>Lubricants, spare parts</td><td>Crude oil storage facilities</td></tr>
</table>

Based on the consumption purposes of the acquired goods and services, procurement activities are often split into two distinct categories. The first category being direct, production-related procurement and the second being indirect, non-production-related procurement.

Direct procurement occurs in manufacturing settings only. It encompasses all items that are part of finished products, such as raw material, components and parts. Direct procurement, which is the focus in supply chain management, directly affects the production process of manufacturing firms. In contrast, Indirect procurement activities concern "operating resources" that a company purchases to enable its operations. It comprises a wide variety of goods and services, from standardized low value items like office supplies and machine lubricants to complex and costly products and services like heavy equipment and consulting services.

Procurement vs acquisition

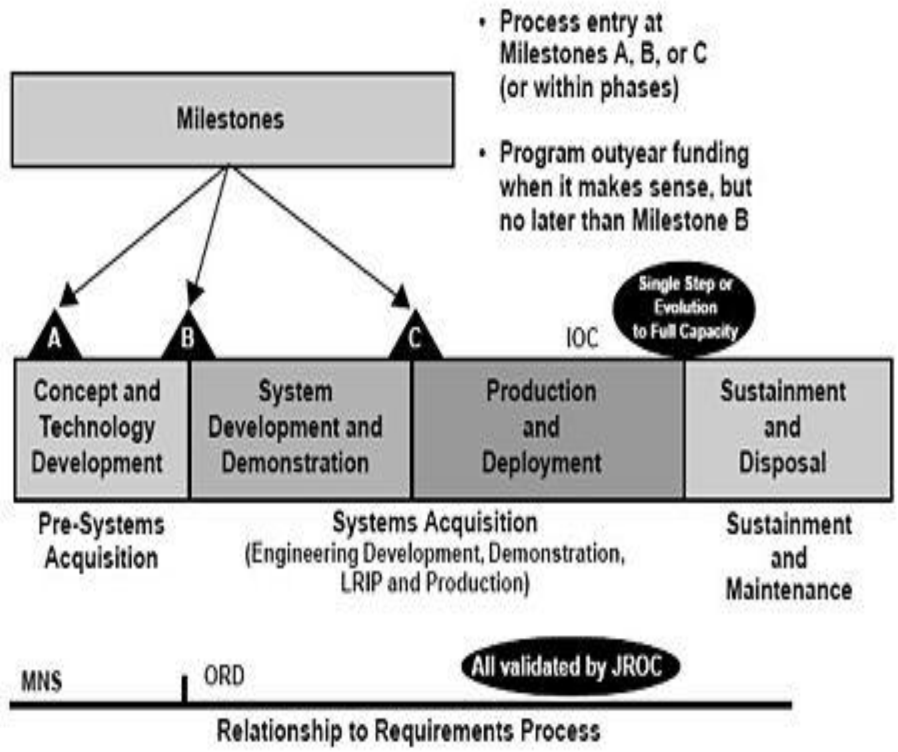
The USDefense Acquisition University (DAU) defines procurement as the act of buying goods and services for the government.[2]

DAU defines acquisition as the conceptualization, initiation, design, development, test, contracting, production, deployment, Logistics Support (LS), modification, and disposal of weapons and other systems, supplies, or services (including construction) to satisfy Department of Defense needs, intended for use in or in support of military missions.[2]

Acquisition is therefore a much wider concept than procurement, covering the whole life cycle of acquired systems. Multiple acquisition models exist, one of which is provided in the following section.

Acquisition process

The revised acquisition process for major systems in industry and defense is shown in the next figure. The process is defined by a series of phases during which technology is defined and matured into viable concepts, which are subsequently developed and readied for production, after which the systems produced are supported in the field.[3]



Model of the Acquisition Process.[3]

The process allows for a given system to enter the process at any of the development phases. For example, a system using unproven technology would enter at the beginning stages of the processand would proceed through a lengthy period of technology maturation, while a system based on mature and proven technologies might enter directly into engineering development or, conceivably, even production. The process itself includes four phases of development:[3]

- Concept and Technology Development: is intended to explore alternative concepts based on assessments of operational needs, technology readiness, risk, and affordability.
- Concept and Technology Development phase begins with concept exploration. During this stage, concept studies are undertaken to define alternative concepts and to provide information about capability and risk that would permit an objective comparison of competing concepts.
- System Development and Demonstration phase. This phase could be entered directly as a result of a technological opportunity and urgent user need, as well as having come through concept and technology development.
- The last, and longest phase is the Sustainable and Disposal phase of the program. During this phase all necessary activities are accomplished to maintain and sustain the system in the field in the most cost-effective manner possible.

Procurement systems

Another common procurement issue is the timing of purchases. Just-in-time is a system of timing the purchases of consumables so as to keep inventory costs low. Just-in-time is commonly used by Japanese companies but widely adopted by many global manufacturers from the 1990s onwards. Typically a framework agreement setting terms and price is created between a supplier and purchaser, and specific orders are then called-off as required. Shared services

In order to achieve greater economies of scale, an organization's procurement functions may be joined into shared services. This combines several small procurement agents into one centralized procurement system.

Procurement process

Procurement may also involve a bidding process i.e.,Tendering. A company may want to purchase a given product or service. If the cost for that product/service is over the threshold that has been established (e.g.: Company X policy: "any product/service desired that is over $1,000 requires a bidding process"), depending on policy or legal requirements, Company X is required to state the product/service desired and make the contract open to the bidding process. Company X may have ten submitters that state the cost of the product/service they are willing to provide. Then, Company X will usually select the lowest bidder. If the lowest bidder is deemed incompetent to provide the desired product/service, Company X will then select the submitter who has the next best price, and is competent to provide the product/service. In the European Union there are strict rules on procurement processes that must be followed by public bodies, with contract value thresholds dictating what processes should be observed (relating to advertising the contract, the actual process etc.).

Procurement steps

Procurement life cycle in modern businesses usually consists of eight steps:

- **Information gathering**: If the potential customer does not already have an established relationship with sales/ marketing functions of suppliers of needed products and services (P/S), it is necessary to search for suppliers who can satisfy the requirements.
- **Supplier contact**: When one or more suitable suppliers have been identified, requests for quotation, requests for proposals, requests for information or requests for tender may be advertised, or direct contact may be made with the suppliers.
- **Background review**: References for product/service quality are consulted, and any requirements for follow-up services including installation, maintenance, and warranty are investigated. Samples of the P/S being considered may be examined, or trials undertaken.
- **Negotiation**: Negotiations are undertaken, and price, availability, and customization possibilities are established. Delivery schedules are negotiated, and a contract to acquire the P/S is completed.
- **Fulfillment**: Supplier preparation, expediting, shipment, delivery, and payment for the P/S are completed, based on contract terms. Installation and training may also be included.
- **Consumption, maintenance, and disposal**: During this phase, the company evaluates the performance of the P/S and any accompanying service support, as they are consumed.

- **Renewal**: When the P/S has been consumed or disposed of, the contract expires, or the product or service is to be re-ordered, company experience with the P/S is reviewed. If the P/S is to be re-ordered, the company determines whether to consider other suppliers or to continue with the same supplier.
- **Additional Step - Tender Notification**: Some institutions choose to use a notification service in order to raise the competition for the chosen opportunity. These systems can either be direct from their e-tendering software, or as a re-packaged notification from an external notification company.

Procurement performance

In July 2011, Ardent Partners published a research report that presented a comprehensive, industry-wide view into what is happening in the world of procurement today by drawing on the experience, performance, and perspective of nearly 250 Chief Procurement Officers and other procurement executives. The report includes the main procurement performance and operational benchmarks that procurement leaders use to gauge the success of their organizations. This report found that the average procurement department manages 60.6% of total enterprise spend. This measure commonly called "spend under management" refers to the percentage of total enterprise spend (which includes all direct, indirect, and services spend) that a procurement organization manages or influences. The average procurement department also achieved an annual savings of 6.7% in the last reporting cycle, sourced 52.6% of its addressable spend, and has a contract compliance rate of 62.6%.[4]Public procurement

Main article: Government procurement

Public procurement generally is an important sector of the economy. In Europe, public procurement accounts for 16.3% of the Community GDP.[5]

Green public procurement

In Green public procurement (GPP), contracting authorities and entities take environmental issues into account when tendering for goods or services. The goal is to reduce the impact of the procurement on human health and the environment.[6]

In the European Union, the Commission has adopted its Communication on public procurement for a better environment, where proposes a political target of 50 % Green public procurement to be reached by the Member States by the year 2010.[7]Alternative procurement procedures

There are several alternatives to tendering which are available in formal procurement. One system which has gained increasing momentum in the construction industry and among developing economies in the Selection in planning process which enables project developers and equipment purchasers to make significant changes to their requirements with relative ease. The **SIP** process also enables vendors and contractors to respond with greater accuracy and competitiveness as a result of the generally longer lead times they are afforded.

ROSMA is a procurement acronym created by ATkearney.{Procurement Solutions Division} It stands for Return on Supply Management Assets and endeavors to quantify not only procurement but every piece of the procurement process including strategic resource management. { }

Procurement frauds

Procurement fraud can be defined as dishonestly obtaining an advantage, avoiding an obligation or causing a loss to public property or various means during procurement process by public servants, contractors or any other person involved in the procurement.[8]

Ways to compare advertised interest rates may include:	• informing the client of the 'comparison rate' which includes all associated fees and charges.

Self-Check 3	Written Test

Describing the impact of consumer debt on the national economy

Directions: Answer all the questions listed below. Use the Answer sheet provided in the

Next page

1: Define ***Ways to compare advertised interest rates?***

___

___

___

2: What are the procurement steps?

___

___

___

3: What is a promissory note?

___

___

Note: **Satisfactory rating - 3 and 5 points Unsatisfactory - below 3 and 5 points**

You can ask you teacher for the copy of the correct answers.

Answer Sheet

Score = ___________

Rating: ____________

Name: _________________________ Date: _______________

Instruction Sheet	LG40:Analyze and discuss the effective use of consumer credit

4.1 Ways to avoid excessive or unmanageable debt are analyzed and discussed
4.2 ***Strategies to minimize fees*** on credit are identified and discussed
4.3 The importance of meeting minimum payments on credit cards is analyzed and discussed
Ways to avoid credit card fraud are identified, analyzed and discussed

Information Sheet	***Strategies to minimize fees***

Strategies to minimize fees on credit may include:

- consolidating savings and credit facilities with the one institution where account servicing fees can be cancelled out
- knowing how many free transactions come with the card

paying the minimum monthly installment on time.

Ways to avoid credit card fraud include:

- not disclosing Personal Identification Number (PIN) to anyone
- selecting a PIN only the card holder would know

signing the back of the credit card.

Self-Check -4	Written Test

Describing the impact of consumer debt on the national economy

Directions: Answer all the questions listed below. Use the Answer sheet provided in the

Next page

1. What are the ways to avoid credit Card fraud ?

____
____
____
____

2. List the strategies to minimizing cost?

____
____
____

Note: **Satisfactory rating - 3 and 5 points Unsatisfactory - below 3 and 5 points**

You can ask you teacher for the copy of the correct answers.

Score = ___________

Rating: ____________

Answer Sheet

Name: _________________________ Date: _______________

5.1 The role of credit reference agencies is analyzed and discussed
5.2 The purpose and use of ***credit reference reports*** in assessing loan applications is analyzed and discussed
5.3 ***Implications of establishing a poor credit history*** are analyzed and discussed
The right to access and ***methods of obtaining own credit reference report*** are analyzed and discussed

Information Sheet	***Strategies to minimize fees***

Credit reference reports **refers to:**

reports established and maintained by credit reference agencies which record all negative events (i.e. defaults) listed by creditors against debtors.

Implications of establishing a poor credit history may include:	• higher interest rate penalties • inability to obtain finance in the future • may disadvantage applications for rental accommodation • necessity to obtain guarantor in future loans.

Methods of obtaining own credit reference file **may include:**

writing, emailing or telephoning the relevant agency requesting a copy of your file, having provided relevant details to identify self.

Self-Check -5	Written Test

: Describing the impact of consumer debt on the national economy

Directions: Answer all the questions listed below. Use the Answer sheet provided in the

Next page

1. What are the roles of credit referents?

____
____
____
____

2. ***Implications of establishing a poor credit history*** may include?

____
____
____
____

Note: **Satisfactory rating - 3 and 5 points Unsatisfactory - below 3 and 5 points**

You can ask you teacher for the copy of the correct answers.

Answer Sheet

Score = ___________

Rating: ____________

Name: _________________________ Date: _______________