BUSINESS STUDIES FORM ONE NOTES

INTRODUCTION TO BUSINESS STUDIES

Objectives: By the end of the topic, the learner should be able to:

i) **Explain the meaning of Business studies**
ii) **Explain the importance of Business studies in society.**

i) **Business:** Any activity that is carried out by an individual or an organization concerning provision of goods and services with a view to making profit.

ii) **Business studies:** Is the study/examination of the business activities in society. These activities are related to the production of goods and provision of services.
-It can also be defined as the study of activities that are carried out in and around production, distribution and consumption of goods and services.

iii) Goods: These are items that are tangible .i.e. they can be touched and felt.

Activity 1: The students to list items in the classroom that can be touched and felt

-Furniture, buildings, books, vehicles e.t.c

iv) Services: These are efforts or acts/actions or activities that may be sold and are intangible (cannot be touched nor felt).

Activity 2: The students to list items that money is paid to get but they cannot touch.

v) Production: Refers to the creation of goods and services or increasing their usefulness through activities such as transporting them to where they are required. People who are involved in production of goods and services are referred to as **producers.**

Activity 3: Using the lists of goods and services above, the students to name those involved in their production.

vi) Distribution: Refers to the movement of goods and services from producers to the users. Some activities that take place as goods and services all moved include transportation, storage, insurance, communication, advertising.e.t.c

vii) Consumption: Refers to the act of using the goods or services produced consumption is the ultimate goal of production. The persons who uses a good or a service is referred to as a **consumer.**

Activity 4: The students to list the consumers of the goods and services listed in activity (1) and (2) above.

Business studies as a subject is composed of topics drawn from various disciplines such as:

a. Commerce
b. Accounting
c. Economics
d. Office practice
e. Entrepreneurship

Commerce

This is the study of trade and aids to trade. Trade refers to the exchange of goods and services for other goods and services or money.

Aids to trade are human activities (services) that assist trade to take place.

Economics

This is the study of how human beings strive to satisfy their endless wants using the available scarce resources.

Accounting

This refers to a systematic way of recording business activities which all used for decision making.

Office practice

This refers to all activities that are carried out in an office e.g. communication, filling, clerical work, reproduction of documents e.t.c

Entrepreneurship

This is the study of activities involved in the process of identifying a business opportunity and acquiring the necessary resources to start and run a business. The person who carries out these activities is refered to as an **entrepreneur.**

Importance of Business studies in society

Business studies is meant to prepare learners to function as informed consumers, producers and workers in the society.

Some of the benefits of learning business studies include:

i. Assists the learners/members of the society to acquire knowledge and awareness of business terminologies which are necessary when discussing business issues such as profit and loss.

ii. Assists the individuals in appreciating the role of business in society/in provision of goods and services.

iii. It enables the learners to acquire basic knowledge, skills and attitudes necessary for the development of self and the nation by starting and operating business.

iv. Equips the members of society with knowledge and skills necessary to start and run a business comfortably.
v. Makes the members of society to appreciate the need for good business management practices
vi. Assists individual to acquire self-discipline and positive attitude towards work
vii. Equips individual with abilities to promote co-operation in society through trade
viii. Enables the individual to understand the role of government in business activities
ix. Equips individuals with abilities to understand the role of communication and information technology in modern business management
x. Helps the individuals to develop positive attitudes towards the environment
xi. Equips the individual with knowledge and skills required to evaluate business performance
xii. It helps individual to develop various intellectual abilities such as inquiry, critical thinking, analysis, interpretation, rational judgement, innovation and creativity.
xiii. It enables learners to acquire skills for wise buying and selling.
xiv. It creates a firm foundation for further education and training in business and other related fields.
xv. It enables one to understand and appreciate the basic economic issues that affect the society such as increase in prices of goods and services.

BUSINESS AND ITS ENVIRONMENT

By the end of the topic, the learner should be able to:

a. Explain the meaning and purpose of a business
b. Identify various business activities
c. Identify various types of business environments
d. Explain how the various business environments influence a business.

Meaning of a business

This refers to any activity carried out by an individual or by an organization with the aim of making a profit.

Profit is what the business earns above what it spends in providing goods and services to the people who need them.

The term **business** also refers to firms or organizations that provide goods and services to make a profit.

Purpose of business (Reasons for the existence of businesses)

Business is important in any society because it is not possible for people to provide themselves with all what they need without direct or indirect aid from others. Some of the main reasons why businesses exist are:

i) **To provide goods and services-**Businesses exist to satisfy the needs and wants of buyers by providing them with goods and services. Buyers include individual consumers, other businesses and the government.

ii) **To create employment-**Businesses provide job opportunities through which members of society can earn money, which can be used to buy goods and services for the satisfaction of their needs.

iii) **To earn profit-**Profit is the primary goal of carrying out business operations. It is earned by the people who put their resources and effort in business

iv) **As an outlet of new innovation-**Some businesses provide unique goods and services which may not be existing in society e.g. plastic fencing poles that are now replacing wooden poles.

v) **To be as own boss-**Some people run businesses so as to be in full control of the operations and make all the decisions regarding the business without need of reference to people.

vi) **To utilize extra resources-**Some people go into business to make use of money or property which is not being put to profitably use at a given time.

vii) **To offer special services-**Some businesses provide services that raise the living standard of people e.g. government enterprises that provide public utilities such as health care and water.

viii) **To utilize spare time-**Some people run businesses in order to make use of extra time at their disposal and in the process make some extra money. A large number of formally employed people have small business which they run during their free time in order to earn more money.

NB: Whatever purpose a business fulfills, it has to earn a reasonable return on the invested money to survive.

TYPES OF BUSINESS ACTIVITIES

People carry out different business activities in order to earn income. **Business activities** are activities which involve the provision of goods or services with an aim of earning a profit.

Activities done without the intention of making profit are referred to as **non-business activities.** Business activities may be grouped into the following seven categories:

a) Extraction

This involves obtaining goods from their natural setting e.g. mining, farming, lumbering, fishing, quarrying e.t.c

b) **Processing-**This involves the conversion of raw materials into more useful products without combining it with other goods. Examples here include milling/grinding flour, refining oil, tanning of skins and hides, conversion of iron into steel e.t.c
c) **Manufacturing-**This involves combining different raw materials to come up with one final product. Such activities include bread baking, making a table e.t.c
d) **Construction-**This involves building of structures such as bridges,ships,aeroplanes,houses,roads,railways e.t.c
e) **Distribution of goods-**This refers to the activities involved in moving goods from where they are produced to where they are needed. People who carry out distribution are called **distributors**. Examples of distributors are **wholesalers and retailers.**
f) **Trade-**Activities in this category involve the buying and selling of goods with a view of making a profit. People involved in trade are called **traders.**
g) **Provisions of services-Activities in this category involve** human acts which could be mental or physical. These include activities such as hair-cutting, hair styling, car-washing, nursing, teaching, driving, and entertaining e.t.c.

NOTE: Students to give examples of activities they pay money for which are not goods.

BUSINESS ENVIRONMENTS AND THEIR EFFECTS ON THE BUSINESS

Business environment refers to conditions or factors which surround and affect business operations. These factors could be within the business (**internal environment)** or from outside the business (**external environment).**

These factors affect the decisions, strategies, processes and overall performance of the business.

Activity: Discuss some factors that have a strong influence on businesses within the immediate environment.

Internal Business Environment

This comprises factors that are within the business unit itself. These factors can be controlled fully by the business. Internal environmental conditions could be either strength or weaknesses. The strengths tend to improve the performance of the firm while weaknesses tend to affect the operations of the business negatively.

Internal environment is also referred to as: **micro-environment.** Micro environmental factors include:

1) **Objectives of the business**

These ate targets or goals that are set by the owners or managers of a business to be achieved. The objectives will influence the following;

a. **The strategies of a business-**This is a plan of action which a business intends to follow so as to achieve its goals.
b. **The resources required-**By studying the objectives set; a business can determine the resources required for its effective operation. These resources may be physical,financial,human e.t.c

2) Management policies and style

The management refers to the people who are responsible for directing the day-to-day operations of a business. It is the management that sets the objectives and policies of an organization.

A policy is a course of action of action for achieving set objectives, which is adopted by a business.(it is the established way of doing things in a business.

a) The policies of a business-The policies adopted by a business may boost or hinder its growth and survival e.g. the management may decide that workers will not be allowed to join trade unions. This may make the workers feel locked out of the decision-making process, resulting in tension. This tension may interfere with the performance of the employees and result in inefficiency.

b) The activities of a business - Management policies will determine the activities of a business i.e. the goods and services provided, location of business e.t.c.

c) Management style-This refers to how managers conduct the daily operations of the business. This will determine how workers relate with their managers. The style adopted by the management will influence the workers performance positively or negatively thus affecting the overall performance of the business.

3) Business structure

This is the formal arrangement of activities that are carried out at various levels of the organization so that objectives of the business can be achieved. Duties and responsibilities of all the workers are defined in the business structure. Their interrelationships are also defined.

A well laid out business structure is likely to lead to success of the business since:

i. Each of the employees know what is expected from them
ii. There will be no conflicts or confusion among the workers
iii. Team work is enhanced
iv. Ensures proper control which is turn promotes efficiency.

A poor business structure leads to business failure.

4) Business Resources

A resource refers to anything that can be used to achieve an objective. These resources include;

a. **Human resource-**Human resource (personnel) refers to the employees working in an organization. Employees will only be useful if they have the necessary knowledge and skills to successfully carry out the assigned tasks. It is therefore necessary for the management to match the correct people with the correct job activities; this will ensure success for the business.
b. **Financial resource-**Money is required in order to start and operate a business.A business with adequate finances that are property allocated to various activities and also monitored is likely to do better than the one lacking such aspects.
c. **Physical resources-**These include tangible facilities which belong to the business such as buildings, machinery, furniture and stock. Availability of such facilities enables the business to operate.
d. **Technology-**This refers to skills and methods used in production. Use of modern technology enhances production of goods and services.

5.) Research and development

Research and development is an important factor for the success of a business. Research generates new ideas, skills and better methods of doing things.

A business has to do market and consumer research regularly to find out how the consumers perceive its goods and services, and how they can improve in order to outdo their competitors.
Research also assists in the development of new and unique goods and services that may attract new consumers or maintain the loyalty of the existing ones.

6.) Business culture

This is a combination of employees expectations, beliefs and values within the business. It is normally passed on from one generation of employees to the next. Employees acquire norms and code of conduct that is acceptable to all from the general manager down to the sweeper. A business that has a culture of involving employees in decision-making may perform better than one that does not involve its employees.

7. Owners

The owners of the business provide finances/resources to start and run the business. They also make decisions concerning operations of the business. Appropriate decisions are likely to lead to well being of the business while poor decisions may adversely affect the business.

External Business Environment

This environment consists of all the factors which affect the operations of the business from the outside. Some of these factors offer business opportunities while others may create problems (threats).
Business have limited or no control over external environmental factors and should therefore try to do adjust in order to cope with them.
External environmental factors are also referred to as **macro-environment i.e.** environment that is in large scale.
External business environment can further be sub-divided into **operating environment** and **remote environment,** depending on whether the factors can be influenced to some extent or not. Those environments that can be influenced are referred to as **operating environment** while those that cannot be influenced are known as **remote environment.**

ENTREPRENEURSHIP

By the end of the topic, the learner should be able to:

i. Explain the meaning of entrepreneurship
ii. Discuss the importance of entrepreneurship to an economy
iii. Describe characteristics of an entrepreneur
iv. Generate business ideas

v. Identify a business opportunity
vi. Evaluate a business opportunity
vii. Explain the need for a business plan
viii. Discuss factors that influence entrepreneurship practices in Kenya
ix. Discuss the causes of business success
x. Recognize the need for ethical practices in business

Meaning of entrepreneurship

This is the process of identifying business opportunities and gathering the necessary resources to start and run a business.

An entrepreneur who identifies business opportunities and gets the necessary resources in order to start and run a business. The entrepreneur therefore creates new businesses or transform the existing ones in the face of risks and uncertainties in order to make profits.

An entrepreneur is therefore a business owner; he starts and organizes the business (the factors of production in appropriate combination**)**

Importance of entrepreneurship to an economy

i. **Creation of employment-**Through entrepreneurship, jobs are created which help in absorbing people who would otherwise have been jobless e.g. people employed in the jua kali sector**.**
ii. **Formation of capital-**Profit earned by entrepreneurs may be used to expand the business or even to start other businesses. Wages and salaries paid to the employees is a source of capital to them.
iii. **Raising standards of living-**Entrepreneurs pay wages and salaries to their employees which enable them to acquire goods and services they need to live comfortable lives. Entrepreneurs also provide a wide variety of goods and services to consumers hence leading to improved living standards.
iv. **Encourages the use of local resources-**Entrepreneurship makes it possible to use/exploit local resources. Idle resources such as scrap metal may be used to make jikos**.**
v. **Improving infrastructure-**The existence of businesses in the economy makes the government establish or improve infrastructure such as roads, communication facilities and water. At other times, entrepreneurs may combine forces to improve infrastructure in their area of operation**.**
vi. **Savings on imports-**Local entrepreneurs are able to produce goods and services that are a substitute to imports. This helps the country to reduce the amount of money required to pay for such imports.

vii. **Reducing foreign dominance of the economy-**Participation of local entrepreneurs in various business activities helps in reducing investments by foreigners in the particular area**.**

viii. **Promotion of technology/promotion of innovation, research and development-**Entrepreneurs are creative and they come up with new and better ways of accomplishing tasks. Most of the inventions and innovations in our society have been developed by entrepreneurs**.**

ix. **Promotion of entrepreneurial culture/helps in the creation of role models-** Successful entrepreneurs/entrepreneurial ventures encourage other members of society to initiate their own businesses and hence act as role models in the business world.

x. **It contributes to government revenue-**Taxes and fees paid by entrepreneurial ventures constitute part of government revenue / income that helps it to facilitate its operations**.**

xi. **It promotes economic growth-**Entrepreneurs produce goods and services. This increases the volume of goods and services in the economy leading to expansion of the economy**.**

xii. **It may promote self-actualization and esteem-**By initiating busine-sses in which they are their own bosses, entrepreneurs pride is boosted and this may promote the overall productivity of the economy.

Characteristics of an entrepreneur

A good entrepreneur should have the following characteristics**:**

a) **Desire to achieve-**An entrepreneur is a person who wishes to excel and has the drive to succeed while competing with others. He/she always tries to accomplish something new.

b) Ability to solve problems-An entrepreneur is expected to struggle with determination to get solutions even under difficult situation so that the business can succeed**.**

c) Risk taker-Entrepreneurs take viable business ventures even when they are not sure of the returns. They assess situations and take calculated risks.

d) Initiative –An entrepreneur should be aggressive in implementing ideas well ahead of other businesses so that he/she can be ahead of them**.**

e)Time consciousness-An entrepreneur should be able to use time wisely and avoid wasting it. A wise and quickly implemented decision may mean success in business whereas time lost may mean failure**.**

f) **Creativity and innovation-**An entrepreneur should be able to generate new ideas as well as think of the best ways of putting them into practice.
g) **Independence and self confidence-**Entrepreneurs are their own bosses and should believe in their ability to do things and succeed.
h) **Persistence and patience-**An entrepreneur should not give up when challenges arise. Sometimes, he/she takes time and make a repeated action or adopts a different course of action in order to overcome such challenges so as to reach the target
i) **Decisive-**Entrepreneurs have strong problem, solving and decision making skills. The business environment is such that decision has to be made quickly to respond to any situation that may arise.
j) **Persuasive-**Convincing people to believe in their ideas and buy their products keeps entrepreneurs in business
k) **Goal-oriented-**Entrepreneurs are achievers who work towards set goals. They continually monitor progress to determine whether they are achieving the goals they have set and where improvements need to be made.
l) **Seek information-**Entrepreneurs use various methods to get the relevant information that is necessary for the success of the business.
m) **Concern for high quality products-**An entrepreneur should strive to cope or beat the existing standards of quality. This will enable him/her succeed in a competitive market.
n) **Commitment to work-**An entrepreneur places priority on getting tasks accomplished. To achieve this he/she may make extra ordinary personal sacrifice e.g. working until very late.
o) **Concern for customer satisfaction-**An entrepreneur should ensure that customers are satisfied so as to continue being/remain loyal to the business.
p) **Desire to feedback-**An entrepreneur should be interested in knowing how the business is performing.

Generating Business Ideas

For an entrepreneur, the first step in starting a business begins with an idea (business idea).

Business ideas are all about thoughts on possible businesses an entrepreneur can start or improve. It indicates among other things;

a) The products to produce/sell
b) Who the business will sell to (market)
c) Where the business will be located

d) How the will be run (management)
e) Why the business is needed (objectives)

Sources of Business Ideas

i. **Newspapers-**Local newspapers like the Daily Nation, East African e.t.c especially in the business and advertising sections have a lot of information about commercial opportunities as well as personal services.

ii. **Shows and exhibition-**Visiting shows and exhibitions organized by manufactures and distributors and asking questions from the sales **persons.** Entrepreneurs can also get business ideas from products displayed in such shows.

iii. Magazines and journals-Reading magazines and journals with business information may equip an entrepreneur with new business ideas.

iv. Hobbies –These are activities pursued for pleasure but they can also serve as a source of business ideas e.g. photography.

v. Vocational training and experience-A business idea may be developed from one's own area of training or experience e.g. a teacher may use ideas from his/her training to start a private school.

vi. Surveys and market research-This involves conducting an investigation to gather information from consumers on what products they require.

vii. Recycling/using waste products-Some waste products could be converted into useful products e.g. scrap metal for making jikos,old tyres for making sandals e.t.c

viii. Listening to what people say-By listening keenly to what people say, one can identify unsatisfied needs e.g. complaints about goods and services in the market. These complaints may form a basis of a business idea for an entrepreneur.

ix. Identifying a market gap (niche)-An entrepreneur may try to identify/spot the needs of consumers which are not being met by the existing goods and services.

x. Brain storming-An entrepreneur can engage other people in a discussion on how best to develop businesses.

xi. Listing attributes of a product-By listing the attributes of a product that is already existing in the market, one can find new use for the product.

xii. Copying/improving an existing business-This involves identifying the weaknesses of a business and trying to come up with solutions.

Business Opportunity

A good business plan is not necessarily a business opportunity. A business idea becomes a business opportunity if it is viable i.e. it can be developed into a successful/profitable business enterprise

A business opportunity is a favourable chance that an entrepreneur accepts for investment. It exists where there is a gap to be filled in the needs of the market. Examples of such gaps include:

a) **In availability of products-**This is where goods and services needed by the consumers are not available at all in the market.
b) **Poor quality products-**A business opportunity exists if one offers better quality goods and services than those of the existing businesses.
c) **Insufficient quantities-**This is where the goods supplied are not enough to meet the demand/need of the consumers.
d) **Unaffordable prices-**A business opportunity exists where one would charge affordable prices.
e) **Poor services-**A business opportunity exists where customers are not served well.

Evaluating a business opportunity

This means assessing whether the identified opportunity is viable or not. This helps in arriving at the best decision concerning the business idea to implement

Evaluation should be done carefully, systematically and without emotions. Evaluation is necessary even where there is only one business idea. This will help in avoiding starting a business that cannot succeed.

Factors to consider when evaluating a business opportunity

The following are the factors to consider when evaluating a business opportunity.

a. **Personal consideration-**These are the abilities and expectations of an entrepreneur. They include the following;
   - **Objectives-**The entrepreneur should evaluate the business idea to find out whether it is in line with his/her objectives.
   - **Skills-**Where a business requires certain specialized skills and those skills are lacking the idea may be dropped.
   - **Commitments-**Where the business is likely to interfere with the entrepreneurs other commitments it may fail.
   - **Interest-**It is necessary to check whether the intended business will interest the entrepreneur or not. If the entrepreneur will not enjoy running the business, the idea should be dropped.

b. **Business consideration-**These are external factors that are likely to affect the operations of the business and they include**;**

i. **Availability of market for the product-**An entrepreneur should assess the availability of customers before starting a business. Customers exist where there is a gap/nich in the market.

ii. **Technology-**The business should be evaluated in terms of whether there is an appropriate technology that can be used in production. Factors to be looked into include;
   a. -Appropriateness of the technology
   b. -The cost of the technology
   c. -The possibility of the business suffering in case the technology becomes outdated/obsolete.

iii. **Availability of raw materials and other resources-**The raw materials and resources required should be within the reach and affordable to the entrepreneur.

iv. **Government policy-**An entrepreneur should consider the requirements of the government before starting a business e.g. the government may require certain businesses to be located in certain areas only.

v. **Amount of capital required-**The capital required to run and maintain the business should be considered i.e the source of capital.

vi. **Profitability of the business-**Within a certain duration of time**.**

vii. **The break-even period-**How long the business can take to support itself**.**

viii. **Possibility of expansion i.e**. the potential for growth of the business.

ix. Impact of the business operations on the environments; some businesses lead to environmental degradation and should be located in appropriate places/effect on community and environmental health**.**

x. **Security-Availability** of security should be considered**.**

xi. **Level of competition-**This will help determine whether the business will survive or not.

xii. **The risks that the business will face.**

BUSINESS PLAN

This is a written document that highlights the objectives of the business and steps to be followed in order to achieve these objectives. It indicates where the business is, where it wants to move to, how and when**.**

Contents of a good business plan

1. Name of the business

2. The product to be sold or produced
3. Personnel to manage the business
4. Amount of finance and other resources required
5. The market to be served (customers)
6. Types of employees required
7. Projection (level of achievement in future in terms of profit)
8. Summary of the plan.

Need for the business plan

i. A business plan is necessary to an entrepreneur for the following reasons:

ii. Avoiding mistakes-in the process of drawing a plan; mistakes that would take place in the business are identified and corrected in the plan. This helps in avoiding the occurrence of such mistakes in the business.

iii. Identifying strength and weaknesses-A business plan helps in identifying strengths or weaknesses and where weaknesses are detected, remedial actions may be taken early enough.

iv. Requirement by financiers-Financial institutions such as banks may require a business plan before they can accept to finance the activities of the business.

v. Allocation of resources-It helps to determine the resources required and plan on how and where to use them. This ensures that resources are neither underutilized nor used for the wrong purpose.

vi. Facilitates business evaluation-A business plan helps an entrepreneur to assess the progress of the business and any deviation (difference) from the intended plan can be corrected in good time.

vii. It helps an entrepreneur outline competition-It helps the entrepreneur to be fully aware of the market she or he plans to operate in, understand important trends and know who her/his competitors are and their strengths and weaknesses. This information aids the entrepreneur to develop products that are better than those of the competitors.

viii. A motivating factor-A business plan is communicated to all employees in the business. This makes them aware of the direction to be taken by the business. This motivates them to work towards that direction.

ix. Adaptability-Normally, not all events occur as predicted in the business plan. However, a well drawn business plan should give room to accommodate any changes that might occur in the future.

x. Tool for control-Planning involves setting of standards against which performances can be assessed. In case of deviation corrective measures can be taken.

Factors that influence entrepreneurship practices

There are many conditions or factors which may encourage or discourage entrepreneurship. Some of these factors are:

i. **Government policy-**Some government policies are favourable to the operations of the business and thus encourage people to go into business while other policies may be unfavourable and will discourage people from going into business. E.g. higher taxes are unfavourable hence discouraging.

ii. **Infrastructure-**infrastructure includes transport and communication networks, water, security e.t.c. Availability of good infrastructure in an area tends to encourage people to set up businesses while poor infrastructure tends to discourage them

iii. **Levels of education and skills-**Relevant and appropriate knowledge and skills are necessary if the business has to succeed. These are acquired through education, training or experience.

iv. **Availability of markets-**Adequate markets encourages existing entrepreneurs to continue producing and also encourage/attract new ones to venture into business.

v. **Availability of resources-**Appropriate resources are necessary for starting and smooth running of a business. These resources include physical, human, capital and technology**.**

vi. **Cultural and social beliefs and attitudes-**These are norms, values and beliefs of a given community. Culture helps determine the kind of goods and services that people consume. this in turn, dictates the type of businesses to be established in such communities.e.g Muslims do not take pork therefore businesses selling pork will not do well in such communities**.**

vii. **Competition-**Businesses will do well if they are able to complete favourably. Others will avoid competition by establishing businesses where there is no competition**.**

viii. **Political stability-**political stability gives conducive atmosphere for businesses to start and thrive on the other hands, where there is no political instability, businesses may not do well and entrepreneurs may close down businesses or new ones may not come up**.**

ix. **Natural factors-**natural factors such as rainfall, temperatures, earthquakes, pests, drought e.t.c. may influence the type of businesses that are carried out in an area, especially agricultural businesses**.**

x. **Presence of role models in the society-**The presence of successful entrepreneurs acts as an encouragement to aspiring entrepreneurs**.**

Causes of Business success

A business is considered as being successful if it makes consistent profit and experiences progressive growth in the scale of its operations.

Some of the factors that lead to the success of business may include:

(i) **Right choice of business-**A good business opportunity needs to be evaluated on the basis of ability to capture many customers, make reasonable profit for the owner(s) and provide an opportunity for growth. Making the right choice of a business or product ultimately contributes to the success of a business.

(ii) Proper managerial skills-An entrepreneur should be able to carry out management roles effectively. A good manager will carry out roles such as;

a) **Hiring staff-**The process of acquiring new employees to take up new positions or to replace employees who have left the business.

b) Assigning duties-Allocating employees duties according to their qualifications.

c) Supervising-Ensuring that employees carry out tasks that are assigned to them

d) Training-Enabling employees to acquire knowledge and skills necessary to perform duties assigned to them.

e) Motivating-giving employees inducement to perform their duties.

(iii) Proper location/availability of customers-The business should be situated in a place convenient for its operations e.g. where customers are easily available**.**

(iv) **Adequate finance/capital-**Money is needed to acquire other resources that are required by the business. A business that has adequate capital is likely to do well as it is able to finance all its operations.

(v) **Lack of competition-**Most businesses are put out of operation by stiff competition. Therefore, a business operating in an area where there is little or no competition is likely to succeed.

(vi) Commitment to business

(vii) **Proper financial management-**Proper management of finances is necessary for the success of the business. It ensures that money is available and is used for the intended purpose.

Management of finances includes**:**

a) **Acquisition of finances-**This involves raising of the required amounts of money. This can be done through a variety of ways such as loans from financial institutions and owner's contributions**.**

b) **Managing cash-**This ensures that the available money is only used for the activities that are beneficial to the well being of the business**.**

c) **Proper record keeping-**This involves having a record of finances raised and how they are used.

(viii) Proper debt management-Care should be taken to ensure that credit is only extended to credit worthy customers (credit worthy customers are those whose chances of paying are high).Debt collection should also be carefully planned to ensure that they are collected when due.

(ix) **Good public relations-**This involves creating and improving a good relationship between the business and other people. Good relations are necessary for attracting and retention of customers.

(x) **Being creative and innovative-**This involves finding new uses of a product, new channels of communication and new ways of doing things. This enables the entrepreneur to be ahead of others.

(xi) **Proper market research-**The business environment usually changes at a high rate. This makes it necessary for an entrepreneur to study his/her customer's preferences, tastes, spending patterns, income levels, competitions, and behavior and substitute products.

(xii) **Good/proper time management-**Time management is the ability to carry out planned activities within the allocated period.

(xiii) **Proper skills and attitudes of employees-**Employing qualified staff results in work being done in a professional manner. This enhances the performance of the business.

(xiv)**Proper pricing of goods and services-**Pricing should be done appropriately. If the prices for the products are too high, the business will lose customers. Very low prices may attract customers but kill the business. It is therefore important to create a balance between price to charge and the profit margin to realize.

ETHICAL ISSUES IN BUSINESS

Ethics -refers to a set of values, principles and rules of acceptable behavior which influence how individuals, groups of people and the society in general behave**.**

Business ethics-refers to acceptable behavior that should be displayed by business people. Business ethics helps businesses in deciding what actions are right or wrong depending on circumstances**.**

Ethical issues-are the moral concerns that arise in the course of carrying out business.

Need for Ethical issues in Business

The need for ethical issues in business includes the following;

i. **Ensures no discrimination in business-**Business ethics ensures there is no discrimination in areas such as recruitment (hiring), promotion, training, remuneration and assignment of duties. These processes should be objective and based on merit, qualification, experience and ability.

-It ensures that everybody is given an equal opportunity (has equal chance) and is not discriminated against because of their sex, religion, ethnicity, social background e.t.c.

ii. **Ensures protection of the environment/Helps in avoiding environmental pollution-**Business ethics prohibits business units from carrying out activities that may cause pollution and degradation of the environment. Environmental degradation may be caused by human activities such as logging and unplanned cultivation. Pollution may be caused by activities such as:

a) Damping effluents from production units into water masses thereby causing water pollution. Water pollution is disastrous to human health and also to aquatic animals.

b) Emitting carbon dioxide and other gases into the atmosphere causing air pollution

c) Damping of waste material on the land surface causing solid waste pollution This creates terrible sites to watch and also breeding places for dangerous insects such as flies**.**

iii. **Ensures fair play in competition-**Ethics ensures that businesses do not engage in unfair practices while competing with others. These practices may include:

- ♣ Destroying a competitor’s product or promotional tools such as billboards
- ♣ Buying and destroying competitor’s products before they reach the market

- ♣ Giving false information about a competitor's product
- ♣ Helps in avoiding environmental degradation-Ethics ensures that the physical environment is not degraded through business activities. Such activities may include:
  - ✈ Deforestation through logging
  - ✈ Unplanned cultivation
  - ✈ Helps in avoiding environmental pollution-Environmental pollution may be caused by activities such as**:**
- ▪ Releasing carbon dioxide and other gases into the atmosphere thereby causing air pollution
- ▪ Channeling effluents from factories to water masses thereby causing water pollution. Such pollution can be harmful to human health and aquatic animals.
- ▪ Disposing of waste material such as paper and scrap metal on the land surface thereby causing solid waste pollution.
- ▪ Producing too loud noise which might be harmful to human beings hearings
- ▪ Emitting too strong light that may be harmful to our eyesight

iv. **Ensures rights of employees are upheld-**Ethics ensures that the employer does not violate the rights of employees especially as laid out in their terms and conditions of employment. Such rights include payment of dues in time**.**

v. **Eliminates use of unfair means of achieving business objectives-**Ethics ensures that the business operations are carried out in a professional way e.g. it is unethical to give or receive a bribe in order to win a business contract. Similarly, it is not ethical to hoard goods awaiting their prices to go up.

vi. **Avoids consumer exploitation-**Ethics ensures that consumers are not exploited by the business. Consumers may be exploited through practices such as:

a) Overcharging them
b) False advertisement
c) Selling poor quality goods and services
d) Selling wrong quantities
e) Selling harmful commodities

THE OFFICE

1. Define the term an office

An office is a building, room or a place set aside for administrative, communication or clerical work of an organization.

2. **Outline the functions of an office**

- Receiving of information in various forms such as calls, personal visits or documents such as letters
- Recording and sorting of information received.
- Storing of information for future reference
- Distribution of information within and outside the organization to the various sections, departments or personnel for necessary action
- Reproduction or making of copies of document by use of various methods, such as photocopying, duplicating and carbon copying
- Protecting or safeguarding the organization's property

3. **State the various reprographic techniques that can be carried out in an office**

- Carbon copying
- Stencil duplication
- Photocopying
- Spirit duplicating
- Ink duplicating

4. **Your school would wish to use photocopying as a method of making copies of exams. State the advantages and disadvantages of using this method**

Advantages of photocopying

- It is a fast method of reprography
- It is a simple method and require little training of the users
- One will obtain the exact copies of the original document
- The method is not expensive if the copies to be made are few
- It is environmental friendly

Disadvantages of photocopying

- The copies that are made fade in the cause of time
- Photocopying can be costly if the copies being made are many
- The employees may misuse the method due to its convenience
- Photocopying machine requires electricity which may be expensive
- Few colours in a document may be obtained by use of this method

5. **State the types of office layout**

- Enclosed office layout

- Open office layout
- Landscape office layout

6. **Suggest reasons why an organization should use landscape office layout**
    - It creates a relaxed atmosphere for the workers
    - It is more attractive and beautiful
    - The image of the organization/firm is enhanced
    - It promotes good working relations and co-operation among the workers
    - Equipment and office facilities may be shared among the employees
    - The flowers or plants used break the monotony of open spaces
7. **State ways in which landscape office layout can be created**
    - By placing plants/flowers in an office
    - By having paintings of animals or plants on the wall
    - By placing fish aquariums in an office
    - Through shaping of office furniture in form of animals, birds and concrete shapes
    - Creating miniature physical features such as waterfalls and mountains in the office
8. **State why you will advice an office manager to use an open office layout instead of an enclosed office layout**
    - In an open office layout it is easier to supervise workers than in an enclosed office
    - An open office discourages absenteeism which may be common in an enclosed office
    - It is cheaper to maintain an open office than an enclosed office
    - Equipment, facilities and machines can be shared in an open office which may not be possible in an enclosed office
    - Floor space is saved in an open office than in an enclosed office
    - There is enhanced attraction and framework in open office
    - It is cheaper to light an open office than an enclosed office
    - It is easy to locate employees in an open office
9. **State the advantages of enclosed office layout**
    - It is ideal for work that is confidential in nature
    - It is more secure than an open office layout

- The office is ideal where high level of concentration is required
- It is prestigious for the occupant of such an office as they are recognized
- The worker is not disrupted by noise or movement of other employees

10. **Highlight the disadvantages of an open office layout**
    - There is a lot of noise and disruption from other employees
    - Contagious diseases may spread easily among the employees
    - The top ranked workers may feel belittled being placed among other workers
    - It is not very conducive for work that is confidential or secretive in nature
    - Property within the office is not very safe
    - Due to use by many people the office may not be very tidy
11. **Outline the factors that have to be taken into consideration when deciding on a type of office layout to use**
    - The cost of construction and maintenance
    - The number of staff to be accommodated in the office
    - The climatic condition of the area
    - Government directive if any
    - The nature of work to be carried out in that particular office
    - The nature and rank of staff to be accommodated in that particular office
    - The floor space available for the office
    - The need to maintain a good work flow among the workers
12. **State the disadvantages of an enclosed office layout**
    - It can encourage absenteeism
    - It is not easy to supervise the employees
    - It is expensive to construct and maintain
    - Facilities and office equipment cannot be shared among the workers
    - Workers can misuse office equipment such as the telephone
    - The office layout takes up more space
    - A lot of time is wasted when moving from one office to another
    - It may promote individualism as some employees are isolated from others

13. **Enumerate the factors you will advice Mr.Mwajuma to consider when buying office machines for his company**
    - The effect of the machine on the workers
    - The cost of the machine or equipment
    - The suitability of the machine for the task that is intended for
    - The availability of after sales services provide by the seller
    - Presence of office staff with the skills required to operate the machine
    - One has to consider space or room to keep the machine or equipment
    - The likelihood of the machine being outdated absolute or out of date
    - One has to consider whether that machine can adopt to future changes

14. **State the best type of machine one would use to perform the following tasks:**

	Functions	**Type of machine**
(a)	To create postage impressions on envelopes	Franking machine
(b)	To fold documents put them in envelope and seal them	Composite machine
(c)	To destroy sensitive but unwanted documents	Paper shredder
(d)	To store large volumes of data	Computer
(e)	To run 300 copies of an exam for students in a school	Printing machine
(f)	To make exam copies of a certain original document	Photocopier
(g)	To trim papers to the required sizes	Guillotine machine

15. Highlight the disadvantages of using office machine

- They can be very costly/expensive to buy and operate
- They occupy space which can be used for other tasks
- Machines may replace labour causing unemployment
- Some may require electricity which may be expensive
- **Any breakdown of the machine may delay work**
- The machine may become obsolete(out of date)
- They are subject to wear and tear(depreciation)
- Some may require specialized or trained personnel to operate

16. State the three categories of office staff

- Managerial staff
- Junior staff
- Subordinate staff

17. Outline the advantages of using office machines

- Machines are labour saving and can be cost effective in the long run
- The output of machines is of good quality
- They can be used to minimize fraud or theft
- Machines can be very fast saving on time
- They can produce uniform work
- Machines can be very accurate as compared to human labour
- Some machines can be adapted to multiple task such as a computer

18. Highlight the role played by a good filing system in an organization

- Filing provides security/safety of documents
- It facilitates easy retrieval or access of documents
- Good filing enhances orderliness and tidiness of an office
- It guarantees confidentiality of information since it cannot get to the wrong hands
- Good filing promotes good communication
- Filing guarantees that documents are protected from damage
- Good filing guarantees good future reference in case the information is required

19. **Outline the various categories of office equipment giving examples in each case**

	Category	**Example**
(a)	Typing office machine	(i)Typewriter

		(ii)Dictating machine
(b)	Mailing office machine	(i)Franking machine (ii)Composite machine (iii)Folding machine
(c)	Communication office machine	(i)Telephone (ii)Telex (iii)Cell phone
(d)	Duplicating/reprographic machine	(i)Photocopier (ii)Duplicator (iii)Printing machine

20. **Distinguish between centralized and decentralized filing system**

In centralized system one department is given the responsibility of keeping and managing all the files in the whole organization. This department is referred to as a registry.Decentralised filing

21. **State the characteristics of a good office worker with office etiquette**

- Courtesy i.e dealing with people politely
- Punctuality-keeping time at all times
- Honesty-telling the truth
- Co-operation with other employees
- Tactical or being diplomatic when dealing with others
- Good judgement and coming up with the best decision
- Neatness and orderliness in terms of work arrangement
- Dedication or loyalty towards the organization

22. **Highlight personal attributes that Bakari should have as an office worker**

- He should be presentable
- He should maintain high standard of morality
- He should have a good sitting posture
- He should maintain high standards of hygiene
- He should be neat and accurate in the organization of his work
- He should maintain good health and physical fitness through having proper diet and exercising

23. **Define the roles played by the following office workers**

(a)Departmental manager

- Maintaining the books of accounts
- He/she may prepare the budget for his/her department
- Submitting reports to the senior manager about performance of the department
- Monitoring and supervising workers in the department
- Assigning roles and duties to employees in the department

(b)Personal secretary

- Receiving and filing information
- Booking appointments for the boss
- Taking and writing minutes during meetings
- He/she can maintain small amount of money for making small or petty purchases in the office
- He/she receives and makes calls for his seniors

24. Highlight trends in office management

- Use of modern computers enhances efficiency
- Introduction of customer care desks or offices to address customers concerns
- Movement toward open and landscape office plan to enhance more interaction among the workers
- Outsourcing for some task that can be done by other firms instead of employing workers to do the same e.g. having external cleaners or security
- Use of the cell phone for communication

25. E-Commerce is a recent trend in business. Outline the advantages of using this method in carrying out business activities.

Advantages

- One can have a wide variety of goods and services from all over the world
- It reduces the cost of travelling to the market or in search of product
- It is fast as deals can be made within a short period of time
- A seller can advertise goods to many consumers over a wide area
- Paper work and the many document used on other trade are removed or reduced as selling and buying is on-line
- A lot of information about the market can be accessed on the internet

HOME TRADE

TOPIC OBJECTIVES: By the end of the topic, the learners should be able to:

i. Explain the meaning and importance of trade.
ii. Classify trade
iii. Explain the forms of home trade
iv. Discuss the types and functions of retailers
v. Discuss the types and functions of wholesalers
vi. Describe the documents used in home trade and the circumstances under which they all used
vii. Explain the means of payment used in home trade and the circumstances under which they are used
viii. Explain the terms of payment used in home trade and circumstances in which they are used.

MEANING OF TRADE

This is the buying and selling of goods and services with the aim of making a profit.

Importance of trade:

Trade plays a vital role in any economy. The various roles played by trade in the economy include:

i. Helps people to acquire what they cannot produce
ii. Avails a variety of goods and services thereby improving the peoples living standards
iii. Creates an outlet for goods thereby enabling the producers to dispose of their surplus produce
iv. Creates employment opportunities
v. Encourages specialization and division of labour
vi. Promotes peace, social relations and understanding the parties involved since they depend on one another
vii. Provides revenue to the business and the government in form of taxes and fees charged on the various trading activities
viii. Ensures steady supply of goods and services
ix. Exploitation of local resources as traders create goods and services using locally available resources
x. Encourages economic growth and development

Classification of Trade

a) On the basis of geographical location of the portion involved, These are:

i. **Home trade-**Also called internal, local or domestic trade.

-It refers to the buying and selling of goods and services within the boundaries of a given country.

-It is further divided into **retail trade** and **wholesale trade.**

ii. **International trade (foreign trade)**

-This is trade that is carried out beyond the boundaries of a country

-This is trade carried out between individuals or government of different countries e.g. trade between a citizen of Kenya and a citizen of Tanzania, or trade between the government of Kenya and the government of Southern Sudan

-International trade carried out between two countries is referred to as **bilateral trade** and international trade carried out among many countries (more than two countries) is referred to as **multilateral trade.**

International trade is classified into the following;

i) **Export Trade-**Which is the sale of goods and services by a country to another country or individuals in one country to another country or individuals in one country to individuals in another country.

ii) **Import Trade-**Which is the buying of goods and services by one country from another country or by individuals in one country from individuals in another country.

Forms of Home Trade

i) Retail Trade

-Retail trade involves the buying of goods and selling them to the final consumer. **A retailer** is the trader who buys goods with a view of selling them to the final consumer.

Classification of Retail Traders

Retailers are classified/categorized according to the amount of capital they need to start and operate their businesses and their sales volume. Thus retailers can be classified as;

i) Small scale retailers

ii) Large scale retailers

i) Small-scale Retail businesses/small scale Retailers

These are retailers whose capital requirement is low and their sales volume also low. They form the majority of retail traders and all found in all parts of the country.

Small scale businesses are easy to start and in most cases they are operated as one-man's business.

A small scale trader serves the needs of people in the immediate neighbourhood and deal mainly in fast moving goods such as foodstuffs, detergents, kerosene e.t.c

Categories and Types of small scale

These are two main categories of small-scale traders as shown below;

a) Small scale Traders without shops

-Itinerant Traders (Hawkers and peddlers)
-Roadside sellers
-Open air market Traders

b) Small scale retailers with shops

-Single shops -Tied shops -Kiosks -Mobile shops
-Market stalls -Canteens -Mail order stores

a) Small scale Retailers without shops

i) Itinerant Traders

These are retailers who move from place to place selling their goods either on foot, by bicycles or motor cycles

-They move from town to town, door to door and from village to village selling their goods. Their goods may include clothes, utensils and foodstuffs. Customers can buy goods without having to travel to look for them

-Examples of itinerant traders are hawkers and peddlers (Hawkers move around on bicycles, handcarts or motorcycles while peddlers walk around)

-The itinerant traders require a licence from the local authorities in order to sell their goods.

Characteristics of itinerant Traders

i) Are found mainly in densely populated areas
ii) Move from place to place in search of customers
iii) They are very persuasive
iv) Their prices are not controlled.

Advantages of itinerant Traders

1. They require little capital to start
2. They are convenient because they bring goods closer to the people
3. The business is flexible in that they can move from place to place. They can also change from line of business to another
4. Few legal formalities are required
5. They usually do not suffer bad debts because they sell in cash.

Disadvantages of itinerant Traders

1. The traders get tired because of moving from one place to another while carrying goods.
2. The business is affected by bad weather conditions
3. The traders sale a limited range of goods
4. It is difficult to transport goods from one place to another.
5. Do not offer guarantee, in case items are to be found defective
6. They are constantly in conflict with the local government.

ii) Roadside sellers

These are traders who sell their goods at places where other people pass by and at busy places such as along busy roads, bus stages, road junctions and entrances to public buildings.

They place their goods on trays, cardboards, empty sacks and mails

They sell items such as fruits, utensils, sweets, clothing and some hardware.

iii) Open-air market Traders

Open air markets are places set aside by the government through the local authorities where people meet to buy and sell goods. Traders selling similar commodities are allocated a special area. Such markets are open on particular days of the week.

The variety of goods sold here is wide and include agricultural produce, clothing, household items, animals, foodstuffs and even furniture.

The traders move from one market to another depending on the various market days.

Advantages of small-scale retailers without shops

i) They require a small amount of capital to start and operate their businesses.

ii) They are convenient since they take goods to the customers within their reach.

iii) They incur low costs of doing business

iv) Most of their goods are low-priced and hence more affordable to customers.

v) The business is flexible. It is easy to change from one business to another

vi) They require few legal requirements

vii) The financial risks involved in these businesses are minimal

viii) They do not suffer bad debts since they sell on cash bases

ix) They interact at personal level with the customers and can convince them to buy their goods.

Disadvantages of small-scale retailers without shops

i) It is tiring for traders to move from place to place especially if the goods are heavy and the distance covered are long
ii) The traders face stiff competition from other traders with more resources
iii) They offer a limited variety of goods
iv) They are affected by unfavorable weather condition
v) Lack of permanent operating premises denies them a chance to develop permanent customers
vi) They face a lot of certainty, especially in terms of a steady flow of income
vii) They sometimes sell defective or low quality goods because customers expect to pay little money for them.

b) Small scale Retailers with shops

These are small scale retailers with permanent locations to operate from. They include;

i) Kiosks

These are small shops or structures found mostly in residential areas, busy streets, highly populated areas or inside building where people pass by or work

They deal in fast-moving items and groceries such as; sodas, cakes, sweets, cigarettes, and newspapers e.t.c. some kiosks also sell food

ii) Market stalls

These are permanent stands found in market places, especially those operated by the various local authorities

They are of different designs depending on the goods they sell or services they offer.

They are rented or leased by individuals from local authorities

They deal in fast moving household goods though some may specialize in other products such as clothing and shoes.

Examples are stalls at Muthurwa markets, Kariokor, and most municipal markets.

Advantages of kiosks and market stalls

- They are small, hence easy to start and operate
- They are conveniently located close to their customers
- They require little capital to start
- They tend to have a loyal group of customers since they have permanent premises
- They incur relatively low running costs

- They give personal attention to their customers
- They are flexible since the owner can change from one business to another easily.

Disadvantages of kiosks and market stalls

- They provide a limited range of products
- They usually do not have adequate higher capital for expansion
- They charge relatively higher prices than the retailers without shops
- They face stiff competition from more established retail businesses
- They sometimes suffer from bad debts
- Due to their size, they do not enjoy economies of scale
- For market stalls the hours for operation are controlled by the local authority concerned

iii) Single shops (unit shops)

-Single shops are mostly located in the trading or market centres in rural areas or in the residential areas of high towns
-They are operated from fixed premises
-They are usually run by one person who may get assistance from him/her family or employ attendance
-Some deal in one line of commodity such as houses, clothing, groceries or electronics

Advantages of single shops

- Minimal capital is required
- Running costs are usually low as the owner may use the services of family members
- They may offer credit facilities to some customers
- They are easy to start because only a licence is required
- They usually have a loyal group of customers
- Flexibility. The owner can change his or her line of business at will
- They are easy to start since the owner does not have to meet any manufactures requirements
- Products prices are fixed by the shop owners
- The owner has the freedom of creativity and independence
- They are convenient since they ensure goods are within easy reach of their customers.

Disadvantages of single shops

- Expansion is difficult due to limited funds
- They face stiff competition from large businesses

- The absence of the owner may result in closure and loss of business
- May suffer bad debts
- Provide limited variety of goods
- The operations of the business are affected by the owner's commitment.

iv) Tied shops

These are shops that mainly sell the products of one particular manufacture or are owned by a specific supplier of certain goods. The shops are owned or controlled by the manufacturer, and are thus tied to the manufacture.

The manufacture/supplier designs the organization of the shop and its appearance e.g. painting hence they look alike. The supply closely supervises the shops.

Examples of tide shops include; Bata shops which sell shoes made by Bata Company, petrol station like National, Kobil, and total e.t.c

Advantages of Tied shops

- Availability of goods is assured at all times
- The supplier carries out promotion for the goods
- The manufacturer/supplier can easily give credit to the shops
- Customers can return or change faulty goods at any of the shops
- The shops are easily identifiable due to their similarity
- Traders are financed by the manufacture
- They get loyal customers who keep buying their branded products
- Advertisement expenses are met by the manufacture
- They get technical advice from the manufacture
- Some operate from permanent premises owned by the manufacture.

Disadvantages of Tied shops

- Decision making is slow because the manufacturer must be consulted
- The variety of goods is limited
- The shops cannot sell goods from any other manufactures even if customers require them
- Prices are fixed by the manufacture and sometimes profit margins may be low
- They inhibit the retailers creativity and innovations
- There is a likelihood of disagreements between the manufacture and the tied shop owners.

Differences/Distinction between a tied shop and single shop

Single shop	Tied shop
-Owner is free to stock whatever	-Dealership can be withdrawn if

he/she wishes	operators stock competing products
-Owned by individual or a group of people	-The owner is normally the manufacturer
-Sells products from different manufacturers	-Sells products from a single manufacturer
-Design of shop according to owners wish	-Shops usually have the same design
-Prices of goods determined by shop owner or different manufactures	-Prices of goods set by the manufacturer
-Operators not trained by manufacturers	-Operators are usually trained by manufacturer

v) **Canteens:** These are retail shops found in institutions such as schools, colleges, hospitals and army barracks.

-They stock a variety of consumable goods such as sodas, bread, tea, groceries and other things used by the people in that institution.

-They are run by the institutions management or by individuals on retail business

-Most of them operate without a license as they are considered to be part of the institution. Their hours of operation are sometimes regulated by the institution

Advantages of canteens

-Some do not pay any rent, thus they incur low overhead costs

-They often require low capital to start

-Some offer credit facilities to their customers

-They are situated at ideal location which is convenient for their customers

-They are assured of a market as they cater for people in particular institution.

Disadvantages of canteens

-The market is limited to people in a particular institution

-They do not open throughout/they open for limited hours e.g. after classes in schools

-They close down when the targeted customers are not available e.g. during school holidays.

-They may suffer from bad debts

-They are difficult to expand due to insufficient funds

vi) **Automatic vending machines;** These are coin or card operated machines used to sell commodities like drinks, stamps, and snacks e.t.c. Examples are coffee shops, ATM's e.t.c

Features

-They dispense goods or services once a coin or a card is inserted and instructions keyed in.

-They operate without an attendant

-They are usually placed at strategic places such as busy streets, office buildings, shopping centres and hospitals.

Advantages of vending machines

- Commodities can be bought anytime because no attendant is required
- They save the owner the cost of employing a shop attendant
- They can be put strategically to boost sales e.g at institutions
- They are fast and accurate
- They are not affected by weather changes
- They provide goods and services on cash basis protecting the owner from the burden of bad debts.

Disadvantages of vending machines

- They provide a limited range of products
- Break-downs or stock-outs may discourage customers
- Maintenance costs are high due to regular servicing, repairs and sometimes vandalism
- The owner may incur losses through fraud and use of inappropriate coins and cards by consumers.
- Customers are forced to carry coins and cards in order to obtain goods or services
- Their use is limited to customers who are familiar with how the machine works
- They are mainly found in urban areas, thereby locking out the people in rural areas.

vii) Mobile shops

Mobile shops, like itinerant traders move from town to town or village to village selling their goods.

-They have vehicles that they have converted into a shop from which customers can buy their goods

-They visit different towns at regular intervals.

Advantages of small scale Retailers

1. Easy to raise capital to start
2. Retailers are in close contact with the consumers and may give credit to credit worthy customers.

3. Are able to use free or cheap labour from family members
4. The risks involved in their businesses are small
5. The business is simple to start and manage
6. Few legal formalities required to start and run the business
7. The trader can easily change from one form of business to another i.e. the business is flexible

Disadvantages of small-scale retailers

1. Traders have limited access to loan facilities
2. They may not afford to hire specialists or technical staff
3. May suffer bad debts if they give credit to customers without proper assessment
4. Do not enjoy economies of scale
5. Have a low turnover because of the little capital invested

LARGE SCALE RETAILERS

Large-scale retailers have the following features/characteristics;

i) Require large amounts of capital to start and maintain
ii) They operate from larger fixed premises
iii) They operate mainly in urban areas
iv) They have a large labour force
v) Buy goods in large quantities from wholesalers or directly from producers and are therefore allowed large trade and quantity discounts and other favourable credit facilities
vi) Require the services of specialists such as salespersons and accountants
vii) May occupy one large premise or several premises in the same town or in different towns
viii) They have large stocks and large sales volumes

TYPES OF LARGE SCALE RETAILERS

a) Supermarkets: A supermarket is a large-scale self-selection/self-service store that deals mainly with household goods such as utensils, foodstuffs and clothes. It has the following features;

Features of supermarkets

i) Requires large capital to start
ii) They stock a wide variety of goods
iii) Offers self service facilities
iv) Goods have price tags or bar codes
v) Prices of goods are fixed
vi) No credit facilities are offered

vii) Sell at comparatively low prices
viii) Goods are systematically arranged for easy selection
ix) Shoppers are provided with baskets or trolleys for convenience
x) There is minimal interaction between buyer and seller
xi) There are employees who pack goods for customers at the pay points.

Advantages of supermarkets

i) Prices may be relatively low because they buy their goods in bulk and are given discounts
ii) Saves time as customers are able to get most goods they require under one roof
iii) Self-service saves the customers time
iv) Few attendants are employed thereby reducing the monthly wage bill
v) Impulse buying leads to more sales, hence high profits
vi) Bad debts are avoided because there are no credit sales.
vii) The price tags on goods help customers to monitor their spending.

Disadvantages of supermarkets

i) Do not offer credit facilities to customers
ii) Do not deliver goods to the customer's premises
iii) Are found mainly in urban areas
iv) May incur losses due to pilferage of goods
v) Impulse buying may lead the customers to buying goods they may not need.
vi) They are expensive to start and operate due to the large amount of capital required
vii) Prices are fixed and bargaining is not accepted, which discourages some customers
viii) Minimal personal interaction limits chances for making more sales

b) Hypermarkets

A hypermarket is a large shopping complex/centre comprising a variety of businesses managed by different people all housed in one building

Examples; **village market, sarit centre, Tuskeys-Kisumu, Nakumatt mega city-Kisumu e.t.c**

Features/Characteristics of Hypermarkets

i) Are served with good access roads
ii) They have ample parking space
iii) Many businesses in one building
iv) Located in the outskirts of town
v) Offer a variety of goods and services

vi) Occupy a large space.

Advantages of Hypermarkets

i) Offer ample and secure parking space to customers
ii) Customers can do all their shopping in one building
iii) They are usually open for long hours
iv) They may provide credit facilities by accepting credit cards
v) There is less traffic congestion as hypermarkets are located away from urban centres
vi) Provide a wide variety of goods and services to customers under one roof.
vii) They have fair prices that are customer friendly.

Disadvantages of Hypermarkets

i) Are only convenient to customers who have cars because they are situated away from city centres
ii) They serve limited number of people due to their location
iii) They require large amount of capital to establish
iv) They can easily exploit their customers since their prices are not controlled
v) Require large amount of space which are not available in central business district (CBD)
vi) They spend a lot of security to safeguard properties

c) Chain stores (Multiple shops); Are large scale businesses with separate branches which are managed and organized centrally. The branch managers are accountable to the head office. Examples; African Retail Traders (ART), White Rose dry cleaners, Nakumatt, Tuskys, Uchumi e.t.c

Characteristics/features of chain stores

i) Are managed centrally from a head office
ii) Prices are standard for all their products in all their branches
iii) All branches deal in the same type of products
iv) Sales are decentralized i.e. the various shops situated in different places act as selling points or branches
v) Purchases of stock are centralized i.e. buy stock buy stock in bulk centrally and distributed to the different branches
vi) Goods can be transferred from one shop to another where the need for them is higher
vii) The shops operate under one name and are similar in appearance and interior layout

Advantages of chain stores/multiple shops

i) They enjoy large trade discounts since they buy their goods in bulk centrally and is passed to consumers in form of low prices
ii) Common costs such as those of advertising are shared
iii) Goods that do not have a high demand in one branch can be transferred to another where their demand is high
iv) They are easily identified by their colour and design
v) They have low operational costs because of the centralized buying, storage, advertising and accounting
vi) They serve a large number of customers because they are spread in many towns and cities
vii) The similarity of the shops in appearance and services serves as an advertising tool
viii) Risks such as losses are spread among many shops
ix) It is possible to pay for goods in one branch and pick them up in another.

Disadvantages of chain stores/multiple shops

i) Large amount of capital is required to start and maintain the business
ii) They cater mainly for the urban areas as they are situated in those places
iii) Organizational problems may occur due to their large size
iv) No credit facilities are offered except those operating exclusively on hire purchase schemes
v) Response to market changes is slow due to the slow decision making
vi) Decision making is slow as the head office must be consulted
vii) Lack of personal touch with customers
viii) Absence of personal touch between employer and employee may reduce incentives for hard work among staff
ix) People tend to shy away from buying similar products such as clothes and this may reduce sales.

d) Departmental stores

This is a group of single shops operating under one roof with a centralized management

Each shop/department specializes in a particular line of products and is headed by its own department manager.

Characteristics of departmental stores

i) Each department has its own manager
ii) Each department sells only one line of products
iii) All departmental managers are answerable to a general manger
iv) They offer a wide variety of goods at relatively low prices

v) They sell goods strictly on cash basis
vi) They are usually in town centres
vii) Goods are not transferable from one department to another as each has its own variety of goods.

Advantages of departmental stores

i) Customers can buy/access a wide variety of goods at fair prices under one roof.
ii) They can afford to hire trained qualified experienced staff who provide quality services
iii) They buy goods in large trade discounts. This enables them to sell at low prices.
iv) Each department is able to make independent and quick decisions that affect its operations.
v) The independence of departments ensures that the weakness of one department does not affect each other.
vi) Savings can be made on some activities such as product promotion by centralizing them.

Disadvantages of Departmental stores

i) A large amount of capital is required to start and maintain the stores
ii) They require a large number of customers to operate profitably
iii) It is difficult to give personal attention to customers
iv) They cater mainly for the urban communities in which they are located
v) They strictly sell their goods on cash basis
vi) Operational costs are high due to the wide variety of services offered
vii) Their large size could encourage theft and pilferage of goods
viii) The independence of **departments** can make central control difficult.

e) Mail order stores

This is a type of retail business where business is carried out through the post office, telephone or email

-Ordering of the goods is done through the post office telephone or email and delivering of goods is done by post or courier

-There is no personal contact between the seller and the buyer and buyers get information from advertisements.

-Goods are dispatched on the basis of cash with order (CWD) or cash on delivery (COD).

Characteristics/features of Mail order stores

-They sell the goods through the post office

-They operate on cash with order (CWO) or cash on delivery (COD) terms

-Heavy advertisement are involved
-Customers do not visit the selling premises.
-There is no personal contact between the buyer or the seller
-All transactions are done through the post office
-They deal with goods that are less bulky, have high value, and are durable and not too fragile
-May have large warehouses

Advantages of Mail order stores

- They reach customers who are far for away from the shopping centres
- Do not require the services of sales personnel or shop attendants for skilled labour since selling is routine
- Total control of distribution is possible
- Payments is made with order or delivery so there is little chance of bad debts
- Eliminates the loss associated with shop space, thus saving on rent
- Supply of goods is based on order thus a trader requires little working capital
- The method eliminates trips to congested stores and lengthy waits queues
- Do not require large storage space for goods.

Disadvantages of Mail order stores

- Advertising and postage costs may increases the price of goods
- There is lack of personal contact between the seller and the buyer
- There is limited variety of goods on offer
- Customers do not have the opportunity of inspecting goods before buying
- There are no credit facilities
- The method is only suitable for those who can read and write
- Should there be a problem with the post office.e.g industrial action like strikes, the business may be affected
- Difficult to operate in places where post office services are poor or unavailable
- Chances of being defrauded are high.

FUNCTIONS OF RETAILERS

These can be discussed as services rendered to consumers, wholesalers and producers

Services Rendered to consumers

i) **Offers credit facilities:** Retailers are in close contact with the consumers and some may give them credit facilities

ii) **After-sales services:** Retailers who sell technical goods e.g. cars, electronics e.t.c may offer after sale services to consumers e.g. transport, installation repair e.t.c

iii) **Provision of variety of goods:** Retailers stock a wide variety of goods from different wholesalers and manufactures enabling the consumers to have a wide choice.

iv) **Advising consumers:** Retailers may offer advice to consumers on choice and use of products

v) **Availing needed goods:** Retailers make goods available to consumers at the right time and place

vi) **Breaking bulk:** Retailers sell goods to consumers in convenient quantities

vii) **Accumulating bulk**

viii) **Stabilizing prices:** By ensuring that goods are continuously available to consumers

Services Rendered to wholesalers

i) Retailers store goods and relieve the wholesalers the burden of storing goods and the storage costs

ii) They relieve the wholesalers the burden of transportation

iii) Retailers advice wholesalers on market trends(on consumers demand)and give valuable information

iv) They help in distribution of goods to the consumers

v) They help in breaking bulk on behalf of the wholesaler

vi) They finance wholesalers to continue with their operations through paying for the goods

vii) They relieve the wholesaler of some risks that arise from the storage of goods such as theft, fire and accidents.

Services Rendered to producers

i) Through wholesalers retailers provide very vital information to manufactures about market demand

ii) They advertise goods on behalf of producers

iii) They sell and market goods to consumers. This relieves the manufactures the task and risk of retailing

iv) They store goods on behalf of the producers

v) They break bulk on behalf of producers to consumers

vi) They finance producers by buying and paying cash

WHOLESALE TRADE

Wholesaling involves selling goods in large quantities to traders for resale. A wholesaler is a trader who buys goods in bulk from producers/manufactures for resale to retailers at a profit.

-There are wholesalers who carry out retailing but that do not make them retailers.

Classification of wholesalers/Types of wholesalers

Wholesalers may be classified depending on a number of factors. These factors include;

a) According to the range of goods they handle
b) According to the geographical area in which they operate
c) According to their method of operation.

i) According to the range of goods they handle

Under this classification, wholesalers may be any of the following;

a) General merchandise wholesalers
b) General line wholesalers
c) Specialized wholesalers

a) General merchandise wholesalers

The word merchandise means **goods**.

-The general merchandise wholesalers stock and sell a wide variety of goods e.g. hardware, clothes, cosmetics and foodstuffs. The retailers who buy from these wholesalers are thus able to get a wide variety of goods for resale.

-They are also called **general wholesalers or full-line wholesalers**

b) General line wholesalers

-These are wholesalers who deal in a wide variety of goods within the same line e.g. textbooks, duplicating papers and other types of stationary.

c) Specialized wholesalers

-These are wholesalers who deal in a particular good from a given line e.g. in the line of grains, they may specialize in maize only.

ii) According to the geographical area in which they operate.

Under this category wholesalers may be;

a) Nationwide wholesalers
b) Regional wholesalers.

a) Nationwide wholesalers:

These are wholesalers who supply goods to traders in all parts of the country.

-They establish warehouses or depots in different areas from Kenya National Trading Corporation (KNTC)

b) Regional Wholesalers

These are wholesalers who supply goods to certain parts of the country only. They may cover a county, District, division e.t.c

iii) According to their method of operation

Under this classification, wholesalers can be:

a) Cash and carry wholesalers
b) Mobile wholesalers
c) Rack jobbers

a) Cash and carry wholesalers: These wholesalers sell goods on cash and self-service basis like supermarkets

-They neither offer transport nor credit facilities to their customers.

b) Mobile wholesalers/Track distributors: These are wholesalers who use vehicles to move from place to place supplying goods to retailers e.g. soda distributors, bread distributors, beer distributors e.t.c.

c) Rack jobbers

These wholesalers specialize in selling certain/particular products to other specialized wholesalers. They buy goods from producers or from other countries for reselling.

E.g. some wholesalers buy horticultural products from producers and sell to other wholesalers in urban areas

-Rack jobbers usually stock their goods in shelves or racks from which customers select the goods to buy. Customers may be allowed to pay for the goods after they have sold them.

d) Drop shippers

These are wholesalers who make orders for goods from manufactures/producers but do not take them from the producers premises. They then look for the buyers for the goods and supply the goods directly from the producers

Alternate classification of wholesalers

An alternative classification of wholesalers is given below:

i) Those who buy goods store them in warehouses and sell them to traders without having added anything to them.

ii) Wholesalers who act as wholesaler's agents or brokers. These are middlemen who are paid a commission for their work e.g. commission agents

iii) Those who after buying the goods and storing them prepare them for sale. They break bulk, pack, brand, sort, grade and blend the goods

These terms are explained as below:

a) **Breaking bulk-** Reducing a commodity into smaller quantities for the convenience of the buyer e.g. buying sugar from the producer in sacks and selling it in packets.
b) **Packing-**Putting goods in packets and boxes ready for sale.
c) **Branding-**Giving a product a name by which it will be sold
d) **Sorting-**Selecting goods to desired sizes, weight, colour and qualities
e) **Grading-**Putting goods in groups of similar qualities to make it easier to price them
f) **Blending-**It involves mixing different grades of a product to achieve qualities like taste and colour.

Functions of a wholesaler

These can be discussed as services rendered to producers, retailers and to consumers.

Services of wholesalers to the producers

i) They relieve the producers the problem of distribution by buying goods from them and selling to retailers
ii) They relieve the producers of some risks they would experience e.g. damage, theft, fall in demand e.t.c
iii) Save the producers from the problem of storage by buying goods and keeping in their warehouses
iv) They prepare goods for sale on behalf of the producers
v) They get feedback from consumers on behalf of producers
vi) They promote products through advertising, displays, trade fairs and exhibitions
vii) They finance producers by buying goods from them and paying in cash.

Services of wholesalers to the Retailers

i) They stock a wide variety of goods in large quantities relieving the retailer from buying from different producers
ii) They avail goods at places convenient to retailers
iii) They break bulk for the benefit of retailers
iv) They offer transport facilities to retailers
v) They offer advisory services to retailers regarding market trends
vi) They offer credit facilities to retailers
vii) They engage in product promotion on behalf of retailers
viii) They sort, blend, pack and brand goods saving retailers from having to do it.

Services of wholesalers to consumers

i) They ensure a steady supply of goods to retailers hence consumers are not faced with shortages
ii) They ensure a stable supply of goods hence there will be stability in market prices
iii) They enable consumers to enjoy a wide variety of goods
iv) They break the bulk of goods thus enabling the consumer through the retailer to get the goods in convenient quantities
v) They prepare goods for sale e.g. branding, blending and packaging
vi) Pass information to consumers through retailers about the goods e.g. new products, new prices and their use.

DOCUMENTS USED IN HOME TRADE

A business document is **a written record** which gives evidence to a stage in the transfer of goods or provision of services from one party or it is written record which gives evidence that trader or a **business transaction** has taken place.

A business transaction is a deal between two or more people involving exchange of goods and services in terms of money.

Business transaction may take place on **cash basis**; in which case goods are paid for before or on delivery or a short while after delivery

Business transaction may also take place on **credit basis;** which means payment is made after a specified period from the date of delivery of the goods or the provision of the services

There are various business documents that are used in various stages of business transactions as discussed below;

a) Documents used at the inquiry stage

This is the first stage in transaction. An **inquiry** is a request by a prospective buyer for information on available goods and services. It is aimed at establishing the following;

- Whether the goods or services required are available for sale
- The quality or nature of the products available
- The prices at which the goods or services are being sold
- The terms of sale in respect to payment and delivery of goods or services

Some of the documents used at this stage include;

i) Letter of inquiry;

This is a letter written by a potential buyer to the seller to find out the goods and services offered by the seller.

A letter of inquiry can be general or specific. A specific letter of inquiry seeks for information about a particular product.

Reply to an inquiry

The seller may reply to the letter of inquiry by sending any of the following documents;

-Price list -A catalogue -Quotation -A tender

i) A price list

This is a list of items sold by the trader together with their prices. The information contained in a price list is usually brief and not illustrated and may include;

-Name and address of the seller -List of the goods and services

-The recommended unit prices of the products -Any discounts offered

Price list show the prices of the commodities at that time.

ii) **A catalogue;** A catalogue is a basket which briefly describes the goods a seller stocks.

It is normally sent by the seller to the buyer when the buyer sends a general letter of inquiry. It usually carries illustrations on the goods stocked, and could be in the form of attractive and colorful pictures

The content of a catalogue includes the following;

- Name and address of the seller
- Details of the products to be sold; inform of pictures and illustrations
- The prices of the products
- After-sales services offered by the seller
- Packaging and posting expenses to be incurred
- Delivery services to be used
- Terms of sale

-Catalogues carry more information than the price list and they are more expensive to print.

iii) **Quotation;** This is a document sent by a seller to a buyer in response to a specific letter of inquiry. It specifies the conditions and terms under which the seller is willing to supply the specified goods and services to the buyer.

The content of a quotation includes the following;

-Name and address of seller -Name and address of the buyer

-Description of goods to be supplied -Prices of the commodities

-Terms of sale i.e. discounts, time of supply, delivery

-Total of the goods to be supplied

Quotations are normally in form of letters, but many large-scale businesses have pre-printed quotations forms which they readily send to the potential customers.

iv) A Tender

This is a document of offer to sell sent by a seller to a buyer in response to an advertised request

Tenders contain the following;

-Date when the tender advertisement was made
-Mode of payment
-Date of making document
-Discounts given
-Name and address of prospective seller called the **tenderer**
-The prices at which the goods can be provided
-Period of delivery
-Mode of delivery
-Tenders are delivered in sealed envelopes which are opened by the buyer on a specified date

The winning tender is usually awarded on the of the lowest quoted price although the buyer is not obliged to accept this especially if quality is likely to be low

Tenders are not binding unless accepted by the buyer.

b) Documents used at the order stage

After receiving replies to inquiry in form of price list, catalogue or Quotation, a prospective buyer will study the terms and conditions stated in them, and then may decide to buy products or not.

i) An Order

If a prospective buyer decides to purchase an item(s), he or she then places an **order**

An order is a document sent by a potential buyer to a seller requesting to be provided with specified products under specified terms and conditions

-An order issued for goods is called a **local purchase order (LPO)**

An order issued for services is called a **local service order (LSO)**

Ways of making an order

i) Filling an order form. This is a pre-printed document that is used for making orders

ii) Writing an order letter

iii) Sending an e-mail, faxing or sending a short text message

iv) Giving a verbal order. Verbal orders have the disadvantage in that they can be misunderstood and there would be no record of items ordered

-Where written orders are made, the potential buyer keeps a copy of the order for use in verifying the goods ordered when they are delivered.

-A written order may contain the following;

- Name and address of the buyer
- Name and address of the seller
- The number of the order
- Quantities ordered and total amount to be paid
- Description of the goods ordered
- Price per item
- Special instructions on such matters as packaging and delivery

ii) Acknowledgement note

On receiving the order, the seller sends the buyer an acknowledgement note
An acknowledgement note is a document sent by the seller to the prospective buyer to inform him/her that the order has been received and it is being acted upon.
After sending the acknowledgement note, the seller has to decide whether to extend credit to the buyer or not. At this stage, the seller has the following options;

i) If the seller is convinced that the buyer is credit worthy, arrangements are made to deliver the ordered goods or services to the buyer.

ii) If the seller is not sure of credit worthiness of the buyer, **a credit status inquiry** can be issued to the buyer's bankers or to other suppliers who deal with the buyer to ascertain the credit worthiness.

iii) If the buyer is not credit worthy then a polite note or a **pro forma invoice** can be sent to him/her

A proforma invoice

This is a document sent by the seller to the buyer requesting the buyer to make payment for goods or services before they are delivered. It indicates that the seller is not willing to grant the buyer credit

Functions of a proforma invoice

i) A polite way of asking for payment before the goods are delivered
ii) Sent when the seller does not want to give credit
iii) Used by importers to get customers clearance before goods are delivered
iv) Issued to an agent who sells goods on behalf of the seller
v) Show what the buyer would have to pay if the order is approved
vi) Can be used to serve as a quotation

Circumstances under which a pro-forma invoice may be used

- If the seller does not want to give credit
- If the seller wants to sell goods through an agent

- If the seller wants to get clearance for imported goods
- If the seller wants it to function as a quotation
- If the seller wants to inform the buyer what he/she pay if the order is approved e.t.c

Documents used at the Delivery stage

After the seller has accepted the order sent an acknowledgement note and where necessary the pro-forma invoice, the seller then prepares the goods for delivery to the buyer. This can be done in the following ways;

- The seller can ask the buyer to collect the goods
- The seller can deliver the goods to the buyer using his/her own means of transport
- The goods can be delivered to the buyer through public transport
- The services(s) can be rendered to the buyer at the sellers or the buyer's premises or at any convenient place.

The main documents that are used at this stage are;

i) **Packing note;** Before delivery goods are packed for dispatch. This is a document prepared by the seller showing the goods contained/packed in every container, box or carton being delivered to the buyer

-A copy of the packing note is packed with the goods to make/help the buyer have a spot check.

The contents of a packing note include;

-Description of goods packed

-Quantities of goods packed

-The means of delivery

NOTE: A packing not does not contain prices of goods. This ensures that those people involved in checking and transporting goods do not know the value of goods. This is done as a precaution against theft.

ii) **Advice note;** This is a document sent by the seller to the buyer to inform the buyer that the ordered goods have been dispatched. It is usually sent through the fastest means possible.

-It contains the following;

-The means of delivery

-A description of the goods

-The quantity dispatched

-Date

-Name and address of buyer and seller

Functions of an advice note

a) Informing the buyer that the goods are on the way so that in case of any delay in delivery, the buyer can make inquiries

b) Alerting the buyer so that necessary arrangements can be made for payments when the goods arrive

c) Can serve as an acknowledgement note, where one is not sent/

iii) **Delivery note;** This is a document sent by the seller to the buyer to accompany the goods being delivered.

-A delivery note is always made in triplicate (3), one copy remains with the seller and two sent to the buyer.

-When the goods reach the buyer, he/she confirms that the goods are the ones ordered for and that they are in the right condition by comparing the delivery note, the order and the goods. If the buyer is satisfied with the goods, he/she signs the two copies, retains the original and send the copy back to the seller. This serves as evidence that the goods have been received in the right condition and in the right quantities.

-Some businesses keep delivery books in which the buyer signs to indicate that goods have been received in good condition. A delivery book is used by the seller if he/she delivers goods by himself/herself as an alternative to a delivery note

The content of a delivery note includes the following;

a. Name and address of the seller

b. Name and address of the buyer

c. Date of delivery

d. Delivery note number

e. Description of the goods delivered

f. Quantities of the goods delivered

g. Space for the buyer to sign and comment on the condition of the goods received.

iv) **Consignment note**

This is a document prepared by a transporter to show that he/she has been hired to deliver specified goods to a particular buyer. This document is used when goods are delivered to the buyer by public means of transport e.g. by trains.

-The seller is the **consignor**, the buyer is the **consignee** and the goods the **consignment**

-The transporting company prepares the consignment note and gives the seller to complete and sign. The seller then returns the note to the transporter (carrier) who takes it together with the goods to the buyer.

-On receiving the goods, the buyer signs the consignment note as evidence that the goods were actually transported.

The content of a consignment note includes the following;

- Details of the goods to the transported
- Name address of seller (consignor)
- Name and address of buyer (consignee)
- Terms of carriage and conditions of transporting the goods
- The transportation cost
- Handling information
- Destination of goods

v) **Goods Received note;** This is a document sent by the buyer to the seller to inform him/her that goods sent have been received. It usually prepared in duplicate, the original is sent to the seller and the copy retained by the buyer.

The contents of the goods received note include;

- Date of the document
- Name and address of the buyer
- Name and address of the seller
- Corresponding purchase order
- Details of goods received
- Date the goods were received.

vi) **Returned goods note/Damaged goods note;** If goods are damaged on the way, the buyer may return them to the seller. The buyer may also return goods for other reasons e.g.

- Wrong type of goods
- Excess goods
- Wrong quality goods

-When the goods are returned, the buyer informs the seller of the return by sending a goods returned note.

-A goods returned note is a document sent by a buyer to a seller to inform him/her that certain goods are being returned to the seller.

-Where the goods are returned because of damage, the note may be referred to as **the damaged goods note.**

The contents of the goods returned note include;

- Details of goods that have been returned to the seller
- Date goods are returned
- The number of (GRN)
- Order number

- Delivery number
- Name and address of both buyer and seller

-When the seller receives the note together with the goods, he issues a credit note

d) Documents used at the invoicing stage

This stage involves the seller requesting or demanding for payment from the buyer for the goods or services delivered.

Some of the documents used at this stage include:

a) Invoice

This is a document sent to the buyer by the seller to demand for payment for goods delivered or services rendered.

There are two types of invoices namely:

a) **Cash invoice-**This is sent when payment is expected immediately after delivery thus acting as a **cash sale receipt**

b) **A credit invoice-**This is sent when a buyer is allowed to pay at a later date.

Functions of an invoice

i) It shows the details of goods sold i.e. quantity delivered, unit price, total value of the goods and terms and conditions of sale.

ii) It is a request to the buyer to make payment

iii) It serves as an evidence that the buyer owes the seller a certain amount of money

iv) It is used as a source document in recording the transaction in the book of accounts.

The contents of an invoice include the following:

- Invoice number
- Name and address of the seller
- Name and address of the buyer
- Date document is prepared
- Details of goods repaired
- Unit prices of goods delivered
- Total value of goods
- Discounts offered
- E and O.E printed at the bottom

The letters **E** and **O.E (**Errors and Omissions Excepted) means the seller reserves the right to correct any errors and omissions made in the invoice.
-On receiving the invoice, the buyer verifies the contents using the local purchase order and the delivery note. If the invoice is in order, the buyer makes arrangements to pay the amount stated.
Businesses which offer services issue a document called **a bill**, which serves the purpose of an invoice.

Differences Between the invoice and pro-forma invoice

The invoice	**The pro-forma invoice**
1) It is issued after goods and services have been delivered	1) It is issued before goods and services have been delivered
2) It shows the total value of the goods or services on credit	2)Shows the total value of goods and services to be bought
3) It is used to demand payment for products sold on credit	3)It is used to demand for payment in advance for products to be bought
4) Used as a basis for making payment for products already bought	4)Used as a basis for preparing payment for products not yet bought
5) Serves as a notice of payment for products bought on credit	5) Serves as a Quotation for products to be bought.

b) Credit note

This is a document sent by the seller to the buyer (credit buyer) to correct an overcharge. It is used to inform the buyer that the amount payable by him/her has been reduced

An overcharge is an excess amount charged beyond the right price.

Causes of overcharge may include;

- Arithmetical errors like wrong addition
- Price overcharges
- Inclusion of wrong or unordered items in the invoice
- Failure to deduct the allowable discounts
- Return of goods (damaged goods)
- Failure to note the return by the buyer of packing cases or containers used to deliver goods to him/her

- Use of wrong price list.

-The purpose of the credit note is to reduce the total invoice amount by the amount of the overcharge.

-A credit note is usually **printed in red** to distinguish it from other documents.

-Contents of a credit note include;

- Name and address of the seller and the buyer
- Credit note number
- Date document is prepared
- Description and value of goods returned by buyer (in case that was done)
- Total overcharge

Reasons why a seller would send a credit note to a buyer/circumstances under which a credit note is sent to a buyer.

-When there is an overcharge in an invoice

-When the original invoice had indicated items that were not supplied

-When the buyer returns empty cases/crates that had been charged in the invoice.

-When the buyer returns some goods to the seller

-If the buyer was entitled to a discount which was not given or taken care of in the invoice.

c) Debit note

This is a document sent by the seller to the buyer to correct an undercharge on the original invoice. It is used to inform the buyer that the amount payable by him has been increased.

-A debit note acts as an **additional invoice.**

-An undercharge arises when amount charged on products is less than their right price.

Causes of undercharge include:

- Price undercharges on items
- Arithmetic errors/mistaken in calculation
- Omission of items in the invoice
- Retention of crates and containers that were not involved by the buyer
- Deductions of more discount than what was give/intended

Circumstances under which a debit note will be sent to the buyer

a) When there is an undercharge in the invoice

b) If the buyer had been given a discount that was not due to him

c) If some items had been omitted in the original invoice

d) If the buyer decides to retain some empty containers or crates

Differences Between a debit note and a credit note

DEBIT NOTE	CREDIT NOTE
1) Issued to correct an undercharge on the invoice.	1) Issued to correct an overcharge on the invoive.
2) Written on blue or black.	2)Usually written in red
3) Issued when containers have not been returned	3) Issued when containers have been returned.

Documents used at the payment stage

This is the final stage of a credit business transaction. It takes place after the invoice has been received and ascertained to be correct or where necessary, corrections made.

The documents used at the payment stage include;

i) Receipt

This is a document issued to the buyer by the seller as proof that payment has been made.

-Payment can be done in cash, cheque, other forms of money or in kind

-The receipt also serves as a source document for making entries in books of accounts.

Contents of the receipt include;

- Date of payment
- Name of the person making payment
- Name of person/institution receiving payment
- Amount paid in words and figures
- Means of payment
- Receipt number
- Signature of person issuing the receipt.

-The issuance of a receipt by the seller to the buyer after receiving payment marks the end of the credit transaction between the seller and the buyer (where payment has been done in full)

-A receipt serves the same purpose as the **cash sale slip**

ii) Statement of Account

This is a document prepared by the seller and sent to the buyer, giving a summary of all the dealings/transactions between them during a particular period of time, usually a month. It has the following details;

- Date when it was prepared
- Name and address of the seller
- Name and address of the buyer
- Account number
- Date column-where the date of each transaction is recorded
- Particulars (Details)column-where the explanation of each transaction is shown
- Money column

-Debit column-increases in the amounts payable due to credit sales or under charge correction.
-Credit column-Decrease in the amounts payable due to overcharges corrected or payments recorded.
-Balance column-Amount owing after each transaction (Balance outstanding)

- Any discounts allowed to the buyer
- Date when the buyer is expected to clear the balance
- Terms of credit e.t.c.

-The statement of account enables the buyer to ascertain the correctness of the transactions which have taken place with the seller over the stated period.

iii) IOU

An IOU (I owe you) is a document written by the buyer and sent to the seller to acknowledge a debt.
-It does not specify date when settlement will be made.
-It acts as evidence that a debt exists.

Summary of documents used in home trade

Document sent by buyer	**Document sent by seller**
-Letter of inquiry	-Price list
-Order	-Catalogue
-Goods received note	-Quotation
-Goods returned note	-Tender
-IOU	-Acknowledgement
	-Advice note
	-Packaging note
	-Delivery note
	-Consignment note

	-Invoice
	-Pro forma invoice
	-Credit note
	-Debit note
	-Receipt
	-Statement of account

MEANS OF PAYMENTS

These are the methods or ways the buyer may use to settle debts arising from a business transaction. These are various means of payments that can be used. These means of payments can be put into the following groups;

i) Cash
ii) Means of payment provided by the post office
iii) Means of payments provided by the commercial banks
iv) Means of payments which arise from private arrangements between sellers and buyers
v) Other means of payment.

i) Cash

This refers to the use of notes and coins to make payments. Currency notes and coins are issued by the central Bank of Kenya and are therefore **legal tender**

-Legal tender means everyone is obliged by law to accept them as a means of payment i.e. no one can refuse to accept them as they are backed by the law.Notes and coins are available in different denominations as follows;

Coins; 5cents, 50cents, sh.1, sh.5, sh.10 and sh.40

Notes; sh.10.sh.20,sh.50,sh.100, sh.200,sh.500 and sh.1000.

-Coins are suitable for settling small debts and are acceptable as legal tender up to a certain maximum e.g. 50cents coins the maximum is sh20 and sh.1 the maximum is ksh.100.

Advantages of cash as a means of payment:

i) It is the only means of payment which is a legal tender
ii) Convenient for settlement of small debts
iii) Convenient to people with or without bank accounts
iv) Cash is readily usable

Disadvantages of cash as a means of payment

i) Not convenient to carry around
ii) Cash can be lost or stolen easily as it is readily usable
iii) Payment is difficult to prove unless a receipt is issued

Circumstances under which cash payment is appropriate

i) Where the amounts involved are small
ii) Where the payee (receiver) does not accept other means of payment
iii) Where cash is the only means available
iv) Where the payee requires cash(money) urgently
v) Where there is need to avoid expenses associated with other means of payments

ii) Means of payments provided by the banks

Commercial banks are financial institutions that accept deposits to and withdrawals from them.

They also lend money to customers. Examples of commercial banks include: **Commercial bank of Kenya, National bank of Kenya, Barclays bank, and Co-operative bank e.t.c**

-There are various means of payments provided by the commercial banks. They are:

a. Cheques
b. Bank drafts/bankers cheques
c. Credit transfers
d. Standing orders
e. Travellers cheques
f. Telegraphic transfers
g. Debit cards
h. Electronic fund Transfer(E.F.T)

a) Cheques

This is a written order by an account holder with the bank (drawer) to the bank (drawee) to pay on demand a specified amount of money to the named person (payee) or the bearer

Parties to a cheque

i) **Drawer-**This is the person or institution who writes and issues the cheque.He is usually a current account holder with the bank
ii) **Payee-**The person or institution to be paid
iii) **Drawee-**The bank(where the drawer has an account)

Details on a cheque; they include:

- Date when it is issued
- Name of the drawer
- The name of the payee, except in bearer cheques
- The name of the drawee(bank)and branch from where it is issued
- Amount to be paid in figures and in words
- The account number of the drawer

- The signature of the drawer
- The cheque number and bank code
- The appropriate revenue stamps

Types of cheques

i) Open cheques
ii) Crossed cheques
iii) Bearer cheques
iv) Order cheques

i) **Open cheques**

This is acheque that can be presented for payment over the counter. You present it and cash is paid to you.

ii) **Crossed cheques**

This is acheque that bears two parallel lines on the face. This means the cheque cannot be cashed over the counter. The cheque is deposited in an account (payee's account)

The payee then withdraws the money from his/her account

A crossed cheque can be opened by the drawer signing twice on its face.

-A crossing can be general or special

-General crossing-general crossings only contains the two parallel lines. This implies that the cheque will be paid through any bank in which it is deposited.

-Special crossings-Has other instructions included in the crossing i.e;

- **Not negotiable-**Means the cheque can be transferred by the payee to a third party, but he third cannot transfer the cheque (only the original payee can transfer the cheque)
- **Account payee only-**Means the cheque should be deposited in the account of the payee.
- **Not transferable-**Means there is no negotiation or transfer of the cheque

iii) **Bearer cheques-**This cheque does not have the name of the payee written on it. The person presenting it to the bank is the one who is paid.

iv) **Order cheque-**The cheque bears the name of the payee. The bank pays this particular payee the amount stated in the cheque after proper identification

Dishonouring a cheque

A cheque is dishonored if the bank refuses to pay and returns the cheque to the drawer.

-A cheque can be dishonored due to the following reasons:

i. Insufficient funds in the account
ii. If the signature on the cheque differs from the drawers specimen signature in the bank.
iii. If the cheque is stalc i.e. presented for payment after six months from the date of issue.
iv. If the cheque is **post dated-**meaning the cheque is presented for payment earlier than the date on the cheque
v. If the amount in figures is different from the amount in words
vi. If there are alterations on the cheque which are not countersigned by the drawer
vii. If the cheque is torn, dirty or defauld making it illegible
viii. If the account holder(drawer) is dead and the bank is aware of the fact
ix. If the drawer instructs the bank not to pay the particular cheque
x. If the cheque contains errors which need to be corrected
xi. If the drawer becomes bankrupt or insane
xii. If the drawer has closed his/her account.

Advantages of using cheques

i) They are more secure than notes and coins because if they are lost or stolen, they can be traced to the person who cashed them.
ii) They are convenient to carry and can be used to pay large sum of money which would be otherwise inconvenient to pay using cash
iii) They can be transferred to a third party to make payment/cheques are negotiable
iv) Payment can be made by cheque without the need to travel to make payment
v) They provide a record of payment because of the counterfaits.The counterfaits acts as proof that payment has been made.
vi) Under special circumstances, they can be cashed or discounted before maturity.

Disadvantages of using cheques

i) Cheques can be dishonored
ii) Requires the payee to go to the bank and in some cases to have an account
iii) The drawer pays some charges e.g. charges for the cheque book
iv) Can only be issued by an account holder/the drawer must have an account
v) They are not readily acceptable by everybody
vi) They do not provide immediate cash.

Circumstances under which a cheque is appropriate as a means of payment

- Where the amount of money involved is large
- Where the policy of the business demands so
- Where a cheque is the only means available
- Where there is need to avoid other risks associated with other means of payments

b) Bank drafts/Banker's cheques

-This is a cheque drawn on a bank i.e. a cheque drawn by one bank to another requesting the latter bank to pay a named person or institution a specified sum of money and charge it to the drawing bank

-It can also be drawn by a bank on the request of a customer. The customer fills in an application form obtained from a bank and hands it over to the bank together with the money she wants to transfer and a commission for the service.

-The bank then prepares the cheque and gives it to the applicant who can then send it to the payee

-A bank draft has the drawing bank's guarantee for payment. It is therefore more readily acceptable than personal cheques.

-It is suitable when urgency is desired in the payment as it is more readily acceptable.

c) Credit transfer

This is a means of payment provided by commercial banks to their current accounts holders who want to pay many people using one cheque/at the same time

-One cheque is drawn and is usually accompanied by a list of the people to be paid, the amount to be paid to each person and the addresses of the bank branches where the payment is to be made.

-The bank then ensures that a credit transfer is affected to the various bank branches and each payee is paid

-A credit transfer is usually used by employers to pay salaries to their staff members.

d) Standing order

This is an instruction to a bank by an account holder to pay a named person or an organization a fixed amount of money at regular intervals over a specified period of time or until stopped

-It is a very useful means of payment for business people as it enables them to regularly pay their recurrent bills e.g. water, insurance, electricity, loan payment, hire purchase payment e.t.c

e) Traveler's cheques

This is a cheque drawn by one bank to another requesting the latter to pay a specified sum of money to a named bearer, who usually would have bought that cheque from issuing bank. The cheque holder pays the value of the cheque plus the charges for the services to the issuing bank.

-Travellers cheques are usually issued in fixed denominations and are very convenient for travel purposes, hence their name. They enable a person to travel without having to carry a lot of cash. The cheques are also readily acceptable as a means of payment.

f) Telegraphic Transfers

This is a method /means of transferring money offered by commercial banks to anybody who wants to send money to another

The sender is required to fill an application form and provide the following information among others:

-His/her name -The amount of money to be remitted

-Name of the payee -The bank where the money would be paid

The applicant is charged a commission and telegraph fee. The paying bank sends a telegram to the payee who has to identify himself/herself before the payment is made

The method is fast and safe.

g) Debit cards

These are plastic cards issued by financial institutions e.g. banks that enables a person to purchase goods and services from any business that accepts them. Debit cards are used to make payments from money held in ones accounts and are therefore an alternative to cash payments. Examples are ATM cards.

h) Electronic Fund Transfer (E.F.T)

EFT is a method of transferring money from one account to another where computers are used. The sender is required to fill an electronic fund transfer form provided by the bank which instructs the bank to transfer money from his/her account to a named account.

Information is then sent to the payee's bank electronically and the amount in the account is increased accordingly. The method is very fast.

iii. Means of payments provided by the post office

The post office provides means of payments that can be used to transfer money from one person to another

The means of payments provided by the post office to facilitate payments includes,

a. Money orders
b. Posta pay
c. Postal orders
d. Postage stamps
e. Premium bonds

a) Money orders

A money order facilitates the transfer of money from one person to another through the post office (and/or bank)

A money order is usually for a specified sum of money usually purchased with cash from the post office

A person wishing to send money using this method visits a post office and completes an application form. Some of the details contained/given in the form include:

- The amount of money to be remitted
- Name of the payee
- The name of the post office where the money order will be cashed
- Name and address of the sender
- Whether the money order is to be ordinary or sent by telegraph
- Whether the sender wishes to be informed if the money has been paid
- Whether the money is to be paid through a bank account or at the post office counter.

The application form, money to be remitted and commission for the service is handed to the post office cleark who prepares the money order and gives it to the sender who may post it or send it to the payee.

-Telegraphic money orders, the post office sends a telegram to the payee informing him/her to go to the post office and claim the money.

-Before payment is made, the payee must;

- Identify himself/herself by producing an ID card
- Identify the person who sent the money.

-The sender of the money is left with a counterfoil which serves as evidence that money was sent and it can be used to reclaim the money if it did not reach the payee

-Money order may be open or crossed. A crossed money order bears two parallel lines drawn diagonally on its face and must be deposited in the bank account of the payee. It cannot be cashed over the counter at the post office.

-An open money order can be presented for payment at the post office counter.

Circumstances under which money order is appropriate

a) Where it is the only means available
b) Where other means are not acceptable
c) Where there is need to avoid inconveniences or risks associated with other means

b) Posta pay

This is an Electronic Fund Transfer (EFT) service offered by the postal corporation of Kenya, for sending and receiving money instantly from various destinations both locally and internationally.

-The person sending money fills in a form called 'send form' giving the following details;

- Name, address and telephone number of sender
- Name, address and telephone number of receiver
- Pay city, town and location of the receiver
- Signature of the sender
- Amount to be sent

-The sender hands over the form, the amount of money to be sent and the commission to the post office clerk for processing

-The transfer is done via the internet through a machine that gives a twelve-digit number for the transaction called the **'Transaction control number'(TCN).**The sender then conveys this number, amount sent and pay location to the recipient and instructions to the recipient to visit the named post office for payment. This message is usually conveyed through the quickest means possible such as a telephone call

-The sender is given a copy of the processed 'send form' as proof that money has been sent. The post office retains the original for record purposes.

-When the receiver visits the post office, he/she will fill a 'receiver form' giving the following details;

i) The transaction number(i.e. the twelve-digit number)
ii) The expected amount
iii) The name, address and telephone number of the sender
iv)The city town or location of the sender
v) Signature of the receiver

The receiver then identifies himself or herself by producing an ID card or passport before receiving the money.

-The recipient/payee is then given the money, a copy of the receive form as proof of having received the money. The paying post office retains a copy as proof of payment.

Advantages of using Posta pay as a means of payment

i) **Accessibility-**Posta pay outlets (post offices) are located countrywide to eliminate movement over long distances to get money

ii) **Ease of use-**Sending or receiving money is easy as one only needs to fill a form which is processed immediately

iii) **Speed-**the transfer of money is instant (fast)

iv) **Security-**Confidentiality in the transmission of money is provided and money is only paid to the person intended

v) **Convenience-**Posta pay services are offered for long hours during the day and pay locations are conveniently located

vi) **Affordability-**Posta pay services are relatively affordable as large amounts can be sent at reasonable costs.

c) Postal orders

-Postal orders are sold by the post office for the purpose of remitting money

-They are available in fixed denominations of sh.5, 10.20,40,60,80,100 and 200

-On buying a postal order, the sender pays for both the face value of the postal order and a commission charged for the service

-Postal orders just like money orders are issued with counterfoils that the sender will keep as evidence of remittance in case the person to whom he/she remits the money does not receive it.

The sender writes the name of the payee on the postal order as a safety measure.

Payment to the bearer can be made in any post office with postal order facilities

Postal orders may also be crossed or open (see crossed and ordinary money orders)

Circumstances under which postal orders are appropriate

i) Where the amounts involved are small

ii) Where it is the only means available

iii) Where there is need to avoid inconveniences and risks associated with the other means of payment.

Differences between postal orders and money orders

Postal orders	**Money orders**
a) It can be cashed at any post office	**a)** Can only be cashed at a specific post office
b) Are in fixed denominations	**b)**Varies according to the needs of the remitter
c) Does not require any application form to make a remittance	**c)**Requires the filling of an application form in making remittance
d) Can be cashed by the bearer	**d)**Can only be cashed by the payee
e) Value can be increased by affixing revenue stamps	**e)**Value cannot be increased by affixing revenue stamps

d) Postage stamps

Postage stamps may be used to pay small amounts of money. The person to whom the stamps are sent can then use them for sending mail and/or to pay someone else.

e) Premium Bonds

Premium bonds are issued by the post office in denominations of sh.10 and sh.20.They mature after a given period, after which one can cash them.

-Bearers can also enter into draws so as to win money.

-Premium bonds can be used to settle debts, but it is not a safe method because they can be cashed by anybody i.e. by the bearer.

Circumstances under which postage stamps and premium bonds are used

i) Where the amounts involved are small

ii) Where they are the only means available.

Means and payments which arise from private arrangements between the sellers and the buyers

There are various business documents that originate from private agreements between buyers and sellers. The buyer acknowledges the credit and accepts to pay at specified future dates by signing some documents. These documents include;

a. I Owe you(IOU)
b. Bill of exchange
c. Promissory note.

a) Bill of Exchange

This is unconditional order, in writing, addressed by one person to another, requiring the person to whom it is addressed by one person to another, requiring the person to whom it is addressed to pay on demand, or at a stated future date, the sum of money on the bill to the drawer, or a named person or to a bearer.

i) **Order-**is a command not a request
ii) **Unconditional-**Without condition i.e. no use of such words as 'if' or 'whom'
iii) The bill must be in writing
iv) Amount of money must be clearly stated
v) Payee must be named. He/she can be the drawer or someone else or the bearer
vi) Date of payment must be stated or can be determined e.g. 'Two months from the date of today' or Three days after 31st January 2012'

-A bill of exchange is prepared by a creditor to a debtor when a creditor wants to be assured of payment by a debtor on a given future date or when asked to do so by the creditor

-If the buyer/debtor signs the bill **"accepted"** then he/she cannot deny responsibility for the debt since he/she has acknowledged responsibility for the date.

Procedure for preparing a bill of exchange

A bill of exchange is written by a person (creditor) to his debtor to seek assurance that the debtor would pay the debt.

Step 1. The creditor prepares the draft and sends to the debtor.

Step 2. The draft and after accepting the conditions laid therein, he/she signs on it and write the words "**accepted".** He/she then sends it back to the creditor. At this point the draft becomes a bill of exchange.

Step 3. The creditor receives the bill and may:

i) Keep it until maturity when he would present it to the debtor(accepted) for payment
ii) Discount it with a bank. This is presenting to a bank or any financial institution and receiving cash against it before the maturity date. One is however charged(discounting charge) for the service
iii) Negotiate it-Using it to pay someone else apart from the payee.

Parties to a bill of Exchange

i) Drawer-This is the person who gives the debtor the written order to pay the value of the bill of exchange(the creditor)
ii) Drawee-This is the person to whom the order to pay is given (Debtor).He or she accepts the bill.

iii) **Payee-**This is the person to whom the payment is to be made. The payee may be the drawer, or

Essentials of a bill of Exchange

i) It must be signed by the drawer(creditor)
ii) It must be accepted by the drawee(debtor)
iii) It must be accepted unconditionally
iv)It must bear appropriate revenue stamps

NOTE: A bill of exchange becomes a means of payment when it is presented (discounted) to the banks or negotiated.

Advantages of using a Bill of exchange

i) The holder may pass rights on the bill to another person
ii) Date of payment is determined
iii) Acceptance by the debtor makes it legally binding
iv) The payee may receive money before due dates by discounting

Disadvantages of using a Bill of Exchange

i) It may be dishonoured on maturity
ii) Cash may not be readily available as banks may be reluctant to cash bills from debtors of doubtful financial backgrounds
iii) It is an expensive form of credit as the creditor may lose part of the face value of bill in form of discount

Circumstances under which a Bill of exchange is appropriate.

-When the creditor wants to be assured that the payment would be done
-Where the creditor wants money while the debtor is not able to raise it before the end of the credit period
-Where the creditor wants to use the debt to pay another debt.

b) Promissory note; This is a document in which a debtor promised to pay a creditor a specified sum of money at a specified time/date.

Features of a promissory note

i) There are two parties i.e. the drawer(debtor) and the payee(creditor)
ii) There is a promise to pay
iii) It is written by the debtor to the creditor
iv)It does not require acceptance since it is signed by the person committing to pay the money
v) The writer/maker is liable on the note as he/she is the debtor.

-After drawing and signing the promissory note, the debtor (borrower) sends it to the seller. (Lender)
-The seller/lender may keep it until maturity and then present it for payment or may discount it with the banks before maturity.

Similarities between a Bill of Exchange and a promissory note:

i) Both act as evidence of the acknowledgement of a debt
ii) Both may be discounted or endorsed before maturity
iii) Both are negotiable i.e. can be transferred from one person to another
iv) Both are legally binding
v) Both allow for adequate time within which to organize for the payment of the value of the bill or note.

Differences between a promissory note and a bill of exchange:

Promissory note	**Bill of Exchange**
-Drawn and signed by the debtor	-Drawn and signed by the creditor
-It does not need to be accepted	-It must be accepted by the debtor for it to be valid
-The drawer and drawee are one person	-The drawer is the creditor and the drawee is the debtor

c) The IOU

-IOU is an abbreviation of 'I owe you'

-It is a written acknowledgement by a buyer of a debt arising from the purchase of goods and services on credit. It is written and signed by the buyer and sent to the seller

-If the seller accepts it, then the buyer can receive goods and services on credit.

Though the IOU does not usually indicate the specific date of payment, the buyer acknowledges the debt and accepts responsibility to pay at a suitable future date

NOTE: The use of IOU is restricted to commercial transactions involving parties who have dealt with each other for a long time; hence they know each other well.

iv) Other means of payment

a) Credit cards
b) Mobile money transfer services e.g. M-pesa.

a) Credit cards(plastic money)

-These are plastic cards that enable a person to purchase goods or services on credit from any business willing to accept the card

-They are both a means of payment and a term of payment

b) Mobile money transfer services e.g. M-pesa

-This is a means of money transfer services provided by mobile phone service providers to their customers (subscribers)
-It can only be used to transfer money between people subscribed to the same mobile phone network e.g. from one safaricom subscriber to another safaricom subscriber, Airtel to Airtel e.t.c
-The sender must register for the money transfer service and is issued with a PIN (personal identification number)
-When money is sent, both the sender and the receiver will receive a message confirming the transfer.
-A person can send money anytime anywhere so long as he/she has value in his/her m-pesa, pesa pap account.
-Each mobile service provider has a range of value that can be transferred using this method.
-A small transaction fee is charges for the transfer i.e. for sending and withdrawing

Benefits of mobile money transfer services

i. **Confidentiality-**The secret PIN protects the value in the customer's account
ii. **Ease of use-**The service is easy to use as the agents assists to carry out transaction
iii. **Speed-**Money transfer is an instant service conveyed to the receiver via the short message service(SMS)
iv. **Convenience-**The service is convenient to both the sender and the receiver, as they only need to go to the nearest agent(money can be sent/deposited or received anywhere)
v. **Accessibility-**The agents e.g. m-pesa agents are located in most parts of towns and also in rural areas. Money can hence be sent and received anywhere and anytime.
vi. **Affordability-**The service charges are very low for registered users and very affordable for non registered users
vii. **Security-**Relatively secure when the sender uses the correct phone number of the receiver.

TERMS OF PAYMENTS

These are the various agreements/conditions agreed upon between sellers and buyers regarding how debts arising from their transactions should be settled. These conditions include;

-How payment is expected

-When payment is expected

-What is included in the quoted price e.t.c.

Terms of payments are broadly categorized into two;

A. Cash payments

B. Deferred payments(credit payments)

-This classification depends on whether the agreement is to pay for the products immediately or at a later date.

A. Cash Terms of payments

Cash terms of payment apply when a buyer is required to pay for goods or services immediately before or after delivery. They include the following:

a) Spot cash-This is where payment is done at the point of purchase.

-Mainly used in retail businesses where customers are required to pay as they get the goods or receive the service.

b) Cash on Delivery (C.O.D)

-This is where the buyer pays for the goods (or services) as soon as they are delivered to his or her premises.

c) Cash with order (C.W.O)

-This is where the buyer is required to pay for the goods when making the order for the goods or the services.

Circumstances under which C.O.D and C.W.O are appropriate

- **i.** When the buyer is new to the seller
- **ii.** Where the buyer's credit worthiness is in doubt
- **iii.** Where the seller is operating mail order stores(C.W.O only)
- **iv.** Where C.W.O or C.O.D is the policy of the business
- **v.** If the cost of collecting debts is considered high by the seller
- **vi.** When a seller is to make goods based on unique specification provided by a particular buyer(C.W.O only)
- **vii.** Where the seller wants to avoid tying up business capital in debts.

d) Prompt cash; This is where payment should be made within a few days (normally seven days) after delivery.

-Prompt cash period allows them to examine the goods and check the invoice to certify its corrections

ii) Deferred payments

This means that goods or service are not paid for in full on delivery. They are instead paid in future in a lump sum or in several instalments.
The period within which a buyer is supposed to pay the seller is referred to as **credit period** and is expressed in terms of days.
-Terms of payments in credit transactions are usually agreed upon by the seller and the buyer depending on;

- Capital base/financial stability of the seller
- The nature of the goods supplied
- The relationship between the buyer and the seller
- The credit worthiness of the buyer

-In determining the credit worthiness of a buyer, the seller will consider;
a) Character-The behavior of the buyer in terms of honesty, which determines the probability of the buyer honoring his /her debt obligations
b) Capacity-The buyer's ability to pay as indicated by past business performance records or the profitability and the value of his/her assets.
c) Capital-The financial position of the buyers business or how much the buyer's business is worth.
d) Collateral-These are the properties of value pledged by the buyer as security for the credit
e) Condition-The effect of the existing economic conditions on the buyer's ability to pay his/her debts.

Forms of Deferred payments (credit payments)

a) Open trade credit/open credit

-Under these forms, goods and services are sold to the buyer who is expected to pay for them at a future date or within a given period
-The buyer may also be required to pay for goods or services on installments.
-Discounts may be allowed to encourage the buyer to pay on time.
-The ownership of the goods passes to the buyer immediately after entering the contract. The seller should however ensure the buyer will pay by:

- Ascertaining the credit worthiness of the buyer
- Asking the buyer to guarantee payment by signing some documents e.g. bill of exchange
- Asking the buyer to have someone else to guarantee the payment
- Asking the buyer to pledge (mortgage) some of his/her property as security

Factors to consider when giving credit

a. Credit worthiness of the buyer
b. Repayment period

c. Amount of goods the customer wants
d. Availability of adequate stock
e. Honesty i.e. reliability of the customer
f. Frequency at which the customer buys from the seller
g. Seller's intention to attract and retain customers

NOTE: No interest is usually charged on open trade credit.

Examples of open trade credit

i) Simple credit(prompt cash/personal credit)

-Is a form of credit extended to a trader or a customer for a very short time, usually not more than a week

-It is a common form of credit between retailers and their customers.

-It is also referred to as prompt cash because payment is made within a short time.

ii) Monthly credit

-A form of credit extended when a seller allows the buyer to pay/settle his/her debt after one month

-The buyer can continue taking goods from the seller up to the end of the month.

-It is a form of credit usually allowed by retailers to salaried workers for goods such as food items and newspapers

iii) Budget Accounts

-Are usually operated by large scale retailers to approved customers

-The retailer keeps an account of the customer in his/her books

-To operate budget accounts;

- A deposit is required
- Regular payments are to be made
- There is a maximum amount of credit to be allowed
- The customer may be charged for any special services given by the seller called "**after sale services**"

iv)Trade credit

-This is credit given by a trader to another trader when goods are bought for selling

-Payments for the goods is made after selling the goods or within an agreed period of time

v) Credit card facilities

-Plastic money (credit cards) enables the holder to obtain goods and services on credit form specific suppliers (people willing to accept the cards)

-They also enable the holders to obtain money from specific banks and other specified financial institutions
-They are available to adults of approved credit worthiness
-Some credit cards can only be used locally while others like **visa cards** can be used both locally and internationally.
-When a customer makes a purchase using the card, the seller electronically verifies the validity of the card and whether the credit-card holder/customer has sufficient credit to cover the purchase. If all is well, the credit card customer signs a specific form that have been filled by the trader. Such forms are usually provided by the card company to the trader. The trader and the card holder retain a copy each and the other copies are sent either to the credit card company or to the trader's bank.
-There are therefore 3 parties to a credit card;

- The company that issues the cards
- The card holder
- The trader

-At regular intervals, the credit card company sends a statement of account to each card holder showing the outstanding balance at that time. The outstanding balance should not be greater than the allowed credit limit.
-Examples of companies that issue credit cards include; **Barclays card, American Express, Access cards and Visa cards.**

Advantages of credit card

- They are safer to carry around than cash
- Convenient to carry around
- Enables the holder to get goods and services from specified sellers without paying immediately
- Some are acceptable both locally and internationally
- Enables the holder to get money from specified banks
- Increases credit rating of an individual

Disadvantages of credit cards

- To acquire the credit card, the applicant is required to have an established credit record
- The holder is charged high interest rate by the card company
- It is prone to abuse through fraud
- Interest is charged if there is delay in payment
- Can only be used by those who are 18 years and above

- Holder may be tempted to overspend
- Their use is limited to only specific areas(urban areas)
- Faces stiff competition from other means of payment such as cheques, money orders and postal orders.
- Only few businesses accept the cards
- Long procedures are involved in getting the cards
- The cards can only be affected by people with high income.

b) Hire purchase

To Hire: Means to use someone else's property for a payment

Hire purchase: Is a method of hiring property with an option to buy.

-The term of payment for a hire purchase are;

- The buyer pays an initial deposit(down payment)
- The remaining amount(balanced is paid in equal monthly installment spread over an agreed period of time
- The installments paid include interest which usually makes the overall price paid relatively higher than would be the case if the goods were obtained on cash terms.

-Goods sold on higher purchase are durable and expensive such as; vehicles, furniture, electronics e.t.c

-The buyer can only posses the commodity but not own it.Therefore'the buyer cannot sell the goods to another person before all installments are paid

-Ownership of the goods remains with the seller. The goods are 'on hire' to the buyer.

-After completing the payment (after the last installment has been made), a certificate is issued to the buyer as proof of transfer of ownership

-Incase the buyer fails to make payment/defaults in payment; the seller can repossess the goods. However if the buyer has paid two thirds of the total/hire purchase price at the time of defaulting, the seller has no legal right to repossess the goods.

-The seller can only recover the remaining amount of money through a court action

-The seller must display both the cash price and the hire-purchase price on the items to enable the buyers to decide under what terms they want to buy the goods.

-A written agreement has to be entered into by both the seller and the buyer. The agreement safe-guards the intervals of all of them

-Examples of hire purchase businesses operating in Kenya include; Africa Retail Traders (ART), Kukopesha, Singer and Amedo.
-For salaried people, the hire purchase has introduced a system where the installments are deducted directly from the buyer's salary every month. This is called the **check-off system**. In this system, no deposits/down payments are required. The buyer's employer takes up the duty of remitting the deposits to the seller on a monthly basis.

Advantages of Hire purchase

To the buyer

a. The buyer acquires possession and use of goods immediately after entering into the contract
b. Installments to be paid are pre-determined, so the buyer knows and is able to budget for this amount
c. One can acquire expensive goods/items which are difficult to get on cash terms
d. Payment is spread over a long duration of time making it convenient/suits the buyer's income
e. Raises standards of living despite limited resources

To the seller

a. The goods belongs to the seller until the last installment is paid
b. He/she can repossess the goods in case the buyer defaults in payments
c. The seller is able to make more profit due to higher prices in the long run
d. The sales volume increase due to greater ability by customers to pay/more buyers are attracted to hire purchase terms leading to more sales
e. No refund is payable to a buyer for goods repossessed from him/her
f. Due to the check-off system, chances of non-payment are minimized.

Disadvantages of Hire purchase

To the buyer

a. The hire purchase price is higher than the cash price.
b. The goods belong to the seller until the last installment is made
c. Because of the easy payment terms, the buyer may be tempted to overspend which might lead to financial problems
d. The variety of goods sold on hire purchase terms is limited to those goods that are durable
e. If the buyer defaults in payment, the already paid ones are treated as hire charges and are not refunded.
f. Goods may be repossessed if the buyer defaults in payment

To the seller

a. Goods repossessed can only be sold as second hand
b. There is a lot of documentation and filing of information/records
c. The cost of operating the business is usually very high
d. The risks of loss on hire purchase sales are normally high as some buyers may default in payment
e. High amount of capital is needed to finance a hire purchase business
f. A lot of money is spent on repair of damaged goods
g. A lot of capital is tied and held in stock and debts.

c) Installment Buying/credit sale(deferred payment)

-In this form of credit selling, the buyer is not required to pay a down payment. Payment for the goods is made in equal installments spread over a period of time. These installments cover interest and related costs of selling.

Other features of installment buying

a. The ownership and possession of goods passes on to the buyer immediately the first installment is paid
b. Once the goods have been sold, they cannot be repossessed by the seller even if the buyer defaults in payment.
c. In case the buyer defaults in payment, the seller can obtain compensation through court action.
d. There is a written agreement between the buyer and the seller(creditor)
e. The buyer may dispose of the goods before paying for them fully
f. Can be used for non-durable goods

BUSINESS STUDIES FORM TWO NOTES

FORMS OF BUSINESS UNITS

TOPIC OBJECTIVES

By the end of the topic, the learner should be able to:

1. Identify the various forms of business units.
2. Explain the characteristics of each form of business unit.
3. Discuss the formation and management of each form of business unit.
4. Discuss the sources of capital of each form of business unit.
5. Discuss the role of stock exchange as a market for securities.
6. Explain the advantages and disadvantages of each form of business unit.
7. Recognize the circumstances under which each form of business units may be dissolved.
8. Discuss trends in business ownership.

BUSINESS UNITS

A business unit is an organization formed by one or more people with a view of engaging in a profitable activity.
Business units are generally classified into private or public sector business units' i.e.
Note: Private sector comprises of business organizations owned by private individuals while the public sector comprises business organizations owned by the government.

1. SOLE PROPRIETORSHIP

This is a business enterprise owned by one person who is called **a sole trader or a sole proprietor.** It is the most common form of business unit and usually found in retail trade e.g. in small shops, kiosks, agriculture e.t.c and for direct services e.g. cobblers saloons e.t.c

Characteristics/Features

- The business is owned by one person
- The capital is contributed by the owner and is usually small. The main source is from his savings and other sources can be from friends, bank or getting an inheritance
- The owner enjoys all the profits alone and also suffers the losses alone
- The owner is personally responsible for the management of the business and sometimes he is assisted by members of his family or a few employees. He remains responsible for the success or failure of his/her business.
- The sole proprietor has unlimited liability meaning that incase of failure to meet debts, his creditor can claim his personal property
- There are very few legal requirements to start the business unit.
- Sole proprietorship is flexible; it is very easy to change the location or the nature of business.

Formation

The formation of a sole proprietorship is very simple. Few legal formalities are required i.e. to start a sole proprietorship, one need only to raise the capital required and then apply for a trading license to operate the business small fee is paid and the trade license issued.

Sources of capital

The amount of capital required to start a sole proprietorship is small compared to other forms of business organizations. The main source of capital is the **Owners savings.** Additional capital may however be raised from the following;

- Borrowing from friends, banks and other money lending institutions such as industries and commercial Development corporation(ICDC)and Kenya industrial estates
- Inheritance
- Personal savings
- Getting goods on credit
- Getting goods on hire purchase
- Leasing or renting out one's properties
- Donations from friends and relatives
- Ploughing back profit.

Management

The management of this kind of a business is under one person. The owner may however employ other people or get assistance from family members to run the business.

Some sole proprietorship may be big business organizations with several departments and quite a number of employees. However, the sole proprietor remains solely responsible for the success of failure of the business

Advantages of sole proprietorship

1. The capital required to start the business is small hence anybody who can spare small amounts of money can start one.
2. Few formal/legal procedures are required to set up this business
3. Decision making and implementation is fast because the proprietor does not have to consult anybody
4. The trader has close and personal contact with customers. This helps them in knowing exactly what the customers need and hence satisfying those needs
5. A sole proprietor is able to assess the credit-worthiness of his or her customers because of close personal relationship. Extending credit to a few carefully selected customers reduce the probability of bad debts.
6. The trader is accountable to him/herself
7. A sole trader is able to keep the top secrets of the business operations
8. He/she enjoys all the profit
9. A sole proprietorship is flexible. One can change the nature or even the location of business as need arises.

Disadvantages of sole proprietorship

1. Has unlimited liability. This means that if the assets available in the business are not enough to pay all the business debts the personal property of the owner such as house will be sold to meet the debts
2. There is insufficient capital for expansion because of scarce resources and lack of access to other sources
3. He/she is overworked and has no time for recreation.
4. There is lack of continuity in the sole proprietorship i.e. the business is affected by sickness or death of the owner.
5. A sole proprietorship may not benefit from advantages realized by large scale enterprises (economies of large scale) such as access to loan facilities and large trade discounts.
6. Lack of specialization in the running of the business may lead to poor performance. This is because one person cannot manage all aspects of the business effectively. One maybe a good salesman for examples but a poor accountant.
7. Due to the size of the business, sole proprietorships do not attract and retain highly qualified and trained personnel.

Dissolution of sole proprietorships

Dissolution refers to the termination of the legal life of a business. The following circumstances may lead to the dissolution of a sole proprietorship:

- Death or insanity of the owner
- Transfer of the business to another person- this transfers the rights and obligations of the business to the new owner.
- Bankruptcy of the owner- this means that the owner lacks the financial capability to run the business.
- The owner voluntarily decides to dissolve the business e.g due to continued loss making.
- Passing of a law which renders the activities of the business illegal.
- The expiry of the period during which the business was meant to operate.

2. PARTNERSHIP:

This is a relationship between persons who engage in a business with an aim of making profits/ an association of two or more persons who run a business as **co-owners**. The owners are called **Partners.**

It is owned by a minimum of 2 and a maximum of 20 except for partnership who provide professional services e.g medicine and law which have a maximum of 50 persons.

Characteristics of partnership

- Capital is contributed by the partners themselves
- Partnership has limited life that is it may end anytime because of the death, bankruptcy or withdrawal of partners.
- Each partner acts as an agent of the firm with authority to enter into contracts.
- Partners are co owners of a business, having an interest or claim in the business.
- Responsibility, profit and losses are shared on an agreed basis.
- All partners have equal right to participate in the management of the business. This right arises from the interest or claim of the partner as a co owner of the business.

Types of partnership

Partnerships can be classified/ categorized in either of the following ways:

(a)According to the type/liability of partners

(b) According to the period of operation

(c)According to their activities

(a) According to the type or liability of partners

Under this classification, partnerships can either be:

i) **General/ordinary partnership-** Here all members have unlimited liability which means in case a partnership is unable to pay its debts, the personal properties of the partner will be sold off to pay the debts.

ii) **Limited partnerships-** In limited partnership members have limited liabilities where liability or responsibility is restricted to the capital contributed.

This means that incase the partnership cannot pay its debts; the partners only lose the amount of capital each has contributed to the business and not their personal property. However, there must be one partner whose liabilities are unlimited.

(b) According to the period/duration of operation

When partnerships are classified according to duration of operation, they can either be;

i) **Temporary partnership-**These are partnerships that are formed to carry out a specific task for a specific time after which the business automatically dissolves.

ii) **Permanent partnerships-** These are partnerships formed to operate indefinitely. They are also called a partnership at will.

c) **According to their Activity-** Under this mode of classification, partnerships can either be:

i) Trading partnerships

This is a partnership whose main activity is processing, manufacturing, construction or purchase and sale of goods.

ii) Non – trading partnerships

This is a partnership whose main activity is to offer services such as legal, medical or accounting services to members of the public.

Types of partners

Partners may be classified according to;

i) Role played by the partners

a) **Active partner:** He is also known as acting partner as he plays an active part in the day-to-day running of the business.

b) **Sleeping/dormant partner:** He does not participate in the management of the partnership business. Although he invests his capital in the partnership, his profit is lower as he is not active. He is also referred to as passive or silent partner.

ii) Liabilities of the partners for the business debts:

a) **General partner:** He/she has unlimited liabilities.

b) **Limited partner:** He/she has limited liabilities

iii) Ages of partners

a) **Major partner:** This is a partner who is 18 years and above. He is responsible for all debts of the business.

b) **Minor partner:** This is a partner who has not attained the age of 18 years but has been admitted with the consent of other partners. Once he reaches 18 years, he then decides if he wants to be a partner or not. Before he attains the age of 18, he takes part in the sharing of profits but does not take part in the management of the business.

iv) Capital contribution

a) **Nominal/Quasi partner:** He does not contribute capital but allows the business to use his/ her name as a partner; for the purpose of influencing customers or for prestige.

-He/she can also be a person who was once a partner and has retired in form of a loan. This loan carries interest at an agreed rate.

-The quasi partner shares the profit of the business as a reward for using his/her name.

b) **Real partner:** He/she is one who contributes capital to the business.

-Other types of partners include secret partners, retiring partners and incoming partners

i) A secret partner: is one who actively participates in the management of the firm but is not disclosed to the public. In most cases secret partners are also limited partners.
ii) A retiring partner: Also known as outgoing partner is one who is leaving a partnership
-He may retire with the consent of all the other partners or according to a previous agreement.
iii) Incoming partner: Is one who is admitted to an existing partnership.
Formation
-People who want to form a partnership must come together and agree on how the proposed business will be run to avoid future misunderstanding.
-The agreement can either be oral (by use of mouth) or within down. A written agreement is called a **partnership deed.**
-The contents of the partnership deed vary from one partnership to another depending on the nature of the business, but generally it contains:
a) Name, location and address of the business
b) Name, address and occupation of the partners
c) The purpose of the business
d) Capital to be contributed by cash partner
e) Rate of interest on capital
f) Drawings by partners and rate of interest on drawings
g) Salaries and commissions to partners
h) Rate of interests on loans from partners to the business
i) Procedures of dissolving the partnership
j) Profit and loss sharing ratio
k) How to admit a new partner
l) What to do when a partner retires dies or is expelled
m)The rights to inspect books of accounts
n) Who has the authority to act on behalf of other partners.
Once the partnership deed is ready, the business may be registered with the registrar of firms on payment of a registration fee.
In case a partnership deed is not drawn, the provisions of partnership act of 1963 (Kenya) applies. The act contains the following rights and duties of a partner:
i) All partners are entitled to equal contribution of capital
ii) No salary is to be allowed to any partner
iii) No interest is to be allowed on capital
iv) No interest is to be charged on drawings

v) All profits and losses are to be shared equally
vi) Every partner has the right to inspect the books of accounts
vii) Every partner has the right to take part in decision making
viii) Interest is to paid on any loans borrowed by partners (The % rate varies from one country to another)
ix) During dissolution the debts from outside people are paid first then loans from partners and lastly partners capital.
x) No partner should carry out a competing business
xi) Any change in business such as admission of new partners must be through the agreement of all existing partners.
xii) Compensation must be given to a partner who incurs any loss when executing the duties of the business.

Sources of capital

i) Partners contribution
ii) Loans from banks and other financial institutions
iii) Getting items on hire purchase
iv) Trade credit
v) Ploughing back profit
vi) Leasing and renting.

Advantages of partnership

i) Unlike sole proprietorship, partnership can raise more capital.
ii) Work is distributed among the partners. This reduces the workload for each partner
iii) Varied professional/skilled labour; various partners are professionals in various different areas leading to specialization
iv) They can undertake any form of business agreed upon by all the partners
v) There are few legal requirements in the formation of a partnership compared to a limited liability company.
vi) Losses and liabilities are shared among partners
vii) Continuity of business is not affected by death or absence of a partner as would be in the case of a sole proprietorship
viii) Members of partnership enjoy more free days and are flexible than owners of a company
ix) A Partnership just like sole proprietorship is exempted from payment of certain taxes paid by large business organizations.

Disadvantages of partnership

i) A mistake made by one of the partners may result in losses which are shared by all the partners
ii) Continued disagreement among the partners can lead to termination of the partnership
iii) Decision-making is slow since all the partners must agree
iv) A partnership that relies heavily on one partner may be adversely affected on retirement or death of the partner
v) A hard working partner may not be rewarded in proportion to his/her effort because the profits are shared among all the partners
vi) There is sharing of profits by the partners hence less is received by each partner
vii) Few sources of capital, due to uncertainty in the continuity of the business few financial institutions will be willing to give long-term loans to the firm.

Dissolution of partnership

A partnership may be dissolved under any of the following circumstances:

i) A mutual agreement by all the partners to dissolve the business
ii) Death insanity or bankrupting of a partner
iii) A temporary partnership on completion of the intended purpose or at the end of the agreed time.
iv) A court order to dissolve the partnership
v) Written request for dissolution by a partner
vi) If the business engages in unlawful practices
vii) Retirement or admission of a new partner may lead to a permanent or temporary dissolution
viii) Continued disagreements among the partners

INCORPORATED FORMS OF BUSINESS UNITS

These are businesses that have separate legal entities from that of their owners. They include:

CO-OPERATIVES

-A co-operative society is a form of business organization that is owned by and run for the economic welfare of its members

-It is a body of persons who have joined together to do collectively what they were previously doing individually for mutual benefit.

Example

In Kenya the co-operative movement was started by white settlers in 1908 to market their agricultural produce. In this case, they knew that they could sell their produce better if they were as a group and not alone

Principles of co-operatives

i) Open and voluntary membership

Membership is open and voluntary to any person who has attained the age of 18 years. No one should be denied membership due to social, political, tribal or religious differences. A member is also free to leave the society at will

ii) Democratic Administration

The principle is one man one vote. Each member of the co-operative has only one vote irrespective of the number of shares held by him or how much he buys or sells to the society

iii) Dividend or repayment

-Any profit/surplus made at the end of every financial year should be distributed to the members in relations to their contribution.

-Part of the profit may be retained/reserved/put in to strengthen the financial position of the society.

iv) Limited interest on share capital

-A little or no interest is paid on share capital contributed (co-operatives do not encourage financial investment habits but to enhance production, to encourage savings and serve the members)

v) Promotion of Education

Co-operative societies should endeavor to educate their members and staff on the ideas of the society in order to enhance/improve quality of decisions made by the concerned parties.

Education is conducted through seminars, study tours, open days

vi) Co-operation with other co-operatives

C-operatives must learn from each other's experience since they have a lot in common.

-Their co-operation should be extended to local national and international.

Features of co-operatives

- Membership is open to all persons so long as they have a common interest. Members are also free to discontinue their membership when they desire so
- Co-operative societies have a perpetual existence; death, bankruptcy or retirement of a member does not affect its operations

- They are managed in a democratic manner. Every member has one vote when electing the managerial committee irrespective of the number of shares held.
- The main aim is to serve the interest of the members where profit is not the overriding factor.
- Co-operative societies have limited liabilities
- There must be a minimum of 10 people with no maximum membership.
- Co-operatives have a separate legal entity from the members who formed it i.e they can own property sue and be sued
- Any profit made by the society is distributed to the members on the basis of the services rendered by each member but not according to the capital contributed.

Formation

-Co-operative societies can be formed by people who are over eighteen years regardless of their economic, political or social background.

-There must be a minimum of 10 persons and no maximum no.

-The members draft rules and regulations to govern the operations of the proposed society i.e. by-laws, which are then submitted to the commissioner of co-operatives for approval

-The registrar then approves the by-laws and issues a certificate of registration

-If the members are unable to draw up their own by-laws, the co-operative societies Act of 1966 can be adopted in part or whole

Management

-A co-perative society is composed/run by a committee usually of nine members elected by the members in a general meeting

-The management committee elects the chairman, secretary and treasurer as the executive committee members, who act on behalf of all the members and can enter into contracts borrow money institute and depend suits and other legal proceedings for the society

-The committee members can be voted out in an A.G.M if they don't perform as expected.

TYPES OF CO-OPERATIVES SOCIETIES IN KENYA

May be grouped according to;

i) Nature of their activities

a) Producer co-operatives

b) Consumer co-operatives

c) Savings and credit co-operatives

ii) Level of operations

a) Primary co-operatives

b) Secondary co-operatives

a) Producer co-operatives

This is an association of producers who have come together to improve the production and marketing of their products.

Functions

- Obtaining better prices for their members products
- Providing better storage facilities for their products
- Providing better and reliable transport means for moving the products from the sources to the market and building feeder roads
- Providing loans to members
- Providing services of grading, packing and processing to the members
- Providing farm inputs e.g. fertilizers, seeds, insecticides e.t.c on credit to members
- Educating and advising members on better methods of farming through seminars, field trips, films and demonstration

-In this type of co-operative members are paid according to the quantity of the produce a member has delivered to the society.

Examples,

KCC-Kenya Co-operative Creameries

K.P.C.U-Kenya Planters Co-operatives Union

K.G.G.C.U-Kenya Grain Growers Co-operative Union

b) Consumer Co-operatives

-These are formed by a group of consumers to buy goods on wholesome and sell them to the members at existing market prices.

-Their aim is to eliminate the wholesalers and retailers and hence obtain goods more cheaply

-The co-operatives allow their members to buy goods on credit or in cash

-Members of the public are also allowed to buy from the society at normal prices thereby enabling the society to make more profits

-The profits realized is shared among the members in proportion to their purchases i.ethe more a member buys, the buyer his/her share of profit

Examples;-Nairobi consumer co-operative union, Bee-hive consumer co-operative society and City-chicken consumer co-operative society

Advantages

- Sell goods of high quality
- Sell goods to members at fair prices
- Sell goods to other people at normal prices thereby making more profit
- Buy goods directly from the producers thereby eliminating middlemen. They are therefore able to make more profit
- Can give credit facilities to the members
- Can pay interest on capital to the members
- Sell a variety of goods to the members at a place where they can easily get them

Disadvantages

Consumer co-operatives are not popular in Kenya because of the following

i. They face stiff competition from large scale retailers such as supermarkets and multiple shops who buy goods directly from the producers and sell- them to consumers at low prices
ii. Cannot offer to employ qualified staff
iii. Majority of their members have low income, so raising off capital is a problem
iv. Kenya, being an agricultural country, produces enough subsistence goods for itself. It therefore does not require consumer co-operatives
v. Reluctance of non-members to buy from the shops lowers the turn-over
vi. Mismanagement of the shops is rampant

Savings and credit co-operatives societies (SACCO'S)

-They are usually formed by employed persons who save part of their monthly salary with their co-operative society, through check-off system

-Their money earns goods interest and when one has a significant amount saved, he/she become entitled to borrow money from the society for any personal project e.g. improving their farms, constructing houses, paying school fees e.t.c

-The SACCOS charge lower interest on loans given to members than ordinary banks and other financial institutions.

-The societies have few formalities or requirements to be completed before giving a loan. These are:

i. Membership
ii. Members salary
iii. Members saving

iv. Guarantee from fellow members

-Profits earned by the SACCO'S maybe shared among the members inform of dividends.

-Most SACCO'S have insured their members savings and loans with co-operative insurance services (CIS).This means if a member dies his/her beneficiaries are not called upon to repay the loan and the members savings/shares is given to the beneficiaries.

-They are the main institutions that provide loans to most people who do not qualify for loans from commercial banks because they do not ask for securities such as title deeds required by the bank.

d) Primary co-operative societies

-These are co-operative societies composed of individuals who are either actual producers, consumers or people who join up together to save and obtain credit most conveniently

-Consumer co-operative societies and most SACCO'S are primary co-operative societies because they are composed of individuals.

-Most primary co-operative societies operate at the village level, others at district levels and a few at national levels.

e) Secondary co-operative societies

-They are usually referred to as unions

-They are generally composed of primary co-operative societies as their members

-They are either found at district levels or at national levels.

Advantages of co-operative societies:

- Since the properties of co-operatives are owned collectively, they are able to serve the interest of the members affectively
- They have limited liability
- Membership is free and voluntary
- Members share profits of a co-operative through dividend that are given
- They have improved the standards of living of their members through increased income from their produce and through savings from incomes.
- Co-operatives benefit their members through giving them credit facilities and financial loans which they could not have got from local banks
- They are run on a democratic basis i.e. all members have an equal chance of being elected to the management committee.

- Many co-operatives are large scale organizations hence able to get the benefits of large scale organizations e.g low production costs leading to low prices of products
- Co-operative enjoy a lot of support from the government and when they are in financial and managerial problems, the government steps in to assist them

Disadvantages

- Majority of the co-operatives are small in size and therefore cannot benefit from economies of scale.
- Members have a right to withdraw from the society and when they do, co-operatives refunds the capital back which might create financial problems to the society.
- Corruption and embezzlement of funds is a problem for many co-operatives.
- Most co-operatives are not able to attract qualified managerial staff hence leading to mismanagement.
- Many suffer from political interference. Sometimes; the election of the management committee is interceded with by some people with personal interest in certain candidates hence the best person may not be elected to run the affairs of the society. This leads to poor management and inefficiency.
- Members may not take keen interest in the affairs of a co-operative society because their capital contribution is small.

Dissolution of co-operative societies

-A co-operative society may be dissolved under any of the following circum-stances.

i. Order from commissioner of co-operatives
ii. Voluntary dissolution by members
iii. Withdrawal of members from the society leaving less than ten members
iv. If the society is declared bankrupt

LIMITED LIABILITY COMPANIES (JOINT STOCK COMPANIES)

Defination: A company; Is an association of persons registered under the companies act who contribute capital in order to carry out business with a view of making a profit.

The act of registering a company is referred to as **incorporation.**

Incorporation creates an organization that is separate and distinct from the person forming it.

-A company is a legal entity that has the status of an ''**artificial person".** It therefore has most of the rights and obligations of a human being. A company can therefore do the following;

- Own property
- Enter into contracts in its own name.
- Borrow money.
- Hire and fire employees.
- Sue and be sued on its own right.
- Form subordinate agencies, ie, agencies under its authority.
- Disseminate or spread information.

-The owners (members) of a company are referred to as shareholders

FEATURES OF COMPANIES (LIMITED LIABILITY COMPANIES)

-A company in an artificial person and has the same rights as a natural person. It can therefore sue and be sued in a court of law, own property and enter into contracts in its own name.

-The members have limited liabilities.

-Companies have perpetual life which is independent of the lives of its owners. Death, insanity or bankruptcy of a member does not affect the existence of the company. (this is referred to as **perpetual existence or perpetual succession)**

- A company is created for a particular purpose or purposes.

Formation

-People who wish to form company are referred to as **promoters**

-The promoters submit the following documents to the registrar of companies:

i) **Memorandum of Association**

-This is a document that defines the relationship between the company and the outsiders. It contains the following:

a) Name of the company/Name clause; -The name of the company must be started and should end with the word "Limited" (Ltd).This indicates that the liability of the company is limited.

-Some companies end their names with **"PLC"** which stands for "**Public limited company"** which makes the public aware that although it is a limited liability company it is a public not private.

b) The objects of the company/objective clause;-This set out the activities that the company should engage in

-The activities listed in this clause serve as a warning to outsiders that the company is authorized in these activities only.

c) Situation clause;-Every company must have a registered office where official notices and other communication can be received and sent

d) Capital clause;-It also states that the amount of capital which the business can raise and the divisions of this capital into units of equal value called shares i.e. authorized share capital also called registered or nominal share capital.

-It also specifies the types of shares and the value of each share

e) Declaration clause:-This is a declaration signed by the promoters stating that they wish to form the company and undertake to buy shares in the proposed firm

-The declaration is signed by a minimum of seven promoters for public limited company and a minimum of two for private company.

-The memorandum of association also contains the names of the promoters

-The promoters signs against the memorandum showing details of their names, addresses, occupation and shares they intend to buy. Each signatory should agree to take at least one share.

i) Articles of Association

-This is a document that governs the internal operations of the company

-It also contains rules and regulations affecting the shareholders in relation to the company and in relation to the shareholders themselves.

-It contains the following;

- Rights of each type of shareholder e.g. voting rights
- Methods of calling meeting and procedures
- Rules governing election of officials such as chairman of the company, directors and auditors
- Rules regarding preparation and auditing of accounts
- Powers, duties and rights of directors
- Methods dealing with any alterations on the capital.

ii) A list of directors with details of their names, addresses, occupations, shares subscribed and statements of agreement to serve as directors

iii) Declaration that registration requirements as laid down by law (by the companies act) have been met. The declaration must be signed by the secretary or a director or a lawyer.

iv) A statement signed by the directors stating that they have agreed to act as directors.

v) A statement of share capital- this statement gives the amount of capital that the company wishes to raise and its subdivision into shares.

-Once the above documents are ready, they are submitted by the promoters to the registrar of companies. On approval by the Registrar and on payment of a registration fee, a certificate of incorporation (certificate of registration) is issued

-The certificate of incorporation gives the company a separate legal entity.

Sources of capital

1. **Shares;** The main source of capital for any company is the sale of shares.
   -A share is a unit of capital in a company e.g. if a company states that its capital is ksh.100,000 divided into equal shares of ksh.10 each.
   -Each shareholder is entitled to the company's profit proportionate to the number of shares he/she holds in the company.

Types of shares:

a) Ordinary shares
b) Preference shares

a) Ordinary shares;-Ordinary shares have the following rights:

- Have voting rights
- Have no fixed rate of dividends. The dividends on them vary according to the amounts of profit made
- They have a claim to dividends after the preference shares
- If the company is being liquidated, they are paid last after the preference shares

b) Preference shares;-They have the following characteristics;

- Have a fixed rate of sharing profits(dividends)
- Have a prior claim to dividends over the ordinary shares
- Have no voting rights
- Can be redeemable or irredeemable. Redeemable shares are the ones that can be bought back by the company at a future date while irredeemable ones are ones that cannot be bought back
- Can be cumulative or non-cumulative. Cumulative shares are the ones that are entitled to dividends whether the company makes profit or not. This means if the company makes a loss or a profit which is not enough for dividends in a certain year, the dividends to cumulative shares are carried forward to the next year(s) when enough profit are made

-Non- cumulative shares are the ones whose dividends are not carried forward to the following year(s)

2. **Debentures**

This refers to loans from the public to a company or an acknowledgement of a debt by a company

They carry fixed rate of interest which is payable whether profit are made or not.

They are issued to the public in the same way as shares.

They can be redeemable or irredeemable.

Redeemable debentures are usually secured against the company's assets in which case they termed as secured debentures or mortgaged debentures.

NB: Where no security is given, the debentures are called unsecured /naked debentures.

3. **Loans from bank and other financial institutions;-**A company can borrow long term or short term loans from banks and other money lending institutions such as Industrial and Commercial Development Corporation [I.C.D.C]

These loans are repayable with interest of the agreed rates.

4. **Profits ploughed back;-**A company may decide to set aside part of the profit made to be used for specified or general purposes instead of sharing out all the profit as dividends. This money is referred to as a reserve.
5. **Bank overdraft;-**A customer to a bank may make arrangements with the bank to be allowed to withdraw more money than he/she has in the account.
6. Leasing and renting of property.
7. Goods brought on credit.
8. Acquiring property through hire purchase

TYPES OF COMPANIES

I. PRIVATE LIMITED COMPANY

Private limited company has the following characteristics;

- Can be formed by a minimum of 2 and a maximum of 50 shareholders, excluding the employees,
- Does not advertise its shares to the public, but sells them privately to specific people
- Restricts transfer of shares i.e. a shareholder cannot sell his/her shares freely without the consent of other shareholders.
- Can be managed by one or two directors. A big private company may however, require a board of directors
- Can start business immediately after receiving the certificate of incorporation without necessarily having to wait for a certificate of trading.

- It does not have an authorized minimum share capital figure.
- Has a separate legal entity and can own property, enter into contracts, sue or be sued.
- Has limited liability.
- Has a perpetual existence.

Formation

-It must have a memorandum of association, article of association list of directors, declaration signed by a director or lawyer and certificate of incorporation.

Advantages of private limited company

i) **Formation:** The Company can be formed more easily than a public company. The cost of information is less than that of a public company

ii) **Legal personality:** A private company is a separate legal entity from its owners. Like a person, it can own property, sue or be Sued and enter into contacts

iii) **Limited liability:** Shareholders have limited liability meaning that they are not responsible for the company's debts beyond the amount due on the shares

iv) **Capital:** They have access to a large pool of capital than sole proprietorship or a partnership. They can borrow money more easily from financial institutions because it owns assets which can be pledge as security

v) **Management:** A private company has a larger pool of professional managers than a sole proprietorship or a partnership. These managers bring in professional skills in their own areas which are of great advantage to a private company

vi) **Assured continuity of the business:** Death, bankrupty or withdrawal of a shareholder does not affect the continuity of the company

vii) **Trading:** Unlike a public company a private company can commence trading immediately upon receiving a registration certificate.

Disadvantages of a private company

i) **Returns:** A private company, unlike sole proprietorship or a partnership, must submit annual returns on prescribed forms to the registrar of companies immediately after the annual general meeting

ii) **Capital:** A private company cannot invite the public to subscribe to its shares like a public limited company. It therefore limited access to a wide source of capital.

iii) Share transfer: The law restricts the transfer of shares to its members/shareholders are not free to transfer their shares

II) PUBLIC LIMITED COMPANY; - Public limited companies have the following characteristics:

a) Can be formed by a minimum of 7 (seven) shareholders and no set maximum.
b) Cannot start business before it is issued with a certificate of trading. This is issued after the certificate of incorporation and after the company has raised a minimum amount of capital
c) It's managed by a board of directors
d) The shares and debentures are freely transferable from one person to another.
e) It advertises its shares to the public/ invites the public to subscribe for/buy its shares and debentures.
f) Must publish their end of year accounts and balance sheets
g) Must have an authorized minimum share capital figure
h) Has a separate legal entity and can own property, enter into contracts, sue or be sued.
i) Has limited liability.
j) Has a perpetual existence.

Advantages of public limited company

i) Wide range of sources of capital : It has access to wide range of sources of capital especially through the sale of shares and debentures

-They can also borrow money from financial institutions in large sums and have good security to offer to the lenders.

ii) Limited liability: Like private companies, public limited company's shareholders have limited liability i.e. the shareholders are not liable for the company's debts beyond the shareholders capital contribution.

iii) Specialized management: PLC'S are able to hire qualified and experie-nced professional staff.

iv)Wide choice of business opportunities: Due to large amount of capital a public company may be suitable for any type of investment

v) Share transferability: Shares are freely transferable from one person to another and affects neither the company's capital nor its continuity.

vi)Continuity: PLC has a continuous life as it is not affected by the shareholders death, insanity, bankruptcy or transfer of shares

vii) **Economies of scale:** Their large size enables them to enjoy economies of scale operations. This leads to reduced costs of production which raises the levels of profit

viii) **Employee's motivation:** They have schemes which enable employees to be part owners of the company which encourages them to work harder in anticipation of higher dividends and growth in the value of the company's shares.

ix) **Share of loss:** Large membership and the fact that capital is divided into different classes' means that the risk of loss is shared and spread.

x) **Shareholders are safe guarded;** Publicity of company accounts safeguard against frauds.

Disadvantages of public limited companies

i) **High costs of formation:** The process of registering a public company is expensive and lengthy. Some of the costs of information are legal costs, registration fees and taxes

ii) **Legal restrictions:** A public company must comply with many legal requirements making its operations inflexible and rigid

iii) **Alienation of owners:** Shareholders non-participation in management is a disadvantage to them

iv) **Lack of secrecy:** The public limited companies are required by law to submit annual returns and accounts to the registrar of companies denying the company the benefit of keeping its affairs secret. They are also required to publish their end of year accounts and balance sheets.

v) **Conflicts of interests:** Directors may have personal interests that may conflict with those of the company. This may lead to mismanagement**.**

vi) **Decision making;** Important decision are made by the directors and shareholders. The directors and shareholders meet after long periods which make decision making slow/delayed and expensive**.**

vii) **Diseconomies of scale:** The large size and nature of business operations of public limited companies may result in high running/operation costs and inefficiency

viii) **Double taxation:** There is double taxation since the company is fixed and dividends distributed to the shareholders are also taxed

ix) **Inflexibility:** Public limited companies cannot easily change its nature of business in response to the changing circumstances in the market. All shareholders must be consulted and agree.

DISSOLUTION OF A COMPANY

The following are the circumstances that may lead to the dissolution of a company:

- ✓ Failure to commence business within one year- If a company does not commence business within one year from the date of registration, it may be wound up by a court order on application of a member of the company.
- ✓ Insolvency – when a company is not able to pay its debts, it can be declared insolvent and wound up.
- ✓ Ultra- vires – this means a company is acting contrary to what is in its objective clause. In such a case, it may be wound up by a court order.
- ✓ Amalgamation – two or more companies may join up to form one large company completely different from the original ones.
- ✓ Court order – the court of law can order a company to wind up especially following complaints from creditors.
- ✓ Decision by shareholders – the shareholders may decide to dissolve a company in a general meeting.
- ✓ Accomplishment of purpose or expiry of period of operation – a company may be dissolved on accomplishment of its objects, or on expiry of period fixed for its existence.

THE ROLE OF STOCK EXCHANGE AS A MARKET FOR SECURITIES

DEFINATIONS

(1) Stock: a group of shares in a public limited company

-Stocks are formed when all the authorized shares in a particular category have been issued and fully paid for.

(2) Stock exchange market: is a market where stocks from Quoted companies are bought and sold

-Stock exchange markets enable share holders in public companies to sell their shares to other people, usually members of the public interested in buying them.

(3) A Quoted Company: is a company that has been registered (listed) as a member of the stock exchange market.

-Companies that are not quoted cannot have their shares traded in the stock exchange market.

(4) Securities: this could either refer shares or documents used in support of share ownership.

(5) Initial Public Offer (I. P. O): refers to situations in which a company has floated new shares for public subscription (Has advertised new shares and has invited members of the public to buy them.

(6) Secondary market: The market that deals in second hand shares i.e. the transfer of shares from one person or organization to another.

There is only one stock exchange market in Kenya i.**e. The Nairobi Stock Exchange.**

A person wishing to acquire shares will do so either at an **IPO** or in the **secondary market.** However, an investor cannot buy or sell stocks directly in the stock exchange market. They can only do so through stock brokers.

ROLES OF THE STOCK EXCHANGE MARKET

(a) **Facilitates buying of shares-** it provides a conducive environment to investors who want to buy shares in different companies.

(b) **Facilitates selling of shares-** it creates a market for those who wish to sell their shares.

(c) **Safeguarding investors' interests-** it monitors the performance of the already quoted companies and those found not meeting expectations are struck off. Companies who want to be quoted must also attain a certain standard of performance.

(d) **Provides useful information-** it provides timely, accurate and reliable information to investors which enable them to make decisions on the investments to make. The information is passed on through mass media and stock brokers.

(e) **Assist companies to raise capital-** it assists companies to raise capital by creating an environment through which companies issue new shares to members of the public in an **IPO**.

(f) **Creation of employment-** it creates employment for those who facilitate the buying and selling of shares eg stock brokers, stock agents etc.

(g) **Raising revenue for the government-** the government earns revenue by collecting fees and other levies/ dues from activities carried out in the stock exchange market.

(h) **Availing a variety of securities-** it avails a variety of securities from which an investor can choose from. The market therefore satisfies needs of various investors eg investors who wish to buy from different companies can do so in the market.

(i) **Fixing of prices-** the stock exchange market is in a position to determine the true market value of the securities through the forces of demand and supply. This is of great importance to both the buyer and the seller.

(j) **Measures a country's economic progress-** the performance of securities in the stock exchange market may be an indicator of a country's economic progress e.g a constant rise in prices and volumes of securities traded within a given period of time would indicate that the country's economy is positively growing.

(k) **Promotes the culture of saving-** it provides investors with opportunities to channel their excess funds. Such people act as role models to other members of the society who may emulate them thereby promoting a saving culture.

PUBLIC CORPORATIONS (STATE CORPORATIONS)

These are organizations formed by and/or controlled by the government (the government has a controlling interest). This means that the government owns more than 50% shares in the corporation. Where the government has full ownership, the organization is known as a parastatal

❖ Public corporations are formed to perform certain/specific functions on behalf of the government.
❖ They are formed to provide essential services that are generally in the public interest, and that may require heavy initial capital investment which few private investors can afford
❖ They are formed by the act of parliament.

Examples

- Kenya Railways corporation- provides railway transport
- Telkom Kenya-provides telecommunication services
- Postal corporation of Kenya
- Industrial and commercial Development corporation (ICDC)- financial and management services
- Mumias and Chemelil sugar companies.
- Kenya air ways- provide air transport services. etc

Characteristics/features of public corporations

- They are formed by the government under the existing laws i.e formed by an act of parliament eg education act
- Initial capital is provided by the government
- They are jointly owned by the government and members of public/private investors
- They are set up to perform certain specific functions on behalf of the government
- They are managed by a board of directors appointed by the government or appointed by the government and the joint owners
- They have an entity of their own and can own property, enter contracts, sue and be sued

- They have limited liability
- Some operate without a profit motive while others have a profit motive

Formation

-Some are formed by an act of parliament while others are formed under the existing laws.

-When formed by an act of parliament, the Act defines its status obligations and areas of operation. The Act outlines the following;

- Proposed name of the corporation
- Aims and objectives
- Goods or services to be produced and provided
- Location(Area of operation)
- The appointment of top executives
- The powers of the Board of directors
- The ministry under which it will operate

Management

-The public corporations are managed by a board of directors appointed by the president or the relevant minister

-The chairman and the board of directors are responsible for the implementation of the aims and objectives of the corporations.

-The chairman of the board of directors reports to the government (president) through the relevant minister.

-The managing director who is usually the secretary of the board of directors in the chief executive officer of the corporation

Sources of capital

-The initial capital is usually provided by the government as a vote of expenditure for the ministry concerned

-Those corporations jointly owned by the government and the public raise capital through the sale of shares

-financial institutions in form of loans

-Retained profits/profits ploughed back.

-Hire purchase

Advantages of public corporations

- Initial capital is readily available because it is provided by the government
- Can afford to provide goods and services at low prices which would otherwise be expensive if they were left to the private sector.

- Most of them produce goods and services in large quantities thereby reaping the benefits of large scale production
- Some are monopolies. They hence enjoy the benefits of being a monopoly e.g. they do not have to incur costs advertising since there is no competition
- They can be bailed out/assisted by the government when in financial problems
- They have limited liability
- Money for research and development can be made readily available by the government
- Through corporations the government is able to remove foreign domination in the country
- They can afford to hire qualified personnel.

Disadvantages of public corporations

- They are managed by political appointees who may not have the necessary managerial know how.
- When they make losses, they are assisted by the government and this could lead to higher taxation of individuals
- Lack of competition due to monopoly leads to inefficiency and insensitivity to customers feelings.
- Political interference may hamper efficiency in the achievement of set goals and objectives.
- Decision-making is slow and difficult because the organizations are large.
- They may lack close supervision because of their large sizes.
- There is embezzlement of large sums of money leading to loss of public funds
- The government is forced to provide goods and services to its citizens in all parts of the country where at times its uneconomical to provide them because the costs of providing them may surpass the returns
- Public funds are wasted by keeping poorly managed public corporations.
- Diseconomies of scale apply in these business units because they are usually very large scale organizations e.g. decision making may take long.

Dissolution of public corporations

They can only be dissolved by the government due to:

1. Persistent loss making

2. Bankruptcy- where the corporation cannot pay its debts
3. Change in the act of parliament that formed the corporation
4. Privatization
5. Mismanagement, resulting in poor management of the corporation

TRENDS IN FORMS OF BUSINESS UNITS

(1) Globalizations:

This refers to the sharing of worlds resources among all regions i.e where there are no boundaries in business transactions

Some companies referred to as multinationals, have branches in many parts of the world e.g coca-cola company

Globalization has been made possible and effective through the development and improvement of information and technology organization i.e

- **World website (internet);** one can acquire and order for goods through the internet. This is referred to as Electronic Commerce (E- Commerce) and E-Banking.
- **Mobile phones** technology has revolutionized ways of life and business and even remote areas have been opened up.

(2) Business Amalgamations/combinations

This occurs when two independent business enterprises combine to form one large organization

Levels of combinations

i) Vertical combination; This is when businesses engaged in different but successive levels of production combine e.g. primary(extractive) level combines with secondary(manufacturing)level or secondary level combining with tertiary level.

Example; A company producing cotton (raw materials) combining with a textile industry.

ii) Horizontal combination; This is where business enterprises of the same level combine e.g. secondary and secondary levels e.t.c

Types of Amalgamation/combination

Amalgamations whether vertical or horizontal can be achieved in these ways;

a) Holding companies

-A holding company is one that acquires 51 percent or more shares in one or more other companies.

-The various companies entering into such a combination are brought under a single control.

-These companies are controlled by the holding company and are called **Subsidiaries**.
-The subsidiary companies are however allowed to retain their original names and status, but the holding company appoints some members to be on the board of directors of these subsidiaries, so as to control their activities.
-Holding companies are usually financial institutions because they are able to buy controlling shares in subsidiary companies

b) Absorptions (takeovers)
This refers to a business taking over another business by buying all the assets of the other business which then ceases to exist.
Example; Kenya Breweries took over the castle company in Kenya

c) Mergers(Amalgamation):
This is where two or more business organizations combine and form one new business organizations.
-The merging companies cease to exist altogether.

d) Cartels
This is a group of related firms/ companies that agree to work together in order to control output, prices and markets of their products – O. P. E. C (organization of petroleum exporting countries) is an example.

(3) Privatization: this is the process of transferring / selling state owned corporations to public limited companies or private investors. This is done by the Government selling their shareholding to members of the public. The main aim is to:

- **Improve efficiency**
- Generate revenue for the government.
- Reduce government control
- To break monopolistic practices
- To reduce government expenditure on corporations that relies on government subsidy.

(4) Check off system- this is a method of remitting money especially to **SACCOS** where the employer deducts the contribution from the source and submits it to the SACCO on behalf of the employee who is a member of the SACCO.

(5) Burial Benevolent Funds (B. B. F): some SACCOS have started systems/ funds to assist their members financially in burials through creation of BBF.

(6) Front Office Savings Account (FOSA); SACCOS have expanded their services to members by introducing FOSA. The account enables members to convinientlydeposit and withdraws money. A member may also be provided with an ATM card which enables him/her to withdraw money at various pesa points/ ATM's.

(7) **Franchising:** this is where one business grants another the rights to manufacture, distribute or produce its branded products using the name of the business that has granted the rights eg General motors' has been granted franchise to deal in Toyota, Isuzu and Nissan vehicles.

(8) **Trusts:** This is where a group of Companies work together to reduce competition. Trusts may also be formed where a company buys more than 50% of shares in a competing company so as to reduce competition.

(9) **Performance contracts:** Employees in state corporations are expected to sign performance contracts in order to improve their efficiency. Other private institutions are also adopting the same practice.

GOVERNMENT AND BUSINESS

BY THE END OF THE TOPIC, THE LEARNER SHOULD BE ABLE TO:

i. Explain reasons for government involvement in business.
ii. Explain how the government gets involved in business.
iii. Discuss the merits and demerits of government involvement in business.
iv. Discuss the importance of consumer protection.

INTRODUCTION

Government involvement in business activities is one of the commercial duties it owes its citizens. It is the one that provides the necessary environment for investments to be undertaken by itself, or by the local and foreign investors. This, the government may do in various ways, these include;

a) Producing goods and services
b) Distributing goods and services
c) Advising producers and traders
d) Promoting trade and economic development
e) Protecting consumers against exploitation by producers and traders
f) As a consumer of goods and services

Reasons for Government involvement in business

The following are the major reasons for the government's involvement and participation in business activities;

1) To prevent exploitation of the public by private businesspersons especially in the provision of essential goods and services such as sugar, transport, communication etc. the Kenya Bureau of standards (KEBS) regulates the quality of goods consumed in Kenya.
2) To provide essential goods and services in areas where private individuals and organizations are unwilling to venture because of low profits/ high risks involved.
3) To provide essential goods and services which private organizations and individuals are unable to provide due to the large amount of initial capital required b e.g. generation of electricity, establishment of airlines etc.
4) To attract foreign investment by initiating major business projects
5) To stimulate economic development in the country e.g. by providing social services
6) To provide goods and services which are too sensitive to be left in the hands of the private sector e.g. provision of firearms.
7) To create employment opportunities by initiating projects such as generation of electricity.
8) To prevent foreign dominance of the economy by investing in areas where the locals are not able to
9) To redistribute wealth where returns are very high
10) To prevent establishment of monopolies

METHODS OF GOVERNMENT INVOLVEMENT IN BUSINESS

The government gets involved in business activities through the following methods:

(i) Regulation

This refers to Rules and restrictions the government requires business units to follow in their business activities. Through this method, the government ensures high quality goods and services and puts in control measures to protect consumers from exploitation. The government regulation measures include;

a) Licensing

A license is a document that shows that a business has been permitted by the government to operate. It is usually issued upon payment of a small fee. Licensing is the process of issuing licenses to businesses. Some of the reasons why the government issues licenses include;

- Regulating the number of businesses in a given place at any given time to avoid unhealthy competition.
- To control the type of goods entering and leaving the country.

- To ensure there are no illegal businesses.
- To ensure that traders engage only in trade activities that they have been licensed for.
- To ensure that those who engage in professional activities meet the requirements of the profession.
- To raise revenue for the government.

b) **Ensuring standards/ enforcing standards;** The government regulates business activities by setting standards that businesses should and ensuring that the standards are adhered to. To achieve this purpose, the government has established bodies such as;

✓ **Kenya bureau of standards (KEBS**) whose main responsibility is to set standards especially for the manufactured goods and see to it that the set standards are adhered to/ met. Goods that meet such standards are given a diamond mark of quality, to show that they are of good quality.

✓ **The ministry of public health** to ensure that businesses meet certain standards as concerning facilities before such businesses can be allowed to operate. Such standards may include clean toilets, clean water and well aerated buildings.

c) **Legislation;** The Government may come up with rules and regulations (laws) that regulate business activities e.g. banning hawking in certain areas, matatus required to carry certain number of passengers e.t.c.

(ii) Training

The government takes keen interest in training and advising people in business about business management strategies and better ways of producing goods and services. The government offers these services through seminars and courses. This is mainly done by **the Kenya Business Training Institute (K.B.T.I). Reasons for government training include;**

- To expose businesspersons to modern developments in management
- Introduce modern technology and skills in management
- Educate the business people on efficient methods of operating a business e.g., effective methods of advertising and keeping books of accounts.
- Expose business people to problems/ challenges facing them and their possible solutions for example, problems of raising capital and identifying investment opportunities.
- Impart proper business ethics e.g. good customer relations and honesty.
- Creating awareness of the available profitable business opportunities in their environment

- Expose business people to government policies regarding business activities in the country.
- Educate business people on how to use available resources to minimize costs and maximize profits.
- Expose people to other opportunities that exist in the import and export market.

(iii) Trade promotion

This is a government initiated and supported policy to encourage local business people to enter into business. This is aimed at increasing the volume and variety of goods and services traded in.

Trade promotion is classified as either **external trade promotion** or **internal trade promotion.**

(a) External trade promotion

- The purpose of external trade promotion is to encourage local business people to enter into the export market.
- It also intended to attract foreign investors into the country.
- In Kenya, external trade promotion is done through the department of external trade in the ministry of trade and industry.
- External trade promotion may also be done by **Commercial attaches.**

Commercial attaches are officers sent by the country's government to work with the embassies in foreign countries as support staff in the field of commerce. Their main duty is to look at the interests of their home countries' exports e.g. cash crops and manufactured goods.

Duties of commercial attaches

- ✓ Explore and identify new markets for more export opportunities.
- ✓ Research and analyze markets for exports from their home countries.
- ✓ Keep statistics of products such as volumes, packaging size and method of manufacturing.
- ✓ Attend meetings, seminars and workshops on trade patterns of the countries and keep data for new markets of exports.
- ✓ Publish and advertise their country's exports in business journals and magazines.
- ✓ Select buyers, agents and distributors of the home country's exports.
- ✓ Inform traders in their home countries of the standards required for exports.
- ✓ Assist sales missions from their home countries by organizing educational tours for them.

- ✓ Organize visits to trade fairs and exhibitions for business people from their home country.
- ✓ Make detailed reports on commercial activities that may help improve the exports of their countries.

To perform these duties, the commercial attaché needs to:

- Keep information on prices paid for exports and terms of payments(conditions to be filled before the payment is made)
- Be aware of the rules that govern payment in international trade.
- Be aware of the working of the regional organizations that operate in developing countries such as **the East African Community (E. A. C), Inter-Governmental Authority for Development (I.G.A.D), Common Market for Eastern and Southern Africa (COMESA), Economic Commission for Africa (E.C.A) and African Growth Opportunity Act (A.G.O.A).**

(b) **Internal trade promotion**

This is done by the government through the ministry of trade. The ministry carries out various activities

TRANSPORT

TOPIC OBJECTIVES

By the end of the lesson, the learner should be able to:

1. Explain the meaning and importance of transport to business.
2. Explain the essential elements of transport.
3. Describe the modes and means of transport.
4. Discuss the advantages and disadvantages of each means of transport.
5. Discuss the factors that influence choice of appropriate means of transport.
6. Discuss trends of transport.

MEANING OF TRANSPORT

Transport is the physical movement of people and goods from one place to another. It helps bridge the gap between producers and consumers hence creating **place utility.**

Importance of Transport to Business

a) **Bridging the gap between producers and consumers/ linking consumers to producers-**Transport links consumers to producers which enable the consumers to obtain the goods they need.
b) **Employment creation-**Transport helps in solving unemployment problem by creating job opportunities. For example, people may be employed as drivers, pilots, mechanics and road constructors.
c) **Promotes specialization-**Transport enables people to specialize in jobs they are best at. For example; producers would concentrate in production only while other people carry out distribution.
d) **Making goods and services more useful-**Through transport goods are moved from a place where they are least required to a place where they are most required thereby making them more useful.
e) **Improving people's standard of living-**It enables consumers to get a variety of goods and services thereby improving the standards of living.
f) **Availing a wide market for products-**It helps producers to widen the markets for their products by enabling them access to areas they would otherwise not have accessed
g) **Increased production/ facilitates mass production-**Due to the wider market created through transport, producers are able to increase the volume of goods produced.
h) **Avoiding wastage-**Transport makes it possible for surplus goods to be disposed of by taking them to areas where they are required. Perishable goods such as flowers, fruits and vegetables can also be transported fast hence minimizing/ avoiding wastage.
i) **Promoting development of industries-**Through transport, raw materials can be taken to manufacturing industries and also finished goods to the market. Similarly, it promotes development of service industries such as tourism.
j) **Adds value to goods and services-** creates utility in goods by moving them from the point of production to where they are needed thereby adding their value.
k) **Leads to the opening of new markets-** Goods and services can be taken to new areas with ease.
l) **It facilitates the movement of labour-** people can easily move from where they stay to where they work.

ESSENTIAL ELEMENTS OF TRANSPORT

In order for a transport system to function efficiently it should have certain basic elements. These elements are:

a) Unit(S) of carriage
b) Methods of propulsion
c) Ways
d) Terminals(terminus)

A. Unit(S) of carriage

This refers to anything i.e. vessel that is used to transport goods and people from one place to another. Units of carriage include: ships, trains, aeroplanes, motor vehicles, bicycles and carts. Units of carriage are also referred to as means of transport**.**

B. Methods of propulsion

This is the driving force (source of power) that makes a unit of carriage to move.The power for most vessels may be petroleum products, electricity, human force or animal power.

C. Ways

It refers to either the route or path passes by the vessel. The route can be on land, on water or through air. Examples of ways are roads, railways, paths, canals, seaways and airways. The ways can be classified into either natural ways or manmade ways.

I. Natural ways-As the name suggests, natural ways are the ways that are provided by nature. They are therefore free to acquire. They include airways and seaways**.**

II. Man-made ways-These are ways that are made available by human being. They include roads, canals and railways. Manmade ways are usually expensive to construct and maintain.

D. Terminals (terminuses)

The vessel used to carry goods and people starts from one destination and ends up at another. At these destinations the loading and off-loading take place respectively. The loading and off-loading places are referred to as terminals or terminus. Examples of terminuses are bus stations, airports and seaports**.**

MODES OF TRANSPORT

Mode refers to the manner in which transport is carried out. There are three modes of transport namely**:**

i. Land transport
ii. Water transport
iii. Air transport

1) Land transport

This mode of transport involves movement of goods and people using units of carriage that move on dry land. The various means under this mode includes:

a) Human Porterage

This involves human beings carrying goods on their heads, shoulders or backs. Human Porterage as a means of transport is the oldest kind of transport and is still very common in our society. The means is suitable for transporting light luggage over short distances. It is also appropriate where other means of transport are not available or convenient.

Advantages of Human Porterage

i. Could be the only means of transport available
ii. Compliments other means of transport
iii. Flexible as it has no fixed time table or routes
iv. May be a cheap means compared to other means of transport
v. Readily available when required
vi. Convenient over short distances

Disadvantages of human Porterage

i. Not suitable for long distances
ii. They add onto congestion on roads
iii. Not suitable for transporting heavy and bulky goods
iv. It is relatively slow
v.Relies on human energy which is exhaustible

b) Carts

Carts are open vessels usually on two or four wheels that are pushed or pulled by either human being or animals such as oxen and donkeys. The carts pushed or pulled by human beings are referred to as hand carts or mikokoteni. The ones pulled by animals, on the other hand, are called animal driven carts. Carts are used to carry relatively large quantities compared to human porterage. Like human porterage, they are not suitable for long distances. Types of goods that are transported using this means include, agricultural produce, water and animal feeds**.**

Advantages of carts

i. Compliments other means of transport
ii. Relatively cheap to hire
iii. Initial buying and maintenance cost is low
iv. Appropriate in remote areas where other means are not available
v. Readily available for hire
vi. Can carry fairly heavier and bulky goods
vii. Convenient for transporting goods over short distances

i. Disadvantages of carts

i. May not be suitable for transporting heavy and bulky goods
ii. Cause traffic jams on roads leading to congestion and accidents
iii. Not suitable for transporting goods over long distances

c) Vehicles

These are means (units of carriage) of transport that ferry goods and people on roads. Vehicles are the most commonly used means of transport.
Vehicles are either passenger or goods carriers. Passenger carriers may be buses, matatus, taxis and private cars while goods are transported using Lorries, pick-ups, tankers and trailers. Vehicles are expensive to acquire and maintain. The convenience of vehicles may depend on the nature of the road on which they travel.
Some roads are impassible especially when it rains while others are usable throughout the year (all weather roads).Of special concern in road transport is the matatus. These are privately owned passenger vehicles which were introduced to supplement the existing mainstream transport companies that were inadequate at independence. They got their name from the amount of fare they used to charge originally, that is, mapeni matatu. The operators have to obtain the relevant documents such as insurance cover in order to be allowed to operate. Their owners may form associations which take care of their interests along given routes or in certain areas.

Advantages of matatus

i. They supplement regular bus companies, especially in remote areas where they are the only means.
ii. They fill up faster than buses hence save time
iii. They are more flexible since they can change routes easily depending on demand
iv. They reach out into the interior of rural areas where big buses cannot access
v. They are more flexible with the fares they charge
vi. They are easier to hire as most of them are readily available
vii. They are cheaper to acquire as compared to buses

Disadvantages of matatus

i. Some matatus are poorly maintained to the extent of being unroadworthy
ii. Most drivers are reckless as they rush to compete for customers. They pick or drop passengers anywhere
iii. In some cases, touts use impolite language when dealing with passengers

iv. They may cause noise pollution such as unnecessary hooting and loud music
v. They may cause congestion in towns unnecessarily because of careless driving and parking
vi. Uncalled for sudden increase in fares at peak hours, during the night and on public holidays
vii. Their operation is concentrated on peak hours, rarely operating at night.
viii. They at times unexpectedly change their route hence causing breach of contract.

Advantages of vehicles

i. Most readily available means of transport
ii. Relatively fast compared to carts and human Porterage
iii. Relatively cheaper over short distances
iv. Flexible as it can offer door to door service
v. Vehicles may be available for transporting special goods
vi. Roads are widely spread thereby making many areas accessible.

Disadvantages of vehicles

i. Acquisition and maintenance costs are high
ii. May not be suitable for transporting heavy and bulky goods over long distances as compared to railways
iii. Traffic jams in roads may cause delays
iv. Vehicle transport is prone to accidents which may lead to loss of goods and life
v.Some roads may be impassible especially during the rainy seasons.

d) Trains

Trains are vessels that transport goods and people on rails hence the term railways.

The terminuses of trains are the railways stations. Therefore; the goods to be transported by trains have to be taken to the railway station. Railway transport is suitable for heavy and bulky goods as well as passengers. There are two types of trains: cargo and passenger train.

Advantages of Trains

-Relatively secure as cases of theft and accidents are rare
-Enables a transporter to plan for the transport of his/her goods as trains follow a fixed timetable
-Economical for transporting heavy and bulky goods over a long distance
-Trains may have facilities for carrying special types of goods e.g. gas, petrol and vehicles

-Where shunting facilities are available trains may deliver goods up to or from the owner's premises

Disadvantages of Trains

-Not flexible as trains follow a strict time table

-Railway lines are expensive to construct and to maintain

-Not all areas are served by railway lines

-Not suitable for transporting urgently required or perishable goods as it is slow

-Unsuitable for transporting goods over short distances

-Trains are expensive to acquire and maintain

e) Pipeline Transport

This is the movement of liquids and gases from one place to another through a pipe. Products transported through pipes include water, gases, petrol and diesel. Solids that cannot be dissolved or damaged by water may also be transported through pipes as suspension. Examples coffee berries from machines to drying places. The pipeline is both a vessel and a way. Products flow by the force of gravity or pressure from an original station. If the original terminal is at a higher level than the receiving terminal, the force of gravity is adequate to move the product. But if the receiving terminal is at a higher level than the original than the originating terminal, then power is required to pump the product uphill. For example, petroleum from Mombasa which is at sea level needs pressure to pump it to all the receiving stations**.**

Advantages of pipeline Transport

-It is labour saving as it requires minimal manpower

-It is environmentally friendly since it is free of noise or smoke

-It may be constructed in areas where it is difficult to construct roads or railway lines. For example, over rugged terrain

-Pipelines allow continuous flow of the goods being transported

-It ensures that road damage is reduced as the number of tankers is reduced on roads

-It helps to reduce accidents that may be caused by tankers on roads

-It reduces delays arising from congestion on roads

-Maintenance costs are reduced as it relies on gravitational force and booster stations along the way

-It may not be affected by adverse weather conditions

Disadvantages of pipeline Transport

-A leakage not detected in good time may lead to high losses

-Initial construction cost is high

-Accidents leakages may lead to environmental pollution
-It is unidirectional that is, travels only in one direction
-It can transport only one product at a time
-It is not flexible since once a line is laid, it cannot be adjusted according to transport patterns or demands
-Generates comparatively fewer job opportunities as it is capital intensive
-It is vulnerable to sabotage by enemies.
-Once laid, it is difficult to re route or re locate.

2) Water Transport

It is a mode of transport where the units of carriage transport goods and people on water. Water in this case includes; navigable rivers, lakes, seas and oceans. The means of transport which are the units of carriage or vessels using this mode include; ships, dhows, boats, steamers and ferries. Water transport can be divided into inland waterways and sea transport.

(a) Inland waterways

This is transport carried out on lakes, rivers and inland canals. The Lake Victoria facilitates transport among the three east African countries i.e. Kenya, Uganda and Tanzania. Ferries also connect the mainland to islands such as Rusinga Islands, found in Lake Victoria.

Water hyacinth has however been a threat to transport on the lake. Most rivers in Kenya are not navigable due to reasons such as:

- ✓ Too small
- ✓ Presence of rapids and waterfalls
- ✓ Too shallow
- ✓ Most are seasonal
- ✓ High gradient

(b) Sea Transport

This is where goods and people are transported in seas and oceans. All types of water vessels may be used in sea transport. Sea transport is important as it connects continents of the world thereby facilitating international trade. Kilindini in Mombasa provides a good natural harbor facilitating sea transport between Kenya and other countries of the world. Ferries also connect the island of Mombasa and the mainland.

Types of Water vessels

a) Ships

A ship is a large vessel that transports people or goods through water. Their sizes however vary depending on quantity of goods and passengers they carry. Ships help in connecting countries or places which borders the sea. They load

and offload in terminals referred to as harbors found at sea ports. For example, the Kilindini harbor is found in the port of Mombasa.
Ships that transport people are referred to as passenger ship while those that transport goods are referred to as cargo ships. Cargo ships are c are convenient for carrying heavy and bulky goods.
Ships may also be classified as either liners or tramps.

Liners

These are ships that are owned and operated by shipping companies called conferences. Each conference is responsible for specifying the route on which each liner would operate the rates to be charged and setting the rules and regulations to be followed by the members.

Characteristics of liners

-Have fixed routes
-Follow a fixed timetable
-Charges are fixed
-Call at specified ports along the route at specified intervals
-Travel at regular intervals.

Tramps

These are ships that do not follow a regular route or time table. Their routes therefore depend on demand. During times when demand is high, they charge higher rates and when demand is low they lower their rates. Tramps can therefore be likened to matatus. Tramps may be owned by either individuals or firms**.**

Characteristics of tramps

-Do not have a fixed rate. They therefore move to wherever there are goods or passengers to carry.
-Have no set timetables. They therefore move according to demand
-Their fares change according to demand.
-Their travelling patterns are irregular and therefore cannot be relied upon

NB: Liners and tramps owners are in constant competition business. Traders therefore need to choose the type of ships to hire. Liners are however more popular than tramps among traders because of their reliability.
When a trader hires an entire ship to transport goods to a given destination, he/she and the ship owner signs a document called a **charter party**. This document shows the terms and conditions under which the goods would be transported.
Other information included in the agreement are destination, nature of the goods and freight charges. When the ship is hired to carry goods for a given

journey the document signed is referred to as **voyage charter**. On the other hand, if the ship is hired to transport goods for a given period of time, the document signed is called **time charter**.

Ships may be specially built to carry special commodities. These may include tankers specially built to transport petroleum products and other liquids. Refrigerated ships may also be available to transport perishable commodities such as meat, fish and fruits.

b) Boats and Ferries

These are water vessels used in transporting goods and people over short distances. They are therefore found in both inland water transport and also the sea transport.e.g the Likoni ferry in Mombasa carries people from and to the island of Mombasa and the main land.

Advantages of water transport

-Sea transport is economical to the owner as the number of employees to carriage volume ratio is less compared to road transport
-Suited for transporting heavy and bulky goods
-It is cheap as the way is natural and free
-Connects countries of the world which border the sea
-Special types of ships are available for transporting goods
-Large volume can be carried thereby reducing cost per unit
-Not affected by traffic congestion
-Some ships can be very luxurious for passengers and may even provide swimming pools.
-At the port/dock, there are many depots for storage of goods.

Disadvantages of water transport-

Sea-sickness, sea-pirates and storms may occur
-They are slow therefore not suitable for transporting perishable and urgently required goods
-It is expensive to construct and maintain artificial harbors
-Unfavorable weather conditions may affect water transport
-Sea transport is not accessible to land locked countries
-Lack of loading and off-loading facilities may lead to delay
-Cost of acquiring and maintaining ships is high.
-Theft of cargo and other valuables may occur during loading and offloading.

3) Air Transport

This refers to the movement of goods, people and documents by aircrafts. Aircrafts/ aeroplanes are the units of carriage and air the way. The terminals include airports and airstrips.

Aeroplanes are fast compared to other means of transport i.e. they are the fastest means of transport. They are therefore suitable for transporting urgently required goods like drugs and perishable goods Such as flowers over long distances.
Aircrafts may be classified as either **passenger planes** or **cargo planes**. Passenger planes transport people from one place to another. On the other hand, cargo planes transport light cargo to the required destinations.
Aeroplanes may be fitted with special facilities for handling special goods.
Aeroplanes are expensive to acquire and to maintain. Their operations may also be affected by weather conditions**.**

Advantages of Air Transport

-There is less handling of goods on the way since aeroplanes may move direct to the final destinations.
-The way does not require construction or maintenance as it is natural and free.
-Planes can move through places where other means cannot, such as over the earth poles and across high mountains/ planes are not hampered by physical barriers.
-Have efficient interconnections between airlines all over the world which makes it convenient
-Suitable for long distance travelers especially from one continent to another
-Very fast therefore suitable for transporting perishable and urgently required goods.
-Chartered planes can be used to reach remote areas.
-The movement of aircrafts is smooth therefore suitable for transporting fragile goods such as glassware and eggs.
-Passengers are given the highest degree of comfort and personal attention making it the most comfortable means of transport.

Disadvantages of Air Transport

-Causes noise pollution
-Air fields are not available in all places
-Cannot be conveniently used to carry heavy and bulky goods
-Expensive to acquire and maintain aircrafts
-Requires highly trained manpower e.g. air traffic controllers, pilots e. t. c
-Unfavorable weather conditions such as fog, mist and heavy rains may cause delay
-It is an expensive means of transport in terms of freight charges

-Not suitable for transporting inflammable goods such as cooking gas and petrol
-In case of accidents results are catastrophic/ accidents are rare but fatal.
-Has limited carrying capacity that should not be exceeded.
-It is not flexible.
-Most airfields/ terminals are located some distance away from town/ city centers and therefore require transport or railway links that are affected by jams occasionally causing delays.
-Recent hijackings by terrorists have made air transport an insecure means especially for transporting valuables.

4) Containerization

This is a recent development in transport. It refers to the packaging of goods in standardized 'box like' containers designed for use in transporting cargo. The containers are mainly made of metal though a few are made of wood. They can either be hired or bought from firms that provide them. The hired containers are returnable to the owner after the goods have been transported. Containers are designed in a way appropriate to transport goods by ships, train, lorry or by air. To safeguard the goods against risks such as theft and unfavorable weather conditions the containers are sealed immediately after goods have been packed. The sealed containers are then transported up to the final destination where they are off-loaded. The consignee can then break the seal.

Goods can be transported in containers as **Full Container Load (F.C.L)** or as **Less Container Load (L.C.L**).Full container load applies where the container is filled with goods belonging to one person. In FCL, goods are delivered to the consignee intact. On the other hand, less than container load applies where a container is filled with goods belonging to several consignors. This may be the case where a single consigner does not have enough goods to fill a container. When such a container reaches the destination, it is opened and the various consignees take their goods.

There are special handling facilities for loading and offloading containers onto and from the units of carriage.

Apart from the container depot at Mombasa, Kenya Ports Authority (K.P.A) has established inland container depots referred dry ports. An example of a dry port is found at Embakasi in Nairobi. The establishment of dry ports aims at relieving congestion at the sea port. It also aims at making handling of cargo easier and efficient for inland importers and exporters.

When containers are off loaded from ships at Mombasa, they are loaded into special container trains called railtainer which transports them by railway to the inland container depot at Embakasi. Containers can also be transported by specially designed trucks between the ports or from the port to consumer's destination.

Advantages of containerization

-Minimizes the risks of loss or damage of goods as containers are sealed at source

-Containers are lifted with devices which make movement and handling easy

-Saves time and labour in loading and off-loading due to use of machines

-Containers sealed at source in presence of customs officials may not be opened until they reach their final destination. This reduces delay.

-Special containers are available for goods requiring special attention like chemicals.

-Insurance costs are relatively low as risks are less

-Space is saved when containers are used as opposed to when individual items are packed in the carrier.

-Can carry large quantities of cargo if packed well.

-Containers are tough structure, which offer protection to sensitive and fragile goods.

Disadvantages of containerization

-They are expensive and this increases the cost of transporting goods

-Contributes to unemployment since it is capital intensive

-Not suitable for transporting small quantities of goods.

-Requires special handling equipment which may be expensive

-May not be suitable for goods with irregular shapes.

-Training labour force is long and expensive.

-They may be used to smuggle illegal goods.

-The large trucks used on the road increase road damage and may increase accidents.

Factors that influence the choice of appropriate means of transport

i. Cost; The cost of transporting a good should be reasonable; except where other factors should be considered such as need for quick delivery. Otherwise should be proportional to the value of goods transported.

ii. Nature of goods; The nature of goods should be considered when choosing a means of transport. For example, perishable goods require a fast means. Similarly, heavy and bulky goods require a means of transport convenient for such goods e.g. trains and ship.

iii. Reliability; The means chosen should be able to deliver the goods to the required place at the right time and in the right form.

iv. Urgency; For goods that are urgently required, the fastest means available should be chosen**.**

v. Safety and Security: The means chosen should ensure that the goods on transit are secure against loss, theft or physical damages.

vi.Distance; Some means of transport are suitable for long distances while others are suitable for short distances. If goods are to be transported for long distances, air, sea or railway transport would be appropriate, otherwise roads would be suitable for short distances.

vii.Availability of means; The means of transport to be selected should be based on its availability. For example, where there is only one means of transport, it would be the only one to be chosen**.**

viii.Flexibility; This is the ability of means of transport to be manipulated to suit the convenience of the transporter. Where flexibility is required, then the means that would provide such should be chosen. For example a matatu is usually more flexible than an aeroplane**.**

ix.Terminals; Some means of transport may have their terminals near the transporter than others. In this case, the transporter should choose the means whose terminals are conveniently accessible to facilitate loading and offloading of goods.

x.Value of goods to be transported- goods of high value require special handling and high security during transportation.

Trends in transport

- Pipeline and containerization
- Electric trains are replacing diesel engines
- Underground tunnels for trains are being used to ease congestion on the surface
- Dual-carriage roads are being developed in various parts to ease congestion and minimize accidents
- Development of planes with larger carrying capacity and speed is a major feature in the transport industry
- Use of bicycles commonly known as boda boda are a common feature in towns, bus terminals and rural areas, supplementing other means of transport to ferry people and cargo to their destinations. The bicycles are being modified to make them more convenient. It is not unusual to find a bicycle (boda boda) which has been fitted with facilities such as:
    - ✓ Motors to increase their speed and reduce energy applied by the cyclist.

- ✓ Music systems to entertain passengers and More comfortable seats.

Motor cycles are also being used as bodabodas in various areas. Similarly, the three wheeled vehicles commonly known as 'Tuk Tuk' is a major feature in cities and most towns.

- Private personal vehicles with less carrying capacity e.g. four-seater vehicles are being used as matatus. The vehicles are convenient to the passengers as they:
  - ✓ Fill up within a shorter time compared to larger vehicles
  - ✓ May accommodate each of the customers interests.
  - ✓ Passenger vehicles are being fitted with radios, music systems and videos to entertain customers as they travel. However, some forms of entertainment may not be conducive to all.

REVISION QUESTIONS ON TRANSPORT
KCSE PAST PAER 1

1. 1996 State four circumstances under which a businessman would choose to transport goods by air? (4mks).
2. 1997 Outline four reasons why a school in Kisumu may prefer to transport its sixty students to a music festival in Nairobi by train rather than by bus. (4mks).
3. 1999 Give five reasons why a manufacturing firm would be located in an area well served by good road network.(4mks).
4. 1999 Outline four limitations of containerization. (4mks).
5. 2000 State four reasons why road transport is popular in Kenya.(4mks).
6. 2001 State four ways in which the nature of goods would influence the choice of transport.
7. 2002 Outline four reasons why a transporter of goods from Mombassa to Nairobi may prefer rail transport to road transport. (4mks).
8. 2003 State the unit of carriage for each of the following modes of transport. (5mks)

Mode of transport	Units of carriage
i. Portage	
ii. Sea	
iii. Road	
iv. Cartage	
v. Air	

9. 2004 list four ways in which transport promotes growth of trade.(4mks)

10. 2000 State four reasons why road transport is popular in Kenya. (4mks)
11. 1995 Give 3 disadvantages of railway transport in Kenya. (4mks)
12. 1998 List 4 disadvantages of using containers to transport goods. (4mks)

KCSE PAST QUESTIONS PAPER 2

1. 1995 Explain five reasons that may account for continued use of hand carts as a mode of transport in Kenya. (12mks)
2. 1996 The oil pipeline has recently been extended from Nairobi to western Kenya.
3. Explain five benefits that may be accounted to the country from the extension. (10mks).
4. 1997 Explain five ways in which an efficient road transport system may promote trade within a country.(10mks).
5. 1998 Discuss five factors that have hindered the expansion of railway transport in Kenya.
6. 1999 Explain five features of an efficient transport system (8mks).
7. 2000 Explain the advantages of pipeline as a mode of transporting oil products. (12mks).
8. 2002 Outline five factors that should be considered when choosing a means of transport.
9. 2003 Explain six advantages of containerization as a mode of transport.(10mks)
10. 2004 Discuss six factors that may discourage the use of pipeline as a means of transporting petroleum products in a country.(12mks).
11. 2005 Discuss 5 circumstances under which a trader may choose to transport goods by rail.

COMMUNICATION

Meaning of communication

1. Communication is the transfer or conveyance of messages or information from one person to another.

2. Communication is the process of sending and receiving meaningful messages, information and ideas between two or more people located at different points in space.

Note: The space between the sender (s) and the receiver (s) maybe as narrow as when people are talking to each other or as wide as between the North Pole and the South Pole.

Effective communication is vital/important for business in that it serves the following purposes.

Importance of communication (purposes)

i. **To give and obtain information**

For an organization to run smoothly there should be proper flow of information within the business and also between the firm and outsiders e.g. the manager may inform members of staff about a planned meeting. Similarly the business may receive a letter of inquiry from a customer

ii. **To clarify issues and points**

Through proper communication the organization is able to clarify confusing issues from within and without the firm for example in cases where there are many managers. It would be necessary to clarify the responsibilities of each manager.

iii. **To enhance public relations**

Good/efficient communication enables the business to create a more positive image and a favorable reputation of itself to outsiders and overcome prejudices and negative attitudes that people may have against the business.

iv. **To start and influence Action**

Proper communication enables the business to get new ideas make plans and ensure that they are implemented in the desired way.

v. **Improving customer service;** Good communication helps in reducing errors providing customers with desired feedback and assisting in handling inquiries more efficiently

vi. **Giving instructions;** Through proper communication management is able to get work done by issuing instructions (procedures and orders)e.g. a supplier may be instructed when and where to deliver the goods ordered.

vii. **To give Reassurance;** Information is needed to reassure people that their performance is good e.g. an employee may feel better is he/she is served with a “will done”memo or a “customer of the year” award.

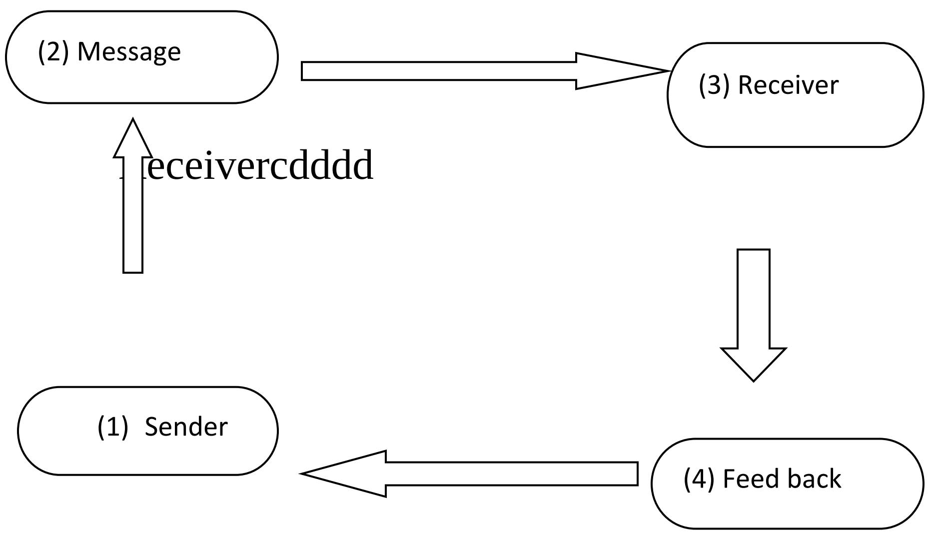
viii. **Confirming arrangements;** Through communication arrangements are confirmed for example confirmation of meetings conferences or details of transactions

ix. **Co-ordinating departments of the firm;** Charges in one department are communicated to other departments that have a direct bearing to those changes e.g. when sales increase the sales department informs the production department so as to increase production proportionality

x. **Modifying behavior of persons within or outside the organization;** Through effective communication persons are trained and counseled and as a result their behavior knowledge and attitudes change

Communication process

Communication is a process that involves interchange of information and ideas between two or more people. Communication therefore is a circular process i.e communication may lead to some reaction which in turn may generate further communications or feedback. This flow can be illustrated as below:



3

Feedback

I. **Sender** –this is the person who writes, speaks or sends signs (symbols or signals) and is the source of the information.

II. **Receiver -** this is the person to whom the information or the message is sent.

III. **Message –** this is the information that is transmitted from the sender to the receiver. It may be spoken, written or in the form of symbols.

IV. **Feed back –** this is the response to the sender's message. A message is said to have been understood if the receiver provides the desired feedback.

Lines of communication

Communication can be classified according to either the levels of the communicating parties or according to the nature of the message.

a) **According to levels**-This can either be:

I) Vertical
ii) Horizontal
iii) Diagonal

i) **Vertical communication**

This is where messages are passed between a senior and her/his juniors in the same organizations

Vertical communication can be divided into two parts

-Downward communication

-Upward communication

-Downward communication-This is a communication process which starts from the top manager to her/his juniors. This can be informed of:

- Training juniors
- Evaluating performance
- Delegating duties
- Solving the problems facing workers
- Inspiring and motivating the juniors(giving rewards)

-Upward communication-This is a communication process that starts from the juniors to the seniors and maybe in the form of:

- Submitting reports
- Giving suggestion
- Submitting complaints a grievances
- Making inquiries

ii) **Horizontal communication (lateral communication)**

This is communication between people of the same level (rank) in the same organization e.g. departmental heads in an organization may communicate to achieve the following:

- Co-ordination and harmonization of different activities.
- To create teamwork within the department.
- To exchange ideas in order to develop human resources.
- To reduce goal blindness among different departments.
- To create a sense of belonging among department heads thus acting as a motivating factor.

One of the major characteristics of this type of communication is that there are less inhibitions. The people involved are more open and free with each other than in the case of people with different ranks.

iii) Diagonal communication

This is communication between people of different levels in different departments or different organizations e.g. an accounts clerk may communicate with a sales manager of the same organization or of different organizations. Diagonal communication enhances team work.

b) According to nature of message

This can either be;

i) Formal communication

ii) Informal communication

Formal communication

This is the passing of messages or information using the approved and recognized way in an organization such as official meetings, memos and letters. This means that messages are passed to the right people following the right channels and in the right form.

Formal communication is also known as official communication as it is the passing of information meant for office purposes.

Formal systems of communication are consciously and deliberately established.

Informal communication

This is communication without following either the right channels or in the right form i.e. takes place when information is passed unofficially. It is usually used when passing information between friends and relatives hence it lacks the formality.

Informal communication may also take the form of gossips and rumor-mongering.

Informal communication usually suppliments formal communication as is based on social relations within the organization.

Note: Both formal and informal communication is necessary for effective communication in an organization.

Essentials of Effective communication

For communication to be effective it must be originated produced transmitted received understood and acted upon. The following are the main essentials to effective communications.

i) **The sender/communicator**
This is the person from whom the message originates. He/she encodes the message i.e. puts the message in the communicative form.

ii) **Message**
This is the information to be sent. It is the subject matter of communication and may contain words, symbols, pictures or some other forms which will make the receiver understand the message

iii) **Encoding;** This is the process of expressing ones ideas in form of words, symbols, gestures and signs to convey a message

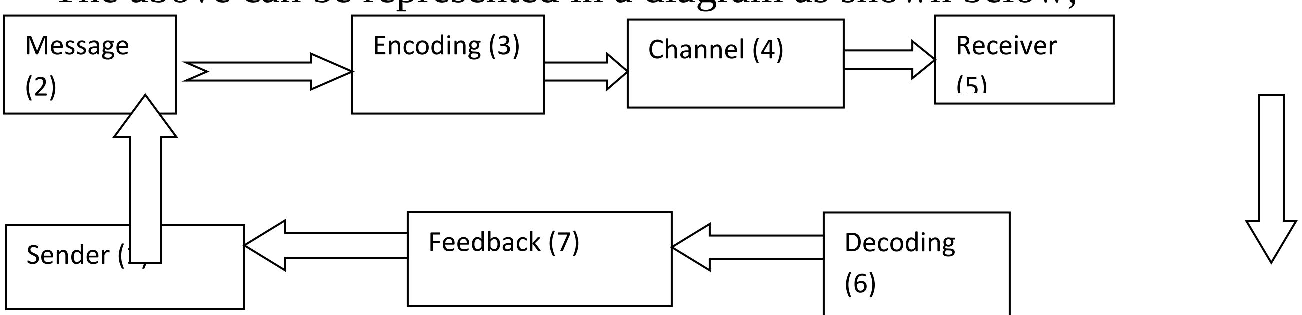
iv)**Medium/channel**; This refers to the means used in communicating. This could be in the form of letters, telephones and emails among others.

v)**The receiver**; This is the person for whom the message is intended. The receiver decodes the message for proper understanding.

vi)**Decoding;** This is the process of interpreting or translating the encoded message to derive the meaning from the message

vii) **Feed-back**; This refers to the reaction of the receiver of the message. This maybe a reply /response which the receiver sends back to the sender.

The above can be represented in a diagram as shown below;



FORMS AND MEANS OF COMMUNICATION

Forms; These are channels or ways of passing on messages. The four main forms are:

i) Oral communication
ii) Written communication
iii)Audio –visual communication
iv) Visual communication

Means; This is the device used to pass on information e.g. messages, letters, telephones e.t.c

(a) **Oral communication**

This is where information is conveyed by talking (word of mouth)
It is also known as **verbal communication**

Means of communication

i) Face-to-face conversation

This involves two or more people talking to each other. The parties are usually near each other as much as possible to ensure effective communication.
It is suitable where subject matter of discussion require convincing persuasion and immediate feed-back.
It may be used during meetings, interviews, seminars, private discussions, classrooms e.t.c
It is the most common means of oral communication

Advantages of face-to-face communication

- Provides for immediate feedback
- Has personal appeal
- Body language can be easily expressed
- One can persuade or convince another
- It is the simplest communication to use
- It is direct i.e. does not pass through intermediaries
- Convenient for confidential messages

Disadvantages of face-to-face communication

- No record for future reference
- Can be time consuming
- Messages can be distracted
- Not suitable when people are far apart
- Unsuitable for the dumb and deaf

ii)**Telephone**

This form of communication is commonly used in offices and homes. It is useful in sending messages quickly over short and long distances.
It is however not suitable for sending;

- Confidential messages
- Long and detailed reports, charts and graphs
- Messages that would require reference or evidence

In Kenya telephone services are mainly provided by Telkom Kenya Limited. The subscriber is required to purchase the telephone equipment from the post office or other authorized dealers before installation.
Installation is done on application by the subscriber (applicant).He/she pays the installation fee in addition; the subscriber is sent a monthly bill with the charges for all the calls made during the month.

The charges for calls depend on the time spent time of the day of the week and distance of the recipient from the caller e.g. it is cheaper to call at night than during the day. It is also cheap to make calls during public holidays and weekends than on weekdays.
There are also mobile phones which have no physical line connection to exchange and may be fixed to a vehicle or carried in pockets. In Kenya these services are provided by safaricom, Airtel, orange and Yu mobile communications.

Advantages of Telephones

- Relatively fast
- Has personal appeal
- Provides for immediate feedback
- One can persuade or convince another
- Suitable for long distance communication

Disadvantages of Telephone

- Can be expensive especially over long distances
- No record for future reference
- Lacks confidentiality
- Not convenient for dumb and deaf
- Can be time consuming

Reasons why mobile phones have become popular

- They are portable and can be conveniently carried around.
- It is not very expensive especially when making local calls.
- Relatively cheap to acquire.
- Some mobile phones can record conversations / calls thereby acting as evidence.
- Can be used to send short text messages (sms)
- Can be used anywhere since they are portable.

iii)Radio calls

This involves transmitting information by use of radio waves i.e. without connecting wires between the sender and the receiver
The device used is called a radio telephone. It is commonly used in remote areas where normal telephone services are lacking or where telephone services are available but cannot be conveniently used e.g. policemen on patrol in different parts of a town
Radio transmission is a one way communication system i.e. only one person can speak at a time. It is therefore necessary for the speaker to say'over' to

signal the recipient that the communication is through so that the recipient can start talking. To end the conversation, the speaker says ‘over and out’
The radio calls are commonly used by the police, game rangers, researchers, foresters, ship owners and hotels situated in remote areas. They are also used for sending urgent messages such as calling for an ambulance and fire brigade
Note; Radio calls are not confidential since they use sound frequencies that can be tapped by any radio equipment that is tuned to that frequency

Advantages of Radio calls

- Relatively fast
- Has immediate feedback
- Has personal appeal
- Provide room for one to persuade and convince another
- Suitable for remote areas
- Convenient for long distances

Disadvantages of Radio calls

- No record for future reference
- Lacks confidentiality
- Messages are sent one way at a time
- Can be expensive
- Cannot be used by dumb and deaf
- Can be time consuming.

iv) **Paging**

This is a means of communication used to locate staff or employers who are scattered in an organization or who are outside and need to be located urgently
When within the organization portable receivers, lighted signals, bells, loudspeakers etc are used
When outside the organization employees are contacted using portable receivers (pocket-size) used to send messages through sms (short message services)
The paying system can only be used within a certain radius. When using a portable receiver, the caller will contact the subscriber by calling the post office which will then activate the pager.
The subscriber is then informed to contact the originator of the message.
Paging is mostly used in emerging cases

v)**Radio**

Usually messages intended for a wide audience can be transmitted through a radio more quickly and economically than by using other forms of communication.;`
Radio is used for different reasons apart from advertising e.g for formal notices, and venue for activities

Advantages of oral/verbal communication

- Very effective method of communication since the recipient can be persuaded/convinced
- It is relatively faster method of communication
- The sender can get immediate feedback
- It indicates some sence of regard hence more appealing.

Disadvantages of oral/verbal communication

- Has no records for future reference
- Is an expensive method especially if the two parties are far apart
- Is not good for confidential messages
- It is not suitable for confidential messages
- It may be time wasting especially where one needs to be convinced

Written Communication

This involves transmission of messages through writing. It is the most formal way of communication because the information is in recorded form and can be used for reference

Means of written communication

(i)Letters

Letters are the most commonly used means of communication.
There are two categories of letters;
a)Formal letters
b) Informal letters
a)Formal letters; These include business letters and official letters.
Business letters are written to pass messages and information from businessmen to customers and vice versa e.g. letters of inquiry and acknowledgement notes.
It can also be used between employees and employers in an organization e.g. a complimentary note.
Official letters are letters between people in authority and others that touch on the activities of the organization e.g. an application letter for an advertised vacancy in an organization.

Formal letters have a salutation clause which usually starts with "Dear Madam "or "Dear Sir". It also bears the addresses of both the sender and the recipient, a subject heading and a complimentary clause ending with "Yours faithfully".
b) **Informal Letters;** These are letters between friends and relatives
They are also known as **Personal letters**

ii) Telegrams

This is a means of communication provided by the post office. The sender obtains the telegram form from the post office and fills the message on it in capital letters and hand it over to the post office employees at the counter. Alternatively the sender may use a telephone to read the message to the post office. The post office then transmits the message to the recipient post office. The charges of a telegram are based on the number of words used, the more the words used the higher the charges. However there is a standing charge. Telegrams are used for sending urgent messages.

Note; Due to changing technology telegrams have lost popularity. Short messages can now be sent by cell phones (mobile phones) using the short messages services (sms)

iii) Telex

This is a means of communication used to send short or detailed messages quickly by use of a teleprinter. The service is provided by the post office on application.

A message is sent by use of two teleprinters one on the senders end and another on the recipients end. When sending information through a teleprinter which is a form of electric typewriter producing different electric signals, its keys are pressed and automatically the message is printed at the recipient's machine.

Telex saves time for both the sender and recipient as the messages are brief precise and received immediately. However, it's an expensive means of communication

iv) **Facsimile (Fax)**

This involves transmission of information through a fax machine. Both the sender and the receiver must have a fax machine. These machines are connected using telephone lines

Fax is used to transmit printed messages such as letters, maps, diagrams and photographs. To send the information, one dials a fax number of the required destination and then the document is fed into the sender's machine. The receiving machine reproduces the document immediately. It is used for long distance photocopying service.

v)Memorandum (Memo)

This is printed information for internal messages within an orgaanisation. It is normally used to pass information between departments or offices in an organization.

Memoranda have no salutation or complimentary clause. They are suitable for informing the officers within an organization of matters related to the firm.

A memo is pinned on the notice board of an organization if it is meant for everybody otherwise passed to the relevant staff.

vi) **Notice**

This is a written communication used to inform a group or the public about past current or future events. It is usually brief and to the point. It can be placed on walls, in public places, on trees, in newspapers or on notice boards.

viii) Reports

These are statements/within records of findings recommendations and conclusion of an investigation/research. A report is usually sent to someone who has asked for it for a specific purpose.

viii) Circulars

These are many copies of a single letter addressed to very many people when the message intended for each is the same.

ix) Agenda

This is an outline of the items to be discussed in a meeting. It is usually contained in a notice to a meeting sent in advance to all the participants of the meeting. The notice of the meeting contains;

- The date of the meeting
- The venue of the meeting
- Time of the meeting
- Items to be discussed

x) Minutes

These are records of the proceedings of a meeting. Keeping minutes of certain meetings is a legal requirements e.g. companies

Keeping minutes for other meetings are for management purposes to ensure that decisions made at the meetings are implemented

Advantages of written communication

- It can be retained for future reference
- Some like letters are relatively cheap(can produce many copies)
- It is suitable for confidential messages
- Allows for inclusion of fine details

- It is not prone to distortion of messages
- Can be used as evidence
- Can be addressed to many people.

Disadvantages of written communication

- It lacks personal appeal
- It takes time to prepare and reach the recipient
- Suitable for the literate only
- Immediate feedback may not be possible
- Does not offer room for persuasion and convincing
- It may be expensive because it involves a lot of paperwork and time.
- Not suitable if the sender and the receiver do not share a common language.

3) Visual Communication

This is the process of passing information by use of diagrams, drawings pictures, signs, and gestures e.t.c

a) Photographs

A photograph is an image (visual representation of an object as it appeared at the time when the photograph was taken

Photographs are self-explanatory and may not be accompanied by any narration or explanation. The recipient is able to get the message at a glance.

b) Signs

Refer to marks, symbols, drawings or gestures whose purpose is to inform the public about such things as directions, distances, dangers and ideas.

Examples; road signs, traffic lights and danger signs on electricity poles

This means of communication can only be effective if the meaning of the sign used is understood.

Graphs; These are used to show and illustrate statistical information

Charts; These are diagrams which show or illustrate the flow of an idea e.g. an organization chart illustrates the whole organization structure indicating the chain of command

Advantages of visual communication

i) It can be used to pass confidential information

The information may be obtained at once

Disadvantages of visual communication

i) Can only be used by people who can see
ii) The information may be wrongly interpreted
iii) It may be an expensive method of communication
iv) Cannot be used for long distances

4) Audio-Visual communication

This is a form of communication in which messages are sent through sounds and signs.

This form of communication ensures that the receiver gets the message instantly.

It is suitable where both the sender and the receiver know the meaning of specific sounds and signs.

Means of Audio-visual communication

i) Television (TV): This is a device that transmits information inform of a series of images on a screen accompanied by sound. It is a very effective method of communication since it combines the advantages of image and sound

A television can be a very suitable means of sending urgent messages especially when it gives live coverage of events.

ii. **Siren:** This is a device used to produce a loud shrill sound accompanied by a flashing light. It is commonly used by the police, ambulances, and the fire brigade and security firms to alert the public of the danger involved e.g. the ambulance siren conveys the message that somebody is seriously sick and therefore other motorists should give way.

Advantages of Audio-visual communication

i) It reaches many people
ii) It is more appealing than other means of communication
iii) Reinforces verbal communication
iv) May have a lasting effect on the receiver
v) Suitable where receivers are illiterate.

Disadvantages of Audio-visual communication

i) It is suitable to those people who can interpret the messages correctly
ii) It is not suitable for confidential messages
iii) Preparation may take long.

5) Audio Communication

This is when the message is transmitted through sounds. Examples include

i) **A whistle;** This is a device which is blown to produce a sharp shrill sound to alert or warn the public or employees in an institution. It is normally used by security guards when there is danger. In some organization, a whistle is used to announce change in shifts

ii) **Horn;** This is also an instrument that is used to produce sound which passes different information depending on the way it is blown.

Other methods of audio communication include drums, alarms, and bells among others

Advantages of Audio communication

i) Is a faster method of communication
ii) It can reach several people at once
iii) The message is received instantly

Disadvantages of Audio communication

i) The message may be interpreted wrongly
ii) It can only be used within a certain radius at a time
iii) It distracts people's attention

FACTORS TO CONSIDER WHEN CHOOSING MEANS OF COMMUNICATION

i) **Speed:** Speed is an important factor when the message is urgent. In such a case telex, fax, telephone, telegram or e-mail would be the most suitable means of communication. Otherwise ordinary mail would be used

ii) **Cost:** The cost incurred in using a means of communication vary from one means to another e.g. it is cheaper to send messages by ordinary mail than by telegram or telex

iii) **Confidentiality:** Some messages are quite confidential and are intended for certain person only. Where confidential messages are involved, appropriate means should be used e.g. registered mail or internal memo enclosed in an envelope

iv) **Distance:** The geographical gap between the sender and recipient is very important in determining the means of communication to be used. Some means are suitable for long distances while others are not.

Paging and sirens are suitable for short distances. For long distances, fax letters, telephone, e-mail may be appropriate

v) **Evidence:** Some means of communication do not provide record of the message communicated while others do. All means of written communication provide evidence of messages communicated.

vi) **Reliability:** This is the assurance (certainty) that the message will reach the intended person at the right time in the right form. Face-to-face communication is more reliable than other forms of communication because one can ask for clearly and get answers immediately. For some written information, courier service may be preferred

vii) **Accuracy:** This refers to the exactness of the message communicated as intended by the sender. Written messages are generally more accurate than other means of communication.

viii) **Desired impression:** The impression created upon the recipient of a message is very important e.g. a telegram or speed post mail will carry some sence of urgency, registered mail will create an impression of confidentiality while use of colourful and attractive letterheads would convey a good image of the business.

ix) **Availability:** One may want to telephone, for example, but the services are not there so the person would be forced to use alternative means e.g. letters or radio call.

BARRIERS TO EFFECTIVE COMMUNICATION

Communication is said to be complete only when the recipient gets the message the way the sender intends it to be. When information is not received the way it was intended then it has been distorted. Distortion of a message is brought about by some communication barriers which may exists in the path of the message between the sender and the recipient. Some of these barriers are:

I. Language used: the language used by the sender should be known (understood) by the recipient so that communication can take place

II. Poor Listening: the effectiveness of communication will depend on the willingness of the recipient to listen keenly .listening require careful attention and concentration. It may however be the task of the sender of the message to attempt to gain the attention of the listener. Through his/her choice of words and expression among others.

III. Negative Attitude: Attitude refers to the feelings of the communicating parties towards each other. It is important that there exists a mutual feeling of trust and respect between the parties concerned in order to avoid bias .If there is mistrust and prejudice then there may be deliberate or unintentional misunderstanding of the message involved.

IV. Poor Timing: poor timing leads to breakdown in communication , therefore for effective communication to take place the message must be sent and received at an appropriate time, eg a message sent when one is in a hurry may not be properly received or delivered

V. Wrong medium: the medium used to communicate must be appropriate for the message being conveyed otherwise there may breakdown in communication e.g. one may not convey a confidential message over the telephone effectively

VI. Prejudgment: our understanding of the message is often conditional by our earlier experiences and knowledge this may make one individual draw premature conclusion e.g. a student who always fail in a subject and this time round has improve may be failed by the teacher because he has always failed in the past .

VII. Ambiguities: it occurs when the sender express in a manner which leads to wrong interpretation. When the receiver interprets the message differently it automatically leads to communication breakdown.

VIII. Emotional responses: emotional responses such as those resulting from hunger or excitement may lead to distortion of message.

IX. Unclear System within the organization: if the channels of passing information in an organization are not clear then the message will not get to the right people for whom the messages intended

X. Noise: it refers to any disturbing sounds which interfere with concentration or listening ability of the recipient of the message the presence of noise may make it impossible for any message to be received in the right way.

XI. Unfamiliar Non-verbal signals: lack of understanding of non-verbal sign may be a barrier to effective communication.

SERVICE THAT FACILITATE COMMUNICATION

Services that facilitate communication include:

i) Mailing services
ii) Telephone services
iii) Broadcasting services

Mailing services

This refers to handling of letters and parcels. They are offered by organizations such as postal corporation of Kenya (P.C.K) securicorl courier and Document handling Limited (D.H.L)

Some of the services offered by the postal corporation include:

a) Speed post: This is service offered by the post office to send correspondence and parcels to a destination in the shortest time possible. The post office uses the quickest means of transport available to deliver the mail. The sender pays the normal postage fee plus a fee for special service. An example of such a service is Expedited Mail Service (EMS) speed post

b) **Ordinary Mail**

These include surface mail and airmail.

Surface Mail: These include letters and parcels delivered by road, rail, water and hand.

AirMail: This consists of letters and light parcels delivered by air.

c) Express Mail;

An express mail is/must be presented at the post office counter by the sender and the envelope clearly addressed and a label with the word "express" affixed. Normal postage plus an extra fee (commission) is charged

The mail is delivered to the receivers nearest post office from where the post office makeS arrangements to deliver the mail to the receiver within the shortest time possible.

NOTE: For speed post special arrangements to deliver the mail start at the sender's post office whereas express mail, the arrangements start at the addressers post office.

d) Poste Restante;This is a service offered by the post office to travelers who may wish to receive correspondence right away from their post office box. The addressee has to inform those who may wish to correspond with him/her of the nearest post office he is likely to use at a particular time

Under this arrangement when addressing the letter, the words poste Restante must be written on the envelope clearly. The addressee must identify himself/herself when collecting the correspondence from the post office. There is no additional charge made apart from normal postage charges. This service can only be offered for three months in the same town

e) Registered Mail;

This service is offered by the post office for sending articles of value for which security handling is required. A registration fee and a commission is paid. The commission depends on the weight of the article and the nature of registration. The sender is required to draw a horizontal and a vertical line across the faces of the envelope.

A certificate of registration is given to the sender. In case of loss, the sender may be paid compensation on production of the certificate of registration.

A green card is sent to the recipient. The card bears his name and the post office at which the mail was registered. The recipient will be required to identify himself before being allowed to posses the mail.
Items that may be registered include jewels, certificate, land title deeds e.t.c.

f) Business Reply Service; This is a service offered by the post office to business firms on request. The firm pays some amount to the post office and an account is then opened from which posted charges are deducted.
The service is useful/more common with firms which would like to encourage their customers to reply their letters. Customers are issued with reply card envelopes (or envelopes marked 'postage paid')
They can send letters to the business by using these envelopes/the card. The customers then place the card/envelope in the post box and the firms post office branch will deduct postage charges from the lump sum amount.

Courier Services

These are services where a service provider receives transports and delivers parcels or important documents to destinations specified by customers in return for payment of fees or charges.
Examples; Akamba bus service, Securicor courier services e.t.c

ii)Telephone services

- Landline/fixed line services
- Cellular (mobile)phone services

i) **Land(Fixed)line services**

Telkom Kenya, through the post office, provides telephone services which offer direct contact between people who are far apart. It makes conversation between people at any distance possible, as long as there are transmission facilities between them. Urgent matters can be discussed and consultations can take place so that instant decision or actions are taken.
The telephone assists organizations to establish a fast and convenient machinery for its internal and external communication network.

ii) **Cellular(mobile)phone services**

These are hand held telephones with digital links that use radio waves.
They are sometimes called cell-phones since they use power stored in a dry cell
In Kenya mobile phone services are provided by safaricom Ltd.(a subsidiary of Telkom Kenya)and Airtel communications Ltd(formally Kencel Communication Ltd)which is a joint venture between a French company and a Kenyan company, yu mobile services and Orange mobile

services . This sector therefore greatly benefits from foreign investment to improve services.

The use of this service is popular. Apart from the provision of telecommunication service, cell phones have different attractive features or services such as short messages service (sms) whereby a caller can send a written message. Recent models of mobile phones enable the user to access the internet and send e-mail messages

Advantages

- They are portable
- Written messages can be transmitted easily and cheaply through the short message service(sms)
- Enables both local and international communication
- The cost of acquiring the equipment is relatively affordable
- Direct feedback is possible
- Has memory for storing written messages
- Has got e-mail capability

Disadvantages

- Some kinds of mobile phones are expensive to buy
- Maintenance expenses of a mobile phone are high. They are also susceptible to damage and repair can be very costly
- Users are greatly inconvenienced in case there is no network coverage
- A special facility where the callers identity is known(displayed on screen)can be abused where recipient does not wish to answer the call
- Mobile phones are a security problem. They are easy targets for thieves
- There is a danger of the radioactive rays or emissions negatively affecting the users health, if such emissions are not adequately controlled

iii) Broadcasting services

Communication commission of Kenya is a regulatory body that receives applications and issues licences for radio and television broadcasting stations.

a) Radio stations

Radio broadcasting is a very important mode of giving news and information to people in the whole world.

The liberalization of the communications sector in Kenya in 1999, Kenya has witnessed a mushrooming of F.m. Stations which are owned by private sector operators e.g. Kiss Radio, Easy fm,Classic fm,Family fm,Kameme e.t.c

They have helped to spread news and information countrywide. Before liberalization, Kenya Broadcasting corperation (KBC) radio was operating as a state owned monopoly.

b) Television Stations

Television broadcasting (telecasting) does not reach as wide an audience as radio broadcasting in Kenya. It however serves the same purpose of relaying news and information to Kenyans. Both radio and television stations are widely used for advertising purposes.

The T.V subsector has been liberalized since 1999 and a number of privately owned stations have emerged e.g. Kenya Television Network (KTN) Nation Television, Family T.V etc. Prior to that time KBC television was in operation as a state owned monopoly.

Other services that facilitate communication

i) Telex
ii) Facsimile
iii) Paging
iv) E-mail

Current trends and Emerging issues in communication

With the advancement of information technology (I.T) there has been a lot of revolution in communication.

The following are some of the current trends and emerging issues in communication;

i) Telephone Bureaux(Bureaus)

These are privately owned kiosks where telephone services are sold. The owner of the kiosk must get authority from the service provider in order to run the bureau. The individual wishing to use the services of the bureau makes payments to the owner of the service. Other services offered by the bureau include selling of scratch cards for mobile telephones and credit cards for landline telephone services.

ii) **Mobile phones (cell phones)**

These are hand held telephones with digital links that use radio waves. They have become an important business and social tool. This is because most people and traders want some flexibility to be able to communicate whenever they are.

Other reasons that have led to the popularity of cell phones include:

- Pre paid services which enable the owners to control communication costs.

- Most cellular phones now allow the owners to browse the internet, check and send mail. This allows business people to communicate research and even place orders.
- Cellular phones have short message services (sms) which enables the owners to send written messages.

iii) E- mail (Electronic Mail)

This is a service provided through the internet for sending messages.
It is similar to sending a letter through the postal system only that it is done electronically.
-Messages can be sent to anyone on the network, anywhere in the world. For this to take place, computers have to be connected to each other to form a network.
-To communicate, one is required to have an email address e.g. raeform2@ yahoo.com. Messages arrive at the e – mail address immediately they are sent.
-It is only the addressee of the message who can retrieve the message since a password is required to access the mailbox.
-E – mail can also be used to send documents and photographs like certificates by scanning and attaching.
- More and more businesses are using e- Mail to communicate with other businesses, their customers and suppliers.

*** QUESTION: OUTLINE THE ADVANTAGES OF USING E- MAIL AS A MEANS OF COMMUNICATION.**

iv) Internet

The internet links computers all over the world. Written and oral information is transmitted on the internet through the use of telephone wires, fibre- optic cables and wireless devices.
The internet has changed the way people communicate in the following ways;

- Increased use of electronic mail (e-mail)
- Quick access to information from all over the world.
- Development of home offices and remote offices.
- Use of teleconferencing and video conferencing.
- Development of e-commerce.

v) Move towards a paperless office

The future office will rely largely on computers. Most of the communication will be done through computers. This may result in less use of paper, hence the use of the term “the paperless office”.

Vi) Decline in the use of postal services

Decline in the use of postal services is a result of the impact of the internet. E-mail has become a popular and preferred mode of communication since it is fast and cheap. However, ordinary mail/ use of postal services may not be completely phased out since the government, businesses and people do not regard an e-mail as a binding or formal communication.

Vii) Transformation of language

The language used to pass and receive messages has evolved through time.e.g the youth have adopted the use of "sheng" in exchanging messages. such language is largely understood by its youthful users. There is also the use of cell phones to send short text messages; which are highly abbreviated and may use slang whose meaning is only known to the users e.g 'av a gr8 day'.

COMMUNICATION REVESION QUESTIONS

1. Define the term communication

-Communication is the process by which information is passed from one person or place to another.

2. Outline the role played by communication in any given organization

a) It is used to give instructions on what should be done at work and during work.
b) It enhances good relations among workers thereby promoting and enhancing their efficiency.
c) Through communication most organizations have been able to improve their image, for example through advertising.
d) It used to improve the relationship between the organization and the customer or clients.
e) For co-ordinating purposes, communication is used to ensure all departments work in harmony.
f) The feedback got from the clients or customers helps to improve an organization's reliability and quality of goods and services offered.
g) Communication is used as a tool for management.
h) Good decisions are made as communication helps one understand all the necessary matters.

3. Briefly explain the following levels of communication

(a) Vertical communication

Involves the flow of information either downwards or upwards, for example, from a senior employee to a junior employee

(b) Horizontal communication

Is also referred to as lateral communication which is passing of information between people of the same rank or status, for example from one departmental manager to another departmental manager

(c) Diagonal communication

Is communication of different people in different levels of management or departments for example a receptionist communicating to a production manager.

4. Distinguish between formal and informal communication

Formal communication is official and documented and follows certain rules for example a worker writing an official letter to an organization's seniors. Informal communication does not conform to any time, for example communicating to friends and relatives.

5. State the essential elements in communication.

a) The sender who is the source of the information being communicated
b) The receiver(or recipient) of information
c) The message being communicated
d) The channel (or medium) through which the message is passed on
e) Feedback which is the response or reaction of the recipient.

6. Highlight the various types of verbal communication

a) Face-to-face communication
b) Telephone conversation
c) Radio calls conversation.

7. State the advantages and disadvantages of verbal communication

Advantages

a) A large number of people can receive the information at once for example when addressing in a meeting.
b) There is immediate feedback
c) Clarification can be made easily and immediately
d) This is personal appeal
e) It can be very convenient and persuasive
f) It is fast since the intended information reaches the recipient immediately.

Disadvantages

a) It is not easy to know if the message or information has been received particularly if the receivers are many
b) It is prone to outside interference due to noise and other forms of disruptions

c) In case of incorrect pronunciation of words, there could be distortion of the information
d) There is no record for future reference.
e) The method is not effective for recipients with learning problems.
f) Can take a lot of time to pass intended information.

8. Outline the various barriers to effective communication

a) Noise may hinder effective communication
b) The emotional state of both the sender and the recipient
c) Use of the wrong channel to communicate
d) Breakdown of a channel used to communicate
e) Illiteracy of the recipient particularly for written communication.
f) The attitude of the recipient towards the sender and the information being communicated
g) Use of difficult vocabulary or words by the sender
h) Lack of concentration on the part of the recipient may affect communication
i) Poor timing by the sender.

9. Highlight reasons that would make an organization use cell phones for communication within and outside the organization.

a) One gets immediate feedback
b) It is fast and can be used to send urgent messages
c) There is personal appeal
d) The sender has a great opportunity to convince and persuade the recipient.
e) It is not very expensive particularly for making calls for a short duration of time
f) It can be used even when both the sender and the recipient are far apart

10. State the various types of written communication.

a) Written
b) Memorandum(memos)
c) Reports
d) Notices
e) Telegrams
f) Circulars
g) Minutes

11. State the reasons why an organization would use written communication instead of verbal communication.

a) Written communication provides evidence which may not be there in verbal communication
b) Written information can be stored for future reference unlike verbal which cannot be stored and depends on the recipients memory
c) It is not prone to distortions and therefore more accurate than verbal communication
d) Written communication can be in form of diagrams, illustration and maps which is not possible for verbal communication
e) Some written communication such as letters would be cheaper and time saving than verbal communication, for example making long telephone calls.
f) Written communication can be used for confidential messages, for example registered mails.

12. State the disadvantages of written communication

a) Written is not very persuasive or convincing
b) There is no personal touch
c) It can only be used by literate
d) It can be slow where letters take time to reach the recipient
e) It takes time to get a feedback from the recipient
f) Messages cannot be enhanced by gestures, that is, body language or face expressions
g) It can be expense to file all the written communication

13. Outline the various means of visual communication

a) Charts
b) Photographs
c) Gestures, which may include signs and symbols
d) Slides

14. State the advantages and disadvantages of audio-visual of communication

Advantages

a) Information is more attractive and appealing
b) Can reach many people at once
c) It can be used even for those who cannot read and write
d) Immediate feedback is received from the way the recipient behave
e) Can be entertaining

Disadvantages

a) Can be misinterpreted, for example if the receiver does not understand the signs or gesture

b) Not suitable for passing confidential information
c) It is not possible for the recipient to give a feedback
d) Gesture and signs are only suitable to those who can understand them
e) The initial cost of preparing these forms of communication may be high for the sender
f) It may take a lot of time to prepare these forms of communication

15. Outline the various service that facilitate communication

a) Registered mail, for sending valuable or confidential information.
b) Speed post services offered by the post office to send letters parcels using the quickest means possible
c) Poste restante, usually used by those without postal addresses
d) Business reply service which enables customers and clients to reply to a business without having to pay for postage stamps
e) Broadcasting services through various radio stations
f) Print media such as the various newspapers, magazines and journals
g) Internet services which connect one to the world wide website
h) Telephone services

16. State the various trends in communication

a) Mobile or cell phone use
b) Internet which uses inter linked computers to the world wide website
c) Fax, which can be used to send written messages very fast
d) Information and telephone bureaus where one can make local and international calls
e) Move towards a paperless office.
f) Transformation of language.

17. Highlight the factors to be considered when choosing a means of communication.

a) The cost because some are more expensive than others
b) Availability of the means
c) Reliability or assurance that the message will reach the recipient
d) The distance between the sender and the recipient
e) The literacy level of both the receiver and the recipient
f) The confidential nature of the information being sent
g) The urgency of the message
h) If there is need for evidence or need for future reference
i) The desired impact of the means upon the recipient

18. Advice Mary Wakio why she should not use telex to communicate to her friends

- **a)** Her friends may be illiterate and may be unable to read the message received
- **b)** Her friends may not have a receiving machine and will be unable to get the information
- **c)** It can be expensive to use as the sender pays a subscription fee and rental fee while he and the recipient pays for the sent message
- **d)** It can be expensive to buy the teleprinters used in receiving and sending information
- **e)** Telex may only send written messages but cannot be used to send maps, diagrams and charts

19. State circumstances when sign language can be the most appropriate form of communication

- **a)** When communicating to someone who has a hearing problem
- **b)** If one wishes to pass a secret or coded message
- **c)** If both the receiver and the sender are far apart but can see each other
- **d)** It can be used in case there is a language barrier
- **e)** In an environmental where there is a lot of noise or physical interference to other forms of communication, sign language may be used
- **f)** It can be appropriate where both the recipient and the sender understand the signs.

20. Explain four factors that have led to the popularity of mobile phones as a means of communication.

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WAREHOUSING

Warehouse: This is a building or a part of a building where goods are received and stored until need arises for them.

-Other terms used to refer to a warehouse are depot, a godown or a silo.

Warehousing; This is the process of receiving goods into a warehouse, protecting such goods against all types of hazards and releasing them to users when need arises for them

-There are three distinct stages in warehousing process namely:

i. Receiving goods into a warehouse
ii. Storing them
iii. Releasing them to users

Importance of warehousing to Business

i. **Steady/continuous flow of goods:** Producers can produce and store goods awaiting demand through warehousing e.g. agricultural products that are produced seasonally are made available throughout the year
ii. **Stability in prices:** Warehousing ensures that there is no surplus or shortage of goods. It ensures that goods are stored when in plenty and released to the market as their need arises. This helps to keep their prices fairly stable
iii. **Security:** Warehousing ensures that goods are protected against physical damage and adverse weather conditions. This also ensures that the quality of the goods is maintained until they are demanded. Goods are also protected from loss through pilferage and theft.
iv. **Bridging the time lay/difference between production and consumption:** many goods are produced in anticipation of demand. Such goods must be stored until their demand arises e.g. gumboots, umbrellas and sports equipment are needed seasonally but are manufactured in advance and stored in a warehouse so as to be released to the users when need arises for them.
v. **Continuous/uninterrupted production schedules:** Manufactures are able to buy raw materials in large quantities and store them awaiting their need to arise. This prevents interruption of the production process because of lack of raw materials
vi. **Preparation of goods for sale:** While in the warehouse, goods can be prepared for sale e.g. they can be blended, packed, graded or sorted out.
vii. **Sale of goods:** Goods may be sold while still in the warehouse. If sold while still in a bonded warehouse, duty passes to the buyer
viii. **Specialisation:** Warehousing encourages specialization in production and distribution. Producers concentrate on producing while distributors store the goods for sale to the customers.

ix. **Unexpected demand can be met:** The government collects agricultural goods e.g. cereals and stores them as buffer stocks to be used in times of disaster or serious shortages.
x. **Clearance of goods:** Warehousing helps in clearance of goods i.e. goods entering the country can be inspected by the customs officials.
xi. Warehousing helps to improve the quality of goods e.g. goods like tobacco and wine mature with time.
xii. Warehousing enables buyers to inspect the goods before they buy them.
xiii. Wholesale warehouses may also operate as showrooms for traders.

Essentials of a warehouse

These are the features and resources a warehouse should have in order for it to function effectively.

These include:

i. **Ideal location:** A warehouse should be located at a suitable place to facilitate receipt and issue of goods e.g. a manufactures warehouse should be located near his/her factory.
ii. **Proper building:** A warehouse should have proper buildings which are suitable for different types of goods to be stored.
iii. **Equipment:** A warehouse should be equipped with appropriate facilities for handling goods such as fork-lifts conveyer belts e.t.c. It should also be well equipped with necessary storage facilities e.g. provision of refrigerated or cold storage for perishable goods such as meat and fruits.
iv. **Accessibility:** A warehouse should be accessible to its users. It should therefore be linked with good and appropriate transport system to facilitate movement of goods in and out of the warehouse.
v. **Safety and security:** It should have/be fitted with safety equipment or facilities necessary for protection of goods against damaged caused by such things like water, fire or sunshine as well as for the protection of the personnel.
vi. **Communication:** A warehouse should have a good communication network or system for easy contact with its clients and suppliers
vii. **Qualified personnel:** A warehouse should have well trained and efficient staff/personnel for proper management and efficient functioning of the warehouse.
viii. **Recording system:** There should be a proper recording system in a warehouse to ensure that all movement of goods is properly monitored.
ix. A warehouse should be spacious enough to allow easy movement and accumulation of goods and personnel.

Types of warehouses

-Warehouses can be broadly classified into three namely:

a. Private warehouses
b. Public warehouses
c. Bonded warehoused

i) **Private warehouses**

These are warehouses that are owned by private individuals/organizations for the purpose of storing their own goods only. They include:

a) Wholesalers warehouses
b) Producers warehouses
c) Retailers warehouses.

a) **Wholesalers warehouses**

These are warehouses for storing the wholesalers' goods as they await distribution or sale. They need warehouses because they buy goods in bulk from producers and store them until they are needed by retailers.

-The wholesalers warehouses also act as showrooms i.e. they display their goods in the warehouse.

-These warehouses also enable the wholesalers to prepare their goods for sale e.g. branding, blending, packing and sorting may be carried out in the warehouse

b) **Producers warehouse**s;

-These warehouses are owned by producers and they are for storing goods prior to their demand.

-The producers may be manufactures of finished goods or farmers

-Such warehouses are built near the manufactures factories or the farmers production points.

-Manufactures who export may locate some warehouses near ports through which they export e.g Mumias sugar warehouse, Bamburi Portland cement warehouse e.t.c

C) **Retailers warehouses**

Some large-retailers such as chain stores and supermarkets own warehouses for storing their large stores

-It becomes necessary for such business to have warehousing facilities due to their large and bulky purchases dictated by the nature of their business

-Goods are distributed from their warehouses to the retail outlets or to the branches

Advantages of private warehouses

i. The owner has full control over its operation and may make major decisions without having to consult anyone.
ii. The warehouse is designed to suit the specific needs of the organizations
iii. It enables special handling, storage and protection of goods by having special facilities which may not be available in a public warehouse
iv. The owner is not tied down by procedures of receiving and issuing goods unlike in public warehouse.
v. The owner does not incur the cost of hiring space unlike with a public warehouse
vi. The operation can be easily automated because the goods to be received stored and dispatched are already known.

Disadvantages of private warehouses

i. The initial construction cost of a warehouse is high
ii. Under-utilization of personnel and facilities may occur especially in times of low volumes
iii. They may not employ qualified management personnel and are consequently disadvantaged in dealing with management problem.
iv. Risks arising from dangers such as fire, pests, theft or damage are not spread

ii) Public warehouses

These are warehouses owned by individuals or organizations who do business by renting space. To those traders who are in need of storage facilities to store goods temporarily. They have the following characteristics;

- Are owned and operated by individuals or companies who do not use them for storing their own goods.
- Are open to any member of the public who wish to rent storing space for their goods
- The customers pay on the basis of space rented and the period of time required to store the goods.
- They are often situated near terminals as airports, sea-ports and railway station and industrial areas. This facilitates the movement of goods in and out of the warehouse.
- The rent paid includes charges for insurance and other services i.e. goods are insured against loss or damage as a result of fire or theft while they are still in the warehouse.

- They provide other services apart from storing the goods e.g. grading,packaging,preparing export samples, preparing market reports and clerical documents
- Imported goods can be sold while they are still in the public warehouse. If such a transaction takes place the goods may change ownership without being physically moved out of the warehouse. This becomes possible if the importer has signed a document called '**a warehouse-warrant'** (which is a negotiable instrument out of order), it is issued by the new owner after the transaction has taken place.

Advantages of a public warehouses

i. A public warehouse serves a number of customers that deal with the same product. It assembles the small orders from these customers and places one order for all of them. This enables them to enjoy economies of large scale buying and delivery of goods to a warehouse.
ii. Goods stored in a public warehouse may be sold without their physical movement from the warehouse.
iii. Traders can rent space to store their goods
iv. Traders do not have to construct their own warehouses/do not have to tie up capital in storage buildings and handling equipment.
v. Goods are insured against risks such as damage by fire and theft
vi. A trader may get a short term loan from the warehousing firm by using the goods held as collateral security.
vii. Apart from the handling, sorting and documentation of goods additional services such as bottling, bagging and repairs of damaged goods can be offered by public warehouses.
viii. Sharing equipment and machinery enables the users to reduce handling costs
ix. Inspection, re-packaging and labeling services provide users of public warehouses the expertise they themselves may not have.

Disadvantages of public warehouses

i. The hirer is denied the opportunity to physically handle the goods and is forced to compete for attention with other hirers of the warehouse. If the hirer had his/her own warehouse, he/she would have absolute authority on the goods and therefore enjoy individual attention.
ii. The hirer may lose contact with his/her customers since they get goods from a rented warehouse, away from the hirers premises
iii. The hirer may get poor services or miss space altogether during peak seasons due to stiff competition for the same facility.

iv. Documentation involving receipt and release of goods in a public warehouse is likely to be a long and complicated procedure due to the large number of clients involved.

v. Continued renting of space can even be more expensive than constructing one's own warehouse in the long run

vi. Public warehouses are sometimes situated far away from the hirer's premises unlike private ones which are usually within the vicinity of the owner's premises.

vii. The operations of a general merchandise public warehouse are difficult to automatic because different kinds of goods need different methods and equipment to handle them.

iii) Bonded warehouses

These are public warehouses for keeping imported goods until customs duties have been paid against them. They are mainly located at the points through which goods enter a country

-Imported goods are kept in this type of warehouses if the owner has not paid customs duties. Such goods are said to be "**goods under bond"**or **"goods in bond"**

-Bonded warehouses are so called because the owners of such warehouses give a **'bond'** to the customs authorities i.e. a sum of money as guarantee that they will not release goods from the warehouses until customs duties have been paid.

-The importer may withdraw the goods either in part or in full after the customs duties have been paid for the goods he/she intends to collect.

-If the goods are sold while still in a bonded warehouse, the new owner of the goods pays the duty before taking them out of the warehouse.

-If the goods re-exported to another country while still in a bonded warehouse, the importer does not have to pay the customs duties e.g an importer may import some goods and further prepare them for sale inside a bonded warehouse and can then re-export them without having paid the customs duties

-When the importer pays the duties to the customs officials, a "**release warrant"** is issued. This is a document that enables the importer to have his/her goods released from a bonded warehouse

-Bonded warehouses have resident customs officials who monitor the movement of goods in and out of a bonded warehouse.

Features of a bonded warehouse

i. Goods are bonded until customs duty is paid
ii. Goods can be re-exported while in the warehouse
iii. Storage charges are made on all goods stored in the warehouse
iv. Goods can be sold while still under bond
v. Goods can be inspected and prepared for sale i.e. they can be repacked, branded and blended while in the warehouse
vi. Goods are released only on the production of a release warrant

Advantages of bonded warehouse to the importer

- While in bond, goods can be prepared for sale
- The owner can look for the market for the goods before paying the duty
- Some goods lose weight while in the warehouse so the duty paid becomes lower if based on weight.
- If goods are sold while still in the bonded warehouse, the duty passes to the buyer
- The importer has more time to arrange for payment of customs duty.
- Security is provided for the goods, so the importer is relived of the task of providing security for his/her goods
- Some goods improve in quality while in a warehouse for example, wine and tobacco.

Advantages of Bonded warehouse to the Government

i. The government gets revenue by levying duty on the goods
ii. The government is able to control the entry of harmful goods
iii. The government is able to verify the documents for goods in transit
iv. The government is able to check on the quantity, quality and the nature/type of goods imported.
v. The government is able to check on illegal goods entering the country.

Disadvantages of a bonded warehouse

i. The importer may eventually fail to pay customs duties. This forces the customs authorities to auction the bonded goods in order to recover the duties.
ii. When the importer withdraws goods from a bonded warehouse he/she ends up paying a higher duty if he/she had paid the duty at once.
iii. The importer incurs costs in hiring a bonded warehouse as opposed to if he/she had a private warehouse

Free warehouses

These are warehouses in which tax-free goods are kept awaiting sale or collection by owners

-Goods stored in these warehouses can be either locally produced, requiring no taxation or imported goods for which customs duties have already been paid.

NOTE: i) All warehouses apart from bonded warehouses are free warehouses since goods held in them are not subject to control by customs authorities. This includes all private and public warehouses

ii) Locally produced goods are stored in free warehouses since no custom duties are paid for them.

Advantages of free warehouses

- Owners of goods stored need not to pay any taxes, thus the goods cannot be auctioned for failure to pay customs duties
- It is cheaper to store goods in free warehouses as compared to bonded warehouses since there are no customs duties levied.
- Clearence of the goods from the warehouse is simple since a "release warrant" to prove payments of duties is necessary
- These warehouses are located at places that are convenient to users

Disadvantages of free warehouses

- The Government does not benefit since no customs duty is levied on the goods stored
- Some unscrupulous traders might use them to store durable goods so as to evade tax.
- Checking and security of goods is more relaxed hence the possibility of storing illegal goods.

Current trends and emerging issues in warehousing

Warehousing technology is undergoing important changes in both building design and handling in storage equipment. These may include;

i) Warehousing design-In modern times, there is an increasing emphasis on high ceiling warehouses to permit storage of more goods and to make it possible for the movement of fork lift trucks and stuck-cranes

ii) Handling of goods-Handling includes the steps involved in moving of goods to and from storage. There is widespread use of modern machines in most warehouses such as conveyer belts, tracks, forklifts and stuck cranes. The use of automated stucker cranes which more by remote control in a fixed path on guide rails, is a new development in warehousing

-Computerization has also greatly helped in monitoring the movement of stock in and out of storage. This has eased the handling, especially in loading and unloading of goods.

iii) Storage of goods-Storage is the condition of the goods at rest in their assigned areas of the warehouse. Most warehouses are currently using storage racks that permit replacement or retrieval of goods without disturbing neighbouring goods.

iii) Environmental pollution-Goods that expired or spoilt while in the warehouse are sometimes discarded in a manner or in areas that may cause pollution to the environment e.g. expired chemicals are sometimes thrown into rivers and oceans thereby endangering the marine life.

-Other times they are burned causing air pollution with toxic gases. Some goods when thrown on land are dangerous to human life

-To avoid the effects of improper disposal of expired or spoilt goods the warehouse owners should come up with methods that are environmentally friendly such as recycling of these goods. They should also be socially responsible for whatever goes out from their warehouses.

INSURANCE

Insurance-This is an undertaking or contract between an individual or business and an insurance an occurrence of risk(s) (i.e. against events whose occurrences are unforeseen but causes financial losses or suffering to the affected parties.

Risks are also referred to as **contingencies, hazards or perils and include:**

-Fire outbreak

-Accidents

-Thefts

-Deaths

-Disabilities

-Risks are real and unforseen. Methods to eliminate such risks has achieved very little and thus has necessitated the need for insurance.

Importance of insurance

1. **Continuity of business**

Every business enterprise is exposed to a variety of risks e.g. fire, theft e.t.c.The occurrence of such risks often result in financial losses to the business. Insurance provides adequate protection against such risks in that, if a trader suffers losses as a result of insured risk, she/he is compensated, thus he/she is able to continue with business operations.

2. **Investment projects**

Insurance enables investors to invest in profitable yet risky business projects that would otherwise avoided.

Not all the money received as premiums (by the insurance companies) is used up for compensation to those who have been exposed to risk and suffered losses. The rest of the money is invested in other businesses to earn profits.

3. **Creation of employment**

Insurance does provide employment opportunities to members of the public.

4. **Government policy**

The profits earned are a source of revenue for the government i.e. insurance companies are profit-making organizations which generate revenue to the government through payments of taxes

5. **Credit facilities**

The insurance industry have also established credit or lending facilities which the business community uses by borrowing. Loans are made available to the public for different investment projects in different sectors of the economy and also for personal requirements.

6. **Development of infrastructures**

The insurance industry plays a crucial role in the development of urban facilities in major towns. Both residential and office buildings have been developed by insurance firms. The firms also participate in development projects in the areas where they operate. They contribute to development of a region by constructing and infrastructural facilities

7. Life policies can be used as security for loans from either the insurance company or other financial institutions.
8. Provision of life and general insurance policies encourages Kenyans to plan ahead for their dependants thereby reducing the number of needy future students.
9. **Loss prevention-**The insurance companies encourage the insured not to cause accidents thus channeling the unclaimed resources into the economy.

THE THEORY OF INSURANCE

The insurance business relies on the law of large numbers in its operations. According to this law, there should be a large group of people faced with similar risks and these risks spread over a certain given geographical area.

Every person in the group contributes at regular intervals, small amounts of money called premium into a "common pool". The pool is administered and controlled by the insurance company.

i) The fact that risks are geographically spread ensures that insurance does not have a concentration of risks in one particular area.

ii) The law of large numbers enables the insurance to accurately estimate the future probably losses and the number of people who are likely to apply for insurance. This is done in order to determine the appropriate premiums to be paid by the person taking out insurance.

Pooling of risks

The insurance operation is based on the theory that just a few people out of a given lot may suffer a loss. There is therefore a "pooling of risks" i.e the loss of the unfortunate few is spread over all the contributors of the group, each bearing a small portion of the total loss. This is why the burden of loss is not felt by the individuals because it is "shared" by a large group.

Benefits of the "pooling of Risks" to insurance company

i) Pooling of risks enables an insurance company to create a common pool of funds from the regular premiums from different risks.

ii) It enables the insurance company to compensate those who suffer loss when the risks occur

iii) The insurance company is able to spread risks over a large number of insured people

iv) Surplus funds can be invested in for example, giving out loans or buying shares in real estates

v) It enables the insurance company to meet its operating costs by using the pool funds

vi) It enables the insurance company to calculate to be paid by each client

vii) It enables the company to re-insure itself with another insurance company.

Terms used in Insurance

Insurance

This is a written contract that transfers to an insurer the financial responsibility for losses arising from insured risk.

Premium

This is the specified amount of money paid at regular intervals by the insured to the insurer for coverage against losses arising from a particular risk.

Risk

These are perils or events against which an insurance cover is taken. It is the calamity or problem a person or business faces and results into losses.

Note: The calculation of premiums depends upon the type of risk insured against. The higher the probability of the risk occurring, the higher the premium. The more the risks the business or person is exposed to the more the premiums payable.

Pure risk

This is a risk which results in a loss if it occurs and results in no gains if it does not occur. For example, if a car is involved in an accident, there will be a loss and if the accident does not occur there will be no gain or loss

Speculative risk

This is a risk which when it occurs, may result in a loss or a profit. For example, a person may buy shares at ksh.50 each, one year later the shares may be valued at ksh40 each meaning a loss of ksh.10

Alternatively, their value might not have changed or might have increased to ksh.45 each. Speculative risk lures people to venture into business in the first place.

Insured

This is the individual or the business that takes out the insurance cover and therefore becomes the policy holder

The insured pays premiums to the insurance company to be compensated should the risk insured against occur or cause loss.

Insurer

This is the business company that undertakes to provide cover or protection to the people who suffer loss as a result of occurrence of risks

Actuaries

These are people employed by an insurance company to complete expected losses and calculate the value of premiums.

Claim

This is a demand by the insured for payment from the insurer due to some loss arising from an insured risk.

Policy

This is a document that contains the terms and conditions of the contract between the insurer and the insured. Its issued upon payment of the first premium.

Information contained in a policy includes;

- Name, address and occupation

- Policy number of the insured
- Details of risks insured
- Value of property insured
- Premiums payable
- Other special conditions of the insurance, for example nominees

Actual value

This is the true value of the property insured

Sum insured

This is the value for which property is insured, as stated by the insured at the time of taking the policy.

Surrender value

This is the amount of money that is refunded to the insured by the insurer in case the former (i.e. the insured) terminates payment of the premiums before the insurance contract matures. The policyholder is paid an amount less than the total amount of the premium paid.

Grace period

This is term allowed between the date of signing the contract and the date of payment of the first premium. During this period the insurance contract remains valid. This period is usually a maximum of thirty (30) days.

Proposer

This is a person wishing to take out an insurance cover (prospective insured)

Cover note (Binder)

This is a document given by the insurance company to an insured on payment of the first premium while awaiting for the policy to be processed. It is proof of evidence that the insurer has accepted to cover a proposed risk.

Annuity

This is a fixed amount of money that an insurer agrees to pay the insured annually until the latter's death. It occurs when a person saves a lumpsum amount of money with an insurer in return for a guaranteed payment which will continue until he/she dies.

Consequential loss

This is loss incurred by a business as a result of disruption of business in the event of the insured risk occurring.

Assignment

This is the transfer of an insurance policy by an insured to another person. Any claims arising from the transferred policy passes to the new policy holder called an assignee

Beneficiaries
These are people named in a life assurance policy who are to be paid by the insurer in the event of the insured

Nomination
This is the act of designing one or more people who would be the beneficiaries in the event of death of the insured. These people are called nominees

Average clause
This clause is usually included in policies to discourage under-insurance. The clause provides that the insured can only recover such proportions of the loss as the value of the policy bears on the property insured. It is usually included in marine or fire insurance policies.

The amounts recoverable are arrived at using the following formulae:

$$\text{Compensation} = \frac{\text{value of the policy}}{\text{Value of property}}\ \text{loss}$$

Example:
If a house worth kshs.800,000 and insured against fire for kshs.600,000 was damaged by fire to the tune of kshs.400,000,the insured would be compensated;

$$\text{Compensation} = \frac{(600{,}000 \text{ x } 400{,}000)}{800{,}000} \Rightarrow \text{(value insured x Actual loss)}$$

Double insurance
This is taking of insurance policies with more than one company in respect to the same subject matter and the risk. It is significant because if one of the insurers is insolvent at the time the claim arises the insured can enforce his/her claim against the solvent insurer or if both insurers are solvent then they share compensation.

(Insolvency is a state where a business is not able to pay all its liabilities from its existing assets)

Co-insurance
This is an undertaking by more than one insurance company to provide insurance cover for the same risk for an insured. This will usually occur for properties that have great value and face great risk exposures that an insurer cannot successfully make compensation for e.g. value of aeroplanes, ships e.t.c

Co-insurance help spread risks to several insurers, each insurer covering only a certain proportion of the total value. The insurance company with the largest share is called the "leader" and acts on behalf of all the participating insurance companies' e.g. in collecting premiums from the insured and carrying out documentation work, making claim after collecting each insurers premium contribution e.t.c

Note: Co-insurance is different from double-insurance in that in co-insurance company approaches another insurance company to help in covering the insured property while in double-insurance; it's the insured who decides to approach different insurance companies to insure the same property against the same risk.

Re-insurance

'Re-insurance' means insuring again. This is a situation where an insurance company insures itself with a bigger insurance company called **le-insurer** for all or part of the risks insured with it by members of the public

Re-insurance indirectly insure an individuals risks.Re-insurance helps to reduce the burden on an insurance company when the loss is too high for a single insurer. When such losses occurs, the claim is met by both the insurer and re-insurer(s) proportionately (according to agreed percentages)

Note:

Re-insurance deal with the protection of insurance companies only, while insurance companies protect individuals and business organizations.

Factors that may make it necessary for an insurance company to Re-insure

i. **Value of property-**When the value of property is great, such as ship, the risk is too high to be borne by a single insurer
ii. **High risk of loss-**When chances of loss through the insured risks are high, it becomes necessary to re-insure.
iii. **Number of risks covered-**When the insurance company has insured many different risks, it would be too costly to compensate many claims at once, hence the need for re-insurance
iv. **Need to spread the risk-**When the insurance company wishes to share liability in the event of a major loss occurring
v. **Government policy-**The government may make a legal requirement for an insurance company to re-insure

Under-insurance

This occurs when the sum insured as contained in the policy is less than the actual value of the property e.g. A property of shs.500, 000 can be offered for insurance as having a value of shs.400, 000

Over-insurance
This is a situation where the sum insured is more than the correct value of property e.g. a person insures property of shs.300,000 for shs.600,000.If total loss occurs, he is compensated the correct value of the property i.e. that which he has lost

Agents
These are people who sell insurance policies on behalf of the insurance company. They are paid on commission that is dependent upon the total value of policies sold

Insurance Brokers
These are professional middlemen in the insurance process. They connect the people wishing to take insurance with the insurers. They act on behalf of many different insurance firms, unlike agents. Their activities include:

- Examination of insurance market trends
- Correspondence between the insured and his clients
- Advising the insured and would be policyholders on the best policies for their property e.t.c.

  He receives a commission (reward) known as **brokerage.**

PRINCIPLES OF INSURANCE
Principles of insurance provide guidance to the insurance firms at the time they are entering into a contract with the person taking the cover. These insurance principles include:

i. Help to determine whether a valid insurance contract exists between the two parties at the time claims are made.
ii. Provide checks and controls to ensure successful operations of insurance for the benefit of both the parties

It is therefore important that a prospective insured (person wishing to take insurance policy) has basic knowledge of these principles as stated in the insurance law.
The insurance principles include;

i) Insurable Interest

This principle states that an insurance claim cannot be valid unless the insured person can prove that he has directly suffered a financial loss and not just because the insured risk has occurred.
Going by this principle one cannot insure his parents or friends or other people's property since he/she has no insurable interest in them. If such properties are damaged or completely destroyed, he/she will not suffer any financial loss.

For example, Mr.x has no insurable interest in the property of his neighbours.He does not suffer any financial loss should they be destroyed.
This principle ensures that people are not deliberately destroying other people's properties/life in order for them to receive compensation.
In life insurance (life assurance) it is assumed that a person has unlimited interest in his/her own life. Similarly it is assumed that one has insurable in the life of spouse and children e.g. a wife may insure the life of her husband, a father the life of his child because there is sufficient insurable interest.

ii) Indemnity

The essence of this principle is that the insurer will only pay the "replacement value" of the property when the insured suffers loss as a result of an insured risk.
This principle thus puts the insured back to the financial position he enjoyed immediately before the loss occurred.
It is therefore not possible, then, for anybody to gain from a misfortune by getting compensation exceeding the actual financial loss suffered as this will make him gain from a misfortune.
This principle does not apply in life assurance since it is not possible to value one's life or a part of the body in terms of money. Instead, the insurance policy states the amount of money the insured can claim in the event of death.

iii) Utmost good faith (uberrima fides)

In this principle the person taking out a policy is supposed to disclose the required relevant material facts concerning the property or life to be insured with all honesty. Failure to comply to this may render the contract null and void hence no compensation.

e.g.

-A person suffering from a terminal illness should reveal this information to the insurer.
-One should not under-insure or over-insure his/her property.

iv) Subrogation

This principle compliments the principle of indemnity. It does so by ensuring that a person does not benefit from the occurrence of loss.
According to this principle, whatever remains of the property insured after the insured has been compensated according to the terms of the policy, becomes the property of the insure.

Example

Assuming that Daisy's car is completely damaged in an accident and the insurance compensates for the full value of the loss, whatever remains of the old car (now scrap), belongs to the insurance company

Scrap metal can be sold for some values and should Daisy take the amount she would end up getting more amount than the value of the car which will be against the principle of indemnity.

Note: This principle cannot be applicable to life assurance since there is nothing to subrogate.

v) Proximate cause

This principle states that for the insured to be compensated there must be a very close relationship between the loss suffered and risk insured i.e. the loss must arise directly from the risk insured or be connected to the risk insured.

Example

i) If a property is insured against fire then fire occurs and looters take advantage of the situation and steal some of the property, the insured will suffer loss from 'theft' which is a different risk from the one insured against, so he/she will not be compensated.

However if the property burns down as a result of sparks from the fire-place, the proximate cause of the loss is sparks which are directly related to fire. So the insured is entitled for compensation.

CLASSES OF INSURANCE

Insurance covers are mainly classified into two,

1. Property (non-life) general insurance
2. Life assurance

1. Life Assurance

The term assurance is used in respect of life contracts. It is used to mean that life contracts are not contracts of indemnity as life cannot be indemnified i.e. put back to the same financial position he was in before the occurrence of loss.(life has no money value, no amount of money can give back a lost or injured life)

Life insurance (assurance) is entered by the two parties in utmost good faith and the premiums payable in such life contracts depend on:

- **i) Age:** The higher the age the higher the premiums as the age factor increase the chances of occurrence of death.
- **ii) Health condition:** A person with poor health i.e. sickly person pays higher premiums as opposed to one in good health.
- **iii) Exposure to health risks:** The nature of a person's occupation can make him susceptible to health problems and death.

Types of policies

i) **Whole life assurance-**In whole life assurance, the assured pays regular premiums until he/she dies. The sum assured is payable to the beneficiaries upon the death of the assured.

-Whole life assurance covers disabilities due to illness or accidents i.e. if the insured is disabled during the life of the policy due to illness or accidents, the insurer will pay him/her for the income lost.

ii) Endownment policy/insurance

This is whereby the insured pays regular premiums over a specified period of time. The sum assured is payable either at the expiry of the period (maturity of policy) or on death of the insured, whichever comes first.

The insured, at expiry of policy is given the total sum assured to use for activities of his own choice.(ordinary endownment policy)

-Where the insured dies before maturity of contract, the beneficiaries are given these amounts.

Note; The assured person may be paid a certain percentage of the sum assured at intervals until the expiry of the policy according to the terms of contract. Such an arrangement is known as **Anticipated Endownment policy.**

Advantages of Endownment policies

- **i.** They are a form of saving by the insured, for future investments
- **ii.** Premiums are payable over a specified period of time which can be determined to suit his/her needs e.g. retirement time
- **iii.** Where the assured lives and time policy matures, he receives the value of sum assured.
- **iv.** Policy can be used as security for loans from financial institutions.

Differences Between a whole life policy and an Endownment policy

Whole life	**Endownment**
i) Compensation is paid after the death of the assured	**i)** Compensation is paid after the expiry of an agreed period
ii) Premiums are paid throughout the life of the assured	Premiums are paid only during an agreed period
iii) Benefits go to the dependants rather than the assured	The assured benefits unless death proceeds the expiry of the agreed period
iv) Aims at financial security of dependants	Aims at financial security of the assured and

	dependants

iii)Term insurance

The insured here covers his life against death for a given time period e.g. 1yr, 5yrs e.t.c.

If the policyholder dies within this period, his/her dependants are compensated.

If the insured does not die within this specified period, there is no compensation. However, a renewal can be taken.

IV) Education plan/policies

This policy is normally taken by parents for their children's future educational needs.

The policy gives details of when the payments are due.

v) Statutory schemes

The Government offers some types of insurance schemes which are aimed at improving/providing welfare to the members of the scheme such as medical services and retirement benefits.

A member and the employer contribute, at regular intervals, certain amounts of money towards the scheme.

Examples

1. N.S.S.F
2. N.H.I.F
3. Widows and children pension scheme (W.C.P.S)

Annuity

Characteristics of life Assurance

- It is a cover for life until death or for a specified period of time
- It may be a saving plan
- It is normally a long term contract and does not require an annual renewal
- It has a surrender value
- It has a maturity date when the assured is paid the sum assured bonuses and interests.
- A life assurance policy can be assigned to beneficiaries
- The policy can be any amount depending on the assureds' financial ability to pay premiums
- The policy can be used as security for a loan

2.General insurance (property insurance)

This type of insurance covers any form of property against the risks of loss or damage. A person can insure any property he has an insurable interest in

General insurance is usually divided into:

i. Fire insurance/department
ii. Accident insurance/department
iii. Marine insurance/department

i) **Accident insurance**

This department covers all sorts of risks which occur by accident and includes the following;

a) Motor policies

-These provide compensation for partial or total loss to a vehicle if the loss results from an accident.

-The policy could either be **third party or comprehensive.**

-Third party policies cover all damages caused by the vehicle to people and property other than the owner and his/her vehicle. This includes pedestrians, fare-paying passengers, cows, fences and other vehicles

In Kenya, a motor-vehicle owner is required by law to have this policy before the vehicle is allowed on the roads. One can also take a third party, fire and theft policy.

Comprehensive policy covers damages caused not only to the third party but also to the vehicle itself and injuries suffered by the owner. Comprehensive policies include full third party, fire, theft and malicious damage to the vehicle.

b) Personal accident policy

-These policies are issued by insurance companies to protect the insured against personal accidents causing;

- Injury to the person
- Partial or total physical disability as a result of the injury
- Loss of income as a result of death

-If death occurs due to an accident, the insured's beneficiaries are paid the total sum assured.

In case of a partial or total disability as a result of accident, the insured can be paid on regular periods, e.gmonthly as stipulated in the policy.

Compensation for injuries where one loses a part of his/her body can be done on a lumpsum basis.

The insured is also paid the value of hospital expenses incurred if hospitalized as a result of an accident.

c) Cash and / or Goods in Transit policies

These are policies that specifically provide cover for loss of cash and goods in transit between any two locations.

E.g. Goods and cash moved from business to the markets, from suppliers to business e.t.c

d) Burglary and Theft policies

These policies cover losses caused by robbers and thieves

Burglary policies are enforceable only if the insured has met the specified safety and precautionary measures for protection of the insured items.

E.g.-How much money should be maintained in different kinds of safety boxes

-Positioning of each of the cash boxes is also an important precautionary measure.

NB: The control measures are aimed at reducing both the extent and probability of loss occurring

e) Fidelity Guarantee policies

These policies cover the employers against loss of money and/or goods caused by their employees in the cause of duty.

-The losses may be as a result of embezzlement, fraud, arithmetical errors e.t.c

-The policies may cover specified employees or all the employees

7) Workmen's compensation (Employer's Accident liability)

These policies provide compensation for employees who suffer injuries in the course of carrying out their duties.

The employer insures his employee against industrial injuries i.e the employer is only liable for the compensation of workers who suffer injuries at work.

f) Public liability

This insurance covers injury, damages or losses which the business or its employees cause to the public through accidents.

The insurer pays all claims from the public upto an agreed maximum

g) Bad debts

This policy covers firms against losses that might result from debtor's failure to pay their debts.

iii)Marine Insurance

This type of insurance covers ships and cargo against the risk of damage or destruction at the sea. The main risks sea vessels are exposed to include; fire, theft, collision with others, stormy weather, sinking e.t.c

Types of Marine Insurance policies

The marine insurance covers are classified as Hull, cargo, freight and ship owners' liability.

a) Marine Hull

This policy covers the body of the ship against loss or damage that might be caused by sea perils.
Included here are any equipment, furniture or machinery on the ship.
A special type of marine hull is the part policy, which is for a specified period when the ship is loading, unloading or at service.

b) Marine Cargo

This type of policy covers the cargo or goods carried by the ship
The policy is taken by the owners of the sea vessels to cover the cargo being transported. It has the following sub-divisions.

i. **Voyage policy-**Here cargo and ship are insured for a specific voyage/journey. The policy terminates automatically once the ship reaches the destination.
ii. **Time policy-**Here insurance is taken to cover losses that may occur within a specified period of time, irrespective of the voyage taken
iii. **Fleet policy-**This covers a fleet of ships,i.e several ships belonging to one person, under one policy.
iv. **Floating policy-**This policy covers losses that may occur on a particular route, covering all the ships insured along that route for a specified period
v. **Mixed policy-**This policy provides insurance for the ship and cargo on specified voyages and for a particular period of time. No compensation can be made if the ship was on a voyage different from the ones specified even if time has not expired
vi. **Composite policy-**This is where several insurance companies have insured one policy of a particular ship especially when the sum insured is too large to be adequately covered by one insurer.
vii. **Construction policy/builders policy-**This covers risks that a ship is exposed to while it is either being constructed, tested or being delivered.

c) Freight policy-This is an insurance cover taken by the owner of the ship for compensation against failure to pay hiring charges by a hirer of the ship.

d) Third parties liability-This is an insurance policy taken by the owner of the ship to cover claims that might arise from damage caused to other people's property.

Description of marine losses

The following are some of the losses encountered in marine insurance.

i. **Total loss,**

This occurs where there is complete loss or damage to the ship and cargo insured. Total loss can be constructive or actual.

In **Actual total loss,** the claims are as a result of the ships and/or cargos complete destruction. It could also occur;

-When a ship and its cargo are so damaged that what is salvaged is of no market value to both the insurer and the insured.

-When a ship is missing for a considerable period of time enough to assume that it has sunk.

-Constructive total loss occurs when the ship and/or cargo are totally damaged but retrieved. It may also occur;

-Where a ship and its cargo are damaged but of market value. This could be as a result of decision to abandon the ship and cargo as the probability of total loss appears imminent.

-If the cost of preventing total loss may be higher than that of the ship and its cargo when retrieved e.g. many lives may be lost in the process of trying to prevent total loss.

ii) General average-This is a loss that occurs as a result of some of the cargo being thrown into the sea deliberately to save the ship and the rest of the cargo from sinking. The losses made are shared by the ship owners and the cargo owners proportionately as the effort was in the interest of both.

iii) Particular average-This occurs where there is a partial but accidental loss to either the ship or the cargo. When this happens each of the affected party is soldy responsible for the loss that has occurred to his property. A claim can, however be made if the loss incurred amounts to more than 3% of the value insured.

Fire insurance-This type of insurance covers property damage or loss caused by accidental fire. Cover is offered to domestic commercial and industrial premises, plant and machinery, equipment, furniture fittings stock e.t.c

-In order to claim for compensation as a result of loss by fire, the following conditions must be fulfilled;

- Fire must be accidental
- Fire must be immediate cause of loss
- There must be actual fire.

There are several types of types of fire insurance policies. These include:

a) Consequential loss policy;(profit interruption policy)

This covers or compensates the insured for the loss of profit suffered when business operations have

It is offered to protect future earnings of an enterprice after fire damage.

b) Sprinkler leakage policy-This provides cover against loss or damage caused to goods or premises by accidental leakages from fire fighting sprinklers

c) Fire and Related perils policy-This covers buildings which include factories, warehouses, shops, offices and their contents. The policy does not cover loss of profit arising from fire damage.

CHARACTERISTICS OF GENERAL INSURANCE

- It's a contract of indemnity
- It cannot be assigned even to ones relatives
- The insured must have an insurable interest in the property to be insured
- Premiums charged depends on the degree of risk, the higher the premium charged.
- Compensation for loss can only be upto a maximum of the value of the insured property or the sum insured in case of under insurance.
- It has no surrender value
- It's normally a short term contract which can be renewed periodically, usually after one year.

Factors to be considered when Determining Premiums to be charged

- Health of the person
- Frequency of occurrence of previous losses
- Extent of the previous losses
- Value of the property insured
- Occupation of the insured
- Age of the person or of the property in question
- Location of the insured(address and geographical location)
- Period to be covered by the policy
- Residence of the insured

Procedure for taking a policy

i) Filling a proposal form
ii) Calculation of the premium to be paid
iii) Issuing of cover note (Binder)
iv)Issuing of the policy

Procedure of claiming compensation

i) **Notification to the insurer-**The insurer has to be notified about the occurrence of any incident immediately.
ii) **Filling a claim form-**The insurer provides the insured with a claim form which he fills to give details of the risk that has occurred
iii) **Investigation of the claim-**The insurer arranges to investigate the cause of the incident and to assess the extent of the loss incurred. The insurer is then able to establish whether the insured is to be compensated and if so, for how much.
iv) **Payment of claim-**On receipt of the report of the assessor, the insurer pays the due compensation to the insured. (Payment of the compensation shows that both the insurer and the insured have agreed on the extent of the loss and the payment is the settlement of the claim)

INSURANCE AND GAMBLING

In most cases, insurance is erroneously taken to be the same as gambling in that small amounts are contributed by many people into a common fund which later benefits just a few people. They are however different and their differences include;

Insurance	Gambling
-The insured must have insurable interest	-A gambler has no insurable interest
-Reinstates the insured back to the financial position just before loss	-Aims at improving the winners financial position
-The insured is expected to pay regular premiums for the insurance cover to remain in force	-Gambling money is paid only once
-Insurance involves pure risks	-Gambling involves speculative risks
-The event of loss might never occur	-The event of bet must happen to determine the winner and the loser.

PAST KCSE QUESTONS

1. 1995 Describe the procedures that should be followed when taking an insurance policy.(10mks)
2. 1996 explain four ways in which the insurance industry promotes the growth of business enterprises. (5mks
3. 1997 Explain four ways in which the insurance industry contributes to the development of Kenya's economy. (10mks)
4. 1998 Discuss various insurance policies under which an insurance company would not compensate the insured in the event of the loss. (10mk
5. 1999 Discuss various insurance policies that the owner of a supermarket may find it useful for the business. (12mk
6. 2000 Explain four benefits of the 'pooling of risks' to an insurance company.(8mks)
7. 2001 Explain the factors that may make it necessary for an insurance company re-ensure.
8. 2002 Explain the meaning of the following terms as used in insurance (10mk
   i) Uberrimae fidei
   ii) Indemnity
   i) Third party motor vehicle insurance
   iv) Contribution.
   v) Subrogation
9. 2003 Discuss four circumstances under which an insurance contract may be terminated. (8mks)
10. 2004 Explain five benefits that could be enjoyed by a person who decided to take out an endowment policy. (10mks

PRODUCT PROMOTION

Product is an item or service offered to the consumers at a price. Therefore, product promotion is the communication or any activity undertaken to inform the consumers, persuade and remind them to buy the product from the market.

The purpose/Importance of product promotion

- ❖ It informs the customer of the availability, price, and where to obtain the product to satisfy their wants
- ❖ It persuade the buyer to buy their products a head of their competitors products in the market
- ❖ It reminds the customers of the continued existence of a given product in the market

- It educate the consumers of the usage of the product to satisfy their needs fully
- It informs them on any improvement that has been made on the product
- It stimulates the demand of the product being promoted in the market
- It brings out the positive features of the product
- It opens new market for the product in the environment

Methods of product promotion

Product promotion may be carried out in the following ways:

I. Personal selling
II. Advertising
III. Sales promotion
IV. Publicity

i. Personal selling

This is a method of promotion where there is an oral presentation in the conversation with the prospective customer. It is done by with the use of salesmen who informs the prospective buyer of all the aspects of the product

Methods of personal selling

Personal selling can be carried out in the following ways;

- Through sales person approaching the customers

A case where the sales person approaches the prospective customers after drawing their attention, explaining details of the product and even demonstrating how the product works in order to persuade the customer to buy.

Steps involved in personal selling through sales person

i. Identify prospective customers who could possibly require the product
ii. Preparing the presentation by gathering all the possible information about the product , as well as designing an appropriate methods that he will be used to present to the customer
iii. Establishing the customers contact, as well as choosing an appropriate time to meet the customer to be. That is the time when the customer may receive him
iv. Arousing the consumers interest in the product by attracting his/her attention through approach and languages, as well as making the prospective customer develop interest in the product
v. Dealing with the objections on the product which may have been brought about by the customer to be
vi. Closing the sale by inquiring whether the prospective customer will be interested in the product or not. This should be done in a polite manner

vii. Offering after sale service to the customer on the product that has been sold

❖ **Shows, trade fairs and exhibitions**

This is where the manufacturer of a given product gets a chance to display publicly to the prospective customer to inform them about the product. The prospective customers' attention is then drawn to the product and more information is given to him about the product at the point where it is displayed.

Advantages of shows, trade fair and exhibitions

- It gives the customer an opportunity to compare various products before making a decision on what to buy
- It gives the sales person an opportunity to explain in fine details the features of the product to the prospective customers
- The manufacturers of the product gets a chance to receive immediate feed back from their customers through interactions during the shows
- The number of people visiting their stall to asses their products will help them determine their potential market size for the product

Disadvantages of shows, trade fairs and exhibitions

- It is expensive to hire a stall for the exhibition of the product
- The sales person may have to explain over and over again for the prospective customers as they may not enter into the stall at the same time
- The trade fairs are not frequently organized, therefore an organization rely on it as the only means of product promotion may not succeed

❖ **Showrooms**

These are large rooms where goods are displayed, especially bulky and durable goods like cars, furniture's, etc for the customer to see and be informed about them to stimulate their interest in them

The room allows the customer to get more information about the product from the sales person in the showroom

Advantages of showrooms

- They enables the seller to get immediate feed back on the product
- They enable the customers to get clarification on the product they need to purchase
- It is a cheap method of production
- It provides an opportunity for the usage of goods to be demonstrated

- The information the prospective customer get from the show room is more reliable

Disadvantages of showrooms

- They are usually located away from the town centers, making them not be accessible by many
- It is expensive to hire showrooms
- They require security to protect the goods inside them which may be very expensive
- Some prospective customers may tamper with goods in the room while trying to operate them

❖ **Free Gifts**

A gift is an item given to the customer free of charge after buying a product which it is pegged on or buying products of a given value. The gift may not necessarily be the same as the product bought, but they are meant to encourage the customer to buy more or give the customer opportunity to explore the product given as a gift.

Advantages of free gifts

- It enable the customer to enjoy the product given as a gift without paying for it
- It persuades the customer to buy more of the product in order to get the gift
- It is an additional product, and therefore increases the customers satisfaction
- It may help in creating loyalty in the product being promoted

Disadvantages of free gifts

- It makes the customer buy including products they didn't require in order to the said gift
- The cost of the product may be very expensive for he customer
- Some middlemen may remove the gift and keep or even sell to the customer to maximize profit

❖ **Free Sample**

This is a product on trial given to the customers freely to influence their demand towards the product. It mainly used when the product is new and the customer may have not known about the existence of the product

Advantages of free sample

- It enables the customer try the product before making a decision to buy it
- The customer is able to enjoy the product that otherwise he may have not enjoyed
- The organization is able to get immediate feedback from the customer about their new product
- It enables the organization to acquire more customers for their product

Disadvantages of free sample

- Some of those receiving the sample may not come back to buy
- It may be an expensive method of promotion especially where many samples are to be given
- Goods given for free may reduce the value of goods that may have been sold to earn profit
- It is not suitable for expensive products

Circumstances under which personal selling is appropriate

i. When launching a new product in the market which requires a lot of awareness to the prospective customers to enable them make a choice
ii. When a product is tailored to meet the customer's needs, as different consumers have different needs, taste and preferences to be addressed.
iii. When demonstration is required on how the product works, especially the technical products
iv. When the organization has the capacity to finance the sales force carrying out the personal selling
v. Where the market is concentrated within a given region that can easily be accessible by the task force

Advantages of personal selling

- It is more flexible than any other method for the marketer is able to meet the needs of different people
- It enable the prospective customer to know more details about the product before making a decision
- The sales person is able to demonstrate the use of the product
- The seller is able to get immediate feedback on the product
- The seller is able to obtain the personal contact of the prospective buyer
- It gives the buyer an opportunity to negotiate the terms of purchase
- It takes care of both literate and illiterate prospective customer
- The seller is able to persuade the prospective buyer to buy the product

Disadvantages of personal

- It is labour intensive and therefore very expensive when the area to be covered is wide method
- It is time consuming as it involves explanation and demonstration
- It may only target a particular group of people
- The seller has to meet the travelling and other expenses involved which may be very expensive
- Salespersons may misuse the resources allocated for them, making the target not to be achieved
- The process may inconvenience the prospective buyer's program
- It may only cover a given region which may not be wide enough

ii. Advertising

This is the presentation of information about a product through public media such as newspapers, radios, billboards, etc

Types of Advertising

- Product advertising: - this is a form of advertisement meant to promote a given product or a particular brand of product
- Institutional advertising: - this is a form of advertisement meant to improve the image of the institution or organization and not a particular product. It is meant to create confidence in the customers about the institution
- Primary demand advertising: - a form of advertisement meant to a new product that has been introduced in the market for the first time. It is mainly to create awareness of the existence of that particular product
- Celebrity advertising: - a form of advertisement where a famous/popular person is used to promote a particular product. It is meant to convince those who identify themselves with that personality to buy the product
- Informative advertising: - a form of advertisement meant to give the customer more information about the product to enable them make an informed decision
- Competitive/persuasive advertising: - a form of advertisement carried out with organizations producing similar product to persuade the customers to buy their products ahead of their competitors
- Corrective advertising: - a form of advertising meant to correct a misleading information that may have been given out about the product
- Reminder advertising: - a form of advertising meant to remind the customers that the product still exists in the market and is still capable of satisfying their needs.

Advantages/Importance of advertising to the business

i. It maintain the sales of an already existing product
ii. It create awareness in the customers about a new product in the market
iii. It informs the customers about the changes that may have been made in the product
iv. It helps in building image or reputation of the selling organization
v. It may increase the volume of the existing sales of a product
vi. It reaches peoples who may have not been reached by the sales person
vii. It complements the effort of the sales person to enable them achieve their sales objectives
viii. It clears the customers misconception and prejudice about the product
ix. It opens up new markets for the products.

Disadvantages of advertising to the business

- It may be costly to the business in terms of money and other resources
- It leads to increase in cost of production if at all it has to be done frequently
- The cost of the advertisement will always reduce the profit margin of the business
- Poorly planned advertisement may negatively affect the business
- Misleading advertisement may reduce the level of business operation

Advantages of advertising to the customer

- They educate them on the usage of the product
- They inform them on the products availability
- They guide them on where to get the product
- The outlines all the features about the product including prices to the customer
- Competitive advertisement may lead to improved quality of goods to benefit the customer
- Information on different prices through competitive advertisement makes the customer to benefit from the reduced prices

Disadvantages of advertising to the consumer

- The advertisement may not disclose the side effect of the product
- The advertising cost may be passed to the consumers through increased price
- Some advertisement may persuade customers to buy what they do not require leading to impulse buying
- Some customers may buy substandard goods due to misleading advertisement

Advertising media

These are channels or agents through which an advertisement message is conveyed to the target group. They includes both the print and electronic media which includes; newspapers, journals, magazines, posters, bill-boards, brochures', radio, television, neon signs, etc

a) Newspaper

These are daily or regularly publications which contains advertisement. They includes, Daily nation, Standard, Taifa Leo, citizen, star, etc

Advantages of newspaper

- The can reach areas that other means may not reach
- Many people can afford them as they are relatively cheap
- They cover a wider geographical area, leading to a wider market
- The message on the news paper can last for a longer period of time, making it to reach more customers
- The advertisement appearing in the newspaper is readily acceptable by the reader
- Colored print makes the advertisement to be more attractive to the reader who in turn gets the information

Disadvantages of the newspaper

- Many of them are written in English or Kiswahili, making them to only target those who can read and understand the language
- It discriminate against the illiterate group who cannot read the information
- They have short lifespan as they may be read only on the day it is circulated
- It cannot be used to focus on a specific target as they are read by almost everybody
- Some of the prospective customers are always in a hurry to read the newspaper and may not pay attention to the advertisement

b) Magazines and Journals

These are periodic publications meant to target a particular class or group of people. They may be published monthly, quarterly, annually, etc. The information reaches the targeted group as they read them

Advantages of magazines and Journals

- The specific information for the targeted people can be published
- They can be read and re-read before the next publication may the information to last longer and plead with the prospective customer

- Their publication is of high quality and colourful, making them to draw the attention of their targeted group easier and passing the information to them
- The quality material they are made of makes them to last longer and can be accessed even by those who may have not been around during their publication

Disadvantages of magazines and journals

- If the time gap between the publication time and circulation time is wide, the advertisement may fail
- They are a bit expensive which makes some of the potential customers not to afford them
- The cost of advertising on them may be expensive for the organization
- Their circulations may be limited to a small geographical region
- The publications may not be available in the vernacular language to reach those who are not able to read either English or Kiswahili

c) Posters and Billboards

A form of advertising that may contain the information about the product either in words, pictures or both for the customer to see and read.

Advantages of posters and billboards

- They are able to convey the information to the large audience, as they are placed in strategic position
- Posters are cheap and easy to prepare
- The use of different colors makes them to be more attractive and appealing to more audience
- It can be used by both literate and illiterate group
- The message may last for a longer period of time
- Billboards are conspicuous and hence attractive to the audience

Disadvantages of posters and billboards

- May be affected by adverse weather condition, especially rain
- If not placed strategically, it may not reach the targeted group
- Incase destroyed by the passersby, the information may not meet the targeted group
- Bill boards are expensive to make and maintain

d) Transit/transport advertising

A form of advertisement whereby vehicles such as trailers, matatus, buses, etc are used to carry and convey the advertisement message

Advantages of transit advertisement

- The message reaches most of the people in the environment
- They message last long as the paints always last on the vehicle
- Transit vehicles may carry the message a long way to their final destination
- It is captivating to the members of the public especially the promotion convoy, hence can easily reach the target

Disadvantages of transit advertisement

- During the rush hour, the crowd may hinder some from getting the information
- It mainly relay the information to those served by the vehicles
- The noise produced by the promotion convoy may be a nuisance to some members of the public

e) Brochures

These are small pamphlets carrying message and pictures about product being advertised.

Advantages of Brochures

- They are easy to carry around as they are small in size
- They are effective in meeting the targeted group
- Their cost of production is not very high
- They can be distributed at different places to meet the targeted group
- Can be made attractive by the use of different colours
- They have a long life and therefore can be used repeatedly
- They can be used to direct others on where to get the product

Disadvantages of Brochures

- The information may not reach the illiterate group
- They may be ignored by the intended users
- They may require frequent updating if many changes are made on the product making it expensive

f) Radio

This is a channel that allows for the advertised messages to be conveyed through sound to the listeners, with some background music accompanying the message

Advantages of Radio

- Different languages may be used to reach different people
- It is accessible even to the remote areas that is not covered by other media
- One can choose the time to advertise to reach the targeted group

- Able to serve many people at the same time
- It can be used for both literate and illiterate members of the group
- The advertisement can be repeated over and over again according to the advertisers needs
- The music accompaniment may attract many people to listen to the information
- Can reach even the blind as they are able to hear
- The message can be conveyed in different languages

Disadvantages of Radio

- Their advertisement does not have any reference
- It may be more expensive than the print media
- Poor timing may make the message no to reach the targeted group
- It may interrupt some programmes to the annoyance of the listener
- It short and brief advertisement may be missed by the listeners
- It is difficult for the listener to visualize the product

g) Television (T.V) and Cinema

Television is a form of media advertisement where the written words are combined with motion pictures and sound to pass the information

Cinema is where the advertised messaged is conveyed during film shows in the cinema halls. It may be before or after the movie.

Advantages of Television (T.V) and Cinema

- It appeals to most people as it is entertaining
- It makes it possible for the demonstration of the use of the product
- It is able to reach both the literate and illiterate viewers
- The advertisement can be aired over and over again to meet the targeted group
- The advertisement may be modified when need arise
- It has wide appeal to many people
- The message can be conveyed in different languages

Disadvantages of Television (T.V) and Cinema

- The cost of advertising through this media is high
- The television sets are expensive to acquire, hence many people may not have them
- Their uses are limited to places with electricity
- The advertisement may not last longer
- The time for airing the information may not suit the targeted audience

h) Neon Signs

This is a form of advertisement where the message is passed to the public through the use of electrical signals transmitted through neon lights. They are usually common in the banks, airlines, jewel shops, etc

Advantages of Neon Signs

- The use of different colours makes them very attractive and catch attention of different people
- They can be put strategically making them to be visible to many people
- Can be used both at night and day
- They direct the customer on where the goods are to be found

Disadvantages of Neon Signs

- Can only be used where there is electricity
- They are expensive to buy and maintain
- The message may not easily reach the illiterate

Advertising Agencies

These are businesses that specialize in advertising work and are hired to carry out the functions for other businesses. They are paid a commission for this

Functions of Advertising Agencies

iii. They help the organizations in designing their trademarks, logos and advertising materials

iv. They book space and airtime for their clients in various media

v. They offer advisory services to their client on selling techniques

vi. They advertise on behalf of their clients

vii. They choose on behalf of their clients the appropriate media to be used

iii. Publicity

This is the mentioning of the product or the organization in the mass media to make it be known to many people. There two types of publicity, that is free publicity (where the payment is not required) and Special featured publicity (where there is payment, for example sponsoring an event in the public)

Advantages of Publicity

- It saves the organization money incase of free publicity
- It is likely to cover a wider region as the publicity is in the media
- The organization may earn credibility due to positive publicity
- The information may be received positively by the customers as the message is likely to be more objective
- It may improve the competitiveness of the firm

Disadvantages of Publicity

- Unfavourable information about the organization may reach the public especially in free publicity
- It is irregular and short lived
- Might require special occasion or event in order to attract the mass media
- The firm does not have control on how the information will appear in the media and the extend of the coverage

iv. Public relations

A process of passing information with an intention of creating, promoting, or maintaining good will and a favourable image of the organization in the public. It involves informing the public about the firm's achievement and how it is contributing to the community welfare and development, to get more approval of the public

Advantages of public relations

- May be used to correct the dented image of the firm
- It informs the public about the activities of the firm
- Assist in upholding the good image of the firm
- It improves the relationship between the firm and its customers

Disadvantages of public relations

- It is costly in terms of time and finance involved
- The customer may make premature buying arising from the picture created by the firm
- Effects may take long before they are actually realized
- It may be difficult to evaluate the impact of the message, since the customers are not obliged to respond to it

v. Point of purchase (Window) display

This is where the items are arranged in the shops strategically, allowing the customers to see them easily. The arrangement is meant to attract the customer's attention and induce them to buy goods as they pass close to the shop

Advantages of Point of purchase display

❖ May induce the customer to buy the product due to their arrangement
❖ As the customers get in to the shop, they are likely to buy including the other goods that were not being displayed
❖ The customers are able to determine the features of the product with ease

- ❖ It is relatively a cheaper method of promotion

Disadvantages of point of purchase

- ❖ The method only work well with the potential customers who are near the shop and not far away
- ❖ They may also attract thieves especially if the product displayed is of high value
- ❖ In case the arrangement does not appeal so much to the customers, they may not get into the shop
- ❖ It may be expensive setting up the display area

vi. Direct mail Advertisement

A form of advertisement which is sent to the potential customers directly in the form of a mail, for example the pricelist being sent to the potential customers

Advantages of direct mail advertisement

- ❖ It is able to reach the targeted group as they are sent to the potential customer directly
- ❖ The message may be made to suit the requirement of the specific customer to be
- ❖ There may be an immediate respond on the message
- ❖ The potential customers incurs no cost to acquire the information

Disadvantages of direct mail advertisement

- ❖ Some mails may not get to the intended customers in time
- ❖ The prospective customer may ignore the advertisement
- ❖ May not be effective where the customer needs to examine the product
- ❖ This method may be expensive especially in terms of material and money
- ❖ It may only appeal to the literate group only

vii. Catalogue

A booklet that gives information about the product that the organization deals in. It gives the description about the product, the picture as well as the prices of the product.

Advantages of catalogue

- ❖ It may be used to advertise all the products in the organization
- ❖ The owner/organization has the total control over the catalogue
- ❖ It gives detailed information about the product
- ❖ Its colourful nature makes it an attractive promotion tool

Disadvantages of catalogue

- ❖ It is expensive to produce increasing the cost of production

- Change in price may affect the whole catalogue

viii. Guarantee (warranty issue)

An assurance given to the customer that the product will serve as expected if used according to the instructions given by the manufacturer. For the guaranteed period the seller will be willing to maintain repair or replace the product for the customer

Advantages Guarantee

- The confidence built in the customer by the guarantee to the customers makes them to buy more products.
- It may create the customers loyalty to the product of the firm
- The fact that the product can be replaced if it gets spoilt within the period is an advantage to the customer

Disadvantages of guarantee

- Repairing or replacing the product may be very costly to the organization
- The method may only be suitable for the durable goods
- The customer may be tempted to mishandle the good during this period

ix. Discount

This is a reduction in price of the commodity, allowing the buyer to pay less than what he would have paid the goods.

Types of discount

- Quantity discount: - Allowed by trader to encourage him/her to buy more quantity of the product being offer
- Trade discount: - Allowed to another trader who is buying products for resale to the consumers
- Cash discount: - Allowed to the customer to enable him pay promptly for the goods bought

x. Loss leader: - Selling the price below the market price to entice the customer to buy

xi. Psychological selling: - Playing with the customers psychology in terms of pricing by quoting odd prices such as 999, 199, 99, etc to convince the customer that the price has been reduced

xii. Credit facilities: - where the customer is allowed to take a product for his consumption and pay for it later. This entices the customer to buy more of the product

xiii. After sales service: - these are services offered to the buyer after the goods have been bought. They may be in terms of packaging, transportation or installation which may be offered to the customers free of charge. This makes the customer to buy more goods with confidence

Sales promotion

These are activities carried out to increase the sales volume of a business. They are activities out of the ordinary routine of business that is carried out by the seller to increase his sales volume.

The methods of carrying out sales promotion includes all the methods of carrying out product promotion as discussed earlier, that is, shows and trade fair, showrooms, free gifts, free sample, personal selling, advertisement, window display, credit facilities, after sales services, etc

Factors to consider when choosing a promotion method

i. The cost of the promotion that is whether the company can afford it or not, for some promotion methods are very expensive that may not be easily affordable to the company.
ii. The nature of the product being promoted especially whether it requires demonstration or not. Products which requires demonstration are best promoted through personal selling
iii. The targeted group for the advertisement, on whether they can be reached by that method or not. The promotion method must reach the targeted group, if it has to be effective
iv. The objective that the firm would like to achieve with the promotion, and whether the method is helping them to achieve that particular objective
v. The method used by the competitor in the market to enable them choose a method that will enable them compete favourably
vi. The requirement of the law concerning product promotion, to enable them not use what the law does not allow

Ethical issues in product promotion

These are rules and regulations to be followed when carrying out promotion to avoid violating other people or businesses right. They include;

- Cheating on performance of the product to attract more customers by given them wrong and enticing information about what the product can do.
- Cheating on the ingredients of the product by telling them that the product contains a suitable type of ingredient which does not exist just to lure them to buy the product
- Not telling them the side effects of the product which may affect them should they continuously use the product due to fear of losing customer

- False pricing, especially a case where they overprice their and later on reduce them slightly just to lure the customer, yet exploit them
- Not caring about the negative effect of the product on the environment, which may includes littering of the environment by the posters used for advertisement
- Social cultural conflict, especially putting up some forms of advertisement which are considered a taboo buy the community leaving around, such as hanging a billboard of a female advertising inner wears next to a church

Trends in product promotion

The following are some changes that have taken place to improve the product promotion activities

- Use of website/internet to advertise product worldwide, which has increased the coverage
- Encouraging gender sensitivity and awareness in product promotion to bring about gender balance
- Use of electronic billboards in advertisement to increase their visibility even at night
- Intensifying personal selling by the business to reach more customers
- Development of promotion convoys to move from one place to the other with music and dancers to attract more prospective customers
- Catering for the rights of the youths when carrying out product promotion and even involving them in carrying out the promotion
- Catering for the interest of those with special needs when carrying out advertisement
- Advertisement through mobile phones by sending them s.m.s about the product

BUSINESS STUDIES FORM THREE NOTES

THEORY OF THE FIRM

Defination:

(i) A firm; This is a single unit of business organization that brings together the factors of production to produce any given commodity.

-A firm may also be defined as a business enterprise under one management and control.

Example; Mumias sugar factory, Bata Shoe Company e.t.c

-Firms may be sole proprietorship, partnerships or companies. They may therefore be small e.g. an artisan or mechanic working in her/his garage or large like a multinational limited company producing many different products e.g. coca-cola company.
-A firm even though under one management and control may have several branches/plants.

(ii) **An industry;** This refers to all those firms producing the same product for a specific market/a group of related firms that compete with one another i.e.

a) Firms that produce the same product e.g. the firms operating as sugar manufactures as Mumias Sugar Company, Sony Sugar Company and Miwani Sugar Company.

b) Firms that extract the same raw materials e.g. the salt mining firms, Magadi Soda Company and other firms which mine salt at the North coast Region near Malindi.

c) Firms that provide similar services e.g. the transport industry such as Akamba Bus service, coast Bus Company and Easy Coach Company.

NOTE: In the definition of the firm, we assume that a firm in a unit that makes decision with respect to the production and sale of goods and services in the regard, we assume that
-All firms are profit-maximisers i.e. they seek to make as much profit as possible.
-Each firm can be regarded as a single consistent decision making unit.
The life of all business enterprises/firms are therefore characterized by several decision-making processes which are all aimed at facilitating realization of the objectives(profit maximization) such decisions may include; what to produce and how much, where and when to produce, how much to invest and how much to price goods/services e.t.c

DECISION ON WHAT GOODS AND SERVICES TO PRODUCE

A firm makes a number of important production decisions. Some of the decision may involve;

i. What to produce
ii. How production is to take place e.g. what raw materials and machinery should be utilized
iii. Where a production plant should be located
iv. When to produce
v. The scale of production e.g. how big should the factory

vi. When and where to invest
vii. How the production can be improved and controlled
viii. What type of business activity to engage in

NOTE: One production decision may lead to a series of decisions requiring to be made e.g.
-for a firm to decide on what goods and services to produce, market research to evaluate the likely success of the product is necessary.
-after establishing the viability of the product in the market, other activities like product design are carried out (the firm may consider redesigning existing products, introducing a product similar to the one in the market or developing a completely new product.
-production may then follow

Factors that influence decisions on what goods and services to produce

Certain factors have to be considered before committing a firm into production of either a new product, adopting or redesigning the existing product.
These factors include;

i. **Whether the firm is product-oriented or market-oriented**

Product oriented firms: This is when the nature of the product itself (its functions and unique qualities) are enough to make sure that the product sells e.g. when cars were first developed, its uniqueness sold it
Market oriented firms; These are firms that produce products that are meant to meet the consumer needs e.g. over time cars are being developed to suit consumer needs.

ii. **Level of competition**

In order to survive in a competitive market, firms must come up with products that consumers prefer.
Firms may therefore develop products which are not currently available or copy rivals ideas and improve on them

iii. **Level of available technology**

The level of technology has a strong influence on the product that a firm produces
New inventions and innovations often result in new products or improved products
-Improved technology may also reduce the costs of production. This means the same output maybe produced using less factors of production or more output may be produced using the same factors of production.

iv. **Management role**

Senior management have the sole responsibility of deciding on what product to produce. A wrong decision may ruin rather than bailed the enterprise. The manager's ability to design a viable product is therefore a vital factor in product development

v. **Financial viability**

In order to determine whether a product will be viable or not, the cost of production and the expected returns should be considered. Funds may only be approved for the product that promises long term benefits to the firm. So if the benefits of the product outweigh the costs, then such product will be developed and if not so, it will be dropped.

vi. **Amount and type of capital in the firm**

Capital refers to machines, equipment, factories, plants and other human made aids to production.

Both financial and physical capital facilitates the production process. The amount of capital in a business will therefore influence what goods it can produce and in what qualities i.e. a firm with physical capital that is very specific may not be able to produce other type of products e.g. a clothing factory may not be able to produce any other goods such as cement.

Other factors may include;

-Need of the consumers
-Need for better quality or more fashionable product
-Need for an easier to market product
-Unmet needs
-Need for a product for which factors of production and technology are easily available

COST OF PRODUCTION

Def: Cost: This is a payment made to the factors of production for their services.

Production costs thus refers to the expenses incurred in acquiring factors of production (inputs) The sum total of all payments to the factors of production engaged in its production.

Types of production costs:

I. **Opportunity costs;** These are values of any alternatives forgone. The cost forgone when the choice of one thing requires the next best alternative to be abandoned

Example: A student with only sh.50 may have to decide on whether to buy a text book or a pair of shoes. If she decides to buy a text book, the pair of shoes will have to be forgone because it's not possible to buy both with only sh.500. The opportunity cost of buying a text book in this case is the cost of the pair of shoes which was abandoned.

II. Fixed and variable costs

Costs may be classified according to their behavior in relation to various levels of output as follows:

a) Fixed costs
b) Variable costs
c) Semi-variable costs

a) Fixed costs

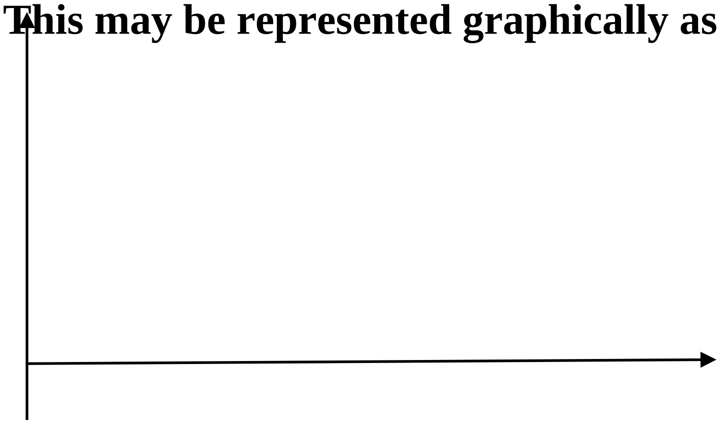
These are expenses which do not change with changes in levels of output/quantity of output. These costs therefore remain the same whether the firm is producing anything or not i.e. whether production is maximum or zero.

Examples:

a) Rent for premises/buildings
b) Depreciation charge on physical facilities
c) Salary of administrative staff
d) Interest paid on loans (borrowed capital)
e) Liance fees e.t.c

Output (units	**FC (sh)**
100	200
200	200
300	200
400	200
500	200

This may be represented graphically as:



b) Variable costs

These are costs that vary proportionately with changes in levels of output. This means that when output decreases the variable costs decrease in the same proportion and when output increases, they also increase in the same proportion. If nothing is produced VC=0

Examples;

a) **Payments on raw materials**
b) **Wages paid to casual labour**
c) **Water, transport and electricity bills**

Output (units)	variable cost (shs)
0	0
100	200
200	400
300	600
400	800
500	1000

This can be represented graphically as;

c) Semi-variable costs

These are costs that vary in relation to changes in output but not proportionately e.g. if output doubles, the semi-variable costs might increase by half.

Those production costs that do not fit in either fixed or variable costs are semi-variable costs.

Example

(i) Labour (permanent employees); No matter what level of output, their salary is fixed. However if one is asked to work extra time and on weekends to cope with extra production levels, then the extra cost is variable. Thus because labour is not totally fixed nor totally variable, it becomes semi-variable.

(ii) Cost of telephone charges. This is because there is often a fixed or standing charge plus an extra rate which varies according to the number of calls made.

-Thus semi-variable (semi-fixed) costs have both fixed and variable component.

Output (units)	**cost (sh)**
0	**4**
1	**10**
2	**18**
3	**24**

4	**27**
5	**32**

(iii) Total costs

Total cost is the sum of all costs incurred in the production at a given level of output i.e. the sum of fixed and variable costs

Total cost=Fixed costs+ variable costs.

-As output increases total costs will also increase.

Illustration

NOTE: It has been assumed that semi-variable costs are part of fixed and variable costs.

(iv) Direct and indirect costs

Costs can be classified according to the way they affect the product. They can either be direct or indirect costs.

a) **Direct costs**

These are costs that can be physically traced to the final product/process.

Examples

i) **Raw** materials i.e. all the materials that can be physically traced to the final product

ii) **Direct labour i.e.** wages for those factory employees directly engaged in the manufacture of the product e.g. wages for machine operators,packers,mixers,assemblers e.t.c

iii) Packing materials used.

iv) Direct expenses i.e. expenses which are directly allocated to a particular unit of goods being made.e.g maintenance costs of machines and equipment, designs and drawings, hire for special tools or equipment for a particular production.

-These costs are also known as **prime costs.** They are usually variable costs.

Indirect costs (factory overheads)

These are costs which cannot be traced or directly identified in the final product i.e. they cannot be attributed to any specific output.

They also include the costs that appear in such small quantities that their effects are negligible.

Examples:

i) Payment for stationary and other items such as lubricating oil, small tools, telephone use, cleaning and transport for employees.

ii) Wages and salaries for managers, supervisers, store keepers, clerks and watchmen.

iii) Payment for rent, land lease, insurance, advertising, warehousing and audit fees.

iv)Payment for the power used in the production process

Indirect costs are also known as **overheads.** They are usually fixed costs.

Average costs

-Average costs refer to costs per unit output

-It is determined by dividing the total of a particular cost by the total output at each level of output.(They are also known as unit costs)

Types of Average costs

i) Average fixed costs
ii) Average variable costs
iii) Average total costs
a) Average fixed costs; (AFC)

Average fixed cost (AFC) is the total fixed cost at each level of output divided by the total output at that level.

AFC=Total fixed costs
Total units produced

Output (units)	**Fixed costs (sh)**	**Average fixed costs (AFC)**
	200	**200**
100	**200**	**2**
200	**200**	**1**
300	**200**	**0.66**
400	**200**	
500	**200**	

b) Average variable costs (AVC)

AVC refers to total variable costs at each level divided by the total units of output produced at that level.

Average variable costs (AVC)=Total variable costs
Total units produced

Output (units)	Variable costs (sh)	AVC
100	200	2
200	400	2
300	600	2
400	800	2

500	1000	2

c) Average Total Costs (ATC/AC)

Average total cost (ATC) is divided by;

i) Dividing the sum of fixed and variable costs (total costs) by the total units produced.i.e

ATC=fixed costs variable costs

Total units produced

ii) Adding average fixed costs (AFC) and average variable cost (AVC) i.e

ATC/AC=AFC+AVC Thus

Output (units)	Total cost	ATC
100	400	4
200	600	3
300	800	
400	1000	2.5
500	1200	2.4

OR

Output (units)	Average fixed costs (AFC) (sh)	Average v costs	ATC=AFC+AVC
100	2	2	4
200	1	2	3
300	0.66	2	2.66
400	0.5	2	2.5
500	0.4	2	2.4

(V) MARGINAL COSTS MC

The marginal cost is the change in total cost (ATC) which results from a unit change in output

Marginal cost is the cost of producing one extra unit of output

E.g. when total costs increase from sh.300 to sh.350 when an additional unit is produced, then MC=sh.50

LOCATION OF THE FIRM

Location; is the site or place from which the business operations/firm would be established.

The management has to make appropriate decisions concerning the location of the firm since a good location would lead to success while a bad location would lead to failure of the business enterprise.

Factors determining the location of the firm

a. Raw materials

The availability of raw materials is one of the factors that determine the location of firms. Firms should be located near the source of raw materials when:

(i) The raw materials are heavy and bulky so that costs of transporting them to far distances would be too high.

(ii) The raw materials are perishable

Advantages of locating firm near source of raw materials:

-Transport cost of raw materials is minimized

-production process can run uninterrupted because of constant supply of raw materials thus continuous production

-storage cost of the raw material will be minimized

-It is easier for the firm to select the quality of raw materials required.

-Easier to get fresh raw materials/undamaged raw materials

b. Labour (Human Resources)

This is divided into 3 categories; semi-skilled and unskilled labour

-Labour intensive firms must be located in areas where there is both abundant labour force and appropriate labour force.

-Firms requiring labour of any kind maybe located in the urban centres because in such areas labour is in plentiful supply

-Agricultural processing firms are found in the rural areas

-Location of the firms near the source of labour reduces the cost of transporting labour force to factories and also reduces time wasting in transporting labour from far.

c. Market

A firm may be located near the market for its products to cut down on production costs .i.e to avoid the costs involved in transportation of the finished products.

Reasons locating near markets

-where the finished product is more bulky or more difficult than the raw materials, then the industry would be located near the market e.g. blocks and bricks used in building will be manufactured near the place where they are required than the source of raw materials because the finished product is more delicate to transport and is susceptible to damage.

-it reduces the cost of transporting the products to the market.

-To minimize the damage of the final product

-where the finished product is perishable or fragile, the industry should be located near the market to avoid breackages or spoilage. Examples are commodities like milk or bread which usually go bad very quickly and therefore need to be consumed immediately they are produced.

d. Transport and Communication

Efficient transport is the lifeline of modern businesses. Firms will choose those locations that have well-developed transport facilities such as roads, railway lines, seaports and airports because;

i) They require constant supplies of raw materials
ii) They need to distribute/send out finished products to different destinations
iii) They need to be in contact with other business associates like suppliers, customers and competitors.

Poorly developed transport facilities may lead to:

-High transportation costs especially where raw materials or the finished products are bulky

-Delays in receiving the raw materials and distributing the finished products

-Where communication network is poor, business people will not be able to give or get information in time.

e. Power and Water Supply

Fuel and power are required to run machines and ensures smooth operations for the business.

Water is required for cleaning, cooling and even as a raw material. They are therefore strong factors in determining the location of a firm i.e. firms that require a lot of power and water need to be located where there is adequate supply of these factors.

f. Government policy

The government may formulate policies that may have implications on the location of the firms, especially with regard to physical planning. Such planning may be aimed at checking rural-urban migration, environmental degradation or for strategic concerns.

The government may therefore encourage the development of firms in some areas by offering concessions to industrialists such as:

a) Offering free or cheap land
b) Reduction of taxes
c) Offering subsidies
d) Offering direct financial assistance
e) Improvement of infrastructure

Other factors:

Proximity to source of credit: Some firms that need credit to finance their operations from time to time might require locating near a reliable source for such funds

Availability of security services: This is an important consideration when deciding where a firm will be located as this has implications in almost all factors of production. Firms will tend to avoid locations that do not have adequate security.

Social amenities: Some firms take into account various activities and institutions that will benefit their employees. Such will include hospitals, schools, social halls or studios.

Availability for ample room for expansion: Businesses will tend to prefer locations that can provide ample room for expansion in future. This will eliminate the need for relocation when the firm experiences expansion

Climate: This is an important factor for agro-based businesses (such as floriculture, horticulture, dairy farming e.t.c) which have to seek locations with suitable climatic conditions

LOCALISATION AND DELOCALIZATION OF FIRMS

LOCALISATION OF FIRMS

Localisation of firms means the concentration of similar firms in one particular area/region.

Subsidiary industries usually develop around the main industries, either to use the by-products of the main industries or to supply them with component parts.

The factors which encourage localization of firms include:

i) A well developed infrastructure in an area which attracts firms into that area
ii) Availability of large population which may provide both labour and market
iii) Interdependence among various firms in areas such as training of personnel
iv) Government policy requiring firms to be located in a certain area
v) Availability of raw materials in a certain area

vi) Availability of ancillary services such as banking, insurance and warehousing

Advantages of localization

Service industries/Ancillary services: It encourages the establishment of support business enterprises e.g. if many firms are located in one region, institutions such as banks, insurance companies and distributors are likely to set up businesses in the area to offer services required

Creation of pool of labour: When industries are concentrated in one area, people tend to migrate to that region in search of employment thus encouraging creation of a pool of labour force. This enables firms to meet their labour force requirements.

Creation of subsidiary industries: Localised firms are likely to attract others which use the finished products of the established firms as raw materials or selling raw materials to the existing firms.

Disposal of waste: Localised firms are able to easily dispose off their waste by either selling them to other firms for recycling or by jointly undertaking waste disposal projects.

Creation of employment: It encourages creation of employment opportunities in the region (it creates interests in the type of labour required thereby leading to creation of employment opportunities.

Development of infrastructure: Concentration of firms in one area encourages development of the necessary infrastructure such as water systems, roads, communication network, health and education facilities in the region

Economies of scale: Firms can combine to employ benefits of large-scale production for the benefits of consumers.

Reduction in costs: Firms that depend on each other for inputs or disposal of outputs are able to save on transport costs when they are located near each other.

Disadvantages of localization

Adverse environmental problems: Concentration of firms in one region may have a negative impact on environment in that region e.g. emissions from factories may cause both air and water pollution; there may also be noise pollution and poor disposal of refuse.

Unbalanced regional development: Localisation of firms may lead to regional imbalance in development. For instance, areas of industrial concentration tend to enjoy provision of social amenities in terms of roads, schools, hospitals and other facilities while other regions suffer. This may cause dissatisfaction among the citizens and disturb national cohesion and unity.

Rural-urban migration: Localisation of industries contributes to rural-urban migration. People migrate from rural to urban regions in search of employment and better living conditions. Such movements may cause;

i) Open unemployment in towns while in rural areas they may cause labour deficiency

ii) Increased population in the areas of industrial concentration sparking a series of problems such as congestion, increased rate of crime, poor living conditions, spread of diseases e.g. HIV and housing problems.

Possible massive unemployment: A fall in demand of products produced by localized firms would result into a widespread unemployment in the affected area.

Strategic reasons: The concentration of firms in one area is risky for a country especially in times of war or terrorism activities as such are easy targets for attack. This may destroy the country's industrial base/capability which may take many years to rebuild.

Dependence: Localisation of firms in one area creates an over-dependence on the products of a single industry. In case of a calamity, the supply of the product from the firms may be disrupted, resulting in serious shortages.

Delocalization of firms

Delocalization refers to establishment of firms in different parts of the country as opposed to localization where firms are concentrated in one area. Delocalization is usually a deliberate government policy of encouraging establishment of firms in various parts of the country, and is applicable under the following circumstances:

-where there is need to curb migration to certain towns

-Due to need to reduce the rate of urban unemployment

-In order to achieve balanced economic development

-As a measure of reducing pollution and social evils in certain urban areas

Advantages of delocalization

Employment creation in many parts of the country: it provides employment opportunities to people living in rural areas thereby improving the peoples living standards and reducing rural-urban migration.

Balanced economic development/balanced regional development: economic development is initiated for many, if not all parts of the country. This promotes national cohesion and unity; and also reduces rural-urban migration.

Market for raw materials: delocalisation creates market for locally produced raw materials thereby creating employment and earning producers income.
Urbanization: This accelerates the rate of urbanizing in many parts of the country, especially to the rural areas.
Service delivery to rural areas/Development of social amenities: It encourages the growth of both social amenities such as hospitals, schools and security firms and infrastructure.
Reduces the effects caused by occurrence of war, terrorism attacks or earthquakes.

Disadvantages

a) **Difficulty of attracting requisite personnel;** This is mainly in the remote or rural areas where the delocalisation may be done. These areas do not usually have the comfort of social amenities of the urban areas, hence are less appealing to highly qualified personnel.

b) **Difficulty of accessing certain assential services;** These are services that may not be in the rural areas where delocalisation is done e.g. banks, insurance co's e.t.c

c) **Spread of pollution, congestion and social evils;** These vices spread to various parts of the country.

d) **Tax burden;** The incentives which are provided by the government to promote smooth relocation are expensive and are an extra burden to the tax payer.

e) **Security;** This maybe a problem in some areas.

f) **Substandard goods;** Continued protection from foreign competition by the government may make the firm to continue producing substandard products.

ECONOMIES OF SCALE

Economies of scale are the benefits the firm or industry derives from expanding its scale of production/the advantages of operating on large scale.
There are two types of economies of scale;

i) Internal economies of scale
ii) External economies of scale

i) **Internal economies of scale**

These are advantages that accrue to a single firm as its production increases, independent of what happens in the other firms in the industry.
Internal economies of scale result from an increase in the level of output and cannot be realized unless output increases.

The internal economies of scale may be achieved by a single plant of the firm or they may arise from an increase in the number of plants.
The internal economies of scale include:

i) Marketing economies (Buying and selling economies)

These are the benefits which a firm derives from large purchases of inputs or factors of production due to the discounts offered in the process e.g. trade and quantity discounts

The firms may also incur less cost per unit in transportation of the goods bought

Selling economies of scale arise from the distribution and sale of the finished product as the scale of production increases, i.e. it is likely to incur less cost per unit in areas such as advertising, distribution e.t.c

ii) Financial economies; As a firm grows, its assets also increase. These assets can be used as security to borrow money/loan from financial institutions at low interest rates.

Large firms can also raise more funds through selling and buying of shares and debentures.

iii) Risk bearing economies; Large firms can reduce risks involved in the market failure through diversification of products or markets.
Diversification of markets or products can be done so that:

a) Failure of one product is offset by the success of other products
b) A failure of a product in one part of the market may be offset by the success of the same product in another part of the market

-Large scale firms are also able to obtain supplies from alternative sources so that failure in one does not significantly affect the activities of the firm.

iv) Managerial economies/staff economies

Large firms are able to hire/employ specialized staff and management. This increases the firms efficiency and productivity i.e.

a) The staff is able to make viable decisions that can go along way in increasing the firms output.
b) The firm/management is also able to put in place better organizational structures which allow for departmentalization and subsequent division of labour.Division of labour leads to specialization and hence the overall increase in the firms output.

-the costs of hiring/employing the specialized staff/management are spread over a large number of units of output of variable cost of production.Thus,the cost of labour is minimized when production increases leading to increased profits.

v) Technical economies:

These are benefits that accrue to a firm from the use of specialized labour and machinery. Large firms have access to large capital which they utilize to obtain those machines and hire the specialized labour.The machines use the latest technology and are put to full use, making the firm production more efficient i.e. cost of the machines and labour are spread over many units of output hence less costly but giving higher profits.

vi) Research economies:

Large firms can afford to carry out research into better methods of production and marketing.(Research is necessary because of the increased competition in the business world today) This improves the quality of the products and increases the sales and profits made by the firm.

vii) Staff welfare economies:

Large firms can easily provide social amenities to their employees including recreations, housing, education, canteens and wide range of allowances. These amenities work as incentives to boost the morale of the employees to work harder and increase the quality and quantity of output. This leads to higher sales and profits.

viii) Inventory economies

A large sized firm can establish warehouses to stock raw materials and therefore enjoy large stocks of raw materials for use when the raw materials are in short supply.Thus, the firm can avoid production stoppages that can be occasioned by shortages of the raw materials. The suppliers of such material may be sold at a higher price to realize profit.

External economies of scale:

External economies of scale are those benefits which accrue to a firm as a result of growth of the whole industry. They are realized by a firm due to its location near other firms. They include;

a) **Easier access to labour:** Where many firms are located in one area a pool of labour of various skills is usually available. Therefore firms relocating to the area find it easy to obtain.
b) **Improved/efficient infrastructure:** Usually where many firms are located, infrastructure would be highly developed e.g. roads, power, water and communication facilities. Firms relocating in that area thus enjoy the services of infrastructure already in place.
c) Firms may be able to dispose off their waste product easily
d) **Ready** market may be available from the surrounding firms
e) Readily available services such as banking, insurance and medical care

f) Adequate supply of power due to large volume of consumption e.t.c

Diseconomies of scale

A firm cannot continue to expand indefinitely or without a limit.As a firm grows or industry expands, the benefits the firm can reap or get from such growth or expansion have a limit.

Any further expansion in the scale of production beyond the limit will actually create negative which would increase the cost of production.

The negative effects to a firm due to its size or scale of production are referred to as **diseconomies of scale.**

Diseconomies of scale are therefore the problems a firm experiences due to expansion.

Sources of diseconomies of scale

Diseconomies of scale may arise from:

a) Managerial functions which become increasingly difficult to perform as the firm expands. Communication and consultations take more time than before.
b) Changing consumer tastes which may not be fulfilled immediately because decision-making may take too long.
c) Increase in the costs of transporting raw materials, components and finished products.
d) Labour unrest or disputes and lack of commitment from the employees because they are not involved in decision making
e) Stoppage of production process when disputes arise since all production stages are interdependent and labour specialized.
f) Lack of adequate finances for further expansion of the firm.

There are two forms of diseconomies of scale fiz internal diseconomies and external diseconomies of scale.

Internal diseconomies of scale

These are the problems a firm experiences as a result of large scale production due to its persistent growth. They include;

i) **Managerial diseconomies of scale**

These are the losses which may arise due to the failure of management to supervise and control the operations properly. This may be because the firm is large resulting into;

a) Difficulties in controlling and coordinating the departments leading to laxity among employees.

b) Difficult in decision making and communication and co-ordination between management and workers. Delays in decision making means lost opportunities.
c) Impersonal relationship between management and workers, and staff problems not easily established which could lead to low morale, disputes, unrests/skills.
d) An increase in management tasks leading to increase in number and impact of risks i.e. any error in judgement on the part of management may lead to big losses.

ii) **Marketing diseconomies of scale**

These are losses which may arise due to changes in consumer tastes. These may be as a result of;

a) A change in tastes leading to fall in demand for the firms products. A large firm may find it difficult to immediately adjust to the changes in the tastes of consumers, hence it will experience fall in its scale.
b) An increase in the scale of production, which leads to higher demand for factor of production such as labour, raw materials and capital. This will result into higher prices for them. This will push up the prices of the goods and services produced, which will cause a fall in sales.

iii) **High overhead costs**

When the output of a firm increases beyond a certain limit, some factors may set in to increase the average costs.e.g the overhead costs incurred in production and marketing activities may increase. This is because firms may intensify their promotional campaign, incur heavy transport expenses and be forced to offer generous discounts in an effort to attract more clients. All these are factors that may increase overheads without any corresponding increase in real benefits to the firm.

iv) **Financial diseconomies of scale**

These are losses which may arise due to a firm's inability to acquire adequate finances for its expansion. This will prevent the firm from expanding further thereby limiting its capacity to increase the volume of its output.

External diseconomies of scale

These are demerits that affirm experiences as a result of growth of the entire industry. These include;

-scramble for raw materials
-unavailability of land for expansion
-scramble for available labour

-competition for available market
-easy targets especially in times of war

Existence of small firms in an economy

As the firm grows in size, its scale of production increases.However, many firms remain small even though they face stiff competition from larger firms. Some of the reasons for existence of small scale firms include;

a) **Size of the market**

Large-scale production can only be sustained by a high demand for a product. If the demand for a product is low, it may not be advisable for a firm to produce on a large scale, hence it will remain small.

b) **Nature of the product;**

The nature of the product sometimes makes it impossible to produce in large quantities e.g. personal services e.g. hairdressing, painting or nursing can only be provided by an individual or a small firm.

c) **Simplicity of organization**

Small firms have the considerable advantage of simplicity in organization. They avoid bureaucracy, wastage and managerial complexity associated with large scale organizations.
Where a firm intends to take advantage of simplicity, the proprietor may maintain its small firm.

d) **Flexibility of small firms**

Small firms are flexible i.e. one can easily switch from one business to another where an owner of a business wishes to maintain flexibility so as to take advantage of any new opportunity, he/she may have to maintain a small firm.

e) **Quick decision making**

In a situation where proprietors want to avoid delay in decision-making, they may opt to maintain a small business as this would involve less consultation.

f) **Belief that a small firm is more manageable**

Many small businesses have the potential of expansion, yet their owners prefer to have them remain small believing that big businesses are difficult to run.

g) **Rising costs of production**

In situations where production costs rise too fast, such that diseconomies of scale set is very early, the firm has to remain small.

h) **Need to retain control**

In order to retain control and independence, the owners of the firm may wish to keep it small.

i) **Legal constraints/Government policy**

In some situations, the laws may restrict the growth of a firm. In such circumstances the existing firms remain small.

j) **Small capital requirements**

As opposed to large scale firms, small firms require little amounts of capital to start and operate.

Implication of production activities on environmental and community health

As production activities take place in a given area, the environment and the health of the community around may be adversely affected by these activities. Some of these effects include:

a) **Air pollution**

This is caused by waste which is discharged into the atmosphere leading to contamination of the air. Such waste may be in funs of industrial emissions and toxic chemicals from the firms. These pollutants cause air-borne diseases. Acid rain due to such emission may also affect plants.

PRODUCT MARKET

The term ‘market’ is usually used to mean the place where buyers and sellers meet to transact business. In Business studies, however, the term ‘market’ is used to refer to the interaction of buyers and sellers where there is an exchange of goods and services for a consideration.

NOTE: The contact between sellers and buyers may be physical or otherwise hence a market is not necessarily a place, but any situation in which buying and selling takes place. A market exists whenever opportunities for exchange of goods and services are available, made known and used regularly.

Definition:

i) Product market; Is a particular market in which specific goods and services are sold and with particular features that distinguish it from the other markets.

-The features are mainly in terms of the number of sellers and buyers and whether the goods sold are homogeneous or heterogeneous

-Product market is also referred to as market structure.

-Markets may be classified according to the number of firms in the industry or the type of products sold in them.

TYPES OF PRODUCT MARKET

The number of firms operating in a particular market will determine the degree of competition that will exist in a given industry. In some markets there are many sellers meaning that the degree of competition is very high,

where as in other markets there is no competition because only one firm exists.
When markets are classified according to the degree of competition, there are four main types, these are;
i) Perfect competition
ii) Pure monopoly(monopoly)
iii) Monopolistic competition
iv)Oligopoly

i) Perfect competition

The word 'perfect' connotes an ideal situation.
This kind of situation is however very rare in real life; a perfect competition is therefore a hypothetical situation.
This is a market structure in which there are many small buyers and many sellers who produce a homogeneous product. The action of any firm in this market has no effect on the price and output levels in the market since its production is negligible.

Features of Perfect Competition

a) Large number of buyers and sellers: The buyers and sellers are so many that separate actions of each one of them have no effect on the market. This implies that no single buyer or seller can influence the price of the commodity. This is because a single firms (sellers) supply of the product is so small in relation to the total supply in the industry. Similarly, the demand of one buyer is so small compared to the total demand of one buyer is so small compared to the total demand in the market that he/she cannot influence the price.
Firms (suppliers) in such a market structure are therefore price takers i.e. they accept the prevailing market price for their products.

b) Identical or homogeneous products: Commodities from different producers are identical in all aspects e.g. size; brand and quality such that one cannot distinguish them. Buyers cannot therefore show preference for the products of one firm over those of the other.
c) Perfect knowledge of the market: Each buyer and seller has perfect knowledge about the market and therefore no one would affect business at any price other than the equilibrium price (market price).If one firm raises the price of its commodity above the prevailing market price, the firm will make no sale since consumers are aware of other firms that are offering a lower price i.e. market price. All firms (sellers) are also assumed to know the profits being made by other firms in the industry (in selling the product)

d) Freedom of entry or exit in the industry; The buyers and sellers have the freedom to enter and leave the market at will i.e. firms are free to join the market and start production so long as the prevailing market price for the commodity guarantees profit. However if conditions change the firms are free to leave in order to avoid making loss.
In this market structure, it is assumed that no barrier exists in entering or leaving the industry.
e) Uniformity of buyers and sellers; All buyers are identical in the eyes of the seller. There are therefore, no advantages or disadvantages of selling to particular buyers. Similarly, all the sellers are identical and hence there would be no special benefit derived from buying from a certain supplier.
f) No government interference; The government plays no part in the operations of the industry. The price prevailing in the market is determined strictly by the interplay of demand and supply. There should be no government intervention in form of taxes and subsidies, quotas, price controls and other regulations.
g) No excess supply or demand; The sellers are able to sell all what they supply into the market. This means that there is no excess supply. Similarly, the buyers are able to buy all what they require with the result that there is no difficult in supply.
h) Perfect mobility of factors of production; The assumption here is that producers are able to switch factors of production from producing one commodity to another depending on which commodity is more profitable to sell. Factors of production are also freely movable from one geographical area to another.
i) No transport costs; The assumption here is that all sellers are located in one area, therefore none of them incurs extra transport costs or carriage of goods. The sellers cannot hence charge higher prices to cover the cost of transport. Buyers, on the other hand, would not prefer some sellers to others in an attempt to cut down on transport costs.

NOTE: The market (perfect competition) has normal demand and supply curves. The individual buyers demand curve is however; perfectly elastic since one can buy all what he/she wants at the equilibrium price. Similarly, the individual sellers supply curve is also perfectly elastic because one can sell all what he/she produces at the equilibrium price.

Perfect competition market hold on the following assumptions;

i) There are no transport costs in the industry
ii) Buyers and sellers have perfect knowledge of the market

iii) Factors of production are perfectly mobile

iv) There is no government interference

Examples of perfect competitions are very difficult to get in the real life but some transactions e.g. on the stock exchange market, are very close to this.

Criticism of the concept of perfect competition

In reality, there is no market in which perfect competition exists. This is due to the following factors:

i) Very few firms produce homogenous products. Even if the products were fairly identical, consumers are unlikely to view them as such.

ii) In real situations, consumers prefer variety for fuller satisfaction of their wants; hence homogenous products may not be very popular in these circumstances.

iii) There is a common tendency towards large-scale operation. This tendency works against the assumption of having many small firms in an industry.

iv) Firms are not found in one place to cut down on transport costs as this market structure requires.

v) Governments usually interfere in business activities in a variety of ways in the interest of their citizens. The assumption of non-interference by the state is therefore unrealistic in real world situations.

vi) Information does not freely flow in real markets so as to make both sellers and buyers fully knowledgeable of happenings in all parts of a given market.

MONOPOLY

A monopoly is a market structure in which only one firm produces a commodity which has no close substitutes.

Some of the features in this market structure are:

a) One seller or producer; supplying the entire market with a product that has no close substitute consumers therefore have no option but to use the commodity from the monopolist to satisfy their need.

b) Many unorganized buyers; in the market the buyers compete for the commodity supplied by the monopoly firm.

c) The monopoly firm is the industry; because it supplies the entire market, the firms supply curve is also the market supply curve, and the demand curve of the firm is also the market demand curve.

d) Entry into the market is closed; such barriers are either put by the firm or they result from advantages enjoyed by the monopoly firm e.g. protection by the government.

e) Huge promotional and selling costs; are incurred in order to expand the market base and to maintain the existing market. This also helps to keep away potential competitors.
f) The monopoly firm is a price maker or a price giver; the firm determines the price at which it will sell its output in the market. It can therefore increase or reduce the price of its commodity, depending on the profit it desires to make.
g) Price Discrimination is may be possible; This is a situation where the firm charges different prices for same commodity in different markets.

Price discrimination may be facilitated by conditions such as;

- ✓ Consumers being in different markets such that it is difficult for one to buy the product in the market where it is cheaper.
- ✓ The production of the commodity is in the hands of a monopolist.
- ✓ Market separation.

Market separation may be based on the following factors;

- **Geographical;** Goods may be sold at different prices in different markets.
- **Income;** Seller may charge different prices for his/her products to different categories of consumers depending on their income.
- **Time;** a firm may sell the same commodity at a higher price during the peak period and lower the price during the off peak period.

Sources of monopoly power

i) Control of an important input in production; A firm may control a strategic input or the entire raw materials used in the production of a commodity. Such a firm will easily acquire monopoly by not selling the raw materials to potential competitors.
ii) Ownership of production rights; where the right to production or ownership of commodity i.e. patent rights, copyrights and royalties belong to one person or firm, then, that creates a monopoly. Similarly, if the government gives licence to produce a commodity to one firm, then this will constitute a monopoly.
iii) Internal economies of scale; The existence of internal economies of scale that enable a firm to reduce its production costs to the level that other firms cannot will force these other firms out of business leaving the firm as a monopoly.
iv) Size of the market; where the market is rather small and can only be supplied profitably by one firm.

v) Additional costs by other firms; A firm may enjoy monopoly position in a particular area if other firms have to incur additional costs such as transport in order to sell in the area. These additional costs may increase the prices of the commodity to the level that it becomes less attractive hence giving the local firm monopoly status.

vi) Where a group of firms combine to act as one; Some firms may voluntarily combine/amalgamate or work together for the purpose of controlling the market of their product. Examples are cartels

vii) Restrictive practices; A firm may engage in restrictive practices in order to force other firms of business and therefore be left as a monopoly. Such practices may include limit pricing i.e. where a firm sells its products at a very low price to drive away competitors.

viii) Financial factors; where the initial capital outlay required is very large, thereby preventing other firms from entering the market.

ix) Where the government establishes a firm and gives it monopoly power to produce and sell ‘cheaply’(Government Policy)

Advantages of monopoly

i. A monopoly is able to provide better working conditions to employees because of the high profits realised
ii. In some monopolies, high standards of services/goods are offered
iii. Monopolies always enjoy economies of scale. This may help the consumer in that the goods supplied by a monopoly will bear lower prices.
iv. A monopolist may use the extra profit earned to carry out research and thus produce higher quality goods and services.
v. The consumer is protected in that essential services such as water and power supply is not left to private businesses who would exploit the consumers.

Disadvantages of monopoly

i. A monopolist can control output so as to charge high prices
ii. Consumers lack freedom of choice in that the product produced by a monopoly has no substitute
iii. Low quality products may be availed to consumers due to lack of competition.

MONOPOLISTIC COMPETITION

Monopolistic competition is a market structure that falls within the range of imperfect competition i.e. falls between perfect competition and pure monopoly. It is therefore a market structure that combines the aspects of perfect competition and those of a monopoly.

Since it is not possible to have a market that is perfectly competitive or a market that is pure monopoly in real world, all market structures in real world lie between the two and are thus known as imperfect market structures.
In a monopolistic market, there are many sellers of a similar product which is made to look different. This is known as product differentiation. These similar products are made different through packaging, design, colour, branding e.t.c
The following are the assumptions of a monopolistic competition.

i. A large number of sellers; Who operate independently.
ii. Differentiated products; Each firm manufactures a product which is differentiated from that of its competitors, yet they are relatively good substitutes of each other. The differences may be real in that different materials are used to make the product or may be imaginary i.e. created through advertising,branding,colour,packaging e.t.c
iii. No barriers to entry or exit from industry; There is freedom of entry into the industry for new firms and for existing firms to leave the industry.
iv. Firms set their own prices; The prices are set depending on the costs incurred in production and the demand in the market.
v. No firm has control over the factors of production; Each firm acquires the factors at the prevailing market prices.
vi. Presence of non-price competitions; Since products are close substitutes of each other, heavy advertising and other methods of product promotion are major characteristics of firms in monopolistic competition.
vii. Buyers and sellers have perfect knowledge of the market.

OLIGOPOLY

This is a market structure where there are few firms. The firms are relatively large and command a substantial part of the market. It is a market structure between the monopolistic competition and monopoly.

Types of Oligopoly

Oligopoly may be classified according to the number of firms or the type of products they sell. They include:

a) **Duopoly;** This refers to an oligopoly market structure which comprises of two firms. Mastermind Tobacco and British American Tobacco (BAT) are examples of duopoly in Kenya.
b) **Perfect/Pure oligopoly** refers to an oligopolistic market that deals in products which are identical. Examples of pure oligopoly are companies dealing with petroleum products such as oil Libya, Caltex, Total, Shell, National Oil, Kenol and Kobil. These firm sell products which are identical such as kerosene, petrol and diesel.

c) **Imperfect/Differentiated Oligopoly;** this is an oligopolistic market structure where firm have products which are the same but are made to appear different through methods such as packaging, advertising and branding.

Features of oligopoly

i) Has few large sellers and many buyers.
ii) The firms are interdependent among themselves especially in their output and pricing.
iii) Non-price competition, firms are in a position to influence the prices. However, they try to avoid price competition for the fear of price war.
iv) There is barriers to entry of firms due to reasons such as; requirement of large capital, Ownership of production rights, control over crucial raw materials, Restrictive practices etc
v) High cost of selling through methods of advertisement due to severe competition.
vi) Products produced are either homogeneous or differentiated.
vii) Uncertain demand curve due to the inter-dependence among the firms. Hence the shifting of the demand curve is not definite.
viii) There is price rigidity i.e. once a price has been arrived at in an oligopolistic market, it tends to remain stable.

This feature explains why a firm in oligopolistic market faces two sets of demand curves resulting to a Kinked Demand Curve. One curve, for prices above the determined one, which is fairly gentle and the other curve for prices below the determined one which is fairly steep.

CHAIN/CHANNELS OF DISTRIBUTION

Introduction

- Channels of distribution are the paths that goods and or services follow from the producers to the final users.
- The persons involved in the distribution of goods from the producer to consumer are called middlemen or intermediaries.
- There are different channels that different products follow. Some of the channels include the following:

(i) Producer to agent to wholesaler to retailer to consumer.
(ii) Producer to co – operative society to marketing board to wholesaler to retailer to consumer.

(iii) Producer to marketing board to wholesaler to retailer to consumer.
(iv) Producer to wholesaler to retailer to consumer.
(v) Producer to wholesaler to consumer
(vi) Producer to retailer to consumer
(vii) Producer to consumer

Costs incurred by middlemen while distributing goods

a) **Buying costs.** They incur this cost by paying for them from the producers or other middlemen.

b) Transport cost. Some middlemen do transport goods from the producer to other middlemen or to the final users.

c) **Storage costs.** Middlemen do keep the goods until their demand arises. This will therefore require them to hire or construct their own warehouses.

d) **Advertising or marketing costs**. Some middlemen do carry out marketing of goods on behalf of the producers and other middlemen. In the process, they pay for such services.

e) **Insurance costs.** Middlemen do insure the goods they are trading in to ensure compensation in the event of loss.

f) **Operation costs.** Middlemen just like other businesses do incur operating costs such as salaries to employees, electricity, maintenance among others.

g) **Preparation costs.** Some middlemen to prepare goods before they are sold to the consumers. Such activities include packing, assembling and blending. They have to meet such costs on behalf the producer, other middlemen and consumers.

CHANNELS OF DISTRIBUTING VARIOUS PRODUCTS (refer to Inventor book three pages 50 to 53)

ROLES OF MIDDLEMEN

The following are some the roles performed by middlemen in the chain of distribution

(i) **Bulk accumulation (assembling).** They similar goods from different producers in small quantities and then offering the large amount gathered to buyers who may want to buy in large volumes.

(ii) **Reducing transactions.** The interactions between the producers and the consumers will be reduced since the middlemen are the ones who will be communicating to the consumers.

(iii) **Bulk breaking.** They buy in large quantities and then sell in small quantities as desired by the consumers.

(iv) **Risk taking.** They assume all the risks related with the movement of goods from the producers to the consumers. Such risks include theft, damages, loss due to bad debts.

(v) **Finance provision.** Middlemen provide finance to the producers by buying goods in large quantities and paying for them in time.

(vi) **Provision of information.** Middlemen gather market information from the consumers then pass to the producers who in turn produce goods in line with the tastes of consumers.

(vii) **Marketing/product promotion**. Middlemen are involved in marketing of goods hence stimulating the interest of consumers.

(viii) **Provision of transport.** Middlemen do transport goods from the producers up to the where the consumers can access them. Both the producers and consumers are hence relieved of transport costs.

(ix) Storage

(x) Variety provision

(xi) Availing goods to consumers

FACTORS TO CONSIDER BEFORE SELECTING A DISTRIBUTION CHANNEL

Factors that influence the choice of a distribution channel include the following:

(i) **Product nature.** Perishable products should be sold directly to the consumers because delays may result to losses since they go bad fast. In addition, bulky products need direct selling in order to reduce transportation and stock handling costs.

(ii) **Nature of the market.** Where the market is concentrated in one area, direct selling is appropriate. A longer channel of distribution is preferred where the market is widely spread.

(iii) **Role of intermediary**. The channel chosen should be able to perform the services related to the product being sold e.g. for technical goods, the middleman should be able to offer technical support to the customers.

(iv) **Resources and size of the firm/producer**. If the producer is small, then direct selling would be appropriate. Large firms with sufficient financial resources can opt for long channels of distribution.

(v) **Channels used by competitors**. If a firm wants its products to compete with those of the competitors, then is it prudent to use similar channels. A firm that wants to avoid competition should use a different channel of distribution.

(vi) **Government policy**. The channel chosen should be able to meet government regulations such as all middlemen distributing pharmaceutical products must be recognized by the relevant government bodies (Pharmacy and Poisons Board).

(vii) **Marketing risks**. In the event the firm wants to avoid risks related to distribution, it will opt for middlemen.

Questions

1. State four channels for distributing imported goods.
2. Explain five factors that can influence the choice of a channel of distribution.
3. Outline five costs incurred by middlemen in the distribution process.
4. Describe the roles played by middlemen in the distribution chain.
5. Outline the circumstances under which a producer would sell directly to consumers.

NATIONAL INCOME

This is the total income received by the providers/owners of the factors of production in a given country over a given time period.

Terms used in national income

(i) **Gross Domestic Product (GDP)**. This is the total monetary value of all goods and services produced in a country during a particular year. Such goods and services must have been produced within the country.

(ii) **Net Domestic Product (NDP)**. This is the GDP less depreciation. Depreciation is the loss in value of the assets such as machines used in the production of goods and services.

(iii) **Gross National Product (GNP)**. This measures the total monetary value of all the goods and services produced by the people of a country regardless of whether they in or outside the country. It takes into account exports and imports. The difference between exports and imports is called net Factor Income from abroad. GNP therefore is the sum of GDP and net factor income from abroad.

(iv) **Net National Product (NNP)**. This recognizes the loss in value of the capital used in the production of goods. Capital here refers to capital goods. NNP is the difference between GNP and the depreciation.

(v) **Per capita income.** This is the average income per head per year in a given country. It is also the national income divided by the population of the country.

CIRCULAR FLOW OF INCOME

- This is the continuous movement of income between the households (providers of factors of production) and the firms (producers of goods and services).
- The factors of production are received from households.
- The firms pay the rewards of such factors to the households (expenditure to the firms and income to the households).
- The households in turn use the income to buy the goods and services produced by the firms (expenditure to households and income to firms).

Assumptions/features of circular flow of income

(i) **Existence of two sectors only.** It is assumed that the economy has only two sectors that is households and firms. The households provide the factors of production while firms are involved in the production of goods and services.

(ii) **Total spending by households**. It is assumed that the households spend all their income on the goods and services produced by the firms i.e. no savings.

(iii) **Total spending by the firms**. It is assumed that the firms spend the money received from the sale of goods and services to pay for the rewards of production factors.

(iv) **Lack of government intervention.** The government does not influence how the firms and households carry out their activities. Such interventions are in the form of taxes, price controls among others.

(v) **Closed economy**. Exports and imports do not exist in such an economy.

Factors affecting the circular flow of income

- The factors can either lead to increase in income and expenditure (injections) or lead to a reduction in the volume of flow (withdrawals).

The factors include the following:

(i) **Savings.** This takes place when the households do not spend all their income on the purchase of goods and services. This reduces the income to be received by firms hence savings is a withdrawal from the circular flow of income.

(ii) **Taxation.** Taxation reduces the amount of money available for spending therefore it is a withdrawal/leakage from the circular flow of income.

(iii) **Government expenditure.** The government may buy goods from the firms or provide subsidies. This will translate in to an injection into the circular flow of income.

(iv) **Investments.** When firms put more capital into the production, output will increase hence an increase in income (injection).

(v) **Imports.** When goods and services are bought from other countries, money will be spent hence a reduction in the circular flow of income (withdrawal).

(vi) **Exports.** Through exports, a country is able to receive money from other countries (injections)

Injections

(i) Investments
(ii) Government spending
(iii) Exports

Withdrawals

(i) Savings
(ii) Taxation
(iii) Imports

APPROACHES USED IN MEASURING NATIONAL INCOME

(i) **Expenditure Approach**

National income is arrived at summing expenditure on all final goods and services (that have reached the final stage of production). Such expenditure is divided into:

a) Expenditure on consumer goods (C)
b) Expenditure on capital goods (I)
c) Expenditure by government (G)
d) Expenditure on net exports (X – M)

Therefore national income = C+I+G+(X – M)

Problems associated with expenditure approach

- Lack of accurate records particularly in the private sector
- Approximation of expenditure of the subsistence sector
- Difficulty in differentiating between final expenditure and intermediate expenditure
- Double counting may exist

- Fluctuating exchange rates may cause problems in the valuation of imports and exports.

(ii) Income approach

- In this method, the national income is arrived at by summing all the money received by those who participate in the production of goods and services.
- Such incomes are in the form of rewards to the production factors (wages, rent, interest and profits).
- Public income is also taken into account i.e. it is the income received by the government from its investments (Parastatals, joint ventures).
- Transfer payments are excluded since they represent a redistribution of incomes from those who have earned them to the recipient's e.g. National insurance schemes.

Problems related to this method

a) Determination of what proportion of transfer payments constitute in the income of a country.
b) Inaccurate data may exist since business people may not tell the truth about their income in order to evade tax.
c) Price fluctuations may make national income determination difficult.
d) Income from illegal activities is not captured.
e) Valuation of income from subsistence economy may be difficult e.g. housewives.

Assignment: Read and make short notes on Output approach (refer to Inventor book three pages 65 – 66).

USES OF NATIONAL INCOME STATISTICS

- **Indicators of standards of living.** If the national income is equitably distributed, then the standards of living will be high.
- **Measuring economic growth.** The statistics of one year are compared with previous year to show whether there is improvement or not.
- **Inter country comparison.** They are used to compare the economic welfare among countries hence knowing which country is better off and by how much. However, the following challenges may be faced when carrying the comparisons: different in currencies, different goods and services, disparity in income distribution and difference in tastes and preferences.
- **Investment decisions.** They assist the government and other investors to know the sectors to

put their money. The statistics provide relevant information concerning the performance of each sector.

- **Basis of equitable distribution of income.** The statistics can be used to spread income to the hands of majority of the citizens incase a few individuals control the economy.
- **Planning purposes.** The statistics will show the contribution of each sector thus helping the government in allocating the funds to the various sectors.

Factors which influences the level of national income.

- ✓ **Quantity and quality of production.** If the factors are more in terms of quantity of good quality, the output will be high hence increasing in national income.
- ✓ **State of technology.** A country with high level of technology will produce goods in large volumes hence high national income.
- ✓ **Political stability.** Countries which are relatively stable politically experience high production hence high national income level.
- ✓ **Accuracy of accounting systems.** If the methods used to gather data are accurate, then the overall statistical figures will the accurate hence reliable.
- ✓ **Proportion of the subsistence sector.** Subsistence sector's output is not normally included in the statistical figures. If it represents a large proportion, therefore the national income level will be low.

NB. For other factors refer to Inventor book three pages 68 – 69.

Reasons why high per capita income is not an indicator of a better living standard in a country

- ❖ **Statistical problems.** The collection of the national income data may be inaccurate meaning that the national income figures might be incorrect hence wrong per capita income.
- ❖ **Changes in money value.** If the currency has been devalued, there can be change in the value of money without necessarily representing any changes in the welfare of the people.
- ❖ **Income distribution.** The per capita may be high even though the income is in the hands of very few people thus it is not a representative of the majority.
- ❖ **Nature of products.** If the products are not meant to satisfy immediate wants of the people, then an increase in per capita income may not lead to a higher economic welfare.

- **Peoples' hard work and attitude.** Increased national income may mean less sleep and more worries. People have no time to enjoy what they produce and their welfare may be low despite the rise in national income.
- **Social costs.** People may migrate from rural areas to urban areas straining family relationships while an increase in industries may create pollution, congestion and other environmental disruptions.

Questions

1. State four problems encountered in comparing standards of living in different countries using national income statistics
2. Using a diagram, describe the circular flow of income.
3. Explain five factors that may influence the level of national income of a country
4. Outline four limitations of expenditure approach used in measuring national income.
5. Explain five reasons why high per capita income may not translate to better living standards in a country.
6. Describe five factors that affect the circular flow of income.

THE CASHBOOKS AND THE LEDGER

The cash book

This is a special ledger which is used to record cash and cheque transactions. It contains only the cash in hand and cash at bank (i.e. cash and bank) accounts

i) Nominal ledger

This ledger is used to record business expenses and incomes (gains). It contains all the nominal accounts.

ii) Private ledger

This ledger is used in recording private accounts i.e. confidential and valuable fixed assets and the personal accounts of the proprietors such as capital accounts and drawing accounts.

iii) The general ledger

The general ledger contains all other accounts that are not kept in any other ledger e.g. buildings, furniture and stock accounts.

-Personal accounts of debtors or creditors who do not arise out of sale or purchase of goods on credit are found in the general ledger e.g. debtors as a result of sale of fixed asset on credit and expense creditors.

C) Private accounts

These are accounts that the business considers to be confidential and are not availed to everybody except the management and the owners.

-These accounts may be personal or impersonal.

-They include capital account, drawings accounts, trading, profit and loss accounts.

Types of ledgers

The following are the main types of ledgers that are used to keep the various accounts

i. The sales ledger (Debtors ledger)

This is the ledger in which accounts of individual debtors are kept.

-It is used to record the value of goods sold on credit and the customers to whom the credit sales are made, hence contains the personal names of the debtors.

-It is called a sales ledger because the accounts of debtors kept herein are as a result of sale of goods on credit. An account is kept for each customer to which is debited the value of credit sale. Payment made by the debtor are credited to the account and debited in the cash book.

ii. Purchases ledger(creditors ledger)

The purchases ledger contains accounts of creditors i.e. contains the records of the value of goods bought on credit and the suppliers of such goods.

It is a record of the debts payable by the business due to credit purchases.

An account is kept for each creditor to the credit side of which is posted the value of.

b) Impersonal accounts

This category of ledger accounts includes all other accounts that are not personal in nature e.g. buildings, purchases, rent, sales and discounts received.

Impersonal accounts fall into two types

1) Real accounts
2) Nominal accounts

1) Real accounts: These are accounts of tangible assets or property e.g. buildings, land, furniture, fittings, machinery, stock, cash (at bank and in hand) e.t.c

These accounts are also used to draw up the balance sheet.

2) Nominal account: These are accounts of items that relate to gains and losses and whose balances at the end of the accounting period.
-All expenses, revenues, sales and purchases are hence nominal accounts.
-The main business expenses include purchases,sales,returns,insurance,stationary,repairs,depreciation,heating,discount allowed, lighting interests,printing,wages,rent,rates and advertising.
The value of losses is included in the same side as the expenses when drawing up the final accounts though it is not an expense.
-The income (revenues) include sales,returns,claims out, interest receivable, dividends receivable and commission receivable. Profit is usually categorised together with these incomes when drawing up the final accounts.

Classification of ledger accounts

Many businesses handle few transactions, hence they have few records to keep. Their accounts can thus be kept in a single ledger referred to as the general ledger
As a business grows the volume of transactions increases. This single ledger, therefore, becomes very bulky with accounts and it becomes difficult to make reference to it.
In order to simplify the recording of transactions and facilitate reference to the accounts, ledger accounts are usually classified and each category kept in a special ledger.
NOTE (i) Since many transactions are cash transactions which are normally recorded in the bank and cash accounts a need arises to remove them from the main/general ledger to a separate ledger called the cash book.
(ii) The number of ledgers kept depends on the size of the business.

Classes of accounts

All accounts can be classified into either personal or impersonal accounts.

a) Personal accounts

-These are account of persons
-They relate to personal, companies or associations.
-They are mainly accounts of debtors and creditors.
NOTE: capital account is the proprietors personal account, showing the net worth of the business hence it is a personal account.
-The account balances of these accounts are used to draw up the balance sheet.
-In the ledger, the trial balance total is not affected.

Purpose of a trial balance

The purpose of a trial balance include:

a) Checking the accuracy in the ledger accounts as to whether;

i-The rule of double entry has been adhered to or observed/ complied with.
ii-There are arithmetical errors in the ledger accounts

b) Gives a summary of the ledger i.e. summary of the transactions which have taken place during a given period
c) Provide information (account balances) for preparing final accounts such as the trading account, profit and loss account and the balance sheet.
d) Test whether the ledger account balances have been posted to the right side of the trial balance.

Limitations of a trial balance

Even when the trial balance totals are equal, it does not mean that there are no errors made in the ledgers. This is because there are some errors that do not affect the trial balance.

A trial balance only assures the book keeper that the total of debit entries is equal to total credit entries. The errors that do not affect the trial balances are:

i. Error of total omission; This occurs when a transaction takes place and nothing about it is recorded in the books of accounts i.e. it is completely omitted such that neither a credit nor a debit entry is made in the ledgers.

ii. Error of original entry; this occurs where both the debit and credit entries are made using similar but erroneous figures. As the wrong amount is recorded in the two accounts.

iii. Error of commission; This occurs where double entry is completed but in the wrong persons accounts especially due to a confusion in names e.g. a debit entry of shs.2000 was made in Otieno's account instead of Atieno's account.

iv. Compensating errors; These are errors whose effects cancel out e.g. over debiting debtors account by sh.300 and under debiting cash account by sh.300.

v. Complete reversal of entries; This occurs where the account to be debited is credited and the account to be credited is debited e.g. the sale of goods to Lydia on credit may be recorded as follows;

Dr.sales a/c
Cr.Lydius a/c   instead of

Dr.Lydius a/c
Cr.sales a/c

iv) Error of principle; This is where a transaction is recorded in the wrong account of a different class from the correct one e.g. repairs of machinery was debited in the machinery instead of debiting the repairs account.

TRIAL BALANCE

-A trial balance is a statement prepared at a particular date showing all the debit balances on one column and all the credit balances on another column.

NOTE: A trial balance is not an account but merely a list of assets, expenses and losses on the left and capital liabilities and incomes (including profits) on the right.

-The totals of a trial balance should agree if the double entry has been carried out correctly and there are no arithmetic errors both in the ledger as well as in the trial balance itself.

-If the two sides of a trial balance are not equal, it means there is an error or errors either in the trial balance or in the ledger accounts or in both.

Errors that may cause a trial balance not to balance

i. Partial omission: A transaction was recorded on only one account i.e. a debit or a credit entry might have been omitted in one of the affected accounts.
ii. Transferring (posting): a wrong balance to a trial balance.
iii. Different amounts for the same transaction might have been entered in the accounts(Amount Dr.different from amount cr)
iv. Failure to post a balance to the trial balance (omission of a balance from the trial balance
v. Posting a balance to the wrong side of the trial balance
vi. Recording a transaction on the same side of the affected accounts(partial reversal entry)
vii. Arithmetic mistakes might have been made when balancing the ledger accounts
viii. Arithmetic errors in balancing the trial balance

BUSINESS STUDIES FORM FOUR NOTES

FINANCIAL STATEMENTS

These are prepared at the end of a given trading period to determine the profit and losses of the business, and also to show the financial position of the business at a given time.

They includes; trading account, profit and loss account, trading profit and loss account and the balance sheet.

They are also referred to as the final statements.

The trading period is the duration through which the trading activities are carried out in the business before it decides to determines it performances in terms of profit or loss. It may be one week, month, six months or even a year depending on what the owner wants.

Most of the business use one year as their trading period. It is also referred to as the accounting period.

At the end of the accounting period, the following takes place;

- All the accounts are balanced off
- A trial balance is extracted
- Profit or loss is determined
- The balance sheet is prepared

Determining the profit or loss of a business

When a business sells its stock above the buying price/cost of acquiring the stock, it makes a profit, while if it sells below it makes a loss. The profit realized when the business sell it stock beyond the cost is what is referred to as the gross profit, while if it is a loss then it is referred to as a gross loss.

It is referred to as the gross profit /loss because it has not been used to cater for the expenses that may have been incurred in selling that stock, such as the salary of the salesman, rent for the premises, water bills, etc. it therefore implies that the businessman cannot take the whole gross profit for its personal use but must first deduct the total cost of all other expenses that may have been incurred.

The profit realized after the cost of all the expenses incurred has been deducted is what becomes the real profit for the owner of the business, and is referred to as Net profit. The net profit can be determined through calculation or preparation of profit and loss account.

In calculating the gross profit, the following adjustments are put in place

- Return inwards/Sales return: - these are goods that had been sold to the customers, but they have returned them to the business for one reason or the other. It therefore reduces the value of sales, and is therefore subtracted from sales to obtain the net sales

  Therefore Net sales = Sales – Return inwards
- Return outwards/purchases return: - these are goods that had been bought from the suppliers to the business and have been returned to them for one reason or the other. It reduces the purchases and is therefore subtracted from the purchases to obtain the net purchases.
- Drawings: - this refers to goods that the owner of the business has taken from the business for his own use. It reduces the value of purchases, and is therefore subtracted from purchases when determining the net purchases. It is different from the other drawing in that it is purely goods and not money
- Carriage inwards/Carriage on purchases: - this is the cost incurred by the suppliers in transporting the goods from his premises to the customers business. It is treated as part of the purchases, and therefore increases the value of purchases. It is added to purchases to determine the actual value of purchases/Net purchases.

  Therefore Net Purchases = Purchases + Carriage inwards – Return Outwards - Drawings
- Carriage outwards/Carriage on sales: - this is the cost that the business has incurred in transporting goods from its premises to the customer's premises. The cost reduces the business profit that would have been realized as a result of the sale, and is therefore treated as an expense and is subtracted from the gross profit, before determining the net profit.
- Opening stock is the stock of goods at the beginning of the trading period, while the closing stock is the stock of the goods at the end of the trading period

  Gross profit is therefore calculated as follows;

  Gross Profit = Sales – Return inwards – (Opening stock + Purchases + carriage inwards – Return outwards – Closing stock)

  Or

  Gross profit = Net sales – Cost of Goods Sold (COGS)

  COGS = Opening Stock + Net Purchases – Closing stock

  Net Profit = Gross profit – Total expenses

Trading Account

This is prepared by the business to determine the gross profit/loss during that trading period

It takes the following format:

Name of the business

Trading Account

Dr For the period (date) Cr

	Shs	Shs		Shs	Shs
Opening stock		xxxxxx	Sales	xxxxxx	
add Purchases	xxxxx		Less Return inwards	xxx	
add Carriage inwards	xxx		Net sales		xxxxxx
less Return Outwards	xxx				
less Drawings	xx	xxxxx			
Goods available for sale		xxxxxx			
Less Closing Stock		xxx			
Cost Of Goods Sold (COGS)		xxxxxx			
Gross profit c/d		xxxx			xxxxxx
		xxxxxx	Gross profit b/d		xxxx

The trading account is completed by the time the gross profit b/d is determined

For example

The following balances were obtained from the books of Ramera Traders for the year ending may 31st 2010

Sales	670 000
Purchases	380 000
Return inwards	40 000
Carriage outwards	18 000
Return outwards	20 000
Carriage inwards	10 000

Additional information:

- During the year the owner took goods worth sh 5 000 for his family use
- The stock as at 1st June 2009 was shs 60 000, while the stock as at 31st May 2011 was shs 70 000

  Required; Prepare Ramera Traders trading account for the period ending 31st May 2010

Ramera Traders
Trading Account

Dr For the period ending 31/5/2010 Cr

	Shs	Shs		Shs	Shs
Opening stock		60 000	Sales	670 000	
add Purchases	380 000		Less Return inwards	40 000	
add Carriage inwards	10 000		Net sales		630 000
less Return Outwards	20 000				
less Drawings	5 000	365 000			
Goods available for sale	425 000				
Less Closing Stock	70 000				
Cost Of Goods Sold (COGS)	355,000				
Gross profit c/d	275,000				
	630,000				630 000
			Gross profit b/d	275 000	

NB: Carriage outwards is not an item of Trading account, but profit and loss account as an expense.

Importance of Trading account

i. It is used to determine the gross profit/loss for a given trading period for appropriate decision making by the management.
ii. It is used in determining the cost of goods that was sold during that particular accounting period.
iii. It is used to reveal the volume of turnover i.e net sales
iv. May be used to compare the performance of the business in the current accounting period and the previous periods. It can also compare its performance with other similar businesses
v. It facilitates the preparation of profit and loss account, since the gross profit is carried forward to the profit and loss account.

Profit and Loss account

In preparation of this account, the gross profit is brought down on the credit sides, with all other revenues/income of the business being credited and the expenses together with the net profit being debited. Net profit = Total Revenues (including Gross Profit) – Total expenses

Name of the business
Profit and Loss Account

Dr	For the period (date)		Cr
	Shs		Shs
Expenses		Gross profit b/d	xxxxxx
Insurance	xxx	Discount received	xxx
Electricity	xxx	Rent income	xxx
Water bills	xxx	Commission received	xxx
Carriage Outwards	xxx	Any other income received	xxx
General expenses	xxx		
Provision for Depreciation	xxxx		
Discount allowed	xxx		
Commission allowed	xxxx		
Rent paid	xxxx		
Any other expense	xxxx		
Net profit c/d	xxxx		
	xxxxxx		xxxxxx
		Net profit b/d	xxxx

The Profit and Loss Account is complete when net profit b/d is obtained. In the trial balance, the revenues/incomes are always credited, while the expenses are debited, and the same treatment is found in the Profit and Loss Account. (Any item that is taken to the Profit and Loss Account with a balance appearing in the Debit (Dr) side of a trial balance is treated as an expense, while those appearing in the Credit (Cr) side are revenue e.g. discount balance appearing in the Dr Side is Discount Allowed, while the one on Cr side is Discount Received)

For example

The following information relates to Akinyi's Traders for the period ending March 28th 2010. Use it to prepare profit and loss account.

Gross profit	100 000	Discount received	12 000
Salaries and wages	20 000	Power and lighting	10 000
Opening stock	150 000	Rent income	10 000
Commission allowed	15 000	Commission received	16 000
Repairs	10 000	Discount allowed	8 000
Provision for depreciation	6 000	Carriage outwards	4 000

Akinyi Traders
Profit and Loss Account

Dr	For the period ending 28th March 2010		Cr
	Shs		Shs
Expenses		Gross profit b/d	100 000
Power and lighting	10 000	Discount received	12 000
Carriage Outwards	4 000	Rent income	10 000
Salaries and wages	20 000	Commission received	16 000
Provision for Depreciation	6 000		
Discount allowed	8 000		
Commission allowed	15 000		
Repairs	10 000		
Net profit c/d	65 000		
	138 000		138 000
		Net profit b/d	65 000

In case the expenses are more than the income, then the business shall have made a net loss, and the loss will be credited.
Net profit/loss can also be found through calculation as follows;
Net profit/loss = Gross profit + Total other revenues – Total expenses
For the above example;
Total other revenues = 12 000 + 10 000 + 16 000= 38 000
Total expenses = 10 000 + 4 000 + 20 000 + 6 000 + 8 000 + 15 000 + 10 000
= 73 000
Therefore; Net profit = Gross profit + Total other revenues – Total expenses
= 100 000 + 38 000 – 73 000= 65 000

Importance of Profit and Loss account

- ✓ It shows the revenue earned, and all the expenses incurred during the accounting period
- ✓ It used to determine the net profit/net loss of a given trading period
- ✓ It is a requirement by the government for the purpose of taxation
- ✓ May be used by the employees to gauge the strength of the business, in terms of its ability to pay them well
- ✓ It is vital for the prospective investor in the business, in terms of determining the viability of the business
- ✓ The creditors or loaners may use it to assess the business ability to pay back their debts
- ✓ It is used by the management to make a decision on the future of their business.

Trading, Profit and Loss Account

This is the combination of trading account and trading profit and loss account to form a single document. It ends when the net profit/loss brought down has been determined. That is;

Name of the business

Trading, Profit and Loss Account

Dr For the period (date) Cr

	Shs	Shs		Shs	Shs
Opening stock		xxxxxx	Sales	xxxxxx	
add Purchases	xxxxx		Less Return inwards xxx		
add Carriage inwards xxx			Net sales		xxxxxx
less Return Outwards xxx					
less Drawings	xx	xxxxx			
Goods available for sale		xxxxxx			
Less Closing Stock		xxx			
Cost Of Goods Sold (COGS)		xxxxxx			
Gross profit c/d		xxxx			xxxxxx
		Xxxxxx	Gross profit b/d		xxxx
Expenses					
Insurance		xxx	Discount received		xxx
Electricity		xxx	Rent income		xxx
Water bills		xxx	Commission received		xxx
Carriage Outwards		xxx	Any other income received		xxx
General expenses		xxx			
Provision for Depreciation		xxxx			
Discount allowed		xxx			
Commission allowed		xxxx			
Rent paid		xxxx			
Any other expense		xxxx			
Net profit c/d		xxxx			
		xxxxxx			xxxxxx
			Net profit b/d		xxxx

End Year Adjustments

The following items may require to be adjusted at the end of the trading period

- Revenues/Income
- Expenses
- Fixed assets

Adjustment on revenues

The revenue may have been paid in advance in part or whole (prepaid revenue) or may be paid later after the trading period (accrued revenue). Prepaid revenue is subtracted from the revenue/income to be received and the difference is what is treated in the profit and loss account or trading profit and loss account as an income, while the accrued revenue is added to the revenue/income to be received and the sum is what is treated in the above accounts as the actual revenue.

Only the prepaid amount and the accrued amounts are what are then taken to the balance sheet.

Adjustment on the expenses

The expenses may have been paid for in advance in part or whole (prepaid expenses) or may be paid for later after the trading period (accrued expenses). Prepaid expenses is subtracted from the expenses to be paid for and the difference is what is treated in the profit and loss account or trading profit and loss account as an expense, while the accrued expenses is added to the expenses to be paid for and the sum is what is treated in the above accounts as the actual expenses.

NB: Only the prepaid amount and the accrued amounts are what are then taken to the balance sheet.

Adjustment on fixed assets

The fixed assets may decrease in value, due to tear and wear. This makes the value to go down over time, what is referred to as depreciation. The amount of depreciation is always estimated as a percentage of cost.

The amount that shall have depreciated is treated in the profit and loss account or T,P&L as an expense, while the value of the asset is recorded in the balance sheet, less depreciation.

For example;

1. 1997 The following Trial balance was prepared from the books of Paka Traders as at 31st December 1995. Trial balance December 31st 1995

	Dr. (shs)	Cr. (shs)
Sales		980,000
Purchases	600,000	
Returns	80,000	20 000

Carriage in		40,000
Carriage out	3,000	
Stock (Jan 1st 1999)	120,000	
Rent	60,000	45 000
Discount	15,000	25 000
Motor vehicle	150 000	
Machinery	250 000	
Debtors	120,000	
Salaries	18,000	
Commission	7,000	12 000
Capital		178,000
Insurance	15 000	
Creditors		240,000
Cash	122 000	
	1 540 000	1 540 000

Additional information

i. Stock as at 31st December was 100,000

ii. the provision for depreciation was 10% on the cost of Motor vehicle, and 5% on the cost of Machinery

Required: Prepare trading profit and loss account for the period ending 31st December 1999

Adjustments: Provision for depreciation;

$$\text{Machinery} = \frac{5}{100} \times 250\ 000 = 7\ 500$$

(New balance of machinery = 250 000 – 7 500 = 242 500. The 242 500 is taken to the balance as Machinery (fixed asset), while 7 500 is taken to the trading profit and loss account as expenses)

$$\text{Motor vehicle} = \frac{10}{100} \times 150\ 000 = 15\ 000$$

(New balance of Motor Vehicle = 150 000 – 15 000 = 135 000. The 135 000 is taken to the balance as Motor Vehicle (fixed asset), while 15 000 is taken to the trading profit and loss account as expenses)

Paka Traders

Trading, Profit and Loss Account

Dr For the period 31/12/1995 Cr

	Shs	Shs		Shs	Shs
Opening stock		120 000	Sales	980 000	
add Purchases	600 000		Less Return inwards	80 000	
add Carriage inwards	40 000		Net sales		900 000

less Return Outwards	20 000	620 000		
Goods available for sale		740 00		
Less Closing Stock		100 000		
Cost Of Goods Sold (COGS)		640 000		
Gross profit c/d		260 000		
		900 000		900 000
Expenses			Gross profit b/d	260 000
Insurance		15000	Discount received	25 000
Carriage Outwards		30000	Rent income	45 000
Salaries		18 000	Commission received	12 000
Provision for Depreciation				
Motor vehicle	15 000			
Machinery	7 500	22500		
Discount allowed		15 000		
Commission allowed		7 000		342 000
Rent paid		60 000	Net profit b/d	174 500
Net profit c/d		174 500		
		342 000		

The net profit/loss may be taken to the balance sheet.
The items that have been adjusted will be recorded in the balance sheet less the adjustment.

The Balance Sheet

The balance sheet will show the business financial position in relation to assets, capital and liabilities. The adjustment that can be made will be on Fixed assets and capital only. That is;

Fixed assets are recorded less their depreciation value (should there be provision for depreciation) as the actual value.

Actual value of assets = Old value – depreciation.

Capital is adjusted with the following; Net capital, Drawings and additional investment. i.e.

Closing Capital/Net capital (C.C) = Opening/initial capital (O.C) + Additional Investment (I) + Net profit (N.P) or (less Net Loss) – Drawings

$$CC = OC + I + NP - D$$

Where:

Opening Capital: - the capital at the beginning of the trading period

Closing capital: - the capital as at the end of the trading period

Additional Investment: - any amount or asset that the owner adds to the business during the trading period

Net profit: - the profit obtained from the trading activities during the period. In case of a loss, it is subtracted.

Types of Capital

The capital in the business can be classified as follows:

- Capital Owned/Owner's Equity/Capital invested; - this is the capital that the owner of the business has contributed to the business. It is the Net capital/Closing capital of the business (C = A – L)
- Borrowed capital: - the resources brought into the business from the outside sources. They are the long term liabilities of the business.
- Working capital: - these are resources in the business that can be used to meet the immediate obligation of the business. It is the difference between the total current assets and total current liabilities

  Working Capital = Total Current Assets – Total Current Liabilities
- Capital employed: - these are the resources that has been put in the business for a long term. i.e.

  Capital Employed = Total Fixed assets + Working Capital

  Or

  Capital employed = Capital Invested + Long term liabilities

Name of the business

Balance Sheet

As at (date)

	Shs	shs		Shs	shs
Fixed Assets					
Land		xxxxx	Capital	xxxxx	
Buildings		xxxxx	Add Net profit	xxxx	
Motor Vehicle		xxxxx	Add additional investt	xxx	
Any other fixed assets		xxxxx	Less drawings	xxx	
xxxxxx			Net Capital		xxxxx
Current Assets			Long term liabilities		
Stock		xxxx	Long term loan	xxxx	
Debtors		xxxx	Any other	xxxx	xxxx
Bank		xxxx	Current liabilities		
Cash		xxxx	Creditors	xxxx	
Prepaid Expenses		xxxx	Short term loan	xxxx	
Accrued revenues		xxxx	Accrued expenses	xxxx	
Any other current assets		xxxx	Prepaid revenues	xxxx	

xxxxxx ________	Any other xxxx
	xxxxx ______ ________
	xxxxxx
xxxxxx	

Example 00A: The following information were extracted from the trial balance of Mwema traders on 31st December 2010

Sales	750 000	Furniture	288 000
Purchases	540 000	Electricity expenses	16 000
Sales return	24 000	Motor vehicle	720 000
Return outwards	30 000	Rent expenses	2 500
General expenses	72 000	Capital	842 500
Commission received	24 000	Bank Loan	250 000
Cash	156 000	Creditors	216 000
Debtors	244 000		

Additional Information

a) Stock as at 31/12/2010 was ksh 72 000
b) Electricity prepaid was shs 4 000
c) Rent expenses accrued shs 3500
d) Depreciation was provided for as follows
-Motor Vehicle 15% p.a. on cost -Furniture 6% p.a. on cost

Required

(i) Prepare Trading, profit and loss account for the year
(ii) Prepare a balance sheet as at 31st December 2012
(iii) Determine the following:
-Owner's equity -Borrowed capital -Working capital -Capital employed

Adjustments:

Motor Vehicle = $\frac{15}{100} \times 720\ 000 = 108\ 000$

Therefore Motor vehicle = 612 000

Furniture = $\frac{6}{100} \times 288\ 000 = 17\ 280$

Therefore furniture = 270 720

Mwema Traders
Trading, Profit and Loss Account

Dr For the period 31/12/2010 Cr

	Shs	Shs		Shs	Shs
Purchases	540 000		Sales	750 000	
less Return Outwards	30 000	510 000	Less Return inwards	24 000	
Goods available for sale		510 000	Net sales		
Less Closing Stock		72 000	726 000		
Cost Of Goods Sold (COGS)		438 000			
Gross profit c/d		288 000			
		726 000			
Expenses					726 000
General expenses			Gross profit b/d		288 000
72 000			Commission received		24 000
Electricity expenses	16 000				
Less Electricity prepaid	4 000				
12 000					
Rent expenses	2 500				
Accrued rent exp	3 500	6 000			
Provision for Depreciation					
Motor vehicle	108 000				
Furniture	17 280	125 280			
Net profit c/d		96 720			312 000
		312 000	Net profit b/d		96 720

Mwema Traders
Balance Sheet
As at 31/12/2010

	Shs		Shs
shs		shs	
Fixed Assets		Capital	842 500
Motor Vehicle	612 000	Add Net profit	96 720
Furniture	270 720	Net Capital	
882 720		939 220	
Current Assets		Long term liabilities	

Stock	72 000		Bank Loan		250
Debtors	244 000		000		
Electricity prepaid	4 000				
Bank	50 000		Current liabilities		
Cash	156 000	526 000	Creditors	216 000	
			Accrued rent	3 500	219 500
		1 408 720			
					1 408 720

Basic Financial Ratios

A ratio is an expression of one item in relation to the other. It is used to compare the groups of related items in the business, for the purpose of assessing the performance of the business. They include:

a) Mark-up

This is the comparison of gross profit as a percentage of cost of goods sold. i.e.

$$\text{Mark-up} = \frac{Gross\ Profit}{Cost\ of\ Goods\ Sold} \times 100$$

$$= \frac{G.P}{COGS} \times 100$$

For example: in (example OOA) above, determine the mark-up of the business.

$$\text{Mark-up} = \frac{Gross\ Profit}{Cost\ of\ Goods\ Sold} \times 100$$

Gross profit = 288 000

COGS = 438 000

$$\text{Mark-up} = \frac{288\,000}{438\,000} \times 100$$

$$= 65.75\%$$

(This implies that the Gross profit of the business is 65.75% of its cost of goods sold)

b) Margin

This is the expression of the gross profit as a percentage of net sales. That is:

$$\text{Margin} = \frac{Gross\ Profit}{net\ sales} \times 100$$

$$= \frac{G.P}{sales} \times 100$$

For example: in (example OOA) above, determine the margin of the business

$$\text{Margin} = \frac{Gross\ Profit}{net\ sales} \times 100$$

Gross profit = 288 000

Net sales = 726 000

$$= \frac{288\,000}{726\,000} \times 100$$

$= 39.67\%$

(This implies that the gross profit of the business is 39.67% of the net sales)

Relationship between margin and mark-up

Since margin and mark-up are all the expression of Gross profit, it is possible to change one to the other.

- Changing mark-up to margin

Mark-up can be changed to margin as follows:

(i) Convert the mark-up percentage as a fraction in its simplest form.

(ii) Add the value of the numerator of the fraction to the denominator to come up with the new fraction (margin fraction) that is

If the mark-up fraction $= \frac{a}{n}$

Margin fraction $= \frac{a}{n+a}$

(iii) Convert the margin fraction as a percentage to obtain margin

For example: in the above example,

Mark –up = 65.75%

$= \frac{65.75}{100}$

$= \frac{263}{400}$

Margin fraction $= \frac{263}{400+263}$

$= \frac{263}{663}$ x 100

$= 39.67\%$

- Changing margin to mark-up

(i) Convert the margin percentage as a fraction in its simplest form

(ii) Subtract the value of the numerator of the fraction from the denominator to come up with the new fraction (mark-up fraction) that is

If the margin fraction $= \frac{a}{n}$

Mark-up fraction $= \frac{a}{n-a}$

(iii) Convert the mark-up fraction as a percentage to obtain mark-up

For example: in the above example,

Margin = 39.67%

$= \frac{39.67}{100}$

$= \frac{263}{663}$

Mark-up fraction $= \frac{263}{663-263}$

$$= \frac{263}{400} \times 100$$
$$= 65.75\%$$

c) Current ratio/working capital ratio

This is the ratio of the current assets to current liabilities. It can also be expressed as a percentage. That is:

$$\text{Current ratio} = \frac{\textit{current assets}}{\textit{current liabilities}}$$
$$= \text{current assets: current liabilities}$$

Or

$$\text{Current ratio} = \frac{\textit{current assets}}{\textit{current liabilities}} \times 100$$

For examples: in (example **OOA**) above, determine the current ratio;

Current assets = 526 000
Current liabilities = 219 500

$$\text{Current ratio} = \frac{\textit{current assets}}{\textit{current liabilities}}$$

$$= \frac{526\,000}{219\,500} \quad = 1052: 439$$

Or

$$= \frac{526\,000}{219\,500} \times 100$$
239.64%

d) Rate of stock turnover

This is the rate at which the stock is bought or sold within a given period of time. It is obtained by;

$$\text{Rate of stock turnover (ROST)} = \frac{\textit{cost of goods sold}}{\textit{average stock}}$$

$$\text{Average stock} = \frac{\textit{opening stock+closing stock}}{2}$$

In (**example OOA**) above, determine the rate of stock turnover;

The cost of goods sold = 438 000
The closing stock = 72 000
The opening stock = 0
Therefore

$$\text{The average stock} = \frac{\textit{opening stock+closing stock}}{2}$$
$$= \frac{0+72\,000}{2} = 36\,000$$

$$\text{Rate of stock turnover (ROST)} = \frac{\textit{cost of goods sold}}{\textit{average stock}}$$

$$= \frac{438\ 000}{36\ 000}$$

= 12.17 Times

e) Return on capital

This is the expression of net profit as a percentage of the capital invested. That is;

$$\text{Return on capital} = \frac{net\ profit}{capital\ invested} \times 100$$

It can be given as a ratio or a percentage.

For example: in (example OOA) above, determine the return on capital of the business

Net Profit = 96 720

Capital invested/owner's equity = 939 220

$$\text{Return on capital} = \frac{net\ profit}{capital\ invested} \times 100$$

$$= \frac{96720}{939220} \times 100$$

= 10.33%

f) Acid test ratio/quick ratio

This shows how fast the business can convert its current assets excluding stock to settle its current liabilities. That is;

$$\text{Quick ratio} = \frac{current\ aassets - closing\ stock}{current\ liabilities}$$

It is given in ratio form.

For example: in above (example OOA), determine the quick ratio;

Current assets = 526 000

Stock = 72 000

Current liabilities = 219 500

$$\text{Quick ratio} = \frac{current\ aassets - closing\ stock}{current\ liabilities}$$

$$= \frac{526\ 000 - 72\ 000}{219\ 500}$$

= 2.07 (or 207 : 100)

Importance of Financial Ratios

- ❖ Mark up and margin helps in the following; setting the selling price, calculating profit or losses and determining the sales for a given period of time
- ❖ Working capital and acid test ratio help in showing whether the business is in a position to meet its short term obligations and checking whether

the business is utilizing its resources properly. That is high working capital ratio shows that most of the resources are idle

❖ Return on capital shows the following;
- The performance of the business in relation to other similar businesses
- Comparison of the performance of the business over different periods
- Whether the business finances have been invested or not
- Help the potential investors on the decision on where to invest

❖ Rate of stock turnover also help in determining how fast or slow the stock is moving. It also helps in computing the gross profit or loss.

MONEY AND BANKING

Barter trade

This is a form of trade where goods and services are exchanged for other goods and services.

Benefits

1. **Satisfaction of wants:** And individual is able to get what he or she needs.
2. **Surplus disposal:** an individual or country is able to dispose off its surpluses.
3. **Social relations:** it promotes social links since the communities trade together.
4. **Specialization:** some communities shall specialize in a particular commodity.
5. **Improved living standards:** this is enhanced by receiving what one is unable to produce.

Limitations of Barter trade

(i) **Lack of double coincidence of wants: -** it is difficult to find two people with the need for each other's product at the same time.

(ii) **Lack of store of value/ perishability of some commodities: -** some goods are perishable thus their value cannot be stored for a long time for future purposes e.g. one cannot store vegetables for exchange purposes in future.

(iii) **Indivisibility of some commodities:** -it is difficult to divide some products like livestock into smaller units to be exchanged with other commodities.

(iv) **Lack of standard measure of value: -** It is not easy to determine how much one commodity can be exchanged for a given quantity of another commodity.

(v) **Transportation problem:** It is difficult to transport bulky goods especially when there is no faster means of transport.

(vi) **Lack of a standard deferred payment: -** The exchange of goods cannot be postponed since by the time the payment is made, there could be fluctuation in value, demand for a commodity may not exist and the nature and quality of a good may not be guaranteed. It may be therefore difficult what to decide what to accept for future payment.

(vii) **Lack of specialization: -** Everyone strives to produce all the goods he or she needs due to the problem of double coincidence of wants.

(viii) **Lacks unit of account-** it is difficult to assess the value of commodities and keep their record.

MONEY SYSTEM

Money is anything that is generally accepted and used as a medium of exchange for goods and services.

Features/ characteristics of Money

For anything to serve as money, it must have the following characteristics:

- ✓ **Acceptability:** The item must be acceptable to everyone.
- ✓ **Durability**: The material used to make money must be able to last long without getting torn, defaced or losing its shape or texture.
- ✓ **Divisibility:** Money should be easily divisible into smaller units (denominations) but still maintains it value.
- ✓ **Cognizability:** The material used to make money should be easily recognized. This helps reduce chances of forgery. It also helps people to differentiate between various denominations.
- ✓ **Homogeneity:** Money should be made using a similar material so as to appear identical. This eliminates any risk of confusion and forgeries.
- ✓ **Portability: -** Money should be easy to carry regardless of its value.
- ✓ Stability in value: The value of money should remain fairly stable over a given time period.
- ✓ **Liquidity: -** it should be easily convertible to other forms of wealth (assets).
- ✓ **Scarcity: -** It should be limited in supply. If it is abundantly available its value will reduce.
- ✓ **Malleability-** the material used to make money should be easy to cast into various shapes.

✓ **Not easy to forge-** money should not be easy to imitate.

Functions of Money

(i) **Medium of exchange:** It is generally acceptable by everyone in exchange of goods and services. It thus eliminates the need for double coincidence of wants.

(ii) **Store of value:** It is used to keep value of assets e.g. surplus goods can be sold and then money kept for future transactions.

(iii) **Measure of value**: Value of goods and services are expressed in money form. Performance of businesses is measured in terms of money.

(iv) **Unit of account:** It is a unit by which the value of goods and services are calculated and records kept.

(v) **Standard of deferred payment:** it is used to settle credit transactions.

(vi) **Transfer of immovable items (assets):** Money is used to transfer assets such as land from one person to another.

DEMAND FOR MONEY

This is the tendency or desire by an individual or general public to hold onto money instead of spending it. It also refers to as liquidity preference.

Money is held by people in various forms:

- Notes and coins
- Securities and bonds
- Demand deposits such bank current account balances.
- Time deposits such as fixed account balances

REASONS (MOTIVES) FOR HOLDING MONEY

1. **Transaction Motive:** Money is held with a motive of meeting daily expenses for both the firms and individuals. The demand for money for transaction purpose by individuals depends on the following factors:

- Size/level of individual's income: The higher the income of and individual, the more the number of transactions thus high demand for transactions.
- Interval between pay days/ receipt of money: if the interval is long, then high amount of money will be held for transaction reasons.
- Price of commodities: if the prices are high, the value of transactions will also increase thus more money balances required.
- Individuals spending habits-people who spend a lot of money on luxuries will hold more money than those who only spend money on basics.
- Availability of credit-people who have easy access to credit facilities hold little amount of money for daily transactions than those who do not have easy access to credit.

The transaction motive can further be divided to;

- **Income motive i.e.** holding money to spend on personal/ family needs.
- **Business motive i.e.** holding money to meet business recurring needs such as paying wages, postage, raw materials. Etc

2. **Precautionary Motive:** Money is held in order to be used during emergencies such as sicknesses.

The amount of money held for this motive will depend on the factors such as:

- **Level of income-** the higher the income the higher the amount of money held for precautionary motive.
- **Family status-** high class families tend to hold more money for precautionary motive than low class families.
- **Age of the individual-** the aged tend to hold more money for precautionary motive than the young since they have more uncertainties than the young.
- **Number of dependant-** the more the dependants one has, the more the money they are likely to hold for precautionary motive.
- **Individual's temperament-** pessimists tend to hold more money for precautionary motives than the optimists because they normally think things will go wrong.
- **Duration between incomes-** those who earn money after a short time are likely to keep less money than those who earn money after a long time.

3. **Speculative Motive:** Money is held to be used in acquiring those assets whose values are prone to fluctuations such as shares/ money is held anticipating fall in prices of goods and services. This depends on the following:

- The wealth of an individual
- The rate of interest on government debt instruments
- Interest on money balances held in the bank.
- How optimistic or pessimistic a person is.

SUPPLY OF MONEY

This is the amount of money/ monetary items that are in circulation in the economy at a particular period of time. They include the following;

1. Total currency i.e. the coins and notes issued by the central bank.
2. Total demand deposits: money held in current accounts in banks and are therefore withdrawable on demand.

Factors influencing supply of money

- **Government policies:** If there is more money in the economy, the government will put in place measures to reduce the supply such as increasing interest rates.
- **Policies of commercial banks:** The more the loans offered by commercial banks, the more the amount of money in circulation.
- **Increase in national income:** increase in national income means that more people will be liquid due to increase in economic activities.]
- **Increase in foreign exchange:** The foreign exchange reserves will increase thus supply increases.

BANKING

This is the process by which banks accept deposit from the public for safe keeping and lending out the deposits in form of loans.

A bank is a financial institution that accepts money deposits from the public for safe keeping and lending out in terms of loans.

COMMERCIAL BANKS

These are financial institutions that offer banking services with a profit motive. Their activities are regulated by the Central bank.

Functions of commercial banks

i. **Accepting deposits:** They accept deposit from members of the public inform of current accounts, savings account and fixed deposit accounts. Such accounts help individuals to keep money safely.
ii. **Provision of safe means of payments:** They provide safe and reliable means of payment such as cheques, bank drafts, credit transfers, electronic funds transfers etc.
iii. **Provision of loan facilities:** They provide loans to members in form of short term and long term. These loans are repayable with interests thus income to the banks.
iv. **Facilitates foreign exchange payments:** They provide foreign exchange that is used in international trade. They also make payments on behalf of their customers.
v. **Provision of safe keeping of valuables:** They provide security for valuables to their customers at a fee
vi. **Discounting bills of exchange:** This is process by which a bank accepts bills of exchange and promissory notes from its customers in exchange of cash less than the face value of the bill or note.

vii. **Provision of financial information: -** They advice their clients on financial matters affecting their businesses such as investment option and wise use of loans.

viii. **Money transfer:-** They provide varied, safe and reliable means of money transfer. Such means include cheques, standing orders, credit transfers, bank drafts, letters of credit, credit cards, travelers cheques etc.

ix. **Act as guarantors and referees: -** They act as guarantors to their customers who want to acquire credit facilities from other financial institutions.

x. **Act as intermediaries: -** They act as a link between the savers and borrowers.

xi. **Credit creation: -** This is the process of creating money from the customer deposits through lending.

xii. **Provision of trusteeship: -** They can manage a business on behalf of the client especially if the client does not have managerial skills. They can also manage the assets of the deceased client if there was no will.

TYPES OF ACCOUNTS OFFERED BY COMMERCIAL BANKS

1. Current account

This is an account where money deposited can be withdrawn on demand by the customer by means of a cheque. This means that money can be withdrawn at any time during the official working hours so long as the account has sufficient funds.

This account is also referred to as demand deposits.

Features characteristics of current accounts

- ✓ Deposits of any amount can be made at any time.
- ✓ Balances in this account do not earn any interest.
- ✓ The account holder is not required to maintain a minimum cash balance in this account
- ✓ Withdrawals can be at any time without giving and advance notice as long as the customer has sufficient funds.
- ✓ Cheque books are issued to the account holder to be used as a means of payment/ cheques are usually used to withdraw money from the account.
- ✓ Monthly bank statements are issued to the account holder.
- ✓ Overdraft facilities are offered to the account holders' i.e the bank can allow customers to withdraw more money than they have in their accounts.

Advantages of current account

- No minimum balance is maintained hence the account holder can access all his/her money.

- Withdrawals can be made at any time.
- Transactions are made easier by use of cheques for example; one does not have to go to the bank in order to make payment.
- Overdraft facilities are available..
- It is possible to deposit any amount at any time during the office hours.
- Use of cheques as means of payment serves as evidence of payments made.
- Payments can be done even if there are insufficient funds in the account using post dated cheques.
- The account holder can withdraw any amount at any time without notice as long as there are sufficient funds in the account.

Disadvantages of current account

- Lengthy procedures of opening the account.
- The account holder does not earn any income since the balances in the current account does not earn interest.
- Initial deposit when opening the account is usually high hence discourages prospective customers.
- Customers are not encouraged to save since they can access their money at any time.
- Ledger fees are charged on the account making the operations of the account expensive.

2. Savings account (deposit account)

This is an account operated by individuals and firms that have money to save.

Features of Savings account

- ✓ There is minimum initial deposit that varies from bank to bank.
- ✓ A minimum balance is maintained at all times.
- ✓ The withdrawals are up to a certain maximum within a given period. Withdrawal above this maximum will require notice.
- ✓ Account holders are issued with a pass book or a debit card (ATM card) for deposits and withdrawals.
- ✓ Overdraft facilities are not allowed.
- ✓ Ordinarily, withdrawals across the counter can only be done by the account holder.
- ✓ The balance on the account above a certain minimum earns some interest.

Advantages of Savings account

- Customers are encouraged to save because of the restricted withdrawals.
- There are relatively low banking charges.
- Initial deposit is usually low as compared to other accounts.

- The balances earn interest to account holder hence an incentive to save.
- ATM facilities have made account operations very convenient to customers.

Disadvantages Savings account

- A minimum balance must be maintained at all times and the customer is denied access to that money.
- For across the counter withdrawals, it is only the account holder who can withdraw cash.
- Withdrawals are restricted and sufficient notice is required before large amounts are withdrawn.
- The account holders do not enjoy services such as cheque books and overdraft facilities like the current account holders.
- Easy access to the money through ATM cards encourages overdrawals.
- Anybody who knows the pin of the card (ATM card) can withdraw money from the account.

Requirements for opening an account

The following are some of the requirements for opening either a current account or a savings account:

i. Photocopies of identification documents such as National Identity Card or Passport.
ii. Passport size photographs (number varies from bank to bank). Some banks are nowadays taking the photographs instead of the customers providing them.
iii. For current account holders, an introductory letter from an existing customer from the prospective customer's employer.
iv. Filling in the application form provided by the bank.
v. Signing of the specimen signature cards. Usually two.

NB: Once these requirements are fulfilled, the bank allocates the customer an account number, upon payment of an initial deposit.

3. Fixed deposit account

This account is also known as **time Deposit account.** It is maintained by those who have money not meant for immediate use.

Once money is deposited, there are no withdrawals until the time expires.

Advantages of Fixed deposit account

✓ Interest earned is relatively high as compared to savings account.
✓ There are no bank charges to the account holder.

- ✓ Money held in fixed deposit account can be used as security to acquire bank loans.
- ✓ Restricted withdrawals encourage savings.
- ✓ The account holder has time to plan for the deposited money.

Disadvantages of Fixed deposit account

- ✓ Access to money is not allowed until the end of the agreed period.
- ✓ Interest is forfeited if there is pre-mature withdrawal.
- ✓ The minimum amount of money for this account is high.
- ✓ The customer is not allowed to deposit more money in this account.
- ✓ A notice is required if the customer wants to terminate the contract before expiry date.
- ✓ The customer is denied the use of the deposited funds before the expiry of the period.

REQUIREMENTS TO OPEN AND OPERATE A BANK ACCOUNT

1. Identification documents such as National Identification Card, Passport and Driving License.
2. Reference letter from employer or an existing customer.
3. Filling an application form giving the information about the customer.
4. Submission of a specimen signature to be held by the bank.
5. An initial deposit is paid and the account becomes operational.

NON- BANK FINANCIAL INSTITUTIONS

These are financial institutions that offer finances for development purposes to individuals and organizations.

These institutions address themselves to the needs of specific sectors in the economy.

They offer the finances inform of either short term or long term loans.

The following are some of the non-bank financial institutions in Kenya

- Development banks
- Building societies
- Finance houses
- Savings and Credit Co-operative Societies
- Micro finance organizations
- Insurance companies
- Pension Funds' Organizations
- Hire Purchase Firms

- **Housing Finance Companies**

They are mainly formed to finance housing activities that is they either put up houses and sell to the individuals or offer mortgage finance to those who wish to put up their own houses. They includes Housing Finance Corporation of Kenya (HFCK), National Housing Corporation (NHC)

- **Development Finance Institutions**

These are development banks which are formed mainly to provide medium term and long term finances, especially to the manufacturing sector. They perform the following functions

✓ Financing people who wishes to start either commercial of industrial enterprises, as well as the existing enterprises in the above sectors for expansion
✓ Offering training services through seminars and workshops to equip the entrepreneurs' with the relevant skill in industrial and commercial sectors
✓ Offer advisory services to those people wanting to start or expand their businesses
✓ Acting as guarantors to people wishing to take loan from other lending institutions to help them expand their business

They includes the following Kenya Industrial Estates (KIE), Development Finance Company of Kenya (DFCK), Industrial Development Bank (IDB), Industrial and Commercial Development Corporation (ICDC)

- **Savings and Credit Co-operative societies**

These are co-operative societies that are formed to enable members save and obtain loans at most conveniently and favorable conditions. They are formed by those engaged in similar activities. They includes: Mwalimu Savings and Credit Co-operative Societies; Afya Savings and Credit societies; Harambee Savings and Credit Societies

- **Insurance companies**

These are companies that assist in creating confidence and sense of security to their clients as well as offering financial assistance to their clients. Their functions include;

✓ Enable the policy holders to save through their schemes
✓ Provide finances to their policy holders in form of loans
✓ Offer guarantee services to the policy holders wishing to obtain loans from other non-bank financial institutions
✓ Provide advisory services to the policy holders on security matters
✓ Provide finances to meet the expenses incases of loans

They includes the following: Stallion Insurance Company; Madison insurance company; Blue shield insurance company

- **Micro Finance Companies**

These are financial companies formed to provide small scale and medium size enterprises with finance. They also carry out the following functions

✓Offer advisory services to their clients in matters such as business opportunities available and how to operate them.

✓Encourage the clients to carry out business activities by offering loans to them

✓They encourage the savings by advancing loans to the individual member of a certain group

✓They supervise, monitor and advise those whom they have given loans They includes the following: Kenya Women finance Trust (KWFT), Faulu Kenya

- **Agricultural Finance Houses**

These are institutions formed to promote the agricultural sector. They carry out the following

✓Giving loans to farmers

✓Offering supervisory and training services to the loaned farmer

✓Offering technical and professional advice to loaned farmer

✓Carry research and come up with better ways and means of agricultural sector

✓Coming up with projects that would open up new areas for agriculture

Differences between commercial banks and non-bank financial institutions

Commercial Banks	**Non-Bank Financial Institutions**
(i) Offer all types of accounts	(i) Offer only two types of accounts savings and fixed deposit
(ii) Provide both short term and medium term finances to their customers	(ii) Mainly provide medium term and long term finances
(iii) Their finance is not restricted to any sector	(iii) Their finance is restricted to a particular sector
(iv) May offer foreign exchange services	(iv) Do not provide foreign exchange services
(v) Their finance is mainly for working capital	(v) They provide capital for development
(vi) Participate in clearing house as	(vi) Do not participate in clearing house since they don’t offer

they offer cheque (vii) Offer facilities for safe keeping of valuable items such as title deeds (viii) Always in direct control of the central bank (ix) May offer overdraft facilities to their customers	(vii) Do not offer facilities for safe keeping of valuable items (viii) Not usually in direct control of the central bank (ix) Do not offer overdraft facilities to their customers

THE CENTRAL BANK

This is a bank established by the government through the act of the parliament to manage and control the monetary matters in the country. It was formed to perform the following functions;

- **Issue currency in the country**, which includes both new notes and coins to replace the worn-out ones
- **Banker to the commercial banks**, by ensuring that all the commercial banks in the country operate an account with them
- **Being the government 's bank**, by offering banking services to the government which enables the government to operate an account with them
- **Advisor to the government on financial issues** in the economy
- **Controller of the commercial banks** on how they carry out their functions in the economy to ensure that their customers are served well
- **Provide links with other central banks in other countries**, facilitating financial relationships. It also provide a link between the country and other financial institutions such as IMF
- Maintain stability in the exchange rates between the local currencies and the foreign ones.
- **Act as the lender of the last resort** to the commercial banks to enable them meet their financial obligations when need arise
- **Facilitates the clearing of cheques** between different commercial banks through its clearing house (a department in the central bank)
- **Administering of the public debt** by facilitating the receipt and providing a means through which the government pays back the borrowed money
- **Control of the monetary system in the country in order to regulate the economy**. In doing this they put in place **various monetary policies** that can either expand the economic activities in the country or depress them.

Monetary policy refers to the deliberate move by the government through the central bank to manipulate the supply and cost of money in the economy in order to achieve a desirable economic outcome. They do this through the use of various tools of monetary policies which includes the following: Bank rates; Open market Operation (OMO); Cash Liquidity ratio requirement; Compulsory deposit requirement; Selective credit control; Directives; Request.

- ✓ **Bank rates**

They may increase or decrease the interest rate at which they lend to the commercial banks to enable them increase or decrease the rate at which they lend money to their customers in the economy to enable the government achieve the desirable economic development in the country

When they increase their lending interest rate, the commercial banks also raise their lending rates to the consumers to reduce the number of people obtaining loans, leading to a reduction of money supplied in the economy.

When they decrease their lending interest rate, the commercial banks also decreases their lending rates to the consumers, increase the amount of money supplied in the economy

- ✓ **Open Market Operations (OMO)**

This is where they regulate the supply of money in the economy by either selling or buying the government securities (treasury bills or bonds) in the open market. That is when they want to increase the supply in the economy, they buying the securities from the members of the public who had bought them to increase more supply of money in the economy.

When they want to reduce the amount of money in circulation they will sell the government security to the public in the open market, to mop up/reduce the excess supply in the economy

The payment of the securities takes money from the individuals accounts in the commercial banks, reducing the amount that the individual can use in the economy, while when buying the central bank pays the security holders in their respective accounts in the commercial banks, increasing the amount that they can use in the economy

- ✓ **Cash/liquidity ratio requirement**

Here the central bank expect the commercial bank to keep a certain proportion of their total deposits in form of cash to enable them meet their daily needs, while the rest are held in liquid assets. This proportion can be reduced by the central bank to reduces the amount of money held by the commercial banks in order to reduce the amount of money spent by the commercial banks in cash, reducing the amount of money in supply, or they may increase the proportion to be held by the commercial banks to enable them increase the amount of money they spent in cash, increasing the amount of money in supply

$$\textbf{Cash ratio} = \frac{\textit{Cash Held}}{\textit{Total Deposits}}$$

- ✓ **Compulsory deposit requirements**

The commercial banks are required to maintain a certain amount of deposits with the central bank which will be held in a special account where the money stays frozen. This reduces the amount of money that the commercial banks hold and are able to spend in their operation, influencing the supply of money in the economy.

The deposit may be increase to reduce the amount of money in the commercial banks, or reduced to increase the amount of money in the commercial banks

- ✓ **Selective credit control**

The central bank may issue a special instruction to the commercial bank and other financial institution only to lend more in a particular sector to control the amount of money reaching the economy. The instruction may be removed, if the bank feels that the supply in the economy has reduced and needs to be increased

- ✓ **Directives**

The central bank may issue a directive to the commercial banks on the interest rate they should charge on their lending and to increase or reduce the margin requirement for borrowing to make it harder or easier for the customers to obtain loan.

Margin requirement is the proportion of money expected to be raised by the client to finance the project he/she wants to obtain the loan for, before being given a loan to complete the project with.

- ✓ **Request (Moral suasion)**

The central bank may appeal to other financial institutions to exercise restrain in their lending activities to the public to help in controlling the money supply

Trends in Banking

These are the positive changes that have taken place in the banking sector to improve their service deliveries to their customers. They include;

1. **The use of Automatic Teller Machines** (ATMs), which has made it possible for the customers to access their money any time of the day. The ATM cards that are used for withdrawals from the ATM machines can also be used as a debit card to make purchases.
2. **Networking all their branches**, which has enable the customers to carry out their transactions in any of the branch.

3. **E-Banking,** which is the banking through the internet. This has made it possible for the customers to transact their financial businesses on-line.
4. **Relaxation of some of the conditions on opening and operating some of the accounts** to make them be more attractive to their customers.
5. **Offering varieties of products** which includes easier credit facilities to their customers to attract more customers.
6. **Liberalization of foreign exchange dealings by licensing forex bureaus** to offer services to the customers, improving the accessibility to the service.
7. **Improving the customers care services**, with some bank setting up a departments known as the customer care department to offer detailed assistance to their customers.
8. **Allowing non bank financial institutions to offer banking services** to the members of the public, for example; KWFT, SACCOs, FOSA, Faulu Kenya, etc
9. **Mobile Banking services (M-Banking),** which allows the customers to carry out their financial transactions over their mobile phones. It has brought about several benefits/ advantages to their customers which includes;

Advantages of m-banking

- Easy transfer of funds from one account to the other in the same bank (inter account transfer)
- Easy transfer of money from ones account to his mobile phone for other transactions
- Ability to check ones account balance in the bank with ease
- Easy to monitor your financial transactions by checking your transaction details over the phone
- Easy payment of the bills such as electricity bill, Dstv bills, etc and other wages
- Ability to transfer money from one mobile number to other in collaboration with the service providers
- Easy request for new cheque books and bank statements from the banks
- Able to top up air time to your mobile phones in collaboration with the service providers
- Reduced risk of carrying large sums of money in cash or cheques that may be stolen

However this development has also come with its challenges, which includes:

Disadvantages of m-banking

- Registration to enjoy all these services must physically be done in the banking hall, which subject the customers to stress queues of the bank
- Only the registered mobile number can carry out these transactions which limits the customer to only using one number
- Users requires a mobile phone with a screen that can display the transaction which a times some may not a ford
- Mobile phones can easily be lost or stolen from the owner, inconveniencing him from carrying out the transactions
- Bank transaction information may load slowly, which may makes it expensive for the user
- Possibility of transferring the funds to a wrong account, due to error in typing of the account number

❖ Introduction of agency banking, which has made them to make their services to be more accessible to even areas where they may have not put up a banking hall.

Agency banking is whereby a retail stores, supermarket, or any other commercial businesses are authorized by the financial institutions to carry out financial transactions on their behalf. They may offer the following services

- Receiving customer deposits
- Offering withdrawal services
- Transfer of funds for customers
- Pay bills for the customers
- Balance inquiry services
- Opening new accounts for the customers
- Fill loan application forms for them

Advantages of agency banking

✓ Reduction of set up and delivery cost to the banks, which in turn passes to the customers in form of reduced cost of accessing services

✓ Time saving as the agents are located close to the customer and the customer may carry out other transactions as he withdraw the money

✓ More convenient for the customer to bank with their local retailers other than the traditional banking halls

✓ Enable the bank to reach far places within the country

REVISION EXERCISES

PAPER 1

1. Give four advantages of barter trade.
2. Highlight four services offered by the central bank of Kenya to the commercial banks.
3. State four methods through which commercial banks can transfer money.
4. State any four current developments that have taken place in the banking sector.
5. Outline four tools of monetary policy used by the central bank to control money supply.
6. Outline four factors that may have led to the downfall of barter trade.
7. Highlight two factors that may influence:
   a. Transaction motive.
   b. Speculative motive.
8. Mention four functions of commercial banks in an economy.
9. Outline three factors that influence the supply of money.
10. Give four characteristics of money.
11. The following are some of the accounts available to customers in Kenya banking industry: Current account, Savings account and Fixed deposit account. Give the account that corresponds to each of the description given below.

	Description	**Type of account**
(a)	Account holders required to deposit a specific initial amount as well as maintaining a minimum balance.	
(b)	Account holders may deposit and withdraw money whenever they want without maintaining a minimum balance.	
(c)	Banks pay interest on deposit at comparatively higher rates.	
(d)	Money may be deposited at any time and interest is earned if a specific balance is maintained.	

12. Outline four benefits that accrue to a customer who uses automated teller machine (ATM) banking services.

PAPER 2

1. Explain five functions of the central bank of Kenya.
2. Describe four measures that the government may put in place to reduce the amount of money in circulation.
3. Explain five services offered by commercial banks to their customers.
4. Explain five ways in which commercial banks facilitate payment on behalf of their customers.
5. Explain four services that the central bank of Kenya may offer as a banker to commercial banks.
6. Explain five in which banks contribute to the development of Kenya
7. Outline five reasons why banks currently account is popular with traders
8. Explain service offered to commercial banks by the central bank of Kenya
9. In what ways of the functions of commercial bank differ with those of non- bank Financial institutions
10. Explain five ways in which central bank of Kenya may control the supply of money in The country
11. Describe methods which may be used by commercial banks to advance money to customers.
12. A businessman wishes to obtain a loan from a commercial bank. Highlight the Conditions that he should satisfy before the bank can grant him the loan
13. Explain five services that the central bank of Kenya offers to commercial bank Explain four disadvantages of using a bank overdraft as a source of finances
14. Describe four ways in which a non- bank financial institutions differ from the commercial banks
15. Discuss five reasons why business people prefer to operate bank current accounts
16. Outline the benefits that bank customer gets from operating a current account Explain the 5 services offered by a commercial banks to their customers

PUBLIC FINANCE

Public finance refers to the activities carried out by the government associated with raising of finances and the spending of the finances raised (it is the study of how government collects revenue and how it spends it)

The components of public finance are;

i. Public revenue

ii. Public expenditure
iii. Public debt

i. Public revenue-refers to the revenues (income) and resources received by the government from different sources.

ii. Public expenditure-refers to the resources spent by the government.

iii. Public debt-refers to the money and resources borrowed by the government.

Purpose of public finance

i. **Provision of essential goods and services.** The government has a responsibility of providing its citizens with essential goods and services such as security,health,schools,drought control, law e.t.c such facilities and services may not be adequately covered by the private sector because of the high costs involved and risks.

ii. **Encouraging consumption of certain commodities-**The government may encourage consumption of certain commodities e.g. maize by subsidizing on their productions or lowering their taxes.

iii. Controlling consumption of certain commodities-The government may also encourage consumption of some commodities e.g. cigarettes and alcohol by imposing heavy taxes on them.

iv. Promotion of Balanced regional development-This may be done by initiating economic projects in areas that are under developed/lagging behind.

v. **Wealth Redistribution-**This is done by heavily taxing the rich and using the money raised to provide goods and services that benefit the poor

vi. To promote economic stability-Economic instability may be caused by factors such as unemployment. Such problems can be solved through public expenditure in projects that generate employment such as ‘kazi kwa vijana’

vii. **Creation of a conducive Business Environment-**Through public expenditure, the government may develop infrastructure such as roads, electricity, security e.t.c thereby creating a conducive environment for businesses to thrive in.

viii. To raise government revenue-Through public finance, the government raises revenue which it uses in provision of essential goods and services to the public.

ix. **Improving balance of payment-**This may be done by improving heavy taxes such as customs duty to discourage importation.

Sources of public finance

There are two major sources of public finance i.e.

i. Public revenue
ii. Public debt (government borrowing)

i. **Public revenue-**This is the income that the government gets from its citizens. The main sources of public revenue are:

a. **Tax:** This is a compulsory payment levied by the government on individuals and firms without any direct benefit to the payer.
b. **Fines and penalties-**These are the charges imposed on individuals, firms and corporations who break the laws of the country.(offenders)
c. **Fees;** These are the payments charged by the government for the direct services it renders to its people e.g. road licence fee, marriage certificate fee and import licence fee.
d. **Rent and rates:** Charged on use of government properties e.g. game parks, forests e.t.c
e. **Eschiats:** Income obtained from properties of persons who die without legal heirs or proper wills. Such people's properties are taken over by the state.
f. **Dividends and profits:** These are the income received from the government direct investments e.g. income/surplus from public corporations.
g. **Interest from loans-**This is the interest on loans advanced by the government to firms and individuals through its agencies such as ICDc,AFC e.t.c
h. **Proceeds from scale of government property.**

g.Public debt (Government borrowing)-This is the money that the government borrows when public revenue is insufficient to meet all its financial obligations.

Government borrowing is also referred to as national debt. It includes all outstanding borrowing by the central government, local authorities and government corporations.

These are two majorly two sources of public debts:

a. Internal borrowing
b. External borrowing

a. Internal borrowing

This refers to borrowing by government from firms and individuals within the country. This may be done through:
Open market operation; the government sells its securities such as treasury bonds and treasury bills. This however has a disadvantage of causing 'crowding out effect' where the government leaves the private investors with little to borrow from.

b. External borrowing

This refers to government borrowing from external sources. It may either be on a bilateral or multilateral basis.
Bilateral borrowing is where the government borrows directly from another country.
Multilateral borrowing is where the government borrows from international financial institutions such as international monetary fund (IMF), World Bank, African Development bank e.t.c.such bodies get finances from various sources which they lend to their member countries who are in need of such funds.
Generally, external borrowing has strings attached. The borrowing country is expected to meet some set conditions, sometimes adversely affecting some sectors of the economy.
The total internal borrowing (internal debt) added to the total external borrowing (external debt) constitutes the national debt.

Classes of public (National debt)

These are two classes of national debt:

i. Reproductive debt
ii. Dead-weight debt.

i. Reproductive debt

This is borrowed money used to finance project(s) that can generate revenue. Such projects, once started may become self sustaining and may contribute towards servicing/repaying the debt. E.g. money used to finance irrigation schemes, electricity production e.t.c.

ii. Dead-weight debt

This is borrowed money that is used to finance activities that do not generate any revenue. Examples are money used to finance recurrent expenditure e.g. payment of salaries or for famine relief e.t.c
Dead-weight debt is a burden to members of the public since they are the ones who are expected to contribute towards its repayment.

Factors to consider before the government decides whether to borrow internally or externally

This refers to how the government spends the finances it has raised on behalf of its citizens.

Categories of government expenditure

a) Recurrent expenditure
b) Development expenditure
c) Transfer payments.

a. **Recurrent expenditure**

This refers to government spending that takes place regularly e.g. payments of salaries to civil servants, fuelling of government vehicles e.g.

Every financial year, the government must allocate funds to meet such expenditure.

Recurrent expenditure is also known as consumption expenditure.

b. **Development expenditure**

This is also referred to as capital expenditure .It is government spending on projects that facilitate economic development. Such projects includes construction of railway lines, roads, airports, rural electrification e.t.c

Once completed expenditure on such projects ceases and may only require maintenance.

c. **Transfer payments**

This is expenditure on things/people who do not directly contribute to a country's national income. Such expenditure include money spent on famine relief, pension, bursaries e.t.c

PRINCIPLES OF PUBLIC/GOVERNMENT EXPENDITURE

These are the considerations that are necessary before any expenditure can be incurred by the government.

They include:

a) **Sanctions:** Every public expenditure must be approved by the relevant authority like parliament.
b) **Maximum social benefit:** Any public expenditure must be incurred in such a way that majority of the citizens are able to reap maximum benefit from it e.g. improved living standards and quality of life.
c) **Flexibility /elasticity-**The policy on public expenditure should be flexible enough to meet prevailing economic situations i.e. it should be possible to increase or decrease the expenditure on projects depending on the prevailing circumstances e.g. during drought, it should be possible to spend on famine relief.

d) **Economy-**public expenditure should be planned carefully and prudently to avoid any possible waste.
e) **Proper financial management (Accountability)-**public funds should be well managed. This should be facilitated by maintenance of proper records which should be audited as required.
f) **Productivity-**The biggest proportion of public expenditure should be spent on development projects and less on non-development projects.
g) **Equity-**Government expenditure should be distributed equitably to all sectors of the economy in order to reduce income and wealth inequalities.
h) **Surplus-**Surplus revenue collected should be saved for emergencies or for when collection of revenue is below projections.

TAXATION

Tax: is a compulsory payment by either individuals or organizations to the government without any direct benefit to the payer.

Taxation-refers to the process through which the government raises revenue by collecting taxes.

Purposes/reasons for taxation

i. Raising revenue for government expenditure. This is the main reason for taxation.
ii. Discouraging /controlling consumption of certain commodities e.g. alcohol and cigarattes which are considered to be harmful.
iii. Discouraging importation of certain commodities in order to protect local industries. This is done by imposing heavy taxes on such commodities.
iv. Controlling inflation. Taxation reduces money supply by reducing peoples 'disposable' income thereby controlling inflation.
v. Reducing inequality in income distribution; this is done by taxing the rich heavily and using the finances raised in provision of goods and services that benefit the poor.
vi. Influencing locations of businesses. This is done by taxing businesses located in urban areas heavily and those in rural areas lightly hence businesses moving to rural areas.
vii. Correcting unfavorable balance of payments. High taxes are imposed on imported commodities thereby discouraging their importation leading to an improvement in the balance of payments.
viii. To protect the key selectors of the economy such as the agricultural sector, by stimulating their growth.

Factors that determine the amount of money raised through taxation

i. Distribution of incomes
ii. Social and political factors
iii. Honesty and efficiency of tax authorities
iv. Citizens level of real income
v. Economic structure of the country i.e. relative size of the country's commercial and subsistence sectors.

Principles of taxation

These are the characteristics that a good tax system should have. They are also referred to as the cannons of taxation.

A good tax system should be;

j. Equitable/principle of equity-Every subject of the state should pay tax in proportion to their income. A tax system should therefore have horizontal and vertical equity.

Horizontal equity means that those at the same level of income and circumstances should pay the same amount of tax.

Vertical equity means that those earning higher incomes should pay proportionately higher amounts of tax than those earning less.

k. Certain/principle of certainty-The tax that an individual should pay should be clear in terms of the amount, time and manner in which it should be paid. The government should also be fairly certain of the amount of tax expected so that planning can be easier.
l. Convenient/principle of convenience-Tax levied ought to be convenient to both the contributor and collector, it should be levied at a time when the payer has money and mode of payment should be convenient to both the payer and the payee.
m. Economical/principle of economy-The cost of collecting and administering the tax should be lower than the tax so collected.
n. Flexible/principle of flexibility-It should be readily adaptable to changing economic times i.e. when the economic conditions of the people improve it should give raised revenue e.g. VAT
o. Ability to pay/non-oppressive-A tax system should be designed in a way that the amount charged is not too high to the extent that the contributors are unable to pay or is discouraged from working hard.
p. Diversified/principle of diversity-There should be different types of taxes so that the tax burden is on different groups in the society. This also ensures that the government has money at all times.

q. Simplicity-A good tax system should be simple enough to be understood by each tax payer. This will motivate them to pay tax.
r. Elastic/principle of elasticity-The tax system should be able to generate more revenue for the government by targeting items of mass consumption.

IMPACT AND INCIDENCE OF TAX

Impact of tax: The burden of tax on the initial person

Incidence of tax: The final resting place of the tax burden.

The person on whom tax is initially imposed may either bear the whole burden or pass part or the whole burden to someone else. E.g. for manufactured goods, the impact of the tax is on the manufacturer and the manufacturer may pass the incidence of the tax to the consumer.

If the manufacturer only passes part of the burden to the consumer, then the incidence of the tax wil be partly on the manufacturer and partly on the consumer.

CLASSIFICATION OF TAXES

Taxes are classified according to;

i. Structure of the tax
ii. Impact of the tax on the tax payer.

a. According to the structure

In this case, taxes are classified according to the relationship between the amount paid on tax and the income of the tax payer. These are:

i. Progressive tax
ii. Regressive tax
iii. Proportional tax

b. Progressive tax

This is a type of tax where the rate/amount paid increases proportionately with increase in income.e.g tax may be as follows

Income	Rate	
0-5000	20%	
5001-10000	25%	
10001-15000	30%	e.t.c

-In progressive tax, those with higher income rates remit a higher proportion of their income as tax compared to those in lower income brackets.

This type of tax is based on the belief that one only needs a certain amount in order to have a decent standard of living.

Advantages of progressive tax

- It reduces income inequality as the rich are taxed more

- It encourages people to work harder/more in order to maintain their standard of living
- The revenue collected is higher
- The unit cost of collecting tax reduces as the tax increases.

Disadvantages of progressive tax

i. It is oppressive-some people are taxed more than the others and punishes people for their hard work.
ii. It may discourage people from working more as any additional income goes tax
iii. Investors may be discouraged from venturing into risky but more profitable businesses as these would attract more tax
iv. It assumes that people earning the same amount of money/income have similar needs and ability to pay tax-which in reality may not be true.
v. It can lead to tax evasion by taxpayers falsifying their level of income.

c. Regressive tax

This is a type of tax that takes a higher proportion of low income earners as compared to high income earners. The fax burden falls more heavily on the poor (opposite of progressive)
Example: sales tax where people pay the same amount irrespective of the level of income.
The assumption is based on the understanding that the one who deems it necessary to buy a certain products considers the utility derived from it to be equal to its price, which includes tax.

d. Proportional Tax

This is a type of tax where the rate of tax remains the same irrespective of the level of income or value of property to be taxed e.g. if the rate is 20% then a person who earns ksh.5000 will pay 20/100 x5000=ksh.1000
Ksh.10, 000 will pay 20/100x10,000=ksh.2000 e.t.c

Example: corporation tax where companies are expected to pay a fixed proportion of their profits as tax.

e. Digressive tax

This is a type of tax where the tax rate increases up to a given maximum after which a uniform tax rate is levied for any further income.
Classification according to impact on the tax-payee
Based on the impact, the tax has on the tax payer; tax may be classified as either:

a. Direct tax
b. Indirect tax

a. Direct tax

These are taxes where the impact and the incidence of the tax are on the same person. It is not possible to shift/pass any part of the tax burden to anybody else.

This type of tax is based on incomes, profits and property of individuals as well as companies.

They include:

i. Personal income tax

This is a tax that is imposed on incomes of individuals and is usually progressive in nature.

Example pay-As You-Earn (PAYE) for salaries.

In most cases it is paid through check-off system where the employer deducts it from the employee's salary and remits it to the tax authorities.

ii. Corporation tax

This is tax levied on profits of companies. It is usually proportional in nature.

iii. Stamps duty

This is tax paid in areas such as conveyance of land or securities from one person to another.

iv. Estate (death) duty

This type of tax is imposed on property transferred after the owners' death. The tax helps in raising government revenue and also in redistributing income since the inheritor has not worked for it.

v. Wealth tax

This is tax levied on personal wealth beyond a certain limit.

vi. Capital gains tax

This is tax levied on gains realized when a fixed asset is sold at a price higher than the book value.

vii. Capital transfer (gifts) Tax

This is tax imposed on the value of property transferred from one person to another as a gift. The tax is designed to seal loopholes whereby a wealthy person may try to avoid tax by transferring his/her property to a friend or a relative as a gift.

This type of tax is progressive in nature. It however does not affect transfers between spouses or to charitable organizations.

Merits/advantages of direct taxes

i. Economical in collection; most of direct taxes are collect at source and the cost of collecting them is fairly low.

ii. Tax revenue is certain; the tax payer knows what and when to pay and the government knows how much tax revenue to expect at what time (can be collected from the annual tax returns in advance)
iii. Equitable /equity; they facilitate fair distribution in tax contribution as people pay according to the size of their income.
iv. Simplicity /simple to understand; they are easy and simple to understand by both the tax payer and the collector.
v. Does not affect the price of goods and services; direct tax does not cause inflation as it only affects consumer's disposable incomes and not the prices of goods and services.
vi. Brings redistribution of wealth; direct taxes are progressive in nature hence the wealthier members of the society are taxed more than the poorer members of the society.
vii. Civic consciousness; tax payers feed the pinch of paying tax and thus take a keen interest in government expenditure.
viii. No leakages; loss of collected revenue is minimized as the tax is paid directly to the tax authorities and not through middle men.
ix. Desirable; the tax is desirable because it only affects people who fall within the jurisdiction of income tax and corporation tax.
x. Elastic/flexible; the tax is flexible in that it can be expanded to cover as many areas as desirable.

It can also be raised or reduced according to the needs of the economy.

DEMERITS OF DIRECT TAX

i. Encourage avoidance and evasion; whenever possible people come up with ways of reducing the amount of tax payable by falsifying information or just ignoring payment.
ii. Discriminatory /not imposed on all citizens; direct taxes are not paid by all citizens as low income earners who do not fall within the tax brackets are exempted
iii. Discourage investment/deterrent to investment; Heavy taxation on profits discourage people from investing in risky but profitable businesses
iv. Discourage work/deterrent to work; High rate of direct tax may deter people from working harder as people may opt for leasure instead of working extra time.
v. Encourage capital flight; high taxes such as corporate tax make foreigners to withdraw their investments and transfer them to countries with lower taxes.

vi. Unpopularity; the burden of the tax (incidence and impact) of tax is borne by the tax payer directly and at once. This makes direct taxes very unpopular.
vii. May inconvenience the tax payer; the tax payer has to comply with complicated formalities relating to sources of income as well as the expenses incurred while generating it. This may force the tax-payer to engage the services of tax experts who have to be paid.
viii. Lack of civic awareness; on tax payers are not interested in scrutinizing government expenditure as they do not feel the pinch of paying tax.

b. Indirect tax

These are taxes in which the impact is on one person and the incidence is partially or wholly on another person. The tax payer may shift either the whole or part of the tax burden to another person.

Such taxes are usually based on the expenditure on goods and services and include the following:

i. Sales tax: this is based on the sales made and may be assessed either as a percentage of the sales or a fixed amount e.g. sh.2 per every kilograms sold. The tax may be collected at one point or various points of sale. In Kenya, sales tax has been replaced by V.A.T
ii. VALUE ADDED TAX (V.A.T): this is the tax that is levied on the value that a business adds borne by the consumer in the final price.
iii. Export duty: this is a type of tax that is levied on exports. The objective may either to raise revenue or discourage the exploitation of some commodities.
iv. Import duty: This is tax levied on imported products,

For the following reasons.

- Raising government revenue
- Reducing incidences of dumping
- Discouraging consumption of imported goods with a view of boosting local production
- Protecting local industries

v. Excise duty: This is a type of tax that is imposed on goods that are manufactured and sold within a country.

Its purpose includes:

- Raising revenue for the government
- Discouraging the consumption of some commodities such as beer and cigarettes.

MERITS OF INDIRECT TAX

I. Can be used selectively; It can be used selectively to achieve a given objective e.g. consumption of some commodities.

II. Tax payment is voluntary; indirect tax is only paid by those who consume the tax commodities therefore those who do not want to pay the tax would only need to avoid taxed commodities.

III. Difficult to evade; the tax cannot be evaded because it is part of the price of the commodity. All those who buy the commodity taxed must therefore pay the tax.

IV. Wide coverage/broad based; the tax is levied on a wide range of essential commodities thus a high amount of revenue is collected.

V. Stimulate effort; indirect taxes if increased increases the prices of goods and services. People who want to maintain the same living standards will therefore have to work harder to be able to buy/affect the same goods and services.

VI. Convenient; the tax is paid in bits as one buys the goods and services. The tax is also hidden in the price of the commodity and the payer may not be aware of it.

VII. Flexible; flexible; the government can raise or reduce the tax rate to suit the prevailing economic situation in a country.

DEMERITS OF INDIRECT TAXES

1. **END** May fuel inflation; continued increase in indirect taxes may fuel inflation as it directly increases the prices of goods and services.
2. Less equitable/regressive; the same amount is charged on both the high and the low income earners making the tax burden to fall heavily on the low income earners. The low income earners end up paying a larger proportion of their income as tax.
3. Can be avoided; indirect taxes can be avoided by people who do not consume the taxed commodity.
4. Encourages falsification of records; traders may falsify their rewards in order to pay less tax.
5. Lack of civic/contributors awareness; the tax is hidden in the price of the commodities therefore the tax payers are not aware that they are contributing anything to the state.
6. Expensive to administer/expensive in collection; the government must employ many tax inspectors making indirect taxes expensive in collection and administration.

7. Uncertainty in revenue collection; the government may not predict the amount of revenue yield as it is not easy to forecast sales and people can also not be forced to buy the taxed commodities.
8. Might interfere with resource allocation; indirect taxes increases the prices of commodities and can therefore force consumers and producers to shift to the consumption and production of commodities that are not taxed.
9. Discourages savings; increased expenditure due to increased prices will lead to low saving and hence low investments.

INFLATION

Control of Inflation

The govt. may adopt the following policies depending on their situation to reduce inflation to manageable levels. They include:

(iv) Monetary policy

This is a deliberate move by the govt. through the central bank to regulate and control the money supply in the economy which may lead to demand pull inflation. The policies include;

- Increase rate of interest of lending to the commercial banks. This forces them to increase the rate at which they are lending to their customers, to reduce the number of customers borrowing money, reducing the amount of money being added to the economy
- Selling of govt. securities in an open market operation (o.m.o). the selling of securities such as Bonds and Treasury bills mops money from the economy, reducing the amount of money being held by individuals
- Increasing the commercial banks cash/liquidity ratio. This reduces their ability to lend and release more money into the economy, reducing their customers purchasing power
- Increasing the compulsory deposits by the commercial banks with the central banks. This reduces their lending power to their customers, which makes their customers to receive only little amount from them, reducing the amount of money in the economy
- Putting in place the selective credit control measures. The central bank may instruct the commercial bank to only lend money to a given sector of the economy which needs it most, to reduce the amount of money reaching the economy

- Directives from the central banks to the commercial banks to increase their interest on the money being borrowed, to reduce their lending rates
- Request by the central bank to the commercial banks (the moral persuasion) to exercise control on their lending rates to help them curb inflation.

(v) Fiscal policy

These are the measures taken by the govt. to influence the level of demand in the economy through taxation process. They include;

- Reduced govt. spending. This reduces the amount of money reaching the consumers, which is likely to increase their purchasing powers, leading to inflation
- Increasing income taxes. This reduces the level of the consumers disposable income and lowering their spending levels, reducing the inflation
- Reducing taxes on production. This reduces the cost of production, lowering the prices of goods reaching the market
- Subsidizing the production. This reduces the cost of production in the economy, which in turn passes over the benefits to the consumers inform of reduced prices.
- Producing commodities that are in short supply. This increases their availability to meet their existing demand in the market, controlling demand pull inflation

(vi) Statutory measures

These are laws made by the govt. to help in controlling the inflation. They include;

- Controlling wages and salaries. This reduces the pressure put on the employers to meet high cost of labour for their production which in turn is just likely to lead to cost push inflation. It also minimizes the amount reaching the consumers as their income, to control their purchasing power and the level of demand, controlling the demand pull inflation
- Price controls. This reduces the manufactures ability to fix their prices beyond a given level which may cause inflation due to their desire to receive high profits.
- Restrictive imports. This reduces the chances of high prices of imported goods impacting on the prices of the goods in the country (imported inflation) and making the manufactures to look for alternative source of raw materials for their production
- Restricting the terms of hire purchase and credit terms of sales. This reduces the level of demand for those particular commodities in the economy which if not controlled may lead to demand pull inflation

- Controlling exports. This ensures that the goods available in the local market are adequate for their normal demand. Shortage of supply of goods in the market is likely to bring about the demand pull inflation

Outline measures that the government may employ to control the following types of inflation;

Cost push inflation

- By controlling the wages and salaries in the economy
- Restricting import on raw materials
- Reducing taxes on production
- Subsidizing the production
- Employing the price control techniques

Demand pull inflation

- Increasing the rate of interest of lending to the commercial banks
- Selling govt. securities on O.M.O
- Increasing the commercial banks cash/liquidity ratio
- Increasing the compulsory deposits from the commercial banks to the central bank
- Putting in place the selective credit control measure
- Directives to the commercial banks
- Request to the commercial banks
- Reducing govt. expenditure
- Increasing income taxes
- Producing commodities that are short in supply
- Restricting terms of hire purchase and credit terms of sale
- Controlling export

ECONOMIC DEVELOPMENT AND PLANNING

Economic Growth

This is the increase in the productivity of a country which can be seen in the continued increase in the national income over a period of years.

It can be measured by taking the average percentage of increase in national income over a period of time (number of years) and be assumed to be the average rate of economic growth in the country

Economic Development

This is the quantitative change or increase in a country's national income over the years, accompanied by favorable changes in the structures within the country that leads to general improvement of the individual well being, as well as the entire nation

A country may experience economic growth without experiencing economic development. This is because the increase in the national income may be as a result of people working for long hours without any time for rest, recreation and other development to occur in their body. This will make them not to have better living, despite the fact that the national income shall have increased.

The expected structural changes to be realized in a case of economic development include;

i) Shifting from depending on agricultural sector to manufacturing sector in the economy
ii) Reducing illiteracy levels
iii) Increase in skilled manpower in the economy
iv) Improvement in health facilities within the country
v) Increase in technology and improvement of entrepreneurial ability
vi) Increase and improvement of institution that handles new methods of productive economic activities

Outline the differences that exist between economic growth and economic development

Economic Growth	**Economic Development**
i) An increase in size of the country's National income	i) An increase in the size and quality of the country's National income
ii) Number of people living in absolute poverty can increase despite the increase in national income	ii) Number of people living in absolute poverty does not increase
iii)Increase in national income could be due to increase in income of only few people	iii) Increase in national income is attributed to general increase of incomes of majority of the people in the country
iv) No tendency to bridge the gap between the rich and the poor	iv)Tends to bridge the gap between the rich and the poor

Underdevelopment

This refers to a situation whereby the economic growth is in the negative direction (decreasing) accompanied by uneven distribution of wealth and decrease in quality and quantity of the factors of production available

Characteristics of Underdevelopment

- High level of poverty. This is characterized by most of the people in the country depending on mainly subsistence, or lives below the poverty levels. Their per capita income is lower as compared to the developed countries
- High disparity in income distribution. The income in this countries are not evenly distributed with the few rich people earning so much while the poor majority earns so little
- Low levels of savings and investments. They have very little if at all exist to save and invest for their further development, making them to continue being poor. This is well illustrated in the vicious circle of poverty
- High population growth rates. This is due to some of them not being able to afford, ignorant about or simply refusing to use the modern birth control methods since they find consolation on their high number of children
- Dominance of subsistence sector. This is due to their inability to raise capital for indirect production
- Problem of unemployment. The high population growth rate leads to high supply of labour that the country's economy cannot afford to absorb all, leading to unemployment
- Under utilization of natural resources. This may be due to lack of capital in this countries or in appropriate technology they use
- Dependence on the developed countries. This is due to their in ability to sustain themselves financially, which makes them keep on calling upon the developed partners for financial assistance
- Poor infrastructure. Their roads and communication networks are not properly maintained due to the in availability of adequate resources to improve them

Goals of Economic Development

The following are the changes that economic development seeks to put in place, which in Kenya they have been joined together in what is referred to as the millennium development goals. They includes

1. Eradicate extreme poverty and hunger

2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development
   Some includes
   - Reducing income disparity in distributions
   - Reducing unemployment
   - Provision of important basic needs such as food, shelter, etc

Factor which may hinder development in a country

The rate of a country's economic development may be influenced negatively by the following factors

i. Low natural resource endowment. Absence or inadequacy of natural resources such as raw materials, fertile land for agriculture, etc may slow the pace of the country's economic development
ii. Inadequate capital. This reduces the rate at which they exploit their natural resources, or produce in the economy
iii. Poor technology used. The traditional methods of production that they use cannot sustain their requirement any more
iv. Poor human resource endowment. Their inability to train adequate skilled manpower together with their inappropriate system of education leads to their slow development
v. Unfavorable domestic environment. Their political, social and economic institutions within their countries are not structured to favour economic development. For example
   - Their political system is characterized by corruption, authoritarian kind of leadership with lengthy procedures and bureaucratic controls that scares the investors
   - Their social environment is still full of outdated or retrogressive cultural values and negative attitude towards work and investment, leading to slow development
   - Their Economic institutions has allowed their markets to be influenced so much that that leads to interference in their smooth operations

Development Planning
This is the process through which the country establishes their objectives to be achieved, identify the resources that will be required and put in place the strategies or methods of acquiring the resources and achieving their pre-determined objectives.
In most cases their objectives or goals are the goals of economic development
The plan will prioritize the objectives to be achieved and even brake it down in to targets that if achieved with the planned strategy and resources, the objective shall have been achieved.
Need for economic planning
It enhances the following

a. Appropriate resource allocation, where resources are allocated according to the need of the objective and in a most productive way
b. Stimulation of effort of people in the desired direction. The plan outlines including the possible outcomes which persuade people to move to that direction
c. Support foreign aid bargain. Since it shows including the objective that the country seeks to achieve, it is capable of convincing the donor to finance it in the country
d. Project evaluation, by assisting on checking whether the predetermined targets or objectives are being achieved
e. Long term decision making, as it will show what each and every sector of the economy will require in the future to make it stable.
f. Avoiding duplication of industries in different parts of the country, for it will show the ones that have been set in those parts and even enhance balancing
g. Promote balancing in regional development by ensuring that they are not concentrated in only one region, ignoring other regions

Problems encountered in development planning
Problems at the planning stage

i) Lack of accurate or detailed data for planning. This may lead to in appropriate plan being developed, as it entirely depends on the quality and availability of the data
ii) Existence of large subsistence sector, which make the planning unrealistic
iii) Lack of qualified personnel to assist in planning. This may make the country to rely on foreign experts who do not fully understand the country

iv) Problem of the private sector which will always require incentives for them to follow the plan

v) Transfer of inappropriate development plan. As some planners may simply borrow a plan that they feel may have worked for a given country, yet the condition in those countries may not be the same

Problems at the implementation stage

i. Over reliance on donor funding, which if they don't receive, the plan may not be implemented
ii. Lack of domestic resources such as skilled personnel, finance and capital may make the implementation a problem
iii. Failure to involve the local people in planning. This will make them not to be willing to implement it, for they will not be understanding it or rebelling for the fact that they were not included
iv. Natural calamities such as diseases, floods, drought, etc may make the funds that had been set aside for implementation be diverted to curb them
v. Over-ambitious plans which are a times just made to impress the donors to release their funds but may not be easy to implement
vi. Lack of co-operation among the executing parties which may make the work not to kick off. For example a conflict between the ministry of finance and that of planning of the amount to be released
vii. Inflation which may make the estimated value of implementation not to be adequate, bringing a problem of finances
viii. Lack of political will and commitment in implementing the plan. This may frustrate the implementation.

INTERNATIONAL TRADE

A trade involving the exchange of goods and services between two or more countries. If the exchange is between two countries only, then it is referred to as bilateral trade, but if it is between more than two countries then it is referred to as multilateral trade.

Advantages of International Trade

- ✓ It enable the country to get access to wider range/variety of goods and services from other countries
- ✓ It enable the country to get what it does not produce
- ✓ It helps in promoting peace among the trading countries

- ✓ It enable the country to specialize in its production activities where they feel they have an advantage
- ✓ It earns the country revenue through taxes and licenses fees paid by the importers and exporters in the country
- ✓ It enable the country to dispose of its surplus goods and services thereby avoiding wastage
- ✓ It creates employment opportunities to the citizens of that country either directly or indirectly
- ✓ It may lead to the development of the country through importation of capital goods in to the country
- ✓ It encourages easy movement of factors of production across the borders of the countries involved
- ✓ It enable countries to earn foreign exchange which it can use to pay for its imports
- ✓ A country may be able to obtain goods and services cheaply than if they have been produced locally
- ✓ During hard times or calamities such as wars, the country is able to get assistance from the trading partners
- ✓ It brings about competition between the imported and locally produced goods, leading to improvement in their quality
- ✓ It gives the country an opportunity to exploit fully its natural resources, due to increased market

Disadvantages of International trade

- ✓ It may lead to collapse of the local industries, as people will tend to go for the imported goods. The collapse may also lead to loss of employment
- ✓ It may also lead to importation of harmful foods and services such as drugs and pornographic materials
- ✓ May lead to over depending on imported commodities especially the essential ones, making the country to be a slave of the other countries, interfering with their sovereignty
- ✓ It may make the country to suffered during emergencies if they mainly rely on the imported goods
- ✓ May make the country to suffer from import inflation
- ✓ May lead to acquisition of bad culture from other countries as a result of their interactions
- ✓ May lead to unfavorable balance of payment, if the import is higher than exports

Terms of Trade

This refers to the rate at which the country's export exchanges with those from other country. That is:

Terms of trade $\frac{Price\ index\ of\ export}{price\ index\ of\ import}$

It determine the value of export in relations to import so that a country can know whether it's trade with the other country is favourable or unfavourable Favourable terms of trade will make the country spent little on import and gain a lot of foreign exchange from other countries

For example;

Then table below shows trade between Kenya and China in the year 2004 and 2005, with the Kenyan government exporting and importing to and from china, and China also importing and Exporting from and to Kenya.

Year	**Average prices of export**	
	Kenya	**China**
2004	1000	4000
2005	1200	6500

Calculate the Terms of trade for;

i. Kenya
ii. China

Solution:

Kenya

a) Export price index (E.P.I) = $\frac{average\ prices\ of\ exports\ in\ the\ current\ year}{average\ prices\ of\ exports\ in\ the\ base\ year}$ x 100

$= \frac{1200}{1000}$ x100

= 120%

b) Import price index (I.P.I) = $\frac{average\ prices\ of\ import\ in\ current\ year}{average\ prices\ of\ import\ in\ the\ base\ year}$ x 100

$= \frac{6500}{4000}$ x 100

= 162.5%

c) Terms of trade (T.O.T) = $\frac{export\ price\ index}{import\ price\ index}$ x 100

$= \frac{120}{162.5}$ x 100

= 73.8%

This implies that Kenya is importing from China more than it is exporting, leading to unfavourable terms of trade i.e. when the percentage is less than 100%, it implies unfavourable terms of trade.

China (work out)

The average prices is the various prices of the individual export or import items divide by their number

Factors that may lead to either favourable or unfavourable terms of trade

The country is experiencing a favourable terms of trade if:

- The prices of imports decline and those of export remains the constant
- The prices of imports declines while those of exports increase
- The price of imports remains constant while those of exports increase
- The prices of import and export increases but the rate of increase in export is higher
- Both prices decrease but the decrease in import prices is higher

The country will experience unfavourable terms of trade if;

- Prices of import increases while those of exports decline
- Prices of import remains constant while those of export declines
- Prices of import increase as the export remains constant
- Both prices increase, but for imports increases at a higher rate than export
- Both prices decrease, but for export decreases at a higher rate than import

Reasons for differences in terms of trade between countries

The terms of trade may differ due to:

i. The nature of the commodity being exported. If a country exports raw materials, or unprocessed agricultural products, its terms of trade will be unfavourable, as compared to a country that exports manufactured goods
ii. Nature of the commodity being imported. A country that imports manufactured goods is likely to have unfavourable terms of trade as compared to that which imports raw materials or agricultural produce
iii. Change in demand for a country's export. An increase in demand for the country's export at the world market will make it have favourable terms of trade as compared to those with low demand at the world market
iv. Existing of world economic order favouring the products from more developed countries. This may make the developing countries to have deteriorating terms of trade
v. Total quantity supplied. A country exporting what most countries are exporting will have their products trading at a lower price, experiencing

unfavourable terms of trade as compared to a country that export what only few countries export

vi. Trade restrictions by trading partners. A country with no trading restrictions is likely to import more products, leading to unfavourable terms of trade, as compared to if it impose trade restrictions

Balance of trade

This is the difference between value of country's visible exports and visible imports over a period of time. If the value of visible/tangible export is higher than the value of visible/tangible imports, then the country experiences favourable terms. If less than the invisible value, then the country is experiencing unfavourable. The country is at equilibrium if the value of visible export and import is the same

Balance of payments

This is the difference in the sum of visible and invisible export and the visible and invisible imports. If positive then it means the country is having favourable terms, while if negative, then it means unfavourable It goes beyond the balance of trade in that it considers the following

- The countries visible/tangible export and import of goods (visible trade)
- The countries invisible/services exported and imported in the country (invisible trade)
- The inflow and outflow of investment (capital goods)

Balance of Payment account

This is the summary showing all the transactions that have taken place between a particular country and the rest of the world over a period of time. The transaction may arise from

a) The export of visible goods
b) The import of visible goods
c) The export of invisible goods/services
d) The import of invisible goods/services
e) Flow of capital in and out of the country

Components of balance of payments account

The balance of payment account is made up of the following

a) Balance of payment on current account
ii) Balance of payment on capital account
iii)Official settlement account/Cash account/foreign exchange transaction account

Balance of payment on current account

This is the account that is used to determine the difference between the value of the country's visible and invisible imports and exports. That is

Balance of payment on current account = (visible export + invisible export) – (visible import + invisible import)

In the account, the payments for the visible and invisible imports are **debited** while the receipts from visible and invisible exports are **credited** that is

Dr	**current account** Cr
Payments for imports (Visible and Invisible)	Receipts from exports (Visible and Invisible)

The balance of payment on current account may be;

- In equilibrium i.e. if Dr = Cr
- Unfavourable i.e. if Dr > Cr (-ve)
- Favourable i.e. if Dr < Cr (+ve)

For example;

A given country had the following values of visible and invisible export and import during the year 2004 and 2005

Trade	**2004 (shs)**	**2005 (shs)**
Visible export	18926	29954
Visible imports	22780	32641
Invisible exports	6568	19297
Invisible imports	5239	16129

Required

Prepare the country's balance of payments on current account for the years 2004 and 2005 and comment on each of them.

Dr **current account year 2004** Cr

	shs		Shs
Visible imports	22780	Visible export	18926
Invisible imports	5239	Invisible export	6568
Total	28019	Total	25494
		Deficit	**2525**

The country experienced unfavourable balance of payment on current account in the year 2004, since they imported more than they exported

Dr **current account year 2005** Cr

	shs		Shs
Visible imports	32641	Visible export	29954
Invisible imports	16129	Invisible export	19297
Total	28019	Total	49251
Excess	**481**		

The country experienced favourable balance of payment on current account in the year 2005, since they exported more than they imported

Balance of payments on capital account

This account shows the summary of the difference between the receipt and payments on the investment (capital). Receipts are income from investments in foreign countries while payments are income on local investments by foreigners paid out of the country.

The capital inflow includes investments, loans and grants from foreign donors, while capital outflow includes dividends paid to the foreign investors, loan repayments, donations and grants to other countries.

In the account the payments are debited, while the receipts are credited. That is;

Dr **capital account** Cr

Payments	Receipts

The account may be;

- In equilibrium i.e. if Dr = Cr
- Unfavourable i.e. if Dr > Cr (-ve)
- Favourable i.e. if Dr < Cr (+ve)

The combined difference on the receipts and payments on both the current and capital accounts is known as the overall balance of payments.

The official settlement account

This account records the financial dealings with other countries through the IMF. It is also called the foreign exchange transaction account, and is always expected to balance which a times may not be the case. That is;

- In case of surplus in the balance of payment, the central bank of that country creates a reserve with the IMF and transfer the surplus to the reserves account.
- In case of a deficit in the balance of payment, the central banks collect the reserves from the IMF to correct the deficit, and incase it did not have the reserves, the IMF advances it/give loan

Balance of payment disequilibrium

This occurs when there is either deficit or surplus in the balance of payments accounts. If there is surplus, then the country would like to maintain it because it is favourable, while if deficit, the country would like to correct it.

Causes of balance of payment disequilibrium

It may be caused by the following;

- Fall in volume of exports, as this will reduce the earnings from exports leading to a deficit.
- Deteriorating in the countries terms of trade. That is when the country's exports decreases in relation to the volume of imports, then her payments will higher than what it receives.
- Increasing in the volume of import, especially if the export is not increasing at the same rate, then it will import more than it exports, leading to a disequilibrium
- Restriction by trading partners. That is if the trading partners decides to restrict what they can import from the country to a volume lower than what the country import from them, it will lead to disequilibrium
- Less capital inflow as compared to the out flow, as this may lead to a deficit in the capital account, which may in turn leads to disequilibrium.
- Over valuation of the domestic currency. This will make the country's export to very expensive as compared to their import, making it to lose market at the world market
- Devaluation of the currency by the trading partner. This makes the value of their imports to be lower, enticing the country to import more from them than they can export to them.

Correcting the balance of payment disequilibrium

The measures that may be taken to correct this may include;

- Devaluation of the country's currency to encourage more exports than imports, discouraging the importers from importing more into the country.
- Encouraging foreign investment in the country, so that it may increase the level of economic activities in the country, producing what can be consumed and even exported to control imports
- Restricting the capital outflow from the country by decreasing the percentage of the profits that the foreigner can repatriate back to their country to reduce the outflow

- Decreasing the volume of imports. This will save the country from making more payments than it receives. It can be done in the following ways;
  1. i) Imposing or increasing the import duty on the imported goods to make them more expensive as compared to locally produced goods and lose demand locally
  2. ii) Imposing quotas/total ban on imports to reduce the amount of goods that can be imported in the country
  3. iii) Foreign exchange control. This allows the government to restrict the amount of foreign currencies allocated for the imports, to reduce the import rate
  4. iv) Administrative bottlenecks. The government can put a very long and cumbersome procedures of importing goods into the country to discourage some people from importing goods and control the amount of imports
- Increasing the volume of exports. This enable the country to receive more than it gives to the trading partners, making it to have a favourable balance of payment disequilibrium. This can be done through;
  1. i) Export compensation scheme, which allows the exporter to claim a certain percentage of the value of goods exported from the government. This will make them to charge their export at a lower price, increasing their demand internationally
  2. ii) Diversifying foreign markets, to enable not to concentrate only on one market that may not favour them and also increase the size of the market for their exports
  3. iii) Offering customs drawbacks. This where the government decides to refund in full or in part, the value of the custom duties that has been charged on raw materials imported into the country to manufacture goods for export
  4. iv) Lobbying for the removal of the trade restriction, by negotiating with their trading partners to either reduce or remove the barrier put on their exports

Terms of sales in international trade

Here the cost trading which includes the cost of the product, cost of transporting, loading, shipping, insurance, warehousing and unloading may be expensive. This makes some of the cost to be borne by the exporter, as some being borne by the importer. The price of the goods quoted therefore at the exporters premises should clearly explain the part of the cost that he/she is going to bear and the ones that the importer will bear before receiving his/her goods. This is what is referred to as the terms of sale

Terms of sales therefore refers to the price quotation that state the expenses that are paid for by the exporter and those paid for by the importer.

Some of the common terms include;

(i) Loco price/ex-warehouse/ex-works. This states that the price of the goods quoted are as they are at the manufacturers premises. The rest of the expenses of moving the good up to the importers premises will be met by the importer

(ii) F.O.R (Free on Rail). This states that the price quoted includes the expenses of transporting the goods from the seller's premises to the nearest railway station. Other railways charges are met by the importer

(iii) D.D (Delivered Docks)/Free Docks. This states that the price quoted covers the expenses for moving the goods from the exporter's premises to the dock. The importer meets all the expenses including the dock charges

(iv) F.A.S (Free Along Ship). States that the price quoted includes the expenses from the exporter's premises to the dock, including the loading expenses. Any other expenses are met by the importer

(v) F.O.B (Free on Board). States that the price quoted includes the cost of moving the goods up to the ship, including loading expenses. The buyer meets the rest of the expenses

(vi) C&F (cost & freight). The price quoted includes the F.O.B as well as the shipping expenses. The importer meets the insurance charges

(vii) C.I.F (Cost Insurance & freight). The price includes the C&F, including the insurance expenses

(viii) Landed. The price includes all the expenses up to the port of destination as well as unloading charges

(ix) In Bond. The price quoted includes the expenses incurred until the goods reaches the bonded warehouse

(x) Franco (Free of Expenses). The price quoted includes all the expenses up to the importer's premises. The importer does not incur any other expenses other than the quoted price

(xi) O.N.O (Or Nearest Offer). This implies that the exporter is willing to accept the quoted price or any other nearest to the quoted one

Documents used in International trade

i) Enquiry/Inquiry. A letter sent by an importer to the exporter asking about the supply of the goods and the terms of sale.

ii) Order of Indent. This asks the supplier to supply goods. It may specify the goods to be supplied and suggest the preferred mode of transport for them. An indent may be open or closed
- Open Indent. Here the importer does not specify the supplier and the goods to be bought and therefore the exporter or export agent is free to choose the supplier
- Closed Indent. Here the importer specifies the supplier and the goods to be bought

iii) Letter of Credit. A document issued by the importers bank to the exporter's bank to assure the exporter of the payment for the goods ordered. The exporter can then be paid by his bank on the basis of this letter.

iv) Import Licence. A document issued by the country to allow the importer to buy goods from abroad.

v) Bill of Lading. A document of title to goods being exported issued by the shipping company to the importer who should use it to have goods released at the port of entry.

vi) Freight Note. A document prepared by the shipping company to show the transportation charges for goods.

vii) Certificate of insurance. A document issued by the insurance company or agent, undertaking to cover the risk against the loss or damage to goods being exported.

viii) Certificate of Origin. A document that shows the country from which the goods are being imported have originated from.

ix) Commercial Invoice. A document issued by the exporter to demand for the payment for the sold on credit to the importer.
It shows the following;
- The name and address of the exporter
- The name and the address of the importer
- The price charged
- The terms of sale
- The description of the consignment
- The name of the ship transporting the consignment

x) Consular Invoice. A document that shows that the prices of the goods that have been charged is fair as certified by the consul with the embassy of the exporting country.

xi) Proforma Invoice. A document sent by the exporter to the importer if he/she is not willing to sell goods on credit. It may be used to serve the following purposes;

- Serve as a formal quotation
- Serve as a polite request for payment before the goods are released for the customer
- To enable the importer to initiated the clearing of the custom duty early enough to avoid delays
- Used to by the importer to obtain permission from the Central Bank to import goods

xii) Airway Bill. Issued by the airline company to show the charges for the goods being transported

xiii) Letter of Hypothecation. A letter written by the exporter to his/her bank authorizing it to resell the goods being exported. This occurs if the bank fails to get payment on the bill of exchange drawn on the importer that it has discounted for the exporter. Should there be a deficit after the resale, the exporter pays the deficit

xiv) Weight note. A documents that shows the weight and other measurements of the goods being delivered at the dock

xv) Shipping advice note. A document issued by the exporter to his/her shipping agent containing instruction for shipping goods.

International Financial Institutions

Some of the institutions that play a role in international monetary system include;

i. International Monetary Fund (I.M.F)
ii. African Development Bank (A.D.B)
iii. African Development Fund (A.D.F)
iv. International Bank For Reconstruction and Development (World Bank)

i. International Monetary Fund (I.M.F)

This bank operates like the central bank of the central banks of the member countries. Its objective includes the following;

- Ensuring that the member country maintains a stable foreign exchange rates for their currencies. This it does by advising the country to raise or increase the supply of their currency to devalue them or increase their value internationally

- Provide financial support to the member country to alleviate poverty and boost their income.
- Relieving heavily indebted countries of debt repayment so that it can use that fund to raise the living standards of its people.
- Providing funds to the member countries to finance the deficits in their balance of payment.
- Provide forum through which the member country can consult and cooperate on matters concerning trade among them
- Maintaining currency reserves of the different countries, enabling member countries to buy foreign exchange to be used to import goods and services.

ii. African Development Bank (A.D.B)

This bank was formed to promote the economic and social progress of its regional member countries in Africa. It main source of finance is the members' contributions and the interest charged on the money they lend members.

Its functions include;

- Providing loans for economic and social development to member countries
- Provide technical advice in planning and implementation of the development plans
- Assist member country to appropriately exploit it resources
- To encourage co-operation among African countries in order to bring economic growth
- To co-operate with various economic institutions in order to bring about development especially in Africa countries

iii. African Development Fund (A.D.F)

This was formed to provide long term financial assistance to the low income countries that cannot obtain loan from other financial institutions at the prevailing terms and condition. Their loans may recover a longer repayment periods with no interest except the commitment fees and service charge which is minimal. They fund activities, which includes;

- Education and research activities
- Offer technical advice to the member countries

iv. International Bank For Reconstruction and Development (World Bank)

The World Bank was formed to carry out the following functions;

- ✓ Giving loans to countries at very low interest rates to finance economic development activities.
- ✓ Provision of grants to finance the provision of social amenities and basic infrastructural development in developing countries.
- ✓ Fighting against corruption and poor governance which may lead to misuse of public funds in different countries.
- ✓ Advancing money to countries to finance balance of payment deficit.
- ✓ Giving advice on economic challenges that countries may face.
- ✓ Availing technical assistance and personnel to help countries run their economic programmes

Economic Integration

This occurs where two or more countries enter into a mutual agreement to cooperate with each other for their own economic benefit. They may do this by allowing free trade or relaxing their existing trade barriers for the member countries.

Economic integration may occur in the following forms;

A. Free Trade Area

This is a case where the member countries agree to abolish or minimize tariffs and other trade restrictions but the individual countries are free to impose restrictions on non-member countries. They includes; Preferential Trade Area (P.T.A), European Free Trade Area (E.F.T.A), Latin America Free Trade Area (L.A.F.T.A), etc.

B. Custom union

This is where the members of the free trade area may agree not only to abolish or minimize their tariffs, but also establish a common tariff for the exchange of goods and services with the non member countries. They include; Economic Community of West Africa States (E.C.O.W.A.S), East Africa Custom Union (E.A.C.U), Central Africa Custom and Economic Union (C.A.C.E.U)

C. Common Market

This is where the member countries allow for free movement of factors of production across the borders. People are free to move and establish their business in any member country. They include; East Africa Common Market (E.A.C.M), European Economic Community (E.E.C), Central American Common Market (C.A.C.M), Common Market for Eastern and Southern Africa (COMESA)

D. Economic Union

This is where the members of the common market agree for put in place a common currency and a common central bank for the member countries. They even develop common infrastructures which includes railways, communication networks, common tariffs, etc

Importance of economic integration

Economic integration will ensure the following benefits for the member countries;

- Availability of wider market for the goods and services produced by the member countries. This enables them to produce to their full capacity
- It enables the country to specialize in the goods they produce best, making them to effectively utilize their resources
- It leads to promotion of peace and understanding among the member countries through interaction
- It leads to high quality of goods and services being produced in the country due to the competition they face
- It allow members to get access to wider variety of goods and services which satisfy different consumer needs
- It leads to creation of employment for individuals living within the region, as they can work in any of the member country
- It increase the economic bargaining power in trading activities by the countries forming a trading bloc
- Improvement of the infrastructure in the region due to increased economic activities.
- It brings about co-ordination when developing industries, as the members will assign the industries to each other to create balance development and avoid unnecessary duplication

Free Trade Area

This is a situation where there is unrestricted exchange of goods and services between the countries. It has benefits/advantages similar to those of economic integration.

Disadvantages of free trade area

Some of the problems it is likely to bring include;

- It may lead to importation of inferior goods and services to the country, as the member country may not be able to produce high quality as compare to other non-member countries
- It may discourage the growth of the infant industries due to competition from well developed industries in other countries

- ❖ It may lead to reduced government revenue because no tariff may be charged on the goods and services
- ❖ A country may be tempted to adopt technology not suitable for its level of development.
- ❖ If not controlled, it may lead to unfavourable balance of payment, where a country imports more than it export
- ❖ It may lead to importation of harmful goods and services, that may affect the members health such as illegal drugs
- ❖ It may lead to lack of employment opportunities especially where more qualified people have moved from their country to secure job opportunities in the country
- ❖ It may expose the country to negative cultural practices in other countries, interfering with their morals. For example the exposure to the pornographic materials.
- ❖ Compromising political ideologies especially where member countries with different ideologies wants to fit in to the bloc
- ❖ It may lead to over exploitation of non-renewable economic resources such as minerals

Trade Restrictions

These are deliberate measures by the government to limit the imports and exports of a country. They are also known as protectionism and includes the following;

- Tariffs which include taxes levied on both import and export. It can be used to increase or decrease the level of both import and export
- Quotas which is the restriction on the quantity of goods to be either imported or exported. It can be increased or decreased to increase or decrease the level of import or export respectively.
- Total ban (zero quota) where the government issues a direction illegalizing either the import or export of the products
- Complicated import procedure in order to discourage some importers from importing
- Subsidies on locally produced goods to discourage imports
- Legislation against importation of certain goods
- Setting the standards of products to be imported

Reasons for trade restrictions

- ➢ To prevent the inflow of harmful goods into the country, that may be harmful to the lives of the citizens

- To protect the local infant industries that may not be able to compete favourably with well established industry
- To give a country a chance to exploit its natural resources in producing their goods
- To protect strategic industry, since their collapse may make the country to suffer
- To minimize dependency of the country to other countries for their stability
- To create employment opportunity to its people by establishing the industries to produce the goods and services
- To prevent dumping of goods in the country by the developed partners which may create unfair competition
- To correct balance of payment deficit by limiting import
- To protect good cultural and social values which may be influenced by unaccepted values they are likely to acquire from other country through interaction
- To expand market for locally produced goods by restricting the number of foreign goods in the market.
- To enable the country earn foreign exchange through imposing taxes and other tariffs

Advantages of trade restrictions

- It promotes self reliance as industries have an opportunity to engage in the production of goods and services that were previously imported
- It protects the local industries from stiff competition that they may have faced from the well developed countries
- It may help to correct the balance of payment deficit
- It restrict the entry of harmful goods into the country as it controls the inflow of imports in to the country
- It enables the country to conserve their valuable social and cultural values from the external influence
- It help in creating more job opportunities through diversification in the production
- It promotes the growth of local/infant industries in the country.

Disadvantages of trade restriction

- There will be availability of limited variety of goods in the country that will limit the consumer's choices
- May lead to production of low quality goods as there will be no competition for the producing firms

- Other countries may also retaliate, leading to reduction in export from their country
- There is likely to be high prices charged on the locally produced goods, since the small firms which produce them may not be enjoying the economies of scale
- The country is likely to be exposed to small market, should all countries restrict which may lead to reduction in trade.
- As a result of the continued protection, some industries may develop a tendency of remaining young to still enjoy the protection, which limits the level of development
- It may lead to emergence of monopoly as the protected industry may end up remaining alone in the market, bringing about the problems of monopolies

Trends in International Trade

i. Liberalization that has led to removal of many trade restriction among the countries, increasing the levels of trade
ii. Development of E-Banking which has enable the international trader to get access to their bank accounts from wherever they are in
iii. Development of export processing zones (EPZ) by the government to allows the industries involved just concentrate in the exported goods only. It enable the country enjoy the following benefits (advantages of EPZ)
   - It creates job opportunities to the citizens
   - It creates market for locally produced raw materials that they use in their production
   - It encourage the foreign investors to invest in the countries, i.e. in the processing zones, increasing the level of investment in the country
   - Encourages export in the country as the incentives given to them by the government makes them to produce more and more for export
   - It stimulates industrialization in the country in all sector including the ones producing for local consumptions

   However EPZ's have the following problems/disadvantages
     - Most of them employs foreigners in their management team, denying the locals a chance to get employed
     - They do not generate revenue to the government, especially during tax free periods

- They are concentrated in few towns, bringing about imbalance regional development
- Some of them encourages social evils such as prostitution in areas where they are developed

iv. Development of e-commerce/website trading which has promoted the selling and buying of items through the internet, with payments made online.

E-commerce has the following benefits/advantages:
- ✓ One is able to access the market worldwide, as the countries are connected to the internet
- ✓ There is no discrimination, as both the small and large industries are able to transact through the internet
- ✓ It is fast to transact the business through internet, as it saves on travelling time and therefore suitable for urgent transaction
- ✓ It is cheap especially on the cost of sending, receiving and storing information
- ✓ It is easy for firms to share valuable information about production

THE STOCK EXCHANGE MARKET

This is a market whereby the buying and selling of shares and other securities takes place. Shares are the smallest units of capital that can be sold to persons by a company for them to become share holders. Other securities traded in this market includes debentures (a unit of loan sold by the companies to the members of the public), government bonds (a long term borrowing certificate by the government from its people) and government treasury bills (a short term borrowing certificate by the government from its people).

Common terms used in stock exchange

i) Securities:- a document certifying that one has lent money to the issuer (the person borrowing the money)

ii) Broker:- a person/firm registered by the capital market authority (CMA) to buy and sell shares and other securities on behalf of their clients

iii) Jobber:- a person/firm who buys and sell shares and other securities with an aim of making a profit

iv)CDSC account:- Central Depository Settlement Corporation account for mobilizing the shares and securities to be traded on at the market

In the stock exchange market only registered/listed/quoted companies are allowed to sell their shares. A quoted/listed company is a company that has been registered as a member of the stock exchange market.

The quoted companies can sell their shares through the Initial Public Offer (I.P.O) or normal trading in the market.
IPO is the initial price that the company will float its shares to the members of the public to buy/subscribe to for the first time. These shares are said to have been issued in the primary market. After the IPO the shares are then accumulated as stock and traded on in the stock exchange market (secondary market).
All the trading of the shares is done through the company's agents or brokers.

Procedure of buying shares:

i. Opening a CDSC account through broker
ii. Filling in the purchase order form by stating the type and the number of shares to be bought
iii. The broker identifies and negotiate with the willing buyer
iv. The shares are then paid for through brokers at a commission
v. Shares are then transferred and credited in the buyers CDSC account

Procedure for selling shares:

i. Opening a CDSC account through broker
ii. Filling in the sales order by stating the price and the number of shares to be sold
iii. The buyer identifies and negotiate with the willing buyer
iv. The buyer pays for the shares through the broker
v. Shares are transferred and credited in the buyer's CDSC account with the sellers CDSC account being debited

Roles of stock exchange market

They perform the following roles:

- They facilitate the buying of shares by creating a conducive environment for the investors who wants to buy shares.
- They facilitate the selling of shares by creating a ready market for those who wish to sell their shares
- They safeguard the investors' interest by ensuring that the companies to be listed have met a given standard of performance. If not they will be deregistered
- Assist the company to raise capital through IPO or sales of shares in the market
- Provide useful information to the investors which is always timely and accurate to assist them in their decision making
- They create employment opportunity to those who facilitate the buying and selling of the shares such a jobbers, brokers, etc

- They help the government in raising the revenues in terms of fees and rents to the government
- They avail variety of securities for the investors to choose from before investing.
- They measure the country's economic progress through checking the performance of the stock, which may be an indicator of the economic performance.

SOURCE DOCUMENTS AND BOOKS OF ORIGINAL ENTRY

These are documents containing the information that makes basis of making entries in the books of accounts. They act as evidence that the transaction actually took place. They includes

- **Cash sale receipt**: - a document that shows that cash as been received or paid out of the business either in form of cash or cheque. It is a source document that is mainly used in making records in the cash journals cash book, cash accounts or bank accounts. If the receipt is received, it means payments has been made and therefore will be credited in the above accounts, or taken to cash disbursement/payment journals, while when issued, it means cash/cheque has been received and therefore will be debited in the above accounts or taken to cash receipt journals
- **Invoice**: - a document issued when the transaction was done on credit to demand for their payment. If the invoice is an incoming invoice/invoice received, then it implies that the purchases were made on credit, and if it is an outgoing/invoice issued then it implies that sales were made on credit.

The incoming invoice will be used to record the information in the purchases journals/diary, while an outgoing invoice will be used to record information in sales journals/diaries

- **Credit note**: - a document issued when goods are returned to the business by the customer or the business return goods to the supplier and to correct any overcharge that may have taken place. If it is received, then it means part of the purchases has been returned and therefore the information will be used to record information in the purchases return journals, while if issued then it means the part of sales has been returned by the customers and therefore used to record the information in the sales return journals/diaries

- **Debit note**: - a document used to correct an undercharge that may have taken place to inform the debtor to pay more. It therefore acts as an additional invoice
- **Payment voucher**: - a document used where it is not possible to get a receipt for the cash/cheque that has been received or issued. The person being paid must sign on it to make it authentic. It is therefore used to record information just as receipts

Books of original entries/Journals/Diaries/day's books/Subsidiary books

These are books where the transactions are listed when they first occur, with their entries being made on a daily basis before they are posted to their respective ledger accounts. The information in the source documents are used to make entries in these books. The books of original entries include:

- Sales journals
- Sales return journals/Return inwards journals
- Purchases journals/creditors journals/bought journals
- Purchases return journals/return outwards journal
- Cash receipt journals
- Cash payment/cash disbursement journals
- Three column cash book
- The petty cash book
- Analysis cash book
- General journals/journal proper

(i) Sales journals

This is used to record credit sales of goods before they can be recorded in their various ledgers. The information obtained in the outgoing invoice/invoice issued is used to record the information in this journal as the source document

The overall total in the sales journal is therefore posted in the sales account in the general ledger on credit side and debtors account in the sales ledger as a debit entry

Sales journal

Date	Particulars/details	Invoice no	Ledger folio	amount

Example:

The following information relates to Tirop traders for the month of June 2010

June 1: Sold goods to wafula on credit of ksh 200, invoice no 0114

2: Sold to the following debtors on credit; Wanjiru ksh 400, Musyoka ksh 300, Wafula ksh 300
5: sold goods on credit to Wanjiru of ksh 300
10: Sold goods to the following on credit Kanini ksh 100, Wafula ksh 500, Wanjiru ksh 600
12: Sold goods on credit to musyoka of ksh 350

Required:

Prepare the relevant day book for the above transactions; hence post the various amounts to their respective individual accounts

Sales journal

Date	Particulars/details	Invoice no	Ledger folio	amount
June 2010:	Wafula	0114	SL	200
1	Wanjiru		SL	400
2	Musyoka		SL	300
2	Wafula		SL	300
2	Wanjiru		SL	300
5	Wanjiru		SL	600
10	Wafula		SL	500
10	Kanini		SL	100
10	Musyoka		SL	350
12	Totals posted to the			
15	sales account (Cr)		GL	3050

(Post the rest to their individual debtors account)

(ii) Sales Return Journals/Return inwards journals

This is for recording the goods that the customers/debtors have returned to the business. It uses the information in the credit note issued as a source document to prepare it. The information is therefore recorded to the return inwards account in the general ledger, while the individual's entries are reflected (credited) also in their respective debtors account for double entry to be completed. It takes the following format

Sales return journal

Date	Particulars/details	Credit note no	Ledger folio	amount

For example;

Record the following transaction for the 2007 in their relevant diaries, hence post them to their respective ledger accounts;

May 1: goods that had been sold to M Okondo of shs 2600 on credit was returned to the business

" 2: G. Otuya returned good worth shs 1320 that was sold to him on credit to the business

" 8: the following returned goods that had been sent to them on credit to the business H Wati shs 3500, Muya shs 4700 M Okondo shs 2900

" 12: G Otuya returned goods worth shs 5400 that were sold on credit to the business

" 30: Goods worth sh 8900 that had been sold on credit to G Otuya were returned to the business

Sales Return journal

Date	Particulars/details	Credit note no	Ledger folio	amount
May				
2007:	M Okondo		S.L	2600
1	G Otuya		S.L	1320
2	H Wati		S.L	3500
8	Muya		S.L	4700
8	M Okondo		S.L	2900
8	G Otuya		S.L	5400
12	G Otuya		S.L	8900
30	Totals posted to			
	Return Inwards a/c		GL	29320
	(Dr)			

(Post the entries to the individual ledger a/c's (Cr))

Purchases Journal

This is used to record the credit purchase of goods. The totals are then debited in the purchases account in the general ledger, while the individual's creditors accounts are credited. It used the invoices received/incoming invoices as it source document. It takes the following format;

Purchases journal

Date	Particulars/details	Invoice no	Ledger folio	amount

For example

The following information relates to Mikwa Traders for the month of April 2011. Record them in their relevant day's book, hence post the entries to their relevant ledger accounts.

April 2011;

" 2. Bought goods worth shs 25 000 on credit from Juma, Invoice no 3502

3. Bought goods worth shs 16 500 from kamau on credit, invoice no 2607

6. Bought goods worth shs 12 700 from Juma on credit, invoice no 3509

8. Purchased goods of shs 25 200 from juma, invoice no 3605; shs 17 500 from Kamau, invoice no 3700; shs 45 000 from Wamae wholesalers, invoice no 3750

15. Purchased goods of shs 9 200 from Wamae wholesalers on credit, invoice no 3762

18. Bought goods of shs 17 000 from Kamau on credit, invoice no 3802

24. Purchased goods of shs 36 000 from Juma suppliers on credit, Invoice no 3812

Purchases Day book

Date	Particulars/details	Invoice no	Ledger folio	amount
April 2011:				
2	Juma	3502	PL	25 000
3	Kamau	2607	PL	16 500
6	Juma	3509	PL	12 700
8	Juma	3605	PL	25 200
8	Kamau	3700	PL	17 500
8	Wamae	3750	PL	45 000
15	Wamae	3762	PL	9 200
18	Kamau	3802	PL	17 000
24	Juma	3812	PL	36 000
	Totals posted to the Purchase account (Dr)		GL	204100

(Post the individual entries to their relevant accounts in the ledger (crediting))

(iii) Purchases Return Journals/Return outwards Journals

This is used to record goods that have been returned to the creditors by the business, reducing the value of the goods that had been purchased. It uses the credit note received as the source documents, with the totals being in the purchases return account while the individual creditor's accounts are debited in their respective ledger accounts. It takes the following format

Purchases return journal

Date	Particulars/details	Credit note no	Ledger folio	amount

For example:

Record the following transaction in the purchases return day book for Njiru's traders for the month of June 2010, hence post the information into their relevant ledger accounts.

June 2010;

" 3. Returned goods worth shs 400 that had been bought from Nairobi stores, credit note no 56

" 8. Return goods of shs 1 200 to Matayos store, Credit no 148

"19. Had some of their purchases returned to the following; Njoka enterprises shs 700, credit note no 205, Nairobi Stores shs 600, credit note no 58, Matayos store shs 1 000 credit note no 191

"26. Returned goods worth shs 1 800 to Njoka enterprise credit note no 210

"30. Return goods worth shs 1 020 to Matayos store, credit note no 200

(iv) Cash receipt Diaries

This is used to record all the cash and cheques that have been received in the business. They may be many that posting directly in the cash book may be tedious and are therefore first recorded here. It totals are posted to the cash and bank accounts in the general ledger (Dr), while the individual accounts are credited in their respective accounts in the ledger. It uses the cash receipt issued and bank slips received as the source documents. It takes the following format;

Cash receipt journal

Date	Particulars/details	Receipt no	Ledger folio	Disc allowed	cash	bank

(v) Cash payment Journals

This is used to record cash and cheques that have been issued to the creditors/out of the business. Its totals are credited (Cr) in the cash and bank account and the individual accounts are debited (Dr) in their respective accounts It uses the cash receipt received and bank slips issued as the source documents. It takes the following format;

Cash Payment journal

Date	Particulars/details	Receipt no	Ledger folio	Disc received	cash	bank

For example:

Record the following transactions into their relevant day books of Onyango traders, hence post the entries to their respective ledger accounts and balance them off;

May 2011:

"1. Cash sales amounting to ksh 3 000, receipt no 0112

"2. Paid the following creditors by cheque after having deducted a cash discount of 10% in each case; H. Mwangi ksh 1 500, J. Mwaniki ksh 1 600, N. Mugo ksh 1 200

"3. Receive the following Chaques from debtors in settlement of their debts after having deducted 5% cash discount in each case; Lucy kshs 22 800 cheque no 0115, Otieno kshs 8 550 cheque no 0011, Martha ksh 1 330 cheque no 0016

"5. Paid for repairs in cash kshs 16 000, receipt no 0251

"10. Paid Juma in cash kshs 9 500, receipt no 0295

"14. Cash sales kshs 17 000, receipt no 02714

"15. Banked kshs 6 000 from the cash till

"15. Received cash from Mary of kshs 13 500, receipt no 0258

"16. Cash sales of kshs 26 400 was directly banked, bank slip no 40152

"20. Cash purchases of kshs 8 920, receipt no 117

"22. Cash purchases of kshs 15 200 was paid for by a cheque, cheque no 512

Cash receipt journal

Date	Particulars/details	Document no	Ledger folio	Disc allowed	cash	bank
May 2011						
2011 1	Sales	0112	GL		3 000	
	Lucy	0115	SL	1200		22 800

3	Otieno	0011	SL	450		8 550
3	Martha	0016	SL	700		1 330
3	Sales	02714	GL		17 000	
14	Cash		“c”			6 000
15	Mary	0258	SL		13 500	
15	Sales	40152	GL			26 400
16						
	Totals to be posted to the cash and bank a/c (Dr)			2 350	33 500	65 080

(Post the totals and the entries to their respective accounts)

Cash Payment journal

Date	Particulars/details	Document no	Ledger folio	Disc Received	cash	bank
May						
2011	H. Mwangi		PL	166.70		1 500
2	J. Mwaniki		PL	177.70		1 600
2	N. Mugo		PL	133.30		1 200
2	Repairs	0251	GL		16	
5	Juma	0295	PL		000	
10	Bank		“c”		9 500	
15	Purchases	117	GL		6 000	
20	Purchases	512	GL		8 920	15 200
22						
	Totals to be posted to the cash and bank a/c (Cr)			477.30		19 500
					40 420	

(Post the totals and the entries to their respective accounts)

(vi) The petty Cash book

This is used to record money that has been set aside to make payments that does not require large amounts, such as cleaning, staff tea, posting letters, etc. it is always kept by the petty cashier, under the supervision of the main cashier. The amount received by the petty cashier is always debited, while the payments made from the same is credited. The credit side also contains the analytical columns for various items of expenditure. The amount credited is also extended to the analysis column for the specific item. At the end of the stated period, the petty cash book is balanced, and the totals are posted to their individual accounts. The individual's accounts are debited with the totals of the analytical columns, while the cash account is credited by the main cashier for the total that was spent in the petty cash book.

Petty cash book can also be operated on an imprest system, where the petty cashier receives a given amount of money at an intervals (imprest) to spend, and report back to the main cashier at the end of the period on how the money has been spent and the balance still remaining for re-stocking (reimbursed), and only the amount spent can be reimbursed so that at the beginning of the period the petty cashier will always have the full amount (cash float).

For example:

A petty cashier of sina chuki traders operate a petty cash book on an imprest of kshs 2 500 on a monthly basis. On 1st February 2010, she had cash in hand of shs 150 and was reimbursed the difference by the main cashier to restore her cash float. The following payments were made during the month of February 2010

Feb; 1. Travelling expenses kshs110
2. Correcting fluid kshs 200
3. Sugar for staff tea ksh 180
4. Stamps kshs 255
10. Telephone kshs 255
15. Entertainment kshs 130
18. Postage stamps kshs 100
20. Bread for staff tea kshs 148
25. Fare kshs 200
26. Duplicating ink kshs 250
27. Entertainment kshs 400
28. Telephone kshs 100
28. Atieno a creditor was paid ksh 150

Required;

Prepare a petty cash book from the above information and post the totals to the relevant ledger accounts.

Sina Chuki Traders

Petty Cash Book

For month of Feb. 2010

Receipt	L.F	Date	Details	Vouch	Total	Travel	Office	Staff	postage	Telephon	Ent.	Ledger

sh				no	sh	exp	exp	tea		e		a/c
		201										
150		0	Bal b/d									
2	C.	Feb	Reimburs									
350	B	1	ement		11	110						
		1	Travellin		0		200					
		1	g exp		20			18				
		2	Correctin		0			0	255			
		3	g fluid		18					255		
		4	Sugar		0						130	
		10	Stamps		25				100			
		15	Telephon		5							
		18	e		25	200		14				
		20	Entertain		5		250	8				
		25	ment		13						400	
		26	Stamps		0					100		
		27	Bread		10							150
		28	Fare		0	310	450		355	355	530	150
		28	Duplicati		14							
			ng ink		8			32				
250			Entertain		20			8				
0			ment		0							
22			Telephon		25							
			e		0							
			Atieno		40							
			Totals		0							
			Bal c/d		10							
					0							
			Bal b/d		15							
					0							
					24							
					78							
					22							
					25							
					00							

The totals in the analytical columns are Debited in the individual accounts, with the petty cash book totals being credited in the cash account.

(vii) The general Journal/Journal proper

This one is used to record purchases or sales of fixed assets of the business on credit. These assets do not form part of the stock since the business does not deal in them, however the business may decide to buy or sell them for one reason or the other.

In this journal, the account to be debited begins at the margin, while the account to be credited is indented from the margin, with a narration below them put in brackets. The narration simply explains the nature of the transaction that has taken place. The individual entries are then posted to their respective accounts by either debiting or crediting depending on the transactions. It takes the following format;

General journal

Date	Particulars/details	Ledger folio	Dr shs	Cr shs

For example:

Journalise then following transactions which took place in the business of J Opuche during the month of March 2005

March 5; Purchased office furniture on credit for shs 25 000 from miugiza Furniture Limited

10; Sold old duplicating machine for shs 15 000 to samba academy on credit

15; Bought a new motor vehicle for shs 800 000 from explo motors Ltd, paying shs 300 000 in cash and balance was to be settled at a later date

18; Sold old vehicle to Mara Secondary school for shs 500 000 on credit

25;The owner converted personal electronic calculator valued at shs 9 000 into business asset

27; Sold old computers valued at shs 20 000 for shs 15 000 on credit to Mara secondary school

30; Sold old dining chairs worth shs 10 000 to Maendeleo for shs 15 000 on credit

General journal

Date	Particulars/details	Ledger folio	Dr shs	Cr shs
March 2005				
5	Office Furniture a/c		25 000	
	Miugiza a/c			25 000

	(Being a credit purchase of			
	office furniture from			
10	Miugiza)		15 000	
	Samba Accadey a/c			15 000
	Duplicating Machine a/c			
	(Being credit sales of			
	duplicating machine to			
15	Samba academy)		800 000	
	Motor vehicle a/c			300 000
	Cash a/c			500 000
	Explo Motors a/c			
	(Being purchase of motor			
18	vehicle from explo. motors,		500 000	
	paying part in cash and part			500 000
	on credit)			
	Mara Sec sch a/c			
25	Motor vehicle a/c		9 000	
	(being the credit sale of old			9 000
	motor vehicle to mara sec			
	sch)			
27	Calculators a/c		15 000	
	Capital a/c		5 000	
	(being conversion of private			20 000
	calculator to business asset)			
	Mara Sec. Sch. a/c			
30	Loss on disposal a/c		15 000	
	Computer a/c			10 000
	(being credit sale of old			5 000
	computers to Mara school at			
	a loss of 5 000)			
	Maendeleo a/c			
	Furniture a/c		1 384 000	1 384 000
	Gain on disposal a/c			
	(being the credit sale of			
	dining chairs to maendeleo			
	at a gain of 5 000)			

The entries are then transferred to their respective accounts in the ledger, with the ones debited in the journals being debited and the ones credited being credited.

The Journal proper can also be used to show the opening entries and the closing entries. That is;

- **Opening entries**

The opening entries are the entries of the assets and liabilities at the beginning of the trading periods to facilitate the opening of different accounts for them. They are the balance b/d for the assets and liabilities of the business.

The assets to be debited are recorded first, followed by the liabilities and capital to be credited. In case the capital is not given, it can be calculated using the book keeping equation, that is A = C + L. the narration then follows the entries.

The opening entries are necessary when;

- A business that did not keep complete accounting records would like to start keeping
- Opening up new sets of accounting books, after closing the old ones
- Starting accounting records for a business which has been bought, though was in full operation

For example;

The following balances were extracted from Martine's store that did not keep complete records, and would like to start keeping on 1st January 2011. Prepare for them their relevant subsidiary book to show the balances.

	Shs
Motor vehicles	230 000
Machinery	40 000
Creditors	10 000
Debtors	5 000
Cash in hand	20 000
Stock	10 000
Insurance prepaid	5 000
Bank	25 000
Premises	335 000
Capital	660 000

Martine's Store
General journal
On 1st January 2011

Date	Particulars/details	Ledger folio	Dr shs	Cr shs
2011 January 1	Premises		335 000	
	Motor vehicle		230 000	
	Machinery		40 000	
	Debtors		5 000	
	Cash		20 000	
	Insurance prepaid		5 000	
	Bank		25 000	
	Stock		10 000	
	Capital			660 000
	Creditors			10 000
	(being the records of assets, liability and capital at the beginning of new period)			
			670 000	670 000

➢ **Closing entries**

At the end of the trading period the business asses how it carried out its trade and the amount of profit it made by preparing the Trading profit and loss account and the balance sheet to show its financial position. These are prepared by the information obtained from the ledgers. That is, all the nominal accounts (sale, purchase, expenses and revenue accounts), both opening and closing stocks are transferred to the trading profit and loss account through the trial balance and general journals, while the rest are taken to the balance sheet.

Uses of general journal;

- ✓ To record purchases of fixed assets on credit
- ✓ To record sales of fixed assets on credit
- ✓ To correct errors by checking the balances
- ✓ To record the opening and closing entries
- ✓ To write off bad debts
- ✓ To record the inter ledger transfers

- ✓ To issues shares and debentures in companies
- ✓ To make end of the year adjustments for the final accounts

In the table below, indicate the books of original entry that the information obtained from the given source documents are used to prepare

Source Document	**Books of Original entry**
Sales Invoice/invoice issued/Invoice retained/invoice copy	Sales journals
Purchases Invoice/Invoice received/Original invoice	Purchases journals
Credit note issued/Credit note retained/Credit note copy	Return inwards/Sales return journals
Credit note received/credit note original	Return outwards/purchases return journals
Original receipt/Receipt received	Cash payment/Analysis cash book/ Cash book
Receipt copy/Retained receipt	Cash receipt journal/Analysis cash book/cash book
Petty cash voucher	Petty cash book

Uses of Journals

- ❖ To relive ledger of many details
- ❖ To record more details about the transaction that are not found in the ledger
- ❖ To facilitate tracing of errors
- ❖ To facilitate the preparation of control accounts
- ❖ To curb frauds and promote efficiency, since they are prepared by different people from the ones handling ledgers

Assignment:

(Exercise 1B pages 50 and 51, Nos16 and 18 in Inventor book 4, KLB Students book)