isabokemicah@gmail.com

COMPLETE BUSINESS STUDIES BOOK

MR ISABOKE MICAH

0714497530

About the book

Education is a key for a country's development, but it becomes a hindrance when it is unequally distributed. This big problem of disparity in Education system can be solved through technology. Hence it's high time we embrace technology in Education sooner than later.

Teachers will therefore use the book in their laptops to teach and even give students notes to read online after revision.

The design of this book make it lively and interesting for both teachers and students as it take us away from the monotony of black and white books. The book is divided into two parts: Theory and Accounting.

We have past K.CSE questions at the end of every topic for further understanding and testing.

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Business Studies (565)

Paper 1: 2 hours - 100 marks

The paper will consist of 25 compulsory short answer questions.

Paper 2: *2 ½ hours* -100 marks

The paper will consist of six (6) essay questions for candidates to ***answer five (5).*** The questions will cover all or any of the areas that make up the course - ***Commerce, Entrepreneurship, Accounting, Office Practice and Economics.***

CHAPTER ONE

BUSINESS STUDIES

Specific Objectives

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

a) Explain the meaning of business studies;

b) Explain the importance of business studies in society.

Content

a.) Meaning of business studies

b.) Importance of business studies in society

Introduction

Definitions

Business

The term business refer to any activity that is carried out by an individual or organization with an aim of making a profit.

Business studies

This is the study of the activities that are carried out in and around production, distribution and consumption of goods and services.

Goods

These are items or things that are tangible in that they can be touched and felt.

Services

These are actions or activities that may be sold and they are intangible.

Production

This is the Creation of goods and services or increasing their usefulness through activities such as transporting them to where it is required. People who produce goods and services are called producers.

Distribution

This is the movement of goods and services from producers to the users. Activities taking place during distribution.

- ✓ Transportation
- ✓ Storage
- ✓ Insurance.
- ✓ Communications
- ✓ Buying and selling
- ✓ Banking
- ✓ Advertising

Consumption

This is the usage of goods and services. Those who use the goods are called consumers.

Economics

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

Commerce

This is the study of trade and aids to trade. Aids to trade are human activities or services that assist trade to take place such as transport, banking, warehousing and communications.

Accounting

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

Office Practice

This refers to all the activities that are carried out in an office. For example, communication, filing, reproduction of documents and clerical work.

Entrepreneurship

This is the study of the activities involved in the process of identifying a business opportunity and acquiring the necessary resources to start and run a business.

Importance of business studies in the society

a.) Assist members of the society to relate the knowledge, skills and attitudes acquired to the day to day running of the business.

b.) Equips the members of the society with skills and knowledge to start and run a business

c.) Assist the individuals with in appreciating the role of business in provision of goods and

services.

d.) Makes the members of the society to appreciate the need for good business management practices.

e.) Helps individual to attain self-discipline and positive attitude towards work.

f.) Equips the individual with knowledge and skills to require to evaluate business performance.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Highlight four ways in which business studies is useful to a community. (4mks)

CHAPTER TWO

BUSINESS AND ITS ENVIRONMENT

Specific Objectives

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;

Content

a.) Meaning and purpose of a business

b.) Business activities

c.) Business environment:

- ✓ Internal
- ✓ External

d.) Effects of various business environments on a business

Introduction

Purpose of a business

The main purpose of starting a business include:

- ✓ To help individuals to interact with other people.

- ✓ To earn foreign exchange.
- ✓ To earn money for your basic needs.
- ✓ To create job opportunities.
- ✓ To enable an individual acquire other goods and services.

Types of business activities

The main type of business activities are as follows:

a.) Extraction

This involves obtaining goods from their natural settings. These activities are:

- ✓ Lumbering
- ✓ Fishing
- ✓ Mining
- ✓ Farming

b.) Processing of raw materials

This involves changing the form of a good without combining it with other goods. Examples include:

- ✓ Grinding
- ✓ Refining

c.) Manufacturing

This involves combining different raw materials to come up with one final product.

d.) Construction

This involves building of structures such as roads, bridges and buildings.

e.) Distribution of goods

This refers to movement of goods from where they are produced to where they are needed. People who carry out distribution are called distributors. Examples include:

- ✓ Retailers
- ✓ Wholesalers

f.) Trade

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

g.) Provision of Services

This is the selling of services to consumers .Services include:

- ✓ Hair stylist
- ✓ Car washer
- ✓ Electrician
- ✓ Insurance companies.

Business Environments and their Effects on the business

This refers to conditions or factors that affect business operations. They are divided into two;

- ✓ Internal environment
- ✓ External environment.

Internal environment/micro-environment

This consist of factors which are within the business unit itself. These factors include:

a.) Business structure

This is a formal arrangement of activities that are carried out at various levels of the organization so that the objectives of the business can be achieved.

b.) Resources

These are things used to achieve an objective of an organization. They include:

- ✓ Human resource
- ✓ Financial resources
- ✓ Physical resources
- ✓ technology

c.) Business culture

Combinations of employees, expectations, beliefs and values within the business.

d.) Owners

These are people who provided finances to start the business.

External environment/macro- environment

These are factors that affect the business from outside. These factors include the following factors:

a.) Economic environment

These factors affect the buyer's ability to buy goods offered to them by a business. They include:

- ✓ Changes in income.
- ✓ Changes in tax rates.
- ✓ Changes in price of other related goods

b.) Demographic environment

This is the population change. Increase in population increases the ability to buy more goods compared to reduction in population. It include the following:

- ✓ Size of the population.
- ✓ Geographical distribution.
- ✓ Age and sex distribution.
- ✓ Birth and death rates.

c.) Legal – political environment

These are laws and policies that regulate business activities. Hence the business to be formed in a country must be in line with the laws and regulations.

d.) Technological environment

Technology ay refer to the level of know how or efficient use of tools and equipment. Advancement in technology will lead to better quality goods and services.

e.) Cultural Environment

Culture are the norms that regulate behaviors of people in a society. Culture dictates how people live and what they consume.

f.) Competitive Environment

This is where firms are trying to outdo each other in their efforts to maximize profits.

g.) Physical Environment

Physical environment include factors such as:

- ✓ Relief and climate.
- ✓ Infrastructure like roads, water supply, electricity and banks.

Good infrastructure may support business activities compared to poor infrastructure.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

CHAPTER THREE

SATISFACTION OF HUMAN WANTS

Specific Objectives

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

a) Explain the meaning and characteristics of human wants;

b) Classify human want;

c) Explain the meaning of goods and services;

d) Discuss characteristics of goods and services;

e) Explain the meaning and characteristics of economic resources;

f) Relate the concepts of scarcity, choice and opportunity cost to real life situations.

Content

a.) Meaning and characteristics of human wants

b.) Types of human wants

c.) Meaning of goods and services

d.) Characteristics of goods and services

e.) Economic resources

f.) Relation between scarcity, choice and opportunity cost to real life situations

Introduction

Human wants

These are the desires that human beings strive to satisfy by using goods and services.

Satisfaction of human wants

This is the process of acquiring and using goods and services.

Characteristics of human wants

a.) They are complementary

Satisfaction of one want may lead to another want.

b.) Competitive

They compete for attention such that each one of them yearns to be satisfied first.

c.) Vary in urgency and intensity

The amount of goods to be satisfied vary from one person to another and from time to time depending on age, sex and situation.

d.) They are insatiable

Human wants cannot be fully satisfied because they are endless and unlimited in number.

e.) They require resource

Human wants requires resources to be satisfied such as money

f.) Some are universal

Most human wants are common to everybody although they vary in quantities.

g.) They are recurrent (repetitive)

A particular want will demand to be satisfied over and over again because wants are not fully satiable.

Types of human wants

I.) Basic wants/needs/primary wants

These are requirements that one cannot do without because they are necessary for life. They fall under food shelter clothing.

Characteristics

- ✓ One cannot do without them.
- ✓ They are felt needs.
- ✓ They cannot be postponed.
- ✓ They are satisfied before secondary wants.

II.) Secondary wants

These are requirements that one can do without but they are required to make life more comfortable. They are categorized into:

a.) Comfort

These are wants that improve one's living standards beyond the level of mere survival

b.) luxury

These are requirements that provide excessive comforts.

Goods and services

Goods are physical commodities that are tangible while services are actions which are intangible.

Characteristics of goods

a.) Are tangible

They can be touched and felt because they are material.

b.) Can be stored

They can be stored for future .The ones that can be stored for longer time are called durable goods while perishable goods cannot be stored for a longer time.

c.) Quality can be standardized

The quality of goods can be made uniform through mechanization.

d.) Can change possession

Goods can change ownership from one person to another through trade.

e.) Can be seen

Most goods can be seen except for a few exceptions such as air.

f.) Can change in quality over time

Some goods may lose value over time such as motorcars and furniture.

Characteristics of services

a.) Are intangible

They cannot be felt or touched because they are immaterial.

b.) Cannot be stored

Services cannot be stored for future use because they can are consumed as they are provided.

c.) Quality cannot be standardized

Quality cannot be standardized because the quality of services are highly variable over time and from one provider to another.

d.) Inseparable from the provider

Services cannot be separated from the provider as they are provided directly to the consumer.

e.) Cannot be seen

They cannot be seen since they are intangible and immaterial.

Differences between goods and services

Goods	Services
Are tangible	Are intangible
Can be stored	Cannot be stored
Can be standardized	Cannot be standardized

Can change possession	Cannot be separated from the provider
Not all goods are perishable	Services are highly perishable
Most can be seen	Cannot be seen
Can change in value	Cannot change in value since they cannot be store

Characteristic of Economic resources

a.) Scarce in supply

Economic resources are less in supply than what is required by human beings

b.) Have money value

Economic resources have monetary value through which they can change ownership

c.) Unevenly distributed

Some places may have plenty of the resources while others may have less because they are available in varying quantities.

d.) Have utility

Utility is the usefulness or ability to satisfy a human want.

e.) Have alternative uses

Economic resources can be put into different uses

f.) Can change ownership

Change in monetary value from one person to another may be effected by sale since it has monetary value.

g.) Can be combined

Economic resources can be combined in various quantities to produce other goods and services.

h.) Can be complimentary

Different economic resources may be consumed together.

Classification of economic resources

They can be categorized as discussed below:

a.) Natural resources

They are resources that occur naturally, man play no part in their creation. They include forests, rivers, mountains, lakes, climate and land.

b.) Man- made resource

They are resources that are created by human beings to be used in satisfying their wants. They are also called artificial goods. Man –made resources are used to produce goods that are either consumer or producer goods.

Consumer goods – goods consumed directly.

Producer goods –goods used to produce other goods. Also known us capital goods.

c.) Human resource

These refers to human beings when rendering their services in production.

Renewable Resources and Non – renewable Resources

a.) Renewable resources

These are resources whose supply can be restored and if they are not, creation of goods and services is reduced and it may stop altogether.

b.) Non – renewable resources

These are resources whose supply cannot be restored after use.Using these resources can lead to their resources.

Renewable resources	Non – renewable resources

Wood	Coal
Natural rubber	Building store
Wool	Gravel
Silk	Iron
Leather	Aluminum
Solar energy	Gold
Hydro – electric power	Lead
Wind power	Natural gas

Relationship between Scarcity, Choice and Opportunity Cost

Scarcity refers to as less than, inadequate in supply or limited supply of economic resources in relation to unlimited human wants. Limited resources necessitates choice thus making choices among various competing alternatives according to the order of priority. When choice is made the foregone item becomes the opportunity cost. Opportunity cost is therefore the value of the forgone alternative where choice has been made.

Opportunity cost is the value of the forgone alternative where choice is made.

Scale of preference is a list of wants in order of their importance.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1995 Classify each of the following goods as either producer or consumer (3mks)

Good	Classification
a) Factory	

b) privates car

c) Iron ore

d) Tools

e) Exercise books

f) Clothing

2. 1196 outline three characteristics of basic human wants. (3mks)

3. 1996 outline four measures that may be taken to conserve forests in Kenya (4mks)

4. 1997 State four ways in which natural resources may be of benefit to a country. (4mks)

5. 1997 Give four reasons why a consumer should satisfy basic wants before secondary wants. (4mks)

6. 1998 Kenya relies heavily on oil as a source of energy. State four reasons why the country should develop alternative sources of energy. (4mks)

7. 1999 State four reasons why consumers have to make a choice between competing needs. (4mks)

8. 2000 State four characteristics of human wants. (4mks)

9. 2001 State three basic wants that individuals in a society have (3mks)

10. 2002 highlight four disadvantages of mining as an economic activity (4mks)

11. 2003 State four reasons why a government may decide to control the exploitation of its natural resources. (4mks)

12. 2004 State whether each of the following activities would satisfy basic or secondary needs. (4mks)

Activities	Basic / Secondary
a) Buying clothes for the family	
b) Transporting farm produce	
c) Providing food for school children	
d) Entertaining a guest	

13. 2005 Outline four ways in which commerce satisfies human wants,(4mks)

CHAPTER FOUR

PRODUCTION

Specific Objectives

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

a) Explain the meaning of production;

b) Distinguish between the different types of utility;

c) Distinguish between direct and indirect production;

d) Describe the levels of production and occupations relating *to* each;

e) Discuss the factors of production and the rewards for each;

f) Explain the role of division of labour and specialization in the production process;

g) Classify goods and services produced in an economy.

Content

a.) Meaning of production.

b.) Types of utility.

c.) Direct and indirect production.

d.) Levels of production and related occupations.

e.) Factors of production as their rewards.

f.) Division of labour and specialization.

g.) Factors that influence the mobility of factors of production.

h.) Classification of goods and services produced in an economy

Introduction

Definition

This is the creation of goods and services or increasing their usefulness to became more satisfying.

Utility

The ability of a good or service to satisfy human wants.

Types of utility

i.) Form utility

This is changing the form of a commodity by converting raw materials to finished goods. For example it can be done though processing.

ii.) Time utility

This is created by storing the goods until the appropriate time to use it. For example storing food for later use.

iii.) Place utility

This is the bridging of geographical gap between the producers and consumers through transportation. For example transporting goods from one area to another.

iv.) Possessive utility

This is the transfer of ownership of goods from one person to another through trade.

Direct and indirect production

There are two types of production:

- ✓ Direct production.
- ✓ Indirect production.

Direct production/subsistence

This is production of goods and services for personal use and the products are not marketed.

Characteristics of Direct Production

- ✓ Productivity usually on small scale
- ✓ Usually for own consumption
- ✓ Production is not for the market
- ✓ Use simple method of production
- ✓ Goods and Services are of low quantity and quality
- ✓ Encourages individualism.
- ✓ Leads to low standards of living.
- ✓ Can be very tiring.

Indirect production

This is the production of goods and services with the aim of selling excess in order to acquire what one does not produce.

Characteristics of Indirect Production

- ✓ Production with a view of exchange.
- ✓ The producer specializes in one or a few areas of production.
- ✓ It results in surplus production of goods and services.
- ✓ Goods produced are of high quality.

Level of production and Related Occupation

There are three levels of production.

a.) Primary level/extractive

This level involves extraction of goods from their natural setting.

b.) Secondary level

In this level raw materials are transformed into finished product or into more useful forms.

c.) Tertiary level

This level of production deals with provision of services and it is divided into three categories as follows:

- ✓ Communal Service
- ✓ Direct personal services.

Level	Nature	Examples
Primary	Extractive	Lumbering , Mining Farming
Secondary	Processing	Maize milling , coffee processing, Oil refining
	Manufacturing	Maize milling, Manufacturing
	Constructive	Road building ,Railway Construction
Tertiary	Commercial services	Banking , Insurance ,Wholesaler
	Direct personal services	Teaching ,hairdressing ,Medical Care

Factors of production

These are resources that are necessary in the production process. They are resources or agents required in the production, without which production is not possible. They are discussed as follows:

a.) Land

Land refers to all the natural resources. For example. Soil, mineral, rivers, lakes and climate. Rewards for land are:

- ✓ Royalty
- ✓ Rent
- ✓ Rates
- ✓ Commission

Characteristics of land as a factor of production

- ✓ Basic factor of production.
- ✓ Supply is fixed.
- ✓ It lacks geographical mobility.
- ✓ Quality is not homogeneous.
- ✓ Productivity of land can be increased by increasing quantity and quality of capital.

- ✓ It is subjected to the law of diminishing returns.
- ✓ It is a natural resource.

b.) Labor

This is human physical or mental effort applied in production. Rewards for labor are:

- ✓ Wages.
- ✓ Salaries.

Characteristic of labor as a factor of production

- ✓ Basic factor of production.
- ✓ Cannot be stored.
- ✓ Labour cannot be separated from the laborer.
- ✓ Laborers sell their labour and themselves.
- ✓ Labour is mobile.

c.) Capital

This refers to all man – made resources used in production of goods and services. Rewards for labour:

- ✓ Interest
- ✓ .

Characteristic of labour as a factor of production

- ✓ Man – made hence supply is under man's control.
- ✓ Basic factor of production.
- ✓ It is subjected to depreciation.
- ✓ Can be improved through technology.

d.) Entrepreneurship

This is the ability to organize other factors of production in appropriate proportions for effective production.The rewards are:

- ✓ Profit
- ✓ .
- ✓ .

Function of entrepreneurship

- ✓ Identifies viable business opportunity.
- ✓ Combine the other factors of production.
- ✓ Provides capital required to carry out production.
- ✓ Employs and rewards other factors of production.

- ✓ He bears all the risks and losses.
- ✓ He makes all the decisions on the business.
- ✓ He controls and manages the business.

Division of labour and specialization

Division of labour

This is where a production process is broken down into stages and each stage is assigned to an individual are group of individuals.

Specialization

This refers to where one concentrates in the production of what he/she can produce best leaving other people to produce other commodities.

Advantages of division of labour and specialization

- ✓ Output per worker is greatly increased.
- ✓ Production of high quality goods and service.
- ✓ A worker can engage in a trade which she/he is best talented.
- ✓ Specialization encourages invention and innovation.
- ✓ Makes production faster and efficient.
- ✓ Enable a worker to acquire skills in a particular field.
- ✓ Division of labour saves time.

Disadvantages of division labour and specialization

- ✓ Specialization leads to monotony of work resulting to boredom.
- ✓ Hinders creativity since people work mechanically just like machines.
- ✓ Specialization make a worker depends on one trade.
- ✓ Use of machines is encouraged which creates unemployment.
- ✓ Specialization may make a country dependent on other countries.
- ✓ Many people are brought together leading to social problems such as crimes and prostitution.

Classification of goods and services produced in an economy.

Consumer goods are produced for final or direct use by the buyer. E.g. food and clothing.

Producer goods produced to be used in production of other goods. E.g. Machines.

Free Goods they are available in abundant as gifts of nature. E.g. Air.

Economic goods they are goods which are scares in supply and have money value. E.g. human resource.

Perishable goods are those that go bad very easily unless stored in special facilities. E.g. flowers and fruits.

Durable goods are those that will continue giving services for a long time. E.g. vehicles and television.

Public goods are those goods that belong to no one in particular but are owned by the government or by all collectively. E.g. roads, airports and rivers.

Private goods are owned by individuals. E.g. personal cars and private schools.

Intermediate goods are goods that are not ready for use before they are further processed. E.g. sisal, Sugar- cane and wheat.

Finished goods are final products that come out of production in the required form. E.g. Furniture from Timber.

Material goods are commodities that are tangible like books, chairs and vehicle.

Non –material goods are services such as teaching, nursing, entertaining.

Ways in which production activities affect environment.

i. Depletion of productive resources e.g. forests, fish in lakes, exhaustion of minerals.

ii. Degradation of environment which may lead to climate changes that may have adverse consequences on the lives of the people.

iii. Pollution of air and water which is detrimental to both human and animal life.

iv. Problem of disposal of solid and plastic waste which may result in spread of diseases.

v. Adverse effects on the ozone layer posing a threat to the future of mankind. For example continues depletion of ozone would lead to increased cases of skin cancer.

vi. Pollution of human habitat making it unhealthy and prone to diseases.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAST KCSE PAPER 1

1. Classify each of the following production activities as either primary or tertiary.

(3mk)

Activity	Level of production
a) Digging clay soil	
b) Constructing a bridge	
c) Selling in shop	
d) Making tea	
e) Transporting medicine	
f) Growing vegetables	

2. Outline four reasons why production in the substance sector is usually low. (4mks)

3. Name four commercial services which are useful to the manufacturer. (4mks)

4. Outline four reasons why a multinational company may prefer setting up a production unit in a developing country instead of exporting finished goods to the country. (4mks)

5. Classify each of the following activities as either primary, secondary or tertiary. (4mks)

Activity	Classification
a) Planting maize	
b) Grinding maize	
c) Selling maize	
d) Harvesting maize	

6. State the meaning of the following terms. (4mks)

   Consumer goods

   Producer goods

7. Name the factor that each of the following resources relate to (5mks)

	Resource	Factor of production
a)	Manager	
b)	Vehicle	
c)	Cotton	
d)	Water	
e)	Owner	

8. Outline three characteristics of direct production. (4mks)

9. Outline four factors that may account for predominant direct production (4mks)

10. List four functions of entrepreneurs as a factor of production (4mks)

11. State four roles of an entrepreneur in production. (4mks)

PAST KCSE PAPER 2

1. Highlight five ways in which an Entrepreneur contributes to the production of goods.

2. Explain five ways in which large scale organization are able to reduce their costs of production.

(10mks)

CHAPTER FIVE

ENTREPRENEURSHIP

Specific Objectives

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

a) Explain the meaning of entrepreneurship;

b) Discuss the importance of entrepreneurship to an economy;

c) Describe the characteristics of an entrepreneur;

d) Generate business ideas;

e) Identify a business opportunity;

f) Evaluate a business opportunity;

g) Explain the need for business plan;

h) Discuss the factors that influence entrepreneurship in Kenya;

I) discuss the causes of business success;

j) Recognize the need for ethical practices in business.

Content

a.) Meaning of entrepreneurship.

b.) Importance of entrepreneurship to an economy.

c.) Characteristics of an entrepreneur.

d.) Business ideas.

e.) Business opportunity.

f.) Evaluating a business opportunity.

g.) Need for business plan.

h.) Factors that influence entrepreneurship in Kenya.

i.) Causes of business success

Introduction

Definition

The process of identifying a business opportunity and getting the necessary resources to start and run the business.

Entrepreneur

This is the person who creates new businesses or transforms the existing ones in the face of risks and uncertainties in order to make profit.

Importance of entrepreneurship to an economy

a.) Creation of employment

Through entrepreneurship jobs are created for people who would otherwise be jobless by absorbing them.

b.) Formation of capital

Entrepreneurs are able to create capital in many ways such as using the profit earned to expand the business.

c.) Reduced rural urban migration

Entrepreneurs are able to set up businesses in the rural areas and employ local people who would have otherwise gone to urban areas to look for employment.

d.) Raising standards of living

Entrepreneurs are able to create goods and services which improve the standard of living of the people and also the salries they get from the employments.

e.) Savings on imports

Local entrepreneurs are able to create goods and services which would have been imported therefore saving the money used on imports.

f.) Improving infrastructure

Areas where many business are set up the government may improve infrastructure such as roads, security or communications to help business.

g.) Making use of local resource

Entrepreneurs makes use of local resources which may have been idle to create goods and services.

h.) Promotion of technology

Entrepreneurs are very creative such that they contribute to development of technology.

Characteristics of an entrepreneur

- ✓ Desire to achieve.
- ✓ Ability to solve problems.

- ✓ Readiness to take risks.
- ✓ Initiative.
- ✓ Time consciousness.
- ✓ Creativity and innovation.
- ✓ Independence.
- ✓ Self-confidence.
- ✓ Desire for feedback.

Business ideas

These are the basic points of the prospective business that an entrepreneur may need.It may indicate the following:

a.) The products the business will sell.

b.) Who the business will sell to.(market)

c.) Where the business will be located.

d.) How the business will run (management).

e.) Why the business is needed (objectives).

Sources of business ideas

I.) Newspapers.

II.) Shows and exhibitions.

III.) Magazine articles.

IV.) Hobbies.

V.) Vocational training and experience.

VI.) Surveys.

VII.) Waste products

VIII.) Spotting a market gap (niche).

Business opportunity

This is an attractive project ideas that an entrepreneur accepts for investments.

Identifying business opportunity

Business opportunity exist where there is a gap in the market that needs to be filled. Examples of such gaps are:

Unavailability of products

This is where the goods and services needed by the consumers are not available in the market.

Poor quality products

A business opportunity may exist where one offers quality goods and services.

Insufficient quantities

This is where the demand for goods and services is higher than quantity demanded

Unaffordable prices

A business opportunity may exists if one would charge lower prices.

Poor services

A business opportunity exists where customers are not well served.

Evaluating a business opportunity

This means assessing whether the identified opportunity is viable or not.

Factors to consider when carrying out business opportunity evaluation

a.) Personal consideration

These are the abilities and expectations of an entrepreneur and they include:

- ✓ Objectives
- ✓ Skills
- ✓ Commitments
- ✓ Interest

b.) Business consideration

These are external factors that are likely to affect business operations and they include:

- ✓ Availability of market
- ✓ Technology
- ✓ Raw materials
- ✓ Government policy
- ✓ Level of competition
- ✓ Security

Business plan

This is a written document that highlights the objects of the business and steps to be followed.

Need for a business plan

a.) Avoid mistakes

Mistakes are identified early and corrected early in the plan.This helps in avoiding occurrence of such mistakes in the business.

b.) Identifying strengths and weaknesses

A business plan helps in revealing the strengths and weaknesses in the business.

c.) Requirement by financiers

Financial institutions such as banks may require the business plan before they can accept to finance the business activities.

d.) Determination of the amount of finances required

A business plan enables in working out the amount of finance that is required to fund the various activities in the business.

e.) Allocation of resources

It helps entreprenuers to allocate the available resources in the most appropriate way.

f.) A motivating factor

A business plan is communicated to all employees in the business making them to work towards the goals hence its motivating factor.

g.) Adaptability

A business plan should give room for adoption of any changes that might occur in future.

Factors that influence entrepreneurial practices

a.) Government policy

Favorable government policies may encourage business activities while unfavorable government policies such high taxation will tend to discourage them.

b.) Infrastructure

Availability of good infrastructure in an area tends to encourage people to set up business while poor infrastructure tends to discourage them.

c.) Levels of education and skills

An entrepreneur who has appropriate knowledge and skills stands a better chance of succending in a businesss than the one who does not.

d.) Availability of markets

Adequate market will encourage production of goods and services and also encourage more

investors compared to inadequate market which will discourage entrepreneurs.

e.) Availability of resources

A business that uses modern technology is able to produce quality goods and services. Such services will attract more customers leading to an increased market for their goods.

f.) Culture

Culture determines the kind of goods and services that the people consume. The culture may favored the business or not.

g.) Competition

A business will thrive if it is able to compete favorably with others.

h.) Political stability

Political stability will encourage formation and growth of business due to favourable environment compared to political instability which will discourage formation of new business and affect the existing ones due to insecurity.

i.) Natural factors

Natural factors such as rainfall, temperatures, earthquakes, pest may influence the type of business that is carried out in a particular area.

Causes of business success

a.) Ability to manage people

Activities involved in the management of people

- ✓ Hiring
- ✓ Assigning duties
- ✓ Supervision
- ✓ Training
- ✓ Motivation

b.) Proper location/availability of customer

A business where customers are easily available has high chances of being succesfull.

c.) Availability of raw materials or stock of goods

A business requires continues supply of raw materials or stock of goods this would enable it to continue operating to meet customer's needs.

d.) Adequate finance

A business with adequate money is able to do well because it has money to finance its operations.

e.) Lack of Competition

A business operating in an area of little or no competition is likely to succeed than where there is high competition.

f.) Commitment to the business

The entrepreneur should be committed only to his or her business and this will give him or her time to manage the business well than when he/she is committed elsewhere.

g.) Good public relations

Good public relation is necessary for attracting and retaining customers.

h.) Being creative and innovative

Creativity and invotation enables the entrepreneur to stay ahead of competition as he finds new users of a product and even new pricing methods.

Ethical issues in Business

Business ethics helps businesses in deciding what actions are right and wrong depending on circumstances.

Need for ethical issues in business

- ✓ Ensures no discrimination in business
- ✓ Creates fairness in competition
- ✓ Ensures protection of the environment
- ✓ Ensures fair play in competition
- ✓ Helps in avoiding environmental degradation
- ✓ Helps in avoiding environmental pollution
- ✓ Avoids consumer exploitation

End of topic

Did you understand everything?
If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

CHAPTER SIX

THE OFFICE

Specific Objectives

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

a) Explain the meaning of an office;

b) Explain the functions of an office;

c) Describe the various office layouts;

d) Explain the uses of various office equipment,

e) Discuss the role of filing in an office;

f) Discuss the duties of various categories of office staff;

g) Describe essential qualities of each category of office staff;

h) Discuss trends in office management.

Content

a.) Meaning of an office

b.) Functions of an office

c.) Types of office layouts

d.) Office equipment

e.) Role of filing in an office

f.) Duties of various office staff

g.) Essential qualities of office staff

h.) Trends in office management

Introduction

An office can be defined as a place, room or building set aside in an organization where communication, secretarial, accounting, administration and clerical work take place.

Functions of an office

i.) Receiving and recording information

The office receives information with means such as letters, telephone calls, orders invoices face to face conversation and reports.

ii.) Distribution (dissemination) of information

The information is passed to other officers concerned for implementation or action.

iii.) Mailing

This involves processing and sending out letters.

iv.) Reproduction of documents

Documents can be reproduced using typewriters, carbon copying, photocopying, duplicating and printing.

v.) Communication

This is the passing of information from one person to another. The office always serve as the centre of communication.

vi.) Safeguarding and controlling of organization's property

The office should ensure that the organization's property is protected and controlled. This may be done through:

- ✓ Insuring the assets.
- ✓ Repairing the assets.
- ✓ Monitoring/supervising their use.
- ✓ Having a record of all assets.
- ✓ Regular servicing of the assets.
- ✓ Appointing staff to take care.
- ✓ To be used on the intended purpose.

vii.) Filling

This is storing of information mainly in files.

Characteristics of a good filing systems

- ✓ Should be simple.
- ✓ Should be flexible/elastic.
- ✓ Be economical
- ✓ Be compact.
- ✓ By not occupying much space.
- ✓ Easy to access.
- ✓ Be safe/secure.
- ✓ Suitable to the organization.
- ✓ Have cross reference.

Role of filling in an office

i. Documents are protected from loss and landing into unauthorized hands.

ii. Aids in office tidiness and efficiency.

iii. Aids to memory as it can be used for future reference.

iv. Documents are kept neat and tidy.

v. Information is stored systematically and can be easily retrieved.

Machines used in reproduction of documents

a.) Carbon copying

The method used to obtain copies using carbon papers. The copies can either be handwritten or typed.

Advantages

i. Convenient especially where few copies are required.

ii. Cheap.

iii. No special training is required.

Disadvantages

i. Not convenient for many copies.

ii. Copies can be misaligned.

iii. Poor quality copies.

iv. Difficult to produce different colors.

v. Copies of photographs cannot be reproduced.

b.) Duplicating

Duplicating is a process whereby a number of copies are obtained with the help of a master copy. A duplicator can produce copies of a notice or report in quantities ranging from less than a hundred to thousands.

The main types of duplicators.

i. Ink duplicator

It uses ink to reproduce documents

Advantages

- ✓ Quite cheap when many copies are used.
- ✓ Errors made on the stencil can be corrected by use of correcting fluid.
- ✓ Copies are permanent and relatively of good quality.
- ✓ Stencils can be stored to be re-used.
- ✓ It is fast.

Disadvantages

- ✓ Expensive where a few copies are required.
- ✓ More time consuming than photocopy.
- ✓ Only coarse absorbent paper can be used hence not suitable for quality copies.
- ✓ Separate runs are required if two or more colors are needed.

ii. Spirit Duplicator

This machine is also known as a hectograph .Spirit duplicators are used to reproduce drawings, handwritten and typewritten matter in a variety of colors. A 'master sheet' is prepared on a special paper with a glossy surface.

Advantages

- ✓ Economical where few copies are required.
- ✓ Copies can be produced in several colors.

Disadvantages

- ✓ Not suitable for many copies.
- ✓ Copies fade out in the course of time.
- ✓ The master is expensive.

iii. Photocopying

This is the reproduction of an exact copy of an original document by use of a photocopier.

Advantages

- ✓ Cheap only a few copies are required.
- ✓ Quicker than duplicating or printing.
- ✓ No special training is required for the operators.
- ✓ Copies produced are of high quality.
- ✓ Colored copies are also possible in some machines.
- ✓ Does not pollute the environment.

Disadvantages

- ✓ Expensive for a large number of copies.
- ✓ Copies may fade out over time.
- ✓ Only selected colors can be copied.
- ✓ It is convenient hence can easily be misused.
- ✓ Cannot be used where there is no electricity.

iv. Printing

This is a method of reproducing documents using either a printing machine or by mechanical means.

Advantages

- ✓ High quality copies.
- ✓ Different colors can be reproduced.
- ✓ Convenient for many copies.
- ✓ Does not pollute the environment.

Disadvantages

- ✓ Expensive
- ✓ Trained personnel is required.
- ✓ Requires electricity.

v. Stencil /screen printing

This is a method of printing where a screen is used. This method is used to print large or irregular surfaces that cannot be fed into machine.

Advantages

- ✓ Cheap
- ✓ Stencils may be stored for future use.
- ✓ Corrections on stencil can be made with the help of correcting fluid.
- ✓ Can be used to produce a variety of colors.
- ✓ Little training is required.

Disadvantages

- ✓ Poor quality.
- ✓ Mass production is difficult.
- ✓ May pollute the environment.

vi. Offset Lithography

This is where the document to be reproduced is filmed using a camera and the information on the films used to produce an image on a flat sheet of metal called a plate.

Advantages

- ✓ Documents produced are of high quality.
- ✓ Appropriate for mass production.

Disadvantages

- ✓ Initial and maintained cost of machines are high.
- ✓ Pollutes the environment.
- ✓ Printing is mainly done on paper which is obtained from trees.
- ✓ Requires a lot of monitoring.

Types of office layout.

Office layout refers to the outlook, arrangement and positioning of furniture and equipment in an office.

a.) Open office layout.

This is a large room where all staff work.

Advantages of open office layout

- ✓ Easy supervision of workers.
- ✓ Construction cost is low because partitions are few.
- ✓ Easy location of workers.
- ✓ Staff movement is minimized thus saving time used in passing information.
- ✓ Promotes teamwork among employees.
- ✓ Maintenance cost is low.
- ✓ Floor space is saved.
- ✓ Discourage absenteeism by employees.

Disadvantages of open office

- ✓ Disruption from colleagues.
- ✓ Senior workers are not placed in areas of privacy failing to confer status to them.
- ✓ Untidy and un–business like appearance.
- ✓ Contagious diseases may easily be passed.
- ✓ There is no privacy.
- ✓ Noise from workers and machines.

b.) Enclosed office lay out

This is an office which is normally occupied by one or two people.

Advantages of enclosed office layout.

- ✓ There is privacy for confidential discussions.
- ✓ There is less noise and disruption from workers and machines.
- ✓ Conducive working environment.
- ✓ Confer status to top level employees.
- ✓ Provides security for valuable and sensitive items such as documents and cash.

Disadvantages of enclosed office.

- ✓ There is no close supervision of workers.

- ✓ Costly to construct and to maintain.
- ✓ Encourage absenteeism.
- ✓ A lot of time is taken by officers when moving from one office to another.
- ✓ Encourages laxity in office.
- ✓ Reduces interaction between managements and other employees.
- ✓ Possible misuse of office facilities.

Differences between open plan and partitioned/closed layout

Open plan	Partitioned Layout
i) Large office ii) Accommodates many workers/ staff iii) Allows sharing of resources iv) Cheaper to construct/ maintain/ decorate v) Suitable for general work/ work that does not require concentration/ secrecy vi) Suitable for junior where space is limited vii) Encourages team work viii) Easy to supervise workers	i) Small offices ii) Accumulates few workers or staff iii) Limits sharing of resources iv) Expensive to construct maintain/ decorate v) Suitable for work that is confidential/ requires concentration vi) Suitable for senior workers vii) Suitable where space is abundant viii) Encourages individualism ix) Difficult to superior/ monitor workers

c.) Landscape office layout

This type of office layout is similar to open office layout but of higher standards in terms of outlook, furniture and other equipment.

Advantages of landscape office layout

- ✓ Promotes team work among employees.
- ✓ Promotes sharing of office equipment thereby reducing the costs buying more.
- ✓ Supervision of workers is easy since the manager may be at a raised ground.
- ✓ Maintenance cost is low.
- ✓ Easy location of workers.
- ✓ Discourages absenteeism of employees.
- ✓ Decoration found in the office creates an attractive and conducive environment to work in.

Disadvantages of landscape office layout

- ✓ Noise from machines and colleagues may be a problem.
- ✓ The office may be expensive to set up and maintain.
- ✓ Senior officers are not placed in areas of privacy.
- ✓ Confidential work may not be conveniently done.
- ✓ The set up may be more inclined to beauty than creating a conducive working environment

Office Equipment

These are facilities used in an office to make work easier and efficient.

Roles of office equipment

- ✓ Speed up and simplify work hence save on time and labour.
- ✓ Enhance neatness and accuracy.
- ✓ Ensure security of documents and other valuables.
- ✓ Provides comfortable working environment.

Types of equipment in an office.

General office machines

Guillotine – trimming documents into required shapes and sizes.

Paper punch – to make holes in papers to facilitate filling.

Stapling machines – for pinning papers together.

Staple remover – to remove pins from papers.

Mail room office machines

Folding machines – folding letters and sealing envelops

Frankling machines – for printing postage impressions on envelopes

Addressing machine – for printing addresses on mail

Sorting machine – for sorting letters

Letter opener – for opening letters

Composite – to fold documents, place them in envelopes, seal the envelope

Typing pool office machines

Typewriter – may be manual, electric or electronic for typing letters, reports and so on.

Dictating machine/Dictaphone – for making shorthand dictations and recording information on tapes.

Paper shredders – cutting unwanted documents into tiny pieces to avoid such documents getting into the wrong hands.

Duplicating machines – for reproducing documents from a master copy. (Stencil).

Communication office machines

Telephone – used to send and receive messages.

Tele – printer (telex machine) – for printing messages which are telexed.

Facsimile (fax machine) – used to transmit printed messages such as letters, maps, diagrams and photographs.

Duplicating office machines

Photocopier, printing machines, stencil duplicator – used to produce documents.

Accounts office machines

Adding machine – adding and subtracting figures.

Cash register – for preparing cash receipts.

Calculating machines – for all types of calculations.

Accounting machines – for posting information to ledgers and preparing payrolls.

Computer – for complex calculations.

Money counting machine – for counting coins and notes.

Disadvantages of office equipment's

i. Labour saving

When machine is used only few staff are required hence the organization saves on salaries and wages.

ii. Speed

They are much faster, thus save time

iii. Accuracy

Machines are more accurate, though it must be appreciated that a machine can only be accurate if the operator is efficient.

iv. Presentable

The final product of a machine is of high quality.

v. Control

Machines assist in reducing frauds.

vi. Uniformity

When a machine is used, there is uniformity in output

vii. Saving on cost

Machines unlike labour, are more economical in terms of cost per unit.

viii. Minimize monotony

Machines eliminate the monotony of doing the same manual work repeatedly which causes fatigue.

Disadvantages of office machines

i. Initial and maintenance cost are high.

ii. Breakdowns may lead to stoppage of production process.

iii. Machines contribute to unemployment.

iv. Machines may became outdated due to advancement in technology.

v. Some machines requires trained manpower who may be difficult and expensive to acquire.

vi. Some machines may require special stationary and other materials.

vii. Carelessness of workers may result into an enormous wastage of resources.

Other equipment's used in an office include:

- ✓ Filling cabinet
- ✓ Safe
- ✓ Trays.

Factors to consider when selecting office equipment's

a.) Cost

This is the initial, maintenance and running costs of the equipment.

b.) Adaptability

This is the ability of the equipment to cope with future changes and development.

c.) Possibility of hiring rather than buying

One has to consider the cost and convenience of buying an equipment as opposed to hiring.

d.) Durability

This refers to the lifespan of equipment.

e.) Effect on staff morale

This refers to staff attitude towards the equipment.

f.) Availability of complementary resources

This refers to accessories required in order to operate the equipment for example power. One has to consider whether the spare parts of the equipment will be readily available or not.

g.) Availability of manpower

This is the personnel required to run or operate the equipment.

h.) Availability of room

One has to consider whether the room for keeping the equipment is available or not.

i.) Security of the equipment

One has to consider whether the available resources are adequate to offer enough security for the equipment or not.

Office staff

Office staff are a team of employees who work to achieve the organizations goals.

They are divided into three groups

a.) Managerial

These are officers involved in formulating and implementing policies, and supervising the activities of the organization.

b.) Junior

These are the employees who carry out the activities of the organizations as assigned to them by the management.

c.) Subordinate staff

These are the unskilled employees who perform non - specialized duties such as cleaning and delivering messages.

Duties of various office staff.

General Manager

- ✓ Controlling all the activities of the organization.
- ✓ Being responsible for co-ordination of all the activities of the organization.
- ✓ Responsible for staffing.

- ✓ Responsible for provision of resources required by the organization.
- ✓ Advising the owner/s on matters related to the organization.
- ✓ Planning the work and the time schedule in an organization.

Company secretary

- ✓ Being responsible for all legal matters of a company.
- ✓ Taking down minutes at general meetings.

Departmental managers.

These are employees responsible for running and controlling the affairs of their individual departments' .E.g. Finance manager whose duties include the following:

- ✓ Keeping book of accounts.
- ✓ Collecting, banking and making payments on behalf of the firm.
- ✓ Making out financial returns to the general manager.
- ✓ Preparing payrolls and buyers.
- ✓ Preparing financial reports such as profit and loss accounts and balance sheet.

Personal Secretary

Duties of personal secretary:

- ✓ Filing information for the boss.
- ✓ Attending meetings and recording minutes.
- ✓ Supervising junior secretarial staff.
- ✓ Receiving and making telephone calls for the boss.
- ✓ Taking dictation from the boss.
- ✓ Making travel arrange and booking hotels for the boss.
- ✓ Keeping the petty cash.

Typist

Functions:

- ✓ Typing information from original documents.
- ✓ Filling documents.
- ✓ Reproduction of documents.

Clerk

Duties /functions:

- ✓ Handling mail.
- ✓ Duplicating and operating various office machines.
- ✓ Indexing and filing.
- ✓ Helps in store-keeping or record -keeping.
- ✓ Ordering, receiving, storing and issuing of stationery.

Telephone operator

A junior officer who runs a switch board

Receptionists

Junior officer and his/her duties include.

- ✓ Supervision of messengers and porters.
- ✓ Receiving and directing visitors to their respective destinations.
- ✓ Taking and passing of messages.
- ✓ Making renewing and cancelling appointments.
- ✓ Keeping visitors record book.

Essential qualities of office staff.

1.) Personal attributes

- Physical appearance.
- Hygiene
- Posture
- Moral behavior.
- Good health

2.) Office etiquette

- Respect
- Punctuality
- Courtesy
- Loyalty

- Honesty
- Co-operation
- Accuracy.

3.) Personal Knowledge and skills

- Knowledge
- Skills

Trends in office Management

This refers to current changes in office management such as computerization. Computerization means employment of computers in the organization's operations.

1.) Computers

A computer is an electronic device used for processing data, storing information and for communication purposes.

Uses of computer

- ✓ Data storage and inventory control
- ✓ It can be used to process amounting transactions and prepare the ledger accounts and payroll.
- ✓ It can accurately keep a record of stock at hand, receipts and issues.
- ✓ It can store information relating to members of staff.
- ✓ Used in communication services, for example, internet, intranet and website.

Advantages of using the computer

- ✓ It economizes on space and material.
- ✓ It speeds up operations.
- ✓ Its output is presentable.
- ✓ It can store a large volume of information.
- ✓ Facilitates communication from one point to another, for example-mail (electronic mail)
- ✓ It is accurate.

Disadvantages of using computers

- ✓ Leads to unemployment.
- ✓ Inhibits innovation.
- ✓ Monotony - Consumers using the same machines all the time get bored.

- ✓ Confidential information in computers may be accessed by unauthorized persons.
- ✓ Requires electricity.
- ✓ Subject to attack by computer viruses
- ✓ Expansive to install.
- ✓ Requires skilled manpower.
- ✓ Requires one to have a back-up system for storage. This is an extra expense.

Uses of computers in communication

Internet

Internet refers to inter-connection of many computers in the world thereby facilitating the flow of information from one place to another. Information is sent as E-mail.

Intranet (innet)

Inter-connection of computers within a small geographical area. For example, it can be used to connect different departments in an organization. In such a case if the sales manager wants to communicate with the production manager, he/she can use a computer instead of having to walk there.

Extranet

This is the interconnection of computers to facilitate communication between the business and selected persons, such as suppliers, customers and employees. Access to extranet requires the use of a password because it is not for use by the general public.

Website

It is a virtual location in the internet where information can be posted for other parties to access. For example, in marketing clothes, designs and prices can be posted in the website for the prospective buyers to access. It can also be used as a source of information. For example, if one wants to access the sales of a certain company in a month, the information may be available in the website either freely or at a cost.

E-commerce

This is carrying out trading activities through the internet. The following are some of its

Advantages:

- ✓ Facilitates access to a large market.
- ✓ Large and small businesses can transact business through the internet without discrimination.
- ✓ A fast way of doing business.
- ✓ Reduces paper work since many dealings are online.

- ✓ Saves on the cost of sending, receiving and storing information.
- ✓ One can access important business information which would be used to enhance running of the business.

Tele - conferencing

This is holding a conference through the computer while the participants are in different geographical areas.

Advantages of internet, intranet, website, extranet and e-commerce.

- ✓ They are fast
- ✓ Low cost incurred compared to travelling.
- ✓ Convenient because you get the information at the touch of a button.
- ✓ Information can be stored for future reference.

Disadvantages

- ✓ High initial cost of equipment.
- ✓ Maintenance cost is high.
- ✓ Users require training which may be expensive.
- ✓ Suffers from occasional breakdown, for example, from virus attack.
- ✓ The facilities are prone to misuse.
- ✓ It requires power to operate.

2.) Office arrangement

Businesses are changing from closed office layouts towards adopting either open or landscape office layouts. This has made it possible for the manager to have better control of the organization at the same time ensuring that customers are satisfactorily served.

3.) Public relations department

The need for customers' satisfaction has necessitated development of customer care departments in many business organizations. In such departments customers may be educated on the use of the organization's products.

4.) Use of cell phones (mobile phones)

Use of cell phones is a recent development in communication. Many business organizations have adopted the use of cell phones by their employees. Their use enables officers to carry out their official duties even when they are away from their normal working stations. Such employees may be provided with airtime by the organization.

5.) Office location

Offices located in town centers are faced with many problems, such as traffic jams, lack of parking space and high running costs. In an effort to solve these problems, some business organizations are

relocating their offices to sub-urban areas. Offices in such areas are more convenient to both the customers and the business owners as they are easily accessible and the cost of running them is lower.

6.) Procedure and routines

Many of the traditional office procedure and routines are becoming outdated as businesses adopt new ones facilitated by automation. For example, use of computers, has enabled employees in management positions to do work that would otherwise have been delegated to junior employees like copy typists and clerks.

End of topic

Did you understand everything?
If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAST KCSE PAPER 1

1. State three reasons why office documents should be filed. (3mks)

2. Outline four duties of an office manager. (4mks)

3. The following are types of office equipment. Paper, fax machine, telex and telephone. In the table below, match each equipment with its appropriate function. (4mks)

	Function	Equipment
a)	Sending and receiving written messages	

b) Sending and receiving verbal messages

c) Sending and receiving copies of messages

d) Sending messages one way only.

4. List four qualities of an office messenger. (4mks)

5. State four factors that determine the period for which documents should be stored.

(4mks)

6. In the space provided name the office equipment used to perform each of the following tasks.

Functions	**Equipment**
a) Printing stamp impression on envelopes	
b) Cutting paper into required sizes	
c) Pinning papers together	
d) Recording, processing, sorting & retrieving information	

7. Outline four function of an office (4mks)

8. Outline four functions of the office in an organization (4mks)

CHAPTER SEVEN

HOME TRADE

Specific Objectives

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

a) Explain the meaning and importance of trade;

b) Classify trade;

c) Explain the forms of home trade;

d) Discuss the types and functions of retailers;

e) Discuss the types and functions of wholesalers;

f) Describe the documents used in home trade;

g) Explain the means of payment used in home trade and the circumstances in which they are used;

h) Explain the terms of payment used in home trade and circumstances in which they are used.

Content

a.) Meaning and importance of trade

b.) Classification of trade

c.) Forms of home trade

d.) Types and functions of retailers

e.) Types and functions of wholesalers

f.) Documents used in home trade

g.) Means of payment in home trade

h.) Terms of payment in home trade

Introduction

Trade

The buying and selling of goods and services with an aim of making a profit.

Importance of trade

- ✓ Helps people to acquire what they might not be able to produce.

- ✓ Avails a variety of goods and services.
- ✓ Helps producers to dispose of their surplus.
- ✓ Create employment.
- ✓ Encourage specialization and division of labour.
- ✓ Promotes social relations and understanding among the parties involved.
- ✓ Provides revenue to the business people and government.
- ✓ Ensure steady supply of goods and services.

Classification of Trade

Trade can be grouped into two:

- Home trade
- Foreign trade

Home trade/local trade

It is carried out within a country's boundaries.

Foreign trade /international trade

It is carried out between two or many countries.

Classification of foreign trade

- ✓ Bilateral which is a trade between two countries.
- ✓ Multi-lateral trade carried out among many countries.

Forms of home trade

Retail trade

This involves buying goods and selling them to the final consumer.it is carried out by a retailer.

Types of Retailers

Small- scale retail business

Requires small amount of capital to start and operate.

Large-scale retail business

Requires large amounts of capital to start and operate.

Classification of Small - scale retailers

Classified into two main groups

- Small scale retailers without shops.
- Small scale retailers with shops.

Small- scale retailers without shops.

a.) Itinerant traders

These are traders who move around selling their goods usually by bicycles, motor- cycles or on foot.

Characteristics of itinerant traders

- ✓ Found mainly in densely populated areas.
- ✓ Move from one shopping centre to another in search of customers.
- ✓ They are very persuasive.
- ✓ Their prices are not controlled.

Advantages of itinerant traders

- ✓ Flexible in that they can move from one place to another.
- ✓ Requires little capital to start and operate their business.
- ✓ Convenient in that they take goods to the customers.
- ✓ They usually do not suffer bad debts because they sell in cash.
- ✓ Few legal formalities required.

Disadvantages of itinerant traders.

- ✓ Affected by weather changes because they operate in open air environment.
- ✓ It is difficult to transport business wares to various places.
- ✓ Do not offer guarantee, in case items are to be found defective.

b.) Roadside sellers.

They are traders who sell their goods at places where other people pass by E.g. Alongside busy Roads, bus stages etc.

c.) Open -air market traders

Open-air markets are places set aside by the government where people meet to buy and sell goods.

d.) Automatic vending machines

They are coin-operated where coins are inserted into the machine depending on the price of what you want to buy.

Small Scale retailers with Shops

a.) Single shops (unit shop)

They are run by one person who may get assistance from his/her family or employed attendants.

b.) Tied shops

Tied shop mainly sell the products of one particular manufacturer and they are owned by the manufacturer.

c.) Kiosk

Small shops or simple structures which sell fast moving goods like newspapers, sweets and soft drinks.

d.) Market stalls

They are permanent stands found in market places which are constructed and owned by local authorities.

e.) Canteens

These are retail shops found in institutions such as schools, colleges, hospitals and army barracks. They sell goods mainly to the people working in the institutions.

f.) Mobile shops

Mobile shop traders move from village to village or from town to town selling their goods.

Advantages of small scale retailers.

- ✓ Easy to raise capital to start the business.
- ✓ Are able to use cheap/ free labour from the family.
- ✓ Risks involved in their businesses are small.
- ✓ The business is simple to start and manage.
- ✓ Few legal formalities are required to start and run the business.
- ✓ The business is flexible.

Disadvantages of small scale retailers.

- ✓ Trader has limited access to loan facilities.
- ✓ May not afford to hire specialist or technical staff.
- ✓ May suffer bad debts due to many credits given to customers.
- ✓ Do not enjoy economies of scale.
- ✓ Have a low turnover because of the little capital invested.

Large Scale Retailers

Characteristics of large Scale Retailers

- ✓ Requires large amount of capital.
- ✓ Operate mainly in urban areas.

- ✓ Requires the services of specialist such as salespersons and accountants.
- ✓ Management is however centralized.
- ✓ Buy goods in large quantities from wholesalers or directly from producers.

Types of large scale retailers

a.) Supermarkets

A large self-service store that deals mainly with household goods.

Features of supermarkets

- ✓ Require large capital to start.
- ✓ Stocks a variety of goods.
- ✓ Offers self-services facilities.
- ✓ Goods have price tags.
- ✓ Prices of goods are fixed.
- ✓ No credit facilities are offered.
- ✓ Sell at comparatively low prices.

Advantages of supermarkets

- ✓ They offer lower prices for their merchandise than other retailers.
- ✓ Saves time as customers are able to get most goods they require under one roof.
- ✓ Customers pick the goods from the shelves and pay for them at the counter hence no time wastage waiting for attendants.
- ✓ Supermarkets employ very few attendants which reduces their monthly wage bill.
- ✓ Impulse buying leads to more sales.
- ✓ They avoid bad debts by not selling on credit.

Disadvantages of supermarkets

- ✓ Do not offer credit facilities to the customers.

- ✓ Do not deliver goods to the customers' premises.
- ✓ Found mainly in urban areas.
- ✓ May incurs losses due to pilferage of goods.
- ✓ Impulse buying may lead the customers to buying goods they may not need.

b.) Chain stores.

Chain stores are large-scale businesses with separate branches which are managed and organized centrally.

Characteristics of chain stores

- ✓ Purchases are centralized.
- ✓ Prices are standard for all their products in all their branches.
- ✓ Sales are decentralized.
- ✓ All branches deal in the same type of products.
- ✓ They are uniform in outward appearance and interior layout.

Advantages of chain stores.

- ✓ Offer low prices for their merchandise.
- ✓ Goods are sold on cash basis, hence reducing bad debts.
- ✓ Chain stores serve a wider market because they are spread all over the country.
- ✓ The businesses are easily publicized by the similar shop fronts and window displays.
- ✓ Slow moving goods in one branch can be transferred to another branch where demand for them is higher.
- ✓ Cost of running the chain stores is controlled and managed by the head office hence the cost is shared among various branches.

Disadvantages of chain stores

- ✓ Requires large amounts of capital to start and run a chain store.
- ✓ Identical products may contribute to low sales as people may shy away from buying identical products.
- ✓ Chain stores do not offer credit facilities in except those operating exclusively on hire purchase schemes.
- ✓ Lack of personal touch with customers.
- ✓ Absence of personal touch between the employer and employee may reduce incentives for hard work among staff.

c.) Departmental stores.

A departmental stores comprises many single shops under one roof and one management.

Characteristics of departmental stores.

- ✓ Offers a wide variety of goods at relatively lower prices.
- ✓ They are attractive and convenient to stop in.
- ✓ They are usually situated in town centers.
- ✓ They may provide services such as restaurants, reading rooms and post office.
- ✓ Each department is managed by a departmental manager dealing in a different line of goods.

Advantages of departmental stores.

- ✓ Customers can buy a wide range of commodities from the different shops under one roof.
- ✓ They sell at low prices.
- ✓ The stores are able to employ specialized staff who provide quality services.
- ✓ Generally open for long hours.
- ✓ Offers adequate parking facilities to customers.

Disadvantages of departmental stores.

- ✓ Large amount of capital is required to start and run the stores.
- ✓ One department may run as a loss to attract customers to other profit making departments.
- ✓ Departmental stores cater mainly for the urban communities in which they are located.
- ✓ Lack personal contact with their customers.
- ✓ Their big size poses management problems related to co-ordination and control of the activities of different departments.

d.) Hypermarket.

It is a large shopping centre in one building comprising a variety of businesses under different management and are located away from the city centre.

Characteristics of hypermarkets

- ✓ Good access roads.
- ✓ Ample parking space.
- ✓ Many business in one building.
- ✓ Attractive and convenient to shop in.
- ✓ Located in the outskirts of town.
- ✓ Offer a variety of goods and services.

Advantages of hypermarkets

- ✓ Offer extensive parking facilities to the customers since they are located away from town centres.
- ✓ Customers can do all their shopping in one building.

- ✓ Hypermarkets save on space, which reduces rents and rates.
- ✓ Usually open for long hours.
- ✓ They may provide credit facilities by accepting credit cards.

Disadvantages of hypermarkets

- ✓ Since they are located away from city centres, they serve only a limited number of people especially those with cars.
- ✓ They are a threat to other retail outlets because most of the customers do most of their shopping in them.
- ✓ Require large space which is not easily available in the central business district (CBD).
- ✓ Their prices are not controlled and therefore customers can be exploited.
- ✓ Requires large amount of capital to start and operate.

e.) Mail order stores.

This is a type of retail trade where the business is carried out through the post office.

Characteristics of mail order stores

- ✓ They sell goods through the post office.
- ✓ They advertise through means such as the print media, electronic media etc.
- ✓ Transactions are carried out through the post office.
- ✓ Customers do not visit the selling premises.
- ✓ Goods are dispatched, mostly on the basis of cash with order or cash on delivery.
- ✓ May have large warehouses.

Advantages of mail order stores

- ✓ Reach customers who are far away from the shopping centres.
- ✓ Does not require the services of sales personnel.
- ✓ No need for skilled labour since selling is routine.
- ✓ May not require transport facilities.
- ✓ Total control of distribution is possible.

Disadvantages of mail order stores.

- ✓ High cost of advertising increases the price of the goods.
- ✓ Inspection of goods by the customer is not possible.
- ✓ The variety of the goods that can be sold is limited.
- ✓ Personal contact between the buyer and seller is not possible.
- ✓ The method is mainly suitable to those who can read and write.

- ✓ Problems arising in the post office may affect the business e.g. strikes

Functions of retailers

Services rendered to consumers

i. Credit facilities

Retailers can give credit to the customers they trust.

ii. After-sales services

After- sales services include transport, installation, repair and maintenance which may be offered by the retailers.

iii. Variety of goods

Retailers may stock goods from different wholesalers or manufacturers for consumers enabling them to have a wide choice of goods.

iv. Advice

Retailers may offer advice to customers on choice and use of products.

v. Availing goods

Retailers makes goods available to consumers at the right time and place.

vi. Breaking bulk

Retailers sell goods to consumers in convenient quantities.

Services rendered to wholesalers.

- ✓ Retailers are good sources of valuable information on the market which assists wholesalers in anticipating consumers' demand.
- ✓ Retailers assist wholesalers in distributing products to consumers.
- ✓ Retailers may relieve the wholesaler the burden of transportation.
- ✓ Retailers may relieve the wholesalers the burden of storage.

Services rendered to the producers.

- ✓ Retailers link with wholesalers in providing valuable information to manufacturers on consumer demand.
- ✓ Retailers market the producers' products to the consumers.
- ✓ Retailers advertise goods on behalf of producers.
- ✓ Breaks bulk on behalf of producers to consumers.
- ✓ Finance producers by buying and paying cash.

Wholesale trade.

Wholesaling involves selling goods in large quantities to traders for resale.

Wholesaler

A trader who buys goods in bulk from producers and then sells them to other traders normally.

Classification of wholesale trade.

a.) According to the range of goods they handle.

i. General merchandise wholesalers.

They deal in a wide range of goods/different types of goods.

ii. General line wholesalers

They deal in a wide range of products but within one line.

iii. Specialized wholesalers.

These deal in particular goods from a given line of products.

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

i. Nationwide wholesalers

They distribute their products to all parts of the country.

ii. Regional wholesalers

They offer their products to certain parts of the country only.

c.) According to their method of operation

i. Cash and carry wholesalers

Traders come and pick goods and pay cash for them and the wholesalers don't offer credit or transportation.

ii. Mobile wholesalers

Mobile wholesalers use vehicles to go around selling goods to traders.

iii. Rack jobbers

They specialize in selling particular products to the other specialized wholesalers.

Terms used in wholesaling

Breaking bulk

This involves dividing a commodity into smaller quantities for the convenience of the buyer.

Packing

This may involve outing goods in packets, boxes or cartoons.

Branding

Giving a product a name by which it will be sold.

Sorting

Selecting goods according to sizes, weights, colors and qualities.

Grading

Putting goods in groups of similar qualities to make it easier to price them.

Blending

This involves mixing different grades to achieve desired tastes, colors or other qualities.

Functions of a wholesaler

Note:

Functions of wholesalers are also the advantages of wholesale trade.

Services of wholesale to the producers.

- ✓ They relieve the producer of the problem of distribution as they buy goods from producers and sell them to retailers.
- ✓ Wholesalers relieve producers of some of the risks they would experience.
- ✓ Saves the producer of the problem of storing by buying in big quantities.
- ✓ Wholesalers carry out market research that is important to producers.
- ✓ They transport, break bulk, pack, brand, sort, and grade and blend goods. This save the producer the problem of having to do this.
- ✓ Wholesalers engage in product promotion through activities such as displays, films, exhibitions etc.
- ✓ Wholesalers may buy goods from producers on cash hence providing producers with finance to operate.

Services of wholesalers to retailers

- ✓ They stock a variety of goods in large quantities hence relieving retailers of the problem of having to move to different producers to buy goods.
- ✓ They avail goods at places convenient to retailers.
- ✓ They break bulk for the benefit of retailers.
- ✓ They may offer advisory services to retailers.
- ✓ They may offer credit facilities to retailers.
- ✓ They engage in sales promotion, hence retailers are saved the problem of having to do so.
- ✓ Wholesalers grade, sort, blend, pack and brand goods. This save retailers the bother of having to do so.

Services of wholesalers to consumers.

- ✓ Ensures steady supply of goods to retailers hence no shortages.
- ✓ Ensures steady supply of goods into the market which leads to stable prices.
- ✓ Wholesalers make it possible for the customers to enjoy a variety of goods.
- ✓ Breaks the bulk thus enabling the consumers through the retailers to get the goods in suitable quantities.
- ✓ Gives information to the consumers through the retailer about goods.

Documents of home trade

Letter of inquiry

- ✓ A document sent by buyer to seller
- ✓ It inquires about the prices and discounts
- ✓ It also informs about the buyer's demand

Quotation

A document sent by the seller to potential buyer when an inquiry is specific in nature.

Contents

Seller gives details about the products

Quotation also mentions about the discounts, if offered

Catalogue

A document sent by seller to the buyer describing the goods a seller stocks. Catalogue also contains pictures with attract the potential buyer to buy the products

Contents

- ✓ Prices of the goods.
- ✓ After – sales services offered by the seller.
- ✓ Packaging and posting expenses to be incurred.
- ✓ Delivery services to be used.
- ✓ Terms of sale.

Price list

This is a list of items sold by the trader together with their prices.

Order

A document sent by the buyer to the seller which mentions the type and quantity of product required. It also mentions the expected delivery date.

Contents

- ✓ Name and addresses of the buyer and 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 packaging and delivery.

Acknowledgement Note

A document sent to a prospective buyer to inform him/her that the order has been received and it is being acted upon.

Packing note

The document used to indicate the items packed.

Contents

- ✓ Quantities of goods packed.
- ✓ A brief description of the goods.
- ✓ The means of delivery.

Advice Note

This is a document sent by the seller to the buyer after goods have been dispatched to inform him/her that the goods have been dispatched.

Contents

- ✓ The means of delivery.
- ✓ A description of the goods.
- ✓ The quantity dispatched.

Delivery note

A document sent by the seller to the buyer with the goods. If this document is signed it signifies that the goods have been received.

Contents

- ✓ Name and addresses of the sellers and buyer.
- ✓ Date of delivery.
- ✓ Delivery note number.
- ✓ Quantity and description of the goods.
- ✓ Space for the buyer of the goods to sign and comment on the conditions of the goods received.

Consignment Note

It is sent when the seller does not use his/her own means of transport and hence hires a transporting company to carry the goods. On receipt of the goods the buyer signs the consignment note as evidence that the goods were actually transported.

Contents

- ✓ Details of the goods to be transported.
- ✓ Name and address of the seller and buyer.
- ✓ Terms of carriage and conditions of transporting the goods.

Invoice

Document sent by the seller to the buyer demanding payment for goods delivered.

Contents

- ✓ Quantity.
- ✓ Price.

- ✓ Discount
- ✓ Description of the goods.

Functions of an invoice

- ✓ Shows the details of goods sold.
- ✓ A request to the buyer to make payments.
- ✓ It is used as a sources document.

Goods received Note

A document sent by the buyer to the seller to inform him/her that goods sent have been received.

Contents

- ✓ Date of the documents.
- ✓ Names and addresses of the buyer and seller.
- ✓ Corresponding purchase order.
- ✓ Details of goods received.
- ✓ Date the goods are received.

Pro-forma invoice

A document sent by the seller to the buyer before goods are delivered showing how the invoice would look like if the buyer buys the goods.

Functions

- ✓ A polite way of asking for payment before the goods are delivered.
- ✓ Sent when the seller does not want to give credit.
- ✓ Used by importers to get custom clearance before goods are delivered.
- ✓ Issued to an agent who sells goods on behalf of the seller.
- ✓ Can be used to serve as quotation.
- ✓ Sent to show what the buyer would have to pay if the order is approved.

Goods Returned Note

A document sent by the buyer to the seller informing him/her of the returned goods.

Reasons for returning the goods by the buyer:

- ✓ Wrong type
- ✓ Excess
- ✓ Wrong quality

- ✓ Damaged goods.

Credit Note

A document sent by the seller to the buyer to inform him/her that the amount payable by him/her has been reduced.

Circumstances under which a credit note may be issued.

a.) When goods are returned

Goods may be returned for them being of wrong quality, excess, damaged or expired

b.) When there is an arithmetic error resulting to overcharge.

Wrong addition may lead to invoicing high value than the correct amount.

c.) When empting containers and packing cases are returned

When empting containers whose value were included in the invoice are returned this is corrected using a credit note.

d.) When goods are priced at higher price than the correct price.

When a product or more are priced at higher price than true price this lead to overcharging which is corrected by issue of credit Note.

e.) When the buyer was charged for goods not supplied

Some goods might be charged by the seller while in real sense they were not supplied due to many reasons e.g. forgetting.

Debit Note

A document sent by the seller to the buyer to inform him or her that the amount payable by him/her has been increased.

Debit Note	Credit Note
Used to correct undercharges	Used to correct overcharge.
Increases the amount on an invoice issued.	Reduces the amount on an invoice issued
The supplier debits the customer's account.	The supplier credits the customer's account.
Issued when a customer's fails to return chargeable/returnable goods	Issued when a customer returns chargeable /returnable goods

Statement of account

A document sent by seller to buyer asking the buyer to pay the outstanding amount.

Contents

- ✓ Names and addresses of the buyer and seller.
- ✓ Account number.
- ✓ Date column.
- ✓ Particulars /details column.
- ✓ Money columns.
- ✓ Terms of credit.

Receipt

A document issued by the seller to the buyer as a proof that payment has been received by the seller.

Contents

- ✓ Date of payments.
- ✓ Name of the person making payment.
- ✓ Amount paid in words and figures and means of payment.
- ✓ Name of the institution or person to whom payment is made.
- ✓ Receipt number.
- ✓ Signature of the person issuing the receipt.

IOU

An IOU (I owe you) is a written acknowledgment of a debt written by the debtor and does not specify the date when settlement will be made.

Means of Payments

Refers to the additional items given out when making payments. The common means of payments

are:

a.) Cash

This refers to notes and coins. Notes and coins are issued by the central Bank and are also referred to as legal tender

Advantages of Cash payment

- ✓ It is the only means of payment which is a legal tender.
- ✓ Convenient for settlement of small debts.
- ✓ It is convenient to people with or without bank accounts.

Disadvantages of cash Payment

- ✓ Not convenient for large amounts.
- ✓ Cash can be lost or stolen easily as it is readily usable.
- ✓ Unless a receipts is issued, payment in cash may be difficult to prove.

Circumstances under which cash payment is appropriate.

- ✓ Where the amounts involved is small.
- ✓ Where the payee does not accept other means of payment.
- ✓ Where cash is the only means available.
- ✓ Where the payee requires cash urgently.
- ✓ Where there is need to avoid expenses associated with other means of payments.

b.) Cheque

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

Parties to a cheque

i. Drawer

This is the person who writes the cheque.

ii. Payee

This is the Person to be paid

iii. Drawee

This is then bank.

Types of cheque

Open cheque

An open cheque is the one that can be cashed over the counter. The payee can receive cash when he presents the cheque to the bank (drawer)

Crossed cheque.

A crossed cheque can only be deposited in an account. When the payee takes the cheque to the bank, the bank increases the money in his account.

Dishonored cheque.

A cheque is dishonored if the bank refuses to pay. It can also be said to have bounced.

Reasons for dishonoring a cheque

- ✓ Insufficient funds in the account.
- ✓ Signature of the account holder may differ from the specimen in the bank.
- ✓ When the cheque is post-dated, i.e. a cheque presented for payments earlier than the date indicated on it.
- ✓ Stale cheque, that is a cheque presented six month after the date issued.
- ✓ If the drawer has closed his/her account with the bank.
- ✓ When the cheque has been altered and the drawer has not signed against the alteration.
- ✓ If a bank learns about death, insanity or bankruptcy of the drawer and have instructions to the bank not to honor the cheque when presented.

Advantages of using a cheque

- ✓ More secure than notes and coins because if they are or stolen, they can be traced to the person who cashed them.
- ✓ They are convenient to carry and can be used to pay large sums of money which would otherwise be inconvenient if paid in notes and coins.
- ✓ Payment can be made by cheque without the need to travel to make the payment.

- ✓ When payment is made by a cheque, the cheque takes the place of a receipts for future reference in case of controversy or loss of other documents.
- ✓ Cheque are negotiable.

Disadvantages of using a cheque

- ✓ Requires the payee to go to the bank.
- ✓ Cheque may be dishonored.
- ✓ The drawer pays some bank charges.
- ✓ Can only be issued by an account holder.
- ✓ Some people may refuse to accept personal cheques fearing that they may be dishonored.

Circumstances under which a cheque is appropriate as a means of payments.

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

c.) Bill of exchange

This is an unconditional order, in writing, 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 a named person or to a bearer.

A bill of exchange must be:

- ✓ Signed by the drawer.
- ✓ Accepted by the drawer.
- ✓ Accepted unconditionally.
- ✓ Bear a revenue stamp.

Advantages of a bill of Exchange

- ✓ The holder may pass the rights on the bill to another person.
- ✓ Date of payment is determined.
- ✓ Acceptance by the debtor makes it legally binding.
- ✓ Acceptance by the debtor makes it legally binding.
- ✓ The payee may receive money before due dates by discounting.

Disadvantages of bill of exchange

- ✓ It may be dishonored on maturity.
- ✓ Cash may not be readily available.
- ✓ 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.

- ✓ Where the creditor wants to be assured that the payment would be made.
- ✓ When 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.

d.) Promissory note.

A document whereby one person promises to pay another person or his/her order, a specified sum of money at a certain stated date.

Similarities between bill of Exchange and promissory note.

- ✓ Both act as evidence of the acknowledgment of a debt.
- ✓ Both may be discounted before maturity.
- ✓ Both are legally binding.

e.) Money order

Money orders are sold by post office for the purpose of remitting money.

Contents of money order

- ✓ Amount of money to be paid.
- ✓ Name of the person to whom the money is to be paid.(Payee)
- ✓ Name of the post office at which the money order is to be cashed.
- ✓ Name and address of the sender.
- ✓ Whether the money order is to be sent by telegraph or ordinary means.
- ✓ Whether the sender wishes to be informed if the money has been paid.

Circumstances under which money order is appropriate.

- ✓ Where it is the means available.
- ✓ Where other means are not accepted.
- ✓ Where there is need to avoid inconveniences or risks associated with other means.

f.) Postal order

Postal orders are sold by the post office for the purpose of remitting money and they are available in fixed denominations.

Circumstances under which postal orders are appropriate

- ✓ Where the amounts involved are small.
- ✓ Where it is the only means available.

- ✓ Where there is need to avoid inconveniences and risks associated with the means of payments.

Postal orders	Credit Note
It can be cashed at any post office.	It can be cashed at specific post office.
Are in fixed denominations.	Varies according to the needs of the remitter
Does not require any application form to make a remittance.	Requires the filling in of an application form in making remittance.
Can be cashed by the bearer	Can only be cashed by the payee

g.) Postal stamps

Used to pay small amounts of money.

h.) Premium Boards

Issued by the post office in denominations of Ksh 10 and sh 20 and they mature after a given period, after which one can cash them.

Circumstance under which postage stamps and premium bonds are used.

- ✓ Where the amounts involved are small.
- ✓ Where they are the only means available.

i.) Bankers cheque (bank draft)

This is a cheque drawn on a bank

Circumstance under which bankers cheque is appropriate

- ✓ Where the amounts involved is large.
- ✓ Where payee wants to be guaranteed of payment.

Terms of payments

This are terms used by the seller to indicate how payment is expected, when it is expected or what is included in the quoted price of a commodity.

They are as follows:

1.) Cash

When goods or services are paid for immediately on or before delivery, it is referred to as spot cash/cash transaction.

Terms used under cash transactions:

i. COD (Cash on Delivery).

The goods or services are paid for when they are delivered.

ii. C.W.O (Cash with Order)

Payment is made at the time of making the order.

Benefits of C.O.D and C.W.O

- ✓ Reduces risk of bad debts.
- ✓ Working capital is readily available.
- ✓ Records maintained are few hence few workers are employed.
- ✓ No time wasted in following customers to pay.

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

- ✓ When the buyer is new to the seller.
- ✓ Where the buyer's credit worthiness is in doubt.
- ✓ Where the seller is operating mail order business.
- ✓ Where cash with order is the policy of the business.

2.) Deferred payments.

This is where goods or services are not paid for in full on delivery but paid in future.

Forms of Deferred payments.

i. Open trade credit

Goods or services are sold on credit such that the buyer pays for them at a future date or within a given period.

Ways in which the seller insures that the buyer will pay.

- ✓ Ascertaining the creditworthiness of the buyer.
- ✓ Asking the buyer to guarantee payments by signing some documents e.g. bill of exchange.
- ✓ Asking the buyer to have someone else to guarantee payment.

- ✓ Asking the buyer to pledge some of his/her property as security.

Factors to consider when giving credit.

- ✓ Credit worthiness of the buyer.
- ✓ Repayment period.
- ✓ Amounts of goods the customers wants.
- ✓ Availability of adequate stock.
- ✓ Honesty/reliability of the customer.
- ✓ Frequency at which the customer buys from the seller.
- ✓ Sellers' intention to attract and retain customers.

Credit period depends on:

- ✓ Buyer /seller relationship.
- ✓ Types of goods.
- ✓ Capital base/financial stability of the seller.

Examples of open trade credit.

i. Simple credit/ prompt cash

Simple credit is extended to a trader or customer for a very short time, usually not more than a week.

ii. Monthly Credit

This type of credit is extended when a seller allows the buyer to settle his/her account after one month.

iii. Budget accounts

Usually operated by large scale retailers. The retailer keeps an account of the customer in his/her books.

iv. Trade credit

This is credit given by a trader to another trader when goods are bought for reselling.

v. Credit card facilities

A credit card enables the holder to obtain goods and services on credit from specific suppliers.

Advantages of credit card

- ✓ Holders can get goods and services from specified sellers without paying immediately.
- ✓ Convenient to carry around.
- ✓ Enables the holder to get money from specified banks.
- ✓ Increases credit ratings of an individual.
- ✓ It is safer to carry the card around than to carry cash.

- ✓ Some cards are internationally acceptable.

Disadvantages of credit card

- ✓ It is prone to abuse through fraud.
- ✓ Interest is charged if there is delay in repayment.
- ✓ Holders may be tempted to overspend.
- ✓ Only a few businesses accept the cards.
- ✓ Long procedures are involved in getting the card.
- ✓ The holder is changed high interest rate by the card company.
- ✓ Use limited to only specific areas (urban areas)

ii. Hire purchase

This is a method of hiring property with an option to buy.

Advantages to the buyer.

- ✓ The buyer may acquire possession and use of goods immediately after entering into the contract.
- ✓ The buyer can possess more goods, including expensive ones.
- ✓ Installments to be paid are pre-determined, so the buyer knows and is able to budget for this amount

Disadvantages to the buyer

- ✓ The goods belong to the seller until the last installment is paid.
- ✓ May lead the buyer into financial problems after buying more than he/she can actually pay.
- ✓ Limited types of goods can be bought on hire purchase.
- ✓ Hire purchase is an expensive way of buying goods.

iii. Installment buying

This is similar to hire purchase except that the ownership and possession of the commodity passes to the buyer immediately the down payment is made.

A comparison of hire purchase and installment buying

Hire purchase	Credit purchase

The buyer does not became the owner of the goods on taking their possession.	The buyer becomes the owner of the goods on taking their possessions.
The buyer cannot resell the goods since he/she is not the legal owner of the goods.	Can resell the goods as he or she is the legal owner.
The hire purchase price is usually higher than the price of goods bought on credit or cash as interest is charged on hire purchase	The price of goods bought on credit or cash is lower than that of the same Goods bought on hire purchase since no interest is charged.
If the buyer defaults in paying any instalment goods may be repossessed by the owner.	Goods can be repossessed if the buyer defaults payments.

Other terms of payment.

Discounts

This is an allowance by the seller to the buyer such that the buyer pays less than the market price.

Types of discounts

Quantity discounts

This is an allowance by the seller to a buyer toe courage bulk buying.

Trade discounts

This is a quantity discount allowed by a trader to another trader so that the buyer can make a profit after selling the goods.

Cash discount

This is an allowance by a trader to his credit customer to encourage them to pay the debts promptly.

Circumstances under which deferred payments may be appropriate.

- ✓ Where the credit worthiness of a customer is unquestionable.
- ✓ Where the seller wants to attract or retain customers.
- ✓ Where the seller wants to increase sales.

- ✓ Where the seller wants to use credit facilities as a competing tool.
- ✓ Where the seller wants to dispose of slow moving stock.

Standing order.

This is an instruction by an account holder to his/her bank authorizing it to be making regular payments of specified amount to a specified person or a firm until the order is cancelled.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Highlight four factors that may contribute towards the growth of business in the Country. (4mks)
2. State four uses of an invoice for a seller of goods. (4mks)

CHAPTER EIGHT

FORMS OF BUSINESS UNITS

Specific Objectives

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

a) Identify the various forms of business units;

b) Explain the characteristics of each form of business unit;

c) Discuss the formation and management of each form of business unit;

d) Discuss the sources of capital for each form of business unit;

e) Discuss the role of stock exchange as a market for securities;

f) Explain advantages and disadvantages of each form of business unit;

g) Recognize the circumstances under which the various forms of business units may be dissolved;

h) Discuss trends in business ownership.

Content

a.) Business units: Sole proprietorships, Partnerships, Co-operatives, Private companies, Public companies, Public corporations, parastatals.

b.) Features of each form of business unit.

c.) Formation and management of each from of business unit.

d.) Sources of capital for each form of business unit.

e.) Role of stock exchange market as a market for securities.

f.) Advantages and disadvantages of each form of business unit.

g.) Dissolution of business units.

h.) Trends in business ownership e.g. Globalization, Amalgamation/mergers.

Introduction

I.) Sole proprietorship

This is a type of business enterprise that is owned by one person.

Characteristics of Sole proprietorship

a.) Owned / formed by a sole trader

Who provides the capital/ start the business.

b.) Faster decision marking

Since the owner has no other person to consult.

c.) Business units are usually small

Due to limited capital / poor management skills.

d.) Business (owner) has unlimited liability

Since personal property/ assets can be sold to pay business debts.

e.) Managed by the owner

With or without assistance of family members which is tiring and may be forced to work for long hours.

f.) Owner bears all the risks/ losses and profit

Since he/she has no other person to share with.

g.) Easy / simple formation

As it requires simple legal formalities/ may only require a trading license to start.

h.) Secrecy/ confidentiality

Operations/ information about the business can be kept in confidence as the owner is the only one accessible to the records

i.) Flexibility/ adaptability to change

It is flexible due less capital needed to start and operate.

Sources of capital for sole proprietorship

- ✓ Borrowing from friends, banks and other money lending institutions.
- ✓ Inheritance.
- ✓ Donations from friends and relatives.
- ✓ Credit buying.
- ✓ Ploughing back profits.
- ✓ Leasing and renting out property.

Advantages of Sole proprietorship.

- ✓ Few legal procedures are required to set up this kind of business.
- ✓ Decision making and implementation is fast because the proprietor does not require to consult anybody in matters relating to the business.
- ✓ A sole proprietor exercises direct personal control on the business at all times.
- ✓ The trader has close and personal contact with customers.
- ✓ A sole proprietor is able to assess the credit-worthiness of his/her customers because of close personal relationship.
- ✓ The trader is accountable to him/herself.
- ✓ The sole proprietor is able to maintain top secret of the business operations.
- ✓ The trader enjoy profits alone.

- ✓ The trader can get assistance from the family members.
- ✓ Sole proprietorship is easy to start since the amount of capital required is small.

Disadvantages of sole proprietorship.

- ✓ Has unlimited liability. This means that if the assets available in the business are not enough to pay all the business debts, personal property of the owner.
- ✓ Expansion of the business may be limited by scarcity of capital.
- ✓ May work for long hours there thereby leaving little time for recreation.
- ✓ If a sole trader falls sick, the business may experience difficulties due lack of adequate management.
- ✓ Lack of consultation may lead to poor decision making hence affecting the business adversely.
- ✓ They may not from advantages realized by large scale enterprise such as access to loan facilities and large trade discounts.
- ✓ The owner bears all the risks and in case of a loss, he/she suffers alone.

- ✓ Death of the owner may lead to collapse or poor performance of the business arising from poor management by other people who take over the business

Dissolution

The term dissolution means to bring a business to an end. The following are some of the factors that may lead to the dissolution to sole proprietorship:

- ✓ If the owner decides to dissolve the business.
- ✓ In case of death, insanity or bankruptcy of the owner
- ✓ Where the intended purpose is completed.
- ✓ Where the court orders the business to dissolve

II.) Partnership

A partnership is business unit owned by more than one person. A partnership is owned by a minimum of two persons and a maximum of 20.

Types of partners

They are classified according to the role they play, their liabilities, and their age and capital contribution as below:

a.) Role played by the partners

Partners are either active or dormant. An active partner is one who plays an active role in the daily operation of the business while dormant does not. They are also called sleeping, passive or silent partners

b.) Liabilities of the partners for the business debts

Partners are either general or limited. Limited partners have limited liabilities while general partners have unlimited liabilities.

c.) Ages of the partners

Partners are either minor or major .A minor partner is somebody who has not attained age of 18 years. This is called the age of majority. A minority takes part in sharing the profits but cannot take part in management until attain the age of majority.

d.) Capital contribution

Partners maybe real or nominal. A real partner is a person who has actually contributed to the capital in the business while a nominal partner is somebody who allows the partnership to use his/her name for the purposes of influencing customers or for prestige.A nominal partner does not contribute and therefore not entitled to profit sharing.Another name for a nominal partner is quasi.

Formation

The agreement by the partners on formation of the partnership business is referred to us partnership agreement. The partnership agreement can either be oral or written. A written agreement is referred to as the partnership deed.

Contents of partnership agreement.

- ✓ Name of the partnership.
- ✓ Address of the head office.
- ✓ Location and area of operation of the business.
- ✓ The term of the partnership – whether temporary or permanent.
- ✓ The objectives of the business.
- ✓ Capital to be contributed by each partner.
- ✓ Rate of interest on capital.
- ✓ Drawings by partners and rate of interest on the drawings.
- ✓ Salaries and commissions to partners.
- ✓ Profit and loss sharing ratio.
- ✓ Means of arbitration to be used to finalize matters which cannot be mutually agreed on.
- ✓ Methods of valuing good will on retirement or admission of a partner.

Note:

In case a partnership Deed has not been draw or it's ambiguous, the provisions of the partnership act of 1963 apply. The act contains the following rights and duties of a partner.

- ✓ All partners are entitled to equal contributions of capital.
- ✓ No salary is to be allowed to any partner.
- ✓ No interest is to be allowed on capital.
- ✓ All profits and losses are to be shared equally.
- ✓ Every partner has the rights to inspect the books of accounts.
- ✓ Every partner has the rights to take part in decision making.
- ✓ Interest to be paid on any loans borrowed by the partners.
- ✓ No partner should carry out competing business.

Management

All the partners shares the responsibility of managing the business however they can empoy skilled man power to manage the business on their behalf.

Partners who take active part in the management of the business are:

- ✓ Major
- ✓ Real
- ✓ General

Partners who do not take active part are:

- ✓ Minor
- ✓ Quasi

Sources of capital

- ✓ Contributions from members.
- ✓ Loans fro banks and other financial institutions.
- ✓ Getting items on hire purchase.
- ✓ Trade credit.
- ✓ Ploughing back profit
- ✓ Leasing and renting.

Advantages of partnership

- ✓ A partnership may be able to raise more capital than a sole proprietorship.
- ✓ Consultancy and sharing of ideas among partners my lead to a better decision.
- ✓ Few legal requirements in the formation of a partnership compared to limited liability.
- ✓ Work is distributed among the partners. This reduces the workload for each partner.
- ✓ Losses may be shared when they occur while the sole proprietor suffers sole losses alone.
- ✓ A partnership may be able to use the abilities of the partners while a sole proprietor has to rely on his own ideas alone.
- ✓ Some partners may have limited liability while the sole proprietor has unlimited liabilities.

Disadvantages of partnership

- ✓ A mistake made by one of the partners may result in losses which are shared by all the partners.
- ✓ The liability of some of the partners is unlimited.
- ✓ Continued disagreement among the partners can lead to termination of the partnership.
- ✓ Decision making may be slow as all of the partners are to be consulted.
- ✓ Actions taken by one partner in good faith on behalf of the business are binding on all partners.
- ✓ A partnership that relies heavily on one partner may be adversely affected in case of retirement or death of the partner.
- ✓ A partnership has limited access to source of capital compared to limited companies hence it may be unable to finance major developments.
- ✓ A partnership may have limited access to variety of managerial skills especially where the partners manage the business themselves.

Dissolution of partnership

- ✓ If the partners mutually agree to dissolve the business.
- ✓ In case of death, insanity or bankruptcy of a partner.
- ✓ In case of completion of the intended purpose or end of the agreed time.
- ✓ A court orders the business to dissolve.
- ✓ When a partner request for dissolution in writing.
- ✓ If the business engages in unlawfull practices.E.g by a change in law.
- ✓ I case of retirement or admission of a new partner.
- ✓ In case of continued disagreements among the partners.

III.) CO-OPERATIVES

A Cooperative society is a group of people who come together mainly to provide convenient and efficient services to members.

Principle of Co –operatives

a.) Open and voluntary membership

Members wishing to join cooperatives societies do no voluntary basis and can leave at will. They are however, expected to meet basic requirements before they can join.

b.) Education for members

Support for educational activities with movement/aimed to foster cooperative principles at all levels to encourage membership and teaching.

c.) The principle of democratic control

The administration of cooperatives is entrusted to a committee elected by members on the basis

d.) Payment on dividends/share of profits

Profits made is shared among the members according to their contribution

e.) Limited interest on share capital

Limited interest should be allowed on capital but based on a fixed rate.

f.) Co-operation with other co-operatives.

Co-operative societies should cooperate with other co-operative for the development of each other.

Characteristics of cooperatives.

- ✓ Formed under co-operative society act.
- ✓ Managed by a management committee elected members.
- ✓ Formed to offer services to the members.

- ✓ Owned by the members.
- ✓ Initial capital comes from members.
- ✓ There is sharing of profits among members.
- ✓ Regulated by the by-laws of the society and co-operative society act.
- ✓ Books of accounts audited by external auditors.

Sources of Capital

- ✓ Member's contribution.
- ✓ Retained Profits.
- ✓ Income from Credit Facilities.
- ✓ Income from Credit Facilities.
- ✓ Income from Investments.
- ✓ Acquiring Property on credit or hire purchase.

Types of Co-operative Societies in Kenya

When classified according to the nature of their activities we have the following:

- ✓ Producer co-operatives
- ✓ Consumer co-operatives
- ✓ Credit co-operatives

When classified according their levels of operation we have:

- ✓ Primary co-operatives
- ✓ 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. They serve the following purposes:

- ✓ Obtaining better prices for their members' products.
- ✓ Providing better storage facilities for the products.
- ✓ Providing loans to the members.
- ✓ Providing services of grading, packing and processing of produce to the members.
- ✓ Providing farm inputs on credit to members.
- ✓ Educating members on better methods of production through seminars, field trips, films and demonstration.

b.) Consumer Co-operatives

These are formed by a group of consumers who come together and start up shops from where they can buy goods of better quality much more conveniently.

Advantages of consumer Co-operatives

- ✓ Sell goods of high quality.
- ✓ Sell goods to members at fair prices.
- ✓ Sell goods to other people at normal prices thereby making more profits.
- ✓ 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 of Consumer Co-operatives.

- ✓ Face stiff competition from large scale retailers.
- ✓ May not afford to employ qualified staff.
- ✓ Majority of their members have low incomes, so raising of capital is a problem.
- ✓ Reluctance of non-members to buy from these shops lowers the turn-over.
- ✓ Consumer shop may be mismanaged.

c.) Savings and Credit Co-operatives Society (SACCOS)

They are formed by groups that came together to save money and provide loans to members as the need arose.

Advantage of SACCOS

- ✓ Profit realized by SACCOs a distributed to members I form of divided.
- ✓ Enables the members to save.
- ✓ Members can obtain loans at low interest.
- ✓ Offer education to members.
- ✓ May offer banking facilities through their front office services.
- ✓ In case of death, the beneficiaries may be refunded twice the amount of share contribution.

Disadvantages of SACCOs

- ✓ May not have enough finances to cater for members' financial needs.
- ✓ Continual default by loanees may cripple the SACCOs financially.
- ✓ Faces stiff competition from well-established financial institutions.
- ✓ Mismanagement of SACCOs is common.
- ✓ Corruption and misappropriations of funds may lead the SACCO into financial problems.

d.) Primary Co-operative societies

These are cooperatives societies composed of individuals who are either actual producers, consumers or people who join up together to save and obtain credit conveniently. Primary co-operatives engage in activities such as the production of sugar- cane, milk, coffee and cashew nuts.

e.) Secondary Co-operative societies.

They are usually referred to us unions. They are generally composed of primary Co-operative societies as their members.

Advantages of Co-operative Societies.

- ✓ Interest of the members are served more efficiently through Co-ownership.
- ✓ Services to members are provided at minimum possible cost due to economies of scale.
- ✓ Members have equal chances of being elected to the management committee.
- ✓ Membership is open and voluntary.
- ✓ Members have limited liabilities.
- ✓ Co-operatives eliminate the exploitation of members by middlemen.
- ✓ The loans given to members carry interest at low rates.
- ✓ Co-operative societies are run on a democratic basis, that is, one person one vote.

Disadvantages of Co-operatives.

- ✓ Majority of the Co-operatives cannot take advantage of the economies of scale due to their own capital base.
- ✓ Poor management due to lack of qualified personnel.
- ✓ Members have a right to withdraw their membership from a Co-operative. When a member withdraws his/her capital contribution is refunded and this may create financial problems for the society.
- ✓ May suffer from political interference.
- ✓ Corruption and embezzlement of funds are perpetual problems for some Co-operative Societies.
- ✓ 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

- ✓ In case of an order from the commissioner of co-operatives.
- ✓ If members voluntarily decide to dissolve the society.

- ✓ In case of withdrawal of members from the society leaving less than ten members.
- ✓ If the society is declared bankrupt.
- ✓ In case of a court order.

IV.) LIMITED LIABILITY COMPANIES

A company is an association of persons who contribute capital inorder to carry out business together with a view to making profit.

Formation

On formation of a company by promoters they need to come up with the following documents:

a.) Memorandum of Association

This document defines the relationship between the company and outsiders. The information contained in the memorandum of Association is divided into subsections called clauses.

These clauses include:

i. Name clause

Contains the name of the proposed company ending with "limited'.

ii. Liability clause

This clause warns members of the public that the liabilities of the members are limited.

iii. Situation clause

Every company must have a registered office where official notices and other communications can be received and sent.

iv. Capital clause

This clause discloses the amount of capital which the business can raise and the division of this capital into units of equal value called shares

v. 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 firms.

vi. The object clause

The objects clause sets out the activities that the company should engage in.

b.) Articles of Associations

This document governs the internal operations of the company. It contains the following:

- ✓ Rights of each type of shareholders.
- ✓ Methods of calling meetings.
- ✓ Rules governing election of officials such as chairman of the company.

- ✓ Rules regarding preparation and auditing of accounts.
- ✓ Powers, duties and rights of directors.
- ✓ A statement signed by the directors stating that they have agreed to act as directors.
- ✓ A list of directors with details of their names, addresses, occupations, shares subscribed and statements of agreement to serve as directors.

Sources of capital

i.) Shares

The main source of capital. Shares are mainly of two types:

- ✓ Ordinary shares.
- ✓ Preference shares.

Ordinary shares

Ordinary shares are those with the following rights:

- ✓ Have voting rights.
- ✓ Have no fixed rate of dividends.
- ✓ They have a claim to dividends after the preference shares.
- ✓ If the company is being liquidated, they are paid last after the preference shares.

Preference shares

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.
- ✓ Can be cumulative or non –cumulative.

ii.) Debentures

Debentures refer to loans from the public to a company.

Classification of debentures

Redeemable Debentures

These debentures are the ones that can be bought back by the company within a specified future period.

Irredeemable Debentures

These are the debentures that cannot be redeemed unless the company is being liquidated

(dissolved)

Mortgage Debentures

They are debentures to which company property is attached as security.

Naked (unsecured) Debentures

These are debentures where no security is attached.

iii.) Loans from Banks and other Financial institutions
iv.) Profit ploughed Back
v.) Bank overdraft
vi.) Leasing and renting of property
vii.) Goods bought on credit
viii.) Acquiring property through hire purchase.

Types of companies

Limited liability companies can be classified into:

- ✓ Private limited company
- ✓ Public limited company

Private limited Company

- ✓ Can be formed by between 2 and 50 shareholders, excluding the employees.
- ✓ Does not advertise its shares to the public, but sells them privately to specific people.
- ✓ Restricts the transfer of shares.
- ✓ Can be managed by one or two directors.

- ✓ Can start business immediately after receiving the certificate of incorporation without necessarily having to wait for a certificate of trading.
- ✓ Profits are distributed and the shareholder on dividends.

Advantages of a private Limited Company

i.) Easy to form

The procedures and cost involved in formation of a private limited Company is less than in public limited Company.

ii.) Separate legal entity

A private company is a separate legal entity from its owners

iii.) Limited liability

The shareholders are not liable to the company's debts beyond the amount due on the shares they hold.

iv.) Wide source of capital

It has access to a large pool of capital than a sole proprietorship or a partnership because it can borrow money easily from financial institutions due to its assets which can act as security.

v.) Professional management

Professional managers can be hired and paid for their services which are of great advantages to a private company.

vi.) Ease in starting trading activities

Unlike a public company, a private company can commence trading immediately it is incorporated

vii.) Continuity

Unlike in a sole proprietorship or a partnership, the death of a shareholder in a private company does not affect the company.

Disadvantages of a private Company

- ✓ Required to make returns.
- ✓ Cannot sell shares to the public
- ✓ Restricts share transfer
- ✓ Lack of flexibility
- ✓ Alienation of shareholders
- ✓ Slow decision making

Public limited Company

- ✓ Can be formed by a minimum of 7 shareholders and not set maximum.
- ✓ Cannot start business before it is issued with a certificate of trading.

- ✓ It is managed by a board of directors.
- ✓ Its shares and debentures are freely transferable from one person to another.
- ✓ It advertises and invites the public to subscribe for its shares and debentures.

Advantages of a public Limited Company

a.) Wide range of sources of capital

They have the advantage raising large amounts of capital because it has good security to offer. Hence easier for public limited companies to borrow money because they are larger and usually well known, so this helps to build confidence in them.

b.) Economies of scale

They are more likely to achieve economies of scale because they are involved in large –scale business operations.

c.) Easy transfer of shares

No restriction on the buying, selling or transfer of shares

d.) Limited liability

Offer limited liability to shareholders meaning that the shareholders are not liable for the companies debts the shareholders capital contribution.

e.) Wide choice of business opportunities.

Due to large amount of capital a public company may be suitable for any type of investment.

f.) Continuity

A public company has a continuous life as it is not affected by the shareholders' death, insanity, bankruptcy or transfer of shares.

g.) Specialized management

It can hire qualified and experienced staff due to its vast resources like financial strength

Disadvantages of public Limited Companies

a.) High cost of formation

The process of registering a public limited company is expensive and lengthy.

b.) Legal restrictions

A public company must comply with many legal requirements making its operations inflexible and rigid.

c.) Alienation of owners

Owners of public limited companies do not participate in the management of their companies.

d.) Lack of secrecy

The requirements by law for public companies to submit annual returns and accounts to the registrar of companies deny the company the benefit of keeping its affairs secret.

e.) Conflict of interests

Directors may have personal intrest that may conflict with those of the company. This may lead to mismanagement.

f.) Delay in Decision making

Major decisions are made by the directors who take a long time to meet. This makes decision making slow.

g.) Diseconomies of scale

The large size and nature of business operations of a public company may result in high running costs and expensive.

h.) Double taxation

The profit made by the company is taxed and the dividends to the shareholders is also taxed

Stock exchange

This is the place where shares of quoted companies are exchanged through buying and selling.

Role of stock exchange

i.) Facilitates buying of shares

Provides conducive environment for investors wanting to buy shares in various companies.

ii.) Facilitates selling of shares

Creates a ready market for those who wish to sell their securities.

iii.) Safeguarding investors interests

This is achieved by requiring the companies that want to be quoted to attain certain standards of performance.

iv.) Provides useful information

Provides timely, accurate and reliable information to investors which enables them to make decisions on the investment to make.

v.) Assists companies to raise capital

Assist companies to raise capital by creating an environment through which such company's issues new shares to members of the public. (I.P.O)

vi.) Creation of employment

Employment opportunities have been created for those who facilitate the buying and selling of securities. E.g. brokers and their Agents.

vii.) Raising revenue for the government

The government earns revenue by collecting fees and other dues from activities carried out in the stock exchange market. Examples are taxes, license fees and rent and rates.

viii.) Availing a variety of securities

The stock exchange market avails a variety of securities from which investors can choose.

ix.) Fixing of prices

The stock exchange market is in the position to determine the equilibrium price (true market value) of the securities. This is of great importance to both the buyers and the sellers.

x.) Measures of a country's economic progress

The performance of securities in the stock exchange market may be an indicator of a country's economic progress.

xi.) Promotes the culture of saving

Stock exchange market provides investors with opportunities to channel their excess funds. Such people may act as role models to other members of the society who may emulate them thereby promoting a savings culture.

Dissolution/liquidation/winding up of limited Liability companies.

i.) Insolvency

When a company is not able to pay its debts, it can be declared insolvent and therefore may be wound up.

ii.) Ultra-vires

When a company acts contrary to the provisions of the objective clause of its memorandum of association, it is said to act ultra- vires.

iii.) Amalgamation

Two or more companies may join together to form one company completely different from the original companies.

iv.) Court order

The court of law can order a company to wind up especially following complaints from the creditors

v.) Decision by shareholders

The shareholders may decide to dissolve the business in a general meeting.

V.) PUBLIC CORPORATIONS

They are also called state corporations and they are formed and controlled by the government in that the government owns more than 50% shares in the cooperation.

A parastatal is a state corporation which is fully owned by the government.

Characteristics of public corporations

- ✓ Formed under an act of parliament.

- ✓ Managed by a board of directors by appointed by the state.
- ✓ Formed to offer essential services to the public.
- ✓ Owned by the government.
- ✓ Initial capital comes from government.
- ✓ Profits realized go the government.
- ✓ Regulated by acts of parliament articles of association and memorandum of association.
- ✓ Published financial statements are presented to parliament.

Advantages of public corporations

- ✓ Initial capital is readily available because it is provided by the government.
- ✓ Protect the public from exploitation because it can provide goods and services at a low price.
- ✓ Enjoys the benefit of large scale production since they produce goods and services in large quantities.
- ✓ Some ar monopolies and enjoys the benefits of monopoly.
- ✓ They can be bailed out by the government when in financial problems.

Disadvantages of public corporations

- ✓ Decision making may take long due to large number of people involved.
- ✓ They are insensitive to customer's feelings because of monopoly powers.
- ✓ The performance may be poor due to lack of accountability on the part of the employees and political appointees who may not be qualified.
- ✓ Diseconomies of scale operations.
- ✓ The cost of providing goods and services to all the citizens regardless of their geographical areas may be expensive.

Dissolution of public Corporation

- ✓ Persistence loss making.
- ✓ Bankruptcy.

Trends in forms of Business Units

a.) Franchising

Where a business permits another the right to manufacture, distribute its branded products using the name of the firm that gives the rights for a fee.

b.) Merger/Amalgamation

Where two or more businesses combine to form one new business.

c.) Holding company

It is a company that acquires 51% or more ownership of one or more companies which will be her subsidiaries under her control but with separate identities.

d.) Cartels

A group of related companies that has agreed to work together in order to control output, prices and markets of their goods and services.

e.) Privatization

Privatization is the changing of a state owned corporations to public limited companies.

f.) Absorptions (take –overs)

This is where a business is taking over another business by buying all the assets of the latter business which ceases to exist.

g.) Front Office Savings Account (FOSA)

It is an account provided by SACCOs to their members to enable them to deposit or withdraw money conveniently.

h.) Check off system

This is system where money is deducted at the source by employer and submitted to the SACCO.

i.) Burial benevolent funds (B.B.F)

Some SACCOs have started systems to assist their members financially in burials through creation of BFF

j.) Trusts

This is where a group of companies work together to reduce competition.

k.) Performance contact

In an attempt to improve performance of a state corporation, employees are expected to sign performance contracts.

l.) Globalization

Where businesses conduct their activities all over the world through technology such as e-commerce/where a business has branches all over the world-called multinationals

Summary of different forms of business units

Characteristics of business units	Sole proprietorship	Partnership	Limited liability companies	Parastatals	C0-operation
Formation	Individuals decision	Partners agreement	Registration with the registrar of companies	Act of parliament	Members decision
Ownership/ membership	One person	Partners(2-20)	Shareholders 2 -50 for private companies and 7 to infinite for public companies	Government	Members (10 to infinite)
Sources of capital	Owners personal savings Loans Retained profit	Member's contributions. Loans. Retained profits	Issues of shares Loans retained Earnings Credit purchases Leases and rents	Government Retained profit Leases and rents	Member contribution Interest on loans Retained profits
Management	One person	Owners only (active	Board of		Management committee

	(owner) With employees or family members	partners) with some employees	directors	A chairman with a board of Director	

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Highlight four advantages of large – scale business organization. (4mks)

2. In the spaces provided, indicate by writing true or false whether each of the following statements is true or false about articles of association of a company. (5mks)

Statement	True / false
a) It contains the activities the company is engaged in	
b) Indicates the procedures to be followed in calling meetings	
c) It contains details of election procedures	
d) It indicates the liabilities of the shareholder	

e) It contains the rights of each shareholders

3. State five advantages of sole proprietorship form of business (5mk)

4. Outline four benefits that Kenya may derive from multi – national operating in the country. (4mks)

5. State four advantages of a partnership over a sole –proprietorship. (4mks)

6. Highlight benefits an investor gets by buying debentures. (4mks)

7. Highlight four benefits of joining a savings and credit co – operative society. (4mks)

8. State four advantages of a hawker over a shopkeeper. (4mks)

9. Highlight four factors that may have hindered the growth of co-operative movements in Kenya. (4mks)

10. In the spaces provided below, indicate with a tick whether each of the following statements related to preferences or ordinary shared. (3mks)

Statement	preference shares	Ordinary Shares
a) Represent ownership		
b) Rate of divided is fixed		
c) Has voting rights		
d) Considered first in liquidation		
e) Redeemable		
f) May be cumulative		

11. Outline four features of a sole proprietorship form of business organization (4mks)

12. Outline four advantages of large business organizations. (4mks)

13. Outline four features of trade credit as a source of finance (4mks)

14. State four reasons why a government may find it necessary to nationalize some industries. (4mks)

15. In the spaces provided name the type of business organization described by each of the following features.

Description	Business Organization
a) Each member has only one role	
b) The business enjoys perpetual succession	
c) Each member may act on behalf of the business	
d) Formed by an Act of parliament	

16. Outline four measures that can be taken to improve efficiency of parastatals in Kenya. (4mks)

17. Outline four ways in which a savings and credit co – operative society can raise capital. (4mks)

18. Outline four features of a private company (4mks)

19. Outline four features of a private company (4mks)

20. List four sources of short – term finance for a business enterprise (4mks)

21. Highlight four disadvantages of cartels to consumers. (4mks)

22. Give five benefits of expanding a business (5mks)

23. Give four benefits of operating a small scale business over a large scale. (4mks)

PAPER 2

1. Explain five principles under which cooperative societies should be managed (10mks)

2. Explain five problems that farmers encounter when they sell their produce through marketing boards. (10mks)

3. Explain five sources of short term finances available to a business organization. (10mks)

4. Currently the government of Kenya is involved in privatizing public corporations. Explain five reasons that could make the government retain some of the corporations. (10mks)

5. Describe five disadvantages of running a business as a sole proprietor (10mks)

6. A group of businessmen from town x have formed a cartel. What reason could have led them to take such an action (10mks)

7. Explain five reasons why a public limited company may prefer to raise finance through issue of ordinary shares instead of debentures. (10mks)

8. Outline the differences between a private limited company and a public corporation (10mks)

9. In what ways do multinational corporations differ from locally owned firms .(10mks)

10. Discuss the factors that may influence the growth of a business unit. (12mks)

11. Explain the factors that make it difficult for many Kenyan to purchase houses through building societies. (6mks)

12. Explain the six benefits that may account to a business organization which expands the scale of its operation. (12mks)

13. Draw five differences between public limited company and a partnership form of a business. (10mks)

14. Describe the problems associated with a sole proprietorship form a business (10mks)

15. Explain six benefits that a company would get by raising capital through sale of ordinary shares (12mks)

16. Wafula who recently retired would like to invest his retirement benefits in either of two business options. Explain five factors that Wafula should consider in choosing the business to invest. (10mks)

17. Outline 4 reasons why the government may decide to nationalize some business enterprises. (10mks)

CHAPTER NINE

GOVERNMENT AND BUSINESS

Specific Objectives

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

a.) Explain reasons for government involvement in business;

b) Explain how the government gets involved in business;

c) Discuss the merits and demerits of government involvement in business activities;

d) Discuss the importance of consumer protection.

Content

a.) Government involvement in business.

b.) Methods of government involvement in business activities: Regulation, Training, Trade promotion, Provision of public utilities, enabling environment.

c.) Merits and demerits of Government involvement in business.

d.) Consumer protection: Need for consumer protection, Methods of consumer protection.

Introduction

Ways in which the government get involves in business activities:

- ✓ Producing goods and services.
- ✓ Distributing goods and services.
- ✓ Advising producers and traders.
- ✓ Promoting trade and economic development.
- ✓ Protecting consumers against exploitation by producers and consumers.
- ✓ As a consumer of goods and services.

Reasons for government involvement in Business Activities.

a.) To prevent exploitation of the public

The government protect the public from exploitation by private business persons especially in the

provision of essential goods and services such as salt, sugar etc. This can be done through the Kenya Bureau of standards.

b.) Provision of essential goods and services

Provision of essential goods and services in areas where private individuals and organizations are unwilling to venture because of ow profit and high risks

c.) Attraction of foreign investment

To attract foreign investment by initiating major business projects.

d.) To stimulate economic development

To stimulate economic development in the country by providing social services.

e.) Provision of sensitive goods

To provide goods and services which are too sensitive to be left in the hands of the private sector for example fire arms.

f.) Creation of employment

To create employment opportunities by initiating projects such as provision of electricity.

g.) To prevent foreign dominance

To prevent foreign dominance in the country by investing in areas where the locals are not able to.

h.) To provide goods and services that require high initial capital

To provide essential goods and services which private organizations are unable to provide due to large amount of capital required.

Methods/ways of government involvement in business activities

i.) Regulations

Ways in which government regulate business activities:

Licensing

The government regulates business activities by requiring that all persons /organization operating business activities to acquire a trading license before starting its operations for it to be legally operating.

Reasons for licensing:

- ✓ Regulating the number of business I a particular area to avoid unhealthy competition.

- ✓ Controlling the type of goods entering and leaving the country.
- ✓ To ensure that there are no illegal business.
- ✓ To raise revenue for the government.
- ✓ To ensure that traders engage only in trade activities that they have license for.
- ✓ To ensure that those who engage in professional activities meets the requirement of the profession.

Ensuring standards

Government set standard that business should meet ensuring that the standards are adhered to by establishing bodies like Kenya Bureau of Standards (KEBS) etc. control standardization.

Legislation (Enacting laws)

The government through legislation sets rules and regulations (laws) that regulate business activities operations like ban of hawking at certain areas in city centre and limiting number of passengers carried by public service vehicles.

ii.) Training

This is mainly done at the Kenya Business Training Institute (K.B.T.I).

Reasons for training of business people by the government.

- ✓ Expose them to modern development in management.
- ✓ Educate them on efficient methods of operating business.
- ✓ Expose business people to problems facing them and their possible solutions.
- ✓ Impact proper business ethics.
- ✓ Expose them to government policies regarding business activities in the country.

iii.) Trade promotion

Trade promotion is a government initiated and supported policy to encourage local business people to enter into business.

Categories of trade promotion

- External trade promotion.
- Internal trade promotion.

External trade promotion

It encourages local business people to enter into export market. External trade promotion can be done by commercial attaches.(officers sent by the country's government to work with the embassies in foreign countries as support staff in the field of commerce.

Duties of commercial attaches

- ✓ Explore and identify new markets for more export opportunities.
- ✓ Research and analyses markets for export from their home country.
- ✓ Keep statistics of products such as volumes, packaging sizes and methods of manufacturing
- ✓ Attend meetings, seminars and workshops on trade patterns of the countries and keep data on new markets for exports.
- ✓ Publish and advertise their own country's exports in business journals and magazines.
- ✓ Select buyerer, agents and distributors of the home country's exports.
- ✓ Make detailed reports on commercial activities that may help improve exports from their countries.

Internal trade promotion

It promote local trade through the ministry of trade by carrying out the following activities:

- ✓ Advising business people on matters such as the type of goods to produce and sources of finance.
- ✓ Training business people on appropriate ways of carrying out business.
- ✓ Offering business persons financial assistance to enable them to start and run their businesses.
- ✓ Creating an enabling environment for business to thrive.
- ✓ Providing incentives such as tax exemptions to encourage local businesses.
- ✓ Organizing shows, trade fairs and exhibitions through which local traders may promote their goods and services.

iv.) Provision of public utilities

These are essential services such as water, transport, sewerage. Power and communication which are provided by the government to enable businesses to operate smoothly.

v.) Enabling environments

Ways I which the government create enabling environment

Subsidies

Subsidy is financial assistance given by the government to businesses to make it easier for them to sell their products at lower prices.

Incentives

An incentive is something that is offered in order to encourage one to do something. In order to attract business people and encourage them to invest, the government may offer various incentives such tax holiday, duty free privileges etc.

Protection

The government protect local business in order for them to compete favorably with product from outside country. This is done through import duties and quotas.

Loan Guarantee

The government may act as a guarantor for local businesses to receive funds from international agencies.

Merits of government involvement in Business

- ✓ The government is able to carry out businesses that require a large capital.
- ✓ The government is able to provide some services which may not be profitable but very essentials to the citizens.
- ✓ Business started and run by the government help solve unemployment problems.
- ✓ Profits realized by business run by the government may be distributed to its citizens through provision of services.
- ✓ Business run by the government help create competition which may make private investors improve on quality and charge reasonable prices.
- ✓ Foreign domination of the country's economy may be reduced.

Demerits of government involvement in Business

- ✓ Government run business are operated by political appointees who may perform poorly but they are still kept in their positions.
- ✓ Government involvement in business may scare away investors who would have rendered the same services in a more efficient manner.
- ✓ Some state- run organizations continuously make losses thereby failing to sustain themselves. This may force the government to finance them with the tax payers money.
- ✓ Most government projects are expensive enterprises which require heavy investment in terms of personnel training and equipment.

- ✓ Corruption and embezzlement of funds are rampant in government enterprises because of poor control.

Need for consumer protection

- ✓ Ensure consumers are protected from the sale of harmful goods.
- ✓ To safeguard consumers get quality goods in time hence no hoarding.
- ✓ To ensure that consumers get quality goods.
- ✓ To safeguard consumers against poor measure of goods i.e. size and weight.
- ✓ To ensure that building construction and safety standards are maintained.
- ✓ To ensure that fair prices are charged for the commodities.
- ✓ To protect consumers from false advertisements.
- ✓ To protect the consumer against breach of contract.

Methods of consumer protection

a.) Government initiated methods

Weights and Measures Acts.

By putting up weights and measures act in order to check on the measurements and weights through Kenya Bureau of Standards.

Setting up Standards

The Kenya Bureau of Standards sets national quality standards and ensures that commodities are of the required standards.

Licenses

This ensures that there is control on the type of business carried out and that professionals engaged in only the business they are competent in.

Food and drug Act

This ensures that producers and traders do not include any substance in the commodities that they sell to the consumers which might have harmful effects on the consumers health.

Trade Description Acts/sale of Goods Act

This ensures that a producer or a trader does not cheat the consumer by providing false descriptions of commodities.

Public Health Act

This ensures that commodities offered for sale are hygienic and of good quality. It also ensures that premises obey health and construction regulations.

Price Control

The government may set a price beyond which commodities should not be sold especially for essential goods and services.

Rent and tribunal act

Ensuring that tenants are not overcharged by land lords.

b.) Consumer initiated methods

They are formed by consumers to protect themselves e.g. formation of consumer associations.

Functions of consumer associations

- ✓ Dealing with complaints about defective items bought by members.
- ✓ Making sure that commodities are not hoarded and that a regular supply is maintained.
- ✓ Ensuring that weight and measures of commodities are correct.
- ✓ Ensuring that health and safety regulations are adhered to.
- ✓ Educating their members on their rights as consumers.
- ✓ Ensuring the availability of essential goods and services at a fair price.

Limitations of consumer initiated methods

- ✓ Lack of support from the government.
- ✓ Lack of capital to finance their organizations.
- ✓ Ignorance of consumers about their rights.
- ✓ Reluctance of many consumers to join these associations.
- ✓ Lack of initiative from consumers to check on traders performance.

c.) Non –governmental Organizations (NGO)

Some non-governmental organizations also participate in activities aimed at protecting the consumers.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. State four ways in which the Kenya Government protects consumers (4mks)

2. Give three disadvantages of railway transport in Kenya (3mks)

3. State four ways in which a government may regulate business activities (4mks)

4. Outline four reasons why a government may find it necessary to protect consumers.

(4mks)

5. Outline four reasons why the government participates in business protection. (4mks)

6. Highlight four limitations of using consumer initiated methods in consumer unfair business practices by traders. (4mks)

7. State four reasons why a government may want to be involved in commercial activities

(4mks)

8. State four reasons why a government may want to be involved in commercial activities

(4mks)

9. Give four functions of the Kenya external trade authority. (4mks)

PAPER 2

1. Explain in the business malpractice that consumer need to be protected against by the government.

(10mks)

2. Explains six functions of marketing boards in Kenya (12mks)

3. Outline five measures that the government of Kenya has put in place to protect consumers from

unscrupulous business practices. (10mks)

4. Explain 5 reasons why consumers need protection against malpractices by some traders. (10mks)

5. Outline 5 circumstances under which the government may find it necessary to nationalize an industry. (10mks)

6. Explain 5 problems that farmers may face when they sell their produce though marketing boards. (10mks)

7. Explain how the Kenya national chamber of commerce and Industry (KNCCI) promotes development of businesses activities in Kenya. (10mks)

8. Discuss the problems faced by KETA (10mks)

CHAPTER TEN

TRANSPORT

Specific Objectives

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

a) Explain the meaning and importance of transport to business;

b) Explain the essential elements of transport;

c) Describe the modes and means of transport;

d) Discuss advantages and disadvantages of each means of transport;

e) Discuss the factors which influence choice of an appropriate means of transport;

f) Discuss trends in transport.

Content

a.) Meaning and importance or transport

b.) Essentials of transport

c.) Modes and means of transport

d.) Advantages and disadvantages of each means of transport

e.) Choice of an appropriate means of transport

f.) Trends in transport. Containerization, Pipeline

Introduction

Transport is the process of moving goods and services from one place to another.

Importance of transport to Business

a.) Linking consumers to producers

Transport links consumers to producers enabling them to obtain goods and services they need

b.) Employment creation

Creates employment opportunities as people are employed as drivers, pilots, mechanics etc.

c.) Promotes specialization

It enables people to specialize in jobs they are best at for example producers would concentrate on production only while other people carry out production.

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 making them more useful.

e.) Improving standard of living

It enables consumers to get variety of goods and services thereby improving the standards of living.

f.) Availing a wide market for products

It enables producers to widen the market for their products by enabling them access to areas they would otherwise not be able to access.

g.) Increased production

Due to a 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.

i.) Promoting development of industries

Through transport, raw materials can be taken to manufacturing industries and also finished goods to the market.

Essential Elements of Transport

a.) Units of carriage

This refers to anything that is used to transport goods and people from one place to another.

Units of carriage

- ✓ Ships
- ✓ Trains
- ✓ Airplanes
- ✓ Motor vehicles
- ✓ Bicycles
- ✓ Carts

b.) Methods of propulsion

This is the driving force/source of power that makes a unit of carriage to move. They include the following:

- ✓ Petroleum
- ✓ Electricity
- ✓ Human force
- ✓ Animal power

c.) Ways

This is either the root or the path passed by the vessel.

Examples of ways:

- ✓ Roads
- ✓ Railways
- ✓ Seaways
- ✓ Airways

d.) Terminals (terminuses)

Terminals are the loading and off-loading places.

Examples include:

- ✓ Bus station
- ✓ Airports
- ✓ Seaports

Modes of transport

Mode refers to the manner in which transport is carried out. There are three modes of transport namely;

- Land transport
- Water transport
- Air transport

Land transport

This mode of transport involves movement of goods and people using units of carriage that move on dry land. The various means here include:

a.) Human porterage

This involves human being carrying goods on their shoulders, heads or backs

Advantages of Human Porterage

- ✓ Compliments other means of transport
- ✓ Flexible as it has no fixed time table or routes.
- ✓ May be a cheap means compared to other means of transport.
- ✓ Readily available when required
- ✓ Convenient over short distances.

Disadvantages of human porterage

- ✓ Not suitable for long distances.
- ✓ Add on congestions on the roads.
- ✓ It is relatively slow.
- ✓ Relies on human energy which is exhaustible.

b.) Carts

Carts are opened vessels usually on two or four wheels that are pushed or pulled by either human beings or animals such as donkeys and oxen.

Advantages of Carts

- ✓ Compliments other means of transport.
- ✓ Relatively cheap to hire.

- ✓ Initial buying and maintenance cost is low.
- ✓ Appropriate in remote areas where other means are not available.
- ✓ Readily available for hire.
- ✓ Can carry fairly heavier and bulky goods.
- ✓ Convenient for transporting goods over short distances.

Disadvantages of carts

- ✓ May not be suitable for transporting heavy and bulky goods.
- ✓ Cause traffic jams on roads leading to congestion and accidents.
- ✓ Not suitable for transporting goods over long distances.

c.) Vehicle

These are means of transport that ferry goods and people on roads. Matatus are the most commonly used in transportation.

Advantages of matatus

- ✓ They supplement regular bus companies.
- ✓ They fill up faster than buses hence save time.
- ✓ They are more flexible since they can change routes easily depending on demand.
- ✓ They reach out into the interior of rural areas where big buses cannot access.
- ✓ They are more flexible with the fares they charge.
- ✓ They are easier to hire as most of them are readily available.
- ✓ They are cheaper to acquire as compared to buses.

Disadvantages of Matatus

- ✓ Some matatus are poorly maintained to the extent of being unroad worthy.
- ✓ Most drivers are reckless as they rush to compete for customers.
- ✓ In some cases, touts use impolite language when dealing with passengers.
- ✓ They may cause noise pollution such as unnecessary hooting and loud music.
- ✓ They may cause congestion in towns unnecessarily because of careless driving and parking.
- ✓ Uncalled for sudden increase in fares at peak hours, during the night and on public holidays.
- ✓ Their operation is concentrated on peak hours, rarely operating at night.
- ✓ They at times unexpectedly change their route hence causing breach of contract.

Advantages of Vehicles

- ✓ Most readily available means of transport.

- ✓ Relatively fast compared to carts and human porterage.
- ✓ Relatively cheaper over short distances.
- ✓ Flexible as it can offer door to door service.
- ✓ Vehicles may be available for transporting special goods.
- ✓ Roads are widely spread thereby making many areas accessible.

d.) Trains

Trains are vessels that transport goods and people on rails.

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 time table.
- ✓ Economical for transporting heavy and bulky goods over a long distance.
- ✓ Trains may have facilities for carrying special type of goods. e.g. gas, petrol and vehicles.
- ✓ Where shunting facilities are available trains may deliver goods up to or from the owners' premises.

Disadvantages of Trains

- ✓ Not flexible as trains follow a strict time table.
- ✓ Railway lines are expensive to construct and 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

Pipeline transport is the movement of liquids and gases from one place to another through a pipe. Products transported through pipes included:

- ✓ Water
- ✓ Gases
- ✓ Petrol
- ✓ Diesel

Advantages of pipeline transport/advantages of transporting oil through pipeline.

- ✓ Road accidents have reduced due to reduced congestion of tankers on the road.
- ✓ Environmental pollution have been reduced as smoke from tankers has reduced/pipes do not

emit smoke Polluters.

- ✓ Road damage has reduced due to reduced heavy tankers on roads.
- ✓ Reduced cost of handling oil due to few workers/employed /pipeline use machine mainly.
- ✓ Pilferage of oil has reduced as it's difficult to steal oil from the hard pipes that area underground.
- ✓ Large volume of oil will be transported within a short time.
- ✓ Ensure regular supply of oil hence reducing oil shortages.
- ✓ Not easily affected by poor weather as pipes can be underground/permanently fixed.

Disadvantages of pipeline transport.

- ✓ Not economical for small quantities.
- ✓ Solid products are not transported through pipeline.
- ✓ Can be easily targeted for sabotage.
- ✓ A variety of product cannot be transported the same time.
- ✓ Very expensive to put up.
- ✓ Providing security has high costs
- ✓ Monitoring pipeline is expensive
- ✓ Heavy loses may be incurred if damaged is not discovered within a short time
- ✓ May result in environmental degradation in case of damage

Water transport

This a mode of transport where the units of carriage, transport goods and people on water. The vessels using this mode include:

- ✓ Ships
- ✓ Dhows
- ✓ Boats
- ✓ Steamers
- ✓ Ferries.

Water transport is divided into two

- Inland water ways
- Sea transport.

Inland waterways

This is a transport carried out on lakess,rivers and inland canals.Most rivers in Kenya are not navigable due to the following reasons:

- ✓ Too small
- ✓ Presence of rapids and waterfalls
- ✓ Too shallow
- ✓ Most are seasonal
- ✓ High gradient.

Season Transport

This is where goods and people are transported in seas and oceans.

Types of water vessels

a.) Ships

Ships may be classified as either liners or tramps.

Liners

These are ships that are owned and operated by shipping companies called conferences.

Characteristics of liners

- ✓ Have fixed routes.
- ✓ Follow a fixed time table.
- ✓ 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.

Characteristics of tramps

- ✓ Do not have a fixed rate.
- ✓ Have no set time tables.
- ✓ Their fares change according to demand.
- ✓ Their travelling patterns are irregular and therefore cannot be relied upon.

b.) Boats and ferries

These are water vessels used in transporting goods and people over short distance.

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.

- ✓ Best 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 volumes can be carried thereby reducing cost per unit.

Disadvantages of water Transport

- ✓ Sea-sickness, sea-pirates and storms may occur.
- ✓ Not suitable for transporting perishable and urgently required goods.
- ✓ It is expensive to construct and maintain artificial harbors.
- ✓ Unfavorable weather conditions may affect water transportation.
- ✓ 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 chips is high.

Air transport

This is a mode of transport in which airplanes are used.

Advantages of Air Transport

- ✓ There is less handling of goods on the way since airplanes may move direct to the final destination.
- ✓ The way does not require construction or maintain as it is natural and free.
- ✓ Planes can move though places where other means cannot.
- ✓ Have efficient interconnections between airlines all over the world which makes it convenient.
- ✓ Suitable for long distance travelers especially from one continent to another.
- ✓ Suitable for transporting perishable and urgently required goods.

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.
- ✓ Unfavorable weather conditions may cause delay.
- ✓ In case of accidents results are catastrophic.
- ✓ It is expensive to construct and maintain airfields
- ✓ It is an expensive means of transport in terms of freight charges.

Containerization

It involves transporting goods packed in standard box like containers.

Advantages of containerization

- ✓ Can carry large quantities of goods if properly arranged.
- ✓ Minimal damage to goods as they are protected against weather conditions by the metallic container.
- ✓ Goods are safe from theft and pilferage as containers remain sealed up to the point of destination.
- ✓ Low insurance premiums due to reduced risks of theft and damage.
- ✓ Easy of loading and off-loading due to use of handling equipment such as cranes.
- ✓ Handing cost may be minimized due to use of modern technology.
- ✓ Containers can be easily moved as they are fitted with appropriate handling devices.
- ✓ it is possible to transport specialized goods using specialized designed containers

Disadvantages of containerization

- ✓ Containers are expensive and this increases the cost of transporting goods.
- ✓ Contributes to unemployment since it is capital intensive.
- ✓ Not suitable for transporting small quantities.
- ✓ Requires special handling equipment which may be expensive.
- ✓ May not be suitable for goods with irregular shapes.

Factors that influence choice of Appropriate Means of Transport.

a.) Flexibility

An efficient transport system should be flexible enough to suit the needs of the one using it.

b.) Urgency

For goods that are urgently required the fastest means available should be chosen

c.) Cost

It should be economical and affordable

d.) Nature of goods

Perishable goods require a faster means and heavy and bulky goods requires a means of transport convenient for such goods. E.g. trains.

e.) Reliability

Reliability is the assurance that the goods will reach the intended destination at the right time and in the right form therefore the means chosen should ensure reliability.

f.) Security

The means chosen should ensure that the goods on transit are secure against loss, theft or physical damages.

g.) Distance

Some means of transport are suitable for long distance while others are for short distance. In long distances, air or railway transport should be chosen while in short distance roads are best.

h.) Availability of Means

The means of transport to be chosen should be based on its availability. Where there is only one means of transport it would be the only one chosen.

i.) Terminals

The means whose terminal is always accessible should be chosen compared to the one whose terminal is not easily accessible.

Trends in Transport.

- ✓ Pipeline and containerization.
- ✓ Electric trains are replacing diesel engines.
- ✓ Underground tunnels for trains are being used to ease congestions on the surface.
- ✓ Dual –carriage roads are being developed in various parts to ease congestion and minimize accidents.
- ✓ Use of Bicycles commonly known as boda boda.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAST PAPER 1

1. State four circumstances under which a businessman would choose to transport goods by air? (4mks)

2. 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. Give five reasons why a manufacturing firm would be located in an area well served by good road network. (4mks)

4. Outline four limitations of containerization. (4mks)

5. State four reasons why road transport is popular in Kenya. (4mks)

6. State four ways in which the nature of goods would influence the choice of transport. (4mks)

7. Outline four reasons why a transporter of goods from Mombassa to Nairobi may prefer rail transport to road transport. (4mks)

8. State the unit of carriage for each of the following modes of transport. (5mks)

Mode of transport	Units of carriage
a) Portage	
b) Sea	
c) Road	
d) Cartage	
e) Air	

9. List four ways in which transport promotes growth of trade. (4mks)

10. State four reasons why road transport is popular in Kenya. (4mks)

11. Give 3 disadvantages of railway transport in Kenya. (4mks)

12. List 4 disadvantages of using containers to transport goods. (4mks)

PAPER 2

1. Explain five reasons that may account for continued use of hand carts as a mode of transport in Kenya. (12mks)

2. The oil pipeline has recently been extended from Nairobi to western Kenya. Explain five benefits that may be accounted to the country from the extension. (10mks)

3. Explain five ways in which an efficient road transport system may promote trade within a country. (10mks)

4. Discuss five factors that have hindered the expansion of railway transport in Kenya. (10mks)

5. Explain five features of an efficient transport system (8mks)

6. Explain the advantages of pipeline as a mode of transporting oil products. (12mks)

7. Outline five factors that should be considered when choosing a means of transport.

(10mks)

8. Explain six advantages of containerization as a mode of transport. (10mks)

9. Discuss six factors that may discourage the use of pipeline as a means of transporting petroleum products in a country. (12mks)

10. Discuss 5 circumstances under which a trader may choose to transport goods by rail.

CHAPTER ELEVEN

COMMUNICATION

Specific Objectives

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

a) Explain the meaning and importance of communication;

b) Describe the lines of communication;

c) Explain the essentials of effective communication;

d) Describe the various forms and means of communication;

e) Discuss the advantages and disadvantages of each means of communication;

f) Discuss the factors that influence choice of an appropriate means of communication;

g) Identify the barriers to effective communication;

h) Discuss services that facilitate communication;

I) Discuss trends in communication.

Content

a.) Meaning and importance of communication.

b.) Lines of communication: vertical/horizontal, formal and informal.

c.) Essentials of effective communication.

d.) Forms and means of communication.

e.) Advantages and disadvantages of each means communication.

f.) Choice of appropriate means of communication.

g.) Barriers to effective communication.

h.) Services that facilitate communication e.g. courier, postal, telecommunication.

i.) Trends in communication: Facsimile (Fax), Developments in the internet (e.g. e-mail, e-commerce), Cell-phones.

Introduction

Communication is the process of passing information from one person to another.

Importance of communication

a.) Facilitates the giving and receiving of information

This is within and between the firm and outsiders. For example the boss informing the members of staff of a planned meeting so that they prepare for it.

b.) Enhances clarification of issues

Some information that is confusing may be due to complex management are communicated well to stop the confusion.

c.) Enhancing public relations

This way the business creates a positive corporate image to members of the public.

d.) Starting and influencing action

New ideas and plans are communicated while making sure they are implemented in the desired way.

e.) Improving customer service

It is one way of handling customer inquiries efficiently and giving them the desired feedback.

f.) Helps to coordinate departments of the organization

Enable good linkage of the activities of all departments in an organization so as to achieve harmony at work.

g.) Way of giving reassurance

For instance the management may appreciate the good work of an employee by serving him/her with a 'well done' memo.

h.) For confirming arrangements

Enables the office to confirm such arrangements as meetings or conferences.

f.) Giving feedback.

For giving instructions – enables the management to get work done by issuing procedures and orders.

Lines of Communication

Lines of communication refers to the direction in which communication flows from the sender to the receiver.

When classified according to the levels of the communicating parties, we have the following:

- ✓ Vertical
- ✓ Horizontal
- ✓ Diagonal communication

Vertical Communication

This is where messages are passed between a senior and his /her juniors in the same organization. It is divided into:

- ✓ Downward Communication
- ✓ Upward Communication

Horizontal Communication (Lateral Communication)

This is communication between or among people of the same level/rank.

Diagonal Communication

This is communication between or among people of different levels in different departments or different organizations.

Classification according to the nature of the messege:

- ✓ Formal Communication
- ✓ Informal Communication

Formal Communication

This is the passing of messages using the approved and recognized way in an organization.

Informal Communication

This is communication which is neither in the right form nor follows the right channels. It is usually used when sending messages to friends and relatives.

Essentials of Effective Communication

The following are the main essential elements of effective communication:

i.) The sender/Communicator

This is the person from whom the message originates. He/she encodes the messenger, this is putting the message in a communicative form.

ii.) Message

This is the information to be sent.

iii.) Medium/channel

This is the means through which the message is to be sent. E.g. Telephone, letter, radio and face to face

iv.) The receiver

This is the person or people for whom the message is intended. The receiver decodes the message for proper understanding.

v.) Feed – back

This refers to the reaction of the receiver to the message. This may be a replay or response which the receiver sends back to the sender.

Forms and Means of Communication

These are methods or ways of passing on messages. There are three main forms of communication.

- ✓ Oral
- ✓ Written
- ✓ Audio – visual

A means of communication is the device used to pass on information such as:

- ✓ Messengers
- ✓ Letters
- ✓ Telephones
- ✓ Face to face.

1.) Oral Communication/verbal communication

This is where information is conveyed by word of mouth. The various means of verbal Communication include:

a.) Face to Face Conversation

This is a means of communication that involves two or more people talking to each other.It is suitable where the subject matter of discussion requires:

- ✓ Convincing
- ✓ Persuasion
- ✓ Immediate feedback

Advantages of Face to Face Communication

- ✓ Provides for immediate feedback.
- ✓ Has personal appeal.
- ✓ Body language can easily be expressed.
- ✓ One can persuade or convince another.
- ✓ It is the simplest means of communication to use.
- ✓ It is direct, that is, it does not pass through intermediaries.

Disadvantages/Limitation of Face to Face Communication

- ✓ No record for future reference
- ✓ Costly/expensive where sender and receiver are far apart and they have to meet.
- ✓ Can be time consuming.

- ✓ Inappropriate gestures/body language-may lead to message being misinterpreted /communication being ineffective.
- ✓ Messages can be distorted.
- ✓ Unsuitable for people with hearing and taking impairments.

b.) Telephone

Means of communication commonly used in offices and homes.

Advantages of Telephone

- ✓ Relatively fast.
- ✓ Has personal appeal
- ✓ Provides for immediate feedback.
- ✓ One can persuade and convince another.
- ✓ Suitable for long distance communication.

Disadvantages of Telephone

- ✓ May be expensive.
- ✓ No record for future reference.
- ✓ Lacks confidentiality.
- ✓ Not convenient for people with hearing and talking impairments.
- ✓ Can be time consuming.

c.) Radio calls

This is a means of communication used to transmit information or messengers by use of a radio waves.

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.
- ✓ Messengers are sent one way at a time.
- ✓ Can be expensive.
- ✓ Cannot be used by people with hearing and talking impairments.
- ✓ Can be time consuming.

d.) Paging

This is a means of communication used to locate and alert staff or employees quickly within a factory, Office and institutions such as hospitals.

2.) Written Communication

This means transmission of messengers through writing.

Means of written communication

- ✓ Letter
- ✓ Telegram
- ✓ Telex
- ✓ Facsimile/fax
- ✓ Memorandum
- ✓ Minutes
- ✓ Circulars
- ✓ Agenda

- ✓ Reports
- ✓ Minutes

Advantages of written Communication

- ✓ It can be retained for future references.
- ✓ Some, like letters are relatively cheap.
- ✓ It is suitable for confidential information.
- ✓ 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

- ✓ Lacks personal appeal.
- ✓ Takes time to prepare and to reach the recipients.
- ✓ Suitable for people who can read and write only.
- ✓ Immediate feedback may not be possible.
- ✓ Does not offer room for persuasion and convincing.

3.) Audio –visual Communication

This is a form of communication in which messages are sent through sounds and signs. It is suitable where both the sender and receiver know the meaning of specific sounds and signs.

Means of audio- visual

- ✓ Siren
- ✓ Television
- ✓ Photographs
- ✓ Signs

Advantages of Audio- visual Communication

- ✓ It reaches many people.
- ✓ It is more appealing than other means of communication.
- ✓ Reinforces verbal communication.
- ✓ May have a lasting effect on the receiver.
- ✓ Suitable where receivers are illiterate.

Disadvantages of Audio- visual Communication

- ✓ It is only suitable for those people who can interpret the message correctly.
- ✓ It is not suitable for sending confidential messages.
- ✓ Preparation may take long.

Factors to Consider When choosing Means of Communication

a.) Speed

Speed is an important factor when the message is urgent.

b.) Cost

The means to be chosen should be economical and affordable in terms of cost.

c.) Confidentiality

Where confidentiality is required, registered mail or an internal memo enclosed in an envelope may be appropriate.

d.) Distance

The geographical gap between the sender and the recipient is important in determining the choice of a means of communication. Some means are suitable for long distances while others are not.

e.) Evidence

Some means provide a record of the message conveyed. This may be necessary for the purposes of future reference.

f.) Reliability

This is the assurance that the message will reach the intended recipient at the intended time, place and in the right form.

g.) Accuracy

Accuracy refers to the exactness of the message to be conveyed by a means of communication. Written messages are generally accurate than other means of communication such as face to face.

h.) Desired impression

The type of impression you want to create upon the receipt also matters when choosing the means of communication.

Barriers to effective Communication

a.) Language Barrier

It is important for the receipt to understand the language being used by the sender in order for communication to take place. Language could also be a barrier in case of foreign languages, differences in dialects and differences in regional accents.

b.) Poor listening

The effectiveness of communication will depend on the willingness of the receipt to listen keenly.

c.) Negative attitude

It is important that there exists a mutual feeling of trust and respect between the parties concerned to avoid bias.If there is mistrust and prejudice, then there may be deliberate or unintentional misunderstanding of the message involved.

d.) Poor Timing

For communication to be effective, the message must be sent and received at an appropriate time.

e.) Wrong Medium

The means of communication used must be appropriate for the information being conveyed, otherwise a wrong choice of medium will be a barrier to effective communication.

f.) Prejudgment

Our understanding of the message is always conditioned by our earlier experiences and knowledge.

g.) Emotional Responses

Emotional responses such as those resulting from anger or excitement may lead to distortion of massages.

h.) Unclear systems 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 message is intended.

i.) Unfamiliar Non- Verbal Signals

Non – verbal signs may be barriers to effective communication because they may be misinterpreted

due to difference in cultures and age- groups among others.

j.) Noise

The presence of noise may interfere with the concentration or listening ability of the recipient of the message.

Services that Facilitate Communication

a.) Mailing Services

This refers to the handling of letters and parcels. Mailing services are offered by organizations such as Postal Corporations of Kenya, Securicor Courier, Document Handling Limited and Roy Parcel Services.

Mailing services are as follows:

i.) Speed post

This is a service offered by the post office to send correspondences and parcels to a destination in the shortest time possible.

ii.) Poste Restante

This is a service offered by the post office to travelers who may wish to receive correspondence while away from their post office box.

iii.) Express mail

In express mail normal postage plus an extra fee (commission) is paid for the services.

iv.) Registered mail

Registered post is a service offered by post office and other service providers for sending articles of value for which security handling is required.

v.) Business Reply Services

This is a service used by firms that intend to encourage their customers to reply to their letters promptly.

b.) Telephone Services

These services are provided by firms such as Telkom Kenya, Safaricom and Airtel. This services are either available on either landline or mobile telephones.

c.) Broadcasting services

d.) Print Media Services

Print media refers to means of written communication that are intended to pass information to a large number of people or the general public.

Trends in Communication

Telephone Bureaus (Bureaus)

These are privately owned kiosks where telephone services are offered.

Mobile Phones (cell phones)

These are hand- held telephones with digital links that use radio waves.

E-mail

It is used to send messages electronically through computers.

Internet

It uses a network of interlinked computers to obtain information.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Outline four reasons why a business person may prefer written communication to verbal communication. (5mks)

2. State five services offered by the post office. (5mks)

3. State four advantages of verbal communication. (4mks)

4. Highlight four advantages of using telex as a means of communication. (4mks)

5. State four features of effective communication. (4mks)

6. State four reasons why the post office is still popular as a means of sending letters. (4mks)

7. Give four reasons why a person would send a message by mail rather than by telephone. (4mks)

8. Highlight four factors that may limit the use of telephone as a means of communication in Kenya. (4mks)

9. State four problems that may interfere with the effectiveness of face to face communication. (4mks)

CHAPTER TWELVE

WAREHOUSING

Specific Objectives

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

a) Explain the meaning and importance of warehousing to business;

b) Discuss the essentials of a warehouse;

c) Identify the various types of warehouses;

d) Explain the advantages and disadvantages of each type of warehouse.

Content

a.) Warehousing.

b.) Essentials of a warehouse.

c.) Types of warehouses.

d.) Advantages and disadvantages of each type of warehouse.

Introduction

Definition

A warehouse is a place or building where goods are stored until their demand arises. Goods stored maybe raw materials or finished goods.

Warehousing is the process of storing goods until the time they are required. It involves the following:

- ✓ Receiving goods into the warehouse.
- ✓ Storing goods.
- ✓ Releasing the goods from the warehouse.

Importance of warehousing to business

a.) Steady flow of goods

Goods are stored at the time of plenty and released as need arises.

b.) Stability in prices

Warehousing helps to keep prices stable by ensuring steady supply of goods.

c.) Protection of goods

Goods stored in warehouse are protected from risks such as theft, fraud and physical damage.

d.) Ensuring continuous production

Raw materials can be bought in large quantities and stored in warehouses awaiting their need to arise. This ensures continuous production.

e.) Preparation of goods for sale

Goods stored in warehouse could be blended, branded, packed, graded or stores out.

f.) Enables owner to look for market

Warehousing gives the owner of the goods a chance to look for a market for goods while the goods are still in the warehouse.

g.) Goods can improve on quality

Some goods such as wine may improve in quality while in the warehouse.

h.) Encourage specialization

The producers concentrate on production while distributors store the goods for sale to the customers.

i.) Buyers can inspect goods

Warehousing enables buyers to inspect the goods before they can buy them.

Essentials of a warehouse

These are features and resources a warehouse should have in order for it to function defectively. They include the following

i. Suitable location

The location should be suitable to facilitate receipt and issue of goods.Eg located near the market.

ii. Proper building design

A warehouse should be designed in a way that it accommodates the intended goods.

iii. Appropriate equipment

A warehouse should be equipped with appropriate facilities for handling goods such as fork-lifts and necessary working materials and tools for easy operation.

iv. Safety facilities

A warehouse should be fitted with safety equipment and facilities necessary for protection of goods against damage caused by such things as water and sunshine as well as for the protection of

personnel.

v. Good transport system

A warehouse should be linked with a good and appropriate transport network to facilitate movement of goods in and out of the warehouse.

vi. Good communication

Communication network should be good for easy contact with its clients and suppliers.

vii. Adequate space

It should be spacious enough to allow easy movement and accommodation of goods and personnel.

viii. Appropriate staff

Warehousing staff should be well trained and efficient for proper management and efficient functioning of a warehouse.

ix. Appropriate special facilities

A warehouse should be equipped with necessary facilities for special goods.

x. Proper recording systems

There should be a proper recording system in a warehouse to ensure that all movement of goods is properly monitored.

xi. Compliance with law

A warehouse should be operated according to the requirements of the law.

Types of warehouses

Classification can be in terms of ownership or goods stored. On the basis of Ownership, warehouses can be private or public. On the basis of types of goods stores we have bonded or free.

Private warehouses

These are warehouses that are privately owned by either individuals or firms for storing their goods only. Such warehouses may be owned by:

- ✓ Wholesalers
- ✓ Producers
- ✓ Retailers

Advantages of private warehouse

- ✓ The owners exercise some degree of control over its operation.
- ✓ Enables special handling, storage and protection of goods by having special facilities which may not be available in public warehouses.

- ✓ The warehouse may be designed to suit the owner's specifications and various needs.
- ✓ The owner may make major decisions without consulting anyone.
- ✓ The owner does not incurs the cost of hiring space unlike in a public warehouse.
- ✓ The owner is not tied down by the procedures of receiving and issuing goods unlike in public warehouses.

Disadvantages of private warehouses

- ✓ High initial construction cost.
- ✓ Due to low volumes, the personnel and facilities may be under-utilized.
- ✓ May not be able to employ qualified management personnel to run the warehouse.

Public Warehouse

They are owned by individuals or firms purposely constructed for renting to those in need of temporary storage of goods.

The warehouse gives the owner of goods an opportunity to:

- ✓ Get the goods prepared for sale through grading, packaging, blending and branding.
- ✓ Look for market for the goods while in the warehouse.
- ✓ Make arrangements to transport the goods to intended destinations.
- ✓ Sell the goods while in the warehouse.

Advantages of public warehouse

- ✓ Traders can rent space to store their goods.
- ✓ Traders do not have to construct their own warehouse.
- ✓ Goods are insured against risks such as damage by fire and theft.
- ✓ A trader may get short term loan from the warehouse by using goods stored as collaterals.
- ✓ It enables its customers to enjoy economies of scale through buying and delivery of goods to the warehouse.

Disadvantages of public warehouses

- ✓ The hirer is denied the opportunity to physically handle the goods and may be forced to compete for attention with other hirers of the warehouse.
- ✓ The hirer may lose contact with his/her customers since they get goods from a rented warehouse, away from the hirers premises.
- ✓ The hirer might get poor services or miss space altogether during peak seasons due to the stiff competition for the same facilities.
- ✓ Documentation involving receipt and release of goods in a public warehouse is likely to be a long and a complicated procedure.

- ✓ Continued renting of space can be even more expensive than constructing one's own warehouse in the long run.
- ✓ Public warehouse are situated far away from the hirer's premises.

Bonded warehouses

They are warehouses specifically meant for keeping imported goods as they await payment of customs duty.

Features of a bonded warehouse

- ✓ Goods can be bonded until custom duty is paid.
- ✓ Goods can be re-exported while in the bonded warehouse.
- ✓ Storage charges are made on all goods stored in the warehouse.
- ✓ Goods can be sold while still under bond.
- ✓ Goods can be inspected or prepared for sale while still in the warehouse.
- ✓ Goods are released only on the production of a release warrant.

Advantages of Bonded Warehouse to the importer

- ✓ Importer can prepare the goods for sale while still in the bonded warehouse.
- ✓ The owner can look for the market of the goods before paying the duty.
- ✓ Some goods lose weight while in the warehouse so the duty paid becomes lower if it is based on weight.
- ✓ The burden of paying the duty passes to the buyer if goods are sold while still in the warehouse.
- ✓ Gives importer time to look for money to pay for customers' duty.
- ✓ Goods in the bonded warehouse are secure.
- ✓ Some goods improve in quality in the warehouse E.g. Wine and tobacco.

Advantages of a Bonded Warehouse to the Government

- ✓ Source of revenue.
- ✓ The government is able to control entry of harmful goods.
- ✓ The government is able to verify documents for goods in transit.
- ✓ Enables the government to control quality of goods entering into the country.
- ✓ Enables the government to control the quantity of goods entering into the country.

- ✓ The government is able to inspect type or nature of goods imported.
- ✓ The government is able to check on illegal goods entering the country.

Disadvantages of a Bonded Warehouse

- ✓ Importers may eventually fail to pay the customs duties.
- ✓ When the importer withdraws goods from a bonded warehouse in bits he/she ends up paying a higher duty than if he/she had paid the duty at once.
- ✓ 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. They can also include all private and public warehouses.

Advantages of Free warehouses

- ✓ Owners of goods stored need not pay any taxes, thus the goods cannot be auctioned for failure to pay custom duties.
- ✓ It is cheaper to store goods in free warehouses since there are no custom duties levied as compared to bonded warehouses.
- ✓ Clearance of the goods from the warehouse is simple since release warrant to prove payment of customs is unnecessary.
- ✓ These warehouses are located at places that are convenient to users.

Disadvantages of Free Warehouse

- ✓ The government does not benefit since no customs duty is levied on the goods stores.
- ✓ Some unscrupulous traders might use them to store durable goods so as to evade tax.
- ✓ Checking and scrutiny of goods is more relaxed hence the possibility of storing illegal goods

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Outline four features of a bonded warehouse (4mks)

2. Highlight four ways in which a warehouse is useful to a trader. (4mks)

3. List three advantages of warehousing to a manufacturer. (3mks)

4. Outline four benefits that consumers get from a warehousing (4mks)

5. Outline four factors that a trader would consider in locating a warehouse. (4mks)

6. State four benefits that a government gets from a bonded warehouse. (4mks)

7. State four features of a bonded warehouse (5mks)

8. State four advantages of public warehouse to retailers. (4mks)

9. The table below contains descriptions relating to some types of warehouse. In the space provided, write the type of warehouse to which each description refers.

Description	Type
a) Used to store exports and imports	
b) Anybody can rent spaces in it for storing goods temporarily.	
c) Operated for the owner's exclusion use.	
d) Owned and operated by manufacturers and farmers.	

10. In which four ways are consumers likely to suffer in a situation where there is no warehousing?

CHAPTER THIRTEEN

INSURANCE

Specific Objectives

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

a) Explain the concept of insurance;

b) Discuss the meaning and importance of insurance;

c) Explain terms used in insurance;

d) Explain the principles of insurance;

e) Distinguish between the classes of insurance;

f) Explain the meaning of reinsurance and co-insurance;

g) Describe procedure for obtaining an insurance policy;

h) Describe the procedure of making an insurance claim.

Content

a.) The concept of insurance.

b.) Importance of Insurance.

c.) Terms used in Insurance.

d.) Principles of Insurance.

e.) Classes of insurance.

f.) Re-insurance and co-insurance.

g.) Obtaining an insurance policy.

h.) Making an insurance claim

Introduction

The unforeseen calamities exposed to business organizations and individuals are referred to as Risks, Contingencies, Perils or hazards.

Insurance

This is a contract between an individual or organization and the insurance company whereby the company undertakes to protect the insured against loss arising from occurrence of the insured risks.

Insured

The person or the organization taking insurance cover.

Insurer

The company giving insurance cover

Premiums

Regular payments which the insured makes to the insurance company.

In insurance many contribute a little each into the common pool and the few who suffer a loss are compensated from it. Hence the term pooling of Risks.

Benefits of pooling of risk to insurance Company

- ✓ It enables an insurance company to create a common pool of funds from regular premiums from different clients.
- ✓ It enables the insurance company to compensate those who suffer loss when the risks occur.
- ✓ The insurance company is able to spread risks over a large number of insured people.

- ✓ Surplus funds can be invested.
- ✓ It enables the insurance company to meet its operating cost by using the pool funds.
- ✓ It enable the insurance company to calculate premiums to be paid by each client.
- ✓ It enables the company to re- insure itself with another insurance company.

Insurance contract.

Insurance is a contract which must meet the following conditions in order to be legally valid.

- ✓ It must be for a legal purpose.
- ✓ The parties must have legal capacity to contract.
- ✓ The terms and conditions of the contract must be acceptable to both the insured and the insurer.
- ✓ There must be a payment in form of premiums and a consideration which is the insurance cover.

Importance of insurance

I.) Employment creation

Provides employment directly or indirectly to individuals who would others be unemployed.

II.) Creating Confidence in investors

Insurance services create confidence in investors who are able to invest in risky but profitable areas in that they are assured of compensation in case of the risks taking place.

III.) Revenue to the Government

Incomes realized in the insurance industry such as profits made by companies and salaries to employees are subjected to taxation providing revenue for the government.

IV.) Continuity of Business

In case the risk insured against occurs, the insured is compensated. This enables the insured to continue running the business.

V.) Spread Risk

Insurance helps in spreading of risks in that each of those who are insured against the risk contribute a little and out of the common pool the few who suffer a loss are compensated.

VI.) Encourage Savings

The amounts contributed as premiums may make the individual's savings.

VII.) Investments

Not all the amounts that is collected from premiums is used for compensation as only a few people may suffer the risk. The amount remaining after compensating may be invested by the insurance companies.

Terms used in insurance

a.) Insurance

This is a written contact between the insured and the insurer whereby the insured transfers to the insurer the financial responsibilities for losses arise from the insured against.

b.) Premium

This is the specific amount of money paid at regular intervals by the insured to the insurer for coverage against losses arising from a particular risk.

c.) Risk

These are perils or events against which an insurance cover is taken.

d.) Pure Risk

This is a risk which result in loss if it occurs and result in no gains if it does not occur.

e.) Speculative Risk

This is a risk which when it occurs may result in a loss or a profit.

f.) Insured

This is the insurance company that undertakes to compensate the insured in event of loss arising from occurrence of the insured risk.

g.) Actuaries

These are people employed by an insurance company to compute expected losses and calculate the value of premiums.

h.) Claim

This is a demand by the insured for compensation from the insurer for loss arising from an insured risk.

i.) Policy

This is a document that contains the terms and conditions of the contract between the insurer and the insured.

j.) Actual Value

This is the true value of the property.

k.) Sum Insured/sum Assured

This is the value for which insurance cover is taken as stated by the insured at the time of taking the policy.

l.) Surrender value

This is the amount of money that is refundable to the insured by the insurer in case the former terminates payment of the premium before the insurance contract matures.

m.)Grace Period

This is time allowed between the date of signing the contract and the date of payment of the first premium.

n.) Insurer

This is the insurance company that undertakes to compensate the insured in event of loss arising from occurrence of the insured.

o.) Proposer

This is a person wishing to take out an insurance cover (prospective insured).

p.) 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.

q.) Annuity

Annuity is a fixed amount of money that an insurer agrees to pay the insured annually until the latter's death.

r.) Consequential Loss

This is loss incurred by a business as a result of disruption of business in the event of the insured risk occurring.

s.) Assignment

This is the transfer of insurance policy by an insured to another person. Any claims arising from the transferred policy passes to the new policy holder called an Assignee.

t.) Beneficiaries

These are people named in a life assurance policy who are to be paid by the insurer in the event of the death of the insured.

u.) Nomination

This is the act of designating one or more people who would be the beneficiaries in the event of the death of the insured. These people are called nominees.

v.) Average Clause

This clause is usually included in policies to discourage under- insurance. The clause provides that the insured can only recover such proportion of the loss as the value of the policy bears on the property insured.

The amount recoverable are arrived at using the following formulae:

$$\text{Compensation} = \frac{\text{value of the policy x } 100}{\text{value of property}}$$

w.) Double insurance

This is the taking of insurance policies with more than one company in respect to the same subject

matter and risk. It is significant because if one of the insurers is insolvent at the time claim arises the insured can enforce his/her claim against the solvent insurer.

If the both insurers are solvent then they share the compensation.

x.) Self-insurance

This is where an individual or organization insures one/itself by accumulating funds to meet any losses that might arise from risks rather than covering the risks with an insurance company.

y.) Proposal Form

This is a form that is filled by a prospective insured seeking to get insurance cover from the insurance company.

Principles of insurance

a.) Uberrima fides/utmost good faith.

The client is required to furnish the insurer with all the details regarding the risk to the covered.

b.) Indemnity

The insured should be restored to the original financial position he was in before the loss occurred.

c.) Contribution

When the risk occurs two or more insurers share the loss. In proportion to the sum-insured with each.

d.) Subrogation

Once the insured is fully compensated for the loss suffered he/she is not supposed to gain out of the loss.

e.) Insurable interest

One should only insure property that he/she stands to suffer a direct financial loss in case the risk insured against occurs.

f.) Proximate cause

For the insured to be compensated there must be a very close connection between the loss suffered and the risk insured against.

Classes of insurance

1.) Life Assurance

- Covers the risk of death.
- It also covers the risk of incapacitation.

Types of life assurance contracts

I.) Term Insurance

- This is a life assurance that provides protection within a specified period of time whereby if the policy holder dies within this period, compensation is offered to the beneficiaries.
- However if the insured does not die within this specified period, there is no compensation.

II.) Whole Life Assurance

- This type of policy requires the assured to pay premiums until he/she dies.
- In the event of death, his/her beneficiaries are paid the sum assured as indicated in the policy.

III.) Endowment Insurance

- The assured is required to pay regular premiums for a specified period of time.
- The sum assured is paid at maturity.
- However, in case the assured person dies before the expiry of the period, the sum assured is paid to his/her beneficiaries.

Whole Life	Endowment
Compensation is paid after the death of the assured.	Compensation is paid after the expiry of an agreed period
Premiums are paid throughout the life of the assured.	Premiums are paid only during the agreed period.
Benefits go to the dependants rather than the assured.	The assured benefits unless death precedes the expiry of the agreed period.
Aims at financial security of the dependants.	Aims on financial security of the assured and dependants

IV.) Annuities

- This type of policy requires the assured (annuitant) to pay a certain sum of money to the

assurer.

- In return the assurer agrees to the annuitant a specified amount or money every year for a specified period or until the annuitant dies.

V.) Statutory Scheme

- It is offered by government aimed at providing welfare to the members of the scheme such as medical services and retirement benefits.

Characteristics of Life Assurance Policy

- ✓ May cover life until death or for an agreed period of time.
- ✓ It deals exclusively with life.
- ✓ It is usually a long term contract and annual renewal is not necessary.
- ✓ Its value depends on the assured ability to pay premiums.
- ✓ May be used as a security when acquiring loan.
- ✓ The policy can be assigned to beneficiaries.
- ✓ It has surrender value.
- ✓ It has maturity date.
- ✓ It may be a savings plan whereby the sum assured is payable either on maturity or to assured's beneficiaries.

2.) General insurance/property insurance

- It covers property against various risks which may result to loss or damages.
- It is also referred to as non-life insurance because it does not cover life.
- It is a contract of indemnity and requires annual renewal.

The risks insured against this class include:

a.) Fire Insurance

This type of insurance covers loss or damage of property caused by fire.The property insured include:

- ✓ Stock
- ✓ Equipment
- ✓ Machines
- ✓ Building

Conditions to be fulfilled when claiming for compensation:

- ✓ Fire must be accidental.
- ✓ Fire must be the immediate cause of loss and not incident cause.
- ✓ The loss is caused by actual fire.

Types of fire insurance policies:

i. Consequential Loss Policy

It indemnify the insured for the loss of profit due to interruption of business activities as a result of fire. It is offered to protect future earning of an enterprise after fire damage.

ii. Sprinkler Leakage Policy

Provides cover against loss or damage caused to goods or premises by accidental leakages from firefighting sprinklers.

iii. Fire and Related Perils Policy (Material Damage Policy)

It covers building which include factories, warehouses, shops, offices and their contents. This policy does not cover loss of profit arising from fire damage.

b.) Accident Insurance

These policies covers all sorts of risks which occur by accident. It includes the following:

Motor policy

These policies are aimed at covering vehicles from losses arising from accidents. The policy requires annual renewal. The policies under motor policies include:

- Third party insurance

This covers losses caused by the vehicle to other people, other vehicles and to property. The policy covers neither the vehicles itself nor the owner.

- Third party, fire and theft

Under this policy, compensation is offered to third parties as well as vehicles itself in case of loss or damage caused by fire or theft.

- Comprehensive policy

The policy covers first, second and third parties or damage.

General Accidents Policies

The risks insured include:

i. Personal cover

The policy covers partial or total physical disability caused to a person due to injury or loss of income due to accident.

The policy offers the following:

- ✓ Where the insured loses part of the body e.g. finger,
- ✓ In case of partial or total disability the insured may get regular payment.
- ✓ In case of death the beneficiaries get the sum insured.
- ✓ Where the insured is hospitalized, the medical bill is met by the insurer.

ii. Workmen's compensation cover

It covers employees who may suffer injuries while on official duty.

iii. Cash or goods in transit cover

It provides cover for loss of cash or goods while being transported.

iv. Theft and Burglary cover

It covers losses arising from activities of robbers and thieves.

v. Bad debt cover

This policy covers an organization against losses which might arise as a result of debtor's failure to pay their debts.

vi. Public liability

This type of insurance covers losses, injuries or damages caused accidentally by a business or its employees to the members of public.

vii. Fidelity guarantee policy

Protects one from loss arising from activities of his/her dishonest employees.

c.) Marine Insurance

Provides insurance cover for the ship, other water going vessels and cargo against sea perils which may lead to financial loss. The perils include:

- ✓ Storms
- ✓ Sinking
- ✓ Fire

The policies available under marine insurance

i. Marine hull policy

Covers the ship against loss or damage as a result of risks at sea.

ii. Marine Cargo Policy

Covers cargo against loss or damage while being transported by ship.

iii. Port policy

Covers a specified peril when the ship is either being loaded, offloaded or serviced.

iv. Voyage Policy

Covers the ship or cargo on a particular journey.

v. Floating Policy

Under this policy regular shippers pay a lump sum to cover their ships. When any of the ships makes a shipment, the amount of insurance for that particular shipment is calculated and deducted from the lump sum.

vi. Time Policy

Covers losses arising within a specified period of time. It usually covers the ship itself.

vii. Mixed Policy

This covers ships against losses while on a specified voyage and specified time.

viii. Fleet Policy

Covers a fleet of ship against losses under one policy.

ix. Composite Policy

Applies where several insurance companies have insured a particular ship against the same risk.

Other Policies under marine insurance

- Construction or builders policy

This covers the risk that a ship is exposed to while it is either being constructed, tested or delivered.

- Freight policy

This is the cover taken by the ship's owner for compensation against failure by the hirer of the ship to pay for freight charges.

- Third party liability

This is a cover taken by the ship's owner to cover claims that may arise from loss caused to other people by the ship.

Marine losses

The following are some of the losses encountered in the marine insurance.

✓ Total loss

This refers to the total damage on either the cargo or the ship or both. It may be classified as either constructive total loss or actual total loss.

i. Constructive total loss

This occurs when the insured ship is extensively damaged and is abandoned because the cost of salvaging it would be more than the wreckage.

ii. Actual total loss

This occurs when there is total damage on either the cargo or the ship or both.

- ✓ Partial losses

It is also referred to as average in marine insurance. It is classified as:

i. Particular average

This is an accidental loss or damage on either the ship or the cargo

ii. General average

This is a loss that occurs when actions taken to save the ship and the cargo result into a loss.

Characteristics of General Insurance

- ✓ The policy cannot be assigned to anybody else.
- ✓ Premiums charged depend on the value of the property and the degree of the risk.
- ✓ The policy is a contract of indemnity.
- ✓ It is normally a short term contract that requires periodical renewal.
- ✓ The policy has no surrender value.
- ✓ Requires the insured to have insurable interest in the property being insured.
- ✓ Compensation goes to a maximum of either the sum insured or actual value of property insured whichever is less.

Factors to be considered when determining premiums to be charged

i. Health of the person.

ii. Residence of the insured.

iii. Value of the property insured.

iv. Occupation of the insured.

v. Extent of the previous losses.

vi. Frequency of occurrence of risks.

vii. Period to be covered by the policy.

viii. Age of the person or of the property in question.

Re-insurance

The term re-insurance refers to insuring again. This may be the case where an insurance company has covered property whose value is very high or the chances of risk occurring are very high.

Factors that may Necessitate Re- insurance./Circumstances that make it necessary for companies to re-insure.

i. Value of the property

When the value of property is great such as a ship, single insurance company may find it difficult to bear the loss.

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 risks

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.

v. Need to spread the risks

When the insurance company wishes to share liability in the event of a major loss occurring.

vi. Government policy

The government may make it a legal requirement for an insurance company to re-insure.

Co-insurance

This refers to covering of the same risk with different insurance companies. This may be the case where the value of the property is too high to be covered by one insurance company.

Co-insurance and double insurance

In Co- insurance it is the insurance company that contacts other insurance companies so that they co-insure while in Double insurance it is the owner of the property that who approaches different insurance companies.

Procedure of obtaining an insurance policy.

i. Filling a proposal firm

The person intending to take insurance policy fills in a proposal form. The applicant fills relevant / material facts on the subject matter of insurance.

ii. Determining the premium to be paid

The premium to be paid is determined depending on the value of the property and the type of risk to be covered.

iii. Payment of the first premium

After the insurance company has accepted to cover the risk and premiums are calculated and the insurer pays the first premium.

iv. Issuing of cover note (binder)

The insured is issued with temporal policy which is valid for 30 days within which the policy would be issued.

v. Issuing of policy

This is the contractual document between the insurer and the insured and it contains the terms and conditions of the insurance cover. Once issued it replaces the cover note and the policy becomes operational.

Procedure for making an insurance claim

The following steps are followed:

i. Notifying the insurer

Immediately the risk insured against occurs, the insured should notify the insurer.

ii. Filling a claim

Filling an official claim form giving all the details relating to the occurrence of the risk then returning it back to the insurer.

iii. Investigation of the claim

On the receipt of the filled claim form the insurer launches an investigation concerning the cause of the occurrence of the risk.

iv. Preparation of the assessment report

Once it is established that the claim is valid, insurance company uses experts called assessors to

prepare a report concerning the extent of the loss suffered.

v. Payment of the claim

On receiving the assessors report, the insurance company makes arrangements to pay the insured. The payment concludes the contract between the insurer and the insured.

Insurance and Gambling

Insurance	Gambling
The person taking the policy should have insurable interest	A gambler has no such interest
The aim of the insurance is to restore the financial position the insured was in before the occurrence of the loss	The aim of gambling is to improve the financial position of the gambler
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	
The event of loss might never occur	Gambling involves speculative risks
	The event of bet must happen to determine the winner and the loser.

Circumstances that may lead to termination of policy.

i. If the assured surrender the policy.

ii. Lapse of time for the policy, that is, if the cover was meant for a specific period.

iii. In case one is unable to pay the premiums for one reason or another.

iv. After compensation in case a risk has taken place.

v. In case of life insurance a policy is terminated by the death of the insured.

vi. On maturity of the policy in case of endowment policy.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

PAPER 2

1. Describe the procedures that should be followed when taking an insurance policy.

(10mks)

2. Explain four ways in which the insurance industry promotes the growth of business enterprises.

(10 mks)

3. Explain four ways in which the insurance industry contributes to the development of Kenya's economy.

(10mks)

4. Discuss various insurance policies under which an insurance company would not compensate the insured in the event of the loss. (10mks)

5. Discuss various insurance policies that the owner of a supermarket may find it useful for the business.

(12mks)

6. Explain four benefits of the 'pooling of risks' to an insurance company. (8mks)

7. Explain the factors that nay make it necessary for an insurance company re-ensure.

8. Explain the meaning of the following terms as used in insurance (10mks)

   i) Uberrimae fidei

   ii) Indemnity

   iii) Third party motor vehicle insurance

   iv) contribution.

   v) Subrogation

9. Discuss four circumstances under which an insurance contract may be terminated.

(8mks)

10. Explain five benefits that could be enjoyed by a person who decided to take out an endowment policy.

(10mks)

CHAPTER FOURTEEN

PRODUCT PROMOTION

Specific Objectives

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

a) Explain the meaning of a product;

b) Explain the meaning and purpose of product promotion;

c) Explain various methods of product promotion;

d) Discuss advantages and disadvantages of each method of product promotion;

e) Discuss factors which influence choice of promotion method;

f) Recognize the need for ethical practices in product promotion;

g) Discuss trends in product promotion.

Content

a.) Meaning of a product.

b.) Meaning and importance of product promotion.

c.) Methods of product promotion.

d.) Advantages and disadvantages of each method of product promotion.

e.) Choice of promotion method.

f.) Ethical issues in product promotion.

g.) Trends in product promotion

Introduction

This is communication intended to inform, persuade or remind customers of the product.

Importance of product promotion

i. Informing

The purpose of informing is to create awareness to prospective consumers about a product. The

information to be passed may include:

- ✓ Existence of the product.
- ✓ Usage of the product.
- ✓ Price.
- ✓ Where the product can be obtained.
- ✓ When the power is available.

ii. Persuading

This refers to convincing customer that a product fulfills his or her need and it is better than any other product in the market so that he/she can buy it.

iii. Reminding

It is good to remind the costumers that the product is still available and is still the best in the market

Methods of product promotion

Methods of product promotion refers to all the activities that aim at increasing the demand for goods and services.

They include the following:

1.) Personal selling

This is where a sales person presents a commodity to prospective buyers face to face with the aim of making sales. The sales person is required to inform the prospective buyer about the features of the product which may include:

- ✓ Uses.
- ✓ Quality.
- ✓ Price quantities.
- ✓ Efficiency.

Circumstances under which personal selling is Appropriate

i. When launching a new product.

New product requires a lot of awareness creation, persuasion and convincing.

ii. When a product is tailored to meet customers specifications.

Customers have varying taste and preferences for example a dress maker needs to respond to his or her customers different tastes in cloth designs.

iii. When demonstration is required

Some products especially technical ones, requires their operations to be explained and this is possible through personal selling.

iv. When the value of the product is high

In this case the seller may want to use personal selling to avoid the risk of losing the item if he/she were to use other methods.

v. When the organizations can afford to finance the sales force

The cost of maintain a team of sales representative can be very high and only a few firms can afford this.

vi. Where the market is concentrated in one area.

The cost involved in accessing the market is reduced if personal selling is used.

Methods involved in personal selling

a.) Sales person approaching customers.

The salesperson approaches prospective customers and after drawing their attention, explains to them details about their product and later persuade them to buy.

Steps involved in personal selling

- ✓ Identifying Prospective Customers through Reading of newspapers and interviews and meeting.
- ✓ Preparing the presentation by gathering information about the product and the prospects.
- ✓ Establishing Customer Contacts by choosing appropriate time when the prospect is likely to be receptive.
- ✓ Arousing interest in the product through the use of appropriate approach and language.
- ✓ Dealing with objections the best way as possible.
- ✓ Closing the sale by asking the prospect to make a firm commitment to purchase.
- ✓ After sales services.

b.) Shows, Trade Fairs and Exhibitions

Trade fair- An event where producers or dealers in a given class of products show and may sell their products.

Exhibition – A public display of products, which are usually carried out doors.

Advantages

- ✓ Products can be compared before making any decision.
- ✓ Salespeople get an opportunity to demonstrate and explain various features of their products to customers.
- ✓ Immediate feed is available.

- ✓ General attendance in a stall would enable an organization to assess the market potential for its products.

Disadvantages

- ✓ It may be costly to hire stalls in which to exhibit.
- ✓ A lot of time is spent on demonstration.
- ✓ Trade fair are not reliable as a method of product promotion since they are not frequent.

c.) Showrooms

These are large rooms in which goods for sale are displayed.

Advantages

- ✓ The seller is able to get immediate feedback from customers.
- ✓ Customer is able to get clarification from sales person before making a decision on whether to buy the product or not.
- ✓ Cheap method of product promotion
- ✓ Uses and operations of goods can be demonstrated.
- ✓ Uses and operations of goods can be demonstrated.
- ✓ Customers can get reliable advice concerning the type of goods to buy.

Disadvantages

- ✓ Show rooms are not always accessible to many people.
- ✓ Putting up or hiring a show room is always expensive.
- ✓ Requiring security which might be expensive to provide.
- ✓ Customers may tamper with products in the show room.

d.) Free Gift

These are products given to customers free of charge after buying a product or goods worth certain value.

Advantages

- ✓ Enables customers to a certain product without buying it.
- ✓ It may induce customers to buy the product or goods worth the desired volume in order to get the gift.
- ✓ Increase customer's satisfaction.
- ✓ May help create loyalty to the firm or brand being promoted.

Disadvantages

- ✓ In an effort to get a gift customers may buy goods he/she does not require.

- ✓ It may be costly.
- ✓ Some middlemen may keep away the gift.
- ✓ There is no assurance that the customer will buy the product after getting the gift.

e.) Free Sample

Free samples refers to the product given to customers freely for trial.

Advantages

- ✓ Enables customer to try a product before arriving at a decision on whether to buy or not.
- ✓ Enables a consumer to enjoy a product he/she may not have otherwise enjoyed.
- ✓ Enables an organization to acquire more customer's thereby increasing sales volume.

Disadvantages

- ✓ Some of the people who receive sample products may not be part of the potential customers.
- ✓ Expensive method of product promotion.
- ✓ Not appropriate for expensive items e.g. motor vehicle.

Advantages of personal selling

- ✓ It is very persuasive due to personal communication.
- ✓ It is very flexible as the marketer is able to meet the needs of each individual customer.
- ✓ There is clarity through asking and answering of questions.
- ✓ The operation and use of products can be demonstrated.
- ✓ Gives the buyer an opportunity to negotiate terms of sales.
- ✓ It is directed to a specified prospective customers.
- ✓ Salespeople are able to obtain first-hand information about the market which can be used to improve the product.
- ✓ It provides an opportunity to establish interpersonal relationships which may bring about a repeat purchase

Disadvantages

- ✓ Labour intensive thus it is the most costly method of communicating with prospective buyers.
- ✓ Personal selling is time consuming.
- ✓ Where a salesperson lacks etiquette, good personal attributes, skills and knowledge it may be difficult to persuade actual and prospective customers.

- ✓ Salespeople can misuse the resources allocated to them.
- ✓ Personal selling may inconvenience prospective buyer's programs.
- ✓ It has limited coverage since it is usually directed to one or few people at a time.

2.) Adverting

This is any form of impersonal presentation of a product made through mass communication media.

Importance of Advertising

- ✓ To maintain the sales of an already existing product.
- ✓ To create awareness of new product in the market.
- ✓ To update customers on the changes.
- ✓ To build and uphold the image and reputation of the selling firm.
- ✓ To increase the volume of sales of an existing product.
- ✓ To reach people who are not accessible to sales persons.
- ✓ To boost the efforts of the salespersons.
- ✓ To reach new markets.
- ✓ To remove or counteract the customers prejudice about the product of the firm.

Types of advertising

a.) Product Advertising

This aims at increasing the sales of a particular brand of a product.

b.) Primary Demand Advertising (informative Advertising)

This refers to a type of Advertising that mainly aims at popularizing a new product to potential customers.

c.) Institutional Advertising

This type of advertising popularized the business organization and not individual products.

d.) Competitive (persuasive)Advertising

This type of Advertising is usually used by organizations that deal in similar products. It is used to convince potential customers that the product provided by the organizations is the best in the market.

e.) Celebrity Advertising

This is advertising whereby famous or popular persons are used in the advertisement.

f.) Reminder Advertising

This method is used to remind customers that the products is still available.

Advertising media

This is a channel through which advertising message is conveyed to the target group.

Types of Advertising media

a.) Newspaper

Regular Publications which contains news and advertisement.

Advantages of Newspaper

- ✓ They cover a wide geographical area and therefore reach a big proportion of the audience.
- ✓ Covey the messages for a long time.
- ✓ Many people can afford to buy them as they are relatively cheap.
- ✓ Advertised message appearing in the newspaper is readily acceptable by the readers.

Disadvantages

- ✓ The entrepreneurs may not be able to reach all parts where customers are found
- ✓ Not all potential customers are able to read.
- ✓ The newspapers may be written in a language that's not familiar to many customers.
- ✓ Newspapers are expensive to buy / may not be afforded by all people.
- ✓ It is expensive to buy newspaper space for advertising / it is expensive to advertise in newspapers.
- ✓ Newspapers are not able to discriminate between the intended target group and other may be read by non-target group.
- ✓ Newspapers make short life span / can easily be discarded.

b.) Magazines and journals

Publications produced periodically for example, monthly or yearly.

Advantages of magazines and journals

- ✓ Target audience can be reached.
- ✓ Journals and magazines have a long lifespan.

- ✓ Publications are of very high quality therefore advertisement placed in them is likely to catch the eye of the audience.

Disadvantages of magazines and journals

- ✓ Magazines and journals are a bit expensive such that not all the members of a target group would have access to them.
- ✓ Circulation of the publications may be limited to a small geographical area.
- ✓ Periodicals target only a certain class of readers and this may limit the target audience of the advertiser.
- ✓ The publication is not available in local vernaculars.
- ✓ Sometimes there is a big time gap between the time the advisement is placed and the time the publications is circulated. Making it impossible for the advertiser to achieve the desired results.

c.) Posters

A poster is a form of outdoor advertising media that may be used to advertise a product.

Advantages of posters

- ✓ When placed at strategic places, it is likely to convey the advertised message to a large audience.
- ✓ It is cheap to prepare.
- ✓ Easy to prepare.
- ✓ Message may last for a long time.
- ✓ Appropriate to both the literate and illiterate.
- ✓ It allows the use of different colors to make it more appealing to the audience.

Disadvantages of posters

- ✓ Adverse weather conditions may affect the quality of the poster.
- ✓ It is silent and therefore some people may not notice the advertisement in it.
- ✓ It can be easily destroyed by passerby.

d.) Billboards (hoardings)

This medium of advertising requires the advertiser to write or paint the advertising message on the brand.

Advantages of Billboards

- ✓ Positioned at strategic positions where they can be read by many people.
- ✓ The advertising message can be understood and remembered easily because they are not over worded.

- ✓ They can convey messages for a long time as they are relatively permanent.
- ✓ They are conspicuous and hence attractive to audience.

Disadvantages

- ✓ Prone to vandalism.
- ✓ Expensive to make.
- ✓ They may not be effective where customers need to examine the good.
- ✓ They can obscure motorists' visibility and this may contribute to accidents.

e.) Transit (transport) Advertising

This medium involves using vehicles such as matatus, buses, trains and Lorries to carry the advertisement message.

Advantages

- ✓ The advertisement reaches people inside the vehicle as well as those in areas served by the vehicle.

- ✓ Transit vehicles can convey the message for a long time as the painting is relatively long lasting.
- ✓ The message is read quite often as many people are regular travelers.

Disadvantages

- ✓ Rush hour crowds may limit traveler's opportunity to read the advertisement.
- ✓ The advertisement may only get to those areas that are served by the vehicle.

f.) Electronic Neon Signs

These are colored lights which usually keep on flickering at regular intervals to attract passers- by.

Advantages of Electronic Neon Signs

- ✓ They are attractive especially during the night.
- ✓ They can direct customers to where services are rendered.

Disadvantages of Electronic Neon Signs

- ✓ They are fairly expensive to install and maintain.
- ✓ They are not usually convincing or persuasive.

g.) Radio

Advantages of Radios

- ✓ Accessible in every areas.
- ✓ Able to serve many people at the same time.
- ✓ Serves both the literate and the illiterate members of the target group.
- ✓ Different radio channels are able to cast in different languages.
- ✓ The advertised messages reaches the audiences promptly.
- ✓ Target audience may be selected through timing of the advertisement.

Disadvantages of Radios

- ✓ Radio advertisement lacks reference.
- ✓ Duo

h.) Television

Advantages of Televisions

- ✓ The advertisement may be aired as frequently as required.
- ✓ The advertisement may be modified as need arises.

- ✓ Dramatized advertisement on the television appeals to many people as it entertaining.
- ✓ Advertisement on TV makes it possible for an organization to show various features of the product being advertised.

Disadvantages of Televisions

- ✓ Advertisement through the TV is expensive.
- ✓ The advertisement may be screened when the target audience is not viewing.
- ✓ TV set is expensive and so only those who have access to it can be targeted.
- ✓ TV advertisements are not long lasting
- ✓ TV sets uses a source of power therefore they cannot work in areas without power.

i.) Cinema

A cinema is a place where films are shown. Such film/movies may be used to pass advertising messages.

Advantages of Cinema

- ✓ Reaches both illiterate and literate people.
- ✓ Target advertisement can be done.
- ✓ Demonstrations and showing of the features of the product is possible.
- ✓ There is combinations of written words, sound and motion pictures .This may create a long lasting impression in the minds of the viewers.
- ✓ Mobile shows are usually taken to highly populated areas. This makes it possible for the advertisement to reach many people.
- ✓ When the advertisement is screened as an interlude in an interesting show, views watch it as they wait for the next show.

Disadvantages of cinema

- ✓ It is difficult for the advertisement to reach potential customers who do not view such movies.
- ✓ They are fairly expensive advertising media.
- ✓ Due to the increasing popularity of television and video, cinema attendance has reduced.
- ✓ Movie halls are few and this limits their use as an advertising media.

Advertising Agencies

These are business that specialize in advertising work and are hired to carry out advertising functions for other businesses.

Functions of Advertising Agencies

- ✓ They help organizations in designing their trademarks, logos and advertising materials.
- ✓ They book space and air time for their customers in various media.
- ✓ They offer advisory services to their clients on selling techniques.
- ✓ They advertise on behalf of their clients.
- ✓ They choose, on behalf of their clients, the appropriate media to be used.

Advantages of Advertising to the Business

- ✓ Creates awareness of the firm's product to potential customers.
- ✓ Helps increase the sales volume of the firm.
- ✓ Popularizes the firm's products and this may encourage frequent use of the product.
- ✓ Reminds consumers about continued existence of the firm's products.

Disadvantages of advertising to the Business

- ✓ Costly to the business in terms of money and other resources.
- ✓ Excess costs incurred in advertising due to reasons such as stiff competition may lead to closure of the business.
- ✓ Costs incurred in advertising may lead to reduced profits.
- ✓ An advertisement not well planned may have negative effects to publicity and this may make customers hate the product being advertised.
- ✓ The business may end up losing in terms of money and reputation if sued due to misleading advertisements.

Advantages of advertising to the customer

- ✓ Customers are educated on how to use the product.
- ✓ Informs the customer about the offers available in the market.
- ✓ Customers may benefit from reduced prices as a result of competitive advertising.
- ✓ Advertisement may guide customers on where to get a product.
- ✓ A customer may benefit from improved quality of products brought about by competitive advertising.
- ✓ Through it, information regarding price and other features of the product may be availed to the customer.
- ✓ Advertising brings about competition which leads better and quality goods hence providing a variety to customers.

Disadvantages of advertising to the customers

- ✓ The advertisement may not disclose to the customer the side effects of the product.
- ✓ Advertising costs may be passed over to the consumer through increased prices.
- ✓ Some advertisements may persuade the customer to purchase a product they do not actually require.
- ✓ Customers may buy sub-standard goods as a result of misleading advertisement.

3.) Publicity

Refers to any mention of a product, firms or person in the mass media.

Classification of publicity

- Free publicity

This is publicity that is not paid for.

- Special Feature Publicity

This is publicity that is paid for by the firm.

Advantages of publicity

- ✓ In case of free publicity, no cost is incurred by the firm.
- ✓ The coverage is wide since publicity is in mass media.
- ✓ Customers are likely to take this form of product promotion more honestly because it is by independent people.
- ✓ May improve the image of the seller among existing and potential customers.

Disadvantages of publicity

- ✓ The firm has no control over free publicity especially on the content of message, timing and space.
- ✓ Only a portion of the information released by the firm might appear in the media.
- ✓ The media may give negative information about the firm which may adversely affect the firm.
- ✓ The media may not cover the firm at the firm's convenience.
- ✓ It is usually not permanent and cannot be in isolation from other promotional methods.
- ✓ Special feature publicity may be costly to the firm.

4.) Public Relations

Public relations is the process of passing information with a view of creating, promoting or

maintaining good will and a favorable image of the organization to the public.

Advantages of public Relations

- ✓ May correct the bad image of the firm.
- ✓ Informs the public about the activities of the firm.
- ✓ Assists in upholding the good image of the firm.
- ✓ Improves the relationship between the firm and its customers.

Disadvantages of public Relations

- ✓ Costly in terms of the time and finance involved.
- ✓ It is difficult to evaluate the impact of the message since customers are not obliged to respond to it.
- ✓ The customer may make premature buying arising from the picture of the firm created by the public relations officers.
- ✓ Effects may take long before they are actually realized.

5.) Other types of product promotion

a.) Point of purchase(window) Display

This is an arrangement of items in the shop at a strategic place where potential customers can easily see them.

Advantages

- ✓ Relatively cheap method of product promotion.
- ✓ May induce a customer to buy the products displayed.
- ✓ Customers who are attracted into the shop are likely to buy products other than those on display.
- ✓ The display enables customers to get features of the product such as color size and the price before making a decision on whether to buy or not.

Disadvantages

- ✓ The method may not reach potential customers who are far away from the point of display.
- ✓ May attract thieves thereby leading to heavy losses.
- ✓ Setting up the display area or window may be expensive.
- ✓ Customers may take the goods displayed to be representative of what is inside which may not be true.

b.) Direct Mail Advertising

This refers to any form of advertising that is sent directly to potential customers through the mail.

Advantages

- ✓ It is able to reach the target audience as it is directed specifically to them.
- ✓ There may be immediate response.
- ✓ Prospects may not incurs expenses to get the information.
- ✓ Message may be tailored to suit needs of each prospect.

Disadvantages

- ✓ Appeals only to those who are literate.
- ✓ Sometimes the mail may not get to the intended customer.
- ✓ It may be expensive in terms of time, materials used and other costs.
- ✓ Some prospects may ignore the advertisement.
- ✓ May not be effective where a customer needs to examine the product.

c.) Catalogue

This is a booklet that gives a brief description of products sold.

Advantages of catalogue

- ✓ It may be used to advertise all the products of a given business organization.
- ✓ The advertiser has total control of the catalogue.
- ✓ Gives detailed information about products.
- ✓ When printed in beautiful colors it became attractive promotional tool.

Disadvantages of a catalogue

- ✓ Expensive to produce.
- ✓ It is usually affected by price changes.

d.) Guarantee

This is an assurance that the product offered for sale will serve as expected if it is used as specified. During the guarantee period, the seller undertakes to either replace or repair the items if it fails to perform as specified.

Advantages

- ✓ The confidence built in customers by the guarantee may help boost the sales.
- ✓ It may help create customer-loyalty to the products of the firm.
- ✓ In case the product develops a problem within the guarantee period, the product will either be repaired or replaced.

Disadvantages

- ✓ Repairing or replacing products after selling may turn out to be very costly to the seller.
- ✓ Customers may be tempted to be careless during the guarantee period.
- ✓ The method may be suitable for durable goods.

e.) Discount

This is a reduction in the sales price of a commodity by the seller so that the buyer ends up paying less.

Types of discounts

i. Trade discount

Trade Discount is a reduction in the catalogue price of the goods allowed only if the quantity ordered by the buyer is quite large.

ii. Quantity discounts

Quantity discount is allowed by a trader to another or consumer to encourage bulk buying.

iii. Cash discount

Cash discounts is a reduction made on the invoice price if payment is met before a given date.

f.) Loss leader

A loss leader is a product being sold below its market price to entice customers to enter the shop. Once in the shop, the customers is likely to buy other goods which are sold at their normal prices.

g.) Psychological selling

These are activities meant to increase sales by playing around with the customer's psychology.

h.) Coupons

A coupon is a small piece of printed paper that gives someone right to acquire (buy) something at a cheaper price than normal.

i.) Credit Facilities

Method of selling where the seller allows a customer to take goods and pay for them later.

j.) After -sales service

Services offered by a seller to a buyer after the buyer has bought goods.

Advantages of after-sales services

- ✓ Consumers are assisted with technical advice on how to use the items.
- ✓ Consumers may be assisted with installation cost of the product.

- ✓ Enhance good relationship between the buyer and sellers.
- ✓ Where an item has a major technical breakdown, it can easily be replaced at no extract cost.
- ✓ Transportation of goods.

Disadvantages of after-sales services

- ✓ The sales person are able to win confidence of the buyers.
- ✓ Demonstration is possible.
- ✓ Information can be gotten from the customer as pertain to the product.
- ✓ More sales and publicity of goods is possible

Factors that influence the choice of product promotion methods.

a.) cost of advertising

The promoter should consider if the chosen method of promotion is within his/her financial ability.

b.) Nature of product

For products that require demonstration of how they have used choice of appropriate promotion method is necessary.

c.) Urgency of the promotional message

The promotional method adapted has to deliver message to the audience at proper good time depending on urgency of the information.

d.) Government policy the law

A firm should use only those methods that are allowed by the law of the land.

e.) Competitors methods

A firm should sue a promotion method that will make it compete favorably with other competing firms.

f.) Objectives of the promoting firm

Firms will choose the promotion activities that will achieve its set goals e.g. to correct firms dented image of a product it can use public relations method.

g.) Geographical coverage of method

A firm should choose a promotion method that is most accessible to its customers.

h.) Target market

A firm should choose a promotion method that addresses specific age or gender.

Ethical issues in product promotion

These are rules and regulations to be followed in order to avoid the violation of other people's rights.

a.) Cheating on performance of the product

This is a situation whereby the promoter of a product does not tell the truth about the performance of the product.

b.) Cheating on ingredients of the product

A product promoter may give false information about the ingredients of the product in an attempt to lure customers to buy.

c.) Not Disclosing Side Effects

Promoters are biased when it comes to disclosing the effects of their products, in that they disclose the positive aspects only.

d.) False Pricing

Some producers overprice their commodities and later reduce the prices slightly. Through promotion the customers may be made to believe that the prices have been reduced, yet they are still an above the normal.

e.) Negative effects on the Environment

Some promotional activities may have adverse effects on the environment such as pamphlets used as a means of advertising may be littered everywhere thereby causing environmental pollution.

f.) Social cultural conflicts

Products promotion has encouraged use of foreign products and styles that conflict with the cultures of the various communities in the country.

Recent trends in product promotion.

- ✓ The use of the internet for advertisement which allows advertisement to reach many people.
- ✓ Re-branding of products using different colors or slightly differentiation names.
- ✓ The many FM radio stations which facilitate advertisement in different languages.
- ✓ Use of an advertising agency to market a firm's product.
- ✓ Operating shops with a wide variety of goods thus facilitating one-stop-shopping.
- ✓ Running a 24-hour shopping business.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. The follow are types of advertising

   - Product advertising

   - Competitive advertising

   -Information advertising

   - Institutional advertising

In the table below, match each type with its appropriate description. (4mks)

Description	Type
a) Create awareness about a product	
b) Promotes the name of the manufacturer	
c) Persuades a particular brand of a product	
d) Promotes a particular brand of a product	

2. State four ways in which consumer's benefits from advertising by business people. (4mks)

3. Give three reasons why manufacturer may offer after sales services to his customers. (3mks)

4. Outline four steps involved in personal selling process. (4mks)

5. State four circumstances under which a trader would advertise his products over the radio instead of the television. (4mks)

6. Identify four disadvantages of advertising through television in Kenya. (4mks)

7. List four disadvantages of advertising through television in Kenya. (4mks)

8. Highlight four limitations of after sales services as a method of promoting products.

9. Outline the advantages of after sales services as a method of sales promotion to a customer. (4mks)

10. Highlight three reasons why traders may engage in sales promotion. (3mks)

11. State four advantages of personal selling method of promoting sales. (4mks)

PAPER 2

1. Abdullah, a manufacturer, exhibited his goods in a local trade shows. However his sales did not increase significantly thereafter. Outline five reasons that may have led to lack of significant sales increase. (10mks)

2. Describe the procedures involved in personal selling methods of sales promotion. (10mks)

3. Outline five ways of attracting customers that traders may put into use. (10mks)

4. Explain five benefits that a trader would get by advertising his goods through the radio. (10mks)

5. Explain the reasons why the firms with popular products find it necessary to continually advertise the same products. (10mks)

6. A multinational company is planning to launch its products in the local Kenyan market. Highlight the factors that should be considered by the company when choosing the appropriate media through which to advertise the products. (10mks)

7. Explain the role of a sales department in a business firm (10mks)

8. What are the benefits accruing to a seller who uses personal selling methods to promote her products? (10mks)

9. Advertising in the newspaper is one way of promoting sales of goods. Highlight five limitations of advertising goods in newspapers. (10mks)

CHAPTER FIFTEEN

DEMAND AND SUPPLY

Specific Objectives

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

a) Explain the meaning of demand;

b) Explain the factors which influence demand for a product;

c) Distinguish between derived demand and joint demand;

d) Derive a demand curve from a demand schedule;

e) Distinguish between movement along a demand curve and shift in the demand curve;

f) Explain the meaning of supply;

g) Explain the factors which influence supply of a product;

h) Derive a supply curve from a supply schedule;

i) Distinguish between movement along a supply curve and shift in supply curve;

j) Determine equilibrium price and quantity;

k) Explain the effects of excess demand and excess supply in the market;

1) Explain the effect of a shift in demand curve on equilibrium price and equilibrium quantity;

m) Explain the effect of a shift in supply curve on equilibrium price and equilibrium quantity;

n) Explain other methods of determining price of a product.

Content

a.) Meaning of demand

b.) Factors which influence demand for a product

c.) Derived demand and joint demand

d.) Demand schedule and demand curve

e.) Movement along a demand curve and shift in a demand curve

f.) Meaning of supply

g.) Factors which influence supply of a product

h.) Supply schedule and supply curve

i.) Movement along a supply curve and shift in the supply curve

j.) Equilibrium price and quantity

k.) Excess demand and excess supply

l.) Effects of shift in a demand curve and shift in a supply curve on equilibrium price and quantity

m.) Other methods of determining price of a product.

Demand

Quantity of a commodity that buyers are willing and are able to buy at a given price over a given period of time.

Factors that influence the demand of a product/determinant of demand.

a.) Price of the commodity

When the price of a product increases its demand decreases and when the price decreases its demand increases.

b.) Level of consumer income

An increase in consumers disposable income generally leads to an increase in the demand for goods and services because the ability to buy increases.

c.) Price of other related products

Commodities are related in two ways. That is as either complimentary or as a substitute. Complementary are goods used together while substitutes can be used instead of each other. Hence the demand for a commodity can be affected by the prices of other commodities depending on the relationship. Reduction of price of a substitute will reduce the demand of the substituted goods while increase in price of the complimentary goods will reduce the demand for the goods.

d.) Changes in taste, fashion and preference of consumers

If taste change in favor of commodity, more of that commodity is likely to be bought even if it's expensive

e.) Government policy

The government may come up with policies that are meant to encourages or discourage the consumption of certain commodities.

This policies may be inform of:

- Taxation

An increase in tax on commodity increases its price which makes its demand to fall and vice versa.

- Subsidies

The government meets part of a cost or production of a commodity so that it can be sold cheaply. Hence the demand rises

- Legislation

The government may pass laws meant to encourage or discourage consumption of a certain commodities.

- Price controls

The government may control the price of certain commodities to ensure that they do not go beyond a certain limit.

f.) Change in the population

An increase in population will bring about an increase in demand for goods and services. While a decrease in population will reduce demand.

g.) Future expectations of changes in price and quantities supplied

If the consumers expect prices of commodity to rise or shortage of the supply of the commodities in future they will buy more of it. while if they anticipate a decline in price of a commodity, they may buy less of it when the price is still high.

h.) Seasonal changes

Demand for some commodities depends on the season.

i.) The distribution of incomes

The demands for goods and services is usually higher when incomes are distributed among many people as opposed to where incomes are in the hands of a few people.

j.) Terms of sale

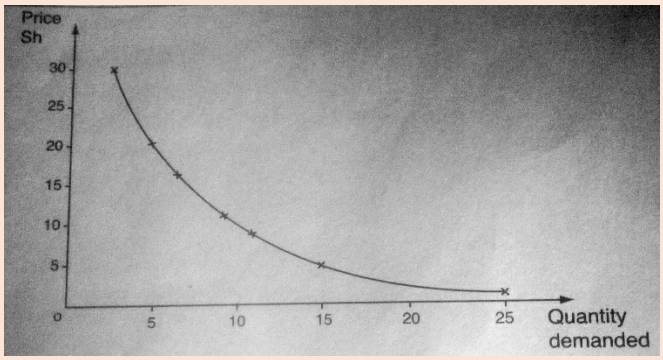
The demands for goods or services can increase if and when favorable terms of sale are offered to consumers. The terms may be offering goods on credit, giving discounts to consumers and lengthening the credit period.

Derived demand
Derived demand is where a good is needed because it give rise to a commodity that is actually demanded e.g. hen and eggs

Joint demand
These are goods that are consumed together .E.g. tea and sugar

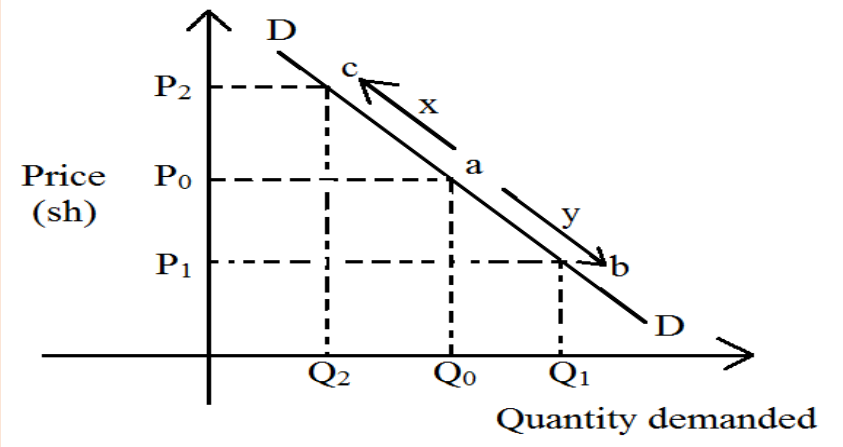
Demand schedule
It is a table showing the quantities of a commodities that consumers are willing and are able to buy at different prices within a given period of time.

Demand Curve
A graph showing the quantities demanded against the prices. On the y axis is recorded the price and on the x axis the quantities demanded.



The tendency of the demand to increase as prices decrease and to reduce as prices increase is referred to as the law of demand. By obeying the law of demand, the demand curve slopes downwards from left to right.

Movement along and shift in demand curve.
Movement along the demand curve
The quantities demanded increase with decreases in prices while the demand decreases with the increase in prices.

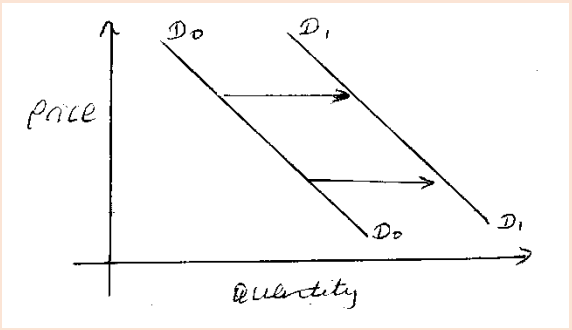


From the above diagram it can be observed that:

- ✓ The initial price was P_0 and the quantity demanded was Q_0 .The price/quantity combination is at point a.
- ✓ When prices increased to P2, The quantity demanded reduced to Q2, leading to a movement along the demand curve from point a to point c.
- ✓ When the price reduced to P1, the quantity demanded increased to Q1, Resulting to a movement along the demand curve from point a and point b.

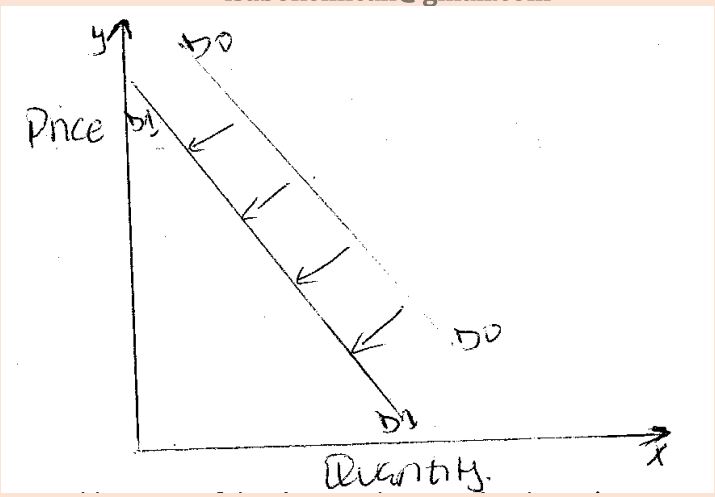
Shift in demand curve

Shift in demand curve is caused by other factors except price. An increase in demand would be indicated by a shift of the demand curve to the right as shown below.



The original demand curve D_0D_0 has shifted to D_1D_1 .Note that the quantities demanded have increased even though the prices have remained unchanged.

On the other hand, reduction in demand may be indicated by a shift of the demand curve D_0D_0 has shifted toD_1D_1 as shown below.



SUPPLY

The quantity of a commodity that sellers are willing and able to bring to the market at a particular price over a given period of time.

Factors which influence supply of a product.

a.) Price of the product

Producers will supply more goods to the market when the prices are high while if the prices go down ,less of the commodity will be supplied in the market.

b.) Law of supply

Increase in supply increases with the increase in price and reduce with the reduction in prices.

c.) Cost of production

An increase in the cost of factors of production or of inputs such as raw materials and labor will lead to an increase in total production costs, The prices of the commodity will go up making the demand to fall hence producers will reduce their supply to avoid excess supply in the market.

d.) Availability of factors of production

The amount of commodity supplied to the market will depend on availability of factors of production and inputs such as raw materials. The lower the factors of production the lower the supply of the commodities

e.) Government policies

Government policies such as taxes, subsidies, quotas and price controls affect supply.

f.) Future expectations of changes in price

The supply will reduce when producers expect prices to rise as they will hoard the goods and sell them when the prices are higher reducing the supplies at the current time.

g.) Natural factors

These can affect the quantity of the commodity supplied favorably or unfavourably.eg in case of agricultural products, weather, diseases and pests may affect the quantity supplied either negatively or positively.

h.) Time

It takes time for supply to adjust to market changes. For example in agriculture, one has to wait for the crops to grow.

Supply schedule

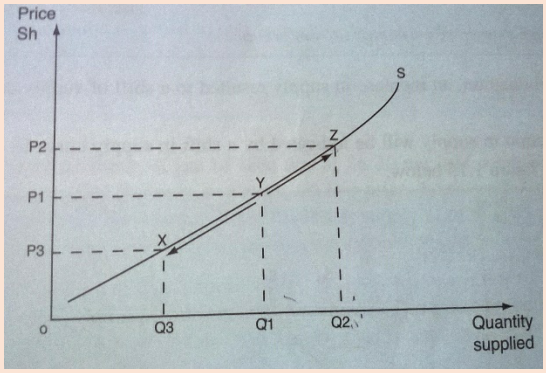
A supply schedule shows, in a tabular form, the quantity of a commodity that the producers are willing and able to bring about to the market at different prices over a given period of time.

Supply curve

A supply curve is a graph showing the relationship between the price of a commodity and the quantity of the commodity supplied.

Movement along the supply curve

A normal supply curves slopes upwards from left to right. Therefore the quantities supplied increases with the increase in prices and decreases with decrease in prices of the commodity.

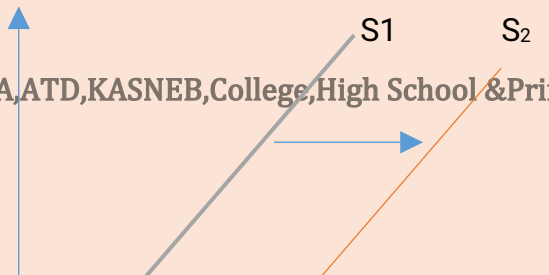


Quantity supplied at price P1 is Q1.If the price increase from P1 to P2 the quantity supplied also increases from Q1 to Q2 . The price /quantity combination therefore moves along the supply curve from point Y to Z.

On the other hand, if price reduces from P1 to P3 the quantity supplied also reduces from Q1 to Q3 .The price/quantity combination moves along the supply curve from point Y to point X.

Shift in supply Curves

Apart from the price of the commodity, a change in any other factor that influences supply of the commodity will lead to a completely new supply curve. Thus an increase in supply will result into a shift of the supply curve to the right as shown below.



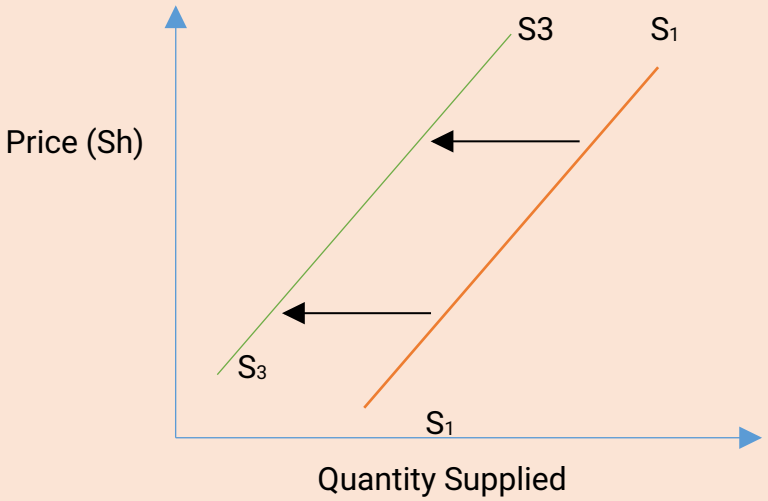
Price (Shs)

S_1

S_2

Quantity Supplied

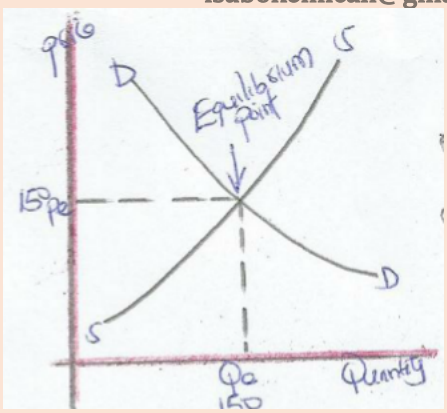
In the above diagram, an increase in supply resulted to a shift of supply curve from S1S1 to S2S2.A reduction in supply will be indicated by a shift in supply curve to the left as shown below.



From the above graph, it can be noted that a decrease in supply resulted into a shift in supply curve from S1S1 to S3S3.

Equilibrium price and quantity.

The price which equates the quantity demanded to quantity supplied is the equilibrium price. The corresponding quantity is known as equilibrium quantity



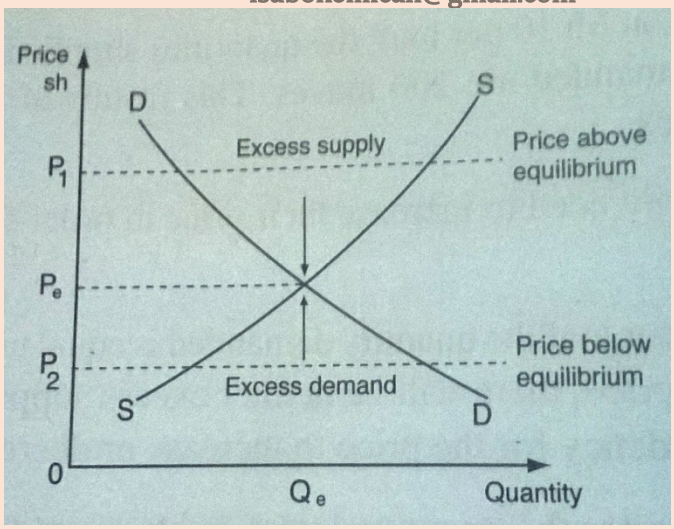
Pe =equilibrium price

Qe =equilibrium quantity

Equilibrium as used in price determination shows that:

- ✓ The buyers and sellers are both satisfied with the prices and quantity.
- ✓ Setting any prices or quantity other than the equilibrium, results in market instability.
- ✓ If the factors determining demand and supply do not change, the equilibrium price will prevail in the market.

Below figure shows movements of price towards the equilibrium



Excess demand

Excess demand refers to the quantities demanded by customers over the quantities that the suppliers are able to supply in the market.

Excess supply

Refers to the quantities supplied over the quantities that customers are able to buy.

Note from the above diagram:

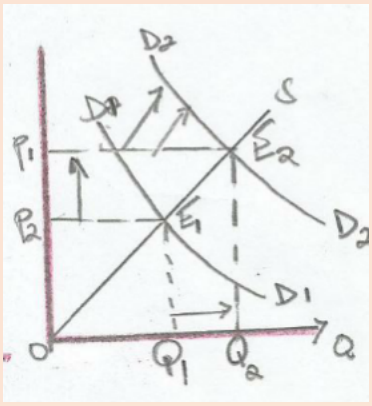
- ✓ If the price is set at p1 which is above the equilibrium price, there would be excess supply in the market. In order to clear this excess supply, sellers will be compelled to lower their prices towards the equilibrium.
- ✓ If the prices is set at p2 which is below the equilibrium price, there would be excess demand. The buyers will then be forced to increase their prices towards the equilibrium price in order to attract more supply.

Effects on shift in demand curve and supply curve on the equilibrium.

Change in demand curve.

Where the demand curve slopes downwards to the right and supply curve upwards to the right an increase in demand will result into an increase in equilibrium price and also the equilibrium quantity.

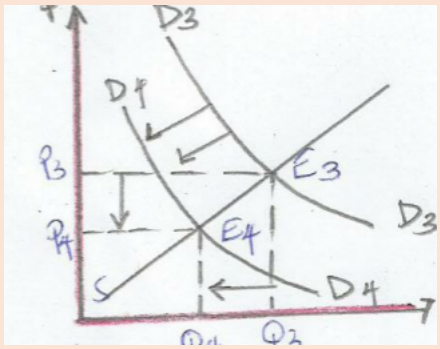
This is because an increase in demand will attract higher prices and the high prices will attract more supply.



Increase in demand

From the above diagram, demand increased from D1D1 to D2D2 with the effect that the equilibrium price and quantity changed from P1 to P2 and Q1 to Q2 respectively. This change moved the equilibrium point from E1 to E2.

A decrease in demand will result into a decrease in the equilibrium price and also the equilibrium quantity.



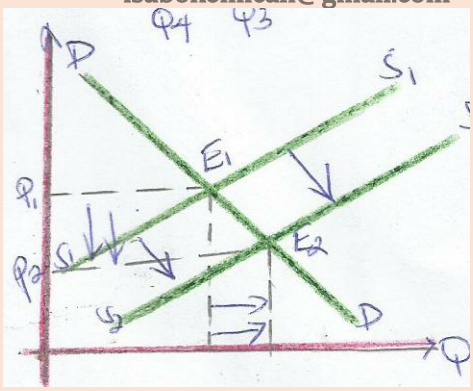
From the figure above, a reduction in demand from D3D3 to D4D4 changed the equilibrium price and quantity from P3 to P4 and Q3 to Q4 respectively. The point of equilibrium hence shifted from E3 to E4.

Change in supply

In a normal situation in which the demand curve slopes downwards from left to the right and the supply curve upwards from left to right ,an increase in supply will bring about a drop in equilibrium price and an increase in equilibrium quantity.

This is because with the increase in goods supplied, the suppliers will be compelled to lower their prices so that they can sell the surplus. At the reduced prices the quantities demanded will be higher.

A decrease in supply will result in an increase in equilibrium price and a decrease in equilibrium quantity as shown below.



Other methods of Price determination

a.) Haggling /bargaining

Buyer and seller negotiate over the price. This process continuous until the two agree on the prices.

b.) Tendering

Public is invited to make bids for the supply or sale of a particular product. The person who offers the most reasonable / lowest price usually wins the tender.

c.) Government intervention

Government may impose tax or offer subsidies thus determine price. Government may also set a price level at which a product may be sold.

d.) Recommending or fixing by a producer

Producer may determine the prices of their products and recommend or even require that they be sold at those prices.

e.) Auction

This is a situation where the prices of the commodity is set through bidding ,buyers are given an opportunity to suggest the price one after the other and the one that sugest the highest price called the highest bidder buys the commodity.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Indicate by writing a demand or supply whether each of the following factors influence demand or supply of a commodity. (5mks)

   a) Changes in the prices of inputs

   b) Change in tastes and preferences.

   c) Changes in technology

   d) Changes in outcomes

   e) Changes on the price of other related products.

2. State the law relating to each of the following.

   a) Demand

   b) Supply

   c) Demand and supply

3. In each of the following cases, indicate whether the supply will increase, decrease or remain constant.

   a) If the demand for coffee rises, the supply of tea is likely to

   b) If the prices of cars fall, the supply of petrol as likely to

   c) if the demand for beef increases the supply of wool is likely to

4. State four factors that may cause an increase in the supply of a product. (4mks)

5. Outline four factors that may cause a decrease in the quantity demand for a product.

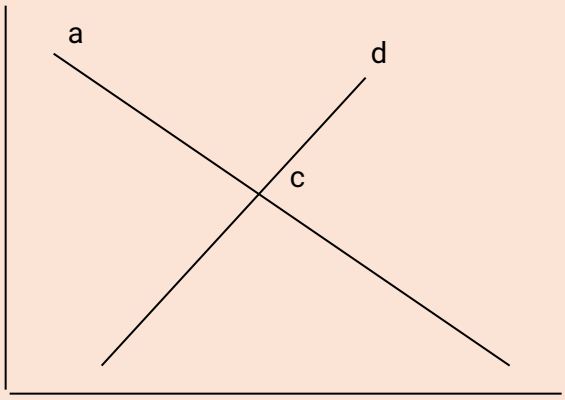
   (4mk)

6. Draw a demand curve based on the demand schedule below

Price (Sh)	Quantity demanded
5	100
10	50
20	25
25	5

(4mks)

7. The following diagrams represent demand and supply of a product. (5mks)



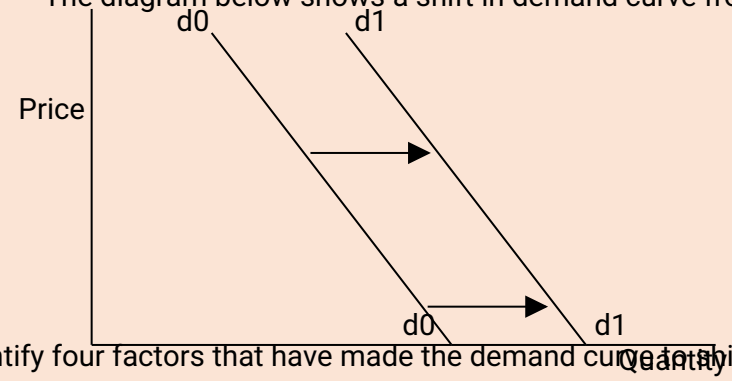
a) Labels the cover (a) and (b)

b) State what is represented by point (c)

c) On the diagram, indicate equilibrium price (PE) and equilibrium quantity (QF).

8. State four factors that may lead to an increase in market supply of a product. (4mks)

9. The diagram below shows a shift in demand curve from d0d0 to d1d1.



Identify four factors that have made the demand curve to shift from d0d0 to d1d1

11. The table below illustrates the demand and supply of commodity.

Price	Quantity demanded kg Kg per month	Quantity kg per month
15.00	80	20
20.00	70	30
25.00	60	40
30.00	50	50
35.00	40	60
40.00	30	70

From the table above, state

a) The nature of the demand for the commodity

b) The nature of the supply of the commodity

c) The equilibrium price

d) The equilibrium quantity.

PAPER 2

1. Outline four ways in which the price of goods and services can be determined in the market other than through the forces of demand and supply curve.

CHAPTER SIXTEEN

SIZE OF THE FIRM

Specific Objectives

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

a) Distinguish between a firm and an industry;

b) Discuss the factors which influence the decision on what goods and services to produce;

c) Describe the criteria for determining the size of a firm;

d) Explain the factors that influence the location of a firm;

e) Discuss advantages and disadvantages of localization and delocalization of firms;

f) Discuss the economies and diseconomies of scale;

g) Justify the reasons for existence of small firms;

h) Discuss the implication of production activities on the environment and community health;

i) Explain the need for maintaining a healthy environment.

Content

a.) The concepts of a firm and industry

b.) Decision on what goods and services to produce

c.) Determining the size of a firm

d.) Location of a firm

e.) Localization and delocalization of firms in an economy.

f.) Economies and diseconomies of scale.

g.) Existence of small firms in an economy.

h.) Implications of production activities on the environment and community health.

i.) Maintaining healthy environments

Definition

Firm refers to a single unit of business organizations that brings together the factors of production to produce any given commodity.

Factors to determining decision on what goods and services to produce.

a.) Profitability

Businesses will produce goods and services that would yield maximum profit.

b.) Level of competition

A firm will produce goods that meet least competition such as goods that are either not available in the market or improvement on existing ones.

c.) Availability of resources

A firm will produce commodities that the resources for which is necessary to produce them are available .e.g. raw materials, appropriate labor, equipment and space.

d.) Government policy

A firm should produce commodities that are favored by government policy. For example the firm should not produce goods which are not illegal.

e.) Demand /market

A firm should produce commodities that have the highest demand. High demand leads to high sales volume.

f.) Cost of production.

A firm would normally produce for which production costs are low.

Factors determining the size of a firm.

a.) The number of employees

Large firms always have a large number of workers compared to a small firms.

b.) Volume of outputs

A firm would be considered big if it has a large volume of output

c.) Floor area covered by premises

A firm may be considered to be large if the floor area covered by the premises is large.

d.) Capital invested

The larger the capital invested in assets the larger the firm.

e.) Production methods

Larger firms are associated with specialization and division of labor as compared to small firms

f.) Market served

A firm having many branches all over the country is said to be big

g.) Sales volume

The amount of sales also determines the size of the firm. The larger the sales volume the larger the firm.

Location of the firm

Location of a firm is the selection of a place where the proposed firm will be established.

Factors that influence the location of firms

a.) Availability of raw materials

If the raw materials are bulky and heavy to transport the firm would be located near the source of the raw. The nature of raw material, perishable raw material also determines the location of a firm.

b.) Market availability

A firm may be located near the market for its products to avoid the costs involved in transportation of the finished products. For example firms that deal in heavy and bulky commodities.

c.) Availability of human resource (labor)

Labour intensive firms should be located in areas where there are abundant and appropriate labour force.

d.) Appropriate transport and communication network

Good transport network for transporting raw materials to the firm and also finished products to the market is needed so the firm will be located in areas with good transport and communication networks.

e.) Adequate power and water supply.

Firms that requires a lot of power and water need to be located where there is adequate supply for power for running machines and clean water supply for cleaning, cooling and even as a raw material.

f.) Government policies

The government may encourage or discourage the development of firms in particular areas to create jobs and prevent congestion by using the following:

- ✓ Offering free or cheap land.
- ✓ Reduction of taxes.
- ✓ Offering subsidies.
- ✓ Offering direct financial assistance.
- ✓ Improvement of infrastructure.

g.) Availability of security

Firms cannot be located in areas without securities compared to areas with maximum security

Localization and Delocalization of Firms.

Localization of Firms

This means the concentration of similar firms in one particular area or region.

Factors which encourage localization of firms.

- ✓ Well-developed infrastructure in an area.
- ✓ Availability of large population which may provide both labour and a market for its products.
- ✓ Government policy requiring firms to be located in a certain area.
- ✓ Availability of raw materials in a certain area.
- ✓ Availability of support industries such as banks

Advantages of localization.

a.) Establishment of support business

Encourages the established of support business enterprises such as banks, insurance companies and distributors.

b.) Employment opportunities

Employment opportunities is always generated in the areas they are located which benefits the people living in those areas.

c.) Development of infrastructure

Infrastructure such as roads, communication network, health and education facilities are likely to arise.

d.) Creation of Pool of labour

Encourages a pool of labour as people tend to migrate to that region in search of employment this enables the firms to meet their labour force requirements.

e.) Easy disposal of waste

Localized firms are able to easily dispose of their waste by either selling it to other firms for recycling or by jointly undertaking waste disposal projects.

f.) Arise of industries

Industries dealing in by products are likely to arise and the communities in those areas will be able to use the by-products.

g.) Security

When industries are closely related, these are few security problems experienced as compared to

the dispersed industries.

Disadvantages of Localization

a.) Cause pollution

Emission from firms may cause both air and water population which have negative effects on the environment.

b.) Regional imbalance

Imbalance in development is experienced because areas of industrial concentration tend to enjoy provision of social amenities such as roads schools while other areas may suffer.

c.) Rural to urban migration

People migrate from rural to urban areas in search of jobs and better living conditions, these movements cause unemployment in urban areas and labour deficiency in rural areas.

d.) Increase social evils

Increased population in areas of industrial concentration leads to series of problems such as congestion, increased rate of crimes.

e.) Economic depression during times of war or calamities

Localization of firms may be risky because if any undesirable thing happens to the region it may destroy the country's economic and industrial base.

f.) Leads to widespread unemployment

A fall in demand for products produced by localized firms, would result in wide spread unemployment in the affected area.

Delocalization of firms

Refers to establishment of firms in different parts of the country

Advantages of delocalization

a.) Employment opportunities

Creates employment opportunities for people living in rural areas

b.) Reduces rural to urban migration

Rural to urban migration is reduced due to the spread of industries to all parts of the country which creates employment to those parts.

c.) Balanced regional development

Due to the spread of industries a balanced regional development is achieved in all the areas where the industries are located.

d.) Increased accessibility of produced goods.

The local communities are able to get the produced goods without necessarily travelling very far.

e.) Provision of market

Provides a market for locally produced raw materials.

Disadvantages of delocalization

a.) Spread of pollution

When industries are spread to many parts of the country, they also spread the pollution to those parts of the countries.

b.) Inadequate skilled manpower

Skilled man power may not be available in rural areas where the industries are spread.

c.) Security

Some areas especially rural areas may lack proper security and some areas such as slums are generally insecure.

d.) Lack of service industry.

Service industries like banks may not be available in rural areas such as banks and many others.

e.) Production of substandard products.

Continued protection of firms from foreign competition by the government may make the firm to continue producing sub- standard products.

f.) Burden to tax payers

Incentives offered by government are an added burden to the taxpayer.

Economies and Diseconomies of scale.

The advantages of expansion of industries is called economies of scale while the disadvantages are called diseconomies of scale.

Economies of scale

Divided into two types

- ✓ Internal economies of scale
- ✓ External economies of scale

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. They include the following:

a.) Marketing economies

A firm that buys in large quantities is likely to get benefits such as large trade discounts and they also incur less cost per unit in transporting the goods bought.

b.) Financial economies

A firm with strong financial base can obtain loans at a low interest rates against their assets.

c.) Risk bearing economies

Large firms can reduce the risks involved in market failure through diversification of products or markets. This can be done so that failure of one product is offset by the success of the other products.

d.) Managerial economies

Large firms are able to practices division of labour which leads to specialization hence an overall increase in the firm's outputs.

e.) Technical economies

These refers to benefits which accrue to a firm due to specialization of both labour and machinery. This is because large scale firms are able to hire specialized labour and machinery more economically than small scale firms.

f.) Research economies

Research is very important in production but it's always very expensive and only firms large firms can afford to raise the needed finance to carry it out.

External economies of scale

These are those benefits that accrue to a firm as a result of the growth of the whole industry. They include the following:

- ✓ Skilled labour force.
- ✓ Ready market may be available from the surrounding industry.
- ✓ Easy disposal of waste products
- ✓ Improved infrastructure.

Diseconomies of scale

These are problems which a firm experience due to expansion.

a.) Internal diseconomies of scale.

These are problems a firm experiences as a result of large – scale production arising from its persistent growth. They include:

- ✓ Managerial diseconomies.
- ✓ High overhead costs.

b.) External economies of scale

These are the demerits that a firm experience as a result of growth of the entire industry.

- ✓ Scramble for raw materials.
- ✓ Non-availability of land for expansion.
- ✓ Scramble for available labour.
- ✓ Competition for available markets.
- ✓ Easy target especially in times of war.

Reasons for the continued existence of small firms in an economy

a.) Flexibility

It is easier for small scale retailers to change from one form of business to another location compared to large scale firms.

b.) Size of the market

If the demand for a product is not high, large scale production may not be necessary and it's only appropriate for such a market to be served by small firms.

c.) Nature of the product

Nature of the product may make it very difficult to be produced in large quantities, such as personalized services as painting which can only be provided by one individual.

d.) Need to retain control

The owners of the firm may wish to keep it small in order to retain control and independence.

e.) Simplicity of organization

Where the firm intends to take advantage of simplicity to avoid the bureaucracy, wastage and management complexity associated with large scale organizations, it may chose to remain small.

f.) Quick decision making

In a situation where the founders want to avoid delay in decision making they may opt to maintain a small business as this would involve less consultations.

g.) Rising cost of production

In situations where production costs rise so fast, such that diseconomies of scale set in very early, the firm has to remain small.

h.) Legal constraints

The law may restrict the growth of a firm hence the existing firms has to remain small.

Implication of production activities on environmental and community health

- ✓ Air and water pollution from factories.
- ✓ Destruction of environment.
- ✓ Solid waste pollution.
- ✓ Noise pollution

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. State disadvantages of concentrating industries in one area within a country. (4mks)

2. Highlight four circumstances under which a firm would be located near the market for its product. (4 marks)

3. Outline four ways in which land influences the location of industries. (4 marks)

4. State four circumstances under which a firm would be located near the market for its Products. (4 marks)

5. State four advantages of locating a firm near the source of raw materials. (4 marks)

6. Identify four problems that tend to limit the growth of small –scale retail business in rural Kenya. (4 marks)

7. Highlight four measures a government may take to attract firms to an area. (4 marks)

8. State four disadvantages of locating a business away from other related business. (4 marks)

9. State four disadvantages of delocalization of industries to a country. (4 marks)

10. State four factors which influence the location of business enterprises. (4 marks)

11. State four measures that local authority could take in order to attract investors to locate their industries within its boundaries. (4 marks)

PAPER 2

1. Outline five benefits that country would get by encouraging businessmen to locate new industries in rural areas. (10 marks)

2. Discuss the factors that have led to the survival of small scale retailers despite competition from supermarkets. (10 marks)

3. Discuss the economic benefits to a community that may result from the concentration of industries in an area. (10 marks)

4. Explain five circumstances that may influence a firm to locate its operations near the source of raw materials. (10 marks)

5. Explain five measures that a government may take to encourage establishment of industries in rural areas. (10 marks)

6. Highlight five advantages of having a business enterprises located in an area. (10 marks)

CHAPTER SEVENTEEN

PRODUCT MARKET

Specific Objectives

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

a) Explain the meaning of a market;

b) Explain the meaning of product market;

c) Discuss the features of various types of product markets.

Content

a.) Meaning of a market

b.) Meaning of product market

c.) Features of various types of product markets

Definition

The product market is the interaction of buyers and sellers to transact business pertaining to a

particular commodity.

Types and features of a product Market.

1.) Perfect competition

A perfect competition is very rare and it has the following characterizes

a.) Large number of buyers and sellers

Buyers and sellers are so many that the separate actions of each person of them has no effect on the market. This implies that no single buyer or seller can influence the price of the commodity.

b.) Homogeneity (uniformity) of the product.

Commodities from different producers are identical in all aspects such that one cannot distinguish them hence there would be no advantage or disadvantage of buying from a particular producer.

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.

d.) Freedom of entry or exit

The buyers and sellers have the freedom to enter and leave the market at will.

e.) Uniformity of buyers and sellers

All buyers and sellers are identical so there is no benefit of selling to a particular buyer or buying from a particular seller.

f.) No government interference

The price prevailing in the market is determined strictly by the interplay of demand and supply and there should not be any form of government intervention.

g.) No excess supply or demand

The sellers are able to sell all that they supply into the market and the buyers are able to buy all what they require hence there are no excess supply and demand.

h.) No transport costs

In a perfect competition market, it is assumed that the buyers and sellers are located in one area hence there is no need for transportation.

2.) Monopoly

This is a market situation where there are many buyers but only one seller called a monopolist.

Characteristics

a.) Only one supply

There is only one supplier for the entire market hence the firm is the industry.

b.) No close substitute

The commodity supplied does not have close substitutes which may bring competition.

c.) Difficulty to enter

It is difficulty for other firms to enter into the market

d.) Fixed prices

Prices are fixed by the supplier

e.) Possibility of price discrimination

Price discrimination may be possible. This is charging different prices for the same commodity in different markets.

Conditions necessary for price discrimination

- ✓ Consumers are in different markets making it difficult for one to go to another market.
- ✓ The cost of maintaining the separate market is not very high.
- ✓ The production of the commodity is in the hands of monopolist hence they are able to control production.

Basis of Market separation

a.) Geographical

Goods may be sold differently in different market. The price charged in local market may be cheaper than foreign market.

b.) Income

Consumers may be charged differently according to their income level

c.) Time

A firm may sell the same commodity at a high price during the peak period and lower the price during the off peak period.

Sources of monopoly power

a.) Control of an important input in production.

A firm may draw its monopoly from having control of an important factor of production such as raw material.

b.) Ownership of production rights

Monopoly can be created if a firm has the right to production or ownership of a commodity such as patents rights, copyrights and royalties belonging only to the firm.

c.) Internal economies of scale

The existence of internal economies of scale that enables a firm to reduce its production costs to the level that other firms cannot. This will force these firms out of business leaving creating a monopoly

d.) Size of the market

The size of a market may be best served by one person or a firm. Addition of more than one firm may lead to all of them incurring losses.

e.) Addition costs by other firms

If other firms have to incur additional cost to enter into the market then their products may be less attractive due to increased price. This make the local firm to be monopolist.

f.) Where a group of firms combines to act as one

Some firms may combine/amalgamate or work together for the purpose of controlling the market of their product. They therefore create monopoly.

g.) Restrictive practices

A firm may include price limit where a firm sells its product at a very low price to drive away competitors, then raising the price after putting the other firms out of business creating monopoly.

h.) Financial factors

If huge capital is required to enter into the market, it may make it very difficult for other firms to enter into the market making the existing firm to operate as a monopoly.

3.) Monopolistic competition

A market structure that combines the aspects of perfect competition and those of a monopoly.

Characteristics

a.) Many buyers and sellers

Many buyers and sellers acting independently

b.) Variation in quality

The products vary in quality or are a close substitutes of each other.

c.) No barriers to entry or exit exists.

New firms wishing to supply the same commodity are free to do so and existing firms wishing to leave are also free.

d.) Perfect knowledge of the market

There is perfect knowledge of the market for both sellers and buyers.

4.) Oligopoly

A market structure with few firms

Types

i.) Duopoly

Where the industry is made up of two firms.

ii.) Perfect /pure oligopoly

Where the products are identical

iii.) Imperfect/differentiated oligopoly

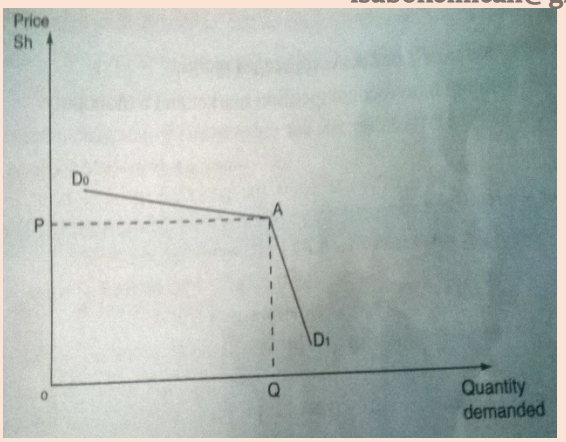
Where the markets have products which are close substitutes or are the same but made to appear different.

Characteristics

- ✓ There are few firms in the market.
- ✓ Interdependence among the firms.

The kinked Demand Curve

Once a price has been arrived at in an oligopolistic market it tends to remain stable. It follows that a firm in oligopolistic market faces two sets of demand curves. One curve, for prices above the determined one. Which is fairly gentle. The other curve, for prices below the determined one which is fairly steep. This is illustrated below.



It can be noted from the above diagram that:

i.) The price that is generally charged in the industry is P. This is the point at which the price is rigid.

ii.) The demand curve (kinked) is D_0AD_1.

iii.) At prices above P the curve is fairly gradual and as such, an increase in price will lead to a big loss in quantities demanded as consumers will shift to suppliers who have not raised their prices.

iv.) At prices below P the curve is fairly steep. A reduction in price will therefore create little additional sales as other firms are likely to reduce their prices to the same level or even lower.

End of topic

Did you understand everything?

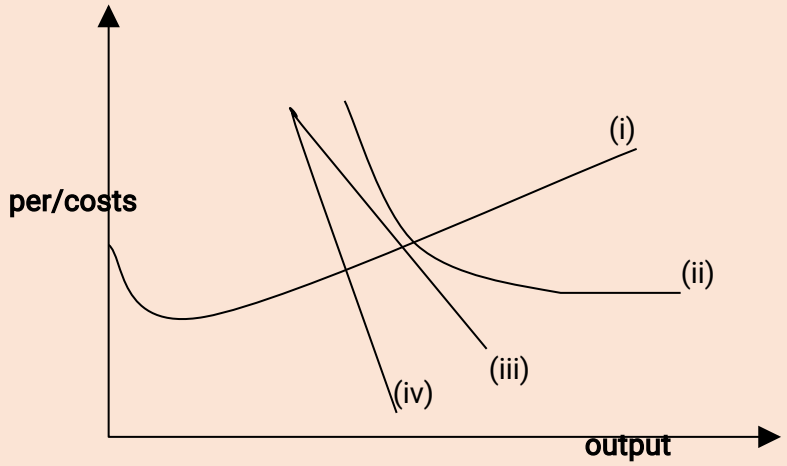
If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

Paper 1

1. State **four** reasons why the government should control activities on monopoly

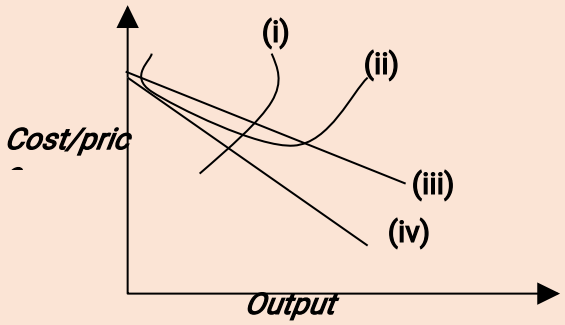
2. The following diagram shows how price and output is determined under monopolistic competition



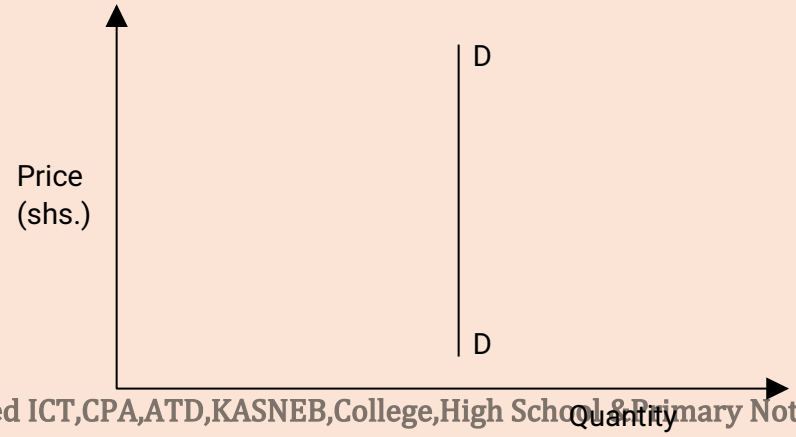
Name the curves:

3. The diagram below represents the short-run equilibrium of a firm in monopolistic competition.

Label the curves and show the best output and price on the graph



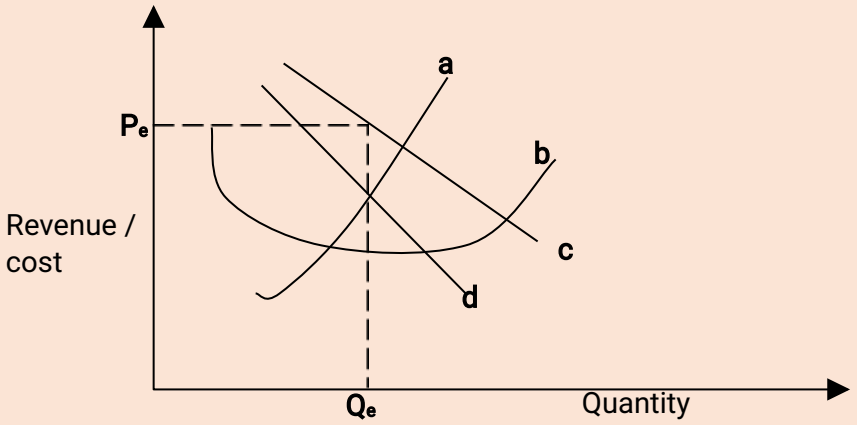
4.



State **four** circumstances under which the phenomenon exhibited above can be experienced in a market structure

5. State **four** sources of Monopoly power

6. The diagram below relate to a market structure



i) Name the market structure represented in the diagram shown above

ii) Name the curves marked

7. Give **four** reasons why market research is important to a trader

CHAPTER EIGHTEEN

CHAIN OF DISTRIBUTION

Specific Objectives

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

a) Explain the meaning of distribution

b) Describe the various channels of distribution

c) Discuss the role of intermediaries in the distribution chain

d) Discuss the factors which may influence choice of a distribution channel.

Content

a.) Meaning of distribution

b.) Channels of distribution

c.) Intermediaries in the distribution chain

d.) Choosing a distribution channel

Introduction

The paths that that goods or services follows from the producers to the consumers.

Middleperson/intermediaries

These are traders that are engaged in distributing goods and services between the producers and consumers.

Expenses incurred by wholesalers when they buy goods from producers.

- ✓ Actual cost of buying the goods.
- ✓ Transport cost.
- ✓ Storage costs.
- ✓ Insurance cost.
- ✓ Salaries and wages.
- ✓ Packing and blending.

Channels of distribution for various products

Distribution of imported goods

i.) Foreign producer to local consumer.

ii.) Foreign producer to agent to wholesalers to retailers to local consumer.

iii.) Foreign producer local agents / importers to local consumer.

iv.) Foreign producer's to wholesaler then to retailer and local finally consumer.

v.) Foreign producer to Local retailer then to local consumer.

vi.) Foreign producer to wholesalers to local consumers.

vii.) Foreign producer's manufactures representatives to wholesaler to retailers to Local Consumer.

Distribution of locally manufactured goods

i.) Local Manufacturers sell direct to consumers.

ii.) Local manufacturers through wholesalers through retailers to consumers.

iii.) Local manufacturers through wholesalers directly to consumers.

iv.) Local manufacturers through retailers to consumers.

v.) Local manufacturers through government agent through wholesaler to retailers to consumers.

vi.) Local manufacturers through government agent through wholesaler and directly consumers.

vii.) Local manufacturers through government agent through wholesaler and directly consumer.

Distribution of local Agriculture Produce.

i.) Farmer (producer) to local cooperative then to marketing board to wholesalers to retailers and finally to consumers.

ii.) Farmer (producer) to retailers and directly to consumers.

iii.) Farmer (producer) may sell directly to consumers.

iv.) Farmer (producer) through wholesaler to retailer then consumers.

v.) Farmer (producer) through marketing board through wholesalers to retailers and finally to consumers.

vi.) Farmer (producer) through marketing board through retailers and finally to consumers.

Roles played by intermediaries in the distribution chain.

a.) Reducing transaction between producers and consumers.

They reduce the number of transaction between many producers and consumers and also assist the producers in searching for and communicating with prospective customers.

b.) Breaking bulk

They buy in large quantities and sell in small quantities breaking the bulk as required by their customers.

c.) Accumulating bulk

Some buy small quantities of the same product from many small producers and then offering the large amount gathered to buyers who may be wanting large quantities.

d.) Risk taking

By taking the possession of goods from producers they assume all the risks associated with the movement of such products from the producers to the consumers.

e.) Provide finance

When intermediaries take the goods immediately they are produced, they relieve the producers from finances needed to sell the goods directly to consumers.

f.) Transport and storage

The intermediaries transport and stores the goods in their warehouses until the demand arises.

g.) Availing goods to consumers

Intermediaries avail goods at places conveniently accessible to consumers. They also ensure steady supply of goods by carrying out warehousing.

h.) Product promotion

They promote the product by passing relevant information to consumers about the product.

Factors influencing the choice of distribution channel

a.) The nature of goods

Where perishable a direct channel to consumers is more preferred because delays may Result into losses.

b.) Size of the market

Where the market is large it may require longer channels to reach consumers while if the Consumers are concentrated in one area, it requires shorter channel.

c.) Costs

Where the cost of marketing and distribution are high manufacturers will dispose goods Through intermediaries.

d.) Lack of facilities / skills

Where the produces lacks facilities to help in distribution he will call upon intermediaries To help them reach consumers.

e.) Government policy.

If the government policy prohibits /required use of a certain channel then it has to be Followed.

f.) Nature of market

Depending on consumer's preferences / taste it may require a personal attention of the Producer.

g.) Competition.

Where competition is high manufacture may have to be closer to the consumer.

h.) Technical goods

Technical goods need to be sold direct to consumer in order to provide necessary information.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Outline four benefits that customers get from small – scale retailers. (4 mks)
2. Highlight four benefits that accrue to a customer who buys directly from a manufacturer (4 mks)
3. Name four channels the a manufacturer would use to distribute his goods to the Customer (4 mks)
4. Highlight four factors that should be considered in choosing a method of distributing agricultural produce (4 mks)
5. Give disadvantages of long chain of distribution of goods to a buyer (4 mks)
6. State four benefits to a large consumer who buys directly from the producer. (4 mks)
7. Outline four benefits to a large consumer who buys directly from the producer. (4 mks)
8. Highlight four circumstances under which a manufacturer may prefer to sell goods directly to the consumers (4 mks)

PAPER 2

1. Describe five circumstances under which a producer would sell his goods to his consumers (10 mks)
2. Zango manufacturers who have been selling their products directly as retailers have decided to distribute the products through wholesalers. Explain five benefits that Zango manufacturers may get from these new arrangements. (10 mks)
3. Describe five channels that can be used to distribute locally manufactured goods (10 mks)
4. Explain four factors that may be considered in determining the appropriate channel for distributing goods (10 mks)
5. Discuss circumstances under which a wholesaler becomes essential in the chain of distribution (10 mks)
6. Explain the channel of distribution for imported goods (10 mks)
7. Kabu manufacturers have decided to distribute their goods through wholesalers.

Discuss five benefits that would account to Kabu manufacturers (10 mks)

isabokemicah@gmail.com

CHAPTER NINETEEN

NATIONAL INCOME

Specific Objectives

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

a) Explain the meaning of national income;

b) Describe the circular flow of income;

c) Explain the methods of measuring national income;

d) Explain the problems encountered in measuring national income;

e) Discuss the uses of national income statistics;

f) Discuss the factors which influence the level of national income.

Content

a.) Meaning of national income

b.) The circular flow of income

c.) Methods of measuring national income

d.) Problems encountered in measuring national income

e.) Uses of national income statistics

f.) Factors which influence the level of national income

Introduction

The total income received by the owners of the factors of production in a given country over a given period of time usually one year. It is the same as National output or national product.

Terms used in national income

Gross Domestic product (GDP) and Net Domestic product (NDP)

GDP refers to the total monetary value of all goods and services produced in a country over a period of one year.

Net Domestic Product is equal to gross domestic product less depreciation.

Gross National Product (GNP) and Net National Product (NNP)

Gross National Product measures the total monetary value of all goods and services produced by the individuals of a given country irrespective of whether they are producing it in their country or outside the country.

GNP = GDP + Net factor income from aboard (export less imports).

Net national product is the gross national product less value of capital used in the production process (depreciation)

NNP = GNP - Depreciation.

Per capita income.

The average income per head per year in a given country.

Per capita income = National income/total population.

The circular Flow of income.

The movement of income from households to the firm and then back to the households is known as the circular flow of income.

The flow money (income) round the economy is shown by the dotted lines while the flow of goods and factor services is shown by continuous (inside) line.

Assumptions made for the circular flow of income to hold.

- ✓ There are only two sectors in the economy that is households and firms.
- ✓ Households spend all their income on goods and services produced by the firms.
- ✓ Firms spend all their revenues on factors of production provided by the household.
- ✓ There is no government intervention.
- ✓ The economy is closed, that is no foreign trade.

The assumptions do not hold because of the following

- ✓ No country can exist without dealing with other countries.
- ✓ It is difficult to have an economy where all incomes are spent on only acquisition of goods and services without savings and investments.
- ✓ It is not possible to have an economy where the government does not take part

Injections

They are factors that increase income and expenditure in the circular flow are referred to as injections.

Withdrawals/leakages

The factors that reduce the volume of flow are referred to as withdrawals/leakages.

Factors that affect the circular flow of income

a.) Savings

Savings by households reduce income received by firms since they have been withdrawn from the circular flow.

b.) Government

The government affects the circular flow by either taxation which reduce the amount of income available for spending or through government expenditure.

c.) Investment

Firms borrow money that households have saved in financial institutions such as banks and use it to invest. The investments leads to higher income to households since the capital goods are either hired or bought from households.

d.) Foreign trade

Through exports a country is able to earn income from other countries. The income earned from the foreigners is an addition to the circular flow of income and hence an injection.

Equilibrium National Income

The national income equilibrium is achieved when total injections are equal to total withdrawals (leakages).

For national income to be in equilibrium the following equation must

Savings + taxes + imports = investments + exports + government expenditure.

Measurement of national income

National income may be measured using the following methods.

1.) Expenditure approach

The national income is arrived at by adding together the expenditure on all final goods and services in the economy. The total expenditure is broken into the following stages:

a.) Expenditure on consumer goods by the general public (C).

b.) Expenditure on capital goods. Capital goods are also called investments denoted by letter (I).

c.) Government expenditure which may be divided into expenditure on goods and services from firms and expenditure on factor services from households. Government is denoted by (G)

d.) Expenditure on net exports.Net exports are atotal exports less total imports.Its denoted by the expression (X – M).

National income = C + I + G + (X – M)

NOTE

Only expenditure on new goods is added in the calculation while expenditure on second hand goods is not added as no production has taken place.

The national income arrived at using the expenditure approach is at market price because it involves expenditure on final goods and services thereby including indirect taxes and subsidies in order to get the national income at factor cost, subsidies are added while indirect taxes are subtracted.

G.N.E at factor cost = C + I + G + (x – m) + (subsidies – Indirect taxes)

To get net national expenditure/national income capital consumption (depreciation) is subtracted from Gross National Expenditure.

Thus: National income = Gross National Expenditure – Depreciation

Problems associated with the expenditure approach

i.) No accurate records of expenditure are kept especially in the private sector.

ii.) Expenditures for the subsistence sectors are only approximations due to lack of records in the sector.

iii.) Differentiating between final expenditure and intermediate expenditure may be difficult.

iv.) Suffers from the problem of double counting.

v.) Fluctuating exchange rates may pose challenges especially in valuation of exports and imports.

2.) Income approach

Income approach takes into account the sum of money that is received as income by different individuals who contribute to the production of goods and services. The incomes include rent, interest, wages and profit.

In addition public income and retained profits are included, it should be noted that transfer payments are excluded from the final calculations of national income because they represent a redistribution of incomes from those who have earned them to the recipients.

Such income include, national insurance and social security benefits to individuals, student's grants and pocket money.

National income may be calculated as:

G.N.I = personal income + retained profit – (transfer payments + stock appreciation).

The national income arrived at using this method is at factor cost because it represents the actual payments to the factors of production. In order to get national income at market price,indirect taxes are added and subsidies subtracted.

Gross National income is got by adding the net income from abroad to gross Domestic product.

Thus .G.N.I = GDP + (x – m)

To arrive at the net National income or simply National income, capital consumption

(Depreciation) is subtracted from Gross National income.

Thus, N.I = G.N.I – depreciation.

Problems associated with the income approach

i.) Problem of inaccurate data

ii.) Price fluctuations make it difficult to calculate national income.

iii.) Problem of handling illegal and unrecorded yield income to recipients.

iv.) Transfer payments pose a problem

v.) Income disclosures aren't true because people and firms like evading tax

3.) Output approach(value added)

The national income is arrived at by adding up the values of all final goods and services produced by firms during the year or it may be calculated by adding up the values to the product at each stage of production.

Government contribution to the national output is also taken into an account. Such services include education, health care and security. To find their value we get what it cost the government to provide them.

The GDP aimed at using this method is a factor cost as it excludes subsidies and indirect taxes. To arrive at the Gross National Product, Net Income from abroad is added to the Gross Domestic Product

Thus, GNP = GDP + (x-m)

To get the Net National Product/National Income depreciation is subtracted from the gross National product.

National Income = GNP – Depreciation

Problems with the output approach

I.) Problems of valuation due to unavailability/inaccuracy of output figure especially in the private section.

II.) Problem of deciding on the goods/services to include eg. Whether the output of a house wife should be included or not.

III.) The problem of valuing output in the subsistence sector.

IV.) Problem of frequent changing process.

V.) Problem of valuing government output since many of its services are not sold in the market.

VI.) Problems of differentiating primary inputs from intermediate inputs.

VII.) Valuing illegal activities like drug trafficking.

National Income statistics

National income statistics refers to all the data collected or computed from various sources that gives information about national income.

Uses of National Income Statistics

i. Use to measure rate of economic growth of a country. When output figures are high it means productivity has improved.
ii. Helps the government to plan its economy since it provides useful information required by planners.
iii. Used to compare the standards of living of people in a country. By comparing the per capita figures.
iv. Help the country to know the size and contribution of various sectors to natural income hence can take appropriate measures to improve them.
v. Shows the progress of the economy over a given period by comparing national income statistics over given period.

Disadvantages of using National income to compare standards of living in different countries.

a.) Different currencies

Conversation of currencies may be tedious.

b.) Different goods and services

The type of goods and services that are used to compute national income may differ from country to country.

c.) Disparity in distribution of income

Although income per capita may be similar in both countries, standards of living may differ considerably because of disparity in income distribution.

d.) Different needs and tastes

National income statistics may not give a true and a fair picture of standard of living due to different in taste and needs of the people.

Factors that influence the level of national income

a.) Labour supply

A country with more labour produces more than a country with less labour and also a country with more skilled labour force would produce high quality goods and services than a country with less skilled labour force.

b.) Capital

A country which uses modern equipment such as tractors in ploughing, would be able to produce more than a country using simple tools like jembes. This is because capital varies from simple tools to modern equipment's.

c.) Entrepreneurship

Availability of Entrepreneurs who have the ability to organize the factors of production in correct proportions, make their output to increase thereby increasing the national income.

d.) Availability of natural resources

The size of national income of a country depends on the natural resources endowment of that country. Therefore a country with abundant resources is likely to have a higher national income relative to a country without.

e.) Level of technology

If advance technology and latest equipment used in the process of production, then more goods can lie produced, which increase the volume or size of national income.

f.) Political stability.

If there is political stability in the country, the production can be sustained at the highest level and the size of national income will be large. In case of political condition is not good the production will be adversely affected and so the size of national income will be small.

g.) Attitude of citizens towards work.

A country whose labour force has negative attitude towards work may register low level of national income compared to another country where citizens are hard working.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

Paper 1

1. Outline **four** reasons why an increase in per capita income may not necessarily lead to a rise in the standard of living of the citizens

2. State **four** factors that affect the circular flow of income in an economy

3. Identify **four** factors that may be contributing to income disparity between the rich and poor citizens in Kenya

4. Account for the difference between the gross National Income figures between Kenya and Uganda

5. Name **three** approaches for measuring national income

6. Highlight **four** problems associated with income approach

7. Highlight **four** problems associated with the output approach in computation of National income

8. Highlight **four** uses of National Income statistics in any given country

9. Outline **four** circumstances under which per capita income would be a good indicator

CHAPTER TWENTY

POPULATION AND EMPLOYMENT

Specific Objectives

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

a) Explain the basic concepts in population

b) Explain the implications of population size and structure on the development of a country

c) Explain the meaning of employment and unemployment

d) Discuss the various types and causes of unemployment

e) Discuss the measures that may be taken to solve unemployment problems

Content

a.) Basic concepts in population: Fertility, Mortality, Growth rate, Optimum population, Under-population, Over-population, Young population, ageing population, Declining Population.

b.) Implication of population size and structure on development.

c.) Employment and Unemployment.

d.) Types and causes of unemployment.

e.) Solving unemployment problems

Definition

Population refers to the number of people living in a particular region at a particular time.

Basic concepts in population

1.) Population growth rate

Rate at which the size of a population changes over a given period of time usually one year.

Factors associated with growth rate

- ✓ Mortality rate-the rate of death in every 1000 people.
- ✓ Birth rate-the number of live births in a year per 1000 people.
- ✓ Migration –population movement from one region to another.it can either be:
    - Immigration-migration into an area.
    - Emigration-migration out of an area.

Factors leading to high birth rate

- ✓ Cultural practices like believing that many children act as a source of security.

- ✓ Early marriages prolonging the woman reproductive life.
- ✓ Children being seen as a source of cheap labour.
- ✓ Many births as a family searches for a male child.
- ✓ Religious beliefs which encourage large families.
- ✓ Ignorance leading to opposition of family planning.

Factors that leads to decline in birth rates

- ✓ Delayed marriages due to such things as staying in school for too long.
- ✓ Craving for a higher standard of living leading to people having few children.
- ✓ Desire to give children better lives than the parents.
- ✓ Where a small family is considered fashionable.
- ✓ Due to reduced infant mortality rates, most people have confident that all the children will survive hence no need of having many children.
- ✓ Availability of viable retirement benefits schemes which made people to stop viewing children as a source of security in old age.

2.) Optimum population

The population level which is equal to the availability resources.

What optimum population depicts

- ✓ It is the population that can generate the highest living standards at the available resources and the state of technology.
- ✓ It is the population size that can lead to the most efficient use of resources while maximizing output per capita.
- ✓ Population below optimum level implies that resources are under-utilized and standards of living are low.
- ✓ An increase in population beyond optimum population level leads to overutilization of resources and hence standard of living.

3.) Under population

This is a situation where available resources in a country are greater than the size of population in the country.

Factors leading to under population

a.) An increase in Death Rate

Natural Catastrophes such as earthquakes, flood etc. will lead to an increase in death rate therefore the country witnesses a reduction of population

b.) A fall in Birth Rate:

When a country decides to reduce the number of children for fear of eventual overpopulation or any socio-political factor which does not favor children, the country becomes under populated

c.) High Level of Emigration

A persistent increase in emigration over immigration will leads to a reduction in a country

d.) Low birth rates

If the birth rate is low, the total population may remain small to the extent that it does not get to the optimum.

Positive effects of under population

a.) No Congestion:

A country with less population experiences little or no congestion

b.) Employment Opportunities:

As a result of small size of the population, there will be enough job opportunity for the people

c.) Increased in Social and Infrastructural Facilities:

An under Populated Country experiences a higher per capita in terms of social and infrastructural facilities available to the people in the country.

d.) Availability of Idle Resources:

The fact that a country is less populated means that the resource available in that country is higher than the number of people; hence, many idle resources would abound everywhere.

Negative Effects of under population

a.) Lower Standard of Living:

Under Population engender lower standard of living as a result of inadequate labor force that would have conveniently boost output and production of goods and services.

b.) Lack of Adequate Manpower:

Under population results to shortage of labor with that attendant effect of low investments and income

c.) Underutilization of Resources:

Resources are highly underutilized in a country with low population

d.) Lack of People to Defend the Country:

At times of war and emergency, a country might find it difficult to mobilize enough people to defend it.

e.) Equilibrium at Less than Full Employment:

Under population leads to reaching of equilibrium at less than full employment as a result of idle resources.

4.) Over population

Occurs when a country's population is large compared to its resources such that the resources are overstretched.

Advantages of over population

a.) Widening Market

Large population provides a wide market for goods and services.

b.) Better utilization of resources

Large population creates increased demand for goods and services and in an attempt to meet the increased demand, there is better utilization of the available resources.

c.) Creates a pool of labour

A pool of labour force is created where producers can satisfy their labour force needs.

d.) Stimulates investments

Due to large population, entrepreneurs may expand their business to meet the growing demand for goods and services due to over population while at the same time new investments are made.

e.) Promotes labour mobility

Overpopulation increases labour mobility as jobless people tend to move from one area to another in search of employment.

Disadvantages of overpopulation

a.) Strain on the available social amenities

Excess demand of the available social amenities such school and health facilities may put pressure on the them resulting to poor services delivery.

b.) Low standard of living

As the population increases while income remain constant, the income per head reduces. Reduced income reduces individual's ability to acquire basic needs such as food and health care.

c.) Encourages rural to urban migration

Many people move from rural to urban areas where they think they can get employment. As a result the urban areas get more people than the available jobs.

d.) High dependency level

In overpopulation areas, there are many people who are not employed. Such people tend to depend on the employed ones for their upkeep and this may strain those who are employed

e.) Imbalance in demand and supply

Overpopulation creates excess demand in population to the supply of goods and services, where the supply of goods and services is not able to keep pace with the increase in demand for them, prices may keep on increasing.

f.) Food shortage

Overpopulation may result in shortage of foods due to increased population in which the amount of food is not enough to feed the whole population.

g.) Increased crime rates

When many people are unemployed because of overpopulation it may make it hard to acquire even the basic necessities and they may engaged in crimes such as stealing to survive.

h.) Environmental degradation

Overpopulation may cause over exploitation of natural resources leading to environmental degradation.

5.) Young population

This a population where there are more young people than old people.

Causes of young population

- ✓ High birth rate and low infant mortality rate.
- ✓ Low life expectancy.
- ✓ High mortality rate be among aging adult.

Problems associated with young population

a.) High dependency ratio

There is high dependency ratio on working population as it may be forced to cater for a large number of young population who are unemployment.

b.) High rate of unemployment

The demand for jobs by many young people entering the labour market is higher than the available jobs creating unemployment.

c.) Increased social evils/crimes

Young population may have a large number of youth idle. They may engage in cries in order to survive.

d.) Low labour supply

Young population may experience low labour supply as many of the youths may have not attained the working age

e.) Pressure on goods and services

Increased demand for goods and services required by the youths may put pressure on them as the demand overtake supply.

f.) Reduced savings and investments

Due to high rate of consumptions by the young people savings is reduced and in turn results in low investments.

g.) Diversion of government expenditure

The government may be forced to divert its expenditure from other needy sectors as it caters for the welfare of the youth.

6.) Ageing population

This is a population with higher proportion of older people. These people are above 65 years old.

Problems associated with ageing population

- ✓ Old people tend to provide a less mobile labour force.
- ✓ Low labour supply is likely as old people tend to be less productive.
- ✓ High dependence of old people on working populations.
- ✓ Society becomes less progressive as it lacks the input of the energetic youth.
- ✓ May led to unemployment due to fall in demand for goods and services required by the youth.

7.) Declining population

This is a population that has been reducing over time.

Effects of declining population

a.) Reduces government expenditure

The government may spend less in provision of resources such as infrastructure and social services making them to improve on the quality of their services to the citizens.

b.) Attainment of optimum population

Declining population may enable a country that has been overpopulated to attain optimum population.

c.) Proper utilization of land and other resources

For a country that is overpopulated, declining population may reduce pressure created on land and other resources and this may lead to improved productivity while declining population may lead to underutilization land and other resources.

d.) Discouraging investments

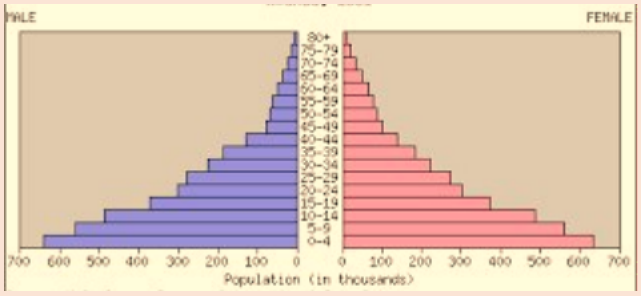
As the population declines, the market for goods and services also declines. This may force the existing business to close down while new investors may be scared away.

e.) Reducing dependency of the unemployed on the employed

For over populated country, decline in population may reduce the dependency of the unemployed because they will now get employment due to reduced population.

8.) Population structure

This is the composition of population according to age, sex, income distribution and levels of literacy. Below is a hypothetical population structure of a country that assumes equal number of male and female.



Implication of Population size and structure on Development

The population structure may have both negative and positive implications.

Positive implications

a.) Increase in market demand

When population increases a wide market for goods and services is created depending on the structure of the population.

b.) Enough labour supply

Rapid population growth leads to increased labour supply which would in turn lead to payment of low wages.

c.) Technological advancement

Competition and pressure of resources may lead to increased labour supply which would lead to higher efficiency and also insipire people to look for new methods of improving productivity.

d.) Diverse talents

In a rapid growing population the number of talents are likely to be many.

Negative implications of a rapid population growth.

a.) Decrease in per capita income

When the growing population depends on a fixed factor of production, output may increase up to a certain point and beyond this point, output per head which also determines per capita income declines.

b.) Increased dependency ratio

In a rapid growing population most the people depend on the available work force for survival.

c.) Reduction in savings and investments

In a large population most of the earnings is spend leaving nothing or very little to save. This will in turn lead to low investment.

d.) Unemployment

The number of people in the labour force exceeds the number of jobs available leading to unemployment.

e.) Strain on social amenities

Due to overpopulation, the government may find it difficult to provide adequate essential social services such as health, education and housing.

f.) Uneven distribution of income

In over populated countries there are very few rich people and very many poor people leading to unequal distribution of income.

g.) Environmental degradation

Over population usually leads to over exploitation of the natural resources leading to environmental degradation

Employment and unemployment.

Employment

The term refers to engagement in any type of income generating activity.

Unemployment

The term refers to inability of people who are capable and willing to work to get meaningful employment opportunities

Types of unemployment

Cyclical unemployment – occurs due to relatively low general demand for goods and services.

Structural unemployment_– caused by changes in production methods, change in technology and changes in demand for goods and services.

Frictional unemployment – occurs when people are unable to secure jobs due to barriers which hinder them from getting jobs such as ignorance. Or when people lose jobs and go looking for new ones

Seasonal unemployment – occurs due to relatively low demand for labour at certain times of the year.

Involuntary unemployment/open unemployment - results from lack of jobs. For example people willing to work at the prevailing wages but work is not available

Real wage/Voluntary unemployment – occurs when job seekers are not willing take up jobs at the prevailing wage rates

Disguised/Hidden unemployment – Occurs when the number of people employed exceeds the number which is required for the job.

Residual unemployment – Affects people who are physically & mentally challenged.

Erratic /Casual unemployment - Affects certain sectors of the economy like construction where demands for labour is erratic and not regular.

Causes of unemployment

a.) Poor education system

The education structure used in developing countries is not beneficial to the students as it does not directly correspond to the prevailing economic activities outside the school system. Rather than providing useful skills to students and molding professionals, theory is what is being taught instead of practical. This mismatch between the school levers and jobs requirements creates unemployment'

b.) Bad leadership

Lack of employment in developing countries is also linked to the bad leadership and corrupt attitude of individuals in power. Moreover, there is a lot of money embezzlement and power retention exhibited by policy makers in the education sector in Africa. This means funds required for improvement of education are diverted for selfish personal use. Hence, the education sector remains largely undeveloped.

c.) Rural to urban migration

When people move from rural areas to urban areas in search of employment, they put tremendous pressure on the available resource and expanding work force that cannot be absorbed.

d.) Rapid population growth

If the population is growing at a faster rate than the economy is expanding, it leads to more workforce entering a labour market which causes unemployment.

e.) Lack of product market

If the demand for goods and services is less due to low income producers will be discouraged to produce more leading to unemployment.

f.) Seasonality in production

Seasonal variations cause unemployment such that during the peak season, employment is high and during off peak seasons employment is low.

g.) Use of inappropriate technology

If a country uses labour intensive methods of production it will limit the growth of employment opportunities.

Methods to solve unemployment

a.) Population control

Advocating for reduction in the population growth rates in the country through various ways such as family planning.

b.) Adaption of appropriate education systems

Introducing the appropriate forms of education and training people for the jobs that are available.

c.) Use of labour intensive methods

Use of labour intensive techniques in government institutions and projects.

d.) Proper planning

By proper planning and management of natural resources and fighting corruption so that resources can be used well to create jobs.

e.) Entrepreneur culture

Through encouraging the entrepreneurship culture in the country by providing a conducive environment for investment.

f.) Delocalization of firms/Rural development

Delocalization of firms by the government to create jobs in rural areas hence reducing rural to urban migration of people in search of employment.

g.) Encouraging direct foreign investments.

Encouraging foreign investment enough various policies such as tax holidays and enabling repatriation of profits from the businesses of foreigners.

h.) Increase government spending or expenditure.

Expenditure on infrastructure such as roads railways and electricity supply creates jobs and releases money in circulation creating demand for goods and services.

i.) Encouraging the use of local resources

Government can increase its expenditure on projects that will create more jobs opportunities.

j.) Encouraging the use of local resources

Government can encourage investment on economic activities that use locally available raw materials or inputs which will intern create more jobs opportunities.

k.) Encouraging the use of local resources

Government can encourage investment on economic activities that use locally available raw materials or inputs which will in turn create employment for those involved in provision.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

1. Explain the following terms as used in business

   i) Census

   ii) Unemployment

   iii) Mortality...

   iv) Optimum population.

2. Highlight **four** negative implications of a rapid population growth in developing countries
3. State **five** causes of unemployment in Kenya
4. Highlight **four** challenges passed to a country by a rapidly growing population

5. The table below shows a change in population size in country X for a period of four years

Year	Total population (000 000)
2001	40
2002	26
2003	13
2004	9

6. Give **four** reasons to account for this trend

7. Give **four** advantages of high population growth rate

CHAPTER TWENTY ONE

MONEY AND BANKING

Specific Objectives

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

a) Explain the meaning and limitations of barter trade;

b) Explain the meaning and characteristics of money;

c) Explain the functions of money;

d) Discuss demand for and supply of money;

e) Explain the meaning of banking;

f) Describe the development of banking;

g) Explain the functions of commercial banks;

h) Explain the main types of accounts offered by commercial banks;

i) explain the functions of non-bank financial institutions;

j) Distinguish between commercial banks and non-bank financial institutions;

k) Discuss the role of a Central Bank in an economy;

1) Discuss trends in banking.

Content

a.) Meaning of barter trade

b.) Meaning and characteristics of money

c.) Functions of money

d.) Demand for and supply of money

e.) Meaning of banking

f.) Development of banking

g.) Functions of commercial banks

h.) Types of accounts offered by commercial banks

i.) Functions of non-bank financial institutions

j.) The role of the Central Bank in an economy

k.) Trends in banking

Introduction

Money is anything that is generally accepted as a medium of exchange for goods and services.

Banking refers to all the activities carried out by financial institutions involving money

Financial institutions includes

- Central bank
- Commercial banks
- Non-financial institutions

Barter trade

Exchange of goods and services for other goods and services

Merits/Advantages /Benefits of barter trade.

Buyer and sellers are able to get the goods and services they require immediately.

a.) A country or person is able to dispose of the surplus

b.) Promote social relations among the trading communities

c.) Promote specialization in production of goods and services.

d.) Promotes the standard of living of people involved in it.

Limitations/draw backs of Barter trade

a.) Lacks standard measure of value.

It is very difficult to determine how much of a commodity can be exchanged for another

b.) Perish ability of commodities

Some commodities cannot be stored for a long period to be used in future for exchange purposes

c.) Requires double coincidence of wants

There must be somebody who wants exactly what you have for you want he has for barter trade to take place.

d.) Indivisibility of commodities

Some commodities cannot be divided into smaller units without loss of value.

e.) Inconvenience in Transporting some Goods

Heavy and bulky goods are difficult to carry as you look for a trading partner.

f.) Lacks units of Account

Where barter trade is used, it is difficult to calculate and hence keep a record of the values of different commodities.

Money system

Characteristics of Money

a.) Acceptability

It must be accepted by everyone to be used as a medium of exchange

b.) Divisibility

It should be divided into smaller units without loss of value.

c.) Portability

Should be light and not bulky to carry around

d.) Durability

It should be able to last for long without getting defaced torn or losing its shape and texture

e.) Stability

Money should be able to last for a long time without changing in value so that it maintains credibility and acceptability.

f.) Homogeneity

Money of the same denomination should be uniform in quality and therefore identical.

g.) Scarcity

Money should be relatively scarce in supply. If it's abundant in supply then it would loss value

Functions of money

a.) Medium of exchange

Money is generally accepted by everybody in exchange for goods and services

b.) Measure of value

Money provides a common denominator in which the value of various goods and services are expressed

c.) Unit of account

The values of different commodities are calculated and records kept in terms of money

d.) Store of value

Money is the most convenient means of storing wealth.This is because money is easily convertible into other forms of assets

e.) Standard Deferred payments

A debt incurred today can be paid later using money .This is because money is acceptable by everyone at all times.

Demand for Money /liquidity preference

It refers to the tendency of an individual or general public to hold onto money instead of speeding it.

a.) The transaction motive

This is a situation where one holds money with a motive of meeting daily expenses such as buying food, paying for transport costs and entertainment. It is divided into two: Business motive and income motive

b.) The precautionary Motive

This is where people tend to hold money to meet expenses that might occur unexpectedly such as sickness accidents.

c.) The speculative Motive

Money can held to be used in the future especially when people anticipate that the prices of goods and services will be lower than they are presently.

Supply of Money

Supply of money therefore refers to the stock of monetary items that are in circulation in an economy at a particular time. It includes Total currency and Total demand deposits

Banking

The banking system of Kenya consists of four elements

a.) Central bank at the top

b.) Commercial banks follows

c.) Specialized development banks is next

d.) The fourth category are non-bank financial institutions

Commercial banks

Formed with the main aim of making profit through financial intermediation. There profits are usually generated through

a.) Interests earned on loans and overdrafts extended to customers

b.) Investments in medium term government securities

c.) Income from operations

Services Offered by Commercial Banks

a.) Accepting deposits

Commercial banks play an important role in the economy by mobilizing domestic savings and enabling efficiency and convenience in transactions by accepting deposits

It has three main accounts

Current accounts

Money is withdraw able on demand by means of cheque.

Characteristics

- A cheque is used to withdraw money from the account
- Money is withdraw able on demand
- No minimum balance is required to be maintained
- Does not earn interest but instead the bank charges ledger fees for services rendered
- Have overdrafts that is bank allows customers to withdraw more money than they have in their current accounts.

Savings account

Characteristics

- Balance on the account above a certain minimum earn interest
- Funds are not withdrawn by use of cheques
- Overdrafts not allowed
- Most cases one is required to maintain a certain amount in the account
- Withdrawable of money exceeding certain maximum amount may require a notice to be given by the customer.
- Ordinarily withdrawals can only be made by the account holders themselves.

Time deposits

They are called fixed deposit account because they do not allow withdrawal or addition of money before the end of a fixed pre-determined period.

Characteristics

- Earns interests at an agreed rate
- There is minimum account that can be allowed for this type of account
- On expiry of the deposits period the account holder can withdraw all the money together with interests.
- If money is withdrawn before the agreed period the customer losses accrued interest, but can be charged for breach of contract

b.) Lending money

They may lend money to individuals, private businesses, the government and other public authorities in form of loans and overdrafts

c.) Safekeeping of valuable items

They accept valuable items such as title deeds, share certificates, jewellery and wills for safe keeping for their customers.

d.) Provision of foreign Exchange

A person with foreign currency can convert it into local currency at the prevailing exchange rates

e.) Giving Advice on investments and Management of Funds

Commercial banks can give advice to their clients on available investment opportunities and the best ways of managing their funds.

f.) Acting as a Guarantor or Referee

Commercial banks may act as guarantors to customers who would want to either get goods on credit from new supplies or secure loans from a financial institution.

g.) Acting as intermediaries Between savers and borrowers

By accepting money from people who have excess to save and give loans to investors, commercial banks act as intermediaries between the two parties.

h.) Money transfer Facilities

Commercial banks provide convenient methods of transferring money through facilities such as;

- Standing order

Instruction to the bank by the customer to be paying a certain amount of money to a named person or institution after a given interval until a specified date.

- Credit transfers

A method of paying many people using one cheque. Its main advantages are saving time, stationary and bank handling costs

- Telegraphic transfers

Method of remitting money offered by commercial banks to anybody who wants to send money to another,

It must have the following information:

i.) Name of the person

ii.) Name of payee

iii.) The amount of money being remitted

iv.) The bank where the money would be paid

- Cheque

A cheque is a written order by the drawer to a bank to pay on demand a specified amount of money to the person named as the payee or to the bearer.

Non- banking financial Institutions (NBFI)

They address themselves to the financial needs of particular sectors of the economy which commercial banks have not been able to cater for adequately.

Examples

a.) Development Finance Institutions (DFI)

Provide medium and long term finances especially to the manufacturing sector. They include:

- Kenya Industrial Estate KIE
- Development Finance Company of Kenya DFCCK\
- Industrial Development Bank IDB
- Small Enterprise Finance Company SEFC

b.) Housing Finance Companies

They are mainly involved in financing housing activities.

Examples

- Houses Finance Company of Kenya HFCK
- East Africa Building Society EABS

c.) Savings and credit co-operation Societies (SACCOS)

These are co-operative societies formed to mainly enable the members save and also obtain loans

most conveniently and at a favorable conditions.

d.) Insurance companies

These companies provides finance to commercial organizations as well as to individuals.

Difference between commercial banks and Non-banking Financial Institutions.

i.) Commercial banks provides current account facilities to their customers while NBFIs do not.

ii.) Commercial banks normally provide short –term and medium –term finance while NBFIs provide medium and long term finance

iii.) Commercial banks provides finance that is not restricted to any particular activity while NBFIs provide finance for specified purpose.

iv.) Commercial banks can provide foreign exchange transactions to their customers while NBFIs do not.

v.) Commercial banks provide finance mainly for working capital while NBFIs provides finance for capital development

vi.) Commercial banks do not participate in capital market trade while NBFIs can participate

vii.) Commercial banks participate in clearing houses while non-bank institutions do not.

The central bank

An institution that control and manage the supply of and demand for money in a particular country.

The objective of monetary control by the central bank

a.) Facilitate rapid and steady economic growth

b.) Create employment

c.) Stabilize prices of commodities

d.) Ensure balance development

e.) Enhance equilibrium in the balance of payment

Function of central bank

a.) Issue of currency

The responsibility of issuing new currency that is notes and coins is solely in the hands of the central bank

b.) Acts as a bank banker

The central bank acts as a banker to commercial banks and other financial institutions in that it

accepts deposits from these organizations. It also acts as a lender of last resort

c.) Acts as the government bank

The government operates its account with the central bank. The central bank is also the government financial adviser

d.) Controlling commercial Banks

The central bank controls commercial banks and other financial institutions by giving instructions to them on lending procedures and proper banking practices.

e.) Acts as a link bank to external financial institutions

The central bank acts as a link to central bank and monetary authorities of the other countries thereby facilitating international financial relationships.

f.) Maintaining stability in Exchange Rates

The central bank is responsible for maintaining a suitable exchange rate between the local currency and foreign currencies.it does this through setting off specific foreign exchange rates or intervening in the foreign exchange market through revaluation or devaluation of domestic currency.

g.) Administering Public Debt

Public debt is the amount money the government has borrowed both internally and externally that is outstanding. The central bank is responsible for management and repayment of the debt when it matures.

h.) Lender of last resort

The central bank plays the role of lender of last resort to the commercial bank. This means that commercial banks can obtain loans to meet their day to day financial obligations.

i.) Control of Monetary system

The central bank is responsible for controlling the monetary system in order to regulate the economy.

Ways in which the central bank regulate money in the economy

a.) Bank rates.

This is the rate at which the central bank lends to commercial banks. It can be varied to encourage or discourage credit/ raising/ lowering bank rate

b.) Open market operation

The central bank may sell or buy securities in the market. Selling securities reduces the money supply

(For lending)

c.) Special deposits/ compulsory deposits/ minimum reserve requirements

The central bank require other financial institutions to have a certain percentage of deposits deposited in the central bank which can be varied to encourage / discourage credits

d.) Cash ratio/ liquidity ratio

The ration of cash/ deposits may be carried to control money supply credit which can be increased to reduce money supply/ can be decreased to increase money supply.

e.) Moral persuasion/ Liquid assets persuasion

The central bank may appeal/ request/ persuade/ restrain leading/ credit rationing. The commercial banks may be required by the central bank to approve loans only for special types of projects e.g. agriculture, manufacturing etc.

f.) Direct action/ directive/ instructions

Central banks can use its authority to direct/instruct the financial Institutions to lend more/ less/ apply credits squeeze/ credit expansions margins requirements.

Trends in banking

a.) Use of computers

b.) Automated Teller Machine (A.T.M)

c.) Credit facilities are now easier to get due to competition

d.) Mobile banks to give access to people who are in remote areas

e.) Customer care services being set up by banks

f.) M-banking to allow an account holder to access his or her bank account anywhere any time

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. State how a credit transfer is used as a means of transferring money through the commercial banks (3 mks)
2. Highlight four advantages of using a telegraphic money order as a means of remitting money though the post office. (4 mks)
3. state four limitations of barter trade (4 mks)
4. In the spaces provide below indicate with a tick whether each of the following statements is true or false about commercial banks (5 marks)

	True	False
- Accept deposits from the members of the public		
- Provides safe custody for the valuables		
- Issues currency for the use in the country		
- Controls money supply in the country		
- Lends more to the public		

5. List four characteristics of money (4 mks)
6. State four methods that central bank may use to control credit (4 mks)
7. List four functions of development (4 mks)
8. highlight four reasons why loans advanced by commercial bank in Kenya may not appeal to many people (4 mks)
9. Give four disadvantages of barter trade (4 mks)
10. State four banking services that the central bank of Kenya provides to the government (4 mks)

11. Wambua intends to import a car from Dubai which costs Kshs. 20, 0000 Dirams. If 4 Dirams = 1 Us Dollar and Kshs 70 = 1 Dollar, calculate the amount in Kenya shillings that Wambua will pay for the car.
12. Highlight 4 functions of the Central Bank of Kenya
13. Given below is the first stage in the historical development of money list the next four stages in their order of occurrence (4 mks)

PAPER 2

1. Explain five in which banks contribute to the development of Kenya (10 mks)
2. Outline five reasons why banks currently account is popular with traders(10 mks)
3. Explain service offered to commercial banks by the central bank of Kenya(10 mks)
4. In what ways of the functions of commercial bank differ with those of non- bank

Financial institutions (10 mks)

5. Explain five ways in which central bank of Kenya may control the supply of money in

The country (10 mks)

6. Describe methods which may be used by commercial banks to advance money to

Customers.

7. 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 (10 mks)

8. Explain five services that the central bank of Kenya offers to commercial banks (10 mks)
9. Explain four disadvantages of using a bank overdraft as a source of finances (8 mks)
10. Describe four ways in which a non- bank financial institutions differ from the commercial banks (8 mks)
11. Discuss five reasons why business people prefer to operate bank current accounts
12. Outline the benefits that bank customer gets from operating a current account (10 mks)
13. Explain the 5 services offered by a commercial banks to their customers(10 mks)

CHAPTER TWENTY TWO

PUBLIC FINANCE

Specific Objectives

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

a) Explain the meaning and purpose of public finance;

b) Describe the various sources of public finance;

c) Categorize government expenditure;

d) Explain the principles of government expenditure;

e) Explain the meaning and purpose of taxation;

f) Explain the principles of taxation;

g) Classify taxes;

h) Explain the merits and demerits of each type of tax;

Content

a.) Meaning and purpose of public finance

b.) Sources of public finance

c.) Categories of Government expenditure

d.) Principles of Government expenditure

e.) Meaning and purpose of taxation

f.) Principles of taxation

g.) Classification of taxes

h.) Merits and demerits of each type of tax

Introduction

These refers to the activities carried out by the government associated with raising revenue.

Sources of finance

i.) Fines imposed by courts on offenders

ii.) Rent and rates paid for the use of government properties

iii.) License fees paid by those who want to operate businesses

iv.) Dividends and profits earned from government direct investments

v.) Investments earned on loans advanced by government to firms

vi.) Taxes

vii.) Government borrowing

viii.) Proceeds from sale of government property

ix.) Government Borrowing

Government borrowing

a.) Internal borrowing

Borrowing by government from firms and individuals within the country.

b.) External borrowing

Government borrows money externally through bilateral or multilateral basis.

Factors to consider before the government can decide whether to borrow internally or externally

- Conditions laid by external financiers
- The crowding out effect
- The relative cost of internal borrowing as compared to external borrowing.

Government expenditure

Spending by the government on the finances it has raised

Categories of Government Expenditure

Recurrent Expenditure

Government expenditure that takes place on regular basis e.g payments of salaries to civil servants, provision of drugs in public hospitals and fuelling of government vehicles

Development Expenditure

This refers to government spending that goes into financing specific projects such as construction of railway lines, roads airports industries and administration offices

Principles of public Expenditures

These are the considerations made by government before any expenditure is incurred

a.) Sanctions

Public expenditure must be sanctioned or approved by relevant authority before it is incurred

b.) Maximum social Benefits

Majority of people should be able to reap maximum benefit out of it

c.) Flexibility

The policy on public expenditure should be flexible enough to meet the prevailing economic situations

d.) Economy

Public expenditure must be incurred in the most economical way by avoiding any possible waste

e.) Proper Financial Management

Public finance should be well managed by proper accounting records which should also be audited as required

Tax

Tax is a compulsory payments by either individuals or organizations to the government

Taxation

This refers to the process through which the government raises its revenue by collecting taxes

Reasons for taxation

a.) Raising revenue

Government raises revenue which is used in providing goods and services

b.) Discouraging consumption

Discouraging consumption of certain products such as beer or cigarettes

c.) Discouraging importation

Discouraging importation of certain products in order to protect local industries such as high tax on imported products

d.) Reducing inequality in income distribution

This is done by taxing the rich and using the money on development projects that benefits the poor

e.) Controlling inflation

Taxation reduces money supply through reduction of people's disposal income thereby controlling inflation

f.) Helping locates businesses

High tax on businesses located on urban areas would make entrepreneurs locate their business in rural areas where tax is less

g.) Correcting balance of payments

High tax on imported products would discourage importation, thereby increasing the balance of payments

The amount of revenue to collected through taxation depends on

- Distribution of incomes
- Social and political factors
- Honesty and efficiency of tax authorities
- Citizens level of real incomes
- Economic structure of the country

Principle of taxation

These are characteristics or cannons of a good taxation system

a.) Equitable

A good tax system should ensure that there is fairness in payments of taxes i.e tax burden should be distributed to the community as equitable as possible.

b.) Certain

The tax that an individual is supposed to pay should be clear in terms of the amount, time and manner in which it should be paid.

c.) Convenient

Tax should be levied at a time when the payee has money and it should be paid in a way that is most convenient to the payees

d.) Economical

The cost of administering tax should be lower than revenue to be collected

e.) Elastic

A good tax system should allow the government to increase revenue as need arises under the current tax system.

f.) Flexible

A good tax system should be capable of changing in accordance with changes in national income. Tax should therefore rise when incomes increases and reduce when income reduces

g.) Diversified

A good tax system should be diversified so that it meets revenue requirements of the country and also be in line with the principle of equity.

Impact and incidence of tax

The burden of tax on initial person is the impact of tax and the final resting place of the tax burden is the incidence of tax.

Classification of taxes

According to structure

Taxes are classified according to the relationship between the amount paid as tax and the income of the tax payers as follows.

a.) Regressive

This is a type of tax which takes a higher proportion of low income earners as compared to high income earners.eg sales tax

b.) Proportional Tax

Tax payers pay a fixed percentage of their income as tax.eg corporate tax

c.) Progressive tax

Amount paid increases proportionately with increase in income.

Disadvantages of progressive tax

- May discourage people from working more as additional income goes to tax
- Investors may be discouraged from taking risks because if the venture is successful than average then the government takes high proportion of the extra profit
- It is based on the assumption that people earning the same amount of income have similar needs and ability to pay tax.

Classification according to impact on the tax.

We get the following taxes;

Direct tax

The impact and the incidence of the tax are on the same person and the person is unable to shift any part of the tax to anybody else. The tax includes the following;

- Personal income tax

Imposed on income earned by individuals. The tax is always progressive in nature as the tax rate increases with increase in income.

- Corporation tax

Levied on profits of companies. The tax paid is always proportional in nature as the tax rate remains the same.

- Stamp duty

Tax paid in areas such as conveyancing of land or securities from one person to another.

- Estate (death)duty

Tax imposed on properties transfers after the owner's death. This helps in generating revenue and also in redistributing income since the inheritor has not worked for it.

- Wealth tax

This tax is levied on personal wealth that goes beyond a certain limit. The main disadvantage is that it may discourage people from accumulating wealth

- Capital transfer/ Gifts tax

This is tax imposed on the value of property transferred from one person to another as gifts.

Merits of Direct tax

a.) Economical in collection

Direct taxes are mostly collected at the source and the cost of collecting them is fairly low.

b.) Tax revenue is certain

Yields from direct tax such as income tax is fairly certain and maybe calculated accurately in advance

c.) Equitable

Direct tax ensures that there is fairness in contribution of tax. This because contributors pay according's to the size of their income

d.) Does not affect the price of goods and services

It affects consumer's disposable income and not the price of goods and services.

e.) Brings redistribution of wealth

The wealthier members of the society are taxed more than the poorer in the case of progressive tax systems. Finance obtained from the wealthier members are used to finance services that benefits the poor.

d.) Simple to understand

Direct tax is both simple and easier to understand by both the contributors and the tax collector.

e.) Desirable

The tax is desirable as it only affects people who fall within the jurisdiction of income tax and corporation tax.

f.) Flexible

The tax is flexible in that it can be expanded to cover as many areas as desirable

g.) Elastic

The tax is elastic in that it may be raised or reduced according to the needs of the economy.

Demerits of Direct tax

a.) Possible tax evasion

It can easily be evaded by tax payers by either ignoring the payments or falsifying their income information

b.) Deterrent to savings

High taxation on people would reduce their ability to save as it leaves them with less disposable income.

c.) Deterrent to work

High tax on personal income may discourage people from working harder. This is because the extra amount of money would be taxed more.

d.) Deterrent to investment

Heavy tax on profits may discourage entrepreneurs from investing in highly risky but profitable areas this is because such profits are highly eroded by tax

e.) Inconvenient

Taxation inconveniences the tax-payer who has to comply with complicated formalities relating to sources of income as well as expenses incurred while generating it. This complication may force the tax payer to engage services of tax experts who has to be paid.

f.) Not imposed on all citizens.

The tax is not imposed on all citizens as low income earners who do not fall within the tax brackets are exempted.

Indirect tax.

In this type of tax the person on whom it is initially imposed may not shoulder the whole tax burden but may shift either the whole or part of it to someone else. The impact and the incidence of tax maybe on different individuals.

This tax is based on consumption of goods and services that involves the following:

Sales tax

Sales tax is based on the sales made by the seller, it may be assessed on either as a percentage such as20% of the sales or fixed amount

Value added tax (VAT)

The tax levied on the value that a business adds to a product.

Export duty

A type of tax that is levied on exports the purpose being to discourage exportation of certain commodity or to raise revenue.

Import duty

Import duty is a tax that is charged on goods entering into a country. The purpose may include:

- ✓ Raising revenue for the government.
- ✓ Reducing incidences of dumping
- ✓ Discouraging consumption of imported goods

Merits of indirect tax

a.) Can be used selectively

It can be used selectively to achieve a specific objective for example if the government want to discourage consumption of beer it imposes a high tax on it.

b.) Tax payment is voluntary

It is only paid by those who consume the taxed commodity. If one does not want to pay the tax he or she would only need to avoid the consumption of taxed commodity.

c.) Not possible to evade

It is not possible to evade because all those who buy the taxed commodity have to pay the tax.

d.) Stimulate effort

Increase in indirect tax is likely to stimulate efforts as people struggles to maintain their current standards of living

e.) More revenue can be raised(broad based)

Indirect tax is likely to yield more revenue. This is because all people are likely to consume the taxed commodities thereby making the tax have a broader base.

f.) Convenient

Indirect tax is convenient because it is not paid in lump sum but in small bits as one buys the commodity. The tax is also hidden in the price of commodity and therefore the payer may not be aware of it.

g.) Elastic.

The tax is flexible which enables the government to either raise or reduce the tax rate to suite the prevailing economic situations in the country.

Demerits of indirect tax.

a.) May fuel inflation

Continued increase in indirect tax may fuel inflation as it directly increases prices of goods and services.

b.) Less equitable

The burden of indirect tax falls heavily on consumers with low income compared to those with high income with high income. This is because all consumers pay the same amount of tax per unit consumed irrespective of the levels of their incomes.

c.) Can be avoided

Indirect tax can be avoided by people who do not consume the taxed commodity.

d.) Might interfere with resource allocation

Indirect tax increases the price of the taxed commodities relative to others. This might discourage consumers from buying them shifting consumption and production resource towards commodities that are not being taxed.

e.) Uncertainty in revenue yield

One cannot predict the amount of revenue yield in indirect tax due to difficulty in forcasing sales as they may be affected by other factors.

f.) Lack of contributor's awareness.

Many of the contributors of indirect tax are not aware that they are contribution anything to the state inform of tax.

Budget.

A budget is a statement of estimates or proposals of the way the government plans to raise finances and how such finances are to be spent in a given financial year.

Types of budgets

I.) Balanced budget

A balanced budget is where budgeted expenditure is equal to budgeted revenue

II.) Deficit budget

A budget having a deficit is where budgeted revenue is less than budgeted expenditure

III.) Surplus budget

A budget having a surplus is where budgeted revenue is less than budgeted expenditure

The raising of government revenue and the expenditure of the revenue raised in order to achieve the desired objectives is referred to as the fiscal policy.

Budget as a tool for planning

The government uses the budget to achieve the following;

- ✓ Checking inflation by collecting more revenue and spending less.
- ✓ Stimulating economic growth by collecting less revenue and spending more
- ✓ The budget may point out specific objectives expected of a particular sectors of the economy
- ✓ Spelling out the measures that the government, intends to take in order to achieve the said objects.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

Paper 1

1. Highlight five reasons why budgeting is important to a business organization (10 mks)
2. Discuss the reasons why a business organization may prepare a budget (10 mks)
3. Discuss the various classes of taxes (10 mks)
4. Outline the disadvantages of direct taxes (10 mks)
5. Explain any 5 principles of public expenditures (10 mks)
6. Discuss the importance of a budget as a toll of control (10 mks)
7. Highlight any five features that a government should consider when deciding on a good tax system (10 mks)

Paper 2

1. Discuss five principles of taxation
2. Outline five sources of non- tax public revenue

3. Explain five principles of public expenditure
4. Highlight five reasons for imposition of tax by the government
5. Discuss five characteristics of a good tax system
6. Outline five reasons why the Kenya government must impose tax.

CHAPTER TWENTY THREE

INFLATION

Specific Objectives

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

a) Explain the meaning of inflation;

b) Determine consumer price index;

c) Explain the various types of inflation;

d) Discuss the causes of each type of inflation;

e) Explain the levels of inflation in an economy;

f) Assess the effects of inflation in an economy;

g) Discuss the methods of controlling inflation.

Content

a.) Meaning of inflation
b.) Consumer price index
c.) Types of inflation
d.) Causes of inflation
e.) Levels of inflation
f.) Effects of inflation in an economy
g.) Controlling inflation

Inflation

This is a situation where the general prices of goods and services in a particular country or region are rising. The opposite of inflation is deflation which refers to a situation where the general prices of goods and services to fall.

Inflation is measured using a consumer price index.

Consumer price index (C.P.I)

Consumer price index measures and allows comparison of prices of goods and services for two different periods.

It also measures the changes in the purchasing power of the consumers in the said periods.

Factors to consider when constructing the consumer price index

a.) Selection of commodities

Commodities selected are those that are generally consumed by average consumers. This is because these commodities are more representative of the state of the economy

b.) Selection of the base year

The year selected for the base year should be a year when the prices were fairly stable.

c.) Determination of Average prices

In computing price index, the average of relative prices of the commodities need to be computed. Simple average may be calculated by adding the indices for all the commodities and then dividing y the number of the commodities. The index for each commodity is calculated by diving the current year's price with the base year's price and multiplying by 100.

Thus, index of current year $= \frac{p_1}{p_0} \times 100$

Where; p_1 = price in the current year

p_0 = price in the base year

Example

commodities	Price per unit base year (21 – 0)	Index of base year	Price in current year (21 – 4)	Index in current year
	sh		sh	
Bread	16	100	20	125
Sugar	40	100	60	150
Salt	10	100	12	120
Rice	20	100	40	200
Maize	48	100	60	125
		500 Average = $\frac{500}{5}$ = 100		average = $\frac{720}{5}$ =144

Comparison of the consumer price index of the year 21 – 0 and that of the year 21-4 indicates that the purchasing power of sh.144 in the year 21-4 is the same as the purchasing power of sh.100 in the year 21- 0.

This means that the standard of living went down by 44% between the year 21 – 0 and year 21-4.

Types of inflation

a.) Moderate/creeping/mild inflation

The general prices of commodities increases slowly. The percentage increase is usually less than 10.

b.) Galloping inflation/rapid inflation

The general price levels increases rapididy.The percentage rate of increase is in terms of tens or hundreds.

c.) Hyper- inflation/runaway inflation

The rise in price levels are extremely high. In this situation the inflation rates can be in thousands or even in millions per cent per annum

Courses of inflation

Demand pull inflation

This type of inflation is caused by excessive demand for goods and services leading to increase of prices.

a.) Increase in government expenditure

When the government spend more money it had borrowed from central bank or printed it increases the supply of money in the economy leading to increase in aggregate demand which may led to upward pressure on the prices of goods and services.

b.) Effects of credit creation

When commercial banks lend more money than the deposit they hold they increases the supply of money which leads to consumers purchasing ability. This increases consumer's ability to purchases more goods and services eventually leading to inflation

c.) Increase in money income

When money income increases, purchasing power will increase and this will have upward pressure on prices as the demand for goods and services increases

d.) General shortages of goods and services

If there is shortage of commodities supplied the demand will be high causing demand pull inflation because the demand pulls the prices of the commodities upwards.

Factors causing shortages of commodities

- ✓ Adverse climatic conditions
- ✓ Hoarding
- ✓ Smuggling

- ✓ Withdrawal of firms from the industry
- ✓ Decline in level of technology

Cost – push inflation

It is caused by an increase in the total production cost of goods and services leading to increase in prices of the commodities.

a.) Rise in wages and salary

An increase in wages and salaries which will be reflected in the increased prices of commodities, which will in turn cause inflation

b.) Increase in taxes

Increase in indirect taxes (e.g. VAT), can increase the cost of production which make firms to increase their prices.

c.) Increase in profit margin

Increase in profit margins by management and shareholders leading to an increase in prices. This is possible where there is no price control.

d.) Increase in cost of inputs other than labor.

Increase in cost of inputs (e.g. raw material) causes the price of finished goods to be high. These inputs can either locally available or imported.

e.) Reduction in subsidies

Reduction in subsidies also lead to an increase in cost of production which will be reflected in an increase in the price of the commodities.

Effects of inflation

The effects can be divided onto;

- ✓ Negative
- ✓ Positive

Negative effects of inflation

a.) Loss of confidence in the monetary system

People lose confidence in local currency as it's difficult to use in transaction when it loses value very fast.

b.) Retardation of economic growth

Hinders implementation of development plans since the cost of projects increases, business people are also not willing to either take risks, invest in new ventures, expand production or hire more workers .This leads to retardation in economic growth.

c.) Reduction in profit

Rise in prices of commodities may lead to reduced sales volume for firms. This in turn may reduce the firm's profits.

d.) Wastage of time

During inflation individuals and firms waste a lot of time hopping around for reasonable prices. The time wasted can be an extra cost to the firm or individual.

e.) Increase in wages and salaries

During inflation firms are always forced by trade unions to raise employees' salaries to cope with inflation. This normally leads to conflict between the parties concerned.

f.) Decline in standards of living

During inflation consumers' purchasing power decreases especially for people who earns fixed income such as pensioners. The reduction in purchasing power bring about a decrease in standards of living.

g.) Loss to creditors

Creditor's loss money when they lend out when the value is high but got paid when the value is less due to inflation.

h.) Discourages savings

Discourages savings/investments since people fear their money will loose value/as they have less disposable incomes.

i.) Adverse effects on the balance of payments.

Leads to balance of payment deficits as imports are highly demanded than exports because the exports are very expensive leading to fall in demand.

j.) Loss of confidence in the monetary system

High levels of inflation may lead to loss of confidence in money both as a medium of exchange and store of value. This may lead to collapse of the momentary system.

Positive effects of inflation

a.) Benefits to Debtors

Debtors will end up paying less in real terms. This is because the debtor end up paying for the old price of the commodity in the future after it would have increased.

b.) Benefit to sellers

Sellers will buy commodities at low prices and sell them later when the prices are high making more profits

c.) Motivation to work

People may be motivated to work harder to cope up with effects of inflation as the prices of the commodities goes up.

d.) Increased job opportunities

Inflation may cause increased job opportunities due to high level of resource use to cope up with inflation.

Controlling inflation

a.) Control of money supply

The government should ensure that increase in money is matched with supply of goods and services. The supply of money can be controlled by monetary policies carried out by the central bank which include:

- ✓ Increasing commercial banks' lending interest
- ✓ Restricting lending capacity by commercial banks
- ✓ Selling of government properties through open market operations
- ✓ Controlling the public sector

b.) Control of the level of demand

Demand pull inflation can be controlled by reducing the level of demand in an economy as a whole. This is achieved by the following fiscal policies:

- ✓ Change in taxation e.g. increase in tax such as income tax would reduce consumer demand for goods and services.
- ✓ Reducing government spending. This will restrict the amount of money in circulation reducing demand for commodities.
- ✓ Restricting terms of hire purchase and credit terms of sale. This will reduce demand for goods and services.

c.) Cost controls

Cost push inflation can be controlled by controlling the factors that contribute to rise in costs. These factors include:

- ✓ Increase in wages and salaries

To curb inflation brought by increase in wages and salaries the government may restrict the increase.

- ✓ Reducing taxes

Taxes such as VAT are believed to be the cause of cost –push inflation, the government can reduce such taxes in order to control inflation.

- ✓ Restricting imports

Where inflation is caused by increase in prices of imports, the importing country can control the inflation by reducing the of such imports.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

Paper 1

1. A country's domestic currency has been depreciating over time highlight five disadvantages of this to the country
2. State **four** negative effect of inflation to a country
3. State any **four** causes of demand-pull inflation
4. State **four** non-monetary methods of controlling inflation in a country
5. Mention **four** desirable effects if inflation
6. Highlight **four** negative effects of inflation in Kenya
7. Highlight **four** negative effects of inflation in Kenya

Paper 2

1. Explain **five** negative effects of inflation to an economy
2. Explain **five** positive inflation effects of inflation to the economy.
3. Explain **five** causes of inflation in an economy
4. Write short notes on the following strains of inflation;
   i) Mild inflation
   ii) Hyper inflation

iii) Demand-pull inflation

iv) Cost push inflation

v) Imported inflation

CHAPTER TWENTY FOUR

ECONOMIC DEVELOPMENT AND PLANNING

Specific Objectives

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

a) Distinguish between economic growth and economic development;

b) Discuss the characteristics of under-development;

c) Explain the goals of development;

d) Discuss the factors which may hinder development;

e) Explain the meaning of development planning;

f) Explain the need for development planning;

g) Discuss problems encountered in development planning.

Content

a.) Economic growth and development

b.) Characteristics of underdevelopment

c.) Goal s of development

d.) Factors which hinder development

e.) Meaning of development planning

f.) Need for development planning

g.) Problems encountered in development planning.

Economic Growth

This is an increase in country's productivity which can be determined by a continued rise in national income over a period of years

Economic development

This is the qualitative change in national income. It is associated with an increase in a fairly distributed national income such that more people are able to lead better lives.

Structural changes which may takes place when a country is experiencing development

- ✓ Shift from agricultural to manufacturing sectors
- ✓ Reduction in illiteracy
- ✓ Increase in skilled non power
- ✓ Improvement in health facilities
- ✓ Increase in technology and improvement in entrepreneurial ability
- ✓ Increase and improvement of institutions that handle new methods of productive economic activities.

Under -development.

Underdevelopment is growth in the negative direction which can be associated with uneven distribution of wealth and also decrease in quality or quantity of factors such as land, labour, capital and technology.

Characteristics of under-development.

a.) High level of poverty

An underdeveloped country is poverty ridden such that majority of its people are living below poverty level and the per capita income especially when compared with those of developed countries is very low.

b.) Disparity in income distribution

Income is not evenly distributed because few rich people owns majority of the country's wealth while many other people are living below poverty line.

c.) Low level of savings and investments

When the per capita income is low it makes people have very little or nothing to save leading to low investments.

d.) High population growth rate

There is always high population growth rate in underdeveloped countries. Population explosion increases the number of people living at or below the poverty line and also increases the dependency ratio.

e.) Dominance of subsistence sector

Traditional subsistence sector tend to dominate the modern industrial sector.

f.) Problem of unemployment

There is always high rate of unemployment in underdeveloped countries because of the high population .The population is always higher than the available jobs in the country,

g.) Underutilization of natural resources

Natural resources in underdeveloped economies, remain under - exploited due to lack of either capital or appropriate technology.

h.) Dependence on the developed countries

Most underdeveloped countries are unable to financially sustain themselves. As a result they keep on relying on the developed countries for financial aid.

i.) Low labour productivity

Labour productivity in underdeveloped countries is extremely low compared with that of developed countries. This due to lack of complimentary factor inputs such as physical capital and skilled management.

Goals of Development

- ✓ Elimination or reduction of poverty
- ✓ Provision of important human basic needs such as food, shelter, health and protection
- ✓ Reduction of disparities in income distribution
- ✓ Provision of opportunities in areas as employment and self-advancement

Factors hindering development

a.) Low Natural Resource Endowment

Inadequacy or absence of significant quantities of natural resources such as raw materials, fertile land, favorable climate and good terrain maybe a barrier to development.

b.) Inadequate capital

If capital is either lacking or not adequate there may be a problem in activities such as exploitation of resources, industrialization and creation of employment opportunities.

c.) Poor technology

Where technology use is low or backward, productivity is also low

d.) Poor human resource Endowment

If there is a shortage of skilled man power it can lead to a barrier in development as the skills to needed for exploitation of the resources is not there

e.) Unfavorable Domestic environment

The quality of social political and economic environment determines the growth of entrepreneurships that in turn determines the rate at which resources are utilized and capital accumulated

Development planning

The policy objectives to be achieved in the long run established by the government include:

- ✓ Eradication of illiteracy in the country
- ✓ Improving its peoples health
- ✓ Raising peoples standard of living
- ✓ Reducing the economy's foreign dominance.

Importance of development planning

a.) Appropriate resource allocation

Planning enables resources to be used efficiently by not being wasted and used for wrong purpose or left idle.

b.) Stimulation of effort

Well laid out development plan may help the government to stimulate the efforts of the people in the desired direction.

c.) Support foreign Aid bargain

A country with a well laid out development plan is better equipped when soliciting for foreign aid as it is able to use the plan in convincing the donors.

d.) Project evaluation

Projects became possible to evaluate at various stages of implementation to assess whether they are in line with the expected outcomes. Where there are deviations they are noted and corrective measures taken before it's too late.

e.) Long term Decision making

A development plan provides a long term view for making decisions in various sectors.

f.) Avoiding duplication of industries

It helps in avoiding duplication of industries. Duplication of industries might happen if similar industries are located in different parts of the country. Through planning, different industries in different parts are set thereby ensuring balanced development in the country.

g.) Promoting balanced in Regional Development

Planning helps in distributing industries to various part thereby achieving balanced regional development.

Problems encountered in development planning

These problems are divided into two

- ✓ Problems encountered at the plan formulation stage
- ✓ Problems encountered at the implementation stage

Problems encountered at the plan formulation stage

a.) Lack of accurate of detailed data

The quality of development plan is greatly reduced when the data on which is based on is either inaccurate, unreliable or simply not existing.

b.) Existence of a large subsistence sector

The large substance sectors in less developed countries makes planning unrealistic.

c.) Lack of qualified personnel

Due to lack of locally qualified personnel, many less developed countries rely on foreign experts, who may not be having adequate knowledge about the local economies they are planning for.

d.) Transfer of inappropriate development plan

Transferring development plans which have worked in developed countries with assumption that they will work in developing countries always end up failing because they may be inappropriate.

Problems encountered at the implementation stage.

a.) Reliance on donor funding

Most of the development plans in developing countries are based on aids from developed countries, if such aid is not released the implementation of the plan becomes difficult.

b.) Lack of domestic resources

Limited domestic resources such as; skilled personnel, finance and capital equipment may hamper implementation of a well laid out development plan.

c.) Failure to involve local people in planning

If the local people who are expected to implement plans are left out during the plan formulation

stage, they may fail to support the plan at implementation stage.

d.) Natural calamities

Natural calamities affect implementation of development plan either directly or directly as the funds set aside for the implementation of the development plan may be diverted to cater for the effects of the natural calamity such as floods, or outbreak of diseases.

e.) Over –ambitious plans

Unrealistic plans which are over ambitious to impression donors are so that they releases funds are difficult to implement.

f.) Lack of co-operation among the executing parties

Lack of co-operation among the experts who are expected to implement the plan may bring it down. For example, if there is conflict between the ministry of finance and the planning agencies, the plan may not take off.

g.) Inflation

If prices are rising too rapidly, the resultant change in planned resource costs may negatively affect its implementation.

h.) Lack of political will

No matter how good the development plan is, if there is no political will or commitment to implement it, then it will never take off.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

Paper 2

1. Discuss **five** principles of taxation
2. Highlight distinguishing features between developing and developed countries.
3. Explain **five** obstacles in the implementation of development plans in the developing countries
4. Every third world country aspires to develop but it is faced with some obstacles. Explain **five** of such obstacles to economic development
5. Every third world country aspires to develop but it is faced with some obstacles. Explain **five** of such obstacles to economic development
6. Explain **five** factors that have frustrated economic development in a developing country like Kenya for the last few decades
7. The national budget is drawn before the beginning of every financial year by the government discuss **five** functions it plays as a planning tool
8. Explain **five** challenges that Kenya is facing in the implementation of her development plans
9. a) Explain **five** changes that may take place when a country is experiencing economic development

CHAPTER TWENTY FIVE

INTERNATIONAL TRADE

Specific Objectives

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

a) Explain the meaning of international trade;

b) Explain the advantages and disadvantages of international trade;

c) Discuss the terms of trade, balance of trade and balance of payments;

d) Discuss the causes of balance of payment disequilibrium;

e) Discuss the measures that may be taken to correct balance of payment disequilibrium;

f) Explain the terms of sale in international trade;

g) Describe the documents used in international trade;

h) Discuss the role of international financial institutions in international trade;

i) Describe the various forms of economic integration;

j) Explain the importance of economic integration to a country;

k) Explain the advantages and disadvantages of free trade;

1) Explain the reasons for trade restriction;

m) Discuss the methods of trade restriction;

n) Discuss the advantages and disadvantages of trade restriction;

o) Discuss trends in international trade.

Content

a.) Meaning of international trade

b.) Advantages and disadvantages of international trade

c.) Terms of trade, balance of trade, balance of payments

d.) Balance of payments disequilibrium

e.) Correcting balance of payments disequilibrium

f.) Terms of sale in international trade

g.) Documents used in international trade

h.) International financial institutions: International Monetary Fund (IMF), African Development Bank (ADB), International Bank for Reconstruction and Development (World Bank)

i.) Forms of economic integration

j.) Importance of economic integration to a country

k.) Advantages and disadvantages of free trade

l.) Reasons for and methods of trade restriction

m.) Advantages and disadvantages of trade restriction

n.) Trends in international trade e.g. Liberalization, Export Processing Zones (E.P.Z)

Introduction

A trade between two or more countries is referred to as international trade.

Classification of international trade

- ✓ Multilateral trade

A trade among many countries

- ✓ Bilateral trade

A trade between two countries

Exports

Goods and services sold by one country to another country.

Imports

Goods and services bought by a country from another country.

Advantages of international trade

a.) Exchange of goods and services

It enables a country to obtain what she does not produce through imports and exports

b.) Promotes peace

Helps in promoting peace among the trading countries

c.) Availability of cheaper goods

Enables a country to obtain goods more cheaply than it can produce them

d.) Encourages specialization

Enables a country to specialize in production of goods and services for which they have comparative advantage in terms of resources endowment.

e.) Promotes competition

Promotes competition between imports and locally produced goods which in effect improves the quality of goods produced.

f.) Transfers of technology

Facilitates transfers of technology from more developed countries to less developed ones thereby accelerating development.

g.) Exploitation of resources

The wide market created by the trade enables a country to fully exploit her resources due to wider market

h.) Morbidity of factors of production

Facilitates the mobility of factors of production such as labour and capital from one country to another.

Disadvantages

a.) Collapse of local industries

May cause collapse of local industries as people tend to buy imported goods.

b.) Harmful and unwanted products

Can result into unwanted and harmful products such as hard drugs entering into the country.

c.) Over dependency

Results into over dependency on imported commodities especially the essential ones could lead to a country becoming a slave of the other and this could compromise its sovereignty.

d.) Problems of supply

A country that relies on imported products may face problems of supply during times of emergency.

e.) Imported inflation

May lead to a country experiencing imported inflation

f.) Negative effects of interaction

Through interaction, people of a given country may end up acquiring bad cultural values from their trading partners

Terms of trade

This is a relationship between what a country exports and what she imports. It is the rate at which a country's export exchange against imports.

Terms of trade = exported price index ÷ imported price index

Reason for Differences in the terms of trade between countries.

a.) Nature of the commodity being exported

A country whose main export is raw materials is likely to experience unfavorable terms of trade. While a country that exports finished products like manufactured goods is likely to experience favorable terms of trade as the prices of manufactured goods are higher compared to unprocessed goods.

b.) Nature of the commodity being imported

A Country that imports expensive goods such as manufactured goods may experience adverse terms of trade while one that imports cheap raw materials may experience favorable terms of trade.

c.) Demands for a country's exports

A country with increased demands for its exports is likely to experience favorable terms of trade while if the demands reduces she may experience unfavorable terms of trade.

d.) Existing world economic order

Due to their bargain powers industrialized countries tend to dominate decision making in the international market. International markets tends to favor products from these two countries hence having a favorable terms of trade as a result.

e.) Total quantity supplied

If a commodity is being supplied by many countries into the world market, its supply becomes very high reducing its price. A country relying on such products may experience unfavorable terms of trade. While a country that relies on exportation of commodities that are in short supply experience favorable terms of trade

Balance of payment Accounts

It is a summary statements showing all the transactions that have taken place between a particular country and the rest of the world over a given period of time.

Transaction may arise from

- ✓ Trade in tangible or visible goods
- ✓ Trade in invisible goods (services)
- ✓ Flow of capital into and out of the country.

Components of balance of payments accounts

It has three major components

a.) The balance of payments of current account

This is the difference between the total value of exports and imports for both invisible and visible goods

In summary

(Visible exports -visible imports) +(Invisible exports - invisible imports) = balance of payments on current account.

Note

The receipts are credited and payments debited in the current account.

The balance of payments on current account may be:

In equilibrium

The receipts are to the payments for visible and invisible goods

Unfavorable

The receipts are less than the payments for invisible and visible goods

Favorable

The receipts are more than the payments for invisible and visible goods

b.) Balance of payment on capital account

The difference between the value of capital receipts and the value of capital payments.

c.) The official settlement Account

This is the account that summarizes the financial transitions between a country's central bank and other countries through the international Monetary Fund (IMF)

Balance of payment Disequilibrium

This occurs when there is either a credit (surplus) or a debit(deficit) balance in the balance of payments.

Causes of Balance of payments Disequilibrium

a.) Fall of volume of export

A decline in the volume of exports may reduce export earnings causing a deficit.

b.) Deterioration in the countries terms of trade

If the value of a countries exports reduce relative to that of imports, the country may experience disequilibrium in the balance of payments as the exports would be earning less compared to what's being paid for the imports

c.) Increase in the volume of imports

When a country's exports remain constant but the volume of imports increases a disequilibrium is likely to occur.

d.) Restriction by trading partners

If a trading partner decides to reduce importation, the other country may be importing more from such partner country compared to what it is exporting to the partner.

e.) Less capital inflow compared to outflow

Where capital inflow is less than capital outflow a country may experience a deficit in capital account and this may be reflected in the balance of payment.

f.) Over valuation of a domestic currency

An overvalued domestic currency makes the country's exports becomes more expensive compared to imports and this may discourage exportation leading to disequilibrium in the balance of payment.

g.) Devaluation by a trading partner

Devaluation encourages exports while discouraging imports. A country trading with a country that has devalued her currency may end up importing more from and exporting less to such a country

Correcting balance of payments Disequilibrium

The measures to be taken are as follows:

I.) Measures that would control the volume of imports

a.) Imposing or increasing import duty

By increasing or imposing import duty, imported goods becomes more expensive than locally produced goods. This would discourage importation of goods.

b.) Quotas

By reducing the maximum amount of goods that can be imported will reduce the amount of imports.

c.) Foreign exchange control

Importers pay for imports through foreign exchange, the amount of imports can be limited by limiting the foreign exchange that is located to the importation of goods.

d.) Administration of bottlenecks

Government may restrict the importation of commodities by putting in place cumbersome and complicated procedures to be followed by those who wish to import.

II.) Measures that would increase volume of Exports

a.) Export compensation scheme

Under this scheme, the exporter is allowed to claim from the government a certain percentage of the value of the products exported. This will enable the exporter to charge less hence increasing the demand for the product in the world market.

b.) Help given to exporters by the government departments

The government departments such as the departments of foreign affairs or trade and industry may give useful information about the world market and also negotiate with other countries to secure preferential treatment for their country's exports.

c.) Customer drawbacks

The government may refund either in full or in part the custom duty paid when importing raw materials for the manufacture of finished products if they are exported. The refund is called draw backs.

III.) Encouraging foreign Investment into the country.

A country may correct disequilibrium in the balance of payments by encouraging foreigners to invest in the country. The foreigners would bring in capital to build and run factories.

IV.) Devaluation

Devaluation promotes exports while restricting imports thereby correcting disequilibrium in the balance of payments.

Terms of sale in international trade

This is the price quotation that states the expenses that are paid for by the exporter and those that are to be paid for by the importer.

The following are some of the common terms of sale in international trade:

LOCO or Ex-warehouse or ex- works

Price quoted covers the goods as they are in the exporter's premises. The importer has to meet the costs of moving the goods from the exporter's premises to their destination.

F.O.R (Free on Rail)

Price quoted includes the expenses for transporting the goods from the seller's warehouse up to the nearest railway station.

D.D (Delivered Docks)

Price quoted includes expenses up to the docks. A dock is a place where ship awaits for cargo.

F.A.S (Free Alongside ship)

Price quoted includes transport expenses up to the docks as well as dock charges.

F.O.B (free on Board)

The price quoted includes the movement of goods up to when they are in the ship.

C & F (Cost and Freight)

The price quoted includes the cost as well as shipping charges.

C.I.F.(Cost insurance and Freight)

The price quoted includes the cost of goods, cost of transport and insurance cover against marine risks up to importers port of entry.

Loaded

Price quoted includes all expenses up to the port of destination as well as unloading charges.

In bond

The price quoted includes the expenses of handling the goods in the bonded warehouse. However, storage charges and customers duties are met by the buyer

Franco (free of Expenses)

This includes the cost of goods and any other expense up to the importers premises. This means that the importer does not incur any other expense other than the quoted price.

O.N.O (or nearest offer the quoted one.)

This means that the exporter is willing to accept the quoted price or any other nearest to the quoted one.

Documents Used in International Trade

a.) Letter of credit

This is a document that enables an importer to get goods on credit to assure the exporter that the amount due would be paid.

Importance

The letter signifies that the issuing bank would pay to the corresponding bank the amount stated therein provided that the exporter meets certain conditions such as submitting the necessary exporting documents

b.) Import license

A document that enables a person to import goods.

Importance

It shows that the importer has a permission to deal with the goods.

c.) Indent

This is an order sent by an importer to an agent in the exporting country.

Importance

- ✓ Contains the details of the goods required.
- ✓ The method of packing.
- ✓ The transporting company.
- ✓ The terms of payments.

d.) Bill of landing

A document prepared when goods ordered are loaded into the ship,

Importance/purpose

- ✓ It is evidence that goods have been received by the owner.
- ✓ It is evidence of the terms of contract between the ship owner and the shipper
- ✓ It is a document of title in that it enables the person named therein or his agent to claim the goods when they arrive at the port of destination.

e.) Policy or certificate of insurance

A document to show that goods are insured before being dispatched

f.) Certificate of origin

A document prepared by an exporter giving details of the goods exported and the name of the country of origin.

Importance
Enables the importer to get preferential treatment on the goods imported especially if they originated from a country that is a member of trading bloc.

g.) Airway Bill

A document prepared when goods are transported by air.

Importance/purpose
It shows the charges that the importer is supposed to pay to the airline company.

h.) Commercial invoice

This is a document that is prepared by the seller to demand payments

Contents include
- ✓ Name and address of the exporter
- ✓ Name and address of the importer
- ✓ Price
- ✓ Terms of sale
- ✓ Description of the consignment
- ✓ Name of the ship transporting the consignment.

Importance/purpose
To demand payments

i.) Consular invoice

A document that shows that the prices charged on the goods are fair as certified by the importing country's officials or consul with the embassy in the exporting country.

Importance/purpose
Helps in speeding up delivery of goods to the importer.

j.) Proforma invoice

It resembles an invoice apart from being marked profoma. It does not hold the buyer liable for payment of the amount marked in it.

Circumstances under which it is issued.
- ✓ To serve as a formal quotation.
- ✓ To serve as a polite request for payment in advance for the goods ordered especially if the customer is new.

- ✓ Where the importer would like to initiate clearing of customs duty early enough to avoid delays.

k.) Freight Note

A document prepared by the shipping company to indicate the charges for shipping the goods.

Importance

It is sent to the exporter who upon payment of the charges gets a receipts

l.) Letter of hypothecation

This is a letter written by the exporter to his or her bank authorizing it to resell the goods being exported.

m.) Weight Note

A document that states the weight and measurements of the goods delivered at the docks

n.) Shipping Note

This is a document that is issued by the ship owner giving details of the goods shipped.

International Financial institutions

a.) International Money Fund (IMF)

Created in a conference held in Bretton Woods in 1944.The objectives of IMF includes

- ✓ Maintenance of stable exchange rates

The fund requires member countries to intervene in the foreign exchange market to ensure that exchange rates are within the required limits

- ✓ promotion of consultation and co-operation amount member countries

Consultation and cooperation among member countries is necessary in order to maintain stable exchange rates and a smooth international trade.

- ✓ Provision of sufficient international liquidity

IMF holds gold and a pool of member countries currencies' which are used to facilitate international transactions,

b.) African Development Banks (ADB)

The Africa Development Bank Group is a multinational development bank supported by 77 nations and established in 1964.The Bank Groups consist of Three institutions:

- ✓ The African Development Bank (ADB).
- ✓ The African Development Fund (ADF).
- ✓ The Nigeria Trust Fund (NTF).

c.) International Bank for Reconstruction and Development (IBRD)

Also referred as World Bank was created in Bretton Woods Conference 1944

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. Outline four benefits that Kenya derives by being a member of preferential Trade Area PTA (4 mks)
2. Give four reasons why it may be necessary for a country to control imports (4 mks)
3. State four benefits that a country may derive from participating in international trade (4 mks)
4. State four methods of controlling imports (4 mks)
5. State four measures that Kenya may take to promote her exports(4 mks)
6. State four factors that may limit the success of trade agreements among African countries (4 mks)
7. State in the spaces provided below, state the business document to which each of the following statements relates (4 mks)

Statement	Document
A. Informs the buyer when goods were dispatched and by	

what means B. A request by seller for payment in advance C. Used to correct under undercharge in an invoice D. Shows details of the transactions between seller and buyer during a given period	

8. Highlights four problems a country by participating in international trade (4 mks)
9. Outline four circumstances under which a proforma invoice may be used (4 mks)
10. Explain the following terms as used in international trade

a. LOCO

b. F.O.R

c. F.A.S

d. Bill of Landing

11. State three functions of departments of international trade in the ministry of commerce and industry
(3 mks)
12. Country X has recorded a surplus balance of payments from its foreign trade. Outline four ways in which the country can spend these surplus earnings (4 mks)
13. List four benefits that a country derive from engaging in international trade (4 mks)

PAPER 2

1. Explain five ways in which a country benefits by participating in international trade (10 mks)
2. Outline five transactions which are recorded in balance of payment account of a country (10 mks)
3. Explain five measures that a country may take to promote her exports (10 mks)
4. Explain the meaning and significance in each of the following terms as used of the following terms as used in foreign trade. Terms of trade, balance of payment, exchange rate, balance of trade and common market. (10 mks)

5. Explain the significance of each of the following documents as used international trade. Bill of lading, proforma invoice, indent, letter of credit
6. Country X has obtained a surplus in its balance of payment. Explain the factors that could have contributed to this surplus (10 mks)
7. Explain six problems being faced by the Kenya External Trade Authority (KETA) (12 mks)
8. Explain the factors that may lead to deteriorating terms of terms of trade for a country (10 mks)
9. Outline five functions of Kenya external Trade Authority (KETA)(10 mks)
10. Highlight five benefit that Kenya gets from trading with other countries

    (10 mks)
11. The domestic currency of a certain country has been depreciating over time. Highlight five disadvantages of the depreciation of the country (10 mks)
12. Highlight five ways in which a bill of lading is useful to an importer of goods (10 mks)

CHAPTER TWENTY SIX

ECONOMIC INTERGRATION

Introduction

This is where two or more countries in the same region join up and cooperate with each other for their own mutual economic benefits.

Forms of Economic integration

Free trade area

Countries within a free trade area agree to either abolish or relax tariffs, quotas and any other trade barrier amount themselves while each individual country remains free to impose restrictions on trade with non-member countries.

Examples are:

- ✓ Preferential Trade Area (PTA).
- ✓ European Free Trade Area (EPTA).
- ✓ The Latin American Free Trade Area (LAFTA)

Customs Union

It is similar to PTA but Unlike PTA countries in a customs Union impose a common Tariff on trade with non-member countries

Example are:

- ✓ East African Customs Union (EACU).
- ✓ BENELUX (Belgium, Netherlands and Luxembourg).
- ✓ The central African Customs and Economic Union(CACEU)

Common Market

It is similar to Customs union but unlike customs union countries in a common market allow free movement of factors of production such as labor, capital and entrepreneurship amount the member countries.

Examples are:

- ✓ European Economic Community (EEC).
- ✓ Central America Common Market (CACM)

Economic union

An economic union has all the features of a common market I.e. Conducive conditions for internal trade, Common external trade barriers and Free factor mobility but unlike Common market it has a joint economic institutions such as central bank, they also may have a common monetary system and common public services such as railways and communication network.

Importance of economic integration

a.) Availability of market

A wider market is created due to economic integration for a country's products.

b.) Encourages specialization

Each country can concentrate on production of goods and services that it can produce cheaply and efficiency leaving other country's to produce what they can.

c.) High Quality and cheap products are produced

High quality and cheap goods are produced due to specialization and competition among members countries.

d.) Promotes peace

Economic integration promotes peace among people of the involved countries as they interact and cooperate with each other.

e.) Common Bargaining Front

Countries involved in economic integration enjoy the benefits of common bargain with non-member countries. This may bring about better terms of trade.

f.) Employment creation

People can easily be employed since they are free to move from one member country to another.

Trade Restrictions /Trade protection /protectionism

This refers to imposition of measures aimed at restricting trade amount countries.

Reasons for Trade Restrictions

a.) Protection of local infant industries

Young growing industries should be protected since they are not able to compete favorably with big established ones which enjoys economies of scale.

b.) Protection of strategic industries

Strategic industries are those that a country cannot do without them, such as food and security it will not be wise for a country to depend on another country for such commodities

c.) Creation and protection of employment

When imports are discouraged due to trade restrictions, it encourages establishment of local industries to produce these goods hence creating employment by hiring people to work in them

d.) Prevention of Dumping

This is a situation where a country disposes of its substandard or inferior products by selling them cheaply into another country. Dumping may create unfair competition in addition to harmful effects.

e.) Preservation of balance of trade and foreign Exchange Reserves

A balance of trade deficit may be rectified by restricting imports because a balance of trade deficit is undesirable.

f.) Protection of Cultural and social Values'

During trade people of different countries interact with each other borrowing cultural values of one another which may be harmful to one's country. Trade restriction may reduce this importation of cultures

Methods of trade restrictions

a.) Tariffs

Tariffs are Taxed levied on either imports or on exports. Tarrifs increases the prices of the commodities that they are levied on thereby reducing the demand for such commodities.

b.) Quotas

This refers to the restrictions on the quantity or on the value of a commodity to be imported or exported over a given period of time. A zero quota is referred to as embargo.

c.) Foreign Exchange Control

The government can therefore make acquisition of foreign exchange more difficult in order to restrict international trade.

d.) Moral persuasion

The government may appeal to importers or export to willfully restrict the importation or exportation of a certain commodity

Disadvantages of trade restrictions

a.) Possible retaliation by other countries

When one country imposes restriction on imports from another country, the other country can also react by similarly imposing restriction on imports from the former country.

b.) Production of low quality commodities

Due to lack of competition the protected industry may end up producing low quality commodities.

c.) High prices for locally produced commodities

Due to their small size the protected infant industry may not enjoy economies of large scale therefore they will have high cost of production.

d.) Less consumer choice

There will be fewer goods and services for consumers to choose from if trade restrictions are put in place leading to low standards of living for such people.

e.) Danger of the need for perpetual protection

The protected infant industries have tendency of remaining young therefore always calling for protection with its inherent problems.

f.) Possible emergence of Monopolies

Protectionism may lead to emergence of monopolies which are always insensitive to customer demands, overcharging and provision of low quality products.

Foreign Exchange Rates

An exchange rate is the price at which one currency is exchanged for another currency.

Types of exchange rates

a.) Fluctuating/flexible /floating /exchange rate systems

This is a situation where there is a free and competitive foreign exchange market. The foreign exchange value of a country's currency depends on:

- ✓ The country's balance of trade.
- ✓ The capital transactions with the rest of the world.
- ✓ Actions of speculators

b.) Fixed exchange Rates

Under this system the values of currencies are fixed in terms of a common denominator

c.) Adjustable peg system

This is where flexibility in exchange rates is managed.

Current trade in international trade

a.) Liberalization

This is the removal of trade barriers amount countries so that each country can freely trade with others

b.) Websites

This is the store of information within the internet where one can get access to it by use of a computer.

c.) Export processing zones (EPZ)

These are areas set aside by the government where industrialists can set up firms to process goods

for export at or no little charge.

Advantage of EPZ

- ✓ Encourages foreign investors into the country.
- ✓ Create jobs opportunities.
- ✓ Stimulate industrialization.
- ✓ Earn the government some revenue after the tax free period.
- ✓ Encourages exports due to the incentives given by the government which in turn helps to correct unfavorable balance of payments

Disadvantages

- ✓ Encourages social evils such as prostitution.
- ✓ Using employ foreigners in management positions.
- ✓ Do not generate revenue for the government during the tax free period.
- ✓ Concentrated only in a few towns which brings about imbalanced regional development.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

1. Outline any **four** problems encountered in development planning in Kenya
2. Mention any **four** obstacles faced by the Kenyan government in realizing its development planning
3. Outline **four** indicators of underdevelopment
4. Highlight **four** circumstances under which a country may be classified as underdeveloped
5. Highlight **three** goals of development
6. Describe **four** reasons why it is important for Kenya to prepare a proper development plan
7. Highlight **four** characteristics of good development plan

PART TWO ACCOUTING

CHAPTER ONE

DETERMING THE NET WORTH OF A BUSINESS

Specific Objectives

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

a) Explain the meaning of the terms assets, liabilities and capital;

b) Derive the book-keeping equation;

c) Prepare a simple balance sheet;

d) Relate the accounting equation to the balance sheet;

e) Explain the meaning of net worth of a business.

Content

a.) Meaning of assets, liabilities and capital

b.) The book keeping equation

c.) Balance sheet

d.) Relationship between book-keeping equation and balance sheet

e.) Net worth of a business

Business transactions

These are all transactions that involve monetary values. It is not easy to memories all the business transactions hence a form of record is needed. When the recording is done in a systematic way it is called book – keeping.

Basic terms used in business

a.) Debtor

A person or organization who owes money to another.

b.) Creditors

A person or organization to whom money is owed

c.) Goods

These are items bought for the purpose of resale.

d.) Assets

These are property of all kind owned by an individual, a business or any other organization and to which a monetary value is attached. There are two types of assets:

Fixed assets

These are assets expected to last for a long time usually more than one year. They are not intended for resale but to help in the running of the business in order to produce and provide goods and services. Examples are buildings, land, motor cars and furniture.

Current assets

These are assets which are expected to last for a very short period of tie usually less than one year. Examples include cash in hand, stock of stationery, debtors and prepaid insurance.

Characteristics of Assets

- ✓ A resource owned and controlled by the business.
- ✓ Must have been acquired in the past.
- ✓ An item of value that can be measured reliably in monetary terms.
- ✓ May be either fixed or current.

e.) Liabilities

These are borrowed money and items bought on credit, A liability is therefore what is owned to others. Examples are a loan borrowed, goods bought on credit, bills not yet paid etc. There are two types of liabilities.

- Long term liabilities

These are debts that are not expected to be settled within one year.

- Short term liabilities

Debts that are payable within one year. For example bank overdrafts and debts for goods (creditors) payable within one month.

Characteristics of a liability

- ✓ It's a present obligation for a business to settle as a result of past commitment.
- ✓ Its settlement may reduce business assets.
- ✓ Amount involved can be measured reliably in monetary terms.
- ✓ Owned to outsiders.
- ✓ May be classified as a long term or short term (current liabilities).

f.) Capital

This is money needed to start and run a business. Also called owners claims or owners' equity.

Book keeping equation

The book keeping equation states that assets is equal to capital added to liabilities.

Assets = capital + liabilities

The book keeping equation can be used to calculate the value of one item given the other two items as follows:

A = C + L

C = A - L

L = A – C

Example

The following table contains information relating to a business A, B, C, and D. Determine the figures represented by W, X and Y.

Business	Assets	Capital	Liabilities
A	620,000	W	230,000
B	X	400,000	120,000
C	800,000	500,000	Y

Solution

Assets = Capital – liabilities

(a) Capital = 620,000 – 230,000

= 390,900

(b) Assets = 400,000 + 120,000

= 520,000

(c) Liabilities = 800,000 – 500,000

= 300,000

Balance sheet

This is a statement that shows the financial position of a business as at a particular date. It is usually prepared at the end of a trading period/accounting period.

Structure of balance sheet

BIGFOOT COMMUNICATIONS

Balance sheet

As at 21st June 2005

Assets	sh	Capital + Liabilities	sh
Stock	20,000	Creditors	9,000
Furniture	8,000	Bank loans	12,000
Cash	30,000		
Debtors	6,000	Capital	43,000
	64,000		64,000

The balance sheet should have the following:

a) Heading which should include:

- ✓ Name of the business e.g. Bigfoot communications.
- ✓ Name of the statement, i.e., balance sheet.
- ✓ The data at which it is prepared ,e.g., as at 21st June 2005.The date is important because assets, capital and liabilities keep on changing as transactions take place and so the balance sheet can only be true at a specific time.

b) Assets ,capital and liabilities

- ✓ Assets are recorded on one side and capital and liabilities on the other side.
- ✓ The total of the two sides of the balance sheet sides must always be equal.

Example

The following balances were extracted from the books of Wasco traders on 30th October 1995.

Cash	20, 520
Bank	160,230
Premises	800,000
Debtors	40,000
Creditors	62,000

2 year loan	40,000
Stock	2,500

Prepare a balance sheet

Solution

Wasco Traders

Balance sheet as at 30th October 1995

Assets		Capital & Liabilities	
	Shs.		Shs.
Fixed Assets		**Capital + liabilities**	
Premises	800,000	Capital	920,750
Current Assets		**Long term liabilities**	
Stock	2,500	2 year loan	40,000
Debtors	40,000	**Current Liabilities**	
Bank	160,230		
Cash	20,520	creditors	62,500
	1,023,250		1,023,250

Note

- ✓ When the assets are more than the liabilities the balance sheet is said to be solvent.
- ✓ When liabilities are than assets such that the difference between liabilities and asset
- ✓ Is negative capital or deficiency.
- ✓ The business is said to be insolvent.

Importance of balance sheet

A balance sheet provide useful information for decision making which may be used I the following ways:

i. Financiers – To know wether the business is in a position to meet their claims

ii. Shareholders – To determine wether their funds are invested wisely.

iii. Government – As one of the documents required for taxation purposes.

iv. Potential investors – In order to make decisions on which shares to buy.

v. The management – To compare their performance with previous years.

Relationship between Book – keeping Equation and Balance Sheet

Book keeping equation also called balance sheet equation because balance sheet shows assets on one side and capital and liabilities on the other side which is a representation of the book keeping equation .

$$A = C + L$$

Net worth of a business

Net worth of a business simply refers to capital. It may be calculated by taking total assets and subtracting the liabilities.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

PAPER 1

1. The following table contains information relating to a business A, B, C, and D. Determine the figures represented by W, X and Y.

Business	Assets	Capital	Liabilities

isabokemicah@gmail.com

A	620,000	W	230,000
B	X	400,000	120,000
C	800,000	500,000	Y

2. In the spaces provided, indicate with a (+) or (-) the effects of each one of the following transactions on the assets, Liabilities or capital (4 marks)

a Bought furniture on credit	Assets	Liabilities	Capital
b. Paid creditors by cash			
c. withdrew cash for personal use			
d. Converted a personal car for business use			

3. The following relate to business A, B and C. For each of the business determine the missing figures: M, N, and P

Business	Assets	Capital	Liabilities
A	30,000	m	12,000
B	n	16,000	13,000
C	60,000	48,000	p

4. For each of the following types of accounts, state in the spaces provided whether you debit or credit increase or decrease the account. (3 marks)

Type of account	To increase	To decrease
a Asset account		

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b Liability account

c. Capital

5. In the table below, determine the missing fig. X, Y and Z for each of business Q, R and S. –

Business	Assets	Capital	Liabilities
Q	250,000	X	120,000
R	Y	1,500,000	Z
S	600,000	100,000	400,000

(3 marks)

6. The following information relates to business A, B, C and D.

Business	Assets	Liabilities	Capital
A	500,000	x	300,000
B	Y	800,000	1,200,000
C	300,000	120,000	z
D	700,000	t	500,000

Determine figure represented by X, Y, Z and T. (4 marks)

CHAPTER TWO

BUSINESS TRANSACTION

Specific Objectives

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

a) Explain the meaning of a business transaction;

b) Distinguish between cash and credit transactions;

c) Determine the effects of transactions on the balance sheet;

d) Discuss causes of changes in capital;

e) Determine the initial and final capital of a business.

Content

a.) Meaning o f a business transaction

b.) Cash and credit transactions

c.) Effects of transactions on the balance sheet

d.) Causes of changes in capital

e.) Initial and final capital of a business

Definition

A business transaction is any dealings between two or more individuals or parties that can be assigned a monetary value.

Classification of business transactions

Cash transactions

This is where both parts of the exchange are executed immediately. That is no credit. Payments may either be in cash or other forms of money such as cheques, money orders, postal orders or anything that can be accepted as medium of exchange.

Cash transactions

This is where goods or services are bought and payment is made at a later date. Payment at a later date is also referred to as deferred payment.

The payment can still be in cash or other forms of money.

Effects of transactions on the balance sheet

A transaction taking place in a business will have the effect of increasing or decreasing some items of the balance sheet.

Example

The balance sheet of Bigfoot communications as at 31st December 2005 and the transactions that took place between the balance sheet date and 20th January 2006 are given below. A balance sheet as at 20th January 2005 after the transaction is shown below.

Bigfoot Communications
Balance Sheet
As at 31st December 2005

Assets	sh	sh	Capital + Liabilities	sh
Fixed Assets			Capital	3,350,000
Buildings	1,000,000		Long term liabilities	
Motor Vans	1,500,000		Loan from bank	800,000
Furniture	200,000	2,700,000	Current liabilities	
Current assets			Creditors	150,000
Stock	300,000			
Debtors	100,000			
Cash in bank	700,000			
Cash in hand	500,000	1,600,000		
		4,300,000		4,300,000

Transactions that took place

a.) Bought stock for cash sh 80,000 on 2nd January 2006.The effect was that the asset cash in

hand decreased by sh 80,000 from sh 500,000 to sh 420,000.The asset stock increased by sh 80,000 from sh 300,000 to sh 380,000.

b.) Transferred sh 100,000 from cash in hand to the bank account on 3rd January.This

effect was : The asset cash at bank increased by sh 100,000 from sh 700,000 to sh 800,000 and the asset cash in hand reduced by sh 100,000 from sh 380,000 to sh 280,000.

c.) Some creditors were paid sh 50,000 by cheque on 5th January .The effect was that the liability creditors reduced by sh 50,000 from sh 150,000 to sh 100,000 and the assets cash in bank also reduced by sh 50,000 from sh 800,000 to sh 750,000.

d.) Bought stock on credit sh 90,000.The asset stock increased by sh 90,000 from sh 380,000 to sh 470,000 and the liability creditors increased by sh 90,000 from sh 100,000 to sh 190,000.

e.) Sold stock on credit at cost sh 150,000 on 12th January .The effect was; stock was decreased by sh 150,000 from sh 470,000 to sh 350,000 and the assets debtors increased by sh 150,000 from sh 100,000 to sh 250,000.

f.) Acquired a loan sh 500,000 from Keya Industrial Estates and used it to repay the bank loan on 16th January .The effect was;The liability KIE loan was created of sh 500,000 and bank loan was reduced by sh 500,000 from sh 800,000 to sh 300,000.

g.) Received cash sh 100,000 from one of the debtors on 20th January .The effect was; the asset cash in hand was increased by sh 100,000 from sh 280,000 to sh 380,000 and the asset debtors reduced by sh 100,000 from sh 250,000 to sh 150,000 and the asset debtors reduced by sh 100,000 from sh 250,000 to sh 150,000.

Note

It can be observed that a transaction affects two items of the balance sheet in either of the following ways;

- ✓ An increase in an asset followed by a decreased in another assets.
- ✓ An increased in a liability followed by a decrease in another liability.(capital is included as liability).
- ✓ Both an asset and liability are affected in the same way.

In a balance sheet the totals must always be equal on both sides.So whatever is done to one side must be done on the other side.

The values on 20th January of the items affected were as follows:

Stock: sh (300,000 + 80,000 + 90,000 – 150,000) = sh 320,000.

Cash: sh (500,000 – 80,000 – 100,000 + 100,000) = sh 420,000.

Bank: sh (700,000 + 100,000 – 50,000) = sh 750,000.

Creditors: sh (150,000 – 50,000 + 90,000) = sh 190,000.

Debtors: sh (100,000 + 150,000 – 100,000) = sh 150,000.

Bank loan: sh (800,000 – 500,000) = sh 300,000.

K.I.E loan: sh 500,000.

The balance sheet as at 20th junuary 2006 after all the transactions would appear as shown below;

Bigfoot Communications
Balance Sheet
As at 20th January 2006

Assets	sh	sh	Capital + Liabilities	sh	sh
Fixed Assets			Capital		3,350,000
Buildings	1,000,000		Long term liabilities		
Motor Vans	1,500,000		Loan from K.I.E	500,000	
Furniture	200,000	2,700,000	Bank loan	300,000	800,000
Current assets			Current liabilities		
Stock	320,000		Creditors		190,000
Debtors	150,000				
Cash in bank	750,000				
Cash in hand	420,000	1,640,000			
		4,340,000			4,340,000

NOTE;

- ✓ Buildings, Motor vans, Furniture and capital remained the same since they were not affected by any transaction.
- ✓ It is also possible for a transaction to affect more than two items on the balance sheet.

Example

Esha bought stock of goods and paid by cash and the balance remained to be paid later. The items affected are: cash reduced, stock increased and creditors increased.

Effects of transactions on balance sheet totals

A transaction affecting the items of the balance sheet would in turn affect the totals of the balance sheet such that they may increase, decrease or have no change. The examples are shown below.

Changes in capital

Capital is the owners claim from the business and it's referred to as the owner's claims or owners' equity .Changes in capital may be as a result of the following.

a.) Drawings

This is refers to cash or other items taken from the business by the owner from private use. Drawing reduces a firm's capital.

To get the remaining capital we less drawings from the initial capital.

b.) Additional investment

These are additional cash or other assets brought in by the owner from his or her personal belongings. Additional investments increase a firm's capital.

To get the new capital after additional investment we add the investments to the capital

c.) Profit

The gains obtained after selling goods or services at a price higher than that which they were bought. The effect of profit is that it increases capital.

So we add the profit to the initial capital to get the new capital.

d.) Losses

Losses are incurred when the cost of goods or services are higher than their sales. Losses reduces the capital hence to find the new capital after loss we take away the loss from the initial capital.

Summary

Capital at the end of a given period (final capital) = Capital at the beginning of the period (initial capital) + profit + added investment – drawings.

The unknown can be found by;

$CC = OC + P + I - D$

$I = C.C - P + D$

$D = O.C - C.C + I + P$

$P = C.C - O.C - I + D$

Example

In the spaces provided, indicate with a (x) whether each of the following transactions will increase, decrease or have no effect in the balance sheet.

Transaction	Increase	Decrease	No effect
Buying stock in cash			
Depositing extra cash into Business account			
Drawing cash for personal use			
Buying stock on credit			

Solution

Transaction	Increase	Decrease	No effect
▪ Buying stock in cash			x
▪ Depositing extra cash into business a/c	x		
▪ Drawing cash for private use			x
▪ Buying stock on credit			x

Example

The following balance sheet was prepared from the books of Makara traders.

Makara traders

Balance sheet

As at 31st Dec 2011

	Sh	sh		sh
Fixed assets			capital	
Motor vehicle	600,000			280,000
Furniture	80,000	680,000	long term liabilities	
			bank loan (5 years)	500,000
Current assets			short term liabilities	
Stock	200,000		creditors 280,000	
Cash	60,000		bank overdraft 20,000	300,000
		300,000		
Debtors	140,000	400,000		
		1,080,000		1,080,000

The following transactions then took place in January 2012

(i) Opened a bank account for the business and deposited shs 120,000 from personal sources.

(ii) Paid part of the bank loan shs 40,000 by cash.

(iii) Bought goods worth shs 50,000 on credit.

(iv) Sold part of the furniture worth shs 10,000 in cash

Required:

Prepare Makara traders balance sheet as at the end of January 2012

Solution

Makara traders

Balance sheet

As at 31st January 2012

	sh	sh		sh	sh
Fixed assets					
Motor vehicle		600,000	capital		400,000√√
Furniture	70,000√	670,00	long term liabilities		
Current assets			bank loan (5 years)		460,000√
Stock	250,000√		short term liabilities		
Cash	30,000√√		creditors		33,000√
Debtors	140,000		bank overdraft	20,000	350,000
Bank	120,000√	540,000			
		1,210, 000√			1,210,000

Each mark (√) 1 mark 10 x1=10 marks

Example

The following balances were extracted from the books of Mile Traders for the year ended 31st December, 2014.

	Kshs	
Stock	100,000	
Capital		800,000
Debtors	50,000	
Creditors		80,000
Cash	10,000	
Net Profit	10,000	
Bank Overdraft		70,000

Machines	600,000
Furniture	200,000

Required: **Prepare** Mile Traders balance sheet as at 31st December 2014.

Solution

Mile Tracks

Balance sheet

As at 31/12/14

Fixed assets	sh	sh		Sh	sh
Machine	600,000		Capital	800,000	
Furniture	200,000	800,000	Add net profit	10,000	810,000
Current Assets			**Current liabilities**		
Stock	100,000		Creditors	80,000	
Debtors	50,000		Overdraft	70,000	150,000
Cash	10,000	160,000			960,000
		960,000			

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

1. State the term that best fit each of the following description
   i. Money brought into the business by owner_____
   ii. Goods bought for resale_____
   iii. Money borrowed by the owner of business. (4mks)
2. For each of the following transactions, indicate with a tick in the spaces provided whether the following business transaction will increase, decrease or have no effect on the balance sheet total.

Transaction	Effects on the balance Sheet		
	Increase	Decrease	No effect
a) investing more cash in the business			
b) paying creditors in cash			
c) Buying a piece of furniture in cash			

3. In the spaces provided, indicate with a (x) whether each of the following transactions will increase, decrease or have no effect in the balance sheet. (4 marks)

Transaction	Increase	Decrease	No effect
a. buying stock in cash			
b. Depositing extra cash into Business account			
c. Drawing cash for personal use			
d. Buying stock on credit			

CHAPTER THREE

LEDGER

Specific Objectives

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

a) Explain the meaning and purpose of a ledger;

b) Explain the concept of double entry,

c) Explain the meaning and format of a ledger account;

d) Explain the rules of recording business transactions in ledger accounts;

e) Record business transactions in various ledger accounts;

f) Describe the procedure of balancing a ledger account;

g) Balance off a ledger account;

h) Extract a trial balance from ledger account balances;

i) Explain the purposes and limitations of a trial balance;

j) Classify accounts;

k) Discuss the various types of ledgers.

Content

a.) Meaning and purpose of a ledger

b.) Concept of double entry

c.) Meaning and format of a ledger account

d.) Rules of posting transactions to various ledger accounts: Asset account, Liability account, Expense account, Revenue account, Capital account.

e.) Recording business transactions in the ledger accounts

f.) Balancing a ledger account

g.) The trial balance

h.) Purpose and limitations of a trial balance

i.) Classification of ledger accounts

Definition

An account (A/C) is a chronological record of all the transactions affecting a particular item. The book of accounts where the transactions are recorded is referred to as the ledger.

All transactions pertaining to a particular item are recorded in one account, and all the accounts are kept in the ledger. An account has the shape of capital letter “T “.

An account has three basic features:

- ✓ Title

This is the name of the account, usually centered on the top of the account.

- ✓ Debit side

This is the name given to the left – hand side of an account and it is usually abbreviated "Dr"

- ✓ Credit side

This is the name given to the right- hand side and it is abbreviated "Cr"

Note;

Each side of an account has four columns:

i. Date column in which the date of the transaction is recorded.

ii. Particular (details) column in which short description of the transaction is recorded.

iii. Folio column which is for cross referencing

iv. The amounts column in which the figures in money terms are recorded.

The pages of a ledger are called folios.

The accounts in the ledger are called ledger accounts.

Rules of recording transactions in ledger Accounts

Transactions resulting in increased in a particular item are recorded on one side of the account while those resulting in decrease are recorded on the other side as follows;

a.) Assets

An increase in asset is recorded on the debit side (debited) while a decrease is recorded on the credit side (credited).

Example

Buying a motor car has an effect of increasing assets and would be recorded in the motor car account on the debit side.

Cash paid out in buying the car reduces the assest cash and would be credited in the cash account.

b.) Liability

An increase in liablity is credited while a decrease is debited.

Example

A payment to a creditor has the effect of reducing liablities and its debited to the creditors account.

If goods are bought on credit they will have the effects of increasing the creditors and would be recorded on the credit side of the creditors account.

c.) Capital

An increase in capital would be recorded on the credit side of the capital account while the decrease in capital would be recorded on the debit side.

Example

If the owners of the business bring money from their personal belongings to the business this has

the effect of increasing capital and would then be credited in the capital account.

d.) Expenses

These are costs incurred in running a business such as salaries and insurance. An increase in expenses is recorded on the debit side of the affected account while a decrease would be credited.

Example

Payments of insurance premium would increase the insurance expense and would therefore be debited in the insurance expense accounts.

e.) Revenues

Revenues refers to incomes earned from sources other than the normal trading activities. An increase in a revenue is credited in the affected revenue account while a decrease would be debited.

Example

Discounts received would have the effect of increasing the discounts revenues and would therefore be credited in the discounts received account.

The concept of double entry

Book keeping is based on the principle of country entry. For example, for every debit made there must be a corresponding credit entry.

In other words ,for every transaction, there is an account to be debited and an account to be credited.

Recording Business Transaction in the ledger Accounts.

The following steps are followed when recording transactions in the ledger:

Step 1

Take each transaction one by one

Step 2

Check the items that are affected by the transactions, name them and every transaction must affect at least two items.

Step 3

Classify each of the affected items as either assets, liability, capital, expenses or revenue.

Step 4

Determine whether each of the items affected has increased or decreased. One item may increase while the other decrease or both increases or both decreases.

Step 5

Decide the side of the account on which to make the record. This is whether to debit or to credit.

Note

Once the account to be debited has been identified, the other one will obviously need to be credited and vice –versa.

Example

2004 Record the following transactions in ledger accounts.

a) Received Ksh. 20,000 cash in respect of rent paid
b) Purchased goods worth 30,000 on credit from crown traders.

Solution

Dr.	Cash Account	Cr
		Kshs. 20,000

Dr.	Rent Account	Cr
Kshs 20,000		

Dr.	Purchases Account	Cr
Kshs 30,000		

Dr.	Cash Account	Cr
	Kshs. 30,000	

Example

1st February 20 – 3 Mathai started a business with sh 70,000 cash.

a.) Accounts affected – cash in hand a/c
- Capital a/c

b.) Nature of the a/c – Cash in hand a/c – Asset
- Capital a/c –(special liability)

c.) Effect - Cash in hand increased by sh 70,000
- Capital increased by sh 70,000

d.) Action - Debit cash in hand a/c with sh 70,000
- Credit Capital a/c with sh 70,000

4th February purchased office equipment for sh 20,000 in cash

a.) Accounts affected – Office equipment a/c
- Cash in hand a/c

b.) Nature of the a/c – Office equipment – Asset a/c
Cash in hand – Asset a/c

c.) Effect - Equipment increased by sh 20,000
- Cash in hand reduced by sh 20,000

d.) Action - Debit equipment a/c with sh 20,000
- Credit cash in hand a/c with sh 20,000

6th February purchased motor vehicle for sh 350,000 on credit from Chama motors on credit

a.) Accounts affected – Motor vehicle a/c
- Creditors ; Chama motors a/c

b.) Nature of the a/c – Motor vehicle a/c – Asset a/c
Creditor; Chama motors – Liabilities a/c

c.) Effect - Motor vehicle increased by sh 350,000
- Creditor ; Chama motors increased by sh 350,000

d.) Action - Debit motor vehicle a/c by sh 350,000
- Credit creditor ; Chama motor a/c with sh 350,000

14th February opened a bank a/c and deposit sh 40,000 from cash till.

a.) Accounts affected – Cash at Bank a/c

- Cash in hand a/c

b.) Nature of the a/c – Cash at Bank a/c – Asset a/c

Cash in Hand a/c – Asset a/c

c.) Effect - Cash at Bank increased by sh 40,000

- Cash in Hand reduced by sh 40,000

d.) Action - Debit Cash at Bank a/c with sh 40,000

- Credit ; Cash in Hand a/c with sh 40,000

Solution

Dr Capital Account Cr

Date	particulars	Folio	Amount sh		Date	particulars	Folio	Amount sh
					20 -3 Feb 1	cash in hand		70,000

Dr Cash in Hand Account Cr

Date	particulars	Folio	Amount sh		Date	particulars	Folio	Amount sh
20-3 Feb 1	Capital		70,000		20 -3 Feb 4 Feb 14	Office equip Cash at Bank		20,000 40,000

Dr Office Equipment Account Cr

Date	particulars	Folio	Amount sh		Date	particulars	Folio	Amount sh
20 -3 Feb 4	Cash in hand		20,000					

Dr Motor Vehicle Account Cr

Date	particulars	Folio	Amount sh		Date	particulars	Folio	Amount sh
20 -3 Feb 6	Chama motors		350,000					

Dr Creditors Chama motors Account Cr

Date	particulars	Folio	Amount sh		Date	particulars	Folio	Amount sh
					20-3 Feb 6	Motor vehicle		350,000

Dr Cash at Bank Account Cr

Date	particulars	Folio	Amount sh		Date	particulars	Folio	Amount sh
20 -3 Feb 14	Cash in hand		40,000					

Recording of stock in ledger accounts

Increase and reduction in stock are not recorded in the stock account, but in other accounts.

Increase in stock

Stock may increase due to either of the following two causes:

a.) Purchase of more goods.

b.) Customers returning goods previously sold to them

Reduction in stock

Assuming that there is no wastage or losses, stock may reduce due to either:

a.) Sale of goods.

b.) Goods previously bought being returned by the business to the suppliers.

Purchase of Goods

Purchase of stock would increase the asset stock.This would be recorded in the purchases account instead of stock a/c.

Only those goods that are bought for purpose of resale are recorded in the purchases account.Stock may be recorded either in cash or on credit.

Purchase of Stock on Credit

Purchase of stock on credit would increase the asset stock and debited in purchases a/c and the liability creditor is increased and credited on Creditors a/c Biashara Stores which is created.

Sale of stock

Sale of stock would reduce the asset stock and would be recorded in the sales account. This is an account in which goods previously bought for resale are recorded when they are sold.

Sale of stock for cash

When stock are sold in cash, the asset cash is increased and debited on cash account while the asset stock is reduced and credited on sales account.

Sale of stock on credit

When stock are sold on credit, the asset debtor is increased and a debtor account is created and debited while the asset stock is reduced and credited on the sales account.

Purchase Returns

They are goods that were previously bought that are returned to the supplies. Goods returned to the suppliers are also called return outwards and they are recorded in purchase returns or returns outwards account.

Sales Returns

These are goods that were previously sold that are returned to the business by customers. Goods returned by customers are also referred to as returns inwards and recorded in sales returns account.

Closing stock is obtained from actual stock taking at the end of the trading period and the amount obtained will be recorded in stock account as the closing stock. The closing stock is the opening stock for the next accounting period.

Recording of Expenses in the Ledger Account

Payments for expense is recorded in the particular expense account such as stationery, wages, advertising and insurance. For example payment made on electricity bill increases electricity expense and the transaction is recorded by debiting electricity expense account. While the cash asset is reduced and credited on the cash account with sh 300.

Recording of Revenues in the Ledger Accounts

Revenue are income obtained and they include, commission received, rent received and discount received. Receipt of a revenue is credited in the particular income account.

Recording of Drawings in the ledger Account

Assets taken out inform of goods or cash are referred to us drawings. The transaction on drawings is recorded as follows:

The drawings account is debited with the value of the assets withdrawn from the business. While the cash account reduces and its credited.

Balancing Ledger Accounts

A ledger account is balanced by finding the differences between the two totals of the debit and credit sides of an account. If the debit side total is more than the credit side total, the difference is called a debit balance.

If the credit side total exceeded the debit side total, the difference would be called a credit balance.

Steps followed when balancing an account.

- ✓ Find the total on each side.
- ✓ Subtract the total of the smaller side from the total of the bigger side.
- ✓ Insert the difference (account balance) on the side with the smaller total as a balance carried down.(c/d) to make the two sides equal.
- ✓ Confirm that the totals of the two sides are equal by writing the totals at the same level and double underscoring them.
- ✓ The account balance should be recorded on the opposite side below the totals as balance brought down (b/d)

Note;

Balance carried forward (c/f) and balance brought forward (b/f) may be used instead of balance carried down and balance brought down respectively. However consistency should be maintained.

If an account has one entry, it is not necessary to insert the total as the figure is the total

Example

Record the following transaction in the affected accounts and balance them off on 10th January 2015. (10mks)

2015

January 1: Start business with furniture worth Sh.130,000

2: Bought goods for Sh.50,000 on credit from Nyamwea.

4: Sold stock of goods for Sh.40,000 cash

5: Opened a bank account and deposited Sh.20,000 from cash till.

6: Obtained a loan from K.I.E Sh.30,000 by cheque.

7: Paid Nyamwea Sh.30.000 by cheque.

8 : Withdraw cash Sh.60,000 from bank for office use.

Solution

Dr ✓ ✓	Capital A/C ✓	Cr
2015 January 10 Balance c/d 130,000 ✓	Sh.	2015 January 1 furniture 130,000 January 10 balance b/d 130,000✓	Sh 130,000

Dr ✓ Cr ✓				Furniture A/C ✓			
2015			Sh.	2015			Sh
January	1	Capital	130,000	January 10	Balance c/d		130,000
							130,000
			130,000				
January	10	Balance	b/d				
130,000							

Dr ✓ Cr ✓				Purchase A/C ✓			
2015			Sh.	2015			Sh
January	2	Nyamwea		January 10	Balance c/d		50,000
50,000✓							
January	10	Balance	b/d				
50,000✓							

Dr ✓ Cr ✓				Sales A/C✓			
2015			Sh.	2015			Sh
January	10	Balance	c/d	January 4	Cash		40,000✓
40,000✓				January	10	Balance	b/d
				40,000✓			

Dr Cr ✓				Bank A/C ✓			
2015			Sh.	2015			Sh
January	5	Cash		January 7	Nyamwea		30,000✓
20,000✓				January 9	Cash		60,000
January	6	loans(KIE)					90,000
30,000 ✓							
January	10	Balance	c/d	January 10	Balance b/d		40,000
40,000✓							
			90,000				

Dr					Cash A/C ✓	Cr			
2015			Sh.		2015			Sh
January	4	Sales	40,000✓		January 5	Bank		20,000✓
			60,000		January	10	Balance	c/d 80,000✓
✓	January	9	Bank	100,000✓				100,000
January	10	Bal	b/d	80,000				

Dr					Loan from K.I.E	Cr			
2015			Sh.		2015			Sh
January	10	Balance	c/d	60,000✓	January 6	Bank		60,000✓
				60,000 ✓				60,000✓
					January 10	Balance	b/d	60,000

Dr					NYAMWEA A/C	Cr			
2015			Sh.		2015			Sh
January	7	Bank	30,000✓		January	2	Purchase	50,000✓
			20,000					
✓					January	7	Bal	b/d 20,000
Jan.	7	Bal	c/d	50,000				

Note;

An account with b/d on the debit side is said to have a debit balance and the one with a balance b/d on the credit side has a credit balance.

Uses of ledger Accounts

- ✓ Shows amount by which a particular item increases or decreases.
- ✓ Enables the computation of the balance of an account at any time.
- ✓ It can be used for reference.

Trial balance

A Trial balance is a statement prepared at a particular date showing all the debit balances in one column and all the credit balances in another column.

To check on both the book keeping and the arithmetic accuracy of the ledger accounts. A trial balance is prepared using the account balances.

After the various debit and credit balances are listed in the trial balance, the total of each side must balance. If the two sides are not equal then it means that there is an error or errors that may cause a trial balance not to balance.

Some of these errors include:

- ✓ A transaction was recorded on only one account.
- ✓ Different amounts for the same transaction might have been entered in the accounts.
- ✓ Transferring (posting) a wrong balance to the trial balance.
- ✓ Failure to post a balance from the ledger account to the trial balance.
- ✓ Posting a balance to the wrong side of the trial balance.
- ✓ Recording a transaction on the same side of the affected accounts.
- ✓ Arithmetical mistakes might have been made when balancing the ledger accounts.
- ✓ Arithmetical errors in balancing the trial balance.

Purpose of a trial balance

a.) Checking the accuracy in the ledger accounts.

b.) The trial balance summarizes the information in the ledger accounts.

c.) Facilitates preparation of final account.

d.) A quick source of information for anyone who want to know the balance in any account.

Limitations of a trial balance

a.) Error of omissions

No record/ entry of transaction is made in the ledger accounts

b.) Error of commission

A transaction is recorded in the wrong account but of the same class with the correct account in which the entry should have been made (NB: Accept an illustration as explanation)

c.) Error of principle

A transaction is recorded in the wrong account and also of the wrong class from that in which the entry should have been made (NB accept an illustration as explanation)

d.) Error of compensation

The effect of the error in the different accounts is such that it cancels out the other. (NB Accept on illustration as explanation)

e.) Error of complete reversal of entries

Where an account to be debited is credited and the one to be credited is debited

f.) Error of original entry

Where transposed figures of the correct amount are entered as debit and credit entries in the correct accounts

A TRIAL BALANCE

Details (Account title)	Dr	Cr
	Sh	
Land and buildings	50,000	94,000
Capital		
Plant and machinery	20,000	
Motor vehicles	30,000	20,000
10 year Bank Loans		10,000
6 year ICDC loan		
Stock	10,000	
Debtors	6,000	7,000
Creditors		1,000
Rent owing		
Cash at Bank	10,000	
Cash in hand	2,000	
Drawings	4,000	
TOTALS	132,000	132,000

Types of ledger

1.) Sales ledger(Debtors Ledger)

Contains account of individual debtors

2.) Purchase ledger (creditors ledger)

Contains accounts of creditors

3.) The Cash Book

Contains cash in hand and cash in bank

4.) Nominal ledger

Contains nominal accounts such as rent expenses account and commission income account

5.) Private ledger

Contains private accounts and balance sheet can also be kept here.

6.) The general ledger

Contains all the other accounts that are not kept in any account e.g building,stock etc.

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

1. The following trial balance of Onyati was incorrectly prepared in 30th June 1995. Prepare the correct Trial Balance.

	Dr.	Cr.
Capital	99,600	30,520
Debtors		
Creditors	25,670	80,000
Motor vehicles		
Cash	2,500	
Stock	140,250	110,520

2. Prepare a trial balance from the following balances extracted from the books of San enterprises on 30th April, 1995

	Shs
Capital	947,000
Cash	74,000
Premises	870,000
Debtors	36,520
Creditors	45,300
Stock	12,250

(4 marks)

3. The following account balances were obtained from the books of Kiboko Traders on 30th June 1999.

Motor vehicle	240,000

Current liabilities	440,000
Land + building	200,000
Current assets	420,000
Furniture	60,000
Capital	480,000

Prepare a trial balance for Kiboko traders as at 30th June 1999.

4. The following balances were extracted from the books of Dipa traders as at 31st December 2000.

Buildings	100,000
Debtors	54,000
Capital	136,000
Sales	85,000
Purchases	48,000
Stock Jan 2000	25, 500
Creditors	37, 500
General expenses	31, 800
Bank overdrafts	2,500

Prepare a trial balance as at 31 December 2000 (5 mks)

5. The following balances were obtained from the books of Rah Traders

Shs.	
Opening stock	50, 000
Sales	360,000
Gross profit	25% of sales
Closing stock	70,000

Calculate

a) Cost of goods sold

b) Rate of stock turnover (5 marks)

6. Enter each of the following transactions relating to Jokin Traders in the relevant 'T' A/c

i. Deposited cash in hand shs. 5,000 into bank

ii. Bought a motor vehicle on credit on for 250,000 from Raji Traders

iii. Paid salaries sh. 2, 400 by cheque (3 marks)

7. Balance the following ledger accounts. (5 marks)

Dr. Cash Account Cr.

	Shs		Shs
Balance b/d	45700	Salaries	4800
Sales	35000	purchases	2000

Dr. Capital Account Cr.

Sh.	Shs		
		Balance	20700

Dr. Salaries Account Cr.

	Sh		sh
Cash	4800		

Dr Capital Account Cr.

	Shs		Shs
Balance	2000		
Cash	2000		

Dr. Sales Account Cr.

	Sh.		Sh.
		Balance b/d	45700
		Cash	35000

8. For each of the following transactions state the account to be debited and credited. (4 marks)

Transactions	**A/c debited**	**A/c credited**
i. paid a creditor from private source		
ii. proprietorship brought in cash from private sources		
iii. Bought goods and paid by cheque		
iv. Proprietor withdrew cash for personal use		

10. Record the following transactions in ledger accounts.

a) Received Ksh. 20,000 cash in respect of rent paid

b) Purchased goods worth 30,000 on credit from crown traders.

CHAPTER FIVE

CASH BOOK

Specific Objectives

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

a) Explain the meaning and purpose of a cash book;

b) Distinguish between the basic types of cash books;

c) Explain the term contra entry;

d) Prepare the various cash books.

Content

a.) Meaning and purpose of a cash book

b.) Basic types of cash books

c.) Contra entry

d.) Preparation of a cash book: Single-column, Two-column, Three-column.

Definition

A cash book is a ledger that contains the cash and bank accounts only. The cash and bank accounts are usually kept in separate from other accounts.

Types of cash books

i. Single- column cash book.

ii. Double - column cash book.

iii. Three - column cash book.

iv. Petty cash book.

v. Analysis cash book.

Single – column cash book

A cash book having the account and the bank account on different pages.

Note

In the ledger folio column, the name of the ledger and the page where the account named in the details column is to be found.

A transaction whose double entry is completed in one book is referred to as a contra transaction. Denoted by " C " in the ledger folio. The "c/d" and "b/d" used against the balance is recorded in the ledger folio column.

Dr Cash Account Cr

Date	Details	L.F	Amount Sh	Date	Details	L .F	Amount sh
20-6				20-6			
Feb 1	Capital	G.L	100,000	Feb 3	Rent	G.L	20,000
5	Sales	G.L	40,000	9	Bank	C	18,000
6	Momani	S.L	22,000	25	Carriage in	G.L	9,000
12	Commission	G.L	7,000	31	Salaries	G.L	16,000
22	Bank	C	50,000	31	Balances	c/d	156,000
			219,000				219,000
31	Balance	b/d	156,000				

Dr Bank Account Cr

Date	Details	L.F	Amount Sh	Date	Details	L .F	Amount sh
20-6				20-6			
Feb 1	Capital	G.L	250,000	Feb 3	Furniture	G.L	15,000
8	Sales	G.L	30,000	9	Purchase	G.L	80,000
9	Cash	C.L	18,000	25	Salaries	G.L	26,000
				31	Drawings	G.L	16,000
				31	Cash	C	50,000
					Amino	P.L	28,000
					Salaries	G.L	32,000
			298,000		Balances	c/d	51,000
31	Balance	b/d	51,000				298,000

Two column cash book

In a two column cash book the bank and cash account are being prepared side by side on the same page. It has the money column on both the debit and credit side.

The first column is for recording cash in hand and the second column for recording cash at bank.

Format for the two column cash book

Dr Cash Account Cr

Date	Details	L.F	Cash sh	Bank sh		Date	Details	L.F	Cash Sh	Bank Sh

The double mid- dividing line separates the debit side from the credit side. To the left we have the debit cash and bank and so is to the right.

Uses of two column cash book.

It is used to:

- ✓ Separate it with other accounts
- ✓ Quick determination of work flow
- ✓ Combine cash and bank accounts

- ✓ Easy reference and double entry transactions
- ✓ To relieve the general ledger of many records that appear

Example

On 1 Match, 2001, mingy traders had Ksh. 13,200 in cash and bank balances of Sh56, 000.The following transaction took place during the month.

2001 2 Cash sales sh. 12,000

12 paid a creditor sh. 8,200

27 received a cheque for sh. 4,500 from debtors

31 paid rent 7,500 in cash

Record the above information in a two column cash book and balance it off.

Solution

Two – column cash book

Dr Cr

Date	Details	Bank	Cash	Date	Details	Bank	Cash
1/3							
1	Bal b/d	13,200	56,000	15/3	Creditor		
2	Sales		12,000	31/3	Rent	7,500	8,200
27	Debtors		24,500				
		25,200	80,500	31/3	Bal c/d	17,700	72,300
1/4	Bal b/d	17,700	72,300			25,200	80,500

Balancing off the two column cash book

When balancing, each of these accounts is considered separately. The total of the debit column of the cash account is compared with the total of the credit column of the same account and the difference obtained.

This balance is then inserted onto the smaller side as balance c/d to make the two sides equal. The same figure is brought down (b/d) on the opposite side below the totals.

Three column cash book.

A three column cash book has three money columns on each of the debit and credit sides. These columns are for discounts, cash and bank.

Discount

A discount is an allowance by the seller of the goods to a buyer so that the buyer pays less than the quoted price.

Types of discounts

- ✓ Quantity Discounts
- ✓ Trade discounts
- ✓ Cash discounts

Note;

Cash discounts are calculated on the amounts owed. For example the money owed by Aisha is sh 10,000.If she is given a discount of 10%, then amount received will be

Discount is 10/100 x 10,000 = 1,000

Amount received 10,000 -1,000 = 9,000

Example

On January 1st 2006, Mutual Traders had cash in hand Shs.74, 000 and a credit. Bank balance of Shs.500, 000.

During the month the following Transactions took place

2006

January 2 Cash Sales Sh.100, 000

January 3 Paid salaries Shs.203, 000 by cheque

January 6 received a cheque of Shs.153, 600

January 6 from Mwanza after allowing her a cash discount of 40%

January 12 Bought office furniture by cheque Shs.170, 000.

January 16 Settled Kamaru's Account Shs.80, 000 in cash deducting Shs.1, 600 cash discount.

January 18 received a cheque for Shs.300, 000 in respect of sales

January 21 Paid wages Shs.48, 000 in cash.

January 22 Withdrew Shs.60, 000 from the bank for office use.

January 25 Took Shs.10, 000 cash for his son/s birthday to be celebrated at home.

January 28 Received Shs.33, 000 cash from Matoka settlement of his account less Shs.1,320 cash discount.

January 30 Deposited all the money into the bank except Shs.50, 000.

Prepare a 3 column cashbook duly balanced.

Solution

Mutua Traders √

Three Column Cash Book

Date	details	Disc. allow	Cash Shs.	Bank. Shs.	date	details	Disc rec.	Cash Shs.	Bank Shs. √
2006					2006				
Jan 1	Bal b/d		74,000√		Jan 1st	Bal /bd			500,000√
					3rd	Salaries			203,000√
2	Sales		100,000 √		12	Furniture			170,000√
6	Mwanza	6,400 √		153,600 √	16	Kamaru	1,600 √	78,400√	
18	Sales		60,000√	300,000 √	21	Wages		48,000√	
22	Bank C		33,000√		22	Cash C			60,000√
28	Maluka	1,320 √			25	Drawing		10,000√	
30	Cash at bank				30	Bank C		80,600√	
30	Bal c/d			80,600√	30	Bal c/d		50,000√	
		7,720	267,000	398,800 √	30		1,600	267,000	933,000
30	Totals		50,000 √	933,000		Totals			398,800√
	Bal b/d					Bal/b/d			

24 ticks @ ½ mk = 12mks

Working

6th January	153,600	=	96%
	6400	=	4%
16th January	80000 less 1600		
	= 78,400		
28th January	33,000 less 1320		
Can give both	33,000 + 1320		

Example

The following were the balances of Kiboko Traders as at 1st January 2009. Cash Sh.40, 000, bank overdraft Sh.17, 000. During the month the following transactions took place.

January 2nd: Mutes a debtor settled his account of Sh.32, 000 by cheque of Sh.30, 000

4th : Paid salaries amounting to Sh.16,000 by cash.

10th: Deposited Sh.12, 000 into the business bank account from the cash till.

14th: Settled Wayua's account of Sh.40, 000 and she was allowed a discount of 1% through a cheque.

16th: Deposited Sh.56, 000 in the bank from private resources.

17th: Sold goods for cash Sh.24,000.

20th: Mutua, a debtor, settled his account by a cheque of Sh.16, 000 having been allowed a discount of 2%.

24th: Purchased furniture Sh.10, 400 paying by cheque.

26th: Received Sh.7, 200 cash from Odhiambo.

30th: Banked all the available cash except Sh.3200.

Required: Prepare a three column cash for Kubuka Traders.

Solution

`KIBOKO TRADERS

(b) Dr THREE COLUMN CASH BOOK FOR THE MONTH OF JANUARY 2009 Cr

Date	Details	Folio	D.A	Cash	Bank	Date	Particulars	Folio	D.R	Cash	Bank
2009						2009					
Jan 1	Balance	b/d		40,000		Jan 1	Bal	b/d			17,000
2	Mutes		2,000		30,000						
10	Cash	C1			12,000	4	Salaries			16,000	
16	Capital				56,000	10	Bank	C1		12,000	
17	Sales			24,000		14	Wayua Furniture		400		39,600
20	Mutua		1,632			24	Bank	C2			10,400
20	Odhiambo	C2		7,200	16,000		Bal	c/d		40000	
30	Cash					30				3,200	
					40,000				400		87,000
			3632	71,000						71,000	
					154,000						154,000

NB: C_1 and C_2 if not indicated don't award. (20 x ½ = 10mks

Example

On 1st November 2013:Tabagon Co. Ltd. had a balance of shs. 12,000 at the bank and shs. 2500 in hand. During the month, the following transaction took place;

Nov. 1 Cash sales Shs. 2500, cash purchase Shs. 1750

Nov. 3 Paid the following accounts by cheque.

Kirop Shs. 1500 less 5% cash discount

Kirui Shs. 2000 less 5% cash discount

Nasimiyu shs. 2100 less 3 % cash discount

Nov. 5 Received the following amounts from debtors,

Ondiek shs. 1200,

Jane shs. 3850 and Mueni by cheque shs. 2050 after allowing

her shs. 300 cash discount.

Nov. 14 Paid office cash to the bank shs. 2000

Nov. 17 Cash sales 8500

Nov. 22 Mueni paid her account of shs. 5000 by cheque less 10% cash discount

Nov. 28 Withdrew all the money from the bank for office use except shs. 1000

Nov. 29 Paid salary cash shs. 8000

Nov. 30 A cheque received from Mueni on Nov. 5th was dishonoured.

Prepare Tobago Co. Ltd. three column cash book. **(10 marks)**

Solution

Prepare Tobago Co. Ltd. three column cash book. **(10 marks)**

Date	***Details***	***F***	***Discount allowed***	***Cash***	***Bank***	***Date***	***Details***	***F***	***Discount received***	***Cash***	*Bank*
2011						*2011*					
Nov 1	*Balance*	*b/ d*		*2500*	*12000*	*Nov 1*	*Purchase*			*1750*	
1	*Sales*			*2500*		*3*	*Kiprop*		*75*		*1425*
5	*Ondiek*			*1200*		*3*	*Kirui*		*100*		*1900*
5	*Jane*			*3850*		*3*	*Nasimiyu*		*63*		*2037*
5	*Mueni*		*300*		*2050*	*14*	*Bank*	*C*		*2000*	
14	*Cash*	*c*			*2000*	*28*	*Cash*	*C*			*14188*
17	*Sales*			*8500*		*29*	*Salary*			*8000*	
22	*Mueni*		*500*		*4500*	*30*	*Mueni*				*2050*
28	*Bank*	*c*		*14188*		*30*	*Bal.*	*c/d*		*20988*	
30	*Bal*	*c/d*			*1050*						
			800	*32738*	*21600*				*238*	*3278*	*2160*
30	*Bal*	*b/ d*		*20988*			*Bal.*	*b/ d*			*1050*

50 1 = 10 marks

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

1. State the meaning of the following terms used in a cash book

   i. Contra entry

   ii. Folio column

2. The following is an extract of a cash book from Ramo traders

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
1/1	Balc/d	2500	4500	2/1	stat	520	
5/1	Sales	1200		3/1	Wages	2400	
10/1	Cash		1500	10/1	Bank	1500	

i. Determine the balances carried down on 10th Jan 1996 (1 mk)

ii. Give the name of the transaction on 10th Jan 1996 (1 mk)

3. Enter the following transactions as in the cash Book of Temple Traders Below(4 mks) March 5 Cash 30,000

March 10 paid a creditor Kshs 7,500 by cheque

March 20 received 5,000 in cash

March 15 deposited 12,500into bank

March 28 Paid wages 2,400 in cash

Date	particulars	Cash	Bank	Date	Particulars	Cash	Bank

4. State four uses of two column cash book (4 mks)

5. For each of the following types of account indicate by writing Dr. or Cr.

   The side of record for increase and decrease

Type of A/c	Increase	Decrease
Asset		
Capital		
Revenue		
Expense		

6. The following is an extract of a cashbook of Maisha traders

Date 19	Particulars	Cash	Bank	Date 19	Particulars	Cash	Bank
1/7	Bal b/d	-	-	2/7	Salary		20000
	Sales	8000		10/7	Purchases		19000
	Kamau		16000	12/7	Rent	5000	
	Sales		20000	12/7	Stationary	6000	
				30/7	Bal c/d	11000	43000

isabokemicah@gmail.com

Determine the opening balances on 1.7..98

7. On July 1999 Kahawa Traders has Kshs 6,000 cash in hand, a bank overdraft of Kshs 2,000.

During the month the following transactions took place

a) Received cheque from debtors totaling to Kshs 80,000

b) Paid telephone bills 1,200 cash

c) Withdrew Kshs 16,000 from bank for office use. Enter the above information in Kahawa traders cashbook given below and balance it off

Kahawa Traders

Cash Book

For the month of July 1999

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank

8. On 1 Match, 2001, Mingi traders had Ksh. 13,200 in cash and bank balances of Sh 56,000. The following transaction took place during the month.

2001 2 Cash sales sh. 12,000

12 paid a creditor sh. 8,200

27 received a cheque for sh. 4,500 from debtors

31 paid rent 7,500 in cash

Record the above information in a two column cash book and balance it off. (4 mks)

9. Outline the uses of two column cash book (4 mks)

10. The following is an extract of a cash book.

Date 200	Particulars	Cash	Bank	Date	Particulars	Cash	Bank

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2/5	Bal	W	X	6/5	Wages		60000
12/5	Sales	20000		18/5	Purchases		30000
20/5		50000		22/5	Rent	6000	150000
28/5	Sales		120000	30/5	Bal c/d	Y	

Determine the figures represented by W, X, Y,Z (4 mks)

CHAPTER SIX

FINANCIAL STATEMENTS

Specific Objectives

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

a) Identify the various financial statements;
b) Explain the importance of each of the financial statements;
c) Explain the concept of trading period;
d) Prepare simple financial statements;
e) Explain the various types of capital;
f) Calculate basic ratios from financial statements;
g) Explain the importance of each of the basic financial ratios.

Content

a.) Financial statements: Trading accounts, Profit and loss account, Trading, profit and

loss account and Balance sheet.
b.) Importance of the financial statements.
c.) Concept of trading period.
d.) Preparations of simple financial statements.
e.) Types of capital: working capital, borrowed capital, capital employed, capital owned.
f.) Calculating basic financial ratios: margins and mark-ups, current ratio/working capital ratio, rate of stock turn-over, return on capital.
g.) Importance of financial ratios

Financial statements

- ✓ Profits or losses in business are usually determined through the preparation of final accounts such as the trading, profit and loss accounts while the financial status of the business is shown in a balance sheet.
- ✓ The trading profit and loss accounts and the balance sheet are referred to as final statements or financial statements.

Determination of profit or loss

- ✓ The difference between the selling price of an item and its cost is termined as either a gross profit or gross loss.
- ✓ The gross profit is realized when the sales proceeds are more than the cost of the goods sold.
- ✓ Thus:

Gross Profit sales - Cost of goods sold.

- ✓ The gross loss is realized when the cost of the goods sold is higher than the sales.
- ✓ To get the sales figures or the cost of Goods sold, adjustments have to be made for the following items.

Returns inwards

- ✓ Goods that are returned by the customers to the business.

- ✓ They are also referred to as sales returns.
- ✓ Returns inwards are usually subtracted from the total sales to arrive at the net sales.

Returns outwards

- ✓ These are goods that are returned by the business to the suppliers.
- ✓ They are also termed as purchase returns.
- ✓ Returns outwards are subtracted from total purchase to arrive at the net purchases.

Carriage inwards

- ✓ Carriage inwards refers to costs incurred in transportation of goods bought.
- ✓ They are also called carriage on purchases.
- ✓ They are considered as part of purchases and are hence added to the purchases when calculating the gross profit or gross loss.

Carriage outwards.

- ✓ Cost incurred in transporting goods sold to where the customers require them.
- ✓ They are also referred to as carriage on sales.
- ✓ Carriage outwards are expenses and are therefore not considered in calculation of gross profit or gross loss.

Examples

Calculation of gross profit and gross loss.

i. Mrs Omar bought bananas for 800 and sold all of them for sh 1000.Her profit was 1000 - 800= ksh 200.

ii. Mrs Moyo had stock of goods worth sh.500.she bought additional stock for sh. 2000 and sold all the stock for sh2800.She therefore made a gross profit of Sh.3000 which is calculated as follows:

Opening stock	500
Add purchase.	2000
Cost of goods sold	2500

Gross profit = sh .(2800 - 2500) = sh 300

Note:

Example

Opening stock is the value of stock at the beginning of an accounting period. Wanderi had stock of goods worth sh 10,000 on 2nd February 20-6.During the month of January he bought goods totaling to sh.50,000 and sold some of the goods for sh58,000.On 28th Febuary,he had unsold stock worth sh 12,000.

Calculate the gross profit.

Solution

The gross profit was calculated as follows:

Opening stock	10,000
Add: Purchases	50,000
Cost of goods available for sale.	60,000
Less closing stock	12,000
Cost of goods sold.	58,000

Opening stock + purchases – sales = closing stock

10,000+ 50,000 – x = 12,000

X = 48,000

Gross profit = KSH (58,000 - 48,000) = KSH 10,000.

Note

Closing stock is the value of stock remaining at the end of the accounting period.

Examples

The following trial balance was extracted from the ledgers of Gathioro's mobile phones business for the year ended 31st Oct 2013.

Gathioro's mobile phones

Trial Balance

As at Gathiro's 31st Oct 2013

Details	**Dr. (Shs)**	**Cr. (Shs)**
Sales		855,000
Purchase	420000	
Sales returns	12000	
Purchase returns		20000
Creditors		165000
Debtors	63000	
Motor vehicle	480000	
Cash in hand	65000	
Furniture	190000	
Carriage inwards	14000	
Stock	280000	
Capital		626250
Drawing	88000	
Telephone	6400	
Insurance	8200	
Postage	3850	
Rent	19600	
Discounts received		4000

Advertising	12900	
Discount allowed	7300	
	1670250	**1670250**

On 31st Oct. 2013, the business had closing stock valued at Shs. 60,000

Required

i. The trading, profit and loss a/c for the year ended 31st Oct 2013. **(8marks)**

ii. A balance sheet as at that date. **(4 marks)**

Solution

Gathioro's mobile phones
Trial Balance
As at Gathiro's 31st Oct 2013

	Shs	*Shs*		
Opening stock		*280000*	*Sales*	*855000*
Add: purchases	*420000*		*Less R.I*	*12000*
Add C. I	*14000*			
Less R.O	*20000*	*414000*	*Net sales*	*843000*
C.O.G.A.S		*694000*		
Less C. stock		*60000*		
C.O.G.S		*634000*		

G.P c/d	*209000*		
	843000		*843000*
Telephone	*6400*	*G.P b/d*	*209000*
Insurance	*8200*	*Discount received*	*4000*
Postage	*3850*		
Rent	*19600*		
Advertising	*12900*		
Discount allowed	*7300*		
Net profit c/d	*154750*		
	213000		*213000*
		Net profit b/d	*154750*

(16 ½ = 8 marks)

Gathioro's mobile phones
Balance Sheet
As at 31st Oct 2013

(ii)

ASSETS			*CAPITAL + LIABILITIES*	
FIXED ASSETS			*Capital*	*626250*
Motor vehicle	*480000*		*Add net profit*	*154750*
Furniture	*190000*	*670000*	*Less drawings*	*88000*
				693000
CURRENT ASSETS			*CURRENT LIABILITIES*	
Stock	*60000*		*Creditors*	*165000*
Debtors	*63000*			

Cash	***65000***	***188000***		
		858000		***858000***

(12 1/3 = 4 marks)

Example

The following trial balance was extracted from the books of Nyaituya on 31st December 2005.

	Dr (Shs)	Cr (Shs)
Sales		720,000
Purchases	340,000	
Returns	20,000	18,000
Rent	16,000	
Advertising	24,000	
Commission		9,000
Debtors/Creditors	54,000	64,000
Stock 1/1/2005	60,000	
Insurance	30,000	
Drawings	40,000	
Furniture and Fittings	100,000	
Cash in hand	15,000	
Premises	400,000	
Capital		288,000
	1,099,000	1,099,000

Additional information. Sh.

(i) Stock as at 31st December 2005 52,000
(ii) Rent accrued 6,000
(iii) Insurance paid in advance 4,000
(iv) Commission due 5,000
(v) Salaries owing 21,000

REQUIRED:

Prepare a trading, profit and loss account for the year ended 31st December 2005 and a balance sheet as at that date. (12 marks)

Solution

(b)

NYAITUYA
TRADING PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST DECEMBER 2005

Opening stock		60,000	Sales	720,000	
Add: Purchases	340,000		Less: Sales returns	20,000	
700,000					
Less: Purchases Returns	18,000	322,000			
		382,000			
Less closing stock		52,000			
Cost of sales		330,000			
Gross profit		370,000			
_____					
		700,000			
700,000					
Rent paid	16,000		Gross profit b/f		370,000
Add: accrued rent	6,000	22,000	Commission received		9,000
Advertising		24,000	Add due commission	5,000	14,000
Insurance paid	30,000				
Less: Advance	4,000	26,000			
Salaries owing	21,000				
Net profit c/f	291,000				_____
	384,000				
384,000					

(21 x 1/3 =

7mks)

NYAITUGA
BALANCE SHEET
As at 31.12.2005

Fixed Assets			Capital		288,000
Furniture & Fittings	100,000		Less drawings	40,000	
Premises	400,000	500,000	Add Net profit		291,000
539,000					
			Net capital		
Current Assets					
Debtors		54,000	Current Liabilities		
Cash in hand	15,000		Creditors	64,000	
Stock	52,000		Rent accrued	6,000	
Advance insurance	4,000		Salaries owing	21,000	
91,000					
Commission due		5,000		130,000	
		630,000			630,000

Example

(b) The following information was obtained from the books of Karanja traders for the year ending 31/dec.2003 (10mks)

	Kshs.
Opening stock	20,000
Purchases	270,000
Sales	300,000
Return inwards	15,000
Closing stock	50,000

Carnage on purchases 10,000

Funding expenses 30,000

(i) Calculate his gross profit or gross loss

(ii) Calculate Net profit or net loss

Solution

Jumbo Traders
Balance Sheet
As at 31st Dec 2014

ASSETS			CAPITAL AND LIABILITIES		
FIXED ASSETS	Sh	sh		Sh	Sh
Land and building	50,000√		Capital	94,000√	
Plant and machinery	20,000√		Less Drawings	4,000√	90,000
Motor vehicles	30,000√				
100,000					
			Long-term liabs		
			10 Year Loan	20,000√	
Current assets					
Stock	10,000√		6 year ICDC Loan	10,000√	30,000
Debtors	6,000		Current Liabs		
Cash at Bank	10,000√		Creditors	7,000√	
Cash at hand	2,000√	28,000	Rent owing	1,000√	8,000
		128,000			128,000

(14 x ½ =7mks)

(i)(a) Working capital =current assets –current liabilities
=28,000√-8,000√
=20,000√ (4x ½ =2mks)
(b) Capital employed =Fixed assets + working capital
OR
=capital + long term Liabilities
CE=FA+WC=100,000+20,000
=120,000 4x ½ =1mk
OR
CE=C+LTL=90,000+30,000

=120,000

(c) Borrowed capital =long term liabilities

=20,000+10,00√

=30,000√ (4x ¼=1mk

(b) Limitation of oral communication

End of topic

Did you understand everything?

If not ask a teacher, friends or anybody and make sure you understand before going to sleep!

Past KCSE Questions on the topic

1. (a) The following is an extract of balances from the books of Otwa traders as at 31st October 1994

Accrued rent		4,000
Cash in hand		7,500
Trade creditors		3,000
Stock		4,000
Bank overdraft	6,000	
Prepaid insurance		1,400
Trade debtors		2,600

Prepare a statement showing working capital (5 mks)

b) The capital account of Nyota traders showed a balance of Kshs 50,000 as at 1st July 1994. For the year 30th June 1995, the following information was available.

i) Proprietor brought in a personal car worth 80,000 for the business use

ii) Net profit amounted Kshs 64, 000. The proprietor withdrew 32,000 from the business for personal use. Prepare the capital account at 30th June 1995

2. The following account balances were extracted from the books of Sawato traders on 30th September 1995.

Purchases	190,550
Opening stock	35,500
Closing stock	25,000
Sales	256,050
Sales return	4,800

Calculate

i. Cost of goods sold (5 mks)

ii) Percentage of gross profit and net profit

3. The following account balances were extracted from the books of Kitu traders on 30th November 1995

Machinery	250,000
Debtor	62,000
Creditors	46,000
Stock	12,680
Cash in hand	1,500
Cash at bank	15,000

Determine the capital as at 30th November1995

4. The following balances sheet relates to Jambo Traders

Jambo traders balance sheet as at 30th June 1995

Calculate Jambo Traders current ration (5 mks)

LIABILITIES		ASSETS	
Capital	127,000	Machines	90,000
Bank		Stock	20,000
Overdrafts	12,000	Debtors	32,000
Creditors	25,000	Cash in hand	22,000
	164,000		164,000

5. During the month of July 1995 Kungu made sales worth Kshs.60,000. His margin on sales was 20%, calculate;

a) The cost of goods sold

b) The gross profit

6. For each of the following transactions indicate with a tick the effect on capital. (4 mks)

Transaction	Increase	Decrease	No Effects
(i) Withdrew cash for personal use (ii) Used personal savings to buy stock (iii) Paid a creditor by cheque (iv) Bought office furniture in cash			

7. The following balances were extracted from the books of Waso traders on 30th October 1995.

Cash	20, 520
Bank	160,230
Premises	800,000
Debtors	40,000
Creditors	62,000
2 year loan	40,000
Stock	2,500

Prepare a balance sheet (5 marks)

8. The following information was extracted from the books of Kwaso traders on 31st August 1997.

Gross profit	130,800
Carriage of sales	4,700
Commission received	8,000
General expenses	18,200
Insurance	4,000

Prepare a profit and loss A/C (5 marks)

9. The balance sheet of Moba Enterprises for the year ended 30th June 1996 is given below. Moba enterprises sheet as at 30th June 1996.

Calculate the return on

a. Capital invested

Sh	sh	sh
Capital	1,200,000	

N.p	240,000	1,440,000	
		F.A	1,400,000
			74,000
C.A			
C.L			
Creditors	3,400		
	1,474,000		1,474,000

(5 marks)

10. The following account balances were extracted from the books of Kiboko enterprises on 30th June 1997.

Opening stock	65,000
Sales	280,000
Purchases	190,000
Purchases returns	10,000
Sales returns	4,200

Closing stock was Kshs. 70,000 as at 30th June 1997. Prepare the trading a/c for period ended 30th June 1997. (4 marks)

11. The following information was extracted from the books of Peshau Traders as at April 1998

Cost of goods sold	65,000
General expenses	280,000
Capital for the period was 20%	10,000

Calculate rate of net profit to capital (5 marks)

12. State four uses of balance sheet for business organizations. (4 marks)

13. The following information relates to Mali traders for the year ended 31st Dec 1998.

Capital 1.198		250,000
Additional investment	68,000	
Drawing	92,000	
Profit	180,000	

Calculate the capital of Mali traders as at 31st Dec 1998 (4 marks)

14. The following information was obtained from the books of Kina Traders on 30th June 1998

Opening stock	8,000
Purchases bank	53,000
Sales	62,900
Return outwards	2,700
Closing stock	12,700

Prepare Kina Traders balance a/c for the year ended 30th June 1998 (5 marks)

15. The following balances were obtained from the books of Rah traders

Opening stock	50,000
Sales	360,000
Gross profit	25% of sales

Calculate

a) Cost of goods

b) Rate of stock turnover (5 marks)

16. Cumvi Traders had a capital of sh 180,000 as at 31.12.1998

Additional information

a) during the year the owner converted her private car worth 90,000 for business use

b) Goods worth sh. 50,000 were taken from the business for her own use

c) Net profit for the year was sh 140,000

Calculate capital as at 31 Dec. 1999 (3 marks)

17. The following figures obtained from the records of Buka Enterprises for the year ended 30th June 2000

Sales	500,000
Cost of goods sold	280,000

Calculate the gross margin (4 marks)

18. The following transactions relates to Tajira Traders for the month of January 2001

Jan 1 started business with Kshs. 20,000 in cash

Deposited 15,000 from cash till into a business Bank account

Bought goods on credit from Wema traders for 6,000

Bought furniture by cheque sh 3,000

Prepare a balance sheet as at 31st January 2001

19. The following balances were extracted from the books of Vuno Traders for the year ended 31st March 2001

Gross profit	186,200
Carriage outwards	13,500
Rent received	34,300
Office expenses	19,600
Salaries	57,000

Prepare a profit and loss for the year ended 31st March 2001 (5 marks)

20. Ngoma traders had the following transactions

Feb. 2 bought goods costing sh 400,000 from Maiyo traders sh. 650,000 by cheque as a part of payment for goods received. Received the above transaction in the account below and balance it off. (5 marks)

Dr Maiyo traders A/C Cr

Date	Details	Kshs	Date	Details	Kshs

21. The following information was extracted from the books of Mutua for the period ended 30th June 2001.

Opening stock	2,000
Purchases	8,500
Closing stock.	2,500
Sales	10,000

Required:

a) The trading Account for the period ended 30th June 2001

b) Calculation of the mark up (5 marks)

22. . Below is a balance sheet of Lela Traders as at 31st Dec 2001

Lela traders.

Balance sheet as at 31st Dec 2001

Capital 1.1 2001	78,000	F.A	87,800
Add net profit	42,000	C.A	55,200
	120,000	C.L	23,000
	143,000		143,000

Calculate

a) Correct ratio b) Return on capital

PAST KCSE QUESTIONS-PAPER 2

1. The following Trial balance was prepared from the books of Paka Traders as at 31st December 1995.

Trial balance December 31st 1995

	Dr.	Cr.
	Kshs	Kshs
Sales		900,000
Purchases	600,000	
Returns inwards	80,000	
Returns outwards		20,000
Carriage in		40,000
Carriage out	3,000	

Stock (Jan)	100,000	
Rent	60,000	
Creditors	170,000	
Debtors	120,000	
Interest expenses	18,000	
General expenses	7,000	
Capital	178,000	
		1,268,000
Creditors		240,000
		6,226,000 6,226,000

Additional information

Stock as at 31st December was 100,000

i. prepare Trading, profit and Loss account for the period ended 31 December 1999

ii. calculate return on capital, current ratio and debtor's ratio
(10 marks)

5. The following is a balance sheet of Bambu traders as at 31st December 2000

Bambu Traders

Balance sheet as at 31st December 2000

a) Sales during the year amounted to Kshs 2,000,000

b) Stock on 1 January 2000 was Kshs. 100,000

c) Gross profit margin was 20%

Calculate

i) Current ratio

ii) Gross profit mark up

iii) Rate of stock turnover

6. The following trial balance was extracted from the books of Maringo traders on 31st December 2001

Maringo traders Trial Balance as at 31st December 2001

Gross Profit		380,000
Closing stock	274,000	
Capital		259,000
Drawings	83,000	
Creditors		93,000
Premises	103,000	
Debtors	123,000	
Cash at bank	33,000	
Bank loan (1 yr)		50,000
General expenses	54,000	
Commission received		20,000
Wages and salaries	132,000	
	802,000	802,000

Prepare

a) Profit and loss Account for the year ended 31st December 2001

b) Balance Sheet as at 31st December 2001 (12 mks)

7. the following information was extracted from the books of Sarai Traders for the year ended 30 April 2003

Sales	480,000
Opening stock (1.5.02)	80,000

Gross profit is calculated at 25%

i) Prepare a trading account for the period ended 30 April 2003

ii) Calculate the rate of stock turn over (10 mks)

8. The following balances were extracted from the Tango traders as at 31st December 2004

Motor vehicle	80,000	
Plant and machinery	70,000	
Loan from Bank		60,000
Stock		25,000
Debtors	30, 000	

Creditors	15,000
Bank	20,000

Prepare a balance sheet for Tango Traders as at 1st December 2004. (5 mks)

9. The following information refers to tea traders for the year ended 31/12/04

Sales	800,000
Expenses	10,000
Commission received	15,000
Purchases	700,000
Opening stock	250,000
Margin	20%

Prepare trading, profit & loss a/c for the year ended 31/12/04

10. (1) The following balances were extracted from books of Motop Traders for the year ended 31/12/2004

Rent	48,000
Lighting	7,200
Water	9,220
Salaries	75,000
Commission received	8,500
Discount allowed	4,600
Discount received	8,500
Gross profit	320,000
General Expenses	98,000
Stock	5,250
Motor Vehicle	2,300,000
Furniture & equipment	650,000
Debtors	270,000
Creditors	396,400
Bank	200,000
Cash	50,000
Capital	3,000,000

Prepare:

Profit and loss a/c for the year ended 31/12/2004

Balance sheet as at 31/12/2003 (4 ½ mks)