**MINEDUC**

**KICUKIRO DISTRICT**

**E.S KANOMBE/ EFOTEC**

**Entrepreneurship**

**Student’s Book for Senior Four**

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## Contents

# **UNIT1: INITIATIATION TO ENTREPRENEURSHIP**

## 1.0. Introduction:

**Why Become an Entrepreneur?**

****

* Be your own boss:
  + Ambition to own a firm or
  + Frustration to work in traditional jobs
* Pursue your own ideas:
  + Recognition of for new products or services and desire to realize those ideas.
  + Thrill of building a business and seeing success of an idea
* Pursue financial rewards:
  + Make more money
* Any given economy needs both the government and the private sector to grow.
* The needs of the country cannot be feasibly catered for by the state on its own.
* Individuals also need to establish themselves as key components in any healthy economy.
* A Big Part of their role is reflected in the effort they put in business creation and management in Entrepreneurship.
* People hold mixed feelings about entrepreneurs.
* There are even unavoidable myths about the whole concept.

## 1.1. Entrepreneurship-Scope and Meaning

* For Economists: An entrepreneur is one who brings resources, labor, materials and other assets in combinations that make their value greater than before and also one who introduces, changes, innovations, and a new order.
* For Psychologists: An entrepreneur is a person typically driven by certain forces: such as need to obtain or attain something, to experiment, to accomplish or perhaps to escape the authority of others.
* For Business person: An entrepreneur is a threat, an aggressive competitor, an ally, a source of supply, a producer of jobs, a market potential…

Whether from economic, psychological, business or layman’s perspective, we all tend to agree with this:

* An entrepreneur is an innovator or developer who: recognizes and seizes opportunities, converts these opportunities into commercial ideas, adds value through time, effort, money or skills, assumes the risks and realizes rewards from these efforts.
* Entrepreneurship is therefore referred to as the process of creating something new with value by devoting the necessary time and effort, assuming the accompanying direct /indirect rewards and risks.
* It is also a process by which individuals pursue opportunities, and put the respective ideas into useful practice.
* The above definitions, evoke six basic aspects of Entrepreneurship:
* Seeking opportunities
* Initiative taking
* Having the tenacity to push the idea through to reality
* Creating something new of value to the entrepreneur and target market
* Taking risk
* Expecting rewards.

## **1.2. Meaning of different concepts related to entrepreneurship**

Entrepreneurship is an act of being an entrepreneur.

An entrepreneur is a person who undertakes innovations, finance and business in an effort to transform innovation into economic goods.

He is that one who has ability to see and evaluate business opportunities from his/her environment, gather the necessary resources and use them to start the identified business and successfully manage it.

## 1.3. Entrepreneurship, Entrepreneur, Intrapreneurship and Manager

* **Entrepreneur;**

This is someone who creates a new business in face of risk and uncertainty for the purpose of achieving profit and growth by identifying significant opportunities and assembling the necessary resources to capitalize on them.

The Oxford Dictionary defines the term as one who organizes, manages, and assumes the risk of a business enterprise.

* **Entrepreneurship:**

This refers to creation and building something of value from practically nothing. Fundamentally, it is a human creative act. It involves finding personal energy by building and initiating an enterprise or organization, rather than just watching, analyzing, or describing one. Entrepreneurship usually requires a vision and the passion, commitment and motivation to transmit this vision to other stakeholders.

* **Intrapreneurship:**

An Intrapreneur is person within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through assertive risk-taking and innovation.

Intrapreneurship is the act of behaving like an entrepreneur, except within a larger organization. It is the practice of applying entrepreneurial skills and approaches within an established company; Being creative with ideas and procedures.

* **Manager**:

A manager can take many forms of definitions based on different fields:

* The person who is responsible for managing an organization. i.e. a bank manager, a station manager, the production manager.
* The person whose job is to organize and sometimes train a sports team .i.e. a football manager.
* The manager of a singer, actor or other entertainer is a person whose job is to arrange the business part of their work.

## 1.4. A Broad Entrepreneurial Process

1. Deciding to become an entrepreneur
2. Developing successful business ideas:
   * Recognizing an opportunity and developing ideas.
   * Feasibility analysis
   * Writing a business plan
   * Industry and competitor analysis
   * Developing an effective business model
3. Moving from an idea to an entrepreneurial firm
   * Preparing the proper legal and ethical foundation
   * Building a new venture’s team
   * Getting financing or funding

4. Managing the resulting enterprise

* + Develop management style and structure
  + Understand key variables for success
  + Identify problems and potential problems

## 1.5. Stages of the entrepreneurship process:

-***Discovery***: to find information, a place or an object, especially for the first time:

Who discovered America?

We searched all morning for the missing papers and finally discovered them in a drawer.

Examples: Scientists have discovered how to predict an earthquake.

She discovered (that) her husband was having an affair.

Following a routine checkup, Mrs. Mason was discovered to have heart disease.

*-****concept development***: when someone or something grows or changes and becomes more advanced for instances: healthy growth and development

The programmer traced the development of popular music through the ages.

The region suffers from under-/over-development (= having too little/much industry).

**-*Resourcing****:* to provide an organization or department with money or equipment:

The school must be properly resourced with musical instruments and audio equipment.

-Actualization

-Harvesting

## 1.6. Distinction between Entrepreneur, Intrapreneur and Manager

1. **Entrepreneurship Vs Intrapreneurship**

***An entrepreneur***“… is one who has a dream and builds an organization to achieve it.”  
***An intrapreneur***is one who has a dream and tries to achieve it within an already existing corporation.

***Entrepreneurs*** must ensure the technology works, and sell it at a profit.  
 ***Intrapreneurs*** must also get their company to let them do the innovative project to completion.  
Change-creators implicitly seek to alter the current smooth operations and  
there is naturally going to be resistance from internal players

1. **Entrepreneurship vs Manager**

|  |  |  |
| --- | --- | --- |
| **POINT** | **ENTREPRENEUR** | **MANAGER** |
| Goal | Starts a venture by setting up a new enterprise for his personal gratification | His major aim is to render his service in an enterprise already set up by someone. |
| Status | He is the owner of the enterprise | He is the servant in the enterprise |
| Risk | He bears all risks and uncertainties involved in the enterprise | Being a servant, he does not bear any risk involved in an enterprise |
| Rewards | He receives profits which are uncertain and irregular | He receivers a salary which is fixed and regular |
| Innovation | As an innovator, he introduces good and services to meet changing needs of the customers. | He executes the plans of the entrepreneur. i.e. translates the ideas into practice |

## 1.7. Relationship between creativity, innovation and invention

### **1.7.1. Entrepreneurship as creativity and innovation**

Entrepreneurship can be partly described as a combination of creativity followed by innovation where creativity is an act of thinking new things, coming up with ideas, new ways of looking at opportunities and new approaches to solving problems and innovation is doing new things or implementing the newly created ideas.

a) Steps of creativity

There are commonly five steps of creativity which are:

i) Problem sensing or perception: This is when a person is aware of the existing  
problem and has the feeling that it has to be solved

ii) Preparation or immersion: Here the individual concentrates on the problem and  
becomes immersed in, visualizes all information relevant it recalling and  
hypothesizing about it.

iii) Gestation or incubation: This is a process of arranging facts into new pattern by  
letting sub consciousness power over it.

iv) Insight or illumination: This is when an idea comes into the mind of an individual

v) Verification and application: this is when an individual sets out to solve a problem  
which she/he has generated new ideas. This is storage of change and should be done with caution.

**Types of creativity**

There are different types of creativity, which makes it difficult to define. People often limit their definitions of creativity to art, but this is too limiting. Creativity comes in the form of original thought, **divergent thinking, problem solving, inspiration and imagination**. In order to improve creativity, it is essential that you understand the definition of creative thinking and what steps you can take to improve your own thought process.

**Divergent thinking**

Divergent thinking moves away from the traditional, convergent thinking, which is linear and analytical. It is looking for the right answer. Divergent thinking, on the other hand, is nonlinear and spontaneous. Rather than finding a single correct answer, the divergent thinker discovers multiple options for addressing problems. Brainstorming, predicting, and imagination activities are all examples of divergent thinking. It is possible to increase divergent thinking by implementing open-ended questions when addressing problems rather than closed questions. We will discuss open-ended questions in a later module. Moving toward divergent thinking may not be comfortable for analytical thinkers, but practice will soon help creativity develop.

**Problem Solving**

It is possible to improve the problem solving process by implementing creativity. This requires looking at each problem as a unique situation rather than applying the same principles to every similar problem.

**Steps to Creative Problem Solving:**

View the problem in different ways.

Do not make assumptions that all similar projects or problems are the same.

Be open to different problem solving options.

Look at the big picture when addressing problems.

Keep looking even when the solution is not easily found.

**Inspiration and imagination**

Inspiration and imagination are essential for creativity. Webster defines imagination as the ability to “recombine the materials furnished by experience or memory, for the accomplishment of an elevated purpose; the power of conceiving and expressing the ideal.” In the modern world, it is easy to ignore the development of the imagination, but this is done to your detriment. Exercising the imagination is necessary to improve creativity.

**Ways to Improve Imagination:**

* Read stories.
* Expose yourself to new experiences and influences.
* Get enough rest.
* Daydream and meditate.

Inspiration is what prompts creativity. Inspiration provides the motivation that helps people believe that they can or should do something creative; or inspiration can be an idea that comes suddenly. Inspiration is different for different people. There are ways to improve inspiration, which we will address in a later module.

**Conclusion**

Many people have pointed out that it is not physically possible to create something out of nothing. The idea of creating something out of nothing is creating something new or original. True creativity does more than take from the creativity of others, which is why we value originality. Although, it is possible to find creative ways to improve on what already exists. There is no single method or setting to create something new. From art to science to the office, you can create something in any area as long as you have the imagination and inspiration to develop new ideas.

If you are interested in receiving one-on-one or group coaching to work with a professional on increasing workplace creativity then sign up for Balancing Change Mindfully for free today

b) Characteristics of creative people

* They tend to be more original than others
* They are more flexible conceptually and easily accept change since they normally have more ideas than non-creative people
* They normally prefer complexity to simplicity
* They do not want simple solutions.

### 1.7.2 Types of Innovation

* Radical innovation: It is an intellectually jump, which change a whole area
* Vertical innovation: Reflects the mobility of ideas at a system level
* Product innovation: it improves or changes the products
* Service innovation(improving services)
* Process innovation( improving the method of production)
* Market innovation(change the marketing strategies)
* etc
* ***Causes of innovation***



* New technologies
* New or shifting buyer needs
* The emergence of new industry segment
* Shifting input costs or availability
* Changes in government regulations

c) Attributes of a good innovator

1. Educated both formally and informally

1. Receptive to change
2. Emphatic-ability to place himself the situation at hand
3. Moderate risk taker
4. High need for achievement
5. Information seeker
6. Knowledge about innovation
7. Communication skills

## 1.8. Qualities of an Entrepreneur (characteristics)

Referring to the meaning of an entrepreneur, intrapreneur and everyday life experiences, what among the following are the characteristics of entrepreneur and those of intrapreneur?

* Creativity and Innovation
* Risk taking
* Hard working
* Bear no financial risk
* Decision making
* Planning and organizing
* Not responsible for the market performance

## **1.9. Characteristics of Entrepreneur**

**1. Hard working**

Hard work involves using extra effort to do whatever one is doing. It involves working at odd hours, at times at night. A hard working person commits more time, more energy and more resources to achieve the desired objective. Commitment and hard work are essential to success in life.

**2. Creativity and Innovative**

Creativity involves using ideas to come up with new products. For a person to be a successful in life, he/she has to be creative by doing new things or doing old things differently. Being innovative helps a person find new business ideas, improve existing business activities, and find solutions to difficult problems. All of these help a person become successful.

**3. Risk taking**

Entrepreneurs are risk takers. They risk starting a business. This is not to mean that they are reckless people. They take moderate risks. Good entrepreneurs assess the risks related to their business before they take them. They do not take every risk, they only take moderate risks and the risks they will be able to manage

**4. Decision making skills**

A successful person in life has to be able to make decisions on various issues, follow the decisions made, and accept the result of the decisions made.

**5. Persistence**

An entrepreneur should be persistent in what he/she does for the business. He/she puts in as much efforts as possible to ensure the business objectives are achieved.

**6. Ability to find viable business opportunities**

Entrepreneurship is about identifying and exploiting opportunities. A person who is able to spot opportunities even where other people are not able to see any is a good entrepreneur. Ability to see opportunities also helps the entrepreneur to take advantage of other opportunities like identifying the best employees, taking advantage of cheap loans from commercial banks, take advantage of the availability of cheap raw materials etc.

**7. Seek information**

Good entrepreneurs are always on the lookout for information. Information that is related to their businesses, this is important so that they can make good decision. Good decisions are based on information. For example, if the business is a manufacturing business, the entrepreneur seeks information about suppliers of new machinery, information about government policies etc. All this information helps the entrepreneur to make informed and profitable decision.

**8. Perseverance**

An entrepreneur should have the determination to keep trying to achieve business success in spite of a lot of difficulties. Starting and growing a business requires a lot of determination and a “never-give-up” attitude.

**9. Self confidence**

An entrepreneur should have a strong belief in his/her abilities. The entrepreneur should be confident that he/she will able to achieve what he/she sets himself to achieve. If a person is not confident of himself/herself, he/she cannot be a good entrepreneur.

**10. Discipline**

A good entrepreneur should have to quality of discipline. Ability to control himself and control his actions, for example, he should be disciplined so that he/she does not spend business money on luxuries because he/she seen other people spending.

**11.** **Goal setting and planning**

Good entrepreneurs set goal to strive for. They set goals and tirelessly work towards achieving those goals. The goals set should be specific, measurable, and achievable and time bound, that is, they must be clear and the entrepreneur should be able to measure and know whether the set goals have been achieved, and set time when the goals should be achieved but the most important thing is that good entrepreneurs set goals for the businesses.

**12. Commitment**

An entrepreneur will succeed in business if he/she is committed to the business and also committed to fulfilling obligations; for example, an entrepreneur should be able to spend a lot of time at the business and also make sure that customers are served properly. The entrepreneur ensures that customers receive very good services and when the entrepreneur makes a promise, he/she fulfills it.

**13. Persuasive and good at networking**

Persuasiveness is the ability to convince others and change their thinking. Networking is the practice of meeting other people involved in the same kind of work, to share information and support each other. A good entrepreneur will always get time to meet and share ideas with people who matter to the business. People whose services he/she is likely to need. People who do the same business and can give good advice. A good entrepreneur will not be an ‘island’ but will always be networking.

**14. Planning and monitoring**

An entrepreneur should be able to put in place means of planning and monitoring business activities. Monitoring business activities helps the entrepreneur to know whether the business is succeeding or failing.

Careful monitoring helps the entrepreneur to decide on what to do if the business is not going according to the set plan.

If there is no monitoring, the entrepreneur will not be able to find alternative solutions to help achieve the set goals.

## 1.10. Characteristics of Intrapreneurs

1. Intrapreneurs are innovators who are not responsible for the market performance of their creations, they are only employed to innovate for the employer enterprise (when they innovate, they bear no personal responsibility for the market success or failure of their innovations).
2. Intrapreneurs are innovators who are under rewards since they have no direct investment in their innovations and bear no financial risk.
3. Intrapreneurs are corporate heroes, so courageous people who make things happen, create new commercial success in spite of stodgy corporate policies and glacial pace of bureaucratic decision making
4. Intrapreneurs are seen as descriptive mavericks prone to shatter the status quo and replace “*what is*” with “*what might be*”
5. Intrapreneurs appear not to be motivated by money, they always have a vision of providing something of value, wealth may come to those who succeed, but the pursuit of wealth is not itself a primary goal.

## 1.11. Role of an entrepreneur in entrepreneurship

**Introduction**

Government of Rwanda has put more effort in self-employment process whereby all citizens are encouraged to think big and try to create their own business activity instead of being employed. The following are rolesof an entrepreneur in entrepreneurship development:

1. Scanning the environment to identify business opportunities that would help him/her to set goals in life
2. Identifying business opportunities needs and analyses them in relation to what he/she would wish to be in future
3. Mobilizing necessary resources needed to start and operate the selected business
4. Proper allocation of resources in the business by making right decision in the right time
5. Setting up the business or arrangement through which the business will be operated
6. Managing business operations, day-to-day activities, direction of manpower, machinery materials, etc
7. Seeking out new, cheaper and more efficient production techniques like launching new products, creation of new markets, discovering new raw materials, new technology, etc
8. Bearing all the risks and uncertainties of success and failure of the enterprise; this involves calculating risks involved in doing selected business and to find out if they can be easily managed or else to find an alternative that can be easily managed.
9. Co-coordinating and planning the activities of the enterprise by monitoring the operations and performance of the business regularly to find out whether it is performing towards achieving the set goals and objectives or not

## 1.12. Role of studying entrepreneurship education

There are a number of reasons why people (students) study entrepreneurship education, these may include:

1. It provides one with knowledge and skills of setting up, operate and manage business successfully
2. Through entrepreneurship education, one is equipped with skills of how to mobilize the various resources needed in production like the human resource, financial resources (like capital), etc.
3. It provides one with knowledge on how properly relate and communicate with clients/customers. This is because in business customer is the boss.
4. It provides one with skills of how to scan the environment so as to identify existing and new business opportunities in order to come up with an opportunity that can be managed, run well so as to make profits.
5. Through entrepreneurship education, one develops the skills of taking self-employment as a career and this helps one to get rid of job seeking which could cause unemployment due to limited jobs.
6. It provides one with the necessary skills needed to have successful business like marketing skills, financial management skills, personal selling skills, etc.
7. Through the acquisition of entrepreneurship skills, many people would come up with numerous businesses and this leads to economic and social development through increased employment opportunities, infrastructural development, etc.
8. Entrepreneurship education equips one with skills which create self-confidence, where one remains focused on what he/he intends to do in future or for a long period.
9. It provides one with skills on how to expand the business, increase productivity and consequently profitability which is one of the goals of operating a business.
10. It equips one with the necessary skills needed by business men in preserving the environment, how to successfully abide by the business legal requirements, so as to carry out the operations of the business smoothly without being intervened b the legal authorities.

## **1.13. Functions of an entrepreneur**

Technical function e.g. repairing air conditioners, extracting teeth, writing computer programs, or install tile.

Managerial functions i.e. direct, coordinate and organize business activities in order to achieve the daily, weekly or monthly goals.

The visionary function: to set organizational goals and shape to be attained in the future.

Planning of the business: to organize the way business activities will be done targeting the set objective.

Face risks i.e. he is the risk taker

Distribution of rewards: in form of rent, wage, interest, salaries, etc, given to various factors of production.

Sale of products i.e. he is responsible of marketing, advertising, and sell the products in order to maximize profit.

Scale of production i.e. he decides the scale of the business according to the  
capital and market available.

## 1.14. **Categories (Types) of entrepreneurs**

Innovative entrepreneurs: gather information, analyzes it to determine possible business opportunities. Seek the opportunities to introduce a new technique, product or business in the market.

Adoptive or imitative entrepreneurs: they adopt successful innovations made by the innovative entrepreneur. What is important here is clever and skillful imitation of successful innovations or business undertaken.

Fabian entrepreneurs: they are very cautious but thrive by following what successful entrepreneurs have done and has been proven to be successful over generations.

Drone entrepreneurs: they are conservative, traditionalist and a successful launch of a business; they get fixed and refuse to make changes in production methods and processes.

Forced entrepreneurs: some people are forced or pushed into entrepreneurship by circumstances e.g. loss of job, educated unemployed. For them it is a do or dies situation.

## **1.15. Benefits of being an entrepreneur**

i) Social recognition

ii) Increased income

iii) Improved standards of living

iv) Flexibility in decision making

v) Developing self confidence

vi) Self-employment

## **1.16. Challenges of being an entrepreneur**

* Long and irregular hours of work
* Low level and insecurity of income
* Low lifestyle due to hard work and demanding work
* Potential loss of resources invested in the business

# **UNIT2:** **Career opportunities**

## **2.0 Career concept**

## **2. 1. Meaning:**

A career is a job or profession that you do for a long period of your life for survival which enables you to achieve your objectives. It refers to an individual's work and life roles over his lifespan. Traditionally, it is seen as a course of successive situation that makes a person's work life.

In most schools, there is a career' teacher choose responsibility is to help students to choose the subjects they will study as preparation of the careers they will do in the future.

Example: Possible career opportunities in different sectors

|  |  |
| --- | --- |
| Sector | Career opportunities |
| EDUCATION | Teacher, lecturer, |
| HEALTH | Doctor, nurse, laboratory assistant, pharmacist |
| SECURITY FORCE | Army, police, security keeper (in different companies) |
| LAW | Lawyer, magistrate, judge, advocates |
| HOTEL and TOURISM | Manager, chief (on different posts), cashier, tourist guides, marketing agent... |
| COMMERCE and | Manager, accountant, secretary, banking officer |
| MANUFACTURING |  |
| MEDIA | Journalist, news reporter, T.V. cameraman/woman, printer |

## **2.2. Sources of career information:**

-schools

-Media (newspapers, radio, TVs,)

-Telephone

-Organizations/institutions

- Internet

-Education and training information

2.3. Career trajectory or path:

With all the bleak economic news and reports of massive layoffs, it is easy to lose sight of an exciting fact of work: These have never been more opportunities and possibilities for talented people than exist today. The rate of new business formation in Rwanda has new companies per year. Employers everywhere are looking for bright, resourceful and committed people to help their businesses grow. The best way to help the best companies find you is to become a self-directed job searcher.

*The career trajectory process*:

* Assess yourself
* Make a list of potential occupations
* Explore the options
* Narrow down your list
* set goal
* Create a career action plan
* Obtain training

## **2.4. Career guidance**

Career guidance is the process of assisting or helping a person to choose a career. This is normally done by parents, school teachers and counselors.

## **2.5. Factors influencing one's career**

1. **Parents**: people prefer to pursue the career of their parents or their parents influence them to pursue a certain career.
2. **Schools and institutions attended**: some schools and institutions influence their students through formal or informal curriculum. E.g. students from KIE mainly are teachers.
3. **Peer pressure and friends:** the peer influence more where one can pursue a certain career because the majority of his colleagues has attended it.
4. **Academic performance**: depending on someone success or failure in one subject or another, he/she can choose the career involving the subjects he succeeds
5. **Role model**: the person can be influenced by another one that he considers as model to him. E.g. the person can prefer to be a businessman because Rubangura is known as famous business man.
6. **Physical and mental ability**: someone's capacity influences his career. For example, someone who lost his legs cannot be a football player.
7. **Personal interest**: the person can choose a career depending on his own choice or need.
8. **Financial expectations**: the person can choose a career depending on the income he is expecting to get from it
9. **Government policy**: depending on what is encouraged by the government, people are concentrated in the career prioritized by the government
10. **Talents and natural abilities**: the choice of career can be influenced by the talents or natural abilities. E.g. musicians.
11. **Demand in job market**: people prefer to pursue the career which has job opportunities.

## **2.6. Process of choosing a career**

It involves seven steps as follow:

1. Definition of your needs and objectives
2. Identify your resources and skills
3. Identify the options (careers you can pursue)
4. Research on your options
5. Evaluate options (compare careers)
6. Decide career
7. Implement a chosen career

## **2.7. Types of income generated by a career**

* Salary: Income earned by a person on regular basis from the

employee for the work he/she does

* Wages: payment to a person who works on temporary basis and the payment is based on contract work or when a person is paid after completing a certain /defined piece of work.
* Profit: Difference between revenue and costs of a business
* Dividends: Profit earned from disposable shares
* Rent: Income earned from renting of buildings and land
* Commission: When a person sells a product on behalf of another one, he/she is paid a commission which is usually a percentage of selling price.
* Interest: this refers to the amount of money charged to the Borrower.
* Pension: regular amount of money paid by the government or a company to a retired former worker
* Royalties: Payment made to people who own intellectual property rights like composing music, writing books, paintings, and production of film...

## **2.8. Types of employment**

1. Self- employment: this is where one goes private by way of utilizing his/her resources to start his/her business enterprise. The enterprise varies from one person to a large business employing many people.
2. Paid employment: this is where one gets employed by another person, business, government, Non-Governmental Organization, churches... and is paid a salary on a periodical basis.

Benefits and challenges of these types of employment

|  |  |  |
| --- | --- | --- |
| Type of employment | Benefits | Challenges |
| Self- employment | Autonomy | Pay more taxes |
| Feeling good at work that benefits you not another one else | Competing with bigger and more established businesses |
| High degree of job security | Ongoing and unexpected expenses |
| Encourage innovation and creativity | Financially responsible of any mistake made |
| High respect in the society | Non-paying clients |
| Creation of employment for other | Need of a lot of self discipline |
| Develop self confidence | Low lifestyle due to hard work |
| Improved standards of living | Long and irregular hours |
| Provide goods and services to the public | Miss of some financial benefits given by the employers |
| Efficient use of business resources | Miss out on paid days off |
| Little or no name recognition |
| Failure to control drawings |
| Miss social contract due to high concentration on the business rather that friendship |
| Fight against misconceptions (myths or negative labels) |
| Paid employment | Certain and specific responsibilities undertaken | Follow strict order and instructions |
|  | Fixed and possible/favorable hours of work | Work over control |
|  | Minimum risks | Low freedom  Limited decision making  for employees |
|  | Regular saving is possible and hence farther investment. | Harassment from the employer |
|  | Housing allowances and medical care can be given | Low level of innovation |
|  | Debt of the firm do not affect the employees | Low level of job security |
|  | Enjoy leisure time | Do not enjoy the profit of the business |

Assignment: find additional five challenges of self-employment and paid employment

## **2.9. Causes of income differences between different careers**

* Level of education by different people
* Government policy of setting different payment levels
* The bargaining power of individuals
* Nature of work done
* Level of demand for the services rendered
* The level of availability of workers in the different careers
* Differences in employer's policies
* Difference in employment terms
* Length of training of some careers.
* Level of economic development of different countries
* Level of profit made by different firms
* Differences in experience of people

## **2.10. Causes of graduate unemployment in Rwanda**

* A number of employers prefer using semi-qualified people because they are cheaper than qualified ones.
* A number of people take on courses which are irrelevant in the job market
* There is high level of discrimination in the job market basing on region and sex
* Most people lack the information regarding job opportunity (availability)
* There is no enough capital to start own business
* The job market requires for extensive experience which some people have not yet acquired
* A number of graduates lack the skills of modern technology and hence fail to fit the firms with modern setting
* Higher rate of corruption
* Many graduates prefer working for other and totally fail to become entrepreneurs by creating their own jobs
* Some employers prefer employing expatriates as opposites to locals.

## **2.11. Solutions to address graduate unemployment in Rwanda**

* Encourage graduates to become entrepreneurs
* Eradication of corruption
* Industrialization of rural areas
* Graduates should be encouraged to take up blue collar jobs
* Graduates should be trained in the appropriate and modern technology
* There should be no discrimination of employees wherever it is based
* Graduates should be encouraged to take courses that are relevant to the job market

# **UNIT3: Setting personal goal.**

## **3.1. Personal attributes/qualities that lead to success in life**

* Decision making skills
* Hard working
* Goal setting
* Creative and innovative
* Persistence
* Initiative
* Task oriented
* Concern for efficiency and quality
* Friendliness,
* respect,
* caring and self-reliance,
* commitment,
* loyalty, honesty,
* Dignity, integrity, prudence/economic well- being.

### **3.2.1. Personal qualities in relation to entrepreneurship:**

* Creativity: determination, decision making, etc.
* Personal development: Goal setting, responsibility, commitment, etc.
* Engagement with society: respect, involvement, tolerance, etc.
* Work in school: attentiveness, communication, loyalty, etc.
* Workplace: cooperation, respect, ethics, etc.
* Initiative: This is the ability of an entrepreneur to do something or to make decisions and action without being directed by others or being told to do so.
* Task oriented: This is where one commitment to complete the work at a given time.

### **3.2.2. Factors which promote status in society**

1. Reputation of one's business: This is the opinion that people might have about a particular business (built out of honesty and efficiency that the owner or the business has displayed within a given period of time)
2. Excellent performance: Status in life might also be built out of extremely good or high quality work that one has performed in a given field or task
3. Values such as honesty, hard work, respect (of self and others), compliance with law etc.
4. Educational background: This refers to the level of education (which reflects one's understanding and ability to perform a certain task)
5. Family background: Members of the society tend to respect someone due to his/her family for instance royal families, well to do and successful families
6. Economic status: People are quite often given respect according to the wealth that they have; the more wealth that one has, the more respect he/she will be accorded by the society.

## **3.2. Characteristics of a goal**

1. Specific: a good goal should be clear in terms of what is to be achieved, when and how it will be achieved.
2. Measurable: A good goal should have indicators to prove or show whether it is being achieved or not; and if achieved, at which extent it is being realized
3. Attainable/achievable: a good goal should be feasible within the area where it is being pursued
4. Realistic: A food goal should be achievable given available resources and the capacity of an entrepreneur and workers
5. Time bound: a good goal should have target time within which it should be achieved.

## **3.3. Importance of setting goals in business**

Providing targets that are to be achieved: A good goal can help an entrepreneur to work towards achieving set targets. This is because goals are well known, measurable time bound and achievable.

Maximum utilization of resources: Since goals are set bearing in mind that the resources are scarce, the entrepreneur is compelled (forced) to optimize the use of the scarce resources in order to achieve his/her goals.

Helping in decision making: In the previous topic, we saw that in decision making process, an entrepreneur needs first and foremost identify a problem to be solved. The problem should be identified in terms of the business goals which are being blocked. This will help to avoid confusion and therefore result into effective decisions being made.

Evaluation of performance: When the business goals are well set, the entrepreneur will find it very easy to evaluate his/her performance. He/she will be able to find out the extent to which he/she has been successful in achieving his/her goals. This is because what is to be achieved is known and the targets are also known. This is particularly important since entrepreneurs always want to get feedback about their business progress in order to plan for the future.

## **3.4. Setting goals using SWOT analysis**

i) Meaning of SWOT analysis

To set meaningful goals, entrepreneurs should first look at what would be the business strength and weaknesses, then opportunities and threats to the business. This will help them to evaluate different business opportunities and then arrive at decision of what to do in business. This comparison is what referred to as SWOT analysis. It is a tool of scanning/ auditing an organization and its environment.

ii) Using "SWOT analysis" to set goals and categorize selected business opportunities

By using "SWOT analysis", the key question to be answered is whether a particular opportunity is worth any amount of effort.

Answering this question would involve taking the following into consideration:

Begin by getting a quick estimate of the time, effort and costs involved and them to the potential incomes that will be generated to determine if there is enough potential profit to motivate the start of business.

While setting the business goals, the entrepreneur needs to identify the likely (probable) constraints which may prevent him/her from achieving his/her goals. The likely challenges may include: resources, labor, competition and so on.

SWOT Chart

|  |  |
| --- | --- |
| Strength  i) Specialist human resource ii)A new innovative product or service iii)Good location of your business iv)Any other aspect of your business that adds value to your product or service | Weaknesses  i)Inadequate business expertise ii)Undifferentiated product or service iii)Bad location of the business iv)damaged reputation |
| Opportunities  i)A developed market such as e­commerce  ii)Joint ventures or strategic alliance iii)A new regional or international market iv)A market vacated by an ineffective competitor | Threats  i)A new competitor in your home market ii)Price wars with competitors iii)A competitor has a new, competitive product or service  iv)Competitors have superior access to  channels of distribution  v) Taxation is introduced to your product or service |

From this table, you can realize that strengths and Weaknesses are internal aspects while opportunities and threats are external aspects.

Simple rules for successful SWOT analysis

* Be realistic about the strength and weaknesses of your business
* Is should differentiate between where the business is today and where it will be in future
* It should be always specific
* Always apply it in relation to your competitors
* Keep it (SWOT) simple and short (avoid complexity and over analysis

Advantages of SWOT analysis

* Know shortcomings and design strategies for improvement
* Make realistic organizational objectives
* Carry out innovation programs in line with opportunities identified
* Expand the range of products, services and benefits
* Respond proactively to competitor action in the market

## 3.6. Learning new skills

**Learning styles**

* Listening,
* Observing/seeing,
* Doing/Writing,
* Reading and
* Speaking.

## 3.7. Learning strategies

* Ask people to explain things when you don’t understand
* Watch other people perform a task you need to learn
* Choose a job that lets you work your hands and move around
* Take notes when listening to instructions
* Read instructions.

## **3.8. PEST analysis**

PEST: Political (legal) forces, Economic forces, Socio-cultural forces and Technological forces.

When planning, the entrepreneur has to consider

1. Internal factor including staff, office technology, wages, finance etc
2. The micro-environment including external customers, agents and distributors, suppliers, competitors etc.
3. The macro-environment including Political (legal) forces, Economic forces, Socio-cultural forces and Technological forces (PEST).

a) Political factors:

The political area has a huge influence upon the regulation of businesses and the spending power of customers and other businesses. The entrepreneur has to consider issues like:

* How stable is the political environment?
* Will the government policy influence laws that regulate or tax the business?
* What is the government's position on marketing ethics?
* What is the government's policy on the economy?
* Does the government have a view on culture and religion?
* Is the government involved in trading agreements such as COMESA, EAC,

RIEPA...

b) Economic factors

Entrepreneurs need to consider the state of trading economy in short and long-terms. This is specifically true when planning for international marketing. They need to look at:

* Interest rates
* The level of inflation, employment, income (per capita) etc
* Long term prospects for the economy, Gross Domestic product (GDP) etc.

c) Socio-cultural factors

The social and cultural influences on business vary from a country to country. It is very important that such factors are considered. They include:

* Dominant religion
* Attitudes towards foreign product and services
* The impact of language on the diffusion of products in the market
* Consumers' time of leisure
* Roles of men and women in the society
* Life expectance of the population

d) Technological factors

Technology is vital for competitive advantage and is a major driver of globalization. Entrepreneur can consider the following:

* Does the technology allow for products and services to be more cheaply and to a better standard of quality?
* Does technology offer consumers and business more innovative products and services such as internet banking, new generation mobile telephone, etc.?
* How is distribution changed by new technology e.g. internet booking?
* Does technology offer a new way to communicate with consumers?

## **3.9. Prioritizing goals in business**

One of the questions that most people normally tend to ask is "how do I achieve all my goals when I am alone and have limited resources?" the most obvious answer is by having your goals prioritized in the order of their importance to you.

i) Meaning of priorities

Priorities are things that should be treated as being the most important ones out of the very many others. Their importance may be due to a number of factors like:

* Contribution to the attainment of the goals
* How they facilitate the happening of others

ii) Importance of prioritizing business activities

It is important that an entrepreneur divides his/her work into things that must be done and those things that he/she wants to do. If this is done it will facilitate the following:

1. Elimination of unnecessary and inevitable fatigue
2. Meaningful or effective use of available resources
3. Systematic implementation of his/her plan
4. Monitoring and evaluation of his/her plan

iii) Identification of priorities in business goals

While identifying priorities, there are some steps that must be taken such as:

* Deciding whether the problem is easy to be dealt with
* Finding out if the problem might solve it self
* Determining whose responsibility, it is so to make necessary decision

iv) Ranking priorities in business goals

This refers to arrangement (order) given to business activities depending on their level of importance in attaining the business goals. This arrangement shows which activity will be done at first round and which will follow until the attainment of business goal.

Ranking business activities will help an entrepreneur to develop a very meaningful plan of action

Time framework and time schedule

The time frame or time schedule is a plan in which an entrepreneur does the following:

* Lay out precisely the steps that are considered necessary to implement the activities that will lead to the achievement of each goal
* Fix the responsibility for each step between either an entrepreneur or key business employees
* Set deadlines for the implementation and accomplishment of each activity and ultimately each goal.

Framework schedules: This refers to a written form of time frame/schedule.

Example of a Framework schedule

|  |  |  |
| --- | --- | --- |
| Steps | Description | Completion date |
| 1 | Make commitment to go in business yourself | Week 1 |
| 2 | Analyze your strengths, weaknesses, opportunities and threats | Week2 |
| 3 | Choose the product or service that fits your strengths and desires.  Find out the markets for your products or service | Week 3 |
| 4 | Forecast your share of the market | Week 4 |
|  | Choose a site for your business. |  |
| 5 | Produce a plan of setting the products | Week5 |
| 6 | Produce a plan showing how markets will be reached | Week 6 |
| 7 | Drawing plan showing how other workers will be got. Decide on the form of business to start | Week 7 |
| 8 | Prepare a plan showing which and how records will be kept | Week 8 |
| 9 | Prepare a plan showing the costs that will be met and how they will be financed | Week 9 |
| 10 | ……………………. | Week 10 |
| 11 | ………………………… | Week 11 |

# **UNIT4: Laws in business operations**

## **4.1. Meaning of laws and Business law Every society and county has laws that govern the way it operates. Without laws and regulations, there would be chaos. Take the following examples, a school and home. Each of these entities has laws and regulations, even when not written, these laws regulate the way members do their daily businesses.**

## **4.2. Meaning of law:**

It is a rule, usually made by a government that is used to order the way in which a society behaves, or the whole system of such rules:

* There are laws against drinking in the street.
* The laws governing the possession of firearms are being reviewed.
* They led the fight to impose laws on smoking.
* They have to provide a contract by law.

### **4.2.1. Laws and business**

Every country has laws in place that govern how people work and do business.

Business persons are therefore supposed to know the laws of the country I n which they operate their business. Breaking laws in any country has serious consequences including paying heavy fines or even closing the business entirely.

### **4.2.2. Business laws help to eliminate the following problems:**

* Traders using wrong weights and measures.
* Debtors failing to pay the amount they owe the business
* Buyers failing to pay for the goods and services they receive on credit.
* Manufacturers producing sub- standard goods.
* Contracts not being enforced
* Business people failing to pay the right taxes to the central government and local authority.
* Poorly compensating people who are wronged
* Etc.

### **4.2.3. Importance of business laws:**

* Helps to instill discipline in business operations
* Conformity with government expectations
* Protection of the consumers, environment
* It provides guidelines and directions in every area of the business.
* It is vital to know the law of contract
* It helps to know the specific taxes like law on income tax an d law on tax
* It helps a business to use a right weights and measures and sales of expired products.

### **4.2.4. Laws related to business:**

* Land act
* food and drugs law,
* consumer protection law,
* National environmental law
* Licensing laws
* Law of contract
* Trade mark and patent laws
* Employment laws
* Tax laws
* Commercial laws
* Consumer protection laws.

## **4.3**. **Legal institutions related to businesses:**

* Commercial courts
* Rwanda Revenue Authority (RRA)
* Rwanda Development Boards (RDB)
* Rwanda Utilities Regulatory Authority (RURA)

### **4.3.1. The commercial high court:**

Article 155 of the constitution of Rwanda establishes the jurisdictions of the commercial high courts and commercial courts to judge commercial cases.

* Commercial Courts: These are specialized courts that handle business related cases and settle business disputes. Commercial courts handle any claims that relate to the following:
* The export or import of goods
* Business documents and contracts
* Exploitation of minerals and resources.
* Carriage of goods by land, sea, air or pipeline
* Insurance
* Banking and financial services
* Operation of markets
* Purchase and sale of good
* Business agency.

### 4.3.2. Rwanda Development Board (RDB)

The Rwanda Development Board is a public institution in charge of creating a conductive business environment in Rwanda through development of the private sector in all aspects. This involves working with and addressing the needs of companies of all sizes (large, SMEs) and both local and foreign investors.

The Rwanda Development Board was set up by bringing together all the government agencies responsible for the entire investor experience under one roof. This includes key agencies responsible for business registration, investment promotion, environmental clearances, privatization (**RIEPA, RIAM, RITA, REMA,** …) and specialist agencies which support the priority sectors of ICT and tourism as well as SMEs and human capacity development in the private sector.

The RDB is independent and influential. It reports directly to the President and is guided by a Board that includes all the key Ministers (e.g., finance, commerce, infrastructure, agriculture).

**Vision**

To transform Rwanda into a dynamic global hub (centre) for business, investment and innovation.

**Mission**

Fast tracking economic development in Rwanda by enabling private sector growth.

**Core value**

These core values are the foundation of RDB’s success. They communicate how RDB will work as the characteristics that will be a hallmark (controller) of a new transformed Rwanda.

**Pro-active**

We do not wait for problems or opportunities to come to us; we take responsibility for pursuing the most urgent challenges and opportunities shaping Rwanda’s development.

Practical and productive

We run like an efficient business seeking maximum benefit for minimum expenses and will work in practical ways to transform the way that the Rwandan government operates.

**Partnership**

We work in partnership, look to build cooperative relationships that will benefit others and generously share credit for our country’s successes.

RDB services to investment and business community.

*1****.* Investment promotion**

* Response to investor enquiries
* Provision of information
* Management of investor visits to Rwanda

***2.* Investment facilitation**

* Provision of application forms and processing of investment certificates
* Access to land
* Environment impact assessment procedures
* Facilitating investors in acquiring utilities including water, electricity and telephone.
* Policy sensitization
* Policy advocacy
* Aftercare services with you after your business is registered
* Value added tax registration (VAT)
* Tax clearance
* Tax identification number (TIN)
* Customs tax exemption approval
* Business license company registration
* De-registration from the register activities for individual business and companies.
* Registration, administration, transferring security’s interest on movable and immovable property.
* Registration and protection of intellectual property rights which include potent, trademarks, copyright etc.

***Law and regulations***

RDB was established by the organic law No 53/2008 to fast track the development of Rwanda in priority areas to achieve the government’s development objectives as outlined in vision 2020 and the Economic Development Poverty Reduction Strategy (EDPRS). It is entrusted with the mission to fast track the development of Rwanda and creates a sustainable GDP growth for Rwanda with good jobs and business opportunities for citizen and non-citizen.

**To reach its vision RDB operates under following departments:**

1. **Trade and Manufacturing Department**

*The* ***RDB trade and manufacturing department*****aims** at supporting SMEs which make today, over 95% of the businesses in Rwanda and prior sectors like Agriculture, tourism and ICT by providing the so called Business Development Services(BDS). These BDS network helps new entrepreneurs and existing businesses to grow, to become more competitive and contribute further to the prosperity of Rwanda.

1. **Asset and Business Management department.**

For that Professional management*,*

* RDB **aims a**t managing the existing assets by privatizing them and ensure that new investments are made to facilitate private sector entry in the future.

**Goals:**

* Maximize financial returns on investment while achieving government development goals
* Facilitate private sector entry into the economy by investing in strategic sectors
* Support goal of a financially independent and self-sustaining RDB by generating revenues for RDB

3. Human Capital and Institutional Development department

As the Rwandan economy grows at a rapid pace, so will the demand for skilled capacity to fill the growing number of opportunities generated in the private sector. Therefore, RDB recognizes that low skills and weak institutions will limit Rwanda’s growth.

**Goals:**

* Development of entrepreneurship and of skills in the labor market that address private sector needs.
* Facilitation of skills development of areas of public institutions that impact on private sector growth.
* This department is the one in charge of providing skills through trainings to different entrepreneurs and employees from different public institutions concerning prior issues and potential business opportunities to be exploited by private sector.

### 4.3.3. Rwanda Revenue Authority (RRA)

**Vision**

To become a world-class efficient and modern revenue agency, fully financing national needs

**Mission statement**

Mobilize revenue for economic development through efficient and equitable services that promote business growth.

**Core strategic values**

* Integrity
* Customer focus
* Transparency
* Professional service delivery
* Team work

**RRA mandate**

The RRA was established under the law No15/95 of 8 November 1997 as a quasi-autonomous body charged with the task of assessing collecting and accounting for tax customs and other specified revenues. This is achieved through effective administration and enforcement of the laws related to those revenue. In addition, it is mandated to collect **non-tax revenues** example public service fees**.**

The authority is also responsible for providing advice to the government on tax policy matters related to revenue collections. It performs other duties in relation to tax administration as may be directed from time by the cabinet.

### 4.3.4. The Office of Registrar General (ORG)

ORG was established in 2008 for the continuation of the roles and functioning of the Rwanda Commercial Registration Agency (RCRSA) and is today administratively organized as a department within the RDB. RDB is a public institution charged with the development of the country, it is composed of different departments and units. The mandates, duties and tasks of ORG and the procedures to be followed as well as the legal capacity of the decisions of the ORG are identified by the various laws assigning registration and other tasks to the register.

**Where does ORG operate from?**

Its head office is on the ground floor of the RDB building at GISHUSHU around Nyarutarama road, Kigali and local offices in eight different districts

**Responsibilities**

ORG has the responsibility of facilitating investment and solving different matters related to commercial business with the aim of improving corporate governance and easy doing business in Rwanda. In particular, the ORG has the responsibilities relating to modernizing harmers relationship and registering, trading companies and business, secured transactions, intellectual property rights and activities to initiate, exercise and halt business activities. Especially, the ORG has the following responsibilities:

* Follow up of the elaboration of laws relating to trading companies, secured transactions, commercial recovery and setting of issues arising from insolvency.
* Follow up of activities related to commercial recovery and setting of issues arising from insolvency.
* Maintaining register data and all records of the ORG
* Publishing all information related to business registration
* Examining on regular basis if the laws that need to be implemented by the ORG are improved and respected
* Designing training, information and sensitization programs for economic operations on organic regulations that govern them as provided for by the law on which the ORG bases its operations
* Insuring monitoring and control of the implementation of laws that govern the business registration operations
* To issue instructions within the framework of implementing and facilitating the respect of laws related to business laws.

**Main laws implemented by the office of the Registrar general**

1. Law No 07/2009 of 27/04/2009 related to companies
2. Law No 10/2009 of 14/05/2009 on mortgage
3. Law No 11/2009 of 14/05/2009 on security interests in movable property
4. Law No 12/2009 related to commercial recovery and settling of issues arising from insolvency
5. Law on intellectual property rights
6. Law related to negotiable instruments.

**Services provided by the ORG**

Some of the services offered by the ORG are the following:

* Registration of business which can score a daily income of at least ten thousand Rwandan francs (10,000Rwf)
* Registration of companies, partnership and societies
* Deregistration from the register activities for individual business and companies
* Issuing the certificate of non-bank rupture to traders and companies
* Registration and protection of intellectual property rights which include trade makers, copy rights etc.

All services in the ORG are provided in 24 hours when the applicant complies with the requirements of the laws

## **4.4. Legal forms of business ownership**

It is an entity formed for the purpose of carrying out commercial activities with a view of producing goods and services for sale in intention of getting a profit.

Business organizations are of **three** forms:

1. Individual proprietorship here a single person holds the entire operations as his personal property small managing it on day-to-day basis.
2. Partnership: here the partnership may have been formed between 2-20 or more members.
3. A company or enterprise: this is legally recognized organization designed to produce goods and/or services to the consumers. They are predominant in capitalist economies mostly being privately owned and function to earn profit that will increase the wealth of its owners.

### **4.4.1. Types of business organization**

a) Sole proprietorship: also known as individual entrepreneurship or sole trade: this refers to a personal owned business organization.

Characteristics of sole proprietorship

* A single person provides the whole capital
* The owner does all or most of the work
* The owner bears all the risks and enjoys all the profit
* The owner can do perpetual succession through family members or relatives
* The main objective is the profit for the owner

Advantages of sole proprietorship business

i) Simplicity

ii) Quick decision

iii) An entrepreneur is the business owner, he is not controlled by anyone else:  
independence

iv) High secrecy

v) Monopoly of profit earned

vi) Total control of the business by the owner

Disadvantages of sole proprietorship

* Limited resource/ capital
* Limited ability
* Does not enjoy economy of scale because it does not use experts
* Limited lifelong: When the owner is sick or dies, the business can be closed
* It is difficult to get loans from the bank
* The owner suffers from long and irregular hours
* Limited competition capacity towards large companies

b) General partnership: This type is characterized by more persons with the aim of making profit.

Characteristics of partnership

* The minimum number of members is two and the maximum is twenty.
* It may be a group of individuals/ companies owing one business and who contribute capital.
* There is no perpetual succession
* The main objective is profit to the partners
* Partners are guided and governed by a partnership deed which acts as the constitution of the partnership
* Each partner acts as an agent of an enterprise and can enter into the contract on behalf of the firm but basing on the partnership deed.
* Profits and losses are shared basing on the agreed terms in the partnership deed.

Types of partners

Active partners: who takes active part in running of the business? They provide capital and share profit.

Dormant/ sleeping/ silent partners: they do not take part in the management of the firm but they contribute capital, shares profit and losses.

General partner/ ordinary partner: this is one whose liability is unlimited. His property can be taken to settle the debts of the partnership

Limited partner: this is one whose liability is limited i.e. his personal property cannot be taken to settle the debts of partnership

Quasi partner: is the person who offers his name to be used in the business but he does not contribute the capital of the business. He does not take part in the management and is not responsible for the firm's debts. He is utilized because he is famous and so has high reputation.

Minor partner: is one who has not attained the age of maturity i.e. under 18 years but enjoys the benefit of the partnership. He is not liable for the debts of the firm except to the extent of the capital contributed or his share of the profit.

New partner: one who comes into the partnership with the consent of all partners. He is not liable for the debts of the partnership incurred before he joined it.

Outgoing partners: people who leaves the partnership with the consent of partners or the partner's deed.

Advantages/ merits of partnership

1. Diffusion of risk
2. More resources or capital
3. Combined talent and skills
4. Increased credibility with potential customers and suppliers
5. It can run even when some members are absent
6. Work can be shared
7. It lasts longer than sole proprietorship

Disadvantages/demerits of partnership

* Risk of implied authority
* Less control of the business by individuals
* Conflicts due to misunderstanding
* Problem of continuity especially when a strong partners disappear
* Unlimited liability of partners for the business debts
* Delay of decision making

3. Limited liability companies/ joint stock companies: this is where liability for the debts of the company is limited to nominal values of the share capital held. The profits of the business are distributed according to the proportion of share capital held by the individuals.

Types of joint stock companies

i. Limited by guarantee

ii. Private company

iii. Public company

iv. Public corporation/ nationalized companies

v. Cooperative societies

i) Limited by guarantee

Companies limited by guarantee are usually utilized by charitable organizations i.e. non-profit driven organizations. Such companies are required to register as non­governmental organizations to the Non-Government Organization Board before they register as companies limited by guarantee

ii) Private limited company

This is not allowed to sell shares to the public. Membership is limited from a minimum of 2 to a maximum of 50. To form it, it requires documents like Memorandum of Association, Articles of Association, etc.

Advantages of private limited companies

* Members enjoy limited liability
* It is capable of raising more capital
* Its property is clearly distinguished from that of its members
* Continuity of the business is not seriously affected the death of a shareholder
* A large company can employ experts, be more efficient and enjoy economies of scale
* It has a right to sue and be sued (to court)

Disadvantages of private limited companies

* It is not easy to raise the initial capital because it is not allowed to appeal for subscription from the public
* Employees are not allowed to purchase shares. This reduces their hard work
* Delays in decision making

iii) Public limited companies

It is allowed to sell shares to the public in order to raise the capital. Membership is unlimited with a minimum number of seven members. Its formation requires written documents like:

1. Memorandum of Association
2. Articles of Association
3. Certificate of Incorporation
4. Prospectus (summary of plan)
5. Trading certificate

Advantages of public limited companies

♦ Members have limited liability

♦ They can raise large capital through issuing shares or debentures

♦ Shares are freely transferable i.e. the members wishing to convert their shares into cash do so quit easily.

* Death of a member does not affect the company
* It enjoys economies of large scale production

Disadvantages of public limited companies

* Decision making and implementation is often slow because of bureaucracy
* There is very limited personal contact between the company, its employees and customers
* The directors are the agents of the company, shareholders have little say
* It is difficult to form it since it requires written documents

iv) Pubic corporations/ nationalized companies

This is a form of enterprise where the government can decide to place production in the hands of state. They have the following characteristics:

* Government owned corporations
* Liability established statute
* Has capacity to borrow and own assets
* Can exercise perpetual succession
* Corporations created by specific registration
* Main objective is to cater for some national interests
* Not subject to the requirements of the companies' act
* Have Corporate status

The major advantage is that of ready and big capital contributed by government while the major disadvantage is mismanagement and corruption by management.

v) Cooperative societies

A cooperative society is a business unit formed with the purpose of benefiting members. There are various types of them which include:

1. Consumer cooperative societies: these are formed with the aim of trading. Individuals come together for the purpose of buying goods at a cheaper price and selling them to members at relatively low price. Each member pays a membership fee and buys share (s).
2. Producer cooperative societies: they deal with the marketing of agricultural products and some of them are involved in production. They are very important in the development of Low Developed Countries (LDC).
3. Transport cooperative societies: they deal with transportation. E.g. ATAMIMORWA
4. Savings and Credit societies: they mobilize savings and provide credits to members. E.g. SACCO

The role of cooperatives in LDCs

1. Financial assistance through credits
2. Creation of employment opportunities
3. Transporting and marketing of the produce
4. Provide storage facilities for raw material and/or finished products
5. Educating farmers how to cultivate and use fertilizers
6. Provision of farm inputs
7. Tractors hire
8. Transformation of the economy from subsistence to a monetized one

Problems faced by cooperatives

1. Leadership problems: cooperatives have sometimes be afflicted by poor management (inadequate accounting expertise and limited funds for training managers in the field of accounts and marketing)
2. Financial problems: lack of finance due to the members who do not their subscription fees some mismanagement of funds by employees and members who do not pay their loans.
3. Poor transport facilities
4. Lack of spare part of their machinery
5. Lack of storage facilities
6. Government interference
7. Conservatism: some members are reluctant to run new methods of production.

Business Formation and registration according to form:

* Registering a sole trade business
* Registering a domestic company
* Registering a foreign company
* Registering a partnership
* Registering a co-operative

## Business registration

**Register of companies, enterprises and business names**

The entrepreneur will have to assess the legal requirements and benefits of registration to the business before considering registration.

The decision to register is based on the availability of resources to meet all costs of registration.

* **Business Registration Process:**

1. For **SOLE PROPRIETORSHIP** business, an entrepreneur can start the business without any legal procedures. There are no formal procedures such as registration and document. An entrepreneur only gets a trading **license** and starts the business.
2. **PARTNERSHIP** may register with the registrar of companies. In this case, they will be required to draw up a partnership deed/agreement. In the absence of an agreement between partners, the partnership cannot be registered.
3. For registering a **COMPANY** (Joint stock Company/ Limited Liability Company), or a **COOPERATIVE**, the following steps are normally followed:

* The promoters would prepare a memorandum of the association which outlines the activities the firm is to be involved in, its objectives and the general organization of the company is to be.
* They will also prepare articles of association of the company that lays down the rules and regulations which will control the internal organization of the company.
* The registration can be processed by the promoters themselves or through a lawyer.
* An application form will be filled and then deposited with the records assistant in the registry.
* A search will be conducted to confirm that firm uses similar names as those chosen by the promoters of the company.
* The application forms are then passed on the registrar of the companies for endorsement and approval.

NB: Registration can be processed by either **self** or through **lawyer**.

1. If the entrepreneur chooses to a **lawyer**, then in filling application forms, will pay any amount for the services. The registration certificate will normally be delivered in a period of about four days if full fees are paid to the lawyer.
2. If the registration is done by **self**, then the filled application forms are deposited with the record assistant in the registry that conducts a search to confirm that there are no similarities between the proposed names of the business with any other name of a registered business already existing. When satisfied that there are no any similarities the Record Assistant then passes the forms to the registrar for endorsement and approval.
3. If all the required documents are in order the registrar of companies will issue a **certificate** of incorporation. This document indicates that they have been allowed to commence business registered for. It puts the company into existence and the company becomes a separate legal entity.

### 4.4.2. Summary of business Registration process in Rwanda

To register a **local enterprise** or a **foreign subsidiary**, the RDB provides a quick and efficient registration service allowing you to have your business incorporated within 24hours.   
The process ends simultaneously by obtaining the **certificate** of incorporation (business registration), Tax Identification Number (tax registration) and the Social Security registration for employee pension submission.

View the table below to see how you can start, add or cease business activities in Rwanda.

|  |  |  |
| --- | --- | --- |
| **Activity** | **Requirements** | **Cost** |
| **Registering a local company** | * Copy of ID/Passport of promoter(s) * Completed application form and two copies of article 14 * Payment of registration fee | Registration fee RWF 25,000 (USD 42) |
| **Registering a branch of foreign company in Rwanda** | * Completed application form and two copies of article 14 * Notarized memorandum and power of attorney to represent the company in Rwanda * Notarized copy of the articles of association * Notarized certificate of registration of foreign company's * List of directors residing in Rwanda * Payment of registration fees | Registration fee RWF 25,000 (USD 42) |
| **Registering additional activities for companies** | * Completed application forms provided * Three notified copies of board meeting minutes * Original registration certificate * Payment of registration fees | Registration fee RWF 10,000 (USD 17) |
| **Requesting duplicate of lost registration certificate** | * Proof of loss of original certificate from parquet general * Copy of registration certificate * Completed application form provided by RDB * Payment slip | **Registration fee RWF 10,000 (USD 17)** |
| **Cessation of trading activities** | * Letter addressed to the Registrar General, stamped by the RRA. * A copy to RRA * Tax clearance certificate from RRA * Original Registration certificate * Minutes of Association notarized * Payment Slip | Cessation fee RWF 5,000 (US$ 8.50) |

### 4.4.3. Role of registering a business.

All small and large-scale enterprises are compelled to register for different reasons:

1. Business protection against imitators thus, avoiding conflicts.
2. Identification and recognition of the business as a productive unity.
3. To know the number of business created able to produce and provide employment is an important data in economic growth.
4. It gives to the owner, the access to banking services using a business name other than the individual and accessing contracts from the government and other institutions.
5. It gives the business a legal recognition to sue or be sued by its members, suppliers, creditors, customers, distributors
6. Obtaining licenses and permits
7. Legal liability protection
8. To be versatile
9. Have continuity entity
10. Safeguarding business name and Protecting product brand

**Consequences of not registering a business**

* Being fined
* Suspension of operation
* Inability to issue official invoices
* Operating outside official system
* Limitation to financial services

# **UNIT5: ROLE OF STANDARDS IN BUSINESS**

## **5.1. Meaning of standards in business**

**Standards** are published documents that establish specifications and procedure designed to maximize the reliability of the materials, products, methods, and/or services people use every day.

**Standard**s address a range of issues, including but not limited to various processes/systems to help maximize product functionality and compatibility, facilitate interoperability and support consumer safety, trade promotion and public health.

Standards form the fundamental building blocks for product development by establishing consistent protocols that can be universally understood and adopted. This helps fuel compatibility and interoperability and simplifies product development, and speeds time-to-market.

Standards also make it easier to understand and compare competing products. As standards are globally adopted and applied in many markets, they also fuel international trade.

It is only through the use of standards that the requirements of interconnectivity and interoperability can be assured. It is only through the application of standards that the credibility of new products and new markets can be verified. In summary standards fuel the development and implementation of technologies that influence and transform the way we live, work and communicate.

The vision of RSB is to be a trusted party in providing internationally recognized and customer suited standardization services. Mission To provide standards based solutions for Consumer Protection

**Why Are They Important?**  
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## 5.2. What role do standards play in government?

Using standards benefits government organizations in many ways, from streamlining their own processes to helping build alternative approaches to regulation.

Government is keen to reduce red tape for both the private and public sectors. A key way to do this is to have regulators and their inspectors concentrate their efforts on those organizations who present the highest risk rather than putting the burden on everyone, as has often been the case in the past.

This is where standards come in. Not to replace regulations, but to complement them. Standards are shaped by best practice, so if an organization is using them, it’s probably being well managed. This makes it easier for regulators to decide where to focus their attention. Standards are the foundation on which a risk-based approach to regulation can be built.

We work closely with the government in many areas. Its representatives participate in our technical committees along with those from business, academia and consumer groups. Together, we make sure that products, processes, new technologies and services incorporate the knowledge and needs of all interested parties.

Using our standards also helps the government’s own processes become more efficient, for example eliminating waste and achieving maximum value for money in its procurement processes.

Finally, standards help government departments encourage the growth of groundbreaking new products and industries – by providing dependable knowledge and standardization so that new technologies can work seamlessly with existing technologies.

**How standards help government encourage innovation**

* Standards create a common framework for innovation that encourages the sharing of knowledge, for example by defining common vocabularies, by establishing essential characteristics of a product or service, or by providing a means to disseminate results of research and development.
* They minimize duplication during research and development, thereby increasing efficiency
* They maximize the ability of a product to be used in conjunction with others.
* They reduce unnecessary variance.
* They can provide a framework for moving from the development bench into production, through defining essential parameters, safety considerations, testing, prototyping and scale-up.

## 5.3. Benefits of International Standards

International Standards bring technological, economic and societal benefits. They help to harmonize technical specifications of products and services making industry more efficient and breaking down barriers to international trade. Conformity to International Standards helps reassure consumers that products are safe, efficient and good for the environment.

**Benefits of standards: the ISO Materials**

ISO has developed materials describing the economic and social benefits of standards, the ISO Materials. They are intended to be shared with decision makers and stakeholders as concrete examples of the value of standards.

**Facts and figures about the benefits of standards**

The repository of studies on economic and social benefits of standards provides an insight of the approaches and results of the studies undertaken by different authors, such as national and international standards bodies, research institutes, universities and other international agencies.

## 5.4. For business

International Standards are strategic tools and guidelines to help companies tackle some of the most demanding challenges of modern business. They ensure that business operations are as efficient as possible, increase productivity and help companies’ access new markets.

Benefits include:

* **Cost savings** - International Standards help optimize operations and therefore improve the bottom line
* **Enhanced customer satisfaction** - International Standards help improve quality, enhance customer satisfaction and increase sales
* **Access to new markets** - International Standards help prevent trade barriers and open up global markets
* **Increased market share** - International Standards help increase productivity and competitive advantage
* **Environmental benefits** - International Standards help reduce negative impacts on the environment

Businesses also benefit from taking part in the standard development process. Read more about the benefits of getting involved in standards development.

## 5.5. For Society

ISO has over 20 500 standards touching almost all aspects of daily life.

When products and services conform to International Standards consumers can have confidence that they are safe, reliable and of good quality. For example, ISO's standards on road safety, toy safety and secure medical packaging are just a selection of those that help make the world a safer place.

To make sure that the benefits of ISO International Standards are as broad as possible, ISO supports the involvement of consumers in standard development work with its Committee on consumer policy (COPOLCO).

International Standards on air, water and soil quality, on emissions of gases and radiation and environmental aspects of products contribute to efforts to preserve the environment and the health of citizens.

ISO's standards on toy safety help make the world a safer place.

## 5.6. For government

ISO standards draw on international expertise and experience and are therefore a vital resource for governments when developing public policy.

National governments can use ISO standards to support public policy, for example, by referencing ISO standards in regulations. This has a number of benefits, including:

* **Expert opinion** - ISO standards are developed by experts. By integrating an ISO standard into national regulation, governments can benefit from the opinion of experts without having to call on their services directly.

**Opening up world trade** - ISO standards are international and adopted by many governments. By integrating ISO standards into national regulation, governments help to ensure that requirements for imports and exports are the same the world over, therefore facilitating the movement of goods, services and technologies from country to country.

## 5.7. For consumers

Interoperability is a real benefit associated with standards. Consider it from a consumers' perspective: when you purchase a laptop, you expect that it will connect wirelessly to the internet no matter where you are.

For example, think about a time you might have been working at the office on an online document, then gone to a café and searched for convenient times for a movie playing nearby, and finally gone home to review and send emails.

Throughout the entire chain of events, not once did you have to think about which standards were being used, whether your laptop's wireless technology would work in these environments or whether there would be an issue with your computer's power supply. Interoperability of standards makes all of this - and much, much more - possible.

Standards also maintain choice for consumers, ensuring that several suppliers can supply similar but compatible products, maintaining competition and keeping prices low while offering a wider range of choices in any one category.

## 5.8. Standards provide:

* **Safety and reliability:** Adherence to standards helps ensure safety, reliability and environmental care. As a result, users perceive standardized products and services as more dependable – this in turn raises user confidence, increasing sales and the take-up of new technologies.
* **Support of government policies and legislation** – Standards are frequently referenced by regulators and legislators for protecting user and business interests, and to support government policies. Standards play a central role in the European Union's policy for a [Single Market](http://www.etsi.org/standards/why-we-need-standards/standards-for-a-single-market).
* **Interoperability** – the ability of devices to work together relies on products and services complying with standards.
* **Business benefits** – standardization provides a solid foundation upon which to develop new technologies and to enhance existing practices. Specifically standards:
* Open up **market access**
* Provide **economies of scale**
* Encourage innovation
* Increase **awareness** of technical developments and initiatives
* **Consumer choice** - standards provide the **foundation for new features** and options, thus contributing to the enhancement of our daily lives. Mass production based on standards provides a greater variety of accessible products to consumers.

**Consider what the world would be like without standards:**

* Products might not work as expected
* They may be of inferior quality
* They may be incompatible with other equipment – in fact they may not even connect with them
* In extreme cases, non-standardized products may be dangerous
* Customers would be restricted to one manufacturer or supplier
* Manufacturers would be obliged to invent their own individual solutions to even the simplest needs, with limited opportunity to compete with others

Society needs standards!

## 5.9. The benefits of standards on a national and international level

Standards may firstly support national health and safety; electrical and fire hazard standards are a prime example. Furthermore, within any one country, the definition of standards may ensure compatibility and interoperability between different industries, thereby helping to develop more comprehensive and wider-reaching products and services.

In a world of increasing globalization, these benefits are increased by an order of magnitude. European standards have been of great importance for the development of a single European market, and the trend is now towards ever-increasing international co-operation. International standards help to break down trade barriers and further world trade. The ever-expanding globalization of the car industry is a prime example.

# UNIT6: MARKET RESEARCH

## **6.1. Notion of marketing in a commercial activity.**

### **6.1.1. Meaning of different terms included into market.**

1. Market:

The term market refers to any place/means or situation that brings buyers and sellers into close contact to transact goods and services.

In entrepreneurship, however, market is a composition of all buyers(people, institutions, and businesses) within a given geographical area who need and are willing and able to buy the products of a business.

Real market for a business is defined as a composition of people, institutions and businesses that are in need of its products and are willing and able to pay for them

Potential market for a business to all people, institutions/organizations and businesses in need of the products of a business and are able but not yet willing to buy these business products.

1. Marketing:

The term marketing refers to a series of activities undertaken by an entrepreneur in order to find out that his/her customers are and their needs.

It consists of all activities that involve the flow of goods and services from the producer to the customer. The major objective of marketing is to ensure that customers’ needs are satisfied as the entrepreneur makes his desired profits.

Some of the marketing activities undertaken include:

* Finding out what people or customers need or want.
* Developing/providing goods or services that meet the identified needs or wants of customers.
* Setting affordable prices
* Making products available at places where customers can assess them easily.
* Etc.

Differences between marketing and selling

* Marketing focuses on customers ‘needs while selling focuses on seller’s needs
* In marketing, a customer enjoys supreme importance, while in selling, a producer enjoys supreme importance
* In marketing, there is an integrated approach to achieve long –term goals, while in selling there is a fragmented approach to achieve immediate gains.
* In marketing, profits are realized through customer satisfaction, while in selling, profits are realized through sales volume.
* In marketing, an entrepreneur converts customer’s needs into a product, while in selling, he converts products into cash.

1. Market research:

Market research refers to the finding out who your customers are, their needs, location, where to buy, etc. This information can be obtained from customers, employers, competitors, company records, etc.

### 6.1.2. MARKETING MIX (Components of marketing/4Ps):

Marketing mix is a term coined by Neil Borden, are the ingredients that combine to capture and promote a brand or product’s unique selling points, those that differentiate it from its competitors

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* **PRODUCT DECISIONS**

The term "product" refers to tangible, physical products as well as services. Here are some examples of the product decisions to be made:

* Brand name,
* Functionality ,
* Styling ,
* Quality ,
* Safety ,
* Packaging ,
* Repairs and Support ,
* Warranty ,
* Accessories and services
* **PRICE DECISIONS**

Once a concrete understanding of the product offering is established we can start making some pricing decisions. Price determinations will impact profit margins, supply, demand and marketing strategy. Similar (in concept) products and brands may need to be positioned differently based on varying price points, while price elasticity considerations may influence our next two Ps.

Some examples of pricing decisions to be made include:

* Pricing strategy (skim, penetration, etc.)
* Suggested retail price
* Volume discounts and wholesale pricing
* Cash and early payment discounts
* Seasonal pricing
* Bundling
* Price flexibility
* Price discrimination
* **PLACE DECISIONS**

Often you will hear marketers saying that marketing is about putting the right product, at the right price, at the right place, at the right time. It’s critical then, to evaluate what the ideal locations are to convert potential clients into actual clients. Today, even in situations where the actual transaction doesn’t happen on the web, the initial place potential clients are engaged and converted is online.

Some examples of pricing decisions to be made include:

* Distribution channels
* Market coverage (inclusive, selective, or exclusive distribution)
* Specific channel members
* Inventory management
* Warehousing
* Distribution centers
* Order processing
* Transportation
* Reverse logistics
* **PROMOTION DECISIONS**

We’ve got a product and a price now it’s time to promote it. Promotion looks at the many ways marketing agencies disseminate relevant product information to consumers and differentiate a particular product or service. Promotion includes elements like: advertising, public relations, social media marketing, email marketing, search engine marketing, video marketing and more. Each touch point must be supported by a well-positioned brand to truly maximize return on investment.

Some examples of pricing decisions to be made include:

* Promotional strategy
* Advertising
* Personal selling & sales force
* Sales promotions
* Public relations & publicity
* Marketing communications budget

**MARKETING 4 Cs/4Ps**

* Consumer wants and needs/Products
* Cost/Price
* Convenience/Place
* Communication/Promotion

### **6.1.3. Importance of the four "P" of marketing in a commercial activity**

We have developed a dedicated marketing process often used with our Cleveland web design and marketing clients. As a part of this process, we incorporate the four Ps through a series of questions designed to help define each brand’s marketing mix. Here are just a few of the questions we use:

* What do consumers want from your product or service?
* How does your product meet those needs?
* Where do potential buyers look for your particular product or service?
* How do you differentiate from your competitors?
* What is the perceived value of your product or service?
* What current interactions do you have with potential clients?
* Of course the list we use is more complete, but we hope the few questions listed above can give you a good starting point in understanding the four Ps.

### **6.1. 4. Marketing strategies:**

* Select customers to serve,
* Segmentation,
* Targeting,
* Differentiation,
* Positioning
* Decide on the value proposition

**MARKET SEGMENTATION**

It can be defined as the process of defining and subdividing a large homogenous market and subdividing into clearly identifiable segments having similar needs, wants, and demand characteristics. Its objective is to design a marketing mix that precisely matches the expectations of customers in the targeted segment.

**TYPES OF MARKET SEGMANTATION**

* Geographic; continent, Nations, states, Regions and cities
* Demographic; age, family size, gender, income, occupation, education, religion, race, generation, social class, etc.
* Psychographic; personality traits, lifestyle or values.
* Behavior; attitude towards the product.



## **6.2. MARKET SUVEY**

### **6.2.1. Meaning of market surveys**

A detailed study of a market or geographical area to gather data on attitudes, impressions, opinions, satisfaction level, etc., by polling a section of the population.

A market survey is a research technique used to gather consumer preferences and purchase intent of a company's products and services within a geographical area. Market surveys are conducted either in-house by the company or through a marketing research agency.

It is a Collection of primary information on other properties that sell or lease in the same market. At a minimum, the characteristics or classification of each building, its rent levels, and tenant occupancy will be included

1. Importance of market surveys

* Identify customer needs and complaints
* Identify nature of demand
* Identify nature and size of completion, customers and market.
* Provide information concerning many various aspects
* Determine real and potential market of different products that would be generated from different ideas.
* Identify the best sources of distributing the products
* Assess the sales representatives’ efficiency
* Analyze the effectiveness of the advertising medium/media used
* Identify the threats, weaknesses, opportunities and strengths of the entrepreneurs and business at large.

1. Limitations of marketing research

* It does not provide complete answers to marketing problems as the answers may be vague or irrelevant.
* It is costly and that’s why most upcoming entrepreneurs do not carry/follow up
* It only provides a base predicting future events and does not guarantee any certainty in the happening of the events
* Due to the changing market environment, the data collected becomes historic and the research findings based on them becomes irrelevant

1. Steps in conducting market assessment of production or business
2. Select the product(good or service) for which market assessment is to be done
3. Identified the market area to be assessed
4. Decide on the assessment approach/method
5. Develop data collection testament
6. Collect data on the 5Ps
7. Analyze the data
8. Analyze the market strategy
9. Assess the feasibility and viability of the product.
10. Factors considered when conducting a market assessment

* The target markets for the products
* The nature of the product to be produced and the market needs
* The competition and substitute product facing the business and this effects the markets
* The target market trends and their implications on the business market,

1. Elements of market survey
   1. Customer Survey

It is a study that assesses how customers think, feel, behave, and what to do about them. It is concerned with the following questions:

What are customers’ perceptions of your corporate or product brand?

What can you change to improve the overall customer experience/ care?

What is the likelihood/ probability that your current customers will purchase from you again?

How are you viewed in relation to your competitors?

Are you making decisions based on your most vocal customers or your entire customer base?

* Types of customers
* **Loyal Customers**

Naturally, we need to be communicating with these customers on a regular basis by telephone, mail, email, etc. These people are the ones who can and should influence our buying and merchandising decisions.

Nothing will make a Loyal Customer feel better than soliciting their input and showing them how much you value it. In my mind, you can never do enough for them. Many times, the more you do for them, the more they will recommend you to others.

* **Discount Customers**

This category helps ensure your inventory is turning over and, as a result, it is a key contributor to cash flow. This same group, however, can often wind up costing you money because they are more inclined to return product.

* **Impulse Customers**

Clearly, this is the segment of our clientele that we all like to serve. There is nothing more exciting than assisting an Impulse shopper and having them respond favorably to our recommendations. We want to target our displays towards this group because they will provide us with a significant amount of customer insight and knowledge.

* **Need-Based Customers**

People in this category are driven by a specific need. When they enter the store, they will look to see if they can have that need filled quickly. If not, they will leave right away. They buy for a variety of reasons such as a specific occasion, a specific need, or an absolute price point. As difficult as it can be to satisfy these people, they can also become Loyal Customers if they are well taken care of. Salespeople may not find them to be a lot of fun to serve, but, in the end, they can often represent your greatest source of long-term growth.

It is important to remember that Need-Based Customers can easily be lost to Internet sales or a different retailer. To overcome this threat, positive personal interaction is required, usually from one of your top salespeople. If they are treated to a level of service not available from the Web or another retail location, there is a very strong chance of making them Loyal Customers. For this reason, Need-Based Customers offer the greatest long-term potential, surpassing even the Impulse segment.

* **Wandering Customers**

For many stores, this is the largest segment in terms of traffic, while, at the same time, they make up the smallest percentage of sales. There is not a whole lot you can do about this group because the number of Wanderers you have is driven more by your store location than anything else.

Keep in mind, however, that although they may not represent a large percentage of your immediate sales, they are a real voice for you in the community. Many Wanderers shop merely for the interaction and experience it provides them. Shopping is no different to them than it is for another person to go to the gym on a regular basis. Since they are merely looking for interaction, they are also very likely to communicate to others the experience they had in the store. Therefore, although Wandering Customers cannot be ignored, the time spent with them needs to be minimized.

Retail is an art, backed up by science. The science is the information we have from financials to research data (the "backroom stuff"). The art is in how we operate on the floor: our merchandising, our people, and, ultimately, our customers. For all of us, the competitive pressure has never been greater and it is only going to become more difficult. To be successful, it will require patience and understanding in knowing our customers and the behavior patterns that drive their decision-making process.

Using this understanding to help turn Discount, Impulse, Need-Based, and even Wandering Customers into Loyal ones will help grow our business. At the same time, ensuring that our Loyal Customers have a positive experience each time they enter our store will only serve to increase our bottom-line profits.

* Importance of customer surveys.
* Retaining customer
* Maximize customer value, etc.
* A customer survey identifies the factors that enhance relationships, and increase sales
* Today’s competitive marketplace requires every organization to listen to the voice of its customers.
* A [customer service survey](http://www.nbrii.com/products/customer-surveys/customer-service-surveys/) can provide management with valuable input on both short-term and long-term decision-making.
* It can offer critical operational and strategic advantages over the competition.
* Losing customers can be devastating to an organization.
* A [customer loss review survey](http://www.nbrii.com/index.php/products/customer-surveys/customer-loss-review-surveys/) can help you identify the root causes of problems so that direct action can be taken to minimize the loss of customers in the future.
  1. Product / service analysis and quality control

Before launching a new product, marketing professionals first test it with a selected audience. A new product survey provides a way for marketers to understand when to start, modify existing ideas, how and who to market. Evaluating new products with online questionnaires provides a cost-effective way to obtain valuable information from the people.

Businesses can take advantage of knowledge gain from online marketing surveys such as the new product survey to:

* Understand which benefits are most important to customers
* Which features are essential in delivering the product
* Identify customer's needs
* Measure advertising and placement factors
* Understand how incentives, warranties, and bundling change price and value perceptions.

**The Product-Service Analysis shows:**

* **Problem**: what problem these products bring to the buyer
* **Benefits**: what ultimate benefits does the buyer see, what positive results will accrue from ownership, and what value to your customers occur from solving his or her problem(s)?

1. **Quality management**
2. **Meaning**

**Business** is concerned with provision of goods and services that satisfy customer’s demands. They can be profitable and successful only the products and services are fit for use and meet the needs of customers.

**Such** fitness for use of the products that gives satisfaction to the customers of products is known as quality

1. **Quality of a product consists of the following attributes:**

* **De**sign of a product
* Reliability of a product
* Durability of a product
* Suitability of the product from customer’s point view
* Product specification
* Easy handling
* Protection of customer interests
* Customer satisfaction

1. **Misconception about Quality**

* The price,
* the origin or where the product was made,
* Brand name,
* customer’s point view,
* quality of the product,
* quality improvement requires large and new investment,
* higher quality costs,
* The staff to be blamed for the quality**.**

1. **Some common terms used about quality management.**

* **Quality control**
  + - These are operational techniques and activities and procedures that are used so as to fulfill the requirement of quality. or those needed by an organization so as to implement quality.
    - A process through which a business seeks to ensure that product quality is maintained or improved and manufacturing errors are reduced or eliminated.
    - Quality control requires the business to create an environment in which both management and employees strive for perfection. This is done by training personnel, creating benchmarks for product quality, and testing products to check for statistically significant variations
* **Quality policy**
  + - This refers to the overall intentions and direction of an enterprise with regard to quality**.**
    - The quality policy shall be used to establish and review quality objectives for continued suitability. We endeavor to meet and exceed customer expectations.
    - The quality policy shall be communicated, understood, implemented and maintained in Rwanda Bureau of Standards certification services
* **Quality planning**
  + - This involves all the various steps that an enterprise may take or use so as to achieve quality.
* **Quality assurance**:
  + - These are planned and systematic activities undertaken or implemented within the quality system and demonstrated as needed to provide adequate confidence that an enterprise will fulfill the requirements of quality. Or
    - It means the degree to which product actually conform to the design specification.
* **Quality system: T**his refers to the organizational structure, procedures and resources, which are needed to implement quality**.**
* **Total Quality Management (TQM**) is a competitive approach to long-term success that’s derived from a dedication to customer satisfaction. Within this system, every employee in a company endeavors to enhance the products, services and internal culture to produce a streamlined set of business processes that deliver an improved customer experience.
* Also commonly known as Quality Management in the United States, a TQM effort is unique in that it requires a high level of commitment to an established philosophy, with every member of the organization not only familiar with the end goal but committed to it is a dedication many attribute to the self-motivation of employees through reward-based incentives.

1. **Factors which affect quality control**

These may be referred to as quality standards of an organization or enterprise

As the firm looks forward to fulfill the requirements of quality, the following factors should be put in consideration:

* Quality inputs or raw materials
* Worker’s conditions
* Clean environment under which good is produced or a service rendered will have an impact on its quality.
* Packing of the products
* Meeting the technical specifications as regard to quality and quantity should be observed.
* Market research
* Proper monitoring and supervision
* Storage facilities

1. **Advantages of quality control:**

**Some benefits of quality control may include the following:**

* **Q**uality control improves the brand image of the enterprise as customers will trust in the product and this will lead to market expansion.
* It also promotes entrepreneurs’ image and reputation in the market.
* It helps the enterprise to determine the product cost and prices.
* It enables the enterprise to comply with standards which are set by supervising agents, this promotes standardization of product.
* Quality control increases customer satisfaction through providing the required goods and specification in conformity with customer needs.
* It leads to an increase or higher market as customer will rush to those products which satisfy their needs and are of good quality and this leads to higher or increased profit making capacity.
* It minimizes wastage in the production process regards the raw materials used
* It enables an entrepreneur or manufacturers to comply with quality standards prescribed by the relevant authorities and the customers in particular.

1. **Disadvantages of quality control**

Quality affects a company in a variety of ways, from productivity and profitability to customer satisfaction and public perception. In addition, quality affects the overall operating costs of a company. Focusing on quality helps keep a company strong in all areas.

**Productivity**

Poor quality costs company money in terms of productivity problems. If a company uses low-quality parts, systems break down, regardless of any high-quality parts also used. Low-quality parts can cause mechanical breakdowns, as well as work slowdowns or even stoppages.

**Profitability**

Quality increases profitability. When employees are engaged in a work environment in which teamwork is emphasized and where quality products are the goal, the work environment flows more smoothly than one in which quality is an afterthought.

**Customer Satisfaction**

Quality has a direct bearing on customer satisfaction. If a company produces a quality product, satisfied customers will rank that company higher in surveys than companies that fail to provide quality products or services. In addition, dissatisfied customers are more vocal in their criticisms of a company with quality problems. Various websites will rank different companies according to customer satisfaction and quality products. Poor companies may get an initial sale of a product or service but it will not create repeat customers.

**Costs**

Quality directly affects costs in a business. While using less expensive parts and equipment might cut costs in the short term, the long-term effects might be far more expensive. For example, using certain software that costs less might save company money in the short term, but that software might be more complicated than more expensive software or lack customer service. In that case, employees will take longer to understand how to use the software. On top of that, if a problem arises with the software, the lack of customer support means it takes longer to accomplish the job, thereby costing the company more money than if it had used a more expensive, higher quality software product.

**What Businesses Can Do**

* Focusing on quality can help a business maintain a satisfied customer base. In turn, this means the business might continue turning a profit. If a business is not profitable, examining the quality of the product or service is an important step to finding a solution. When focusing on quality, it must be a team effort, with everyone within the company committed to implementing any quality changes managers’ mandate. Although the initial cost might seem expensive, the overall costs of ensuring delivery of quality products and services might prove to be less than expected
  1. **Supplier survey**

The Supplier Survey was developed to collect key information on partnered and potential supplier businesses and make that data available to decision makers. This system will assist them in accessing risk within the supply base and provide a single and consistent assessment across the entire corporation.

Partnered suppliers are invited to complete the surveys and submit information that can be used to help buyers in the selection process.

**Supplychain**(raw materials-transporters-warehouse- manufacturers-wholesalers- retailers-customers)

**Developing a marketing Plan**:

* Product description,
* Customer description, Demand/need for the product, Competition,
* Current production,
* Price,
* Sales forecast for next 12 months,
* Business location,
* Promotion

**Types of Suppliers**

There are 7 main types of suppliers:-

1. **Manufacturers and Vendors**: These are the companies that research, develop and actually produce the finished product ready for purchase. Manufacturers and vendors are the source of the supply chain.  Distributors, wholesalers, resellers and retailers who purchase goods from manufacturers and vendors benefit from the cheapest prices because no other companies have added their margin to cost of the goods yet.
2. **Wholesalers and Distributors**: These suppliers are companies that buy in bulk from several manufacturers or vendors. They warehouse the goods for reselling to smaller local distributors, wholesalers and retailers. Distributors and wholesalers may also supply larger quantities to organisations or government departments directly. A genuine wholesale supplier will require your VAT or Tax ID number. This distinguishes them from discount retailers and resellers who market, particularly online, as wholesalers.
3. **Affiliate Merchants**: An affiliate merchant is a supplier that wishes to drive traffic to their website or sales of their product through banner ads and links placed throughout a network of affiliates. Merchants will normally pay affiliates a commission for every visit to the website or every sales conversion.
4. **Franchisors**: A franchisor is a business owner and will grant a licence to an individual, which allows them to develop their own business using the trademark, name, know-how and business systems of the franchisor which includes suppliers and often at better pricing than an individual could get themselves.
5. **Importers and exporters**: These suppliers will purchase products from manufacturers in one country and either export them to a distributor in a different country, or import them from an exporter into their country. Some may travel abroad to buy direct from suppliers in another country.
6. **Independent crafts people**: These are normally manufacturers of products they have designed or produced on smaller unique scales of economy and will usually sell direct to retailers or the end consumer through agents or trade shows.
7. **Drop shippers:** These are suppliers of products from single or multiple companies that will deliver direct to the buyer once they have made the purchase from your business. This can be cost effective as it eliminates the need for storage or display of the items for sale.

* **Choosing the right suppliers (considerations**)

There are different factors that may be considered when choosing suppliers of products for an entrepreneur and they include the following:

* Minimize the costs of transport and communication
* Saves the producer from costs of storage
* Gets flesh supplies
* Easy to get quality product
* Easy to make follow up of your supplier
* Advice from supplier is easy
* Credit facilities
* Good relationship
* Easy to assess the quality of raw material
* Price variations of different suppliers
* Lead time(Entrepreneur should select a supplier who can deliver the items in the required time)
  1. **Competitor survey**

Competitor analysis identifies the strengths and weaknesses of competing products or services. The competitive advantages of each product are discussed, and a short summary of the market position is generated. Alternative methods are market surveys or lab tests of competitor products

Information here you will answer questions like:

* Who are you competitors and their nature?
* Where are they located?
* What are their strengths and weakness?
* What are their sales Volume?
* What is their market activity?

**Benefits may include** to discover the strengths and weaknesses of competing products or services and to develop a list of issues that need to be addressed in order to compete effectively or a list of desirable features that the new product could include. **The importance of competitor analysis**

Meeting the need of customers is the aim of marketing, but this alone is not enough to guarantee success - the real challenge is the ability to satisfy customer needs better than competitors. Competitor analysis starts with seeking answers to the following questions, as identified in Jooste et al, (2009):

**Who are our present and potential competitors (Identify competitors)?**

Although the answer to the question might appear straightforward, the range of potential and current competitors is often far broader than appears at first sight. Companies must realise that competitors don’t always offer the same or similar products or services.

**What are the positions competitors established in the market (Analyse strategic groups)?**

Competitors can initially be categorized into groups on the basis of similarities and differences in the strategies pursued. The conceptualisation of strategic groups makes the process of competitor analysis more manageable. Having a more focused and narrow approach will assist in strategy implementation and success.

**What are their strategic objectives and thrusts?**

The analyses of competitor objectives is important because it provides insight into whether a competitor is satisfied with its important profit and market position, and thus how likely it is to retain its present strategy, especially when the competitor makes particular strategic move. Companies must understand competitor objectives and thrusts as it will influence its own strategic decisions.

**What are their present and future strategies?**

Past and present strategies of each major competitor need to be reviewed by companies. Past strategies provide insight into failures and reveal how organisations engineered changes. Reviewing competitor strategies involves the assessment of the competitors target market and differential advantage. It is also advantages for organisations to evaluate how successful the competitors have been in achieving its objectives and carrying out its strategies.

**What are their strengths and weaknesses?**

A precise understanding of a competitor’s strengths and weaknesses is an important prerequisite for developing a strategy to compete against it. Whether competitors can carry out their strategies and reach their goals depends on their resources and capabilities. Ideally with this in mind organisation would use its own strengths to take advantage of a competitor’s weaknesses.

What are their response patterns?

A major objective of competitor analysis is to be able to predict competitor’s responses to market and competitive changes. Scenario planning and counter response strategies could minimise risk and assist with the implementation of own strategies and plans.

Failure to understand competitors will lead to costly marketing mistakes and could have detrimental financial implications for companies

* **Sources of competitor information**
* Identifying competitors
* Competitor product features
* Competitor strengths and weaknesses
* Competitor intelligence
* Competitor profiling

# **UNITY 7: BUSINESS ORGANISATION AND MANAGEMANT**

## **7.1. Business organization**

### **7.1.0. Meaning of business organization**

It is an entity formed for the purpose of carrying out commercial activities with a view of producing goods and services for sale in intention of getting a profit

### **7.1.1. Forms of business organization**

1. According to the size

**Factors determining the size of business**

* Amount of capital invested in the business
* The number of paid employees
* Technology used
* Volume of sale over a given period

From the above factors, business can be divided into the following: ***Micro business, small business, medium business and large/macro business.***

1. **Micro-business:** these are businesses which are very small; they require very little money to be started; they require very simple technology to operate.

They don’t have to be registered before they commence operations but may have to obtain operating licenses from the local authorities. Their target is the local market or traveling community transiting through the area.

**Example:** Bicycle repairing, kiosks, road side selling...

1. **Small businesses (characteristics)**

* Those businesses operate from the fixed local premises which are of a permanent nature
* They employ family labor but the total number of employed people may not exceed 20 people.
* They require little money to be started
* Their periodically sales are relatively higher than those of micro-business
* They may use some basic and simple technology in the production process
* They are generally easy to start.  **Example:** Shop, bakeries

1. **Medium size businesses (characteristics)**

* Those are very well established businesses which may employ up to 100 people
* They use advanced technology and produce on a relatively big scale.
* They require a lot of capital to be started
* The business may be producing for local as well as export market

**Example:** big bakeries, milk processing and packaging, mattress manufacturing

1. **Large sized businesses**

* Those are businesses which are large
* They may employ more than 100 people
* Their production methods are specialized and produce in large quantities
* They require a lot capita to be started
* In most cases they may result from medium sized business growing and becoming large. They may be producing for both local and foreign market

**Example:** Sugar woks, MUKWANO industries

**Note**! *The size into which a business falls may vary from a country to a country, it depends on the level of development*

A guide to determine the size of business

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Indicators of business size** | **Micro-business** | **Small-business** | **Medium-business** | **Macro/large business** |
| **Man power: number of employees** | **1-2** | **3-20** | **21-100** | **Over 100** |
| **Size of capital** | Little money to be started | Little capital but greater than micro business | A lot of capital | A lot of capital |
| **Registration** | Not necessary to register | May or not register | Registration is necessary | Registration is necessary |
| **Sales volume** | Very low | Low | Relatively high | Very high |
| **Level of technology** | None, basic, simple | Simple and skilled owner | Modern technology and skilled labor | Automated and skilled labor |
| **Energy** | No energy, necessarily it relies on manpower | Basic technology for lightning | Use of a lot of energy | Depend on energy |

1. According to products/activities
2. Trade: this refers to buying and selling of goods and services. It may be exchange of goods/ services against money or goods/services against themselves.
3. Providing service: By service we mean intangible product which provides satisfaction to a person who receives it. Example of people who provides service: teacher, medical doctor, musician, transporters, lawyer, counselors...
4. Agriculture: this refers to keeping animals and growing crops
5. Manufacturing: this refers to the transformation of raw materials into valuable finished products.

a) Agribusiness

1. Meaning

Agribusinesses are those ones whose operations involve production and selling of agricultural products for profit. Example: crops, livestock, poultry farms

However, for any agricultural activity to be called an agribusiness, it must be producing with the aim of selling and making profit

2. Types of agribusinesses

1. Crop production: here the businesses are engaged in the production and selling of crops like bananas, coffee, tomatoes, maize, cassava, tea...
2. Livestock production: Here the businesses are engaged in rearing and selling different animal for their meats or their products like milk, skins... Example: cattle, goats, sheep, rabbits...
3. Poultry keeping: In this type of agribusiness, the business is concentrated on rearing and selling different types of birds for their meats, eggs, skins and feather. Example: chicken, turkey, duck
4. Agricultural support businesses: here the business provides support services to agribusinesses such as inputs like fertilizers, drugs.

Other types of businesses include:

* Agriculture (keeping bees for honey)
* Mushroom growing
* Horticulture (growing flowers)
* Fish farming

Requirement of agribusinesses

1. Land: agribusinesses like crop production, livestock, farming, agriculture  
   and so on, require land because crops are grown on land (in soil) and  
   livestock requires grasses to feed.
2. Capital: an entrepreneur who wishes to start and run a business requires  
   capital for accessing the required inputs for production.
3. Human resource: Agribusinesses require human resources to do the  
   involved works like tilling land, planting and weeding the crops, harvest  
   the crops and so on.

Importance of agribusinesses

* They produce food which is required for people to survive
* They provide employment to a large population
* They provide the revenue to the government through taxes
* They provide markets t other businesses

Who can do agribusiness?

Answer:

* Anyone who has access to land
* Anyone who has capital
* Anyone who needs to earn income
* Anyone who is already engaged in subsistence agriculture as a way of living

Challenges to agribusinesses and how to overcome them

Challenges:

* Natural hazards like unreliable rainfall. Weather changes which affect animals and crops and reduce productivity.
* Pest and diseases which attack crops and animals
* Lack of markets for the products which arises losses to entrepreneurs
* Low and unprofitable prices for the products which lead to losses
* Infertile and poor soils which lead to poor yield
* Competition from other producers and products (see fall in prices)
* Lack of support services like transport

The overcoming of the above challenges

* Employing modern farming techniques which are helpful to increase output
* Getting information on mates behavior and ensure that your products are on demand
* Practice of irrigation in dry seasons
* Knowing what your competitors are doing and learn from their experiences in order not to be out competed

b) Manufacturing business

1. Meaning and types of manufacturing businesses

i) Meaning

Manufacturing businesses are businesses which transform or process raw materials and make products that are significantly different from the inputs. They do it by changing the form of their low materials/inputs or add value to them. For example, a manufacturing business may for example use timber to produce different furniture and timber products while others may use tomato to produce tomato juice, tomato sauce, tomato soup, etc.

A person making pots, baskets, carpets or tablecloths for sale is in manufacturing business and is therefore manufacturer. Likewise, carpenters, brick makers, local welders, milk processors, coffee processors and maize millers are all doing manufacturing businesses. Entrepreneurs in manufacturing businesses are called manufacturers.

ii) Types of manufacturing businesses

1. Agro-processing businesses: these use agricultural products to make different products like food, juice drink, etc. or extract cooking oil and products from agricultural products like samisen, sunflower, cotton, coffee processors, etc.
2. Beverage manufacturing businesses: these make different drinks like soft and alcoholic drinks such as beer, water etc. examples: BRALIRWA, INYANGE INDUSTRIES, URWIBUTSO ENTERPRISE...
3. Metal fabricating businesses: these produce different types of metal to make products like windows, doors, chairs, tables, beds, furniture, water tanks, bicycles, etc. e.g. Uganda baati, Sembule Steel Mills, TUMPECO Ltd, etc
4. Chemical manufacturing businesses: these produce human and animal drugs, industrial chemicals, soaps, different fuels, etc. E.g. SURFO RWANDA, pharmaceuticals, etc.
5. Plastics manufacturing businesses: these make plastic cups, basins, jerycans, tarpaulins and other plastic materials. E.g. MIRONKO PLASTIC
6. Textiles manufacturing businesses which make clothes. E.g. UTEXRWA.
7. Extractive manufacturing businesses like brick making, stone quarrying, basket weaving, timber and timber products manufacturing businesses, which use timber to produce different products like furniture and others.

2. Importance of manufacturing businesses

1. Profitable businesses are a source of income to their owners and families
2. They provide employment to the people who earn income thus enabling them to meet their needs.
3. They produce goods required by the people and other businesses
4. They use or add value to local raw materials and products
5. They provide market for local producers and raw materials
6. They recycle products (wastes) which would otherwise have been thrown away and polluted the environment.
7. They contribute to development programs by making donations to them or directly participating in them. E.g. building roads, health services, etc.
8. They pay taxes to the government which uses the countries to provide services to the citizens.

3. Challenges in manufacturing businesses

* Lack of sufficient capital to procure the required technologies to improve their operations.
* Inadequate credit services to provide entrepreneurs with facilities to enable them finance their business operations.
* Inadequate support services like roads, telephone, water and electricity which make it difficult and expensive to operate their businesses.
* Lack of skilled manpower to operate some production technologies, which compels business to hire expensive foreign experts. Those learning on the job produce poor quality goods and at times damage the machines.
* Lack of appropriate technology suitable for the local situations. This compels entrepreneurs to use that which does not optimize productivity and profitability.
* Competition from imported manufactured products which are produced by well-established business often producing on a large scale and lower prices.
* Inadequate markets to absorb even the little that is produced. This is due to people having low incomes, competition from imported products, etc.
* Lack of reliable sources for constant supply of raw materials which forces some businesses to operate seasonally (in particular, agro-processing business)

Ways of overcoming the above challenges

1. Conducting through market surveys before starting their businesses to ensure that they go into businesses, whose outputs will be competitive, have a fair sized market and profitable prices

2. Establishing good relationship with their customers and ensuring that they are always satisfied with their products and cannot be taken away by competitors.

3. Keeping and using up-to-date information and data on suppliers, Customer taste and their buying habits to ensure that their businesses are not left behind by the challenges taking place.

4. Saving and reinvesting their business profit back to the business to ensure that they maintain adequate working capital to run their business operations.

5. Locating their business in areas where they can easily access support services, markets as well as raw materials.

6. Undertaking research and development to come up with new products that meet the customers' needs and beats off competition

7. Formation and being active member of the relevant business associations

8. Monitoring and keeping abreast with what their competitors are doing and learning from their experiences.

9. Regularly training their staff to ensure that they are skilled enough to manage the business operations

c) Service businesses

1. Meaning of service businesses

Some business products provide intangible benefits which satisfy customers' needs and for which they are willing to pay. The invisible and intangible products that provide the benefits enjoyed by customers are known as services. The business provided by them is known as services businesses. While some businesses produce products which are material and visible called goods, others produce invisible and intangible products called services.

Examples: transport businesses, hair and beauty salon, motor vehicles repair garages, lodges, telephone businesses, hospitals and clinics, restaurants and hotels, etc

2. Services needed by a community and businesses that can provide services

|  |  |
| --- | --- |
| Examples or types of services needed in | Business that can provide services |
| a community |  |
| Education | \*nursery, primary and secondary schools \*Polytechnics, vocational training institutions  \*Commercial colleges  \*Universities and other institutions of  higher learning |
| Medical or health | Clinics, pharmacies, laboratories, hospitals, nursing homes, etc |
| Transport | Boda-boda, taxi, bus services, commercial goods transporters, marine transporters, air transporters |
| Entertainment | Discos, theatres, cinemas, sports, mountaineering, travel agencies, swimming, etc. |
| Security | Security services |
| Food and drinks | Bars, restaurants, etc. |
| Tourism | Tour and travel agencies, hotels, lodges, camping sites, supplying tents, etc. |
| Utilities | Electricity, telephones |
| Financial | Banks, micro-finance institutions... |
| Beautification | Salon, barber shops, bridal agencies |
| Technical | Motor vehicle garages, electricians. |

3. Benefits from service businesses

* They support operations of other businesses and help improve their productivity by providing them with communication facilities, transport, power, etc.
* Service businesses like transport and communication help open up different part of the country. By doing so, other businesses can be established in those areas to tap into the business opportunities. This benefits the businesses as well as the community living there.
* Service businesses help in communications e.g. telephones, radios, newspaper, TVs. By doing this, information can quickly be relayed by the sender to the target groups. The government and communities use these service businesses to promote their development programs.
* Service businesses like financial institutions provide financial services which are vital for the operations of other businesses e.g. by providing them with safe custody deposit services, credit facilities, payment services, money transfers, etc.
* Security services enable businesses to operate in a conductive, secure and predictable environment. This enhances confidence, attracts more businesses and spurs development.
* Education services impart knowledge and skills and help to produce skilled and more productive manpower for other businesses.

4. Challenges in service businesses

1. Maintaining a high quality of service being rendered: the quality of services rendered by the service businesses depends on the technical skills of entrepreneurs and the workers. Therefore, how to motivate staff and ensure that they render high quality services to customers is a big challenge to service businesses.
2. Retaining staff: operations and services rendered by service businesses depend on the skills and motivation of their staff. This implies therefore that a business which seeks to be number one has got to continuously train its staff to ensure that they have the technical capacity to provide better services all the time. However, it is common for such staff to leave the business soon after they have received the training. At times the staff may join rival businesses or start their own to rival the ones they have left. Therefore, how to retain their staff is a big challenge to service businesses.
3. High costs of inputs: since service businesses are highly competitive, entrepreneurs have got to pay salaries to their staff, use high quality and expensive inputs in order to remain on top and advertise heavily to attract new customers and retain old customers. All these increase the costs of production and reduce the profitability of the business.
4. Bad debts: By the nature of their products, service businesses tend to have many repeat customers. After becoming regulars, such customers may ask for credit facilities (being served without paying cash but promising to pay later). In some cases, a number of such customers do not meet their obligations and their debts become bad debts. Bad debts are a big threat to the probability and survival of service businesses and equally so to other types of businesses.

Note that service businesses can also experience the some problems as those ones experienced by agribusinesses and manufacturing businesses.

How to overcome the above challenges?

Answer: The entrepreneurs should:

* Conducting a thorough market survey before they start their businesses to ensure that they go into an area where they have sufficient technical expertise and ability to face competition and challenges
* Treating their staff very well e.g. paying them well, involving them in making
* important decisions, assuring them of job security, regular refresher training, having binding contracts with them, etc. so as to keep them satisfied and motivated to doing a good work all time.
* Providing staff with good working conditions or an enabling environment so that they can render high quality services demanded by the customer. This entails providing them with the necessary equipment and facilities, uniforms, meals, etc. so that their minds are allowed to concentrate on their work.
* Avoid selling on credit and where inevitable, secure firm and legal
* Undertakings for the customers to pay postdate cheques, signed agreements or contracts, etc.

d) Trading businesses

1. Meaning

Trading businesses are businesses that buy and sell goods. The goods bought and sold may be of different types and in different quantities. Trading may be done by exchanging goods against goods (butter trade) or goods against money. Trading businesses buy goods at low prices and sell them at high prices in order to make profit.

2. Types of trading

a) Retail trading businesses

Retail trading businesses sell their products in small quantities or numbers. Such businesses stock many different products but in few numbers or small quantities of each item. Examples of retail trading businesses include hawking vending, kiosks, groceries, shops, bars, restaurants, etc. these businesses are usually located close to their customers. Retail trading businesses buy their stocks from wholesalers.

b) Wholesalers

Wholesaler trading businesses sell their products in large quantities or bulk. Their customers are mainly retail trading businesses or big customers who buy in bulk. e.g. Schools and other institutions. Wholesalers may be manufacturing businesses which set up shop outlets for their products, their agents, independent wholesaler businesses or importers. Unlike retail trading businesses which tend to stock many different goods to try and meet the needs of their customers as much as possible, wholesalers tend to specialize in particular goods.

3. Benefits of trading businesses

Like agriculture, manufacturing and service businesses, trading businesses too are beneficial to their owners and families, community, customer and the nation. The benefits are similar to some of the business already seen.

Perhaps, one other important category of beneficiaries of trading businesses are other businesses notably agriculture and manufacturing businesses whose products are distributed and sold by the trading businesses. In addition, trading businesses make goods available and affordable to customers by bringing them close to the customers and breaking them down into manageable quantities and prices. Furthermore, they provide markets to the products of other businesses.

4. Challenges in trading businesses and how to overcome them

Trading businesses face challenges which are similar to those faced by agri, manufacturing and service businesses. The methods used to overcome them are also similar.

Perhaps one challenge faced by trading businesses which may be unique to them is the expiry of the shelf life of goods before they have been sold. This challenge if not checked cause big losses in trading businesses.

Entrepreneurs can overcome this problem by correctly estimating the quantity of any good that can be sold over a given period, purchasing and stocking accordingly. Only goods with longer shelf life should be purchased. Furthermore, goods with shorter expiry periods (shelf life) should be sold first.

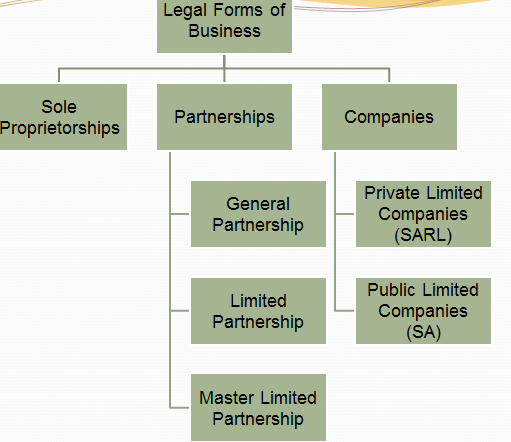
1. **According to life span**

- Temporary or short term businesses

- Permanent or long term businesses

**4. According to ownership**

FORMS OF BUSINESS ORGANISATIONS



**Factors to consider when choosing a legal structure for the business**:

• The government regulations

• Transferability and continuity of ownership interest

• Management control

• Profit and loss distributions

• Liability of business owner(s)

• Ease of establishing and terminating the business

• Tax treatments

Organizing it is the process of grouping activities and resources in logical and appropriate fashion/model

There are five components of organization:

* Designing jobs
* Grouping jobs or departmentalization
* Authority and responsibility
* Span on management
* Delegation and empowerment

Job analysis and design

Prior to actually designing a job, the organization must determine the description of the job itself.

Job analysis: it is the process of gathering, analyzing and synthesizing information about job.

It specifies the task that must be accomplished to complete a job and determines the skills and knowledge necessary to perform the task.

Steps involved in job analysis

* Examine how each job fits the overall organization
* Select jobs to be analyzed
* Collect data to be analyzed
* Prepare job description
* Prepare job specification

A major output of a job analysis is job description, which is a written summary of the job. It helps the organization in several activities such as recruiting and training. It enables workers to understand specific job details and what j ob fits their particular skills and interest.

In other words, the organization is a social unity of people, systematically arranged and managed to meet a need or pursue collective goals on a continuing basis. All organization has management structure that determines the relationship between functions and positions; that delegates and subdivides roles, responsibility and authority to carry out defined tasks.

## 7.2. **Business organization:**

Business organizations are of **three** forms:

1. Individual proprietorship here a single person holds the entire operations as his personal property small managing it on day-to-day basis.
2. Partnership: here the partnership may have been formed between 2-50 or more members.
3. A company or enterprise: this is legally recognized organization designed to produce goods and/or services to the consumers. They are predominant in capitalist economies mostly being privately owned and function to earn profit that will increase the wealth of its owners.

### **7.2.1. Types of business organization**

a) Sole proprietorship: also known as individual entrepreneurship or sole trade: this refers to a personal owned business organization.

Characteristics of sole proprietorship

* A single person provides the whole capital
* The owner does all or most of the work
* The owner bears all the risks and enjoys all the profit
* The owner can do perpetual succession through family members or relatives
* The main objective is the profit for the owner

Advantages of sole proprietorship business

i) Simplicity

ii) Quick decision

iii) An entrepreneur is the business owner, he is not controlled by anyone else:  
independence

iv) High secrecy

v) Monopoly of profit earned

vi) Total control of the business by the owner

Disadvantages of sole proprietorship

* Limited resource/ capital
* Limited ability
* Does not enjoy economy of scale because it does not use experts
* Limited lifelong: When the owner is sick or dies, the business can be closed
* It is difficult to get loans from the bank
* The owner suffers from long and irregular hours
* Limited competition capacity towards large companies

b) General partnership: This type is characterized by more persons with the aim of making profit.

Characteristics of partnership

* The minimum number of members is two and the maximum is twenty.
* It may be a group of individuals/ companies owing one business and who contribute capital.
* There is no perpetual succession
* The main objective is profit to the partners
* Partners are guided and governed by a partnership deed which acts as the constitution of the partnership
* Each partner acts as an agent of an enterprise and can enter into the contract on behalf of the firm but basing on the partnership deed.
* Profits and losses are shared basing on the agreed terms in the partnership deed.

Types of partners

Active partners: who takes active part in running of the business. They provide capital and share profit.

Dormant/ sleeping/ silent partners: they do not take part in the management of the firm but they contribute capital, shares profit and losses.

General partner/ ordinary partner: this is one whose liability is unlimited. His property can be taken to settle the debts of the partnership

Limited partner: this is one whose liability is limited i.e. his personal property cannot be taken to settle the debts of partnership

Quasi partner: is the person who offers his name to be used in the business but he does not contribute the capital of the business. He does not take part in the management and is not responsible for the firm's debts. He is utilized because he is famous and so has high reputation.

Minor partner: is one who has not attained the age of maturity i.e. under 18 years but enjoys the benefit of the partnership. He is not liable for the debts of the firm except to the extent of the capital contributed or his share of the profit.

New partner: one who comes into the partnership with the consent of all partners. He is not liable for the debts of the partnership incurred before he joined it.

Outgoing partners: people who leaves the partnership with the consent of partners or the partner's deed.

Advantages/ merits of partnership

* Diffusion of risk
* More resources or capital
* Combined talent and skills
* Increased credibility with potential customers and suppliers
* It can run even when some members are absent
* Work can be shared
* It lasts longer than sole proprietorship

Disadvantages/demerits of partnership

* Risk of implied authority
* Less control of the business by individuals
* Conflicts due to misunderstanding
* Problem of continuity especially when a strong partners disappear
* Unlimited liability of partners for the business debts
* Delay of decision making

3. Limited liability companies/ joint stock companies: this is where liability for the debts of the company is limited to nominal values of the share capital held. The profits of the business are distributed according to the proportion of share capital held by the individuals.

Types of joint stock companies

i. Limited by guarantee

ii. Private company

iii. Public company

iv. Public corporation/ nationalized companies

v. Cooperative societies

i) Limited by guarantee

Companies limited by guarantee are usually utilized by charitable organizations i.e. non-profit driven organizations. Such companies are required to register as non­governmental organizations to the Non-Government Organization Board before they register as companies limited by guarantee.

ii) Private limited company

This is not allowed to sell shares to the public. Membership is limited from a minimum of 2 to a maximum of 50. To form it, it requires documents like Memorandum of Association, Articles of Association, etc.

Advantages of private limited companies

* Members enjoy limited liability
* It is capable of raising more capital
* Its property is clearly distinguished from that of its members
* Continuity of the business is not seriously affected the death of a shareholder
* A large company can employ experts, be more efficient and enjoy economies of scale
* It has a right to sue and be sued (to court)

Disadvantages of private limited companies

* It is not easy to raise the initial capital because it is not allowed to appeal for subscription from the public
* Employees are not allowed to purchase shares. This reduces their hard work
* Delays in decision making

iii) Public limited companies

It is allowed to sell shares to the public in order to raise the capital. Membership is unlimited with a minimum number of seven members. Its formation requires written documents like:

1. Memorandum of Association
2. Articles of Association
3. Certificate of Incorporation
4. Prospectus (summary of plan)
5. Trading certificate

Advantages of public limited companies

♦ Members have limited liability

♦ They can raise large capital through issuing shares or debentures

♦ Shares are freely transferable i.e. the members wishing to convert their shares into cash do so quit easily.

* Death of a member does not affect the company
* It enjoys economies of large scale production

Disadvantages of public limited companies

* Decision making and implementation is often slow because of bureaucracy
* There is very limited personal contact between the company, its employees and customers
* The directors are the agents of the company, shareholders have little say
* It is difficult to form it since it requires written documents

iv) Pubic corporations/ nationalized companies

This is a form of enterprise where the government can decide to place production in the hands of state. They have the following characteristics:

* Government owned corporations
* Liability established statute
* Has capacity to borrow and own assets
* Can exercise perpetual succession
* Corporations created by specific registration
* Main objective is to cater for some national interests
* Not subject to the requirements of the companies' act
* Have Corporate status

The major advantage is that of ready and big capital contributed by government while the major disadvantage is mismanagement and corruption by management.

v) Cooperative societies

A cooperative society is a business unit formed with the purpose of benefiting members. There are various types of them which include:

1. Consumer cooperative societies: these are formed with the aim of trading. Individuals come together for the purpose of buying goods at a cheaper price and selling them to members at relatively low price. Each member pays a membership fee and buys share (s).
2. Producer cooperative societies: they deal with the marketing of agricultural products and some of them are involved in production. They are very important in the development of Low Developed Countries (LDC). E.g. coproriz
3. Transport cooperative societies: they deal with transportation. E.g. ATAMIMORWA
4. Savings and Credit societies: they mobilize savings and provide credits to members. E.g. SACCO

The role of cooperatives in LDCs

1. Financial assistance through credits
2. Creation of employment opportunities
3. Transporting and marketing of the produce
4. Provide storage facilities for raw material and/or finished products
5. Educating farmers how to cultivate and use fertilizers
6. Provision of farm inputs
7. Tractors hire
8. Transformation of the economy from subsistence to a monetized one

Problems faced by cooperatives

* Leadership problems: cooperatives have sometimes be afflicted by poor management (inadequate accounting expertise and limited funds for training managers in the field of accounts and marketing)
* Financial problems: lack of finance due to the members who do not their subscription fees some mismanagement of funds by employees and members who do not pay their loans.
* Poor transport facilities
* Lack of spare part of their machinery
* Lack of storage facilities
* Government interference
* Conservatism: some members are reluctant to run new methods of production.

### **7.2.2. Organizational structure**

An organizational structure is a prescribed pattern of a work related deals, which is established for the accomplishment of organizational objectives.

It serves as instrument for introduction of logical and consistent relationship among various functions, which make up the organization.

An organizational chart is a graphic representation of firm/enterprise hierarchy of authority.

Note that an organizational structure is primarily represented by an organizational chart.

The structure refers to designed relationship among resources of the management system.

The structure department

Any organizational structure must be departmentalized i.e. division of responsibilities. Departmentalization can be done through 4 ways such as

1. By functions 2. By product 3.By geography 4. By type of customers

Roles of an organizational structure

1. Facilitate the use of available resources
2. It facilitates a company to easily achieve its objectives
3. It leads to specialization and coordination
4. It maintains the relationship between all organizational resources.
5. It facilitates managers to arrange and locate different works

## **7.3.** MANAGEMENT AND MANAGEMENT FUNCTIONS

“QUOTE: The most efficient way to produce anything is to bring together under one management as many as possible of the activities needed to turn out the product. “ Peter[Drucker](http://www.brainyquote.com/quotes/quotes/p/peterdruck173392.html)**”**

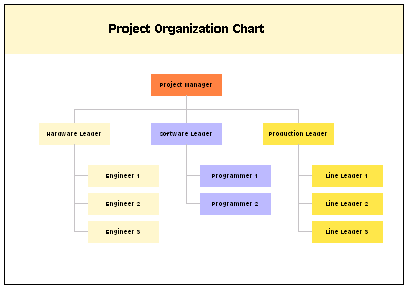
1. **DEFINITION OF MANAGEMENT**

In all business and organizational activities is the act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively.

Management is the process of reaching organizational goals by working with and through people and other organizational resources.

1. **MANAGEMENT FUNCTIONS**

* Planning
* Organizing
* Leading
* Staffing
* Coordinating
* Controlling
* **PLANNING**
* Setting the long-term objectives of the business.
* Establish strategies to achieve the objectives.
* Implement the strategies/actions.
* Evaluation of the actions
* Corrective measures
* **ORGANISING**
* Identify the various tasks to be done in an organization,
* Choosing the right people for these tasks,
* To ensure the right resources are available to perform these tasks.



* **LEADING**
* To influence others and inspiring them to get things done.
* Leadership is different from management;
* The manager has authority to get things done but a leader may or may not have authority.





* **STAFFING**
* Job analysis
* Recruitment
* Appointment
* Training and Development
* Retention, Retrenchment (Downsizing)
* **COORDINATING**
* Synchronization and integration of;
* Activities and responsibilities,
* Organizational Structures and
* Organizational resources
* To ensure they are used in pursuit of the specified goals.



* **CONTROLLING**
* Establish performance standards
* Measurement of performance
* Comparison of Expected performance and Actual performance, identify deviations.
* If there any unfavorable deviations, take corrective measures.

Managerial functions by summary

1. Planning: it is a process of selecting goals and determining how to achieve them.
2. Organizing: this refers to the coordination and supervision of factors of production particularly land, capital and labor.
3. Leading: this involves directing the work of organizational members towards organizational goals.
4. Staffing: this refers to identification of right people who will do the jobs as necessary to achieve organizational objectives
5. Controlling: this refers to the evaluation of achievement and taking measures towards success of organizational goals/objectives.
6. Budgeting: this refers to the transformation of all plan in financial statement showing the revenue expected and the expenses assumed.
7. Decision making: The entrepreneur is responsible of making decision for the business.

People in Business organizations

* Shareholders/Partners
* Employees/workers
* Service providers/
* suppliers
* Customers
* Government
* Financial institutions/lenders

Factors considered in choosing people to work with in a business organization

* Financial capacity
* Experience
* Skills,
* Talent and performance
* Knowledge etc.

## 7.4. HUMAN RESOURCES MANAGEMENT (HRM)

### 7.4.1. Definition of Concepts

* **Human resources**

These are all people who work in an organization or enterprise.

* **Management**

Management has different definitions given by different scholars.

**10** **Georges R. Terry**

Management is a distinct process consisting of planning, organizing and controlling performance to determine and accomplish the objectives by use of people and material resources.

**20 E. F. Brech**

Management is concerned with seeing that the job gets done, its tasks all centered on planning and guiding the operations which are going on in the enterprise.

**30 Stanley Van**

Management is simply the process of decision making and control over the action of human beings for the express purpose of attaining predetermined goals.

**40 S. George**

Management consists of getting things done through others.

In general, management can be defined as the process of coordinating individuals’ efforts to achieve a particular objective/goal.

* **Human resources management**

This is the management function that helps to recruit, select, train and develop members for an organization.

HRM is concerned with human dimension in an organization.

**Note: Difference between personnel management and human resource management**

|  |  |
| --- | --- |
| **Personnel management** | **Human resource management** |
| 1. the most important managerial task was to finish the project at all costs ( workforce exploitation)  2. Personnel management regards employees as cost and aims to minimize cost and increase productivity.  3. Personnel management functions on a reactionary basis; that is, it follows a set of rules and regulations that state what to do when an employee has a problem. It deals with immediate concerns.  4. Personnel management has a short term agenda | 1. The task is trying to create a healthy balance where organizational targets are achieved and individual needs are met as much as possible.  2. The HRM however, sees employees  as human resources and its main aim is to ensure that the employees of an organization are used in such a way that the employer obtains the greatest possible benefit from their abilities and the employees obtain both material and psychological rewards from their work  3. HRM is proactive  4. HRM, on the other hand, has a long-term agenda, the focus of which is employee development. It is a strategic function where recruitment, selection, the welfare of employees, their training, development and retention is planned and the most effective ways |

* **Human Resources Manager**

This is somebody in charge of human resources in an organization

* 1. **Qualities of human resource manager**
* Fairness and firmness
* Tactic and resourcefulness
* Competence
* Confidence
* Long-term perspective (Vision 2020)
* Sympathy and consideration
  1. **Categories of personnel**
* Administrative staff (higher level)
* Personnel of supervision (Medium)
* Executive staff (Lower level)

**3. Human resource recruitment and selection**

**a. Definition**

HR Recruitment is the process of finding and attracting capable applicants for

employment. The process begins when the new recruits are sought and ends by integrating new employee.

b**. Objectives of human resource recruitment**

* To search people whose skills fit the company’s value.
* To anticipate and find people for positions that do not exist.
* To seek out non-conventional ground of talents
* To search talents globally within the company.
* To develop an organizational culture that attracts competent people to the company
* To ensure entry based on the quality not on quantity.

**c. Sources of recruitment**

***i) Internal sources***

The organization re-employs retired or retrenched employees to get their loyalty to the organization.

**Why? Because:**

* Morale of employee can be improved.
* Suitability of internal sources can be judged better “as known devils are better. than unknown angels.”
* Stability of employees can be improved.
* Cost of selection can be minimized.
* Cost of training can be reduced.

***ii) External sources***

These include:

* Campus recruitment
* Public employment exchange.
* Professional bodies or organizations
* Casual applicants.
* Similar organizations (stopped)

iii) Factors considered in choosing people to work with in a business organization

* Evaluation of competence: consider educational career and level, professional training, working experience, technical skills and intellectual capacity.
* Personality: The ability of working with others: work as team.
* Cost of employee: Consider the salary and wages that will be paid to the employee
* Age: Consider his maturity
* Sex: depending on the kind of work, consider a person's sex.

■ Language: Consider the ability to communicate with customers in different languages.

d. **process of recruiting an employee in a business (organization):**

**Step1:** **Identifying the vacancy**: This steps involves identifying the post to be filled the number of person needed, duties to be performed and qualification

**Step2: Preparation** of the job description and person specification

**Step3**: Advertising using other sources of recruitment to publicize the vacant post

**Step4**: Receipt of application from interested candidates

**Step5**: Short-listening and identifying the prospective employee with the required c**haracteristics**

**Step6**: Arranging the writing test and interview with the selected candidates

**Step7**: Informing the successful candidates and unsuccessful candidates

**Step8**: Issuing appointment letter by giving a formal appointment letter.

**Step9**: Conducting induction training

**e) Important Principles underlying Recruitment & Selection**

As responsible human resource manager, you have to make sure that:

1. A motivation for the filling of a post has been approved;
2. Job evaluation has been conducted and approved as far as new posts are concerned;
3. A job description has been developed from the above-mentioned job evaluation, addressing the main objectives and inherent requirements of the post (post and person specifications);
4. The job description has been utilized for the proper drafting of an advertisement that has been approved;
5. A selection committee has been appointed to handle the selection of the most suitable candidate(s);
6. Selection criteria for screening purposes have been identified and applied consistently for the screening of candidates;
7. Selection criteria for short-listing purposes have been identified and applied consistently to shortlist candidates;
8. Selection criteria for the final selection of candidates have been identified beforehand and applied consistently to identify the most suitable candidate(s);
9. A nomination for appointing the most suitable candidate(s) has been approved by the executing authority or his/her delegate;
10. Unsuccessful candidates are notified timeously by means of a letter of regret;
11. A candidate is informed in writing of his/her appointment as the most suitable candidate; and a candidate accepts, in writing, his/her appointment.

### Job description

*“*The more accurate and realistic the specifications of and skill requirements for each job the more likely it is that workers will be matched to the right job and, therefore, be more Competent in that job”.

The process of selecting a competent person for each position is best accomplished through a systematic definition of the requirements for each job, including the skills, knowledge and other qualifications that employees must possess to perform each task. To guarantee that personnel needs are adequately specified, (1) conduct a job analysis, (2) develop a written job description and (3) prepare a job specification.

* 1. **Job Analysis**

Job analysis is a systematic investigation that collects all information pertinent to each task performed by an employee. From this analysis, you identify the skills, knowledge and abilities required of that employee, and determine the duties, responsibilities and requirements of each job. Job analysis should provide information such as:

* Job title.
* Department.
* Supervision required.
* Major and implied duties and responsibilities.
* Unique characteristics of the job including location and physical setting.
* Types of material used.
* Types of equipment used.
* Qualifications.
* Experience requirements.
* Education requirements.
* Mental and physical requirements.
* Manual dexterity required.
* Working conditions (inside, outside, hot, cold, dry, wet, noisy, dirty, etc.).
  1. **Job Description**

The job analysis is used to generate a job description, which defines **the duties of each task, and other responsibilities of the position.** The description covers the various task requirements, such as mental or physical activities; working conditions and job hazards. The approximate percentage of time the employee should spend on each activity is also specified. Job descriptions focus on the **what**, **why**, **where** and **how of the job**.

There are two excellent resources the manager can use to develop job descriptions. First, ask employees themselves to describe their jobs. A good employee may know more about the job than anyone else.

**c) Job Specification or personnel specifications**

The job specification describes the person expected to fill a job. It details the knowledge (both educational and experiential), qualities, skills and abilities needed to perform the job satisfactorily. The job specification provides a standard against which to measure how well an applicant matches a job opening and should be used as the basis for screening and recruiting.

### 7.4.2. Recruitment stages

- Definition of a post

- Definition of the candidate’s profile

- Identification of recruitment sources

 - Implementation of recruitment means

 - Recruitment campaign

- Selection

- Recruitment decision

- Integration

***Selection***

**Definition**: This is the process of picking individuals of the pool of job applicants those have higher qualifications and competence to fill the jobs or posts.

How?

***Step1***: **Pre-selection**: the analysis of each candidate application and short list those who will go for written exams. The unqualified job seekers are eliminated based on the information supplied in their application forms.

***Step2***: **Selection test**: Job seekers, who pass the pre-selection, are called for tests. Tests are used to determine.

The applicant’s ability, personality and aptitude

***Step3***: **Employment interview**:

Types

a) one-to one interview Candidate interviewer



b) Sequential interview Candidate interviewers

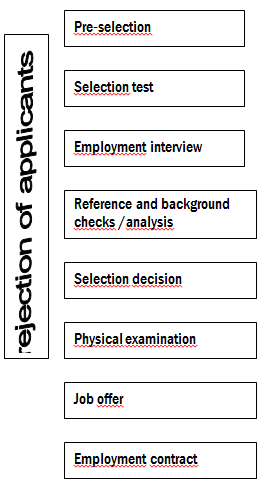


c) Panel interview Candidate Interviewers



***Step4***: **Selection decision**: After the interviews, reference and background checks for verifying information and gaining additional background, the successful applicant is given a job and he/she is given a letter of appointment.

Then a contract of employment is made depending on level of job.



***Induction***

The induction of a new employee is the beginning of the process that may turn them into a long-term, loyal member of staff. Poor induction demotivates people and demotivated staff will lead to high staff turnover.

***a) Definition***

Induction refers to welcoming new employee when he/ she first joins the organization so as to feel comfortable and start working.

**b) Aim or objective of induction**

According to JOHN (2007), starting a new job is a demanding and often stressful experience. Quite apart from the obvious challenge of tackling new tasks, there is also the need to become accustomed to a new organization, a new environment and new colleagues. ***The purpose of induction is to support new employees during this difficult period and to help them become fully integrated into the organization as quickly and as easily as possible.***

**c) Advantages of effective induction**

The advantages of an effective and systematic induction process are as follows:

* To enable new employees to settle (s’installer) into the Company quickly and become productive and efficient members of staff within a short period of time.
* To ensure that new entrants are highly motivated and that this motivation is reinforced (It is generally recognized that new employees are highly motivated and an effective induction process will ensure that this motivation is reinforced)
* To assist in reducing staff turnover, lateness, absenteeism and poor performance generally.
* To ensure that new employees operate in a safe working environment.
* To reduce costs associated with repeated recruitment, training and lost production

**d) When induction process starts**

The induction process begins even before the candidate is offered the job. The impressions formed at interview or on other visits to the organization’s premises will remain with the successful candidate once they begin work. The attitude of company staff the candidate has met and the style of correspondence or telephone communications involved in the process of inviting the candidate to interview and making the job offer will have given the new employee expectations of how they will be treated. Written documentation will demonstrate the standards the organization finds acceptable so, for example, a spelling mistake in a letter inviting a candidate to attend an interview will have created a poor impression even before they have come on to the premises.

***e) What do we put in an acceptance letter?***

Once an offer has been made and the successful candidate has accepted the position, it is necessary to send a letter giving all the details that are required by the new employee. This letter should include the following details that will be needed to prepare the employee for a successful first day at a new workplace.

**(i) Starting instructions**

* **Time**: Usual start time or a little later to be sure that those necessary will be available to meet the new employee.
* **Place**: Which entrance? Report to reception or go to a specified office or department.
* **Transport:** Where can you park? What public transport is available?
* **Appearance**: Is there a uniform required? If so, from where should this be collected? If not, is there any particular dress code that the employee should know about?
* **Documents**: Are there any specific documents that the employee will need?

**(ii)Other requirements**

* **Medical:** Is the employee expected to have a medical test before reporting?
* **Catering:** What facilities are available? If most employees bring a packed lunch as there are no facilities either nearby or on the premises this should be mentioned.

f) What should we cover during induction?

Most new employees tend to be concerned primarily with two matters:

i) Whether they can do the job and

ii) How they will get on with their new colleagues.

Therefore, it is important that a systematic induction process is carried out effectively. Preparations should be made for the arrival of the new entrant well in advance.

**First day of employment**

Even if, new employee can have negative or positive impressions before, the first day is very crucial. What should be done the first day?

***i) Introduction to other employees***

The new entrant will want to get to know his/her colleagues and quickly become part of the team and time should be made for this process.

It is therefore important to introduce him or her to colleagues (NB: Colleagues should be briefed on the new entrant’s arrival) at the earliest opportunity. An introductory talk will be appropriate at this time and can be combined with the provision of general information and exchanging any necessary documentation. This talk should be as brief as possible, because the employee is unlikely to be receptive to detailed information at this stage.

According to JOHN, E., (2007) Establishing friendly relations with colleagues can help to provide psychological support and introduce the employee to behavioral norms. Allocating a new member of staff a “friend” who can answer questions is often a sensible approach to take.

**ii)** ***Physical layout of the office***

A quick understanding of the layout of the premises, the location of departments, cloakrooms, canteen, etc. is helpful and necessary. Perhaps the “friend” could take the new employee to the “canteen” to become familiar with the layout.

***First week***

Induction will normally continue on subsequent days of the first week covering matters such as:

-Explaining essential procedures, e.g. for claiming expenses, payment of wages,

-Conditions of Employment

* Probationary periods of employment
* Reporting in when sick including when on leave
* Arrangements for requesting leave: annual leave,
* Issue of uniforms,

-Health and Safety, Security, Fire

* Location of fire-fighting equipment
* First aid facilities , company’ Doctor
* Loss of personal effects
* Security of department/building
* Arrangement for keys, passes, ID Badges etc.
* Violence and aggressive behaviour

-Conduct

- Education, Training, Promotion

* Study leave
* Means of advancement, promotion opportunities
* Employee appraisal

-Employee Involvement and Communication

**Training**: after an employee is selected, placed and introduced, he/she must be provided with training facilities.

***a) Definition***

Training is the act of increasing the knowledge and skills of an employee for doing a particular job.

This is normally done during the period of probation of training or trial. If the employee’s performance during the probation period is satisfactory his services will be, regularized and he will be placed permanently on a job. If the employee’s performance is not satisfactory the company may extend the probation, period or ask the candidate to quit the job.

## b) What is the purpose of training?

* This needs to be clearly understood as a basis for the appropriate use of learning. From the organization’s point of view, the purpose of learning is to:
* Maximize productivity or service provision
* Develop the adaptability of the workforce
* Develop the organization as a whole
* Increase job satisfaction, motivation and morale
* Improve standards and safety at work
* Make the best use of existing material, resources and equipment
* Standardize working practices and procedures.

***c) Evaluation of training programme and performance appraisal****.*

* Evaluation of training programme leads to controlling and correcting the training programme. Humbling suggested five levels at which evaluation of training can take place. These are:
* Reactions
* Learning
* Job behavior
* Organization
* Ultimate value

Reactions: training programme is evaluated on the basis of trainee’s ability is evaluated on the basis of trainee’s reactions to the usefulness of coverage of the matter.

Learning: trainee’s ability is evaluated on the basis of quality of content learned and time in which it is learned and learner’s ability to use content learnt.

Job behavior: this evaluation includes the manner and extent to which the trainee has applied his learning to his job.

Organization: this is evaluation of the use of training; learning and change in behavior through increased productivity and quality, ultimate value.

* Performance appraisal: Performance appraisal is a method of evaluating the behavior of employee in work sport, normally including both the quantitative and qualitative aspects of the job.

Performance here refers to the degree of accomplishment of the tasks that make up an individual’s job. It indicates how well an individual is fulfilling the job demand.

**Limitations to Human Resource Recruitment**

* **Organizational policy or culture**

The organizational rules and regulations can affect human resource recruitment. If they are very hard to follow, people will have little or no motivation to come and work for the organization.

* **Supply and demand of workers**

The prevailing situations at labor market influence recruitment of workers. When demand for workers is very high, labor market will be competitive and it will not be easy for an organization to find people coming to fill different posts and vice-versa. If supply of labor is high the company will get workers easily and vice-versa.

* **Cost of recruitment**

Expenses made on recruitment are very high. These expenses include costs of advertisement, test setting and administration and marking, recruitment campaign, all these can lead to non-respect of recruitment stages.

* **Company pay package**

If a company pays higher salary to its employees, people will be motivated to come, apply and work but if the salaries are very low, people will not be coming to apply for a job.

* **Post requirements**

Some posts require skills and experience for which it is difficult to find qualified people. Others are high risks related posts. If so, it will be hard for the organization to find people to fill those posts.

* **Unemployment rate**

If unemployment rate in the country is high, people will be coming for job searching and also accepting lower salaries and it will be easy for the company to find workers because employment opportunities are very limited.

### 7.4.3. Motivation of employees

**Meaning:** is derived from the word “motive”. A motive is an inner state that energizes activities or moves and direct or channels behavior towards goals.

Motivation in simple terms may be understood as the set of forces that causes people to behave in certain ways.

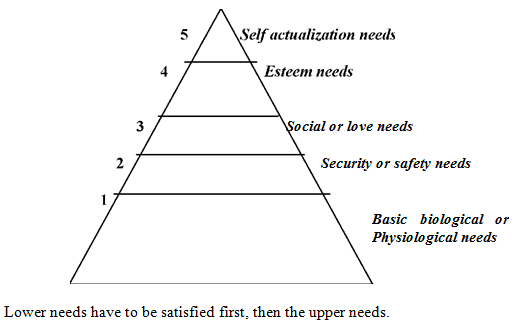
**Importance of motivation**

* Motivated employees are always looking for better ways to do a job
* A motivated employee generally is more quality oriented
* Highly motivated workers are more productive than apathetic workers.
* Every organization requires human resources, in addition to financial and physical resources for it is to function.

#### 7.4.3.1. Theories of motivation

**a) Maslow’s hierarchy of needs**

According to Maslow, human needs from the hierarchy, starting at the bottom with the physiological needs and ascending to the highest needs of self-actualization as shown in figure below. He says when one set of needs are satisfied they no longer work as motivators as a man seeks to satisfy the next higher lever of needs.



**Physiological needs**: these are the basic necessities of human life i.e. food, water, warmth, shelter, sleep and sexual satisfaction. Maslow’s states that until these needs are satisfied to the required level, the man does not aim for the satisfaction of the next higher level needs. As far as work in organization is concerned these needs include basic needs like pay, allowances, incentives and benefits.

**Security/Safety Needs**: These refer to the need to be free of physical danger or the feeling of loss of food, job of shelter. When the physical needs are satisfied, man starts thinking of the way by which he can continue to satisfy physiological needs.

**Social needs**: When the physiological and security needs are satisfied, the social needs begin occupying the mind of a man. Social needs at work places include conformity, security, plans etc.

**Esteem needs**: These needs are powerful, prestige, status, and self-confidence. Every man has a feeling of importance and he wants others to regard him highly. These needs make people aim high and make them achieve something great. These needs for employee include status, awards, promotion title, nice office equipment, good means of transport, etc.

**Self-Actualization needs**: This is the highest need in the hierarchy. This refers to desire to become what one is capable of becoming. Man tries to maximize his potential and accomplish something, when is activated in him.

**b) Theory X and Theory Y**

In his 1960 book, *The Human Side of Enterprise*, Douglas McGregor proposed two theories by which to view employee motivation. He avoided descriptive labels and simply called the theories **Theory X** and **Theory Y**.

Both of these theories begin with the premise that management's role is to assemble the factors of production, including people, for the economic benefit of the firm. Beyond this point, the two theories of management diverge.

**Theory X**

Theory X assumes that the average person:

* Dislikes work and attempts to avoid it.
* Has no ambition, wants no responsibility, and would rather follow than lead.
* Is self-centered and therefore does not care about organizational goals.
* Resists change.
* Is gullible and not particularly intelligent.

Essentially, Theory X assumes that people work only for money and security.

**Theory X - The Hard Approach and Soft Approach**

Under Theory X, management approaches can range from a *hard approach* to a *soft approach*.

The hard approach relies on coercion, implicit threats, close supervision, and tight controls, essentially an environment of command and control. The soft approach is to be permissive and seek harmony with the hope that in return employees will cooperate when asked to do so. However, neither of these extremes is optimal. **The hard approach results in hostility, purposely low-output, and hard-line union demand.** The soft approach results in ever-increasing requests for more rewards in exchange for ever-decreasing work output. The optimal management approach under Theory X probably would be somewhere between these extremes. However, McGregor asserts that neither approach is appropriate because the assumptions of Theory X are not correct.

**Theory Y**

The higher-level needs of esteem and self-actualization are continuing needs in that they are never completely satisfied. As such, it is these higher-level needs through which employees can best be motivated.

Theory Y makes the following general assumptions:

* Work can be as natural as play and rest.
* People will be self-directed to meet their work objectives if they are committed to them.
* People will be committed to their objectives if rewards are in place that address higher needs such as self-fulfillment.
* Under these conditions, people will seek responsibility.
* Most people can handle responsibility because creativity and ingenuity are common in the population.

Under these assumptions, there is an opportunity to align personal goals with organizational goals by using the employee's own quest for fulfillment as the motivator. McGregor stressed that Theory Y management does not imply a soft approach.

McGregor recognized that some people may not have reached the level of maturity assumed by Theory Y and therefore may need tighter controls that can be relaxed as the employee develops.

**Theory Y Management Implications**

If Theory Y holds, the firm can do many things to harness the motivational energy of its employees:

* ***Decentralization and Delegation*** - If firms decentralize control and reduce the number of levels of management; each manager will have more subordinates and consequently will be forced to delegate some responsibility and decision making to them.
* ***Job Enlargement*** - Broadening the scope of an employee's job adds variety and opportunities to satisfy ego needs.
* ***Participative Management*** - Consulting employees in the decision making process taps their creative capacity and provides them with some control over their work environment.
* ***Performance Appraisals*** - Having the employee set objectives and participate in the process of evaluating how well they were met.

If properly implemented, such an environment would result in a high level of motivation as employees work to satisfy their higher level personal needs through their jobs.

### 7.4.3.2. Methods of motivating employees

**a) Money in form of wages and salaries**

**b) Rewards**

* People join organizations expecting rewards. Firms distribute money and other benefits in exchange for the employee’s availability, competencies and behaviors.

**c) Welfare Programmes and Fringe benefits**

During the World War II certain non-monetary benefits were given to employees as means of neutralizing the effect of inflationary conditions. These benefits include:

* Housing
* Health care
* Education
* Canteen etc.

It has been recognized that these benefits help employees in meeting some of their lives’ problems and to meet social obligation of employees.

* **Reasons for Fringe benefits**
* Employment demands
* Employers security
* To improve human relations.

**Employee demands**: Employees demand more and different types of fringe benefits rather than pay because of reduction in tax burden of the part of employees.

**Employer’s preference**: employers prefer fringe benefits to pay as fringe benefits motivate the employees for better contribution to the organization. It improves morale and works as an effective advertisement.

**As social security**: Employer had to provide various benefits like safety measure compensation in case of workers accidents medical facilities etc.

**To improve human relations**: human relations are maintained when the employees are satisfied, economically, social and psychological fringe benefits satisfy the worker’s economic, social and psychological needs. Thus fringe benefits improve human relations.

**d)** **Promotion**

* **Meaning**: Promotion means an improvement in prestige, position and responsibilities of an employee within his/ her organization.

**Purposes of promotion:**

* + To motivate employees to higher productivity
  + To attract and retain services of a qualified and competent people.
  + To recognize and reward efficiency of an employee.
  + To fill up high vacancies from within the organization.
  + To impress upon others that opportunities are available to them too in the organization.

**Types of promotion**

1. **Horizontal Promotion**: This type of promotion involves an increase in responsibility and pay e.g. a lower division clerk is promoted as an upper division clerk. This type of promotion is referred to as upgrading the promotion of an employee.
2. **Vertical Promotion**: This type of promotion results in a greater responsibility, prestige and pay together with a change of nature of the job.

**3) Dry Promotion**: this type of promotion results in an increase in remuneration/ pay with change in responsibilities.

**e) Other methods of motivation**

-Security of job

-Favourable working conditions

-Recognition

-Participation

-Communication

#### 7.4.3.3. Non-motivational factors

* **Inadequate salary**

Employees come to work in an organization to earn salary to satisfy their needs. If the salary is not enough to help them to access basic necessities, they find little or no motivation to work hard for increased quality and productivity.

* **Favoritism**

If the management does not treat employees as being equal where some individuals or group of individuals are favored than others, the employees who have not those favors are likely to be demotivated. The inequalities may be in rewards, promotion, demotion…

* **Lack of dialogue**

In the organization where the manager uses dictatorship style of leadership without employee’s involvement in decision making as regards daily activity of the organization, employees’ follows commands and they show no motivation or commitment.

* **Lack of vision**

Where the manager is not able to set long-term objectives/goals to be followed in an organization, employees are not motivated because they have no direction towards goals/objectives to be achieved.

* **Internal conflicts**

In the organization where there is misunderstanding between employees themselves or between employees and supervisors or managers, employees cannot put their efforts together to achieve goals of the organization.

* **Bad working conditions**

As the employees come to the organization they expect good working conditions to protect them and provide a good working environment. These include health mentally and physically, safety and welfare, equipment and other facilities. If they are not provided to help the workers, they are less motivated.

### 7.4.4. Disciplinary measures

## Introduction

The organization Disciplinary measures will be used only when necessary and as a last resort. Where possible, informal and/or formal counseling or other good management practice will be used to resolve matters prior to any disciplinary action being taken. The procedure is intended to be positive rather than punitive but t sanctions may have to be applied in some circumstances.

## Some definitions

**a) SUSPENSION**

Suspension can be used as disciplinary measure but suspension can be used for investigation purpose and in that case suspension is not considered as disciplinary action. The purpose of suspension here is to remove a member of staff from the workplace in order to prevent him influencing or being influenced by others or to prevent possible interference with evidence.

**b) COUNSELLING**

Counselling is an attempt to correct a situation and prevent it from getting worse without having to use the disciplinary procedure. Where improvement is required, the employee must be given clear guidelines as to:

* what is expected in terms of improving shortcomings in conduct or performance
* the time scales for improvement
* when this will be reviewed
* the employee must also be told, where appropriate, that failure to improve may result in formal disciplinary action

A record of the counselling should be given to the employee and a copy retained in their personnel file. It is imperative that any counselling should be followed up and improvements recognized and recorded. Once the counselling objectives have been met, any record of the counselling will be removed from the employees file.

## 7.5. Conflict management

### 7.5.1. Definitions:

* Conflict is a misunderstanding between people. It can also be defined as an active disagreement between people with opposing opinions or principles.
* Conflict management refers to resolution problem relating to misunderstanding between people in or outside the organization.

### 7.5.2. Reasons for conflicts

The following are the items employees consistently complain and if not cared for they create conflicts.

**1° higher salaries**: Pay is the number one are in which employees seek change.

**2° internal pay equity**: Where there is differentiation in salaries between employees conflicts may arise.

**3° Over-management**: employees often complain of to many chiefs where an employee can have conflict of tasks and instructions.

**4° Benefits programmes**: Particularly health insurance, retirement and paid time off.

**5° Human resources department response to employees**: The department needs to be responsive to employees’ questions, if not conflicts will arise.

**6° Favoritism**: Employees need fair treatment where each employee is treated equivalently as regards policies, behavioral guidelines, opportunities for development, frequent communication, if not conflict will occur.

**7° Work loads are too heavy**: If departments are under staffed, employees feel as if their workloads are tow heavy and this may lead to complaints.

### 7.5.3. Types of conflicts

* **Collective conflicts**

These are conflicts regarding the whole organization. These include:

* + **Intra-organizational conflicts**: these are conflicts which arise inside the organization between employees themselves or employees and managers or among themselves.
  + **Inter-organizational conflicts**: These are conflicts which arise between the organization and other organizations. This may because of markets for raw materials, for final products or services.
* **Individual conflicts**

These are conflicts arising between individuals interest. These include:

* **Intra-personal conflicts**: These include individual’s conflict relating to how he/she usable to fit to company rules and regulations.
* **Inter-personal conflicts**: These are conflicts between individuals in an organization. It may be between employees, employees and authorities or managers or managers themselves for other matters not necessarily relating to job or work.
* **Collective individual conflicts**: This is when people put their effort together to fight one individual. This may be done by managers to fight one employee or employees to fight against one the managers.

### 7.5.4. Techniques of conflicts resolution

These can be: avoidance, accommodation, confrontation, collaboration and negotiation and compromise.

* **Avoidance**: Each organizational member takes measures which can help to avoid occurrence of conflict in an organization by respecting rights of others and fulfilling one’s duties as well.
* **Accommodation**: Adjustment to the others’ views and behaviors
* **Confrontation**: opposition to somebody’s weaknesses / problems showing him/her evidences to convince him/her.
* **Collaboratio**n: Consultation from one another where difficulties arise.
* **Negotiation and compromise:**

This is where the opposed individuals or groups come together, discuss their problems and come up with agreements for corrective measures:

For negotiation to succeed, the following steps are to be respected:

* Identify and define the conflict in specific terms.
* Focus on areas of common interest and potential areas for agreement.
* Never jump to conclusions or make assumptions about what another is feeling or think
* Listen without interrupting; ask for feedback if needed to assume a clear understanding of the issue.
* Generate alternative solutions
* Discuss the pros and cons of the alternatives, listen as well as state your case.
* Select the best course of action that all can agree upon;
* Implement only the parts of the plan that are in agreement
* Follow-up to evaluate the effectiveness of the plan and make any adjustments necessary.

### 7.5.5. Advantages and disadvantages of conflicts

Conflicts can be beneficial or hindrance to the organization.

They can be advantageous in sense that the spirit of competition between opposed individuals or groups drives to excel to the higher levels as weaknesses are opposed to creative solutions which can be proposed.

In contrast, conflict can be disadvantageous in sense the competition gets fierce on the same team, and opposing groups destroy each other, hence destroying the whole organization.

**Advantages**

* Handing-over in question policies, practices and procedures
* Clarification of latent faintness and frustrations
* Better mutual comprehension
* Reinforcement of professional relationships

**Disadvantages of conflicts**

* System stability threatening
* Time and energy wasting
* Professional team disintegration
* Harmful effect at the working environment

# **UNITY8: FINCIAL MANAGEMENT**

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## 8.1. MEANING AND PURPOSE OF FINANCIAL MANAGEMENT

* When we talk of financial management, the first thing that comes to our mind is money. This is true because financial management is about the management of money and financial resources of organizations. Without financial resources, business organization would not need financial management.
* Financial management is concerned with raising financial resources and effectively using those resources to achieve the goals of organization.
* It is also defined as a process of acquisition, allocation and utilization of financial resources.
* It may refer to dealing with monetary decisions that business enterprises make and the tools and analysis used to make these decisions
* The above definition of financial management implies that financial management is the process of putting to advantage available financial resources. All business organizations depend on financial resource and managing properly financial resources is key to survival of a firm.
* Financial management involves planning, directing and controlling the financial activities of an organization such that the organization gets maximum benefit from these resources. To clearly understand the meaning of financial management, let’s look at the usual or routine tasks performed by financial management.

The following are some of the routine tasks performed under financial management.

* Budgeting for the enterprise.
* Collection of cash and cheque payments
* Making payments to credit suppliers.
* Banking of collected cash.
* Keeping of financial records and preparing financial statements and reports.
* Collection debts.
* Payment of salaries wages, bills and dues.

## 8.2. OBJECTIVES OF FINANCIAL MANAGEMENT

Financial management is generally concerned with procurement; allocation and control of financial management include the following:

* ***Liquidity:*** Is the objective of financial management to ensure the enterprise is able to pay its short term obligations. Financial management therefore ensures regular and adequate supply of funds.
* ***Profitability:*** This is financial management objective that ensures that an organization maximizes profits. Profits satisfy shareholders and expand the business.
* ***Efficiency:*** As a financial management objective, it ensures that business enterprise minimize costs so as to maximize profits.
* ***Return on capital:*** Financial management ensures an adequate return to shareholders in form of dividends.
* ***Safety of investments:*** Another function of financial management is to ensure all the investments of the enterprise are safe. This involves investing fund in less risky ventures with reasonable rate of return.
* ***Manage risks:*** Financial management enables enterprise to identify, assess and manage business risks.

## 8.3. BUSINESS CAPITAL

One of the most important considerations before starting any business knows the amount of capital required and the source of that capital. In simpler terms, you need to answer these key questions about business capital.

* Why do I need capital?
* How much capital do I need?
* Where can I get capital from?
* What are the benefits and costs of each possible source of capital?

In the business sense, the money you need to start and run the business is called **capital**. How much you need and from where you get it and the implications of each source are what we want to investigate.

Capital is the amount of financial and physical resources that is needed by the entrepreneur to properly implement a business plan.

Alternatively we can define capital as the amount of financial resources needed to implement a business plan. Capital should not only be looked at in terms of cash at hand but all the financial resources available to the entrepreneur.

### 8.3.1. EQUITY FINANCING VS DEBT FINANCING

**Equity financing**: means financing a business by selling shares. The buyers of shares get a stake in the business because as shareholders, they are part owners of the business.

**Debt financing** means borrowing money and not giving up any ownership. The borrower money is paid back with interest at a later date. When both options (equity and debt) are available, merits and demerits of each must be considered before making a decision as to which form to use.

### 8.3.2. MERITS OF EQUITY FINANCING

The merits of equity financing are:

* The funds are committed to the business much longer since investors only realize their investment only when the business is doing well.
* Most shareholders will be ready to provide additional funding when it is needed. This is usually so if the business is in crisis.
* Equity financiers (investors) get interest in the business and do whatever they can make it succeed since that is the only way they can recover their investment.
* Equity financiers can easily bring valuable business contacts and skills into the business.
* You do not pay interest on equity funds. Interest can be high and a burden to a start-up business and so avoiding it is a great benefit.
* You do not need collateral to secure equity financing as is required for debt financing. Most new enterprises lack sufficient assets to guarantee loans and so equity financing is a relief.

### 8.3.3. DISADVANTAGES OF EQUITY FINANCING

The demerits of equity financing include:

* You lose control over your own business. If the investors put in much money, they end up with more shares and more control.
* Investors may come with other ideas and end up diverting your idea to something different from what you had in mind.
* Raising equity finance is costly and time consuming. The money may not come in when it is needed and this may affect business programmes

## 8.4. MONEY

# REVISION QUESTIONS (1)

1**.** Draw a flow of funds through financial system graph and make a brief comment.

2. Write short note on debt and equity market.

3. Differentiate between money and capital market.

4. Give four examples of money market and capital market instruments.

5. According to you, what is importance of financial intermediaries?

6. What do you mean by financial management? What are its purposes /objectives?

7. Relate finance to the following: accounting and economics.

8. Describe the scope of financial management according to both traditional and modern approach.

9. Using an example, explain how the business gives dividends to the shareholders.

10. Explain the Key activities of the financial management.

11. Explain any three types of capital you know.

12. Differentiate equity capital from debt capital (use an example). Which one can you prefer to use? Why?

13. How can you finance your business expansion?

14. Evaluate the start up investment of a business of your choice.

15. Suppose that you want to start a business, give ways through which you can get the capital needed. How can you use it (after getting it)?

16. using an example, differentiate between simple and compound interest rate fixed and variable interest rate and deposit rate and lending rate.

17. Using an example, explain: the break-even point (graph) and payback period

18. What are types of financial institutions you know in Rwanda? Differentiate then basing on their functions.

19. What are types of accounts you can open in the commercial banks? Differentiate them. Which one do you want now? Why?

20. Having Rwandan francs and needing to go Uganda, where can you get Ugandan Shillings?

21. Write short note on **any** interesting topic you have seen in this content (summarize each unit).

### 8.4.1. Definition

Money refers to anything that is generally acceptable for the discharge or settlement of debts or obligations. It is a “**legal tender**” meaning that everyone in the country concerned must accept it in settlements of debts.

### 8.4.2. Brief historical concept of money or evolution of money

Initial evolution of money was the direct consequence of the disadvantages of barter trade. Since then, items used as money included commodities, precious metals, coins, paper, bank deposits and plastic credit cards. Evolution phases are detailed below.

**1. Barter system**

This was the earliest form of exchange where commodities were exchanged directly for other commodities. Therefore, societies missed the functions of money. Barter trade is therefore the direct exchange of goods and services for other goods and services.

The barter trade required the double coincidence of wants where has to be a reciprocity of wants.

**Problems of barter trade**

**(i)Cumbersomeness**: it is a very cumbersome economic activity when there is specialization. A buyer has to look a large number of goods and services to her specialists to obtain a variety of goods he needs to satisfy his daily wants.

**(ii)Double coincidence of wants**

The system depends on double coincidence of wants where there has to be a reciprocity of wants

**(iii) Time wasting**

The timed and energy which could have been evoked to production is spent on a laborious system of exchange.

It is very difficult to get a uniform measure of value for goods. E.g. it is very difficult to determine the value in the exchange of maize for a goat.

**(iv) Indivisibility of goods**

It is difficult to breakdown some commodities into smaller units to permit small transactions.

**(v) Multiple exchange rates**

The exchange rates vary between commodities due to lack of uniformity and standard.

The exchange rates vary between commodities due to lack of uniformity and standard.

(vi**) Limited future trade**

It makes future trade impossible since some goods are perishable. Even where goods are not perishable, the costs of storage may be very high.

**(vii) Lack of standards for deferred payments**

It is difficult to determine how much should be paid in the future for a transaction, which is undertaken. Credit contracts and transactions may be not made.

**(viii) Lack of economies of scale**

It discourages large production since the demand for goods is never certain. Therefore economies cannot be enjoyed under barter system.

**2. Commodity money**

Many different Commodities have been used at different stages as money. These are corn, salt, tobacco, cloth, cattle, hoes, etc. It is the intrinsic value of these commodities that provided their general acceptability

Through superior to barter, commodity money had limitations, e.g. indivisibility, perishable, not easily portable, unusable as standard of value or debts.

**3. Metallic money**: The weakness of Commodity money motivated societies to use precious and intrinsically valuable metals (durable commodities) e.g. gold, silver, copper, iron, beads and so on. The metals were superior in that they were durable, portable, divisible and highly valued due to their scarcity.

**4. Coins/ the coin stage**

As the metals became generally accepted as medium of exchange, the state took over the minting of coins. The government made coins using a fixed quantity of gold or silver for value and the amount of cheap base metal to give the coin durable. The value of money one held depended on the number of coins one had rather than the weight of the metals. However, debasing or the coins become a problem. Debasement is a process where say the gold or silver content of coins is reduced (by meeting) to make more coins from the melted metal.

Such coins of course have less value (less gold or silver) than their face value. In short; metals were debased to make **token money** or representative coins whose metal value was less than the face value.

**5. Paper money**

In the beginning, people used to deposit their gold with the Gold Smith (Custodians of gold who were acting as bankers of that time).In turn, the Goldsmith could give them receipts which they were to use to get back their gold. Later people started to use receipts to settle debts and obligations because such receipts were as good as gold. When the work of the Goldsmith( the task of issuing paper money) was taken over by central banks, these gold documents were, standardized to make paper money. This marked the origin of paper money and the origin of banks. In the beginning, paper was as gold because it was fully backed by gold. But eventually countries abandoned the gold standard and started printing money which was not fully backed by gold (**fiduciary issue**)

**6. Deposit money / bank deposits**

This created by the commercial banks in the process of accepting deposits and

**7. Plastic money**

Plastic credit cards (e.g. the American Express, Diners card, Master card etc.) are the most recent evolution in money perhaps made possible by the development in information technology. With a credit card, you do not have to have cash on you to transact. Your bank account is debited automatically once you present the card e.g. at supermarket or petrol station where such cards are acceptable.

In most developing countries credit cards are rarely used because of technological constraints and indifference, and may be low average incomes. Like the, case of gold theft before, the cards are also vulnerable to theft thanks to the modern technology

### 8.4.3. Functions of money

In an economy, money plays the following functions

**(i)Medium of exchange**: money makes it possible to determine the value and quantity of commodities to be exchanged. In case of direct exchange of commodities (barter trade), there has to be a double coincidence of wants (reciprocity of wants). I.e. seeking for one who has the commodity you want and who wants the commodity you have.

**(ii)Unit of account**

It used as a unit to effect or carry out business calculations and accounting

**(iii)Measure of Value**

The relative values or prices of commodities are determined through the intermediary of money. This reflects the relative quality and quantity of commodities to be exchanged in the market. Money therefore serves as unit of account or measure of value.

**(iv)Store of wealth:**

Money can be used to store value or wealth because it is not bulky and it is not perishable. It does not suffer physical deterioration nor involve storage costs and can easily be turned into other forms of wealth

**(v) Standard/means of differed payments**

Money facilitates payments of debts and transactions to some future time. In case of barter systems, there are problems of changes of commodities in terms of age, value and quality. It therefore permits credit transaction, which is the hallmark of modern economic exchange.

**(vi) Money enables specialization**

It enables specialization to take place by ascertaining the demand for goods. It facilitates the settlement of transactions .e.g. Setting prices, payment of wages, etc

### 8.4.4. IMPORTANCE OF FINANCIAL MANAGEMENT

Finance is the blood of any business. Business plans cannot be implemented unless there are finances. Financial management is central to any business because it affects all activities of an enterprise. Financial management is important to an organization irrespective of its size, ownership, location or structure. The functions of financial management include the following:

* Ensure that assets are used in a way that brings the highest possible return.
* Repaying all borrowed funds using generated profits that the borrowed funds generated.
* Evaluating the need for new assets and determining how much value they will add to the organization.
* Ensuring optimal use of available resources.
* Ensuring accountability to shareholders
* Eliminate fraud and misuse of resources.
* Determine the profitability of the enterprise by maintaining proper records.
* Obtain funds to finance additional activities and investments.
* **Characteristics/qualities of money**

Whatever is used as money must satisfy the following basic requirements.

**(i)Acceptability**: it must acceptable to society. I.e. all the people in the country must be confident that others will accept it.

**(ii)Portability**: it must be easy to transport, easily movable from one place to another. It must not be heavy in relation to its value. In other words, it should have high ration of value to bulk and weight.

**(iii)Divisibility**: it must be divisible to smaller denominations to make possible smaller transaction. It means that it should be capable of being broken down into smaller units without any loss in value.

**(iv)Durability**: Money must not be perishable so as to function as store of value/ wealth. It therefore should be long lasting because people will not accept anything that is subject to rapid deterioration and losses in value while people’s possession.

**(v) Scarcity**: Money must be scarce. Otherwise it would lose value if it is in plenty and people would prefer to keep their wealth in form of property.

**(vi)Homogeneity**: one piece of money should be as good as others. I.e. there should be similarity. For instance a ten shilling note should be similar to all other ten shilling notes used in that country.

**(vii)Limited supply**: Whatever serves, as money should be scarce or limited in supply. If there is no limitation in supply, either natural or artificial, people will have not confidence in the value of the commodity.

**(viii)Stability**: money should have a stable value for a long period of time with very minor variations in value

**(ix)Difficult to forge**: it should be difficult to forge whatever is used as money. Forgery may lead to loss of value and confidence in money

* **Role of money in the development**

**a) Encourage specialization:** it acts as a link between producers and consumers, which encourages specialization. Specialization increases quality and quantity of output.

**b) Stimulates production:**  People are encouraged to invest so as to earn or increase their money income.

**c) Stimulates investment**

People save money, which enables capital accumulation to take place.

d) **Emergence of commodity market**

It encourages the rise of commodity markets, which lead to trade, and development of secondary and tertiary sectors.

**e)Government revenue**

Its existence encourages taxation, which raises government revenue that is spent on development projects.

**f)Operation of price mechanism**

It makes it possible for the price system to operate which reduces subsistence production and ensures the effective utilization of resources.

**g)Acquisition of resources**

It enables countries to acquire various resources like skills, capital, raw materials, power etc that they may lack from others.

## 8.5. Business capital

**Capital** is any form of wealth employed to produce more wealth. It exists in many forms in typical business including cash inventory, plant and equipment.

### 8.5.1. Different types of capital

**i) Fixed capital**

This refers to a company’s permanent or fixed assets such as building, land, computer and equipment, fixture and fittings, vehicles, furniture.

Lenders of fixed capital expect the assets purchased to improve the efficiency and thus the profitability of the business and to create improved cash flows that ensure repayment.

**ii) Working capital**

This represents a business’ temporary funds. It is the capital used to support a company’s normal short-term operations. It includes short term debts (debtors), stock, cash at bank, cash in hand, prepayment or payment in advance.

***Working capital= current assets-current liabilities***

**iii) *Growth capital***

Unlike working capital, this is not related to the seasonal fluctuations of small business, instead, its requirement surface when an existing business is ***expanding or changing its primary directions.***

For each stage of your business life, time comes when you may require outside funding. The different types of capital are explained below:

* ***Seed capital***: This type of capital is the money you need to do your initial research and planning for your business. Business registration, communication and other small expenses before starting the business.
* ***Start***-***up capital:*** Start-up, or working capital, is the funding that helps you pay for equipment, rent, supplies, etc., for the first year or so of operation. When a person says he/she is looking for capital to start the business, they are definitely referring to start-up capital.
* ***Mezzanine (expansion) capital***: Mezzanine capital is also known as expansion capital, and is funding required helping a company grow to the next level, purchase bigger and better equipment, or move to a larger facility.
* ***Bridge capital***: Bridge funding, as its name implies, bridges the gap between current financing and the next level of financing.

### 8.5.2. Calculating the capital needed to start a business

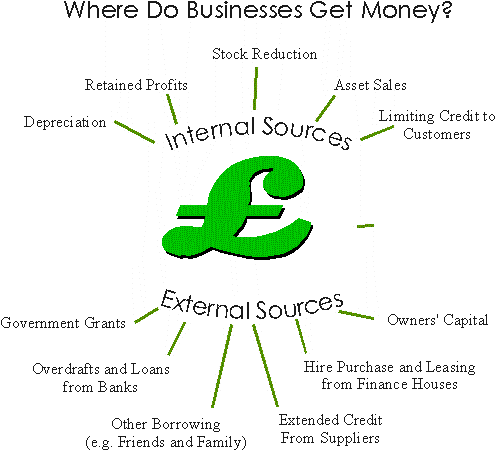
***Start-up investment*** is the onetime expense of operating a business. It is also called ***seed capital.***

In a restaurant for example, Start-up expense would include stores, food processors, tables, chairs and other items that would not be replaced very often.

Example:

|  |  |
| --- | --- |
| **Particular** | **Estimated cost** |
| Store | $22 000 |
| Food processors | $11 000 |
| Table and chairs | $6 000 |
| Cash register | $1 500 |
| Dishes and Silverware | $8 400 |
| Renovations | $15 000 |
| Industrial cooking system | $45 000 |
| Industrial dish washers/ dish racks | $18 000 |
| **Total start-up investment** | **$127 500** |

## 8.6. Choosing appropriate source of financial capital (sources of capital in business)

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**a) Personal saving**

The first entrepreneurs should look at for starting-up their businesses in money which is in their pockets. It is the least expensive source of funds available.

***b) Family and friends***

They are obvious source of loans, but here you have to remember that they will get back their money with interest.

If they invest capital in exchange for ***equity***, they get back much more that their original amount.

Acknowledge that equity is more risky that debt but explain that the potential for reward is much higher. Be sure that any financial agreement is properly documented and signed so that there is no misunderstanding later. Nothing ruins a perfectly good relationship more quickly than a dispute over money.

***c) Financial institutions and the five “Cs” of borrowing***

It can be difficult for new entrepreneurs to get loans from banks and other financial institutions because bankers tend to be conservative lenders; they are very trustful in old borrowers.

Bankers operate under the principle of five “Cs”

1. ***Collateral:*** property or other assets pledged against the loans that the lender can take and sell if the loan is not paid.

***2. Character:*** typically analyzed in the form of the owners personal credit for a small business. One’s ability to borrow money is called credit. Before a financial service company will lend you money, it will want to know your ***credit history*** which is the record of how deal-ability and punctually a company or individual has paid off past debts.

***3. Capacity:*** the business cash flow must be sufficient to cover the monthly loan payments. You will have to report your projected cash flow so that the lender can determine whether you will be able to repay the loan.

Your ***debt service*** is the amount you will have to pay each period until the loan is paid.

***4. Capital:*** How much of your own money have invested in your business? Have you gotten friends or family to invest? As we have noted, a banker wants to see that you are risking your own money as well.

***5. Conditions:*** the state of the industry and economic climate at the time the loan is made and during its anticipated term.

If inflation is on the rise for example, the bank may be concerned that your earnings will not keep place with it thus reducing your capacity to repay the loan.

Lenders will expect you to sign a personal guarantee which status that you will be responsible for paying off the loan in the event that the business cannot do so. In other words, in the case of default the lender will have the right to take both business and personal assets.

You may think that you have good credit because you have never borrowed money or used credit card. Wrong! What you have is no credit to establish credit you must prove that you are capable of making regular payment on debts.

Typically, most banks will not lend anyone without a credit history but money store will through resolving charge accounts which are credit accounts that have a single borrowing limit and may be used and repaid on a repeated cycle.

One way to begin a good credit history is to open one of these store accounts, charge of few,

small purchase and never miss a payment or pay later than the due date. These records of on time payments will become a part of your credit report.

***d) Vendor financing***

Entrepreneur frequently benefits from the establishment of trade credit from vendors. Pay eliminating the need for cash in allowance or act the time of purchase you have an opportunity to hold into the money for a longer period on well have more time to generate cash for repayment.

In essence, the vendor is providing finance for your business.

***Float*** is the term for the time between a payment transactions and when the cash is actually in the seller’s account. If you receive your phone bill on March 1 band pay it on March 20, you have floated the bills for 20 days.

***Account payable*** is money a business owes its suppliers, this is the account ***receivable*** of a supplier.

We should negotiate the best possible payment terms with your suppliers in advance so that your business can use float to have as much cash on hand as possible. This is a form of short-term financing from your own company. If you are not able to pay on time, always call the creditors and request permission to pay it later never just skip a payment.

***e. Self funding- foot strap financing***

Last but not least there is always ***foot-strap financing*** which is finding creative ways so stretch existing capital as far as it can go. If you cannot secure venture or angel financing do not let it spot you.

Many hugely successful businesses have been started for under $10, 000 by entrepreneurs who used a variety of techniques to stay of root including the following:

* Hiring as few employees as possible using temporary service agencies for staffing needs can help cut down on insurance and tax expenditures.
* Leasing rather than buying equipment
* Getting suppliers to extend your credit term so you can take longer to pay bills.
* Using personal savings, taking a second mortgage, arranging low interest loans from friends and relatives
* Putting profit back into the business to keep it going

***f. Merging of businesses***

This is when the firms combine their resources/capital to become one big firm. In this way, a firm raises capital and expands the business.

***g. Trade bill security document***

People raise capital by issuing trade bills loans to the lender. They promise to pay back the lender with an interest in a stated period of time.

***h. Gambling***

Gambling is where people play a game of chance for money or risk a sum of money on the outcome of a game or the event. The winner can use this money to begin or expand his/her business

***i) Advances from customers***

Here the customers pay for the products before the products are made. The money paid by customers is used to buy goods and other inputs needed

***g. Selling shares***

A company can raise its funds by selling shares where people will bring money in the business and then share the profit earned proportionally to the share held.

***k. Debenture***

A debenture is a loan certificate issued by a company when it borrows from the public. By issuing it, a business can get money from the public in form of loan.

***l. Fund raising***

This is a collection of money for an organization from so many people. This money can be used to start or expand the business.

***m. Inheritance***

Some people get money which they use to start business from inheritance. Parents, friends and relatives leave their property to their family members, friends and relatives. These properties can be used to start or expand the business.

### **8.6.1. Uses of capital**

* Payroll and peripheral expenses
* Payment for utilities
* Marketing and sales related costs
* It is used to finance the business expenses or costs.
* Facilitates further production (machinery and human capital)
* Capital buys other factors of production (financial capital)
* Serves as raw materials for further production
* It helps to pay the rent; insurance ; taxes and maintenance of different equipment, premises, vehicles….etc

## 8.7. The concept of interest

The interest refers to the amount of money charged on the individual or a firm for the amount of money borrowed.

### Interest rates

An interest rate is the ratio (rate) in percentage at which interest is paid by a borrower for the use of money borrowed from a lender. Usually is expressed in a period of one year

### 8.7.1. Term or period of the loan

A loan term is a period over which a loan agreement is made and before or at the end of that period the loan should be repaid or renegotiated for another term.

**Fixed and variable interest rates**

**a. Fixed interest rate loan**

The fixed interest loan is a loan by which the interest charged remains fixed for the loan’s entire term i.e. the payments remain constant over the entire term

**b. Variable interest rate loan**

This a loan in which the interest rate charged on the capital varies as market interest rates change.

### 8.7.2. Simple and compound interest rate

**a. Simple interest**

It is a quick method of calculating the interest charged on a loan. Simple interest is determined by multiplying the interest rate by principal by the number of period.

***I=P.R.T***

Where **P:** is the loan amount borrowed, **R:** interest rate and **T:** Term of the loan (in years).

**E.g.1Answer: I=**10,000,000\*0.1\*2=2,000,000. He will pay 10,000,000+2,000,000=12,000,000

**E.g.2.** Joy lent Mary 600,000 at an interest rate of 20% , how much money will Joy receive after 6 months.

**Answer: I=**600,000\*0.2\*1/2=60,000. She will receive 600,000+60,000=660,000.

**b.Compound interest**

The compound interest is that one which occurs on the initial principle and accumulated interest of a principal depositor loan.

Compound interest allows a principal amount to grow at a faster rate than simple interest which is calculated as a percentage of only the constant principal amount.

**CI=[P(1+r) t]- P**

Where CI is compound interest, P: principal, r: interest rate and t: the time or period

**N.B: “P(1+r)t” is also called Future value i.e. CI=FV-P**

**E.g.** Let P=50,000; r=10% and t=2years. Compute the compound interest.

**Answer: CI= [50,000(1+0.1)2****]-50,000=10,500**

### 8.7.3. Future value and present value in compound interest

**Calculation of future value (FV of n period)**

Consider a principal amount PV which earns interest for **n** periods at **i** per period (p. p) compound interest. This information may be placed on a time diagram where the **n** compounding periods are indicated by T1, T2, T3 ……….Tn

At : **T1**: FV1 = PV+I

= PV+PV\* i

**FV1= PV(1+i)1**

**T2** : FV2: FV = PV(1+i) (1+i)

**FV2= PV(1+i)2**

**T3 :** FV3 = PV(1+i)2 (1+i)

**FV3= PV(1+i)3**

**Tn :**

FVn= PV(1+i) n

**Calculation of Present value in compounding**

1. FV=PV(1+i)n

Therefore: PV **= or**

**PV =**

PV=FV (1+i)-n

**Calculation of period (n) in compound interest**

When calculating the period that money will take to get on the interest that the investor want there are easy formula to use which is to use the logarithm,

we know that: FV=PV (1+i)n

Therefore using logarithm,

Log FV=log PV(1+i)n

Log PV=log FV+ log (1+i)n

log (1+i)n=log FV-log PV

n log (1+i) = log FV- log PV

n log (1+i) = log

**n =**

**Example**

An investor deposited $500,000 in bank and he wants this amount to be double on the interest of 4% annually.

1. What is the future value of this amount
2. How many time will take

**Solution**

1. **FV= 500,000 X 2= $1,000,000**
2. **n = = == 30years**

**Calculation of the interest rate in compounding interest**

We know that PV= PV (1+i)n

Which is (1+i)n

**i = - 1**

(1+i)= - 1

i=(1/n-1

or

**Example**

An investor invest the amount 60,000 RWF In the bank and want to have 120,000 RWF in 10 years at what interest rate can be calculated on?

**Solution**

**FV= 120,000RWF, PV=60,000, n = 10 years, i=?**

**i = -**1

i= -1 **i= 7,17%**

**or**

i= (1/10-1 =-1=0.0717=**7,17**

* + 1. Determinants of interest

The following are some of the factors that determine the interest charged:

* Availability of funds to be lent
* Demand for funds by borrowers
* Government policy towards borrowing(Government regulate interest).
* Security provided(Better security means lower interest)
* Duration of payment(Long term loans normally attract less interest)
* Rate of inflation in the economy.

## 8.8. Break - even point and payback period

### 8.8.1. Break-even point

Another key component of every sound financial plan is break-even analysis. A small company’s ***break-even point*** is the level of operation (sales dollars or production quantity at which it neither earns a profit nor incurs a loss). At this level of activities sales revenue equals to expenses. That is the firm’s “***break-even”.***

By analyzing costs and expenses, an entrepreneur can calculate the minimum level of activity required to keep the form in operation. These techniques can then be defined to project the sales needed to generate the desired profit. Most potential lenders and investors will require entrepreneurs to prepare a break-even analysis to assist them in evaluating the earnings potential of the new venture or business.

In addition to its being simple useful screening device for financial institutions, break-even analysis can also serve as a planning device for the small business owner. It occasionally will show a fully prepared entrepreneur just how profitable a proposed business venture is likely to be.

In sensitivity analysis, we ask what will happen to the project if sales decline or costs increase or something else happens. As a financial manager you will also be interested in knowing how much should be produced and sold at a minimum to ensure that the project does not lose money.

Such exercise is known as break-even analysis and the minimum quantity at which loss is avoided is called ***beak-even point.***

**b. Constructing a break-even chart**

The following outlines the procedures for constructing a graph that usually portrays the firm’s break-even point (that point where revenues equals to expenses)

***Step 1:*** On the Horizontal axis, mark a scale measuring sales volume

***Step 2:*** On the vertical axis, mark a scale measuring income and expenses in dollars.

***Step 3:*** Draw a fixed expense line intersecting the vertical axis at the proper dollar level parallel to the horizontal axis

***Step 4:*** Draw a total expense line upwards beginning at the point where the fixed cost line intersects the vertical axis. The precise location of the total expense line is determined by plotting the total costs incurred at a particular sales volume.

The total costs for a given sales level is found by the following formula:

***Total expenses = fixed expenses + variable expenses***

***Step 5:*** beginning at the graph’s origin draw a 45 degree revenue line showing where total sales volume equals total income.

***Step 6:*** Locate the break-even point by finding the intersection of the total expenses line and the revenue line. If the business operates at a sales volume to the left of the break-even point, it will incur a loss because the expenses line is higher than the revenue line over this range. This is shown by the triangular section labeled ***loss area*** on the other hand, if the firm operates at a sales volume to the right of the Break-even point, it will earn a profit because the revenue line lies above the ex penses line over this range. This is shown by the triangular section labeled ***profit are***Income and expenses.

For **example** we can use the following data to calculate break-even point.

* Sales price per unit = $250
* variable cost per unit = $150
* Total fixed expenses = $35,000
* Total sales or total production = $ 450,000

Selling price quantity = fixed cost +( quantity \* variable cost per unit)

P \* Q = FC + Q \*V

Quantity \* (P-V) = FC

**Break even == = 350units**

**Break even in sales amount= 350 units x $ 250=$ 87500**

**Break - even Point on the graph**

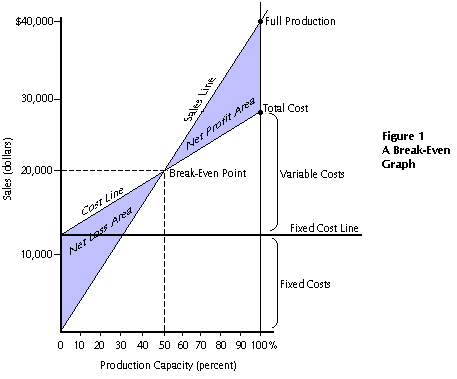
Example

Total cost=$30,000

Total fixed cost=$10,000

Total variable cost= TC-FC = $30,000 - $10,000 = $20,000

Total sales or total production = $40,000

8.8.2. Pay-back period

When compiling and analyzing start-up cost, a consideration will be how long it will take for you to earn back your start-up investment.

Payback estimates for you and your investor how long it will take your business to earn enough to cover the start-up investment it is measured monthly.

Payback period is a useful measure for the financial analysis of a project, or is the length of time a project takes to pay back the money which has been is invested in a company. This calculation can be done into two ways, either using cash flows or using discounted cash flows.

***Pay back = start-up investment / Net profit per month***

**Example**: As DERBOATY’s business required a start-up investment of $ 1000. The business is projecting a net profit per month of $ 400. How many months will he take to payback his start-up investment.

***Pay-back period = $1000 / $ 400 = 2.5 month***

### **8.8.3. Return on investment (ROI)**

Return on investment is a business performance measure used to evaluate the return from a financial investment.

It is the one of the many tools used to evaluate business investment.

The return on investment is important in making decisions for purchase decisions, funding decisions and investment decisions.

Return on investment is a measure used to calculate the efficiency of an investment or to compare the efficiency of a number of different investments.

ROI is calculated as:

ROI=

Return on investment compares investment returns and costs. When potential projects on investments compete for funds, then the project or investment, with the highest return on investment is considered a better option.

Example

What is the return on investment for a project expected to cost Rwf 500,000 over the next five years but is expected to increase business profits by Rwf 700,000 over the same period?

Solution

RIO =

=

= = 40%

# **UNITY9:** FINANCIAL INSTITUTIONS (INTERMEDIARIES)

## 9.1. Definition

Financial intermediaries are financial institutions, which bring together the deficit – spending units (borrowers) and surplus spending units (lenders) together in the economy by channeling funds from lenders to borrowers. Generally they are supposed to play the following roles inter alia:

1. to stand between lenders (savers) and borrowers and to satisfy the interest of the two

2. To facilitate the pooling of risks

3. To increase liquidity of the financial system through giving loans, investing in treasury bills, bonds and shares, etc.

## 9.2. Types of financial Intermediaries

### 9.2.1. Banking financial intermediaries

E.g. Commercial banks, Micro finances, co-operatives and central banks

These have the following characteristics:

i) Their liabilities from part of money supply in the economy.

ii) They create new primary liabilities, which are considered as money

iii) They usually lend short-term loans

iv) Usually charge low late of interest unlike non-banking intermediaries

v) They generally accept current or short-term deposits

vi) They usually do not undertake high-risk investments.

### 9.2.2. Non-banking financial intermediaries

These, are financial institutions that receive deposits from the public, give loans but do not create new deposits or new credit. E.g. insurance companies, development banks, building societies, post office savings banks, housing finances savings and credit schemes, African development bank( ADB), the East African Development Bank(EADB), Rwanda Development Bank (RDB), Building Societies and Housing Finance Institutions for Rwanda, etc

### 9.2.3. Differences between banking and non-banking financial intermediaries

|  |  |
| --- | --- |
| **Banking Financial intermediaries** | **Non –banking Financial Intermarries (NBFI)** |
| 1. Create credit which is considered as money (deposit money)  2. Usually lend short term & medium loans  3. Maintain short term deposits  4. Provide finance mainly for working capital  5. Undertake less investment risks  6.Bank loans can be used for a range of activities  7. Pay lower rate of interest on deposits  8.Are allowed to deal foreign exchange | 1. Do not create credit. Just lend funds got from surplus spending units  2.Lend/ invest long term & medium loans  3.Maintain long term deposits  4.Capital developments  5.Undertake more investment risks  6.Loans are specific to particular activities that NBFI is specialized in (housing industry etc  7.Pay higher rate of interest on deposits  8.Are not allowed |

**Note:**

1. The above differences are generalized. At times in practice there is no clear –cut between roles played by banking financial intermediaries and non-banking financial intermediaries.

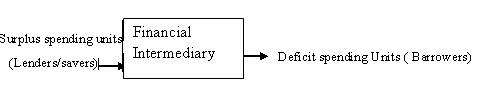
2. The difference between banking and non- banking financial intermediaries also applies to the differences between **money markets** (operated by banking financial intermediaries) and **Capital markets** (operated by non- banking financial intermediaries).

Capital and money markets form **credit markets**

## 9.3. Role of financial intermediaries

**i) Bridging the gap between Savers & borrowers**

They act as middlemen (intermediaries) between savers and borrowers and bring the two into contact.



**ii) Pooling risk and secure economies of scale**

There are many risks involved in lending especially defaulting with financial intermediaries help to minimize. By handling loans to a large number of borrowers, the intermediaries can determine fairly the percentage of losses they will sustain through default, which can be recovered in interest rate.

**iii) Increasing liquidity of financial system**

They provide the public with more liquid and less risky assets, which can be invested in securities.

E.g., Individuals may contribute to pension funds and can be assured of pension without taking risks, while the finance accumulated in the pension’s funds is invested in a variety of securities of varying risks and earning power.

**iv) Provision of specialist knowledge of investment.**

They assist investors by providing them with specialist knowledge and experience in investment, which the general public can support.

### 9.3.1. Specialized Financial Institutions (S.F.I)

These are non-bank financial intermediaries, which do not perform all functions of the ordinary Commercial banks and include the following

**1. Post office bank**

Sometimes the post office bank is called the national savings bank. It caters primarily for those who love small amounts of money but have no ready access to savings facilities in commercial banks. E.g. Peasants in rural areas, students etc. they receive deposits on savings accounts, do not operate current account and cannot create deposit money using cheque.

2.**Building societies and Housing Finance Institutions**

These are institutions which use funds they collect to specialize in lending for house purchases or building but taking a mortgage on the property as security until the loan is paid. They lend for long-term housing.

**3. Insurance companies**

These institutions indemnify people who suffer losses though misfortunes. They receive premium on various types of risks insured against. As a result, insurance companies receive large sums of money which they invest in securities e.g. Buy bonds and whose proceeds are used to indemnity those who suffer from losses.

They can lend to the government by buying treasury bills.

**4. Pension funds/ N.S.S.F**

These are institutions that receive and accumulate incomes from workers which are reinvested in government securities, property shares etc.

The proceeds from these investments are then used to pay workers upon retirement.

They are therefore managed by insurance companies or social securities institutions. They receive savings from workers and invest in long term investment. They benefit employees on retirement.

**5. Development banks**

These are banks which give medium, long-term loans for development where commercial banks concentrate on short term loans. They are usually established by the government

E.g. **a)** Rwanda Development Bank (**RDB**)

**Difference between commercial banks and Development banks**

|  |  |  |
| --- | --- | --- |
| **Commercial Banks** | | **Development Banks** |
| 1.Are banking financial intermediaries  2.Aim at making profit  3.Give short term loans  4.Accept deposits from the public  5.Create credit  6.Undertake less risky investment  7.Can be owned privately or by government  8.Change high interest on borrowed | 1.Are non- banking financial intermediaries  2. Aim at enhancing national development  3. Give long term loans  4.Do not accept deposit from the public  5.Do not create credit  6.Can undertake even more risky investments  7.Are owned by the government  8.Charge lower interest on borrowers | |

In short, a commercial bank is a profit making financial institution, which deals in credit whereas development banks are government owned financial institutions which do not aim at making profit but aim at enhancing development of the country that they lend.

E.g. UDB, EADB, ADB

**b) African Development bank ( ADB)**

\* Founded in 1964 after the formation of the O.A.U. its main purpose is provision of soft loans (loans at low rate) to African countries for development purpose. Its head quarters are in Abidjan. The ADB finances infrastructural projects like irrigation, ports, dams, etc.

c) The East African development bank (E.A.D.B)

It has been founded in 1947 as result of east African Treaty of cooperation.

**Objectives**: i) Equal distribution of industries in EAC

ii) Investing in risky projects

iii) Avoiding competition in industries in E.A.C

**6. Cooperatives**

They receive deposit and accept shares. They lend to members and carry out other activities like marketing, transport, agriculture, etc.

**7. Stock exchange market**

This is a market of shares and bonds where governments, companies or individuals buy and sell these financial assets to make capital gains

**8. Investment Trust**

These are limited companies registered for the purposes of holding shares in other companies. In purchasing a share in an investment trust, an investor indirectly invests in a very large number of different companies. Its income consists of the dividends it receives from its holdings in different companies, which in turn is paid out as dividends to its own shareholders

**What are reasons for setting up specialized Financial Institutions?**

i) They facilitate the financing of medium and long-term projects, which ordinary commercial banks do not undertake in preference to short projects.

ii) They facilitate financing of long-term development oriented projects

iii) They offer unique services. Some institutions such as insurance companies offer unique services, which commercial banks can undertake

E.g. insuring and indemnifying against risks and losses, which can encourage the growth of local entrepreneurship

iv) They promote investment projects. Institution like development banks are very useful in financing industries/ projects, undertaking feasibility study on projects etc which commercial banks do not undertake.

v) They facilitate the raising of capital for business formation. Institutions like stock exchange market facilitate the transfer of share and securities which promote the formation and development of companies and large scale business.

vi) They cater for small time savers. Institutions like post office savings bank assist people who have low income to save their money.

## 9.4. Banking Financial Institutions and their functions

### 9.4.1. Commercial Banks

These are joint stock institutions, which carry out business in the country, accept deposits from the public, give out loans and make profits in various ways. They are dealers in credit or borrowed funds.

They are referred to as joint stock banks because the capital for starting such banks is usually raised through the sale of shares and the shareholders are the owners of the banks. Commercial Banks in Rwanda include; C.B.R (Commercial Bank of Rwanda), B.K (bank of Kigali), BACAR is now called FINA BANK, BCDI called now ECOBANK), ACCES BANK, KCB, Banque Populaire du Rwanda SA, Urwego opportunity bank, Agaseke, Equity Bank, etc

**(1) Objectives of commercial banks**

For commercial bank to attain sound Commercial balancing targets, it has to pursue the following objectives:

**(a)Security objectives**

The commercial bank has to guard against loss of credit through default of repayment. The banks **endeavour** not to tend if there is any risk of inability to pay.

**(b)Profitability objectives**

A commercial bank has to invest in profitable ventures and also has to lend out for a rate of interest so as to raise dividends for shareholders (owners).

**c) Liquidity objective**

A commercial bank has to ensure that there is always liquid cash to meet the day to day needs of the customers. A commercial bank is supposed to pay the customers on demand without any notice.

**(2) Functions of commercial banks**

**a) They accept deposits and keep them safety**

Commercial banks accept deposits, in four types of accounts maintained on behalf of customers**.**

**i) Current account**

They are also called demand deposit accounts. Money in the current account do not earn interest in stead the banks charge a fee on them called **ledger fee**

**ii) Savings Accounts**

In these accounts cash withdrawal is usually done at specified interval. E.g. Every seven days or once per a week. Instead of cheques, specially designed forms are used for withdrawals. Balances in these accounts usually earn interest

**iii) Term deposit**

These are **fixed deposit accounts** where with drawls cannot be made until the expiry of some pre-greed duration such as six months, one year, two years, etc.

These accounts do earn interest depending on the deposit amount and period. Time deposits are highly preferred by banks because they can freely trade with it during the deposit period when the owner is not expected to withdraw it.

**b) Giving loans**: Bank accepts deposit not for their own sake but lends them and thus makes profit from interest charged on loans. Loans are actually a major source of income for banks.

**c) Safe keeping of valuable articles and documents. E.g. Wills**

Commercial banks do accept valuable items such as jewerllery, certificates etc, for sake custody for their clients at a fee.

**d)They exchange currencies for customers**

**(P**rovision of Foreign exchange)

**Mo**st commercial banks maintain foreign exchange department to cater for foreign exchange needs of customers or anybody interested in buying or selling foreign exchange.

**b) Giving loans**: Bank accepts deposit not for their own sake but lends them and thus makes profit from interest charged on loans. Loans are actually a major source of income for banks.

**e)Giving loans and overdrafts to customers**

The loans may be short term, medium term or loan at short call and short notice.

f) **Investment consultancy and funds Management**

Commercial banks also advice their clients on various investment opportunities such as stock markets. They can also undertake to manage client’s funds independently by investing such funds in the most profitable ventures. This is usually done for pension funds of corporate client.

g) They facilitate easy and quick payments of debts by cheques or standing orders. A standing order is a form from the customer authorizing the bank to pay regular payments to creditors. E.g. Payments for rents, insurance etc

**h)Executor and trustee services:**

The banks can also undertake to manage estates of deceased clients on behalf of the family of the deceased. I. e they look after the property of deceased customers and distribute their assets as laid down in the will.

**i) They create deposit money through credit creation**

j) They facilitate international trade by selling travelers cheques to customers wishing to travel to other countries. E.g. T.P.A travelers cheques.

**k) They discount bills for customers**

**Note: The difference between a loan and overdraft**

**I**n case of loan, there is a formal contract between the banks the borrower and the interest is paid usually on a monthly basis. An overdraft is when the customer draws more money on his/her account than he/she has deposited there. The amount of overdraft is simply noted on the customer’s account and interest is paid on the amount overdrawn.

**(4)Assets and Liabilities of Commercial Banks**

**Assets**: assets refer to what Commercial banks own or what it has or what belongs to it. These include the following.

* Cash held by the bank and cash due from other banks
* Liquidity assets like loans to bills brokers
* Bills Discounted for customers
* Investments in securities of short and long term nature
* Advances to customers e.g. loans and over drafts to customers
* Investments in other business ventures
* Deposits or reserves with the central bank
* Time deposits with other banks and financial institutions
* Fixed assets like buildings
* Acceptances and guarantee by other parties.

**Liabilities**: Liability of a commercial bank is what a bank owes other parties. It is what the bank must pay other parties. Liabilities can also be referred to as claims on the commercial banks. The liabilities include the following:

1. Share capital of the bank
2. Reserves of other banks with the bank
3. Current savings and time deposits by the customers
4. Time deposits from other commercial banks
5. Time deposits from other non-bank financial intermediaries and government
6. Obligations on behalf of customers
7. Cheques drawn on the bank by other banks
8. Bills discounted with the central bank
9. Dividends payment due
10. Acceptance and guarantees on behalf of the customers.

***9.4. Central bank***

The central Bank is a bank established by the government to control the banking system, formulate, and manage the monetary policies for the economy. It also stabilizes prices (low inflation rate).

E.g.: NBR = National Bank of Rwanda

**(i)Difference between commercial banks and central bank**

|  |  |
| --- | --- |
| Commercial Banks | Central Banks |
| * 1. Aims at making profit   ( profit making Bank )   * 1. creates credit through lending   2. Commercial banks are not authorized. Organizes the printing of money   3. Accepts deposit from the public   4. does not formulate monetary policy   5. is owned by the shareholders( Public) who may be individuals or the government or both   6. does not control other financial institutions   7. is answerable to its shareholders   8. is not a bankers bank   9. provide safe custody for valuable items   10. is a joint stock bank   11. can look after the property of decreased customers | 1. Non – profit making. It is for serving in public interest  2. Doesn’t create credit  3. It is an institution legally authorized to issue country‘s currency to print money.  4. Doesn’t accept deposit from the public. only government institutions can operate accounts with the central Banks  5. Formulate monetary policy  6. Must be owned by the government  7. Controls all other financial institutions  8. Is answerable to government  9. is a banker’s Bank  10. Does not provide safe custody for valuable items  11. Is a statutory bank  12. Does not provide trustee services |

**(ii) Functions of central bank**

**a) Stabilization/ Regulatory Functions**

i) It regulates credit and the rate of interest through its monetary tools.

ii) It is the financial advisor to the government

iii) It controls monetary supply in the economy

iv) It maintains price stability i.e Controls inflation

V) It stabilizes the external value of the currency i.e it controls or regulates the exchange rate.

**b) Central functions**

**i**) It maintains the financial and monetary control over the commercial banks and other financial institutions

ii) It supervises the commercial bank’s operations

iii) It provides the operational license to the commercial banks

**(c)Financing function**

**i)** It is the lender of last resort to the commercial banks i.e. it lends money to the commercial banks when they are in temporary financial difficulties

**ii)** It issues currency on behalf of government

iii) It manages and deals in government public debts

iv) It rediscounts bills for commercial banks.

(v)It pays s interest on the public debts marketing the government securities and advices the government on economic policy.

**d) Banking Functions**

i) It is the banker to the government but not to individuals i.e it maintains accounts for the government and its institutions and ministries

ii) It is a banker’s bank .i.e every commercial bank in the county is bound by laws to keep a certain percentage of all their deposit with the central bank.

iii) It also keeps and maintains the foreign exchange reserves of the country.

iv)It is a clearing house for all commercial bank

**(iii)The Monetary policy**

The monetary policy is a deliberate set of actions by the government to control (increase or reduce) the demand and supply of money in the country. Money supply may be expanded (increased by making borrowing easy) to stimulate the economy. Alternatively, money supply may be restricted (decreased by making it hard to borrow).

**Objectives of Monetary Policy in LDC**

1. To stimulated economic growth in the country
2. To attain and maintain full employment level in he economy
3. Maintenance of domestic price stability
4. Prevision of monetary incentives to prospective investors or entrepreneurs
5. Attainment of balanced growth and development of the economy
6. Attainment of equitable distribution of income
7. Maintenance of stable balance of payment
8. To combat monetary and demand pull inflation
9. To create broad and continuous market for government securities
10. To maintain a low structure of interest rate
11. To ensure that government deficits are financed at lower interest rates.
12. To foster savings of the community

**Tools of Monetary Policy**

**1. Open Market Operation (OMO)**

Open Market Operation is simply the stocks (titres) market where everybody is free to buy and sell company stocks including the government securities

This is a measure which involves the buying and selling of government securities (bonds) by the central bank through commercial banks to or from the general public so as to stabilize the economic conditions during periods of depression or recession and inflation.

a) During the period of inflation when there is need to reduce the amount of money in circulation, the central bank removes money from the public by selling to them (public and institutions) the securities.

b) During depression or recession when there is scarcity of money, the central bank injects money into the economy by buying securities from the public through the commercial Banks.

**2. Bank rates (Interest Rates)**

a) When the economy is experiencing inflation, the central bank raises the bank rate so as to discourage the public from borrowing but instead to encourage them to save with the banks and helps to control the inflationary pressure.

b) During recession when there is Scarcity of money, the central bank lowers bank rates so as to increase the amount of money in circulation.

c) As central bank acts as lender of last resort, can also make cash available to the commercial banks by either

i) Lending cash directly at a low interest rate

ii) Buying approved short-term securities

**3. Legal reserve requirement**

The legal reserve requirement is the fraction of deposits which commercial banks are required by the law to keep with the central bank

a) During inflationary period, the central bank raises the legal reserve requirement in order to reduce the capacity of commercial banks to lend money. It may also increase the cash ratio.

b) During the period depression, to expand credit and boost the economy, it lowers the legal reserve requirement so as to increase the capacity of commercial banks to lend to the public

**4. Special Deposits Requirements**

These are deposits which the central bank directs the commercial banks to keep with the central bank over and above the legal reserve requirement: without interest on such funds.

During times of inflation, this deposit reduces the ability of banks to lend. It is normally used during period of inflation only.

**5. Selective/ Discriminatory credit control**

The central bank gives specific instruction to commercial banks to favour or discriminate against certain sectors of borrowers in the economy. This action is intended to control the flow of credit into different activities in his economy. Under this the central bank issues directives from time to time to commercial banks asking them to give or not to give loans for any specific purposes.

The central Bank may also set maximum limits for loans that commercial banks can lend to any borrower.

**6. Moral Suasion**

The central bank may appeal to moral and patriotic inclinations of the banks to either contract or expand the level of their credit creation to help the government attain its economic objectives.

In other words, this is the issuing of persuasive instructions by the central banks requiring their cooperation in the implementation of the monetary policies

## 9.5. Cooperatives

A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise. It may also be defined as a number of individuals or businesses work together to achieve a common purpose.

**Main features/ characteristics of a cooperative**

* Owned and managed by the workforce.
* The workload and decision making is shared.
* In large co-operatives it is commons to find that a manager is appointed to manage the day to day matters of the business
* Every member has equal voting rights
* Major objective of rendering service to the members
* Profits are shared equally
* Voluntary organization

**Type of co-operatives**

There are several types of co-operatives

1. Consumer co-operative societies

2. Producer cooperative societies

3. Marketing or trader co-operatives

4. Transport cooperative societies

5. Worker co-operatives

6. Savings and credit cooperative societies

**(i)Consumer Co-operative societies**

These cooperatives are formed with aim of trading. The people come together for the purpose of buying goods at cheap prices and selling them to members at relatively low prices. Each member pays a membership fee and buys share(s)

**(ii)Producer Cooperative Societies**

It deals with the marketing of agricultural products and some of them are involved in production.

**(iii)Transport Cooperative Societies**

As the name implies, they deal with transportation

**(iv)Savings and Credit Cooperatives**

These cooperatives mobilize savings and provide credit to members

**Advantages**

* It easier to form a co-operative compared to a company
* It has limited liability
* Perpetual existence – death, insolvency or retirement of a number does not affect it since it is a separate legal entity.
* Enjoys economies of scale e.g. farmer co-operatives
* Enjoys state assistance since many African governments have adopted co-operatives as an effective tool of socio- economic change

**Disadvantages**

* **Lack of business acumen(good judgment)** –co-operative many find it difficult to raise finance since banks are not so willing to lend them money because their main aim is not to make a profit
* **Slow decision** – **making** process due to the system of one member one vote
* Lack of profit motive breeds fraud and corruption in the management.
* **Lack of mutual interest** – idealistic and ethical aims may not be agreeable with all members.

**The role of cooperatives in Less Developed Countries (LDCs)**

* Financial assistance: They credit to members.
* Creation of employment opportunities
* Transporting and marketing of produce
* Provide storage facilities for raw materials and or finished products
* Educating farmers how to use fertilizers and so on
* Provision of farm inputs
* Tractors hire: They may buy tractors that may be hired at low rates by members
* Transformation of the economy from subsistence to monetized one

**Problems faced by cooperatives**

* Leadership problems (Poor management): There is inadequate accounting experts
* Limited fund to attract training managers in the field of accounts
* Financial problems: They lack finances and this is mainly for three reasons, namely: members are reluctant to pay their subscriptions; sometimes funds are mismanaged by employees; and members are reluctant to pay back funds borrowed from cooperative
* Poor transport facilities e.g. some cooperatives lack motor vehicles
* Lack of infrastructure like roads and those existing infrastructure may be in poor condition
* Lack of spare parts for machinery etc owing to being expensive
* Lack of storage facilities like buffer stocks
* Government interference
* Conservatism: Farmers are reluctant to learn new methods of production and hence limited output and poor quality

## 9.6. Micro finances

Microfinance is the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services.

Microcredit, or microfinance, is banking the unbankables, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral. In general, banks are for people with money, not for people without.

Microcredit is based on the premise that the poor have skills, which remain unutilized or underutilized. It is definitely not the lack of skills that make poor people poor. charity is not the answer to poverty. It only helps poverty to continue. It creates dependency and takes away the individual’s initiative to break through the wall of poverty. The other services according to microfinance are ***micro savings***, money transfer vehicles and ***micro insurance***.

Microcredit is an innovation for the developing countries. Microcredit is a service for poor people that are unemployed, entrepreneurs or farms who are not bankable. The reason why they are not bankable is the lack of collateral, steady employment, income and a verifiable credit history, because of this reasons they can´t even meet the minimal qualifications for a ordinary credit.

By helping people with microcredits it gives them more available choices and opportunities with a reduced risk. It has successfully enabled poor people to start their own business generating or sustain an income and often begin to build up wealth and exit poverty.

Microcredit belongs to the group of financial service innovations under the term of microfinance, by helping people with microcredits it gives them more choices that are available and opportunities with a reduced risk. It successfully enables poor people to start their own business generating or sustain an income and often begin to build up wealth and exit poverty.

Microcredit plays an important role in fighting the multi-dimensional aspects of poverty, increases household income, which leads to attendant benefits such as increased food security, the building of assets, and an increased likelihood of educating one’s children, reduces the vulnerability to external shocks like illness, weather and more. Microfinance is also a means for ***self*-*empowerment***.

Women are in most cases responsible for children, and in poor conditions, it results in physical and social underdevelopment of their children. 1.2 billion People in the world are living on less than a dollar a day. There are many reasons why women have become the primary target of microfinance services. A recent World Bank report confirms that societies that discriminate on the basis of gender ***pay the cost of greater poverty***, ***slower economic growth***, ***weaker governance, and a lower living standard for all people***. At a macro level, it is because 70 percent of the world’s poor are women. Women have a higher unemployment rate than men in virtually every country and make up the majority of the informal sector of most economies. They constitute the bulk of those who need microfinance services.

Giving women access to microcredit loans therefore generates a multiplier effect that increases the impact of a microfinance institution’s activities, benefiting multiple generations.

* **Role of Microfinance Banks in Promoting Entrepreneurship in Rural Areas**

**Credit Delivery**

This is perhaps one of the most important roles of Microfinance banks, as the loans extended are used to expand existing businesses and in some cases to start new ones

**1. Boosting Small Scale Enterprises/Agriculture**

About 60 percent of poor people in the country live in the rural areas and 90 percent of them are farmers and artisans. Microfinance banks have therefore been the main sources of funding to these less disadvantaged groups. Rural people are empowered through microfinance loans and services, and hence small-scale agricultural practice and microenterprise is developed. Governments go into co-operatives to partner (collaborate) with the microfinance banks to raise bulk loans to be disbursed to the beneficiaries, in so doing the banks are increasing and sustaining the number of people going into small businesses.

**2. Employment Generation**

Agriculture and microenterprises contributes immensely to job creation, and are of particular interest to all Microfinance Bank in rural areas. Microfinance banks have so far engaged in extending credits and other services to many rural enterprise and hence generating employment and promoting entrepreneurship. The promotion of employment in rural areas by microfinance banks covers the following areas; blacksmithing agriculture, gold-smiting, watch repairing, bicycle repairing, basket weaving, barbing, palm wine tapping, cloth weaving, dyeing, food selling, carpentry, brick-laying, pot-making, leather works and drumming. Even though found in urban areas, these industries are more prominent in the rural areas. It has, therefore, been acknowledged that the rural setting is an arena of many industries, which could be developed to contribute significantly to the national economy, just as rural people are more frequently self-employed

**3. Improvement in Skill Acquisition**

Improvement of the condition of women through the provision of, skills acquisition and adult literacy is another role played by microfinance banks. This is done through building capacities for wealth creation among enterprising poor people and promoting sustainable livelihood (source of income) by strengthening rural responsive banking methodology and the introduction of simple cost-benefit analysis in the conduct of businesses.

**4. Facilitates Poverty Alleviation**

Employment and income generation are important aspects of poverty alleviation efforts. Microfinance banks have accelerated the operation of government poverty alleviation programmes and in doing that promising entrepreneurs are supported and new ones emerged. To achieve the United Nation’s Millennium Development Goals (MDGs) by 2015 required these microfinance institutions for success. The success of these programmes and projects for advancement of the MDGs are linked with the promotion of entrepreneurs in rural areas and subsequent reduction in the level of poverty (K

Other roles played by microfinance banks include; reorientation of the rural populace on a sound financial practices, as well as issues such as reproductive health care, and girl child education. All these areas have a direct link with entrepreneurial capabilities of the rural people.

**Challenges facing Microfinance Banks**

**(i) High Operating Cost**: Small Units of services pose the challenges of high operating cost, several loan applications to be processed, numerous accounts to be managed and monitored, and repayment collections to be made from several locations especially in rural communities.

**(ii) Repayment Problem:** Loan default is a major threat to microfinance banks’ sustainability; it is the deadly "virus" which afflicts the operation of the banks. It demoralizes staff and deprives beneficiaries of further valuable services.

**(iii) Inadequate Experienced Credit Staff**:

Micro financing is more than dispensing loans, to be viable, microfinance banks require experienced and skilled personnel. As a young and growing industry, there is a dearth of experienced staff in planning, product development and effective engagement with clients.

**(iv) Problems of illiteracy**, which affects record keeping and decision-making ability of borrowers and consequently affects their relationship with the banks.   
**(v)** Inadequate or non-monitoring of micro and small enterprises by banks, leading to defaults

## 9.7. Bank deposits

### 9.7.1. Definition

**Deposit**: money deposited in a bank or some similar institution.  
In deposit terminology, the term Bank Deposit refers to an amount of money in cash or checks form or sent via a wire transfer that is placed into a bank account.

The target bank account for the Bank Deposit can be any kind of account that accepts deposits.  
For example, a Bank Deposit is generally made when opening an account or in the course of routine business or personal transactions that involve placing funds with the bank for future use. Bank deposits can be made in a number of different ways. The most direct way is to walk into a bank or a bank branch in which you hold an account. You are then usually required to fill in a Bank Deposit slip with the particulars of your account and the amount of money you wish to deposit. In addition, Bank Deposits can be made via wire transfer, as well as through a direct deposit plan from employers in many cases.

### 9.7.2. Importance of bank deposits

* Security
* Facilitate the use of available deposits
* Facilitate the access to bank loans

### 9.7.3 . Forms of deposits

The following are accounts maintained by commercial banks:

**(1) Current or demand deposit account**

These are accounts which can be drawn only by cheques at anytime and no interest is payable on the deposits. The basic features include the following

i) Deposit is made through deposits slips or pass book (carnet de banque)

ii) Withdrawals are made through cheques only. The clients hold chequebooks.

iii) Withdrawals can be made by any time on demand

iv) No interest is payable on the account

Banks Impose charges or ledger fees on the account

vi) No restrictions on the withdrawals

vii)No notice of withdrawals is required

viii) No minimum balance required

**(2)Savings Accounts**

These are accounts which are withdrawn by pass book and a small rate of interest is payable. The basic features include the following:

* They are through savings pass book or deposit slip
* Withdrawals are through the savings pass book. Though some books these days offer cheques
* Minimum Deposits initial deposits are required.
* Low interest is payable on the account
* Minimum balances must be maintained
* Withdrawals are regulated
* Notice of withdrawals beyond certain amount required

**(3)Time or Fixed Deposit Accounts**

These are account to which attract high interest rates and money is kept for a specified contract period of time. The basic features include the following:

(a)Money is kept for a specific contract period

(b)High interest is payable if the withdrawal is made before the end of the

Contract period

(c) No interest is payable if the withdrawal is made before the end of the contract period

**Collection account**

Some businesses and organizations open up account for receiving payments. For example: Schools have collection accounts for receiving school fees. Such accounts are only suitable for businesses that collect a lot of money from very many people.

## 9.8. Bank Credit

Bank credit has to do with the amount of funds that an individual or a business may be able to borrow from one or more lending institutions. Assets such as property, savings and stock accounts, current indebtedness, employment status and annual net [salary](http://www.wisegeek.com/what-is-a-salary.htm) or wages, and overall credit rating are all components that factor into determining the bank credit of the applicant.

### 9.8.1. Definition of credit

**Credit** is the **trust** which allows one party to provide ***r*esources** to another party where that second party does not **reimburse** the first party immediately (thereby generating a ***debt***), but instead arranges either to repay or return those resources (or other materials of equal value) at a later date. The resources provided may be financial (e.g. granting a **loan**), or they may consist of **goods or services** (e.g. consumer credit). Credit encompasses any form of deferred payment. Credit is extended by a ***creditor***, also known as a ***lender***, to a ***debtor,*** also known as a**borrower.**

Credit does not necessarily require **mone*y***. The credit concept can be applied in barter economies as well, based on the direct exchange of goods and services (Ingham 2004 p.12-19). However, in modern societies credit is usually denominated by a ***unit of account***. Unlike money, credit itself cannot act as a unit of account.

Movements of ***financial capital*** are normally dependent on either credit or *equity* transfers. Credit is in turn dependent on the reputation or *creditworthiness* of the entity, which takes responsibility for the funds. Credit is also traded in financial markets.

### 9.8.2. Types of credit

* [Mercantile or commercial credit](http://en.wikipedia.org/w/index.php?title=Mercantile_or_commercial_credit&action=edit&redlink=1)
* [Investment credit](http://en.wikipedia.org/wiki/Investment_credit)
* [Bank credit](http://en.wikipedia.org/wiki/Bank_credit)
* [Consumer or personal credit](http://en.wikipedia.org/w/index.php?title=Consumer_or_personal_credit&action=edit&redlink=1)
* [Real estate credit](http://en.wikipedia.org/w/index.php?title=Real_estate_credit&action=edit&redlink=1)
* [Public or government credit](http://en.wikipedia.org/w/index.php?title=Public_or_government_credit&action=edit&redlink=1)
* [International credit](http://en.wikipedia.org/w/index.php?title=International_credit&action=edit&redlink=1)

**1. Trade credit**

The word *credit* is used in commercial [**trade**](http://en.wikipedia.org/wiki/Trade) in the term "[**trade credit**](http://en.wikipedia.org/wiki/Trade_credit)" to refer to the approval for delayed payments for purchased goods. Credit is sometimes not granted to a person who has financial instability or difficulty. Companies frequently offer credit to their customers as part of the terms of a purchase agreement. Organizations that offer credit to their customers frequently employ a [credit manager](http://en.wikipedia.org/wiki/Credit_manager).

**2. Consumer credit**

Consumer debt can be defined as ‘money, goods or services provided to an individual in lieu of payment.’ Common forms of consumer credit include [credit cards](http://en.wikipedia.org/wiki/Credit_card), store cards, motor (auto) finance, personal loans ([**installment loans**](http://en.wikipedia.org/wiki/Installment_credit)), [**consumer lines of credit**](http://en.wikipedia.org/wiki/Line_of_credit), retail loans (retail installment loans) and [**mortgages**](http://en.wikipedia.org/wiki/Mortgage_loan).

The cost of credit is the additional amount, over and above the amount borrowed, that the borrower has to pay. It includes [***interest***](http://en.wikipedia.org/wiki/Interest), arrangement fees and any other charges. Some costs are mandatory, required by the lender as an integral part of the credit agreement. Other costs, such as those for[***credit insurance***](http://en.wikipedia.org/wiki/Credit_insurance)***,*** may be optional. The borrower chooses whether or not they are included as part of the agreement.

**3. Investment credit or investment tax credit**

The investment credit is the tax incentive that permits companies or individuals to deduct a specified percentage of certain investment costs from their tax liability in addition to the normal allowances for [**depreciation**](http://encyclopedia2.thefreedictionary.com/depreciation). Investment credits are ***similar to investment allowances***, which permit investors or businesses to deduct a specified percentage of certain capital costs from taxable income. Both investment credits and investment allowances differ from accelerated depreciation by offering a percentage deduction at the time an asset is purchased. In effect, the credits are [**subsidies**](http://encyclopedia2.thefreedictionary.com/subsidy) for investment.

The U.S. adopted investment credits and investment allowances in 1962 in order to protect domestic business from foreign competition but have since been applied toward the support of energy conservation, pollution control, or various forms of desirable economic development.

**i) Government Debts** refers to the total money, which a country owes to its various creditors both internally and externally.

**ii) National Debt** is the debt owed by the central government to people and institutions within its own borders (internal debts) and to foreign creditors (external debts). It is therefore the debt, which a central government owes to its both nationals and outsiders but does not include the debts incurred by the local authorities.

**iii) Public Debt** includes the national debts plus the debts incurred by the local government authorities and public corporations

**What are types of public debts?**

The types of public debts are:

**(i)Reproductive debts** (these are self-liquidating debts, which are incurred for the purchase of real assets

**(ii) Dead Weight Debts** (They are non- self-liquidating loans/debts). Such debts mainly are borrowed to finance recurrent expenditure with no real assets e.g. debts incurred to finance wars. These are mainly characteristic of national debts

**(iii)Funded debts** refer to the debts, which have interests attached to them but have no fixed dates of repayment. They are debts with no obligations on the part of the government to pay back at a fixed future date.

**(iv)Unfunded debts** refers to the debts with a fixed periods i.e. its maturity is fixed for a certain duration e.g. 10 years, 20 years, etc

**(v)Floating debts:** These form part of national debt and consist of short-term borrowings by the government. They mainly consist of treasury bills and other advances by the central bank to the government

**What are the causes of public debts/national debts?**

The causes of public debts are rising energy (oil) prices, World recession, increased interest rates, limited revenue from taxation, to meet desired expenditure of the government, need to fill the savings gap, debt servicing, financing ambitious development plans like dams, airports, etc, fill the manpower gaps to pay expatriates, to finance natural calamities, to supplement the budget deficit,

**What is the government Budget?**

The government budget is a fiscal statement of the revenue and expenditure estimates of the government for a particular accounting period usually one year. It is usually prepared on annual basis and presented by the minister of finance before the parliament for approval

**What are types of budget?**

Types of budget are:

**1. Balanced budget:** Fiscal Revenue equals proposed Expenditure in the financial year i.e. planned expenditure equals planned revenue

**2. Unbalanced budget:** Planned expenditure and revenue are not equal

**3. Surplus budget:** Proposed government revenue is greater than planned government expenditure

**4. Budget deficit:** Planned expenditure is greater than planned revenue

### 9.8.3 . Forms of credit

#### 9.8.3.1 . Forms of credit according to the destination

* **Treasury Bills ,Notes, Bonds and Shares**

The credit may be taken from the bank for buying government securities such as Treasury bonds, bills, Notes and shares.

**What are capital markets?**

The capital market is the market of securities, where companies and governments can raise long-term loans. The capital market includes the **bond market, collective investment schemes,** and the **share (stock) market.**

The capital markets are the mechanism that allows the exchange of money between companies and investors, companies and banks, and investors and banks as each party seeks to raise capital or put capital to work.

There are basically three capital market products i.e. investing in Bonds, collective Investments Schemes (CIS), and Investing in Shares (Stocks)

**A. Investing in Bonds**

The bond is a debt security, similar to an I.O.U. When you purchase a bond, you are lending money to the government, corporation, or other entity known as the issuer. In return, of the loan, the issuer promises to pay you a specified **rate of interest** during the life of the bond and to repay **the face value** of the bond (**the principle amount)** when it measures, or comes due.

Among the types of bonds you can choose from are ***government securities and corporate bonds***

**a)Government securities**

The government securities include Treasury Bills (**T-Bills)**, Treasury Notes **(T-Notes)** and Treasury Bonds (**T-Bonds).** They are marketable securities the government sells (through banks) in order to control inflation and also raise the cash needed to run the government. When you buy one of these securities, you are lending money to the government.

T-bills, Notes and Bonds are sold at auction and can be bought for more or less than the face value, depending on demand. They can also be resold on the open market, and the price can fluctuate further. The interest rate is paid every six months, and does not change throughout the term of the product. If you hold onto them until maturity, you will get the face value plus interest, no matter what you paid for them at auction.

T-bills, Notes and Bonds are monetary policy instruments central bank, on behalf of the government uses to manage money supply. A lender/ investor pays the government some money and six or 12 months or 2 months, etc years later, the government pays that money back, with interest.

However, unlike a regular savings account, you do not receive interest on your bonds until they mature. A simplified example to illustrate this is-let’s say a 364-day T-bill is yielding 5%. You could buy a Sh 100,000treasury bill for Sh 95,000 (a discount), and one year from now, you would receive Sh 100,000 back, 95,000 which is return of your principal and Sh5, 000 of which is your interest (Sh 100,000x5%).

**Differences between T-bills, T-notes and T-bonds**

* Treasury bills are issued for terms less than a year
* Treasury notes are issued in terms of 2, 3, 5, and 10 years
* Treasury bonds are issued in terms of more than 10years-30years

**b) Corporate bonds**

Corporate bonds are issued by various corporations, and rated as to their risk. The higher the risk, the higher the return the corporation must promise. These bonds are less safe than government bonds, since there is a chance the company can go bankrupt and default on the bonds.

Corporate bonds offer corporations a relatively safe way to gain funds for investment in the company’s growth. Alternative is to go public and raise equity by selling shares/stocks. This is a long and expensive procedure. Selling bonds, while still complicated, is relatively much easier and provides a quicker way to raise capital for corporate expansion.

**Factors considered when investing in bonds**

**(i)Interest rate**

The Bonds pay interest that can be fixed, floating or payable at maturity. Most debt securities carry an interest rate that stays fixed until maturity and is a percentage of the face (principal) amount.

**(ii)Maturity**

A bond’s maturity refers to the specific future date on which the investor’s principal will be repaid. Bonds maturities generally range from one day up to 30 years. In some cases, bonds have been issued for terms of up to 100 years.

**(iii)Call provisions (Favors the issuer most)**

Some bonds have redemption or provisions that allow or require the issuer to repay the investors principal at a specified date before maturity.

**(iv)Puts (Favors the investors)**

Some bonds have puts, which allow the investor the option of requiring the issuer to repurchase the bonds at specified times prior to maturity.

**(v)Principal payments and Average Life**

Your choice of maturity will depend on when you want or need the principal repaid and the kind of investment you are seeking within our risk tolerance. Some individuals might choose short term bonds for their comparative stability and safety, although their investment returns will typically be lower than would be the case with long term securities.

**(vi)Yield**

It is the return you actually earn on the bond based on the price you paid and the interest payment you receive.

**(vii)Current yield**

This, is annual return on the amount paid for the bond and is derived by dividing the bond’s interest payment by its purchase price.

**(viii)Yield to maturity and yield to call**

-The yield to maturity equals all interest you receive from the time you purchase the bond until maturity.

-Yield to call is calculated in the same way as yield maturity, but assumes that a bond will be called and that the investor will receive face value back at the call date.

**B. Collective Investment schemes (CISs)**

These are private financial arrangements. They pool resources of many small savers, generating a large pool. The resources are then invested in various assets like shares, bonds, property, etc with the sole purpose of generating high returns while minimizing risks through diversification of investments.

Collective investment schemes are pools of funds that are managed on behalf of investors by professional money manager. The manager uses the money to buy stocks, bonds, or other securities according to specific investment objectives that have been established for the scheme. In return for putting money into these funds, the investor receives shares or units that represent his/ her pro-rata share of the pool of fund assets.

Collective Investment Schemes provide a means for mobilization of savings and enable small investors to participate in capital markets.

**C. Investing in Shares**

The share (or stock) is a stake in a company. When you buy a share, you become a part owner or a shareholder of the company

**Types of shares**

**i)Ordinary shares(Equity shares)**

These are shares or stocks that give the shareholder part ownership of the company in proportion to the number of shares held. The shareholders have voting rights and can appoint and dismiss directors. If the company makes profits, they are entitled to a share of it in the forms of dividends, if declared, which are based on proportionate ownership. In the event of liquidation, ordinary shareholders are paid last after every one else has a claim on the company’s assets has been paid.

**ii)Preference shares**

Preference shares bear a fixed annual rate of dividend with priority over all ordinary shares in distribution of dividends from annual profits have prior claim to repayment on winding up the company. The shareholders in this category have no voting rights in a company, but are given priority with regard to dividends and repayment in the event of winding up.

**iii)Redeemable Preference shares**

These are shares that can be redeemed (paid back to the shareholder) by the company either at the fixed dates and prices, or on certain specified terms at the discretion of the board.

**Advantages of owning shares**

* **Dividends**
* **Capitalgrowth**: If the company is growing, the value of share will also grow
* **Capitalgain**: When shares are sold at price that is higher than the price at which they were purchased, this represents a profit. This profit is called capital gain.
* **Votingrights*:*** Shares give a shareholder the right to attend and vote on important company policies at the company’s Annual General Meetings including making a choice on the directors of the company
* **Collateral*:*** Shares may be accepted as collateral (for example security for a loan)
* **Transferability**: Shares are negotiable and can be passed on to another person; and they can be inherited

**Disadvantages of owning shares**

* **Share prices:** The share prices can go down or up depending on number of factors such as the performance of the company, demand and supply factors
* **Ifthecompany’sprofitsfall*:*** The fall in the profits result if fall of the dividends and when the company makes loss it may not be able to pay any dividend
* **Ifthecompanygoesintoliquidation*,*** the shareholders are the last to be paid after all other creditors
* **If the share prices fall,** their value lessens and if the company collapses or becomes insolvent, the shares become worthless

**How are the shares bought and sold?**

Shares can be bought either during the offer period or from existing shareholders. New issues of shares usually take the form of Initial Public Offerings (IPOs), where shares are sold in a primary market. The purchase from existing shareholders takes place in a secondary market.

**Primary Market**

This refers to the purchase of shares in an Initial Public Offerings (IPOs), whereby a company offers its shares to members of the public for the first time. To buy these shares, a share application for (SAF) is obtained from participating brokers/dealers and authorized selling agents, which is completed by the prospective investor

The Share Application Form (SAF) is then sent to the Leader Broker and Registrar for processing, where the share allocation is made. Once payment is made, a receipt is issued to the purchaser

**Secondary Market**

At the secondary market, shares can only be bought through a licensed broker/dealer, which is a firm that buys and sells securities on behalf of investors for a commission or a brokerage fee.

The broker/dealer or investment advisor will provide all the necessary advice, that is, which shares to buy. But the ultimate decision to invest your money is up to you, the investor. Before investing in shares, you should be clear about your own financial position and what you hope to achieve from your investment.

To sell shares, an investor needs to contact a broker/dealer and instruct him to sell either all or some of your shares.

* **Investments**

The public may contract a credit bank investing in different economic activities expecting the returns (profits)

## 9.9 . Forms of credit according to the beneficiaries

(i)Individual customer

(ii)Credit with the companies

### 9.9.1. Forms of credit according to the duration of refunding

* Short term credit
* Medium term credit
* Long term credit

## 9.10. Banking documents

* Withdrawal and deposit slip,
* Money transfer slip,
* Bank statement,
* **B**ankers card
* Bank checks

### 9.10.1. Bank cheques

**A** cheque is a written order by an account holder instructing the bank to pay a stated amount of money to a named person.

There are three parties of cheque. These parties are called Drawer, Payee and drawee respectively:

* **Drawer**: This is the account holder, who issues a cheque instructing the bank to pay a stated amount of money to a named person or business.
* **Drawee:** The bank that is instructed to make payments to a named person on behalf of the account holder
* Payee: a person or a business named on the cheque that is supposed to receive payment against the cheque.

### 9.10.2. Types of cheques

* **Bearer’s cheque:** This is a cheque on which the payee is not named such that any who presents it to the bank and receives payment. This is a very insecure way of writing cheques. If such a cheque is stolen, it can be used by the thief.
* **Open cheque:** A cheque that can be presented for payment across a bank counter. When an open cheque is presented to the bank, cash is paid immediately.
* **Crossed cheque:** A cheque with parallel lines across its face. This means that the cheque can not be presented for payment but instead must be banked and the payee gets money from the account on which the cheque is banked.
* **Post-dated cheque:** A cheque not yet due for payment. This means that the date on the cheque is a future date and the bank cannot pay it until that date.
* **Stale cheque:** A cheque that is more than six months old. Such a cheque cannot be paid by a bank.
* **Blank cheque:** A cheque that is signed but which does not show the amount of money to be paid. This means that the person with the cheque can write any amount.
* **Dishonoured cheques:** This is a cheque which, when presented, is **not** paid by the bank for certain reasons. This could be lack of insufficient funds or because it is not in order.

**A cheque may be dishonoured under the following reasons:**

* If the cheque is not signed by the drawer or if there are differences in the signatures.
* If the cheque is postdated i.e. when the cheque is presented for payment before its maturity date.
* If the cheque is stale i.e. a cheque presented for payment after a period of validity. More than six months after the date of issue.
* When the account is already closed by the drawer.
* When the cheque has no date on which it was written
* When the amount on the cheque is greater than the amount on the account.
* When the amount in words on the cheque differs from the amount in figures
* When the drawer is dead or bankrupt, then the cheque may be dishonoured.

### 9.10.3. Advantages of using cheques

* Acts as a record of payment
* Can be used for deferred payment or future payment by writing a postdated cheque.
* Convenient to use
* Crosed cheques can be sent by post safely compared to cash.
* Cheque allows the transfer of money without money leaving the bank.
* Ensures accuracy of payment: This is because mistakes made inn accounting large sum of money are avoided
* Evidence of payment in itself.
* It is very safe: Money can be stolen and be readily used by the thief but a cheque can be specifically crossed to enable payment to be made only to the named person and to his account
* Payment can be stopped where fraud is discovered by the drawer by instructing the bank not to pay

### 9.10.4. Disadvantages of using cheque

* Cheque books are paid for by the account holder.
* Cheque are not legal tender unlike cash.
* Cheques written to be paid by up country banks take long to mature and until then, the person paid would not access the money
* Cheques may be rejected by banks for reasons says, lack of sufficient funds, signature differed
* Given the illiteracy rate prevailing in the country, the majority of the people do not understand the functioning of cheques
* There is a delay in using the money since the cheques take a long time to mature compared to cash that is instantly available

# UNIT 10: ACCOUNTING

## 10.1. Meaning

Accounting is a systematic process on an information system that accumulates records, classifies, summarizes and report commercial transactions with the aim of showing the financial conditions of the business entity.

This information in the form of financial statement is then communicated to those who make decision concerning the operation of an enterprise.

***When we say Accounting we mean***

* Recording data
* Classifying data and summarizing data
* Communicating what has been brought from the data

In other words, accounting may be defined as the process of collecting, recording, summarizing and communicating financial information. .

**Purpose of accounting**

1. To record, classify, summarize and analyze commercial and financial transactions

2. Assessment of tax imposed by the government

3. Facilitate rational decision making

4. Measure the effectiveness or performance of the business (monitoring of management)

5. To establish the future planning

6. Ascertain the financial position of the business (profit or loss)

**Qualitative characteristics of accounting information**

* Understandability
* Relevance (timeliness)
* Reliability (free from error and bias)
* Comparability and consistency (comparison with other organizations)

## 10.2. Functions of accounting

* To reflect the claims against resources and the interest in the institutions
* To manage the resources held by specific entities
* To measure the changes in those resource claims and interest
* To assign the changes to specifiable period of time

## 10.3. Users of accounting information

* **Owners of the business:** the proprietor of the business will use this information in order to determine the performance of his business whether it is succeeding or failing.
* **Lenders:** lenders like banks will need accounting information in order to assess the financial capacity of the business to determine whether to give out the loan or not.
* **Customers:** those are clients of the business, they want to know/ be sure if the business can meet their demand condition (sustainability of supply)
* **Creditors:** They are business suppliers on credit. They need accounting information to assure if the business is credit worthy such that it meets their payments. They want also to know more about how long they will expect the payment.
* **Management/employers:** managers want to know about the financial strength of the business. They require the information related to profit sharing, job security and whether the business is still strong enough to continue existing
* **Government department:** those may include the revenue department such as RRA in (Rwanda Revenue Authority) Rwanda which uses the accounting information to determine the tax obligation or tax liability of the business.
* **Shareholders:** In the case of companies, those are investors who want to know that their investments in the business are secured and what the returns (dividends) are likely to be.
* **Local community:** the public need to know the extent to which the business is concerned about their welfare possibility of providing employment, pricing of products to decide whether there is need to get involved in.
* **Donors:** are those who give something especially money to an organization in order to help people. Before start, continue or stop the donation, they check accounting books to see the way the money offered has been used.

## 10.4. Accounting principles

In order to provide useful information to the users of financial statement, accountants must rely on the following principles:

* **Business entity concept:** business records must be independent of its owner’s transaction i.e. it could not experience the interference of the owner’s transaction.
* **Principle of consistency:** this principle states that when a business has once fixed a method for the accounting treatment of items, it will enter similar items that follow in exactly the same way. It requires that a particular accounting procedure, once adapted by a company, remains in use from one accounting product to the next.
* **Principle of sincerity:** This principle states that the accounting unit should reflect in good, faith and reality of the company’s financial status. (honest)
* **Principle of prudence/ conservatism concept:** this requires that the profit is not recognized until a sale has been completed, the accountant should anticipate some costs which can be made in future such as bad debts.
* **Principle of continuity:** when starting financial information one should assume that the business will not be interrupted (the business will continue to operate indefinitely). This implies that financial reports are prepared with the expectation that a business will remain in operation indefinitely which enables the accountant to project estimates for a long period in the future. It is also known as ***the going concern concept.***
* **Principle of periodicity:** each accounting entry should be allocated to a given period and split accordingly if it covers several periods. Comparison of financial statements is made possible through the use of accounting periods of equal length. The time period could be one month, in term (three months) or annual (twelve months).
* **Principle of full disclosure (materiality):** all information and value pertaining to the financial position of a business must be disclosed in the records. This means that any omission of one item may default the financial position either find a profit instead of loss and vice versa.
* **Historical cost:** this requires that the transactions are recorded at the price ruling at the time and asset at their original cost.
* **Principle of comparability:** it means that the information presented is such a way that the decision maker can recognize similarities, differences and trends between different companies or between different periods.
* **Accrual concept:** it refers to the recognition of items at the occurrence of the transaction and not when cash is received or realized.
* **Matching concept:** it requires that revenues from business activities and expenses associated with earning that revenue are recorded in the same accounting period.
* **Substance over from concept:** transactions and other events should be recorded with accordance to financial and economic reality (substance) other than their legal form. E.g. you can record the asset before you pay the totality of its price (last installment).
* **Duality concept (dual concept):** this is the basis for the double entry system of book keeping that stems from the fact that every transaction has a double (dual) effect on the position of a business as recorded in the accounts.

## 10.5. Branches of accounting

***i) Financial accounting:*** primarily concerned with record keeping directed towards the preparations of profit and loss account and balance sheet.

***ii) Cost accounting:*** it is the process of accounting towards the cost per unit of output.

***iii) Management accounting:*** primarily concerned with the supply of information which is useful in management

## 10.6. Book keeping

The part of accounting that is concerned with recording is often known as ***book keeping.*** Until about 100 years ago, all accounting data were recorded manually in books hence the term book keeping.

The main purpose of accounting for business is to assess if there was certain profit or loss for the accounting period.

In accounting period, there may be numerous financial transactions involved in the business. Without a proper method of recording transactions, it is not possible to remember the various financial receipts and payments taking place during a period of time.

* + To have permanent record of each transaction of the business and show its financial effect on the business.
  + To assess the combined effect of all the transactionsmade during an accounting period upon the financial position of the business as a whole.

## 10.7. Accounting cycle (process)

The accounting cycle refers to the complete process of recording business transactions and processing accounting data to generate useful financial information.

The accounting cycle starts from recording individual transactions in the books of accounts and ends with the preparation of financial statement and thee closing process. Having a proper cycle and procedure helps business organizations to ensure that their financial records are accurate and correct.

**Major steps in accounting cycle**

* Analyzing and recording transactions from source documents to journals
* Posting transactions to ledger accounts
* Preparing a trial balance
* Preparing a adjusting entries
* Preparing adjusted trial balance
* Preparing financial statement

## 10.8. The double entry system of book keeping

### 10.8.1. Accounting equations

By adding upward the accounting record say belongs to a business and deducting what they say the business owns, you can identify what business is worth accounting to those accounting records. The whole financial accounting is based upon this very simple idea. It is known as accounting equation. It can be explained by saying that if a business is to be set up and start trading it will need resource.

Let us assume just that is the owner of the business who has supplied all of the resources, this can be shown as

***Resources supplied = resources in the business of the owner***

In accounting, special terms are used to explain many things. The amount of the resources supplied by the owner is called **capital.** The actual resources that are then in the business are called **assets.** This means that when the owner has supplied all the resources, the accounting equation can be shown as:

***Capital = assets***

Usually, whoever person, other than the owner has supplied some of the assets, ***liabilities*** is the name given to the amount owing to these people for these assets. The accounting equation has now changed as to:

***Capital = Assets – Liabilities or Assets = Capital + Liabilities***

All transactions that are recorded in accounting have two aspects. One aspect is ***debited*** and another aspect is ***credited***.

Proprietor introduces capital in his business and his capital is also called ***equity.*** With this owner, equity assets are required

Example: Peter, started a business with Rwf 80,000 Capital hence cash of Rwf 80,000 is asset of the business and the business owes to Peter, the proprietor Rwf 80,000. This relationship between assets of business and proprietor’s capital or equity is what we have been called before ***accounting equation***.

***Assets = equities***

***Cash Rwf 80,000 = Capital/ equities Rwf 80,000***

***A =O E***

Here A stands for ***assets*** and E stands for ***owner’s equities***

* In the above example, if Peter purchases goods for Rwf 50,000 then the accounting equation will be as follow:

***Goods Rwf 50,000 + Rwf 30,000 cash = Owner’s Equity Rwf 80,000***

***Assets 80,000 = equities rwf 80,000***

* If Peter purchases some more goods of Rwf 20,000 on credit from Mr Steven, then the amount of Rwf 20,000 is payable to Mr Steven. Hence this amount is a *liability* of the business. Accounting equation will be as follow:

***Goods Rwf 50,000 + 20,000 + Cash Rwf 30,000 = owner’s Equity +Liabilities Rwf 80,0000***

***Assets Rwf 100,000 = OE Rwf 80,000 + L Rwf 20,000***

***A = OE + L,***

***A-L = OE,***

***100,000 – 20,000 = 80,000***

Here A stands for assets, E for equity and L for Liabilities

**Transactions of income statement**

These are also included in the accounting equation if goods of Rwf 20,000 are sold for Rwf 28,000 cash. There is a profit of Rwf 8,000 which belongs to the proprietor. This sale will also reduce stock of goods to the extent of Rwf 20,000. Hence the equation will be as follow:

***Goods 50,000 + (Cash 30,000 + 28,000) = owner’s equity (80,000 + 8,000) + Liability 20,000*** or

***Assets Rwf 108,000 = E Rwf 88,000 + L Rwf 20,000***

***A = E + L***

* Now out of cash, if proprietor pays the liability of Rwf 20,000, the accounting equation is as follow:

***Goods 50,000 + Cash (58,000 – 20,000) = OE 88,000.***

* The accounting equation is also called ***Balance sheet equation***

### 10.8.2. Double entry accounting system

Every accounting transaction affects two items. We need to show these effects when we first record cash transaction. That is, when we enter the data relative to the transaction in the accounting books, we need to ensure that we do so in a way that ensures that the items that were affected by the transaction and only those items are shown as having changed. This is the book keeping stage of accounting and the process we use is called ***double entry.*** You will often hear it referred to as ***double entry book keeping.*** Either term is correct.

If we want to show the double effect of every transaction, when we are doing our book keeping, we have to show the effect of each transaction on each of the two items it affects.

For each transaction, this means that a book keeping entry will have to be made to show an increase or decrease of the other item, from this description; you will probably see that the term ***double entry book keeping*** is a good one as each entry is made twice (double entry).

The basis of this system is that transactions which occur are entered in a set of ***accounts*** within the accounting book. Account is a place where all information relating to a particular asset or liability or capital is recoded.

Thus, there will be an account where all the information concerning office equipment will be entered. Similarly, there will be an account for building where all information concerned with building will be shown. This will be extended so that every asset, every liability and capital will each have its own account for transaction involving that item.

**Rules of double entry recording**

1. Every transaction affects at least two accounts
2. There must be at least one debit and one credit
3. The total debit must be equal to the total credit
4. The detail in the account refers to the name of the other account where double entry is recorded

The following diagram shows the application of the rules of double entry



**The accounts for double entry**

Each account should be shown on a separate page in the accounting book, the double entry system divides each page into two halves; the left hand side of each page pose is called the ***debit*** side while the right side of each page is called the ***credit*** side. The title of reach account is written across the top of the account at the centre. This is the layout of page of an account book.

***Title of account written here***

|  |  |
| --- | --- |
| *Left hand side of the page. This is* ***debit side*** | *Right hand side of the page. This is the* ***credit side*** |

Do you see how the people shape resembles a “**T**”? Not surprisingly.

These are commonly referred as **T accounts.**

Many students find it very difficult to make account entries in the accounts because they forget that ***debit*** and ***credit*** have special accounting meaning. Do not fall into that trap. You must not confuse any other meanings you know for those two terms with the accounting ones.

You describe the entries in the accounts by saying something like ***debit account “X”*** with $2 and ***credit account “Y”*** with $2, inserting the names of the accounts and the actual amount in place of X and Y. So for example, if you paid $10 by cheque for an inventory, you would say debit the inventory accounts will $10 and credit the bank account.

To actually make this entry, you enter $10 on the *left hand (i.e. debit) side* of the inventory’s account and on the *right hand (i.e. credit) side of the bank account*

As we said, the transactions increase or decrease assets, liabilities or capital.

In terms of Assets, Liabilities and capital:

* To increase an asset we make a debit entry
* To decrease an asset we make a credit entry
* To increase a liability or capital account we make a credit entry
* To decrease a liability or capital account we make a debit entry

Planning these in table organized by type of item, the double entry rules for book keeping are:

|  |  |  |
| --- | --- | --- |
| ***Accounts*** | ***To record*** | ***Entry in the account*** |
| Assets | An increase | Debit |
| A decrease | Credit |
| Liabilities | An increase | Credit |
| A decrease | Debit |
| Capital | an increase | Credit |
| a decrease | Debit |

Let us look again on the accounting equation

|  |  |  |  |
| --- | --- | --- | --- |
|  | Capital Assets Liabilities | | |
| To increase each item | Credit | Debit | Credit |
| To decrease each item | Debit | Credit | Debit |

The double entry rules for liabilities and capital are the same but they are the opposite of those for assets. Looking at the accounts, the rules will appear as:

***Capital account***

|  |  |
| --- | --- |
| Decrease  **-** | Increase  **+** |

***Any Asset account***

|  |  |
| --- | --- |
| Increase  **+** | Decrease  **-** |

***Any liability account***

|  |  |
| --- | --- |
| Decrease  - | Increase  **+** |

In a real business, at least one full page would be taken for each account in the account books.

The double entry system has accounts that are categorized as ***assets, capital, income, expenses*** etc.

As we said later an account may be presented in T-account format or columnar format.

***T-Account format (full presentation)***

As we said before in T-account format both debit and credit are presented an opposite side on the page as shown below:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| DR | Account name | | | | | | CR |
| Date | Particular | Ref | Amount | Date | Particular | Ref | amount |
|  |  |  |  |  |  |  |  |

Example: T-format

* On the 1st March 2011, DERBOATY the entrepreneur started a business by contributing Rwf 1.5 million cash as share capital
* On the 2nd March 2011, he bought a welding machine at Rwf 650,000
* On 5th March 2011, he bought raw materials (stock) at RWf 550,000 cash

Show DERBOATY’s business transaction relevant accounts

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| DR | Capital | | | | | | CR |
| Date | Particular | Ref | Amount | Date | Particular | Ref | amount |
|  |  |  |  | 1/3/2011 | Cash |  | 1,500,000 |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| DR | Cash | | | | | | CR |
| Date | Particular | Ref | Amount | Date | Particular | Ref | amount |
| 1/3/2011 | Capital |  | 1,500,000 | 2/3/2011 | W.Machine |  | 650,000 |
|  |  |  |  | 5/3/2011 | Raw Material |  | 550,000 |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| DR | Welding Machine | | | | | | CR |
| Date | Particular | Ref | Amount | Date | Particular | Ref | amount |
| 2/3/2011 | Cash |  | 650,000 |  |  |  |  |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| DR | Raw materials | | | | | | CR |
| Date | Particular | Ref | Amount | Date | Particular | Ref | amount |
| 5/3/2011 | Cash |  | 550,000 |  |  |  |  |

**Classification of accounts**

Accounts are grouped into classes, each class computes items of a fairly similar nature and they are 3 main classes:

1. Personal Accounts
2. Impersonal account

► ***Personal Accounts***

These are accounts which deal with business transactions carried out with persons of firms such accounts exists in a name of people or organization (firm).

**Example:** John, SONARWA, UTEXRWA, etc are accounts of debtors or creditors or credit customers, credit suppliers, loan holders (loan capital and the capital account). Any other accounts as are impersonal

**►Impersonal accounts:**

They are accounts which appear in the ledger in the name of things/items. Impersonal accounts are subdivided into two: ***real accounts*** and ***normal accounts***

***i) Real accounts***

These are accounts that contain records involving physical and tangible property and material objects in its business such as cash account, Motor account, Plant account, Equipment account, Stock account, Furniture account, Building account, etc.

***ii) Nominal accounts***

These are accounts record items of expenses or gain incurred in trading. ***Example***: salaries account, insurance account, electricity account, rent receiving account, interest received account, discount received account, discount allowed account, etc.

The ***rule principles*** followed when recording transactions in the journal and posting them into the ledger.

1. Personal accounts (deposits and creditors) debit the receiver of value and credit the giver of value
2. Real accounts (cash, assets ...) debit property acquired and credit property deposited off.
3. Nominal accounts debit expenses or losses and credit incomes gained and revenue.

It should be noted that under double entry system, one account is debited while the other is credited. The debiting and crediting is a means of either increasing or decreasing an account.

The debiting and crediting replace plus (+) and minus (-) signs of arithmetic respectively.

## 10.9. Business documents or source document

These are documents prepared when a transaction takes place and to provide evidence that transaction has taken place. It is the information on this document that is recorded or interred in the books of the business. Source accounts include the following:

1. ***Bank statement:*** this shows the details of deposits and withdrawals made from the account holder’s bank account.
2. ***Bank deposit slip:*** these are issued by the bank confirming receipt of money from the depositors.
3. ***Cash receipts:*** these prove that money has been received, from who and how much.
4. ***Cash sale receipts:*** these are a record of a day’s sales on cash basis (cash transaction),
5. ***Invoice:*** this document gives the description of goods purchased or sold on credit. For services consumed a bill is raised. **E.g.** medical bill, electricity bill, water bill, etc.
6. ***Delivery note:*** this proves that goods have been delivered and received by the customer.
7. ***Local purchases order (LPO):*** this is a proof that the commitment has been made to purchase from a supplier goods or services.
8. ***Payment vouchers (receipts):*** these show to whom payments were made, when paid (debt), the purposed amount and who authorized them.
9. ***Staff file:*** this shows details of personnel, who they are, when they are employed, what they are to do and how much they should be paid.
10. ***Cheque counter foil:*** this is whether the details of information on the cheque issued and recorded and detached when the cheque is made. It provides a good accountability for money spent by the business.
11. ***) Debit note:*** this is the document spent by the seller to the buyer to collect an understanding in the original invoice. It can also be used to the buyer who failed to return packing materials (containers that were not charged in the original price or invoice/ *facture*).
12. ***Credit note:*** is a document used to show that there is a reduction in the amount owed. It is over when part of the goods purchased or sold is returned.

* ***Incoming credit note*** is sent by creditor (credit supplier)
* ***Outgoing credit note*** is issued to debtors in the business (credit customers

END!!!!!!!!!!!!!!!!!!!!!!!!!!