BUSINESS STUDIES NOTES

- **INFLATION**

Control of Inflation

The govt. may adopt the following policies depending on their situation to reduce inflation to manageable levels. They include;

a) Monetary policy

This is a deliberate move by the govt. through the central bank to regulate and control the money supply in the economy which may lead to demand pull inflation. The policies include;

- Increase rate of interest of lending to the commercial banks. This forces them to increase the rate at which they are lending to their customers, to reduce the number of customers borrowing money, reducing the amount of money being added to the economy
- Selling of govt. securities in an open market operation (o.m.o). the selling of securities such as Bonds and Treasury bills mops money from the economy, reducing the amount of money being held by individuals
- Increasing the commercial banks cash/liquidity ratio. This reduces their ability to lend and release more money into the economy, reducing their customer's purchasing power
- Increasing the compulsory deposits by the commercial banks with the central banks. This reduces their lending power to their customers, which makes their customers to receive only little amount from them, reducing the amount of money in the economy
- Putting in place the selective credit control measures. The central bank may instruct the commercial bank to only lend money to a given sector of the economy which needs it most, to reduce the amount of money reaching the economy
- Directives from the central banks to the commercial banks to increase their interest on the money being borrowed, to reduce their lending rates
- Request by the central bank to the commercial banks (the moral persuasion) to exercise control on their lending rates to help them curb inflation.

b) Fiscal policy

These are the measures taken by the govt. to influence the level of demand in the economy through taxation process. They include;

- Reduced govt. spending. This reduces the amount of money reaching the consumers, which is likely to increase their purchasing powers, leading to inflation
- Increasing income taxes. This reduces the level of the consumers disposable income and lowering their spending levels, reducing the inflation
- Reducing taxes on production. This reduces the cost of production, lowering the prices of goods reaching the market

- Subsidizing the production. This reduces the cost of production in the economy, which in turn passes over the benefits to the consumers inform of reduced prices.
- Producing commodities that are in short supply. This increases their availability to meet their existing demand in the market, controlling demand pull inflation

c) Statutory measures

These are laws made by the govt. to help in controlling the inflation. They include;

- Controlling wages and salaries. This reduces the pressure put on the employers to meet high cost of labour for their production which in turn is just likely to lead to cost push inflation. It also minimizes the amount reaching the consumers as their income, to control their purchasing power and the level of demand, controlling the demand pull inflation
- Price controls. This reduces the manufactures ability to fix their prices beyond a given level which may cause inflation due to their desire to receive high profits.
- Restrictive imports. This reduces the chances of high prices of imported goods impacting on the prices of the goods in the country (imported inflation) and making the manufactures to look for alternative source of raw materials for their production
- Restricting the terms of hire purchase and credit terms of sales. This reduces the level of demand for those particular commodities in the economy which if not controlled may lead to demand pull inflation
- Controlling exports. This ensures that the goods available in the local market are adequate for their normal demand. Shortage of supply of goods in the market is likely to bring about the demand pull inflation

Outline measures that the government may employ to control the following types of inflation;

Cost push inflation

- By controlling the wages and salaries in the economy
- Restricting import on raw materials
- Reducing taxes on production
- Subsidizing the production
- Employing the price control techniques

Demand pull inflation

- Increasing the rate of interest of lending to the commercial banks
- Selling govt. securities on O.M.O
- Increasing the commercial banks cash/liquidity ratio
- Increasing the compulsory deposits from the commercial banks to the central bank
- Putting in place the selective credit control measure

- Directives to the commercial banks
- Request to the commercial banks
- Reducing govt. expenditure
- Increasing income taxes
- Producing commodities that are short in supply
- Restricting terms of hire purchase and credit terms of sale
- Controlling export

- **ECONOMIC DEVELOPMENT AND PLANNING**

Economic Growth

This is the increase in the productivity of a country which can be seen in the continued increase in the national income over a period of years.

It can be measured by taking the average percentage of increase in national income over a period of time (number of years) and be assumed to be the average rate of economic growth in the country

Economic Development

This is the quantitative change or increase in a country's national income over the years, accompanied by favorable changes in the structures within the country that leads to general improvement of the individual well being, as well as the entire nation

A country may experience economic growth without experiencing economic development. This is because the increase in the national income may be as a result of people working for long hours without any time for rest, recreation and other development to occur in their body. This will make them not to have better living, despite the fact that the national income shall have increased.

The expected structural changes to be realized in a case of economic development include;

i) Shifting from depending on agricultural sector to manufacturing sector in the economy
ii) Reducing illiteracy levels
iii) Increase in skilled manpower in the economy
iv) Improvement in health facilities within the country
v) Increase in technology and improvement of entrepreneurial ability
vi) Increase and improvement of institution that handles new methods of productive economic activities

Outline the differences that exist between economic growth and economic development

Economic Growth	Economic Development
i) An increase in size of the country's National income	i) An increase in the size and quality of the country's National income
ii) Number of people living in absolute poverty can increase despite the increase in national	ii) Number of people living in absolute poverty does not increase

income	
iii)Increase in national income could be due to increase in income of only few people	iii) Increase in national income is attributed to general increase of incomes of majority of the people in the country
iv)No tendency to bridge the gap between the rich and the poor	iv)Tends to bridge the gap between the rich and the poor

Underdevelopment

This refers to a situation whereby the economic growth is in the negative direction (decreasing) accompanied by uneven distribution of wealth and decrease in quality and quantity of the factors of production available

Characteristics of Underdevelopment

- High level of poverty. This is characterized by most of the people in the country depending on mainly subsistence, or lives below the poverty levels. Their per capita income is lower as compared to the developed countries
- High disparity in income distribution. The income in this countries are not evenly distributed with the few rich people earning so much while the poor majority earns so little
- Low levels of savings and investments. They have very little if at all exist to save and invest for their further development, making them to continue being poor. This is well illustrated in the vicious circle of poverty
- High population growth rates. This is due to some of them not being able to afford, ignorant about or simply refusing to use the modern birth control methods since they find consolation on their high number of children
- Dominance of subsistence sector. This is due to their inability to raise capital for indirect production
- Problem of unemployment. The high population growth rate leads to high supply of labour that the country's economy cannot afford to absorb all, leading to unemployment
- Under utilization of natural resources. This may be due to lack of capital in this countries or in appropriate technology they use
- Dependence on the developed countries. This is due to their in ability to sustain themselves financially, which makes them keep on calling upon the developed partners for financial assistance
- Poor infrastructure. Their roads and communication networks are not properly maintained due to the in availability of adequate resources to improve them

Goals of Economic Development

The following are the changes that economic development seeks to put in place, which in Kenya they have been joined together in what is referred to as the millennium development goals. They includes

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

   Some includes
   - Reducing income disparity in distributions
   - Reducing unemployment
   - Provision of important basic needs such as food, shelter, etc

Factor which may hinder development in a country

The rate of a country's economic development may be influenced negatively by the following factors

i. Low natural resource endowment. Absence or inadequacy of natural resources such as raw materials, fertile land for agriculture, etc may slow the pace of the country's economic development
ii. Inadequate capital. This reduces the rate at which they exploit their natural resources, or produce in the economy
iii. Poor technology used. The traditional methods of production that they use cannot sustain their requirement any more
iv. Poor human resource endowment. Their inability to train adequate skilled manpower together with their inappropriate system of education leads to their slow development
v. Unfavorable domestic environment. Their political, social and economic institutions within their countries are not structured to favour economic development. For example
   - Their political system is characterized by corruption, authoritarian kind of leadership with lengthy procedures and bureaucratic controls that scares the investors
   - Their social environment is still full of outdated or retrogressive cultural values and negative attitude towards work and investment, leading to slow development
   - Their Economic institutions has allowed their markets to be influenced so much that that leads to interference in their smooth operations

Development Planning

This is the process through which the country establishes their objectives to be achieved, identify the resources that will be required and put in place the strategies or methods of acquiring the resources and achieving their pre-determined objectives.

In most cases their objectives or goals are the goals of economic development

The plan will prioritize the objectives to be achieved and even brake it down in to targets that if achieved with the planned strategy and resources, the objective shall have been achieved.

Need for economic planning

It enhances the following

a. Appropriate resource allocation, where resources are allocated according to the need of the objective and in a most productive way

b. Stimulation of effort of people in the desired direction. The plan outlines including the possible outcomes which persuade people to move to that direction
c. Support foreign aid bargain. Since it shows including the objective that the country seeks to achieve, it is capable of convincing the donor to finance it in the country
d. Project evaluation, by assisting on checking whether the predetermined targets or objectives are being achieved
e. Long term decision making, as it will show what each and every sector of the economy will require in the future to make it stable.
f. Avoiding duplication of industries in different parts of the country, for it will show the ones that have been set in those parts and even enhance balancing
g. Promote balancing in regional development by ensuring that they are not concentrated in only one region, ignoring other regions

Problems encountered in development planning

Problems at the planning stage

i) Lack of accurate or detailed data for planning. This may lead to in appropriate plan being developed, as it entirely depends on the quality and availability of the data
ii) Existence of large subsistence sector, which make the planning unrealistic
iii) Lack of qualified personnel to assist in planning. This may make the country to rely on foreign experts who do not fully understand the country
iv) Problem of the private sector which will always require incentives for them to follow the plan
v) Transfer of inappropriate development plan. As some planners may simply borrow a plan that they feel may have worked for a given country, yet the condition in those countries may not be the same

Problems at the implementation stage

i. Over reliance on donor funding, which if they don't receive, the plan may not be implemented
ii. Lack of domestic resources such as skilled personnel, finance and capital may make the implementation a problem
iii. Failure to involve the local people in planning. This will make them not to be willing to implement it, for they will not be understanding it or rebelling for the fact that they were not included
iv. Natural calamities such as diseases, floods, drought, etc may make the funds that had been set a side for implementation be diverted to curb them
v. Over-ambitious plans which are a times just made to impress the donors to release their funds but may not be easy to implement
vi. Lack of co-operation among the executing parties which may make the work not to kick off. For example a conflict between the ministry of finance and that of planning of the amount to be released
vii. Inflation which may make the estimated value of implementation not to be adequate, bringing a problem of finances
viii. Lack of political will and commitment in implementing the plan. This may frustrate the implementation.

- **INTERNATIONAL TRADE**

A trade involving the exchange of goods and services between two or more countries. If the exchange is between two countries only, then it is referred to as bilateral trade, but if it is between more than two countries then it is referred to as multilateral trade.

Advantages of International Trade

- ✓ It enable the country to get access to wider range/variety of goods and services from other countries
- ✓ It enable the country to get what it does not produce
- ✓ It helps in promoting peace among the trading countries
- ✓ It enable the country to specialize in it's production activities where they feel they have an advantage
- ✓ It earns the country revenue through taxes and licenses fees paid by the importers and exporters in the country
- ✓ It enable the country to dispose of its surplus goods and services thereby avoiding wastage
- ✓ It creates employment opportunities to the citizens of that country either directly or indirectly
- ✓ It may lead to the development of the country through importation of capital goods in to the country
- ✓ It encourages easy movement of factors of production across the boarders of the countries involved
- ✓ It enable countries to earn foreign exchange which it can use to pay for its imports
- ✓ A country may be able to obtain goods and services cheaply than if they have been produced locally
- ✓ During hard times or calamities such as wars, the country is able to get assistance from the trading partners
- ✓ It brings about competition between the imported and locally produced goods, leading to improvement in their quality
- ✓ It gives the country an opportunity to exploit fully its natural resources, due to increased market

Disadvantages of International trade

- ✓ It may lead to collapse of the local industries, as people will tend to go for the imported goods. The collapse may also lead to loss of employment
- ✓ It may also lead to importation of harmful foods and services such as drugs and pornographic materials
- ✓ May lead to over depending on imported commodities especially the essential ones, making the country to be a slave of the other countries, interfering with their sovereignty
- ✓ It may make the country to suffered during emergencies if they mainly rely on the imported goods
- ✓ May make the country to suffer from import inflation
- ✓ May lead to acquisition of bad culture from other countries as a result of their interactions
- ✓ May lead to unfavorable balance of payment, if the import is higher than exports

Terms of Trade

This refers to the rate at which the country's export exchanges with those from other country. That is:

Terms of trade = $\frac{Price\ index\ of\ export}{price\ index\ of\ import}$

It determine the value of export in relations to import so that a country can know whether it's trade with the other country is favourable or unfavourable

Favourable terms of trade will make the country spent little on import and gain a lot of foreign exchange from other countries

For example;

Then table below shows trade between Kenya and China in the year 2004 and 2005, with the Kenyan government exporting and importing to and from china, and China also importing and Exporting from and to Kenya.

Year	**Average prices of export**	
	Kenya	**China**
2004	1000	4000
2005	1200	6500

Calculate the Terms of trade for;

i. Kenya

ii. China

Solution;

Kenya

a) Export price index (E.P.I) $= \frac{\textit{average prices of exports in the current year}}{\textit{average prices of exports in the base year}} \times 100$

$= \frac{1200}{1000} \times 100$

$= 120\%$

b) Import price index (I.P.I) $= \frac{\textit{average prices of import in current year}}{\textit{average prices of import in the base year}} \times 100$

$= \frac{6500}{4000} \times 100$

$= 162.5\%$

c) Terms of trade (T.O.T) $= \frac{\textit{export price index}}{\textit{import price index}} \times 100$

$= \frac{120}{162.5} \times 100$

$= 73.8\%$

This implies that Kenya is importing from China more than it is exporting, leading to unfavourable terms of trade i.e. when the percentage is less than 100%, it implies unfavourable terms of trade.

China **(work out)**

The average prices is the various prices of the individual export or import items divide by their number

Factors that may lead to either favourable or unfavourable terms of trade

The country is experiencing a favourable terms of trade if:

- The prices of imports decline and those of export remains the constant
- The prices of imports declines while those of exports increase
- The price of imports remains constant while those of exports increase
- The prices of import and export increases but the rate of increase in export is higher
- Both prices decrease but the decrease in import prices is higher

The country will experience unfavourable terms of trade if;

- Prices of import increases while those of exports decline
- Prices of import remains constant while those of export declines
- Prices of import increase as the export remains constant
- Both prices increase, but for imports increases at a higher rate than export
- Both prices decrease, but for export decreases at a higher rate than import

Reasons for differences in terms of trade between countries

The terms of trade may differ due to:

i. The nature of the commodity being exported. If a country exports raw materials, or unprocessed agricultural products, its terms of trade will be unfavourable, as compared to a country that exports manufactured goods
ii. Nature of the commodity being imported. A country that imports manufactured goods is likely to have unfavourable terms of trade as compared to that which imports raw materials or agricultural produce
iii. Change in demand for a country's export. An increase in demand for the country's export at the world market will make it have favourable terms of trade as compared to those with low demand at the world market
iv. Existing of world economic order favouring the products from more developed countries. This may make the developing countries to have deteriorating terms of trade
v. Total quantity supplied. A country exporting what most countries are exporting will have their products trading at a lower price, experiencing unfavourable terms of trade as compared to a country that export what only few countries export
vi. Trade restrictions by trading partners. A country with no trading restrictions is likely to import more products, leading to unfavourable terms of trade, as compared to if it impose trade restrictions

Balance of trade

This is the difference between value of country's visible exports and visible imports over a period of time. If the value of visible/tangible export is higher than the value of visible/tangible imports, then the country experiences favourable terms. If less than the invisible value, then the country is experiencing unfavourable. The country is at equilibrium if the value of visible export and import is the same

Balance of payments

This is the difference in the sum of visible and invisible export and the visible and invisible imports. If positive then it means the country is having favourable terms, while if negative, then it means unfavourable It goes beyond the balance of trade in that it considers the following

- The countries visible/tangible export and import of goods (visible trade)
- The countries invisible/services exported and imported in the country (invisible trade)
- The inflow and outflow of investment (capital goods)

Balance of Payment account

This is the summary showing all the transactions that have taken place between a particular country and the rest of the world over a period of time. The transaction may arise from

a) The export of visible goods
b) The import of visible goods
c) The export of invisible goods/services
d) The import of invisible goods/services
e) Flow of capital in and out of the country

Components of balance of payments account

The balance of payment account is made up of the following

a) Balance of payment on current account
ii) Balance of payment on capital account
iii) Official settlement account/Cash account/foreign exchange transaction account

Balance of payment on current account

This is the account that is used to determine the difference between the value of the country's visible and invisible imports and exports. That is

Balance of payment on current account = (visible export + invisible export) – (visible import + invisible import)

In the account, the payments for the visible and invisible imports are **debited** while the receipts from visible and invisible exports are **credited** that is

Dr **current account**	Cr
Payments for imports (Visible and Invisible)	Receipts from exports (Visible and Invisible)

The balance of payment on current account may be;

- In equilibrium i.e. if Dr = Cr
- Unfavourable i.e. if Dr > Cr (-ve)
- Favourable i.e. if Dr < Cr (+ve)

For example;

A given country had the following values of visible and invisible export and import during the year 2004 and 2005

Trade	2004 (shs)	2005 (shs)
Visible export	18926	29954

Visible imports	22780	32641
Invisible exports	6568	19297
Invisible imports	5239	16129

Required

Prepare the country's balance of payments on current account for the years 2004 and 2005 and comment on each of them.

Dr **current account year 2004** Cr

	shs		Shs
Visible imports	22780	Visible export	18926
Invisible imports	5239	Invisible export	6568
Total	28019	Total	25494
		Deficit	**2525**

The country experienced unfavourable balance of payment on current account in the year 2004, since they imported more than they exported

Dr **current account year 2005** Cr

	shs		Shs
Visible imports	32641	Visible export	29954
Invisible imports	16129	Invisible export	19297
Total	28019	Total	49251
Excess 481			

The country experienced favourable balance of payment on current account in the year 2005, since they exported more than they imported

Balance of payments on capital account

This account shows the summary of the difference between the receipt and payments on the investment (capital). Receipts are income from investments in foreign countries while payments are income on local investments by foreigners paid out of the country.

The capital inflow includes investments, loans and grants from foreign donors, while capital outflow includes dividends paid to the foreign investors, loan repayments, donations and grants to other countries.

In the account the payments are debited, while the receipts are credited. That is;

Dr **capital account** Cr

Payments	Receipts

The account may be;

- In equilibrium i.e. if Dr = Cr
- Unfavourable i.e. if Dr > Cr (-ve)
- Favourable i.e. if Dr < Cr (+ve)

The combined difference on the receipts and payments on both the current and capital accounts is known as the overall balance of payments.

The official settlement account

This account records the financial dealings with other countries through the IMF. It is also called the foreign exchange transaction account, and is always expected to balance which a times may not be the case. That is;

- Incase of surplus in the balance of payment, the central bank of that country creates a reserve with the IMF and transfer the surplus to the reserves account.
- Incase of a deficit in the balance of payment, the central banks collect the reserves from the IMF to correct the deficit, and incase it did not have the reserves, the IMF advances it/give loan

Balance of payment disequilibrium

This occurs when there is either deficit or surplus in the balance of payments accounts. If there is surplus, then the country would like to maintain it because it is favourable, while if deficit, the country would like to correct it.

Causes of balance of payment disequilibrium

It may be caused by the following;

- Fall in volume of exports, as this will reduce the earnings from exports leading to a deficit.
- Deteriorating in the countries terms of trade. That is when the countries exports decreases in relation to the volume of imports, then her payments will higher than what it receives.
- Increasing in the volume of import, especially if the export is not increasing at the same rate, then it will import more than it exports, leading to a disequilibrium
- Restriction by trading partners. That is if the trading partners decides to restrict what they can import from the country to a volume lower than what the country import from them, it will lead to disequilibrium
- Less capital inflow as compared to the out flow, as this may lead to a deficit in the capital account, which may in turn leads to disequilibrium.
- Over valuation of the domestic currency. This will make the country's export to very expensive as compared to their import, making it to lose market at the world market
- Devaluation of the currency by the trading partner. This makes the value of their imports to be lower, enticing the country to import more from them than they can export to them.

Correcting the balance of payment disequilibrium

The measures that may be taken to correct this may include;

- Devaluation of the country's currency to encourage more exports than imports, discouraging the importers from importing more into the country.
- Encouraging foreign investment in the country, so that it may increase the level of economic activities in the country, producing what can be consumed and even exported to control imports
- Restricting the capital outflow from the country by decreasing the percentage of the profits that the foreigner can repatriate back to their country to reduce the outflow
- Decreasing the volume of imports. This will save the country from making more payments than it receives. It can be done in the following ways;
    i) Imposing or increasing the import duty on the imported goods to make them more expensive as compared to locally produced goods and lose demand locally

ii) Imposing quotas/total ban on imports to reduce the amount of goods that can be imported in the country
iii) Foreign exchange control. This allows the government to restrict the amount of foreign currencies allocated for the imports, to reduce the import rate
iv) Administrative bottlenecks. The government can put a very long and cumbersome procedures of importing goods into the country to discourage some people from importing goods and control the amount of imports

- Increasing the volume of exports. This enable the country to receive more than it gives to the trading partners, making it to have a favourable balance of payment disequilibrium. This can be done through;
  i) Export compensation scheme, which allows the exporter to claim a certain percentage of the value of goods exported from the government. This will make them to charge their export at a lower price, increasing their demand internationally
  ii) Diversifying foreign markets, to enable not to concentrate only on one market that may not favour them and also increase the size of the market for their exports
  iii) Offering customs drawbacks. This where the government decides to refund in full or in part, the value of the custom duties that has been charged on raw materials imported into the country to manufacture goods for export
  iv) Lobbying for the removal of the trade restriction, by negotiating with their trading partners to either reduce or remove the barrier put on their exports

Terms of sales in international trade

Here the cost trading which includes the cost of the product, cost of transporting, loading, shipping, insurance, warehousing and unloading may be expensive. This makes some of the cost to be borne by the exporter, as some being borne by the importer. The price of the goods quoted therefore at the exporters premises should clearly explain the part of the cost that he/she is going to bear and the ones that the importer will bear before receiving his/her goods. This is what is referred to as the terms of sale

Terms of sales therefore refers to the price quotation that state the expenses that are paid for by the exporter and those paid for by the importer.

Some of the common terms include;

(i) Loco price/ex-warehouse/ex-works. This states that the price of the goods quoted are as they are at the manufacturers premises. The rest of the expenses of moving the good up to the importers premises will be met by the importer
(ii) F.O.R (Free on Rail). This states that the price quoted includes the expenses of transporting the goods from the seller’s premises to the nearest railway station. Other railways charges are met by the importer
(iii)D.D (Delivered Docks)/Free Docks. This states that the price quoted covers the expenses for moving the goods from the exporter’s premises to the dock. The importer meets all the expenses including the dock charges

(iv) F.A.S (Free Along Ship). States that the price quoted includes the expenses from the exporter's premises to the dock, including the loading expenses. Any other expenses are met by the importer

(v) F.O.B (Free on Board). States that the price quoted includes the cost of moving the goods up to the ship, including loading expenses. The buyer meets the rest of the expenses

(vi) C&F (cost & freight). The price quoted includes the F.O.B as well as the shipping expenses. The importer meets the insurance charges

(vii) C.I.F (Cost Insurance & freight). The price includes the C&F, including the insurance expenses

(viii) Landed. The price includes all the expenses up to the port of destination as well as unloading charges

(ix) In Bond. The price quoted includes the expenses incurred until the goods reaches the bonded warehouse

(x) Franco (Free of Expenses). The price quoted includes all the expenses up to the importer's premises. The importer does not incur any other expenses other than the quoted price

(xi) O.N.O (Or Nearest Offer). This implies that the exporter is willing to accept the quoted price or any other nearest to the quoted one

Documents used in International trade

i) Enquiry/Inquiry. A letter sent by an importer to the exporter asking about the supply of the goods and the terms of sale.

ii) Order of Indent. This asks the supplier to supply goods. It may specify the goods to be supplied and suggest the preferred mode of transport for them. An indent may be open or closed
   - Open Indent. Here the importer does not specify the supplier and the goods to be bought and therefore the exporter or export agent is free to choose the supplier
   - Closed Indent. Here the importer specifies the supplier and the goods to be bought

iii) Letter of Credit. A document issued by the importers bank to the exporter's bank to assure the exporter of the payment for the goods ordered. The exporter can then be paid by his bank on the basis of this letter.

iv) Import Licence. A document issued by the country to allow the importer to buy goods from abroad.

v) Bill of Lading. A document of title to goods being exported issued by the shipping company to the importer who should use it to have goods released at the port of entry.

vi) Freight Note. A document prepared by the shipping company to show the transportation charges for goods.

vii) Certificate of insurance. A document issued by the insurance company or agent, undertaking to cover the risk against the loss or damage to goods being exported.

viii) Certificate of Origin. A document that shows the country from which the goods are being imported have originated from.

ix) Commercial Invoice. A document issued by the exporter to demand for the payment for the sold on credit to the importer.

   It shows the following;
   - ❖ The name and address of the exporter
   - ❖ The name and the address of the importer

- ❖ The price charged
- ❖ The terms of sale
- ❖ The description of the consignment
- ❖ The name of the ship transporting the consignment

x) Consular Invoice. A document that shows that the prices of the goods that have been charged is fair as certified by the consul with the embassy of the exporting country.

xi) Proforma Invoice. A document sent by the exporter to the importer if he/she is not willing to sell goods on credit. It may be used to serve the following purposes;
- Serve as a formal quotation
- Serve as a polite request for payment before the goods are released for the customer
- To enable the importer to initiated the clearing of the custom duty early enough to avoid delays
- Used to by the importer to obtain permission from the Central Bank to import goods

xii) Airway Bill. Issued by the airline company to show the charges for the goods being transported

xiii) Letter of Hypothecation. A letter written by the exporter to his/her bank authorizing it to resell the goods being exported. This occurs if the bank fails to get payment on the bill of exchange drawn on the importer that it has discounted for the exporter. Should there be a deficit after the resale, the exporter pays the deficit

xiv) Weight note. A documents that shows the weight and other measurements of the goods being delivered at the dock

xv) Shipping advice note. A document issued by the exporter to his/her shipping agent containing instruction for shipping goods.

International Financial Institutions

Some of the institutions that play a role in international monetary system include;

i. International Monetary Fund (I.M.F)
ii. African Development Bank (A.D.B)
iii. African Development Fund (A.D.F)
iv. International Bank For Reconstruction and Development (World Bank)

i. International Monetary Fund (I.M.F)

This bank operates like the central bank of the central banks of the member countries. Its objective includes the following;

- Ensuring that the member country maintains a stable foreign exchange rates for their currencies. This it does by advising the country to raise or increase the supply of their currency to devalue them or increase their value internationally
- Provide financial support to the member country to alleviate poverty and boost their income.
- Relieving heavily indebted countries of debt repayment so that it can use that fund to raise the living standards of its people.
- Providing funds to the member countries to finance the deficits in their balance of payment.
- Provide forum through which the member country can consult and cooperate on matters concerning trade among them

- Maintaining currency reserves of the different countries, enabling member countries to buy foreign exchange to be used to import goods and services.

ii. African Development Bank (A.D.B)

This bank was formed to promote the economic and social progress of its regional member countries in Africa. It main source of finance is the members' contributions and the interest charged on the money they lend members.

Its functions include;

- Providing loans for economic and social development to member countries
- Provide technical advice in planning and implementation of the development plans
- Assist member country to appropriately exploit it resources
- To encourage co-operation among African countries in order to bring economic growth
- To co-operate with various economic institutions in order to bring about development especially in Africa countries

iii. African Development Fund (A.D.F)

This was formed to provide long term financial assistance to the low income countries that cannot obtain loan from other financial institutions at the prevailing terms and condition. Their loans may recover a longer repayment periods with no interest except the commitment fees and service charge which is minimal. They fund activities, which includes;

- Education and research activities
- Offer technical advice to the member countries

iv. International Bank For Reconstruction and Development (World Bank)

The World Bank was formed to carry out the following functions;

- ✓ Giving loans to countries at very low interest rates to finance economic development activities.
- ✓ Provision of grants to finance the provision of social amenities and basic infrastructural development in developing countries.
- ✓ Fighting against corruption and poor governance which may lead to misuse of public funds in different countries.
- ✓ Advancing money to countries to finance balance of payment deficit.
- ✓ Giving advice on economic challenges that countries may face.
- ✓ Availing technical assistance and personnel to help countries run their economic programmes

Economic Integration

This occurs where two or more countries enter into a mutual agreement to cooperate with each other for their own economic benefit. They may do this by allowing free trade or relaxing their existing trade barriers for the member countries.

Economic integration may occur in the following forms;

A. Free Trade Area

   This is a case where the member countries agree to abolish or minimize tariffs and other trade restrictions but the individual countries are free to impose restrictions on non-member countries. They includes; Preferential Trade Area (P.T.A), European Free Trade Area (E.F.T.A), Latin America Free Trade Area (L.A.F.T.A), etc.

B. Custom union

   This is where the members of the free trade area may agree not only to abolish or minimize their tariffs, but also establish a common tariff for the exchange of goods and services with the non member countries. They include; Economic Community of West Africa States (E.C.O.W.A.S), East Africa Custom Union (E.A.C.U), Central Africa Custom and Economic Union (C.A.C.E.U)

C. Common Market

   This is where the member countries allow for free movement of factors of production across the boarders. People are free to move and establish their business in any member country. They include; East Africa Common Market (E.A.C.M), European Economic Community (E.E.C), Central American Common Market (C.A.C.M), Common Market for Eastern and Southern Africa (COMESA)

D. Economic Union

   This is where the members of the common market agree for put in place a common currency and a common central bank for the member countries. They even develop common infrastructures which includes railways, communication networks, common tariffs, etc

Importance of economic integration

Economic integration will ensure the following benefits for the member countries;

- Availability of wider market for the goods and services produced by the member countries. This enables them to produce to their full capacity
- It enables the country to specialize in the goods they produce best, making them to effectively utilize their resources
- It leads to promotion of peace and understanding among the member countries through interaction
- It leads to high quality of goods and services being produced in the country due to the competition they face
- It allow members to get access to wider variety of goods and services which satisfy different consumer needs
- It leads to creation of employment for individuals living within the region, as they can work in any of the member country
- It increase the economic bargaining power in trading activities by the countries forming a trading bloc
- Improvement of the infrastructure in the region due to increased economic activities.
- It brings a bout co-ordination when developing industries, as the members will assign the industries to each other to create balance development and avoid unnecessary duplication

Free Trade Area

This is a situation where there is unrestricted exchange of goods and services between the countries. It has benefits/advantages similar to those of economic integration.

Disadvantages of free trade area

Some of the problems it is likely to bring include;

- It may lead to importation of inferior goods and services to the country, as the member country may not be able to produce high quality as compare to other non-member countries
- It may discourage the growth of the infant industries due to competition from well developed industries in other countries
- It may lead to reduced government revenue because no tariff may be charged on the goods and services
- A country may be tempted to adopt technology not suitable for its level of development.
- If not controlled, it may lead to unfavourable balance of payment, where a country imports more than it export
- It may lead to importation of harmful goods and services, that may affect the members health such as illegal drugs
- It may lead to lack of employment opportunities especially where more qualified people have moved from their country to secure job opportunities in the country
- It may expose the country to negative cultural practices in other countries, interfering with their morals. For example the exposure to the pornographic materials.
- Compromising political ideologies especially where member countries with different ideologies wants to fit in to the bloc
- It may lead to over exploitation of non-renewable economic resources such as minerals

Trade Restrictions

These are deliberate measures by the government to limit the imports and exports of a country. They are also known as protectionism and includes the following;

- Tariffs which include taxes levied on both import and export. It can be used to increase or decrease the level of both import and export
- Quotas which is the restriction on the quantity of goods to be either imported or exported. It can be increased or decreased to increase or decrease the level of import or export respectively.
- Total ban (zero quota) where the government issues a direction illegalizing either the import or export of the products
- Complicated import procedure in order to discourage some importers from importing
- Subsidies on locally produced goods to discourage imports
- Legislation against importation of certain goods
- Setting the standards of products to be imported

Reasons for trade restrictions

- To prevent the inflow of harmful goods into the country, that may be harmful to the lives of the citizens
- To protect the local infant industries that may not be able to compete favourably with well established industry
- To give a country a chance to exploit its natural resources in producing their goods
- To protect strategic industry, since their collapse may make the country to suffer
- To minimize dependency of the country to other countries for their stability

- To create employment opportunity to its people by establishing the industries to produce the goods and services
- To prevent dumping of goods in the country by the developed partners which may create unfair competition
- To correct balance of payment deficit by limiting import
- To protect good cultural and social values which may be influenced by unaccepted values they are likely to acquire from other country through interaction
- To expand market for locally produced goods by restricting the number of foreign goods in the market.
- To enable the country earn foreign exchange through imposing taxes and other tariffs

Advantages of trade restrictions

- It promotes self reliance as industries have an opportunity to engage in the production of goods and services that were previously imported
- It protects the local industries from stiff competition that they may have faced from the well developed countries
- It may help to correct the balance of payment deficit
- It restrict the entry of harmful goods into the country as it controls the inflow of imports in to the country
- It enables the country to conserve their valuable social and cultural values from the external influence
- It help in creating more job opportunities through diversification in the production
- It promotes the growth of local/infant industries in the country.

Disadvantages of trade restriction

- There will be availability of limited variety of goods in the country that will limit the consumer's choices
- May lead to production of low quality goods as there will be no competition for the producing firms
- Other countries may also retaliate, leading to reduction in export from their country
- There is likely to be high prices charged on the locally produced goods, since the small firms which produce them may not be enjoying the economies of scale
- The country is likely to be exposed to small market, should all countries restrict which may lead to reduction in trade.
- As a result of the continued protection, some industries may develop a tendency of remaining young to still enjoy the protection, which limits the level of development
- It may lead to emergence of monopoly as the protected industry may end up remaining alone in the market, bringing about the problems of monopolies

Trends in International Trade

i. Liberalization that has led to removal of many trade restriction among the countries, increasing the levels of trade

ii. Development of E-Banking which has enable the international trader to get access to their bank accounts from wherever they are in

iii. Development of export processing zones (EPZ) by the government to allows the industries involved just concentrate in the exported goods only. It enable the country enjoy the following benefits (advantages of EPZ)

- It creates job opportunities to the citizens
- It creates market for locally produced raw materials that they use in their production
- It encourage the foreign investors to invest in the countries, i.e. in the processing zones, increasing the level of investment in the country
- Encourages export in the country as the incentives given to them by the government makes them to produce more and more for export
- It stimulates industrialization in the country in all sector including the ones producing for local consumptions

However EPZ's have the following problems/disadvantages

- Most of them employs foreigners in their management team, denying the locals a chance to get employed
- They do not generate revenue to the government, especially during tax free periods
- They are concentrated in few towns, bringing about imbalance regional development
- Some of them encourages social evils such as prostitution in areas where they are developed

iv. Development of e-commerce/website trading which has promoted the selling and buying of items through the internet, with payments made online.

E-commerce has the following benefits/advantages:

- ✓ One is able to access the market world wide, as the countries are connected to the internet
- ✓ There is no discrimination, as both the small and large industries are able to transact through the internet
- ✓ It is fast to transact the business through internet, as it saves on travelling time and therefore suitable for urgent transaction
- ✓ It is cheap especially on the cost of sending, receiving and storing information
- ✓ It is easy for firms to share valuable information about production

THE STOCK EXCHANGE MARKET

This is a market whereby the buying and selling of shares and other securities takes place. Shares are the smallest units of capital that can be sold to persons by a company for them to become share holders. Other securities traded in this market includes debentures (a unit of loan sold by the companies to the members of the public), government bonds (a long term borrowing certificate by the government from its people) and government treasury bills (a short term borrowing certificate by the government from its people).

Common terms used in stock exchange

i) Securities:- a document certifying that one has lent money to the issuer (the person borrowing the money)
ii) Broker:- a person/firm registered by the capital market authority (CMA) to buy and sell shares and other securities on behalf of their clients
iii) Jobber:- a person/firm who buys and sell shares and other securities with an aim of making a profit
iv) CDSC account:- Central Depository Settlement Corporation account for mobilizing the shares and securities to be traded on at the market

In the stock exchange market only registered/listed/quoted companies are allowed to sell their shares. A quoted/listed company is a company that has been registered as a member of the stock exchange market.

The quoted companies can sell their shares through the Initial Public Offer (I.P.O) or normal trading in the market.

IPO is the initial price that the company will float its shares to the members of the public to buy/subscribe to for the first time. These shares are said to have been issued in the primary market. After the IPO the shares are then accumulated as stock and traded on in the stock exchange market (secondary market).

All the trading of the shares is done through the company's agents or brokers.

Procedure of buying shares;

i. Opening a CDSC account through broker
ii. Filling in the purchase order form by stating the type and the number of shares to be bought
iii. The broker identifies and negotiate with the willing buyer
iv. The shares are then paid for through brokers at a commission
v. Shares are then transferred and credited in the buyers CDSC account

Procedure for selling shares;

i. Opening a CDSC account through broker
ii. Filling in the sales order by stating the price and the number of shares to be sold
iii. The buyer identifies and negotiate with the willing buyer
iv. The buyer pays for the shares through the broker
v. Shares are transferred and credited in the buyer's CDSC account with the sellers CDSC account being debited

Roles of stock exchange market

They perform the following roles;

- They facilitate the buying of shares buy creating a conducive environment for the investors who wants to buy shares.
- They facilitate the selling of shares by creating a ready market for those who wish to sell their shares
- They safeguard the investors' interest by ensuring that the companies to be listed have met a given standard of performance. If not they will be deregistered
- Assist the company to raise capital through IPO or sales of shares in the market

- Provide useful information to the investors which is always timely and accurate to assist them in their decision making
- They create employment opportunity to those who facilitate the buying and selling of the shares such a jobbers, brokers, etc
- They help the government in raising the revenues in terms of fees and rents to the government
- They avail variety of securities for the investors to choose from before investing.
- They measure the country's economic progress through checking the performance of the stock, which may be an indicator of the economic performance.

- **SOURCE DOCUMENTS AND BOOKS OF ORIGINAL ENTRY**

These are documents containing the information that makes basis of making entries in the books of accounts. They act as evidence that the transaction actually took place. They includes

- **Cash sale receipt**: - a document that shows that cash as been received or paid out of the business either in form of cash or cheque. It is a source document that is mainly used in making records in the cash journals cash book, cash accounts or bank accounts. If the receipt is received, it means payments has been made and therefore will be credited in the above accounts, or taken to cash disbursement/payment journals, while when issued, it means cash/cheque has been received and therefore will be debited in the above accounts or taken to cash receipt journals

- **Invoice**: - a document issued when the transaction was done on credit to demand for their payment. If the invoice is an incoming invoice/invoice received, then it implies that the purchases were made on credit, and if it is an outgoing/invoice issued then it implies that sales were made on credit.

  The incoming invoice will be used to record the information in the purchases journals/diary, while an outgoing invoice will be used to record information in sales journals/diaries

- **Credit note**: - a document issued when goods are returned to the business by the customer or the business return goods to the supplier and to correct any overcharge that may have taken place. If it is received, then it means part of the purchases has been returned and therefore the information will be used to record information in the purchases return journals, while if issued then it means the part of sales has been returned by the customers and therefore used to record the information in the sales return journals/diaries

- **Debit note**: - a document used to correct an undercharge that may have taken place to inform the debtor to pay more. It therefore acts as an additional invoice

- **Payment voucher**: - a document used where it is not possible to get a receipt for the cash/cheque that has been received or issued. The person being paid must sign on it to make it authentic. It is therefore used to record information just as receipts

Books of original entries/Journals/Diaries/day's books/Subsidiary books

These are books where the transactions are listed when they first occur, with their entries being made on a daily basis before they are posted to their respective ledger accounts. The information in the source documents are used to make entries in these books. The books of original entries include:

- Sales journals
- Sales return journals/Return inwards journals
- Purchases journals/creditors journals/bought journals
- Purchases return journals/return outwards journal
- Cash receipt journals
- Cash payment/cash disbursement journals
- Three column cash book
- The petty cash book
- Analysis cash book
- General journals/journal proper

a) Sales journals

This is used to record credit sales of goods before they can be recorded in their various ledgers. The information obtained in the outgoing invoice/invoice issued is used to record the information in this journal as the source document

The overall total in the sales journal is therefore posted in the sales account in the general ledger on credit side and debtors account in the sales ledger as a debit entry

Sales journal

Date	Particulars/details	Invoice no	Ledger folio	amount

Example:

The following information relates to Tirop traders for the month of June 2010

June 1: Sold goods to wafula on credit of ksh 200, invoice no 0114

2: Sold to the following debtors on credit; Wanjiru ksh 400, Musyoka ksh 300, Wafula ksh 300

5: sold goods on credit to Wanjiru of ksh 300

10: Sold goods to the following on credit Kanini ksh 100, Wafula ksh 500, Wanjiru ksh 600

12: Sold goods on credit to musyoka of ksh 350

Required:

Prepare the relevant day book for the above transactions; hence post the various amounts to their respective individual accounts

Sales journal

Date	Particulars/details	Invoice no	Ledger folio	amount
June 2010:				
1	Wafula	0114	SL	200
2	Wanjiru		SL	400
2	Musyoka		SL	300

2	Wafula		SL	300
5	Wanjiru		SL	300
10	Wanjiru		SL	600
10	Wafula		SL	500
10	Kanini		SL	100
12	Musyoka		SL	350
15	Totals posted to the sales account (Cr)		GL	3050

(Post the rest to their individual debtors account)

b) Sales Return Journals/Return inwards journals

This is for recording the goods that the customers/debtors have returned to the business. It uses the information in the credit note issued as a source document to prepare it. The information is therefore recorded to the return inwards account in the general ledger, while the individual's entries are reflected (credited) also in their respective debtors account for double entry to be completed. It takes the following format

Sales return journal

Date	Particulars/details	Credit note no	Ledger folio	amount

For example;

Record the following transaction for the 2007 in their relevant diaries, hence post them to their respective ledger accounts;

May 1: goods that had been sold to M Okondo of shs 2600 on credit was returned to the business

" 2: G. Otuya returned good worth shs 1320 that was sold to him on credit to the business

" 8: the following returned goods that had been sent to them on credit to the business H Wati shs 3500, Muya shs 4700 M Okondo shs 2900

" 12: G Otuya returned goods worth shs 5400 that were sold on credit to the business

" 30: Goods worth sh 8900 that had been sold on credit to G Otuya were returned to the business

Sales Return journal

Date	Particulars/details	Credit note no	Ledger folio	amount
May 2007:				
1	M Okondo		S.L	2600
2	G Otuya		S.L	1320
8	H Wati		S.L	3500
8	Muya		S.L	4700
8	M Okondo		S.L	2900
12	G Otuya		S.L	5400
30	G Otuya		S.L	8900

	Totals posted to Return Inwards a/c (Dr)		GL	29320

(Post the entries to the individual ledger a/c's (Cr))

c) Purchases Journal

This is used to record the credit purchase of goods. The totals are then debited in the purchases account in the general ledger, while the individual's creditors accounts are credited. It used the invoices received/incoming invoices as it source document. It takes the following format;

Purchases journal

Date	Particulars/details	Invoice no	Ledger folio	amount

For example

The following information relates to Mikwa Traders for the month of April 2011. Record them in their relevant day's book, hence post the entries to their relevant ledger accounts.

April 2011;

" 2. Bought goods worth shs 25 000 on credit from Juma, Invoice no 3502
3. Bought goods worth shs 16 500 from kamau on credit, invoice no 2607
6. Bought goods worth shs 12 700 from Juma on credit, invoice no 3509
8. Purchased goods of shs 25 200 from juma, invoice no 3605; shs 17 500 from Kamau, invoice no 3700; shs 45 000 from Wamae wholesalers, invoice no 3750
15. Purchased goods of shs 9 200 from Wamae wholesalers on credit, invoice no 3762
18. Bought goods of shs 17 000 from Kamau on credit, invoice no 3802
24. Purchased goods of shs 36 000 from Juma suppliers on credit, Invoice no 3812

Purchases Day book

Date	Particulars/details	Invoice no	Ledger folio	amount
April 2011:				
2	Juma	3502	PL	25 000
3	Kamau	2607	PL	16 500
6	Juma	3509	PL	12 700
8	Juma	3605	PL	25 200
8	Kamau	3700	PL	17 500
8	Wamae	3750	PL	45 000
15	Wamae	3762	PL	9 200
18	Kamau	3802	PL	17 000
24	Juma	3812	PL	36 000
	Totals posted to the Purchase account (Dr)		GL	204100

(Post the individual entries to their relevant accounts in the ledger (crediting))

d) Purchases Return Journals/Return outwards Journals

This is used to record goods that have been returned to the creditors by the business, reducing the value of the goods that had been purchased. It uses the credit note received as the source documents, with the totals being in the purchases return account while the individual creditor's accounts are debited in their respective ledger accounts. It takes the following format

Purchases return journal

Date	Particulars/details	Credit note no	Ledger folio	amount

For example;

Record the following transaction in the purchases return day book for Njiru's traders for the month of June 2010, hence post the information into their relevant ledger accounts.

June 2010;

" 3. Returned goods worth shs 400 that had been bought from Nairobi stores, credit note no 56

" 8. Return goods of shs 1 200 to Matayos store, Credit no 148

"19. Had some of their purchases returned to the following; Njoka enterprises shs 700, credit note no 205, Nairobi Stores shs 600, credit note no 58, Matayos store shs 1 000 credit note no 191

"26. Returned goods worth shs 1 800 to Njoka enterprise credit note no 210

"30. Return goods worth shs 1 020 to Matayos store, credit note no 200

e) Cash receipt Diaries

This is used to record all the cash and cheques that have been received in the business. They may be many that posting directly in the cash book may be tedious and are therefore first recorded here. It totals are posted to the cash and bank accounts in the general ledger (Dr), while the individual accounts are credited in their respective accounts in the ledger. It uses the cash receipt issued and bank slips received as the source documents. It takes the following format;

Cash receipt journal

Date	Particulars/details	Receipt no	Ledger folio	Disc allowed	cash	bank

f) Cash payment Journals

This is used to record cash and cheques that have been issued to the creditors/out of the business. Its totals are credited (Cr) in the cash and bank account and the individual accounts are debited (Dr) in their respective accounts It uses the cash receipt received and bank slips issued as the source documents. It takes the following format;

Cash Payment journal

Date	Particulars/details	Receipt no	Ledger folio	Disc received	cash	bank

For example:

Record the following transactions into their relevant day books of Onyango traders, hence post the entries to their respective ledger accounts and balance them off;

May 2011:

"1. Cash sales amounting to ksh 3 000, receipt no 0112

"2. Paid the following creditors by cheque after having deducted a cash discount of 10% in each case; H. Mwangi ksh 1 500, J. Mwaniki ksh 1 600, N. Mugo ksh 1 200

"3. Receive the following Chaques from debtors in settlement of their debts after having deducted 5% cash discount in each case; Lucy kshs 22 800 cheque no 0115, Otieno kshs 8 550 cheque no 0011, Martha ksh 1 330 cheque no 0016

"5. Paid for repairs in cash kshs 16 000, receipt no 0251

"10. Paid Juma in cash kshs 9 500, receipt no 0295

"14. Cash sales kshs 17 000, receipt no 02714

"15. Banked kshs 6 000 from the cash till

"15. Received cash from Mary of kshs 13 500, receipt no 0258

"16. Cash sales of kshs 26 400 was directly banked, bank slip no 40152

"20. Cash purchases of kshs 8 920, receipt no 117

"22. Cash purchases of kshs 15 200 was paid for by a cheque, cheque no 512

Cash receipt journal

Date	Particulars/details	Document no	Ledger folio	Disc allowed	cash	bank
May 2011						
1	Sales	0112	GL		3 000	
3	Lucy	0115	SL	1200		22 800
3	Otieno	0011	SL	450		8 550
3	Martha	0016	SL	700		1 330
14	Sales	02714	GL		17 000	
15	Cash		"c"			6 000
15	Mary	0258	SL		13 500	
16	Sales	40152	GL			26 400
	Totals to be posted to the cash and bank a/c (Dr)			2 350	33 500	65 080

(Post the totals and the entries to their respective accounts)

Cash Payment journal

Date	Particulars/details	Document no	Ledger folio	Disc Received	cash	bank
May 2011						
2	H. Mwangi		PL	166.70		1 500
2	J. Mwaniki		PL	177.70		1 600

2	N. Mugo		PL	133.30		1 200
5	Repairs	0251	GL		16 000	
10	Juma	0295	PL		9 500	
15	Bank		"c"		6 000	
20	Purchases	117	GL		8 920	
22	Purchases	512	GL			15 200
	Totals to be posted to the cash and bank a/c (Cr)			477.30	40 420	19 500

(Post the totals and the entries to their respective accounts)

g) The petty Cash book

This is used to record money that has been set aside to make payments that does not require large amounts, such as cleaning, staff tea, posting letters, etc. it is always kept by the petty cashier, under the supervision of the main cashier. The amount received by the petty cashier is always debited, while the payments made from the same is credited. The credit side also contains the analytical columns for various items of expenditure. The amount credited is also extended to the analysis column for the specific item. At the end of the stated period, the petty cash book is balanced, and the totals are posted to their individual accounts. The individual's accounts are debited with the totals of the analytical columns, while the cash account is credited by the main cashier for the total that was spent in the petty cash book.

Petty cash book can also be operated on an imprest system, where the petty cashier receives a given amount of money at an intervals (imprest) to spend, and report back to the main cashier at the end of the period on how the money has been spent and the balance still remaining for re-stocking (reimbursed), and only the amount spent can be reimbursed so that at the beginning of the period the petty cashier will always have the full amount (cash float).

For example:

A petty cashier of sina chuki traders operate a petty cash book on an imprest of kshs 2 500 on a monthly basis. On 1st February 2010, she had cash in hand of shs 150 and was reimbursed the difference by the main cashier to restore her cash float. The following payments were made during the month of February 2010

Feb; 1. Travelling expenses kshs110
2. Correcting fluid kshs 200
3. Sugar for staff tea ksh 180
4. Stamps kshs 255
10. Telephone kshs 255
15. Entertainment kshs 130
18. Postage stamps kshs 100
20. Bread for staff tea kshs 148
25. Fare kshs 200

26. Duplicating ink kshs 250
27. Entertainment kshs 400
28. Telephone kshs 100
28. Atieno a creditor was paid ksh 150

Required;

Prepare a petty cash book from the above information and post the totals to the relevant ledger accounts.

Sina Chuki Traders
Petty Cash Book
For month of Feb. 2010

Receipt sh	L. F	Date	Details	Vouch no	Total sh	Travel exp	Office exp	Staff tea	postage	Telephone	Ent.	Ledger a/c
		2010										
150		Feb	Bal b/d									
2 350	C.	1	Reimbursem									
	B	1	ent		110	110						
		1	Travelling		200		200					
		2	exp		180			180				
		3	Correcting		255				255			
		4	fluid		255					255		
		10	Sugar		130						130	
		15	Stamps		100				100			
		18	Telephone		148			148				
		20	Entertainmen		200	200						
		25	t		250		250					
		26	Stamps		400						400	
		27	Bread		100					100		
		28	Fare		150							150
		28	Duplicating		247	310	450	328	355	355	530	150
			ink		8							
2500			Entertainmen		22							
22			t		250							
			Telephone		0							
			Atieno									
			Totals									
			Bal c/d									
			Bal b/d									

The totals in the analytical columns are Debited in the individual accounts, with the petty cash book totals being credited in the cash account.

h) The general Journal/Journal proper

This one is used to record purchases or sales of fixed assets of the business on credit. These assets do not form part of the stock since the business does not deal in them, however the business may decide to buy or sell them for one reason or the other.

In this journal, the account to be debited begins at the margin, while the account to be credited is indented from the margin, with a narration below them put in brackets. The narration simply explains the nature of the transaction that has taken place. The individual entries are then posted to their respective accounts by either debiting or crediting depending on the transactions. It takes the following format;

General journal

Date	Particulars/details	Ledger folio	Dr shs	Cr shs

For example;

Journalise then following transactions which took place in the business of J Opuche during the month of March 2005

March 5; Purchased office furniture on credit for shs 25 000 from miugiza Furniture Limited

10; Sold old duplicating machine for shs 15 000 to samba academy on credit

15; Bought a new motor vehicle for shs 800 000 from explo motors Ltd, paying shs 300 000 in cash and balance was to be settled at a later date

18; Sold old vehicle to Mara Secondary school for shs 500 000 on credit

25;The owner converted personal electronic calculator valued at shs 9 000 into business asset

27; Sold old computers valued at shs 20 000 for shs 15 000 on credit to Mara secondary school

30; Sold old dining chairs worth shs 10 000 to Maendeleo for shs 15 000 on credit

General journal

Date	Particulars/details	Ledger folio	Dr shs	Cr shs
March 2005				
5	Office Furniture a/c		25 000	
	Miugiza a/c			25 000
	(Being a credit purchase of office furniture from Miugiza)			
10	Samba Accademy a/c		15 000	
	Duplicating Machine a/c			15 000
	(Being credit sales of duplicating machine to Samba academy)			

15	Motor vehicle a/c Cash a/c Explo Motors a/c (Being purchase of motor vehicle from explo. motors, paying part in cash and part on credit)		800 000	 300 000 500 000
18	Mara Sec sch a/c Motor vehicle a/c (being the credit sale of old motor vehicle to mara sec sch)		500 000	 500 000
25	Calculators a/c Capital a/c (being conversion of private calculator to business asset)		9 000	 9 000
27	Mara Sec. Sch. a/c Loss on disposal a/c Computer a/c (being credit sale of old computers to Mara school at a loss of 5 000)		15 000 5 000	 20 000
30	Maendeleo a/c Furniture a/c Gain on disposal a/c (being the credit sale of dining chairs to maendeleo at a gain of 5 000)		15 000	 10 000 5 000
			1 384 000	1 384 000

The entries are then transferred to their respective accounts in the ledger, with the ones debited in the journals being debited and the ones credited being credited.

The Journal proper can also be used to show the opening entries and the closing entries. That is;

- ***Opening entries***

The opening entries are the entries of the assets and liabilities at the beginning of the trading periods to facilitate the opening of different accounts for them. They are the balance b/d for the assets and liabilities of the business.

The assets to be debited are recorded first, followed by the liabilities and capital to be credited. Incase the capital is not given, it can be calculated using the book keeping equation, that is A = C + L. the narration then follows the entries.

The opening entries are necessary when;

- A business that did not keep complete accounting records would like to start keeping
- Opening up new sets of accounting books, after closing the old ones
- Starting accounting records for a business which has been bought, though was in full operation

  For example;

The following balances were extracted from Martine's store that did not keep complete records, and would like to start keeping on 1st January 2011. Prepare for them their relevant subsidiary book to show the balances.

		Shs
Motor vehicles		230 000
Machinery		40 000
Creditors		10 000
Debtors		5 000
Cash in hand		20 000
Stock		10 000
Insurance prepaid		5 000
Bank		25 000
Premises		335 000
Capital	660 000	

Martine's Store
General journal
On 1st January 2011

Date	Particulars/details	Ledger folio	Dr shs	Cr shs
2011	Premises		335 000	
January 1	Motor vehicle		230 000	
	Machinery		40 000	
	Debtors		5 000	
	Cash		20 000	
	Insurance prepaid		5 000	
	Bank		25 000	
	Stock		10 000	
	Capital			660 000
	Creditors			10 000
	(being the records of assets, liability and capital at the beginning of new period)			
			670 000	670 000

- **Closing entries**

At the end of the trading period the business asses how it carried out its trade and the amount of profit it made by preparing the Trading profit and loss account and the balance sheet to show its financial position. These are prepared by the information obtained from the ledgers. That is, all the nominal accounts (sale, purchase, expenses and revenue accounts), both opening and closing stocks are transferred to the trading profit and loss account through the trial balance and general journals, while the rest are taken to the balance sheet.

Uses of general journal;

- ✓ To record purchases of fixed assets on credit
- ✓ To record sales of fixed assets on credit
- ✓ To correct errors by checking the balances
- ✓ To record the opening and closing entries
- ✓ To write off bad debts
- ✓ To record the inter ledger transfers
- ✓ To issues shares and debentures in companies
- ✓ To make end of the year adjustments for the final accounts

In the table below, indicate the books of original entry that the information obtained from the given source documents are used to prepare

Source Document	Books of Original entry
Sales Invoice/invoice issued/Invoice retained/invoice copy	Sales journals
Purchases Invoice/Invoice received/Original invoice	Purchases journals
Credit note issued/Credit note retained/Credit note copy	Return inwards/Sales return journals
Credit note received/credit note original	Return outwards/purchases return journals
Original receipt/Receipt received	Cash payment/Analysis cash book/ Cash book
Receipt copy/Retained receipt	Cash receipt journal/Analysis cash book/cash book
Petty cash voucher	Petty cash book

Uses of Journals

- ❖ To relive ledger of many details
- ❖ To record more details about the transaction that are not found in the ledger
- ❖ To facilitate tracing of errors
- ❖ To facilitate the preparation of control accounts
- ❖ To curb frauds and promote efficiency, since they are prepared by different people from the ones handling ledgers

Assignment:

(Exercise 1B pages 50 and 51, Nos16 and 18 in Inventor book 4, KLB Students book)

- **FINANCIAL STATEMENTS**

These are prepared at the end of a given trading period to determine the profit and losses of the business, and also to show the financial position of the business at a given time.

They includes; trading account, profit and loss account, trading profit and loss account and the balance sheet.

They are also referred to as the final statements.

The trading period is the duration through which the trading activities are carried out in the business before it decides to determines it performances in terms of profit or loss. It may be one week, month, six months or even a year depending on what the owner wants.

Most of the business use one year as their trading period. It is also referred to as the accounting period.

At the end of the accounting period, the following takes place;

- All the accounts are balanced off
- A trial balance is extracted
- Profit or loss is determined
- The balance sheet is prepared

Determining the profit or loss of a business

When a business sells its stock above the buying price/cost of acquiring the stock, it makes a profit, while if it sells below it makes a loss. The profit realized when the business sell it stock beyond the cost is what is referred to as the gross profit, while if it is a loss then it is referred to as a gross loss.

It is referred to as the gross profit /loss because it has not been used to cater for the expenses that may have been incurred in selling that stock, such as the salary of the salesman, rent for the premises, water bills, etc. it therefore implies that the businessman cannot take the whole gross profit for its personal use but must first deduct the total cost of all other expenses that may have been incurred.

The profit realized after the cost of all the expenses incurred has been deducted is what becomes the real profit for the owner of the business, and is referred to as Net profit. The net profit can be determined through calculation or preparation of profit and loss account.

In calculating the gross profit, the following adjustments are put in place

- Return inwards/Sales return: - these are goods that had been sold to the customers, but they have returned them to the business for one reason or the other. It therefore reduces the value of sales, and is therefore subtracted from sales to obtain the net sales

  Therefore Net sales = Sales – Return inwards

- Return outwards/purchases return: - these are goods that had been bought from the suppliers to the business and have been returned to them for one reason or the other. It reduces the purchases and is therefore subtracted from the purchases to obtain the net purchases.
- Drawings: - this refers to goods that the owner of the business has taken from the business for his own use. It reduces the value of purchases, and is therefore subtracted from purchases when determining the net purchases. It is different from the other drawing in that it is purely goods and not money

- Carriage inwards/Carriage on purchases: - this is the cost incurred by the suppliers in transporting the goods from his premises to the customers business. It is treated as part of the purchases, and therefore increases the value of purchases. It is added to purchases to determine the actual value of purchases/Net purchases.

  Therefore Net Purchases = Purchases + Carriage inwards – Return Outwards - Drawings

- Carriage outwards/Carriage on sales: - this is the cost that the business has incurred in transporting goods from its premises to the customers premises. The cost reduces the business profit that would have been realized as a result of the sale, and is therefore treated as an expense and is subtracted from the gross profit, before determining the net profit.
- Opening stock is the stock of goods at the beginning of the trading period, while the closing stock is the stock of the goods at the end of the trading period
  Gross profit is therefore calculated as follows;

  Gross Profit = Sales – Return inwards – (Opening stock + Purchases + carriage inwards – Return outwards – Closing stock)

  Or

  Gross profit = Net sales – Cost of Goods Sold (COGS)

  COGS = Opening Stock + Net Purchases – Closing stock

  Net Profit = Gross profit – Total expenses

Trading Account

This is prepared by the business to determine the gross profit/loss during that trading period
It takes the following format;

Name of the business
Trading Account
Dr For the period (date) Cr

	Shs	Shs		Shs	Shs
Opening stock		xxxxxx	Sales	xxxxxx	
add Purchases	xxxxx		Less Return inwards	xxx	
add Carriage inwards	xxx		Net sales		xxxxxx
less Return Outwards	xxx				
less Drawings	xx	xxxxx			
Goods available for sale		xxxxxx			
Less Closing Stock		xxx			
Cost Of Goods Sold (COGS)		xxxxxx			
Gross profit c/d		xxxx			
		xxxxxx			xxxxxx
			Gross profit b/d		xxxx

The trading account is completed by the time the gross profit b/d is determined

For example

The following balances were obtained from the books of Ramera Traders for the year ending may 31st 2010

Sales	670 000
Purchases	380 000
Return inwards	40 000
Carriage outwards	18 000
Return outwards	20 000
Carriage inwards	10 000

Additional information;

- During the year the owner took goods worth sh 5 000 for his family use
- The stock as at 1st June 2009 was shs 60 000, while the stock as at 31st May 2011 was shs 70 000

Required; Prepare Ramera Traders trading account for the period ending 31st May 2010

Ramera Traders

Trading Account

Dr For the period ending 31/5/2010 Cr

	Shs	Shs		Shs	Shs
Opening stock		60 000	Sales	670 000	
add Purchases	380 000		Less Return inwards	40 000	
add Carriage inwards	10 000		Net sales		630 000
less Return Outwards	20 000				
less Drawings	5 000	365 000			
Goods available for sale		425 000			
Less Closing Stock		70 000			
Cost Of Goods Sold (COGS)		355 000			
Gross profit c/d		275 000			
		630 000			630 000
			Gross profit b/d		275 000

Carriage outwards is not an item of Trading account, but profit and loss account as an expense.

Importance of Trading account

i. It is used to determine the gross profit/loss for a given trading period for appropriate decision making by the management.
ii. It is used in determining the cost of goods that was sold during that particular accounting period.
iii. It is used to reveal the volume of turnover i.e net sales
iv. May be used to compare the performance of the business in the current accounting period and the previous periods. It can also compare its performance with other similar businesses
v. It facilitates the preparation of profit and loss account, since the gross profit is carried forward to the profit and loss account.

Profit and Loss account

In preparation of this account, the gross profit is brought down on the credit sides, with all other revenues/income of the business being credited and the expenses together with the net profit being debited. *Net profit = Total Revenues (including Gross Profit) – Total expenses*

Name of the business

Profit and Loss Account

Dr For the period (date) Cr

	Shs		Shs
Expenses		Gross profit b/d	xxxxxx
Insurance	xxx	Discount received	xxx
Electricity	xxx	Rent income	xxx
Water bills	xxx	Commission received	xxx
Carriage Outwards	xxx	Any other income received	xxx
General expenses	xxx		
Provision for Depreciation	xxxx		
Discount allowed	xxx		
Commission allowed	xxxx		
Rent paid	xxxx		
Any other expense	xxxx		
Net profit c/d	xxxx		
	xxxxxx		xxxxxx
		Net profit b/d	xxxx

The profit and loss account is complete when net profit b/d is obtained. In the trial balance, the revenues/incomes are always credited, while the expenses are debited, and the same treatment is found in the profit and loss account. (Any item that is taken to the profit and loss account with a balance appearing in the Debit (Dr) side of a trial balance is treated as an expenses, while those appearing in the credit side is revenue e.g. discount balance appearing in the Dr side is Discount allowed, while the one on Cr side is Discount received)

For example

The following information relates to Akinyi's Traders for the period ending March 28th 2010. Use it to prepare profit and loss account.

Gross profit		100 000
Salaries and wages		20 000
Opening stock	150 000	
Rent income		10 000
Discount received		12 000
Commission allowed	15 000	
Repairs		10 000
Discount allowed		8 000
Commission received	16 000	
Carriage outwards		4 000
Provision for depreciation		6 000
Power and lighting		10 000

Akinyi Traders
Profit and Loss Account

Dr	For the period ending 28th March 2010		Cr
	Shs		Shs
Expenses		Gross profit b/d	100 000
Power and lighting	10 000	Discount received	12 000
Carriage Outwards	4 000	Rent income	10 000
Salaries and wages	20 000	Commission received	16 000
Provision for Depreciation	6 000		
Discount allowed	8 000		
Commission allowed	15 000		
Repairs	10 000		
Net profit c/d	65 000		
	138 000		138 000
		Net profit b/d	65 000

Incase the expenses are more than the income, then the business shall have made a net loss, and the loss will be credited.

Net profit/loss can also be found through calculation as follows;

Net profit/loss = Gross profit + Total other revenues – Total expenses

For the above example;
Total other revenues = 12 000 + 10 000 + 16 000
= 38 000
Total expenses = 10 000 + 4 000 + 20 000 + 6 000 + 8 000 + 15 000 + 10 000
= 73 000
Therefore; Net profit = Gross profit + Total other revenues – Total expenses
= 100 000 + 38 000 – 73 000
= 65 000

Importance of profit and loss account

- ✓ It shows the revenue earned, and all the expenses incurred during the accounting period
- ✓ It used to determine the net profit/net loss of a given trading period
- ✓ It is a requirement by the government for the purpose of taxation
- ✓ May be used by the employees to gauge the strength of the business, in terms of its ability to pay them well
- ✓ It is vital for the prospective investor in the business, in terms of determining the viability of the business
- ✓ The creditors or loaners may use it to asses the business ability to pay back their debts
- ✓ It is used by the management to make a decision on the future of their business.

Trading, Profit and Loss Account

This is the combination of trading account and trading profit and loss account to form a single document. It ends when the net profit/loss brought down has been determined. That is;

Name of the business

Trading, Profit and Loss Account

Dr For the period (date) Cr

	Shs	Shs		Shs	Shs
Opening stock		xxxxxx	Sales	xxxxxx	
add Purchases	xxxxx		Less Return inwards	xxx	
add Carriage inwards	xxx		Net sales		xxxxxx
less Return Outwards	xxx				
less Drawings	xx	xxxxx			
Goods available for sale		xxxxxx			
Less Closing Stock		xxx			
Cost Of Goods Sold (COGS)		xxxxxx			
Gross profit c/d		xxxx			
		xxxxxx			xxxxxx
<u>Expenses</u>			Gross profit b/d		xxxx
Insurance		xxx	Discount received		xxx
Electricity		xxx	Rent income		xxx
Water bills		xxx	Commission received		xxx
Carriage Outwards		xxx	Any other income received		xxx
General expenses		xxx			
Provision for Depreciation		xxxx			
Discount allowed		xxx			
Commission allowed		xxxx			
Rent paid		xxxx			
Any other expense		xxxx			
Net profit c/d		xxxx			
		xxxxxx			xxxxxx
			Net profit b/d		xxxx

End Year Adjustments

The following items may require to be adjusted at the end of the trading period

- Revenues/Income
- Expenses
- Fixed assets

Adjustment on revenues

The revenue may have been paid in advance in part or whole (prepaid revenue) or may be paid later after the trading period (accrued revenue).

Prepaid revenue is subtracted from the revenue/income to be received and the difference is what is treated in the profit and loss account or trading profit and loss account as an income, while the accrued

revenue is added to the revenue/income to be received and the sum is what is treated in the above accounts as the actual revenue.
Only the prepaid amount and the accrued amounts are what are then taken to the balance sheet

Adjustment on the expenses

The expenses may have been paid for in advance in part or whole (prepaid expenses) or may be paid for later after the trading period (accrued expenses).
Prepaid expenses is subtracted from the expenses to be paid for and the difference is what is treated in the profit and loss account or trading profit and loss account as an expense, while the accrued expenses is added to the expenses to be paid for and the sum is what is treated in the above accounts as the actual expenses.
Only the prepaid amount and the accrued amounts are what are then taken to the balance sheet

Adjustment on fixed assets

The fixed assets may decrease in value, due to tear and wear. This makes the value to go down over time, what is referred to as depreciation. The amount of depreciation is always estimated as a percentage of cost.
The amount that shall have depreciated is treated in the profit and loss account or T,P&L as an expense, while the value of the asset is recorded in the balance sheet, less depreciation.

For example;

1. 1997 The following Trial balance was prepared from the books of Paka Traders as at 31^{st} December 1995. Trial balance December 31^{st} 1995

	Dr. (shs)		Cr. (shs)	
Sales			980,000	
Purchases	600,000			
Returns	80,000	20 000		
Carriage in			40,000	
Carriage out	3,000			
Stock (Jan 1^{st} 1999)	120,000			
Rent	60,000		45 000	
Discount	15,000		25 000	
Motor vehicle	150 000			
Machinery	250 000			
Debtors	120,000			
Salaries	18,000			
Commission	7,000			12 000
Capital			178,000	
Insurance	15 000			
Creditors				240,000
Cash	122 000			
	1 540 000			1 540 000

Additional information

i. Stock as at 31^{st} December was 100,000

ii. the provision for depreciation was 10% on the cost of Motor vehicle, and 5% on the cost of Machinery

Required:

Prepare trading profit and loss account for the period ending 31st December 1999

Adjustments:

Provision for depreciation;

Machinery = $\frac{5}{100} \times 250\ 000$

= 7 500

(New balance of machinery = 250 000 – 7 500 = 242 500. The 242 500 is taken to the balance as Machinery (fixed asset), while 7 500 is taken to the trading profit and loss account as expenses)

Motor vehicle = $\frac{10}{100} \times 150\ 000$

= 15 000

(New balance of Motor Vehicle = 150 000 – 15 000 = 135 000. The 135 000 is taken to the balance as Motor Vehicle (fixed asset), while 15 000 is taken to the trading profit and loss account as expenses)

Paka Traders

Trading, Profit and Loss Account

Dr For the period 31/12/1995 Cr

	Shs	Shs		Shs	Shs
Opening stock		120 000	Sales	980 000	
add Purchases	600 000		Less Return inwards	80 000	
add Carriage inwards	40 000		Net sales		900 000
less Return Outwards	20 000	620 000			
Goods available for sale		740 000			
Less Closing Stock		100 000			
Cost Of Goods Sold (COGS)		640 000			
Gross profit c/d		260 000			
		900 000			900 000
Expenses			Gross profit b/d		260 000
Insurance		15 000	Discount received		25 000
Carriage Outwards		30 000	Rent income		45 000
Salaries		18 000	Commission received		12 000
Provision for Depreciation					
Motor vehicle	15 000				
Machinery	7 500	22 500			
Discount allowed		15 000			
Commission allowed		7 000			
Rent paid		60 000			
Net profit c/d		174 500			

	342 000		342 000
		Net profit b/d	174 500

The net profit/loss may be taken to the balance sheet.
The items that have been adjusted will be recorded in the balance sheet less the adjustment.

The Balance Sheet

The balance sheet will show the business financial position in relation to assets, capital and liabilities. The adjustment that can be made will be on Fixed assets and capital only. That is;
Fixed assets are recorded less their depreciation value (should there be provision for depreciation) as the actual value.

Actual value of assets = Old value – depreciation.

Capital is adjusted with the following; Net capital, Drawings and additional investment. i.e.

Closing Capital/Net capital (C.C) = Opening/initial capital (O.C) + Additional Investment (I) + Net profit (N.P) or (less Net Loss) – Drawings

$$CC = OC + I + NP - D$$

Where:
Opening Capital: - the capital at the beginning of the trading period
Closing capital: - the capital as at the end of the trading period
Additional Investment: - any amount or asset that the owner adds to the business during the trading period
Net profit: - the profit obtained from the trading activities during the period. Incase of a loss, it is subtracted

Types of Capital

The capital in the business can be classified as follows

- Capital Owned/Owner's Equity/Capital invested; - this is the capital that the owner of the business has contributed to the business. It is the Net capital/Closing capital of the business (C = A – L)
- Borrowed capital: - the resources brought into the business from the outside sources. They are the long term liabilities of the business.
- Working capital: - these are resources in the business that can be used to meet the immediate obligation of the business. It is the difference between the total current assets and total current liabilities

  Working Capital = Total Current Assets – Total Current Liabilities
- Capital employed: - these are the resources that has been put in the business for a long term. i.e.

  Capital Employed = Total Fixed assets + Working Capital

  Or

  Capital employed = Capital Invested + Long term liabilities

Name of the business
Balance Sheet
As at (date)

	Shs	shs		Shs	shs
Fixed Assets					
Land	xxxxx		Capital	xxxxx	
Buildings	xxxxx		Add Net profit	xxxx	
Motor Vahicle	xxxxx		Add additional investt	xxx	
Any other fixed assets	xxxxx	xxxxxx	Less drawings	xxx	
			Net Capital		xxxxx
Current Assets					
Stock	xxxx		Long term liabilities		
Debtors	xxxx		Long term loan	xxxx	
Bank	xxxx		Any other	xxxx	xxxx
Cash	xxxx				
Prepaid Expenses	xxxx		Current liabilities		
Accrued revenues	xxxx		Creditors	xxxx	
Any other current assets	xxxx	xxxxxx	Short term loan	xxxx	
			Accrued expenses	xxxx	
			Prepaid revenues	xxxx	
			Any other	xxxx	xxxxx
		xxxxxx			xxxxxx

For example 00A

The following information were extracted from the trial balance of Mwema traders on 31st December 2010

Sales		750 000
Purchases		540 000
Sales return		24 000
Return outwards		30 000
General expenses		72 000
Commission received	24 000	
Rent expenses	2 500	
Electricity expenses		16 000
Furniture		288 000
Motor vehicle		720 000
Capital	842 500	
Bank Loan		250 000
Creditors		216 000
Cash		156 000
Debtors		244 000

Additional Information

a) Stock as at 31/12/2010 was ksh 72 000
b) Electricity prepaid was shs 4 000
c) Rent expenses accrued shs 3500
d) Depreciation was provided for as follows

i. Motor Vehicle 15% p.a. on cost
ii. Furniture 6% p.a. on cost

Required

(i) Prepare Trading, profit and loss account for the year

(ii) Prepare a balance sheet as at 31st December 2012

(iii) Determine the following:

a. Owner's equity
b. Borrowed capital
c. Working capital
d. Capital employed

Adjustments:

Motor Vehicle = $\frac{15}{100} \times 720\,000$

= 108 000

Therefore Motor vehicle = 612 000

Furniture = $\frac{6}{100} \times 288\,000$

= 17 280

Therefore furniture = 270 720

Mwema Traders

Trading, Profit and Loss Account

For the period 31/12/2010

Dr	Shs	Shs	Cr	Shs	Shs
Purchases	540 000		Sales	750 000	
less Return Outwards	30 000	510 000	Less Return inwards	24 000	
Goods available for sale		510 000	Net sales		726 000
Less Closing Stock		72 000			
Cost Of Goods Sold (COGS)		438 000			
Gross profit c/d		288 000			
		726 000			726 000
Expenses			Gross profit b/d		288 000
General expenses		72 000	commission received		24 000
Electricity expenses	16 000				
Less Electricity prepaid	4 000	12 000			
Rent expenses	2 500				
Accrued rent exp	3 500	6 000			
Provision for Depreciation					
Motor vehicle	108 000				
Furniture	17 280	125 280			
Net profit c/d		96 720			

	312 000		312 000
		Net profit b/d	96 720

Mwema Traders
Balance Sheet
As at 31/12/2010

	Shs	shs		Shs	shs
Fixed Assets					
Motor Vehicle	612 000		Capital	842 500	
Furniture	270 720	882 720	Add Net profit	96 720	
			Net Capital		939 220
Current Assets					
Stock	72 000		Long term liabilities		
Debtors	244 000		Bank Loan		250 000
Electricity prepaid	4 000				
Bank	50 000		Current liabilities		
Cash	156 000	526 000	Creditors	216 000	
			Accrued rent	3 500	219 500
		1 408 720			1 408 720

Basic Financial Ratios

A ratio is an expression of one item in relation to the other. It is used to compare the groups of related items in the business, for the purpose of assessing the performance of the business. They include:

a) Mark-up

This is the comparison of gross profit as a percentage of cost of goods sold. i.e.

$$\text{Mark-up} = \frac{Gross\ Profit}{Cost\ of\ Goods\ Sold} \times 100$$
$$= \frac{G.P}{COGS} \times 100$$

For example: in (example OOA) above, determine the mark-up of the business.

$$\text{Mark-up} = \frac{Gross\ Profit}{Cost\ of\ Goods\ Sold} \times 100$$

Gross profit = 288 000

COGS = 438 000

$$\text{Mark-up} = \frac{288\ 000}{438\ 000} \times 100$$
$$= 65.75\%$$

(This implies that the Gross profit of the business is 65.75% of its cost of goods sold)

b) Margin

This is the expression of the gross profit as a percentage of net sales. That is:

$$\text{Margin} = \frac{Gross\ Profit}{net\ sales} \times 100$$

$= \frac{G.P}{sales} \times 100$

For example: in (example OOA) above, determine the margin of the business

Margin = $\frac{Gross\ Profit}{net\ sales} \times 100$

Gross profit = 288 000

Net sales = 726 000

$= \frac{288\ 000}{726\ 000} \times 100$

= 39.67%

(This implies that the gross profit of the business is 39.67% of the net sales)

Relationship between margin and mark-up

Since margin and mark-up are all the expression of Gross profit, it is possible to change one to the other.

- Changing mark-up to margin

  Mark-up can be changed to margin as follows:

  i) Convert the mark-up percentage as a fraction in its simplest form

  ii) Add the value of the numerator of the fraction to the denominator to come up with the new fraction (margin fraction) that is

  If the mark-up fraction = $\boldsymbol{\frac{a}{n}}$

  Margin fraction = $\boldsymbol{\frac{a}{n+a}}$

  iii) Convert the margin fraction as a percentage to obtain margin

  For example: in the above example,

  Mark –up = 65.75%

  $= \frac{65.75}{100}$

  $= \frac{263}{400}$

  Margin fraction = $\frac{263}{400+263}$

  $= \frac{263}{663}$ x 100

  = 39.67%

- Changing margin to mark-up

  (i) Convert the margin percentage as a fraction in its simplest form

  (ii) Subtract the value of the numerator of the fraction from the denominator to come up with the new fraction (mark-up fraction) that is

  If the margin fraction = $\boldsymbol{\frac{a}{n}}$

  Mark-up fraction = $\boldsymbol{\frac{a}{n-a}}$

  (iii) Convert the mark-up fraction as a percentage to obtain mark-up

  For example: in the above example,

  Margin = 39.67%

  $= \frac{39.67}{100}$

$= \frac{263}{663}$

Mark-up fraction = $\frac{263}{663-263}$

$= \frac{263}{400} \text{ x } 100$

= 65.75%

c) Current ratio/working capital ratio

This is the ratio of the current assets to current liabilities. It can also be expressed as a percentage. That is:

Current ratio = $\frac{current\ assets}{current\ liabilities}$

= current assets : current liabilities

Or

Current ratio = $\frac{current\ assets}{current\ liabilities} \text{ x } 100$

For examples: in (example OOA) above, determine the current ratio;

Current assets = 526 000

Current liabilities = 219 500

Current ratio = $\frac{current\ assets}{current\ liabilities}$

$= \frac{526\ 000}{219\ 500}$ = 1052 : 439

Or

$= \frac{526\ 000}{219\ 500} \text{ x } 100$

239.64%

d) Rate of stock turnover

This is the rate at which the stock is bought or sold within a given period of time. It is obtained by;

Rate of stock turnover (ROST) = $\frac{cost\ of\ goods\ sold}{average\ stock}$

Average stock = $\frac{opening\ stock+closing\ stock}{2}$

In (example OOA) above, determine the rate of stock turnover;

The cost of goods sold = 438 000

The closing stock = 72 000

The opening stock = 0

Therefore

The average stock = $\frac{opening\ stock+closing\ stock}{2}$

$= \frac{0+72\ 000}{2}$ = 36 000

Rate of stock turnover (ROST) = $\frac{cost\ of\ goods\ sold}{average\ stock}$

$$= \frac{438\ 000}{36\ 000}$$

$$= 12.17 \text{ Times}$$

e) Return on capital

This is the expression of net profit as a percentage of the capital invested. That is;

$$\text{Return on capital} = \frac{net\ profit}{capital\ invested} \times 100$$

It can be given as a ratio or a percentage.

For example: in (example OOA) above, determine the return on capital of the business

Net Profit = 96 720

Capital invested/owner's equity = 939 220

$$\text{Return on capital} = \frac{net\ profit}{capital\ invested} \times 100$$

$$= \frac{96720}{939220} \times 100$$

$$= 10.33\%$$

f) Acid test ratio/quick ratio

This shows how fast the business can convert its current assets excluding stock to settle its current liabilities. That is;

$$\text{Quick ratio} = \frac{current\ aassets - closing\ stock}{current\ liabilities}$$

It is given in ratio form.

For example: in above (example OOA), determine the quick ratio;

Current assets = 526 000

Stock = 72 000

Current liabilities = 219 500

$$\text{Quick ratio} = \frac{current\ aassets - closing\ stock}{current\ liabilities}$$

$$= \frac{526\ 000 - 72\ 000}{219\ 500}$$

$$= 2.07 \text{ (or } 207 : 100)$$

Importance of Financial Ratios

- Mark up and margin helps in the following; setting the selling price, calculating profit or losses and determining the sales for a given period of time
- Working capital and acid test ratio help in showing whether the business is in a position to meet its short term obligations and checking whether the business is utilizing its resources properly. That is high working capital ratio shows that most of the resources are idle
- Return on capital shows the following;
  - The performance of the business in relation to other similar businesses
  - Comparison of the performance of the business over different periods
  - Whether the business finances have been invested or not
  - Help the potential investors on the decision on where to invest

- ❖ Rate of stock turnover also help in determining how fast or slow the stock is moving. It also helps in computing the gross profit or loss.

• MONEY AND BANKING

Barter Trade

This is the exchange of goods for goods or services for services, or goods for services

Advantages

i. It improves the social interactions between parties involved
ii. People can access goods and services they are not able to produce
iii. They expose the good cultural practices from other trading communities through interaction
iv. Help one to dispose off his surplus
v. It enhances specialization in the production of goods and services
vi. It does not require a common medium of exchange to take place
vii. It promotes the standard of living as the people involved are practicing direct production

Disadvantages

i. It requires double coincidence which may be lacking since you may not know the person requiring your product
ii. It lacked the standard measure of value since it may not be possible to determine how much of product A can be used to exchange product B
iii. Indivisibility of some commodities into smaller units to exchange for smaller quantities of the other product. Especially exchange of animals for other goods
iv. Perishability of some commodities which restrict them to exchanged within a given period of time which a times may not be possible
v. Inability of some goods such as pieces of land and other bulky goods to be moved around due to their bulkiness
vi. Lack of standard differed payment making it difficult for them to be paid for in future
vii. Lacks of unit of account since it is difficult to asses the value of different commodities to keep their record

Due to all these challenges, the members involved felt the need to develop a common medium of exchange to help them carry on with their trading activities. This led to the invention of money

Money

Money is anything that is generally acceptable and is in common use as a medium of exchange.

Characteristic of Money

- ✓ It is generally accepted (Acceptability) by those involved in trade.
- ✓ It can easily be divided into smaller unit to settle different transactions (Divisibility)
- ✓ It can easily be carried from one place to the other where the transaction is taking place (Portability)
- ✓ The material used to make money must be able to last for a relatively longer period of time before getting spoilt (Durability)

- ✓ The value of the money should remain stable for a longer time to maintain it credibility and acceptability in the market, and also stabilize the trading activities (Stability in value)
- ✓ The same denominations should be uniform in quality and identical for easy recognition (Homogeneity)
- ✓ The money material should be easily recognized to enable the parties involved differentiate them from the original and counterfeit materials (Cognisability).
- ✓ Money should be relatively scarce in supply to enable it maintain its value
- ✓ The material used to make coins or metallic money should be easy to recast into then required shapes (Malleability)
- ✓ The material used to make money should not be easily available and the skills for making money should be well secured to make money not easy to be forged

Functions of Money

Money can be used to carry out the following functions

- ➢ As a medium of exchange of goods and services, since it is acceptable to many people
- ➢ As a measure of value of goods and services, to allow room for comparison of different goods and services
- ➢ As a unit of account, since the value of goods and services can be measured in terms of money and recorded in the same form
- ➢ As a store of value or wealth, since it can easily be converted into other forms of wealth
- ➢ As a standard deferred payment since its value can be stabilized, allowing for credit transactions
- ➢ To transfer immovable assets such as land or buildings to their owners in other places

Demand for Money

This is the desire to hold money in its liquid form rather than other forms such as fixed assets. That is the desire to hold the coins and notes both in cash and in the bank, rather than spending them. This desire is a times referred to as liquidity preference.

The demand for money will depend on the motive/intention for which that money is held, which may be categorized as follows:

- ❖ The transaction motives
- ❖ The precautionary motives
- ❖ The speculative motives

❖ The transaction motives

This is where one holds money with an intention of meeting the daily expenses such as buying food, transport cost, entertainment, etc. The amount of money however that one may hold for this purpose will depend on a number of factors which includes;

a. The individuals level of income. A person who earns more money tends to have more expenditures and therefore will require a lot of money to meet them, making him to hold more money as compared to that who earns little

b. The intervals between the receipts of income. That is the interval between the time when an income is earned and when it is likely to be earned again is long, then a lot of money will be kept for this motive
c. The individual spending habits. That is one who spends a lot on luxuries will have to hold a lot to meet their expensive cost.
d. Price of the commodities. That is if the commodities that a person uses are expensive, then he will be forced to hold more money
e. Availability of credit. That incases where individuals cannot obtain goods on credit, they will be forced to hold more money to pay for them than if they are assured that they can obtain goods on credit

❖ The precautionary motives

This is where money is held to meet the unforeseen personal or family expenditure such as medical bills, funeral bills, accidents, etc. However the amount of money held for this motive will depend on the following factors

a. The level of income of the individual. That is if high then a higher portion of income will be held for this motive
b. Family status. A high class family will hold more money for this than a low class family
c. The age of the individual. The old have more uncertainties about life than the young, and therefore will hold more money for this than the young
d. The number of dependants. A family with more dependants will have to hold more money for this to be able to take care of all its dependants incases of emergencies
e. The individual temperament. That is those who are optimistic and are positive about life believe that nothing bad will happen to them, and therefore does not need to keep money for this
f. Duration between the first and the next income. If the income comes after a longer duration then the individual will have to hold more money for this motive

❖ The speculative motives

This is where the individual hold money with an intention of taking advantage of business opportunities that may present itself. That is they hold so that should there be a drop in price of goods they may buy more, or should there be a chance to invest in any profitable business they may invest.

SUPPLY OF MONEY

This is the total amount of money supplied in the economy inform of currency coins and notes by the central bank. The money though will be held by banks, individuals or the government, but the central bank has to put in place the mechanism of controlling the amount of money reaching the economy

BANKING

Banking is the procedure of accepting of the deposits of money from the customers and carrying out financial services associated with holding of such deposits in the banks.
Banks therefore refers to institutions that are involved in the banking process

Development of Banking

Assignment:

Read and make notes on the development of banking right from the inception of the idea to the modern banks and plastic money

Commercial Banks

These are banks formed with the main objective of making profit through financial activities. They are trading businesses just like any other business organization in the country that work to make profit. In Kenya they are all the banks that are involved in money transactions with an intention of making profit. They includes KCB, Barclays, Equity Banks, NBK, Co-operative Banks, Standard Charter Bank, CBA, etc

The banks generate their profits through the following

(i) Interest earned through loans and overdrafts given to their customers
(ii) Investments especially short term investments in government securities such as treasury bills.
(iii) Income from the daily operations which includes the fees charged on the customers for the services they are offered by the banks

Functions of the Commercial Banks

1. Accepting deposits from their customers for safe keeping in the bank. This is done through three main types of accounts which includes, the Fixed deposit accounts, the Current account and the Savings accounts.
2. Lending Money to their customers in form of Loans and Bank Overdrafts to meet their financial needs. These are then paid back with interest which also becomes an income for the banks
3. Safe keeping of valuable items such as title deeds, certificates, jewellery, etc which the customer may fear keeping in their premises due to insecurity
4. Provision of foreign exchange to their customers who would like to convert their local currencies to foreign or foreign to local
5. Offering advice on investment and management of funds to their client to enable them improve their financial discipline and increase their financial position in the society
6. Offering trustee services to their clients, where they may undertake to manage the estate of their clients on his request.
7. Acting as a guarantor or referee to their customers who would like to get loan from other financial institution or obtain goods on credit.
8. Acting as intermediaries between savers and borrowers by receiving deposits from the savers and giving the borrowers inform of loans and overdrafts (credit creation)
9. Offering money transfer facilities/means of payments to their customers inform of the following:
    a) Standing orders: - This is an instruction to the bank by its customer to be paying a certain amount of money to the named persons at intervals until the specified time or be advised otherwise. It help in settling the recurrent expenditure such as rent, salaries, insurance premium, loan recovery, etc

b) Credit transfer: - This is the paying of many people using one chaque. That is a list of those who are to be paid is compiled by the client, giving their names, addresses, their account numbers and the amount each is suppose to receive and is given to the bank together with a chaque of the total amount, and the bank transfer money to their accounts.
c) Telegraphic transfers: - where the person wants to send money to anybody fill his details and the bank where it is to be paid, pay the commission and the bank the bank sends a telegram to the payee.
d) Electronic Fund Transfer (EFT) where the money is transferred from one account to the other through the use of computers. The sender fills in the details in the transfer form and the payment is made electronically
e) Cheque: - which is a written order by the drawer (the account holder) to the drawee (the bank) instructing it make the specified sum to the payee (the person to be paid)

Types of accounts offered by commercial banks

i. Current Account

This is an account that allows the owner to withdraw money from his account anytime he wants through the use of cheque. The owner can withdraw or deposit any amount money to his account any time anywhere within the working hours of the bank. It has the following characteristics/Features;

- Withdrawal can be done by the use of cheque.
- Money can be withdrawn anytime it is demanded
- No minimum balance is to be maintain in the account
- No interest is given on the deposit instead the bank charges ledger fees for the services
- The bank allows an overdraft in this account.
- The account holders are issued with bank statements on a monthly basis
- Any amount can be withdrawn from this account so long as there is money

Advantages of current account

- There is an overdraft facilities in this account
- Payments are made through cheques, making it convenient
- No minimum balance is to be maintained in this account
- Bank statement is issued to the account holders regularly
- The cheques provide evidence of payment that has been made
- The account holder can withdraw money from the account without any notice

Disadvantage of current account

- There is lengthy procedure in opening this account
- No interest on the money deposited in this account
- High initial deposits may be required in this account
- The operation of this account may be expensive due to the ledger fee charged
- It does not encourage saving because the money can easily be accessed in the account

ii. Savings Account

This is an account operated by people who would like to save money. It has the following features;

- Initial minimum deposit is required
- A minimum balance must be maintained for the account to remain operational
- Deposits can be made to this account at any time
- The frequency of withdrawals is regulated by the bank policy
- A notice is required incase you want to withdraw more than the set maximum amount
- The amount maintained in this account earns interest from the bank
- The account holder has to personally visit the bank to make withdrawals

Advantages of Savings account

- Low minimum initial deposit is required
- Interest is earned if a minimum deposit is maintained
- Deposits into the account can be made at anytime
- Restriction on the amount that can be withdrawn enable the holders to save
- The use of ATMs in some bank has made it possible to withdraw money at any time

Disadvantages of savings account

- Minimum balance has to be maintained or else the account be closed
- No overdraft facilities in this account
- Restricted withdrawals denies the holder a chance to enjoy his money
- The account holder must personally visit the bank to withdraw the money
- A notice must be given if the account holder wants to withdraw more than the set maximum amount
- The introduction of ATMs in this account discourages the savings culture

iii. Fixed Deposit account/Time deposit

This is an account whereby the money is deposited once into the account for an agreed period of time and at a given interest rate. Once money is deposited, they will be no further deposits and withdrawals until the period expires, or else there will be a penalty for withdrawals before maturity time.
This account is appropriate for those with large sum of money with no immediate need for its use. It has the following features;

- The account is opened for an agreed period of time
- The account holder is issued with the receipt or certificate of deposit upon opening of the account with terms and condition
- The account attracts higher interest rate
- No further deposit or withdrawal is allowed before the expiry of the period
- Withdrawal of money before the expiry period attracts penalty

Advantages of fixed deposit account

- The deposits earns higher interest than savings account
- Money in the account can be used as security for loan
- No ledger fees is charged on this account
- Restricted withdrawals may encourage savings

- The depositor may negotiate for a higher interest rate

Disadvantages of fixed deposit account

- The account holder may lose the interest if the amount is withdrawn before the maturity time
- The initial minimum deposit is relatively high.
- No further deposit after the first deposit in to the account
- A notice is required if you want to terminate the contract before the expiry period
- Access to money before the maturity time is not allowed
- No partial withdrawal can be made on this account before the expiry of the period

Requirements for opening a bank account

For one to open an account with the commercial banks, the following will be required by the bank

- Photocopies of identification documents, such as Identification cards or passport
- Two passport size photographs, though some banks nowadays take the photos of their customers in the banks
- An introductory latter from an existing customer of the bank or from the employer incase of the current account
- Filling in the application form provided by the bank
- Signing of the specimen signature cards

Non-Banking financial institutions

These are institutions formed to cater for the financial needs of a particular sector of the economy which the commercial banks may have not catered for appropriately.

They includes: Agricultural finance houses, Housing finance companies, cooperative societies, insurance companies, Development finance institutions, Micro Finance companies

- Housing Finance Companies

They are mainly formed to finance housing activities that is they either put up houses and sell to the individuals or offer mortgage finance to those who wish to put up their own houses. They includes Housing Finance Corporation of Kenya (HFCK), National Housing Corporation (NHC)

- Development Finance Institutions

These are development banks which are formed mainly to provide medium term and long term finances, especially to the manufacturing sector. They perform the following functions

- Financing people who wishes to start either commercial of industrial enterprises, as well as the existing enterprises in the above sectors for expansion
- Offering training services through seminars and workshops to equip the entrepreneurs' with the relevant skill in industrial and commercial sectors
- Offer advisory services to those people wanting to start or expand their businesses
- Acting as guarantors to people wishing to take loan from other lending institutions to help them expand their business

They includes the following Kenya Industrial Estates (KIE), Development Finance Company of Kenya (DFCK), Industrial Development Bank (IDB), Industrial and Commercial Development Corporation (ICDC)

- Savings and Credit Co-operative societies

These are co-operative societies that are formed to enable members save and obtain loans at most conveniently and favorable conditions. They are formed by those engaged in similar activities. They includes: Mwalimu Savings and Credit Co-operative Societies; Afya Savings and Credit societies; Harambee Savings and Credit Societies

- Insurance companies

These are companies that assist in creating confidence and sense of security to their clients as well as offering financial assistance to their clients. Their functions include;

- Enable the policy holders to save through their schemes
- Provide finances to their policy holders in form of loans
- Offer guarantee services to the policy holders wishing to obtain loans from other non-bank financial institutions
- Provide advisory services to the policy holders on security matters
- Provide finances to meet the expenses incases of loans

They includes the following: Stallion Insurance Company; Madison insurance company; Blue shield insurance company

- Micro Finance Companies

These are financial companies formed to provide small scale and medium size enterprises with finance. They also carry out the following functions

- Offer advisory services to their clients in matters such as business opportunities available and how to operate them.
- Encourage the clients to carry out business activities by offering loans to them
- They encourage the savings by advancing loans to the individual member of a certain group
- They supervise, monitor and advise those whom they have given loans

They includes the following: Kenya Women finance Trust (KWFT), Faulu Kenya

- Agricultural Finance Houses

These are institutions formed to promote the agricultural sector. They carry out the following

- Giving loans to farmers
- Offering supervisory and training services to the loaned farmer
- Offering technical and professional advice to loaned farmer
- Carry research and come up with better ways and means of agricultural sector
- Coming up with projects that would open up new areas for agriculture

Differences between commercial banks and non-bank financial institutions

Commercial Banks	Non-Bank Financial Institutions
(i) Offer all types of accounts	(i) Offer only two types of accounts savings and

	fixed deposit
(ii) Provide both short term and medium term finances to their customers (iii) Their finance is not restricted to any sector (iv) May offer foreign exchange services (v) Their finance is mainly for working capital (vi) Participate in clearing house as they offer cheque (vii) Offer facilities for safe keeping of valuable items such as title deeds (viii) Always in direct control of the central bank (ix) May offer overdraft facilities to their customers	(ii) Mainly provide medium term and long term finances (iii) Their finance is restricted to a particular sector (iv) Do not provide foreign exchange services (v) They provide capital for development (vi) Do not participate in clearing house since they don't offer (vii) Do not offer facilities for safe keeping of valuable items (viii) Not usually in direct control of the central bank (ix) Do not offer overdraft facilities to their customers

The Central Bank

This is a bank established by the government through the act of the parliament to manage and control the monetary matters in the country. It was formed to perform the following functions;

- **Issue currency in the country**, which includes both new notes and coins to replace the worn-out ones
- **Banker to the commercial banks**, by ensuring that all the commercial banks in the country operate an account with them
- **Being the government 's bank**, by offering banking services to the government which enables the government to operate an account with them
- **Advisor to the government on financial issues** in the economy
- **Controller of the commercial banks** on how they carry out their functions in the economy to ensure that their customers are served well
- **Provide links with other central banks in other countries**, facilitating financial relationships. It also provide a link between the country and other financial institutions such as IMF
- Maintain stability in the exchange rates between the local currencies and the foreign ones.
- **Act as the lender of the last resort** to the commercial banks to enable them meet their financial obligations when need arise
- **Facilitates the clearing of cheques** between different commercial banks through its clearing house (a department in the central bank)
- **Administering of the public debt** by facilitating the receipt and providing a means through which the government pays back the borrowed money
- **Control of the monetary system in the country in order to regulate the economy**. In doing this they put in place ***various monetary policies*** that can either expand the economic activities in the country or depress them.

Monetary policy refers to the deliberate move by the government through the central bank to manipulate the supply and cost of money in the economy in order to achieve a desirable economic outcome. They do this through the use of various tools of monetary policies which includes the following: Bank rates; Open market Operation (OMO); Cash Liquidity ratio requirement; Compulsory deposit requirement; Selective credit control; Directives; Request

- ✓ **Bank rates**

They may increase or decrease the interest rate at which they lend to the commercial banks to enable them increase or decrease the rate at which they lend money to their customers in the economy to enable the government achieve the desirable economic development in the country
When they increase their lending interest rate, the commercial banks also raise their lending rates to the consumers to reduce the number of people obtaining loans, leading to a reduction of money supplied in the economy.
When they decrease their lending interest rate, the commercial banks also decreases their lending rates to the consumers, increase the amount of money supplied in the economy

- ✓ **Open Market Operations (OMO)**

This is where they regulate the supply of money in the economy by either selling or buying the government securities (treasury bills or bonds) in the open market. That is when they want to increase the supply in the economy, they buying the securities from the members of the public who had bought them to increase more supply of money in the economy.
When they want to reduce the amount of money in circulation they will sell the government security to the public in the open market, to mop up/reduce the excess supply in the economy
The payment of the securities takes money from the individuals accounts in the commercial banks, reducing the amount that the individual can use in the economy, while when buying the central bank pays the security holders in their respective accounts in the commercial banks, increasing the amount that they can use in the economy

- ✓ **Cash/liquidity ratio requirement**

Here the central bank expect the commercial bank to keep a certain proportion of their total deposits in form of cash to enable them meet their daily needs, while the rest are held in liquid assets. This proportion can be reduced by the central bank to reduces the amount of money held by the commercial banks in order to reduce the amount of money spent by the commercial banks in cash, reducing the amount of money in supply, or they may increase the proportion to be held by the commercial banks to enable them increase the amount of money they spent in cash, increasing the amount of money in supply

Cash ratio = $\frac{\textit{Cash Held}}{\textit{Total Deposits}}$

- ✓ Compulsory deposit requirements

The commercial banks are required to maintain a certain amount of deposits with the central bank which will be held in a special account where the money stays frozen. This reduces the amount of money that the commercial banks hold and are able to spend in their operation, influencing the supply of money in the economy.

The deposit may be increase to reduce the amount of money in the commercial banks, or reduced to increase the amount of money in the commercial banks

- ✓ **Selective credit control**

The central bank may issue a special instruction to the commercial bank and other financial institution only to lend more in a particular sector to control the amount of money reaching the economy. The instruction may be removed, if the bank feels that the supply in the economy has reduced and needs to be increased

- ✓ **Directives**

The central bank may issue a directive to the commercial banks on the interest rate they should charge on their lending and to increase or reduce the margin requirement for borrowing to make it harder or easier for the customers to obtain loan.

Margin requirement is the proportion of money expected to be raised by the client to finance the project he/she wants to obtain the loan for, before being given a loan to complete the project with.

- ✓ **Request (Moral suasion)**

The central bank may appeal to other financial institutions to exercise restrain in their lending activities to the public to help in controlling the money supply

Trends in Banking

These are the positive changes that have taken place in the banking sector to improve their service deliveries to their customers. They include;

- ❖ **The use of Automatic Teller Machines** (ATMs), which has made it possible for the customers to access their money any time of the day. The ATM cards that are used for withdrawals from the ATM machines can also be used as a debit card to make purchases.
- ❖ **Networking all their branches**, which has enable the customers to carry out their transactions in any of the branch
- ❖ **E-Banking,** which is the banking through the internet. This has made it possible for the customers to transact their financial businesses on-line
- ❖ **Relaxation of some of the conditions on opening and operating some of the accounts** to make them be more attractive to their customers.
- ❖ **Offering varieties of products** which includes easier credit facilities to their customers to attract more customers
- ❖ **Liberalization of foreign exchange dealings by licensing forex bureaus** to offer services to the customers, improving the accessibility to the service
- ❖ **Improving the customers care services**, with some bank setting up a departments known as the customer care department to offer detailed assistance to their customers.

- **Allowing non bank financial institutions to offer banking services** to the members of the public, for example; KWFT, SACCOs, FOSA, Faulu Kenya, etc
- **Mobile Banking services (M-Banking),** which allows the customers to carry out their financial transactions over their mobile phones. It has brought about several benefits/ advantages to their customers which includes;

<u>Advantages of m-banking</u>

  - Easy transfer of funds from one account to the other in the same bank (inter account transfer)
  - Easy transfer of money from ones account to his mobile phone for other transactions
  - Ability to check ones account balance in the bank with ease
  - Easy to monitor your financial transactions by checking your transaction details over the phone
  - Easy payment of the bills such as electricity bill, Dstv bills, etc and other wages
  - Ability to transfer money from one mobile number to other in collaboration with the service providers
  - Easy request for new cheque books and bank statements from the banks
  - Able to top up air time to your mobile phones in collaboration with the service providers
  - Reduced risk of carrying large sums of money in cash or cheques that may be stolen

  However this development has also come with its challenges, which includes;

<u>Disadvantages of m-banking</u>

  - Registration to enjoy all these services must physically be done in the banking hall, which subject the customers to stress queues of the bank
  - Only the registered mobile number can carryout these transactions which limits the customer to only using one number
  - Users requires a mobile phone with a screen that can display the transaction which a times some may not a ford
  - Mobile phones can easily be lost or stolen from the owner, inconveniencing him from carrying out the transactions
  - Bank transaction information may load slowly, which may makes it expensive for the user
  - Possibility of transferring the funds to a wrong account, due to error in typing of the account number

- Introduction of agency banking, which has made them to make their services to be more accessible to even areas where they may have not put up a banking hall.

  Agency banking is whereby a retail stores, supermarket, or any other commercial businesses are authorized by the financial institutions to carry out financial transactions on their behalf. They may offer the following services
  - Receiving customer deposits
  - Offering withdrawal services
  - Transfer of funds for customers
  - Pay bills for the customers

- Balance inquiry services
- Opening new accounts for the customers
- Fill loan application forms for them

Advantages of agency banking

- ✓ Reduction of set up and delivery cost to the banks, which in turn passes to the customers in form of reduced cost of accessing services
- ✓ Time saving as the agents are located close to the customer and the customer may carry out other transactions as he withdraw the money
- ✓ More convenient for the customer to bank with their local retailers other than the traditional banking halls
- ✓ Enable the bank to reach far places within the country

Exercises on money and banking

Paper 1

1. Give four advantages of barter trade.
2. Highlight four services offered by the central bank of Kenya to the commercial banks.
3. State four methods through which commercial banks can transfer money.
4. State any four current developments that have taken place in the banking sector.
5. Outline four tools of monetary policy used by the central bank to control money supply.
6. Outline four factors that may have led to the downfall of barter trade.
7. Highlight two factors that may influence:

    a. Transaction motive.

    b. Speculative motive.

8. Mention four functions of commercial banks in an economy.
9. Outline three factors that influence the supply of money.
10. Give four characteristics of money.
11. The following are some of the accounts available to customers in Kenya banking industry: Current account, Savings account and Fixed deposit account. Give the account that corresponds to each of the description given below.

	Description	Type of account

(a)	Account holders required to deposit a specific initial amount as well as maintaining a minimum balance.	
(b)	Account holders may deposit and withdraw money whenever they want without maintaining a minimum balance.	
(c)	Banks pay interest on deposit at comparatively higher rates.	
(d)	Money may be deposited at any time and interest is earned if a specific balance is maintained.	

12. Outline four benefits that accrue to a customer who uses automated teller machine (ATM) banking services.

Paper 2

1. Explain five functions of the central bank of Kenya.
2. Describe four measures that the government may put in place to reduce the amount of money in circulation.
3. Explain five services offered by commercial banks to their customers.
4. Explain five ways in which commercial banks facilitate payment on behalf of their customers.
5. Explain four services that the central bank of Kenya may offer as a banker to commercial banks.
6. Explain five in which banks contribute to the development of Kenya
7. Outline five reasons why banks currently account is popular with traders
8. Explain service offered to commercial banks by the central bank of Kenya
9. In what ways of the functions of commercial bank differ with those of non- bank Financial institutions
10. Explain five ways in which central bank of Kenya may control the supply of money in The country
11. Describe methods which may be used by commercial banks to advance money to customers.
12. A businessman wishes to obtain a loan from a commercial bank. Highlight the Conditions that he should satisfy before the bank can grant him the loan
13. Explain five services that the central bank of Kenya offers to commercial banks
14. Explain four disadvantages of using a bank overdraft as a source of finances

15. Describe four ways in which a non- bank financial institutions differ from the commercial banks
16. Discuss five reasons why business people prefer to operate bank current accounts
17. Outline the benefits that bank customer gets from operating a current account
18. Explain the 5 services offered by a commercial banks to their customers

- **<u>Product Promotion</u>**

Product is an item or service offered to the consumers at a price. Therefore, product promotion is the communication or any activity undertaken to inform the consumers, persuade and remind them to buy the product from the market.

The purpose/Importance of product promotion

- It informs the customer of the availability, price, and where to obtain the product to satisfy their wants
- It persuade the buyer to buy their products a head of their competitors products in the market
- It reminds the customers of the continued existence of a given product in the market
- It educate the consumers of the usage of the product to satisfy their needs fully
- It informs them on any improvement that has been made on the product
- It stimulates the demand of the product being promoted in the market
- It brings out the positive features of the product
- It opens new market for the product in the environment

Methods of product promotion

Product promotion may be carried out in the following ways:

I. Personal selling
II. Advertising
III. Sales promotion
IV. Publicity

i. Personal selling

This is a method of promotion where there is an oral presentation in the conversation with the prospective customer. It is done by with the use of salesmen who informs the prospective buyer of all the aspects of the product

Methods of personal selling

Personal selling can be carried out in the following ways;

- Through sales person approaching the customers

A case where the sales person approaches the prospective customers after drawing their attention, explaining details of the product and even demonstrating how the product works in order to persuade the customer to buy.

Steps involved in personal selling through sales person

i. Identify prospective customers who could possibly require the product
ii. Preparing the presentation by gathering all the possible information about the product , as well as designing an appropriate methods that he will be used to present to the customer
iii. Establishing the customers contact, as well as choosing an appropriate time to meet the customer to be. That is the time when the customer may receive him
iv. Arousing the consumers interest in the product by attracting his/her attention through approach and languages, as well as making the prospective customer develop interest in the product
v. Dealing with the objections on the product which may have been brought about by the customer to be
vi. Closing the sale by inquiring whether the prospective customer will be interested in the product or not. This should be done in a polite manner
vii. Offering after sale service to the customer on the product that has been sold

- **Shows, trade fairs and exhibitions**

This is where the manufacturer of a given product gets a chance to display publicly to the prospective customer to inform them about the product. The prospective customers' attention is then drawn to the product and more information is given to him about the product at the point where it is displayed.

Advantages of shows, trade fair and exhibitions

- It gives the customer an opportunity to compare various products before making a decision on what to buy
- It gives the sales person an opportunity to explain in fine details the features of the product to the prospective customers
- The manufacturers of the product gets a chance to receive immediate feed back from their customers through interactions during the shows
- The number of people visiting their stall to asses their products will help them determine their potential market size for the product

Disadvantages of shows, trade fairs and exhibitions

- It is expensive to hire a stall for the exhibition of the product
- The sales person may have to explain over and over again for the prospective customers as they may not enter into the stall at the same time
- The trade fairs are not frequently organized, therefore an organization rely on it as the only means of product promotion may not succeed

- **Showrooms**

These are large rooms where goods are displayed, especially bulky and durable goods like cars, furniture's, etc for the customer to see and be informed about them to stimulate their interest in them The room allows the customer to get more information about the product from the sales person in the showroom

Advantages of showrooms

- They enables the seller to get immediate feed back on the product
- They enable the customers to get clarification on the product they need to purchase
- It is a cheap method of production
- It provides an opportunity for the usage of goods to be demonstrated
- The information the prospective customer get from the show room is more reliable

Disadvantages of showrooms

- They are usually located away from the town centers, making them not be accessible by many
- It is expensive to hire showrooms
- They require security to protect the goods inside them which may be very expensive
- Some prospective customers may tamper with goods in the room while trying to operate them

❖ **Free Gifts**

A gift is an item given to the customer free of charge after buying a product which it is pegged on or buying products of a given value. The gift may not necessarily be the same as the product bought, but they are meant to encourage the customer to buy more or gives the customer opportunity to explore the product given as a gift.

Advantages of free gifts

- It enable the customer to enjoy the product given as a gift without paying for it
- It persuades the customer to buy more of the product in order to get the gift
- It is an additional product, and therefore increases the customers satisfaction
- It may help in creating loyalty in the product being promoted

Disadvantages of free gifts

- It makes the customer buy including products they didn't require in order to the said gift
- The cost of the product may be very expensive for he customer
- Some middlemen may remove the gift and keep or even sell to the customer to maximize profit

❖ **Free Sample**

This is a product on trial given to the customers freely to influence their demand towards the product. It mainly used when the product is new and the customer may have not known about the existence of the product

Advantages of free sample

- It enables the customer try the product before making a decision to buy it
- The customer is able to enjoy the product that otherwise he may have not enjoyed
- The organization is able to get immediate feedback from the customer about their new product

- It enables the organization to acquire more customers for their product

Disadvantages of free sample

- Some of those receiving the sample may not come back to buy
- It may be an expensive method of promotion especially where many samples are to be given
- Goods given for free may reduce the value of goods that may have been sold to earn profit
- It is not suitable for expensive products

Circumstances under which personal selling is appropriate

i. When launching a new product in the market which requires a lot of awareness to the prospective customers to enable them make a choice
ii. When a product is tailored to meet the customer's needs, as different consumers have different needs, taste and preferences to be addressed.
iii. When demonstration is required on how the product works, especially the technical products
iv. When the organization has the capacity to finance the sales force carrying out the personal selling.
v. Where the market is concentrated within a given region that can easily be accessible by the task force.

Advantages of personal selling

- It is more flexible than any other method for the marketer is able to meet the needs of different people
- It enable the prospective customer to know more details about the product before making a decision
- The sales person is able to demonstrate the use of the product
- The seller is able to get immediate feedback on the product
- The seller is able to obtain the personal contact of the prospective buyer
- It gives the buyer an opportunity to negotiate the terms of purchase
- It takes care of both literate and illiterate prospective customer
- The seller is able to persuade the prospective buyer to buy the product

Disadvantages of personal

- It is labour intensive and therefore very expensive when the area to be covered is wide method
- It is time consuming as it involves explanation and demonstration
- It may only target a particular group of people
- The seller has to meet the travelling and other expenses involved which may be very expensive
- Salespersons may misuse the resources allocated for them, making the target not to be achieved
- The process may inconvenience the prospective buyer's program
- It may only cover a given region which may not be wide enough

ii. <u>Advertising</u>

This is the presentation of information about a product through public media such as news papers, radios, billboards, etc

Types of Advertising

- Product advertising: - this is a form of advertisement meant to promote a given product or a particular brand of product
- Institutional advertising: - this is a form of advertisement meant to improve the image of the institution or organization and not a particular product. It is meant to create confidence in the customers about the institution
- Primary demand advertising: - a form of advertisement meant to a new product that has been introduced in the market for the first time. It is mainly to create awareness of the existence of that particular product
- Celebrity advertising: - a form of advertisement where a famous/popular person is used to promote a particular product. It is meant to convince those who identify themselves with that personality to buy the product
- Informative advertising: - a form of advertisement meant to give the customer more information about the product to enable them make an informed decision
- Competitive/persuasive advertising: - a form of advertisement carried out with organizations producing similar product to persuade the customers to buy their products ahead of their competitors
- Corrective advertising: - a form of advertising meant to correct a misleading information that may have been given out about the product
- Reminder advertising: - a form of advertising meant to remind the customers that the product still exists in the market and is still capable of satisfying their needs.

Advantages/Importance of advertising to the business

i. It maintain the sales of an already existing product
ii. It create awareness in the customers about a new product in the market
iii. It informs the customers about the changes that may have been made in the product
iv. It helps in building image or reputation of the selling organization
v. It may increase the volume of the existing sales of a product
vi. It reaches peoples who may have not been reached by the sales person
vii. It compliments the effort of the sales person to enable them achieve their sales objectives
viii. It clears the customers misconception and prejudice about the product
ix. It opens up new markets for the products.

Disadvantages of advertising to the business

- It may be costly to the business in terms of money and other resources
- It leads to increase in cost of production if at all it has to be done frequently
- The cost of the advertisement will always reduce the profit margin of the business
- Poorly planned advertisement may negatively affect the business
- Misleading advertisement may reduce the level of business operation

Advantages of advertising to the customer

- They educate them on the usage of the product
- They inform them on the products availability
- They guide them on where to get the product
- The outlines all the features about the product including prices to the customer
- Competitive advertisement may lead to improved quality of goods to benefit the customer
- Information on different prices through competitive advertisement makes the customer to benefit from the reduced prices

Disadvantages of advertising to the consumer

- The advertisement may not disclose the side effect of the product
- The advertising cost may be passed to the consumers through increased price
- Some advertisement may persuade customers to buy what they do not require leading to impulse buying
- Some customers may buy substandard goods due to misleading advertisement

Advertising media

These are channels or agents through which an advertisement message is conveyed to the target group. They includes both the print and electronic media which includes; newspapers, journals, magazines, posters, bill-boards, brochures', radio, television, neon signs, etc

a) Newspaper

These are daily or regularly publications which contains advertisement. They includes, Daily nation, Standard, Taifa leo, citizen, star, etc

Advantages of newspaper

- The can reach areas that other means may not reach
- Many people can afford them as they are relatively cheap
- They cover a wider geographical area, leading to a wider market
- The message on the news paper can last for a longer period of time, making it to reach more customers
- The advertisement appearing in the newspaper is readily acceptable by the reader
- Colored print makes the advertisement to be more attractive to the reader who in turn gets the information

Disadvantages of the newspaper

- Many of them are written in English or Kiswahili, making them to only target those who can read and understand the language
- It discriminate against the illiterate group who can not read the information
- They have short lifespan as they may be read only on the day it is circulated
- It can not be used to focus on a specific target as they are read by almost everybody
- Some of the prospective customers are always in a hurry to read the newspaper and may not pay attention to the advertisement

b) Magazines and Journals

These are periodic publications meant to target a particular class or group of people. They may be published monthly, quarterly, annually, etc. The information reaches the targeted group as they read them

Advantages of magazines and Journals

- The specific information for the targeted people can be published
- They can be read and re-read before the next publication may the information to last longer and plead with the prospective customer
- Their publication is of high quality and colourful, making them to draw the attention of their targeted group easier and passing the information to them
- The quality material they are made of makes them to last longer and can be accessed even by those who may have not been around during their publication

Disadvantages of magazines and journals

- If the time gap between the publication time and circulation time is wide, the advertisement may fail
- They are a bit expensive which makes some of the potential customers not to afford them
- The cost of advertising on them may be expensive for the organization
- Their circulations may be limited to a small geographical region
- The publications may not be available in the vernacular language to reach those who are not able to read either English or Kiswahili

c) Posters and Billboards

A form of advertising that may contain the information about the product either in words, pictures or both for the customer to see and read.

Advantages of posters and billboards

- They are able to convey the information to the large audience, as they are placed in strategic position
- Posters are cheap and easy to prepare
- The use of different colors makes them to be more attractive and appealing to more audience
- It can be used by both literate and illiterate group
- The message may last for a longer period of time
- Billboards are conspicuous and hence attractive to the audience

Disadvantages of posters and billboards

- May be affected by adverse weather condition, especially rain
- If not placed strategically, it may not reach the targeted group
- Incase destroyed by the passersby, the information may not meet the targeted group
- Bill boards are expensive to make and maintain

d) Transit/transport advertising

A form of advertisement whereby vehicles such as trailers, matatus, buses, etc are used to carry and convey the advertisement message

Advantages of transit advertisement

- The message reaches most of the people in the environment
- They message last long as the paints always last on the vehicle
- Transit vehicles may carry the message a long way to their final destination
- It is captivating to the members of the public especially the promotion convoy, hence can easily reach the target

Disadvantages of transit advertisement

- During the rush hour, the crowd may hinder some from getting the information
- It mainly relay the information to those served by the vehicles
- The noise produced by the promotion convoy may be a nuisance to some members of the public

e) Brochures

These are small pamphlets carrying message and pictures about product being advertised.

Advantages of Brochures

- They are easy to carry around as they are small in size
- They are effective in meeting the targeted group
- Their cost of production is not very high
- They can be distributed at different places to meet the targeted group
- Can be made attractive by the use of different colours
- They have a long life and therefore can be used repeatedly
- They can be used to direct others on where to get the product

Disadvantages of Brochures

- The information may not reach the illiterate group
- They may be ignored by the intended users
- They may require frequent updating if many changes are made on the product making it expensive

f) Radio

This is a channel that allows for the advertised messages to be conveyed through sound to the listeners, with some background music accompanying the message

Advantages of Radio

- Different languages may be used to reach different people
- It is accessible even to the remote areas that is not covered by other media
- One can choose the time to advertise to reach the targeted group
- Able to serve many people at the same time
- It can be used for both literate and illiterate members of the group
- The advertisement can be repeated over and over again according to the advertisers needs

- The music accompaniment may attract many people to listen to the information
- Can reach even the blind as they are able to hear
- The message can be conveyed in different languages

Disadvantages of Radio

- Their advertisement does not have any reference
- It may be more expensive than the print media
- Poor timing may make the message no to reach the targeted group
- It may interrupt some programmes to the annoyance of the listener
- It short and brief advertisement may be missed by the listeners
- It is difficult for the listener to visualize the product

g) Television (T.V) and Cinema

Television is a form of media advertisement where the written words are combined with motion pictures and sound to pass the information

Cinema is where the advertised messaged is conveyed during film shows in the cinema halls. It may be before or after the movie.

Advantages of Television (T.V) and Cinema

- It appeals to most people as it is entertaining
- It makes it possible for the demonstration of the use of the product
- It is able to reach both the literate and illiterate viewers
- The advertisement can be aired over and over again to meet the targeted group
- The advertisement may be modified when need arise
- It has wide appeal to many people
- The message can be conveyed in different languages

Disadvantages of Television (T.V) and Cinema

- The cost of advertising through this media is high
- The television sets are expensive to acquire, hence many people may not have them
- Their uses are limited to places with electricity
- The advertisement may not last longer
- The time for airing the information may not suit the targeted audience

h) Neon Signs

This is a form of advertisement where the message is passed to the public through the use of electrical signals transmitted through neon lights. They are usually common in the banks, airlines, jewel shops, etc

Advantages of Neon Signs

- The use of different colours makes them very attractive and catch attention of different people
- They can be put strategically making them to be visible to many people

- Can be used both at night and day
- They direct the customer on where the goods are to be found

Disadvantages of Neon Signs

- Can only be used where there is electricity
- They are expensive to buy and maintain
- The message may not easily reach the illiterate

Advertising Agencies

These are businesses that specialize in advertising work and are hired to carry out the functions for other businesses. They are paid a commission for this

Functions of Advertising Agencies

iii. They help the organizations in designing their trade marks, logos and advertising materials
iv. They book space and airtime for their clients in various media
v. They offer advisory services to their client on selling techniques
vi. They advertise on behalf of their clients
vii. They choose on behalf of their clients the appropriate media to be used

iii. Publicity

This is the mentioning of the product or the organization in the mass media to make it be known to many people. There two types of publicity, that is free publicity (where the payment is not required) and Special featured publicity (where there is payment, for example sponsoring an event in the public)

Advantages of Publicity

- It saves the organization money incase of free publicity
- It is likely to cover a wider region as the publicity is in the media
- The organization may earn credibility due to positive publicity
- The information may be received positively by the customers as the message is likely to be more objective
- It may improve the competitiveness of the firm

Disadvantages of Publicity

- Unfavourable information about the organization may reach the public especially in free publicity
- It is irregular and short lived
- Might require special occasion or event in order to attract the mass media
- The firm does not have control on how the information will appear in the media and the extend of the coverage

iv. Public relations

A process of passing information with an intention of creating, promoting, or maintaining good will and a favourable image of the organization in the public. It involves informing the public about the firm's achievement and how it is contributing to the community welfare and development, to get more approval of the public

Advantages of public relations

- May be used to correct the dented image of the firm
- It informs the public about the activities of the firm
- Assist in upholding the good image of the firm
- It improves the relationship between the firm and its customers

Disadvantages of public relations

- It is costly in terms of time and finance involved
- The customer may make premature buying arising from the picture created by the firm
- Effects may take long before they are actually realized
- It may be difficult to evaluate the impact of the message, since the customers are not obliged to respond to it

v. Point of purchase (Window) display

This is where the items are arranged in the shops strategically, allowing the customers to see them easily. The arrangement is meant to attract the customer's attention and induce them to buy goods as they pass close to the shop

Advantages of Point of purchase display

- ❖ May induce the customer to buy the product due to their arrangement
- ❖ As the customers get in to the shop, they are likely to buy including the other goods that were not being displayed
- ❖ The customers are able to determine the features of the product with ease
- ❖ It is relatively a cheaper method of promotion

Disadvantages of point of purchase

- ❖ The method only work well with the potential customers who are near the shop and not far away
- ❖ They may also attract thieves especially if the product displayed is of high value
- ❖ In case the arrangement does not appeal so much to the customers, they may not get into the shop
- ❖ It may be expensive setting up the display area

vi. Direct mail Advertisement

A form of advertisement which is sent to the potential customers directly in the form of a mail, for example the pricelist being sent to the potential customers

Advantages of direct mail advertisement

- ❖ It is able to reach the targeted group as they are sent to the potential customer directly
- ❖ The message may be made to suit the requirement of the specific customer to be
- ❖ There may be an immediate respond on the message
- ❖ The potential customers incurs no cost to acquire the information

Disadvantages of direct mail advertisement

- Some mails may not get to the intended customers in time
- The prospective customer may ignore the advertisement
- May not be effective where the customer needs to examine the product
- This method may be expensive especially in terms of material and money
- It may only appeal to the literate group only

vii. Catalogue

A booklet that gives information about the product that the organization deals in. It gives the description about the product, the picture as well as the prices of the product.

Advantages of catalogue

- It may be used to advertise all the products in the organization
- The owner/organization has the total control over the catalogue
- It gives detailed information about the product
- Its colourful nature makes it an attractive promotion tool

Disadvantages of catalogue

- It is expensive to produce increasing the cost of production
- Change in price may affect the whole catalogue

viii. Guarantee (warranty issue)

An assurance given to the customer that the product will serve as expected if used according to the instructions given by the manufacturer. For the guaranteed period the seller will be willing to maintain repair or replace the product for the customer

Advantages Guarantee

- The confidence built in the customer by the guarantee to the customers makes them to buy more products.
- It may create the customers loyalty to the product of the firm
- The fact that the product can be replaced if it gets spoilt within the period is an advantage to the customer

Disadvantages of guarantee

- Repairing or replacing the product may be very costly to the organization
- The method may only be suitable for the durable goods
- The customer may be tempted to mishandle the good during this period

ix. Discount

This is a reduction in price of the commodity, allowing the buyer to pay less than what he would have paid the goods.

Types of discount

- Quantity discount: - Allowed by trader to encourage him/her to buy more quantity of the product being offer
- Trade discount: - Allowed to another trader who is buying products for resale to the consumers
- Cash discount: - Allowed to the customer to enable him pay promptly for the goods bought

x. Loss leader: - Selling the price below the market price to entice the customer to buy
xi. Psychological selling: - Playing with the customers psychology in terms of pricing by quoting odd prices such as 999, 199, 99, etc to convince the customer that the price has been reduced
xii. Credit facilities: - where the customer is allowed to take a product for his consumption and pay for it later. This entices the customer to buy more of the product
xiii. After sales service: - these are services offered to the buyer after the goods have been bought. They may be in terms of packaging, transportation or installation which may be offered to the customers free of charge. This makes the customer to buy more goods with confidence

Sales promotion

These are activities carried out to increase the sales volume of a business. They are activities out of the ordinary routine of business that is carried out by the seller to increase his sales volume.
The methods of carrying out sales promotion includes all the methods of carrying out product promotion as discussed earlier, that is, shows and trade fair, showrooms, free gifts, free sample, personal selling, advertisement, window display, credit facilities, after sales services, etc

Factors to consider when choosing a promotion method

i. The cost of the promotion that is whether the company can afford it or not, for some promotion methods are very expensive that may not be easily affordable to the company.
ii. The nature of the product being promoted especially whether it requires demonstration or not. Products which requires demonstration are best promoted through personal selling
iii. The targeted group for the advertisement, on whether they can be reached by that method or not. The promotion method must reach the targeted group, if it has to be effective
iv. The objective that the firm would like to achieve with the promotion, and whether the method is helping them to achieve that particular objective
v. The method used by the competitor in the market to enable them choose a method that will enable them compete favourably
vi. The requirement of the law concerning product promotion, to enable them not use what the law does not allow

Ethical issues in product promotion

These are rules and regulations to be followed when carrying out promotion to avoid violating other people or businesses right. They include;

- Cheating on performance of the product to attract more customers by given them wrong and enticing information about what the product can do.
- Cheating on the ingredients of the product by telling them that the product contains a suitable type of ingredient which does not exist just to lure them to buy the product
- Not telling them the side effects of the product which may affect them should they continuously use the product due to fear of loosing customer

- False pricing, especially a case where they overprice their and later on reduce them slightly just to lure the customer, yet exploit them
- Not caring about the negative effect of the product on the environment, which may includes littering of the environment by the posters used for advertisement
- Social cultural conflict, especially putting up some forms of advertisement which are considered a taboo buy the community leaving around, such as hanging a billboard of a female advertising inner wears next to a church

Trends in product promotion

The following are some changes that have taken place to improve the product promotion activities

- Use of website/internet to advertise product world wide, which has increased the coverage
- Encouraging gender sensitivity and awareness in product promotion to bring about gender balance
- Use of electronic billboards in advertisement to increase their visibility even at night
- Intensifying personal selling by the business to reach more customers
- Development of promotion convoys to move from one place to the other with music and dancers to attract more prospective customers
- Catering for the rights of the youths when carrying out product promotion and even involving them in carrying out the promotion
- Catering for the interest of those with special needs when carrying out advertisement
- Advertisement through mobile phones by sending them s.m.s about the product