GENERAL BUSINESS EDUCATION

Student Textbook
Grade 12

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Unit 1

MARKETING

Unit Outcomes

At the end of this unit, students will be able to:

- understand the concepts of marketing and market.
- appreciate and determine marketing functions.
- recognize marketing mix.

Introduction

Marketing completes the basic mission of an economy. It tries to identify the needs and wants of customers. Marketing avails products of a company at the right time, moves goods to the appropriate place and tries to determine the market size, converts the heterogeneous market into homogeneous through market segmentation. Marketing approaches the market with distinct marketing mix.

The role of marketing in society is significant. Have you ever gone to your nearest market? What did you do? Did you buy products? Why did you buy the product? Did you sell any thing? Did you communicate with the seller? Did the seller force you to buy his product? Answer to these questions will help you to understand how marketing plays important role to satisfy your needs and wants.

Contents of the unit

In order to be able to achieve the above learning outcomes, students will learn the following topics in this unit.

- Definition of marketing
- Markets and types of markets
- The major marketing functions
- The marketing mix
- Marketing management

1.1 What is Marketing?

- ***What do you understand about marketing and its economic role?***

Although marketing contains many functions, marketing always begins and ends with customer. After identifying the basic needs and wants of its customers, marketing tries to fulfil marketing needs and wants better than the competitors. As a field of study, marketing has been defined by various authors in different purposes. But for this purpose,

Marketing is defined as a social and managerial process by which individuals and groups obtain what they need and want through creating and exchanging products and value with others.

To explain this definition further, let us define the basic concepts involved in the process of marketing.

Needs and Wants: Think about what you really need: food, shelter, clothing, friend, love, knowledge, to stand first in your class, or to be a doctor, or musician. All these are your needs. **Needs are very basic things that are essential to your physical, psychological, and social-well being**. When your needs are not met or satisfied, you feel deprived and are highly motivated to change the situation.

Your **wants** are based on your needs, but they are more specific. When you are hungry, you need food, but you may want "kitfo" or "doro wat", or hamburger depending on your experiences, culture, and personality or any other factor. In developed countries, people have many choices. But in poor countries, like ours, we have limited choices. Producers do not create needs, but they do shape our wants by providing many alternatives. If producers are accurate in assessing our wants and needs, they will provide the products that are most satisfying to us. If they do not know needs and wants of customers, it will be difficult for them to sell their products.

Exchange and transaction: How do marketers know what to produce? How can they be sure that their offerings will satisfy our wants and needs? In a market economy, the exchange process is the mechanism that enables producers to identify consumer preferences. When we trade something valuable (usually money) for something else such as goods or services, we vote for that item; the producer of the item is encouraged to make more of them. In this way, supply and demand are balanced, and society obtains the goods and services that are most satisfying.

For exchange to take place, there are certain conditions. At least two parties (seller and buyer) must participate. Each party must have something of value to the other such as product or money. Each party also must want to deal with the other party. Each must be free to accept or reject the other's offer. Finally, each party must be able to communicate and deliver the product or money.

When the exchange actually occurs, it takes the form of a **transaction.**
For example, Abebech gives Fatuma Birr1.50 and gets pen in return. A trade of value takes place. There are also some conditions in transaction. It involves at least two things of value (product and money), agreed-upon conditions, a time of agreement, and a place of agreement.

Product: People satisfy their needs and wants with products. Product is anything that can be offered to a market for attention, acquisition, use or consumption that might satisfy a want or need. It includes physical objects, services, persons, places, organizations, heritage, hospitality, and ideas. But, for convenience, we classify offers as goods and services but collectively as product.

Customer Value: Customer value is the difference between the values the customer gains from owning and using a product and the costs of obtaining the product.

Customer Satisfaction: Customer satisfaction depends on a product's perceived performance in delivering value relative to a buyer's expectations. If the product's performance falls short of the customer's expectations, the buyer is dissatisfied. If performance matches expectations, the buyer is satisfied. If performance exceeds expectations, the buyer is delighted.

Activity: 1

- **Define marketing and the basic concepts used in your definition using your own words.**

1.2 What is Market?

- ***What do you know about markets? How do you determine the size of a market?***

The concept of exchange leads to the concept of a market. A market is the set of actual and potential buyers of a product. Market is a mechanism that brings buyers and sellers of a product together. Market consists of group of organizations and /or individuals who may want the product offered by the seller and who have the requisite purchasing power, the willingness to spend resource to buy the product, and the authority to make such an expenditure.

We may say that a certain market is big or small. The size of a market depends on the number of people who exhibit the need, have resources to engage in exchange, and are willing to offer these resources in exchange for what they want.

Markets are broadly classified as **consumer and industrial markets**. **Consumer markets** consist of purchasers and/individual household members who intend to consume or benefit from the purchased products and who do not buy products to make profits.

Industrial markets or also known as **business-to-business markets** are grouped broadly into producer, reseller, governmental, and institutional categories. These markets purchase specific kinds of products for use in producing other products, for resale or for day-to-day operations.

Producer markets consist of individuals and business organizations that buy certain products to use in the manufacture of other products.

Reseller markets consist of intermediaries such as wholesalers and retailers that buy finished products and sell them for a profit.

Government markets consist of Federal, Regional, Zonal, Woreda and Municipality Governments. They buy goods and services to maintain internal operations and to provide citizens with such products as highways, education, water, energy, police, national defence and the like.

Institutional markets include churches, not-for-profit schools and hospitals, teacher's associations, labour unions, foundations, human right group, fraternities, charitable organizations. The goals of such organizations are different from business organizations.

Activity: 2

- **Define market and explain the different types of markets.**

1.3 Major Marketing Functions

- ***What functions do marketing process perform?***

The marketing process involves eight major functions and numerous related activities. All these functions are essential if the marketing process is to be effective. These functions are broadly classified as exchange, physical distribution and facilitating functions.

1.3.1 Exchange Functions

All companies manufacturers, wholesalers, and retailers – buy and sell to market their merchandise.

1. **Buying** includes obtaining raw materials to make products, knowing how much merchandise to keep on hand, and selecting suppliers.
2. **Selling** creates possession utility by transferring the title of a product from seller to customer. Possession utility is created by transferring title or ownership of a product to the buyer.

1.3.2 Physical Distribution Functions

These functions involve the flow of goods from producers to customers. Transportation and storage provide time and place utility, and require careful management of inventory.

1. **Transporting** involves selecting a mode of transport that provides an acceptable delivery schedule at an acceptable price.
2. **Storing** of goods is often necessary to sell them at the best selling time. **Storage and warehouses** are sometimes used interchangeably**.** However, they are different**.** Warehouses are used as a temporary custody for finished goods. But, storage is a place for keeping production inventory at perfect state until required for production. An obvious reason for storage of finished goods is to have products available whenever the customers want them. A surplus in one market must be stored until transportation facilities take it to a more scarce market. There are two types of storage operations. One kind of storage equalizes the seasonal production to the pattern of demand. The other is the storage at all times which is necessary to keep the marketing system operating and other places of mass accumulation for wholesalers and retailers.

1.3.3 Facilitating Functions

These functions help the other functions take place. These are not basic functions of marketing, but essential to the other functions.

1. **Financing:** helps at all stages of marketing. To buy raw materials, manufacturers often borrow from banks or receive credit from suppliers. Wholesalers may be financed by manufacturers, and retailers may receive financing from the wholesaler or manufacturer. Finally, retailers often provide financing to customers.

2. **Standardizing and Grading: Standardizing** sets uniform specifications for products or services in terms of colour, size, chemical characteristics, quality etc. **Grading** classifies products by size and quality, usually through a sorting process. Grading is very common for agricultural, textile, leather products. Together, standardization and grading facilitate production, transportation, storage and selling.
3. **Risk taking:** Risk is the possibility of loss. Even though competent management and insurance can minimize risks, risk is constant reality of marketing because of such losses as bad-debt expense, obsolescence of products, theft of product by employees, flood, earthquake, war, criminal acts of others and product liability suits due to defective products, misleading advertisement etc.,
4. **Gathering market information:** Information is necessary for making all marketing decisions such as price, product, promotion, distribution and the like. Management must make marketing decisions based on accurate information.

Activity: 3

- **Form a group of five to ten students in your class. And then list the basic marketing functions in any organization that are necessary to satisfy the needs and wants of customers and identify typical examples of each function from your area.**

1.4 Marketing Mix- Overview

- ***What are the basic marketing variables that marketing managers can manipulate in the course of their managerial activities?***

Marketing mix can be defined as the mixture of controllable variables such as product, price, place and promotion that can be manipulated by the management of the organization. In other words, the marketing mix consists of the way in which the various component parts and techniques of the marketing effort are combined and varied in order to achieve marketing objectives. The basic ingredients of the marketing mix are: product, place, price and promotion. The overview of the marketing mix elements are given as follows.

Figure 1.1 Marketing mix

Product: As previously stated, products are solutions to customers' needs. The provider needs to make various product decisions, including functionality, range offered, brand names, packaging, service and support. The product is normally the critical element in the mix, with all other decisions relating to this element.

Price: This element determines what a provider is paid. Various price setting models exist with decisions relating to factors like market penetration, credit terms, discount policy and cost of provision.

Place: Place is perhaps more readily described as distribution. It is about making the product available. Some form of structured network is normally required – a distribution channel. However, true marketing power may lie with the control of this channel as opposed to control of the product. For example, large supermarket chains can largely determine which goods are made available to the consumer.

Promotion: The promotional element of the mix provides communication with the desired customer group. A range of mechanisms can be deployed for this purpose: advertising, public relations, direct mail, Internet marketing, selling and sales promotion. The blend of methods is often referred to as the communications mix. Generally, promotion aims to make a target market aware of a product offering, develop a long-term relationship with the customer and create and stimulate demand. The effect of promotional techniques can be difficult to evaluate and organizations need clear aims and goals to obtain maximum benefit from a promotional budget.

1.4.1 Product

- ***Can you mention some products that are familiar to you?***

What is a product? A product is a bundle of physical, service and symbolic attributes designed to produce consumer want satisfaction. Product elements include quality /features, options/ style, brand name, packaging /sizes, service, warranties/ returns. To further understand the nature of products, it is better to see the classifications of goods.

Classifications of various types of goods

Generally, goods can be classified into two major groups; namely consumer and business goods [industrial goods]

Consumer goods: Consumer goods are intended for use by household consumers for non-business purposes, and can be broken into four categories – convenience goods, shopping goods, specialty goods and unsought goods.

1. **Specialty goods** are goods with unique characteristics and / or brand identification, for which a significant group of buyers are habitually willing to make a special purchasing effort. Buyers have a strong brand preference and are willing to spend extra time and effort in buying them. Usually manufacturers can utilize fewer retail outlets, which the manufacturer deals with directly. Advertising is often carried out on a co-operative basis.

   Some examples could be specific brands and types of cars, hobbies equipment, photographic equipment, computer equipment. A sports car or racing car is a specialty good if potential buyers are willing to travel to the few dealers. Specialty goods do not involve shopping comparisons; the buyer only invests shopping time to reach the outlets carrying these goods. The seller of a specialty good does not necessarily have to be established in a convenient location; however, it is important that prospective buyers receive information as to this location.

2. **Convenience goods** are those that the consumer has adequate knowledge of the particular product wanted before going out to buy it. The product is purchased with a minimum of effort, and usually the advantages of shopping around to compare price and quality are not considered worth the extra time and effort required. Consumers are willing to accept any of several brands and will buy the one that is most accessible. Goods in this category include groceries, tobacco products, inexpensive confectionery, pharmacy items such as toothpaste and hardware items such as light bulbs and batteries. Convenience goods typically are purchased frequently, have a low unit price, are not bulky and are not greatly affected by fad and fashion.

3. **Shopping goods** are products for which customers usually wish to compare quality, price and style in several stores before making their purchase. Goods in this category include women's apparel, furniture, major appliances and cars. Usually these goods are sold direct to the store by the manufacturer with no wholesalers involved. The name of the store is often more important than the brand of the goods.

4. **Unsought goods** fall into two categories - new products that consumers are not yet aware of (e.g. video telephones, talking computers) and products that the

consumer does not currently require such as insurance. Sellers and marketers of this category of products face significant advertising and selling barriers.

Business goods [industrial goods]: Business goods are intended primarily for use in producing other products or for providing services in a business. They are raw materials, fabricating materials and parts, installations, accessory equipment and operating supplies.

1. **Raw materials** are business goods that will become part of another physical product, and include goods in their natural state such as minerals, land and products of the forests and the seas, as well as agricultural products such as wheat, cotton, fruits, vegetables, livestock and animal products like eggs and milk.
2. **Fabricating materials and parts** include pig iron being converted to steel, yarn being woven into cloth, and flour becoming part of bread. To ensure adequate and timely supply, buyers usually purchase in large quantities and may place orders twelve months or more in advance. These goods are usually marketed direct to the user.
3. **Installations** include long-lived, expensive, major equipment of a business user, such as generators, industrial buildings, railway engines and aircraft. High levels of personal selling by skilled staff are usually involved with no use of intermediaries. Often the product is supplied to the buyer's detailed specification, involving much pre sale and post sale servicing.
4. **Accessory equipment** is used in the production operations of a business, and includes items such as cash registers, small power tools, forklift trucks and computers. These goods are usually sold by intermediaries.
5. **Operating supplies** are the 'industrial goods' of the business sector. They are short-lived, low price items usually purchased with a minimum of effort, and aid a firm's operations but do not become part of the finished product. Examples include lubricating oils, pencils and stationery and cleaning supplies.

Product Life Cycle (PLC)

The product life cycle (plc) depicts graphically a product's sales volume from introduction to the market to its withdrawal from the market.

Like human beings, products also have their own life-cycle. From birth to death human beings pass through various stages e.g. birth, growth, maturity, decline and death. A similar life-cycle is seen in the case of products. The product life cycle goes through multiple phases, involves many professional disciplines, and requires many skills, tools and processes. The stages include introduction, growth, maturity and decline. The features of these stages are given in the following table.

Table 1.1 The four main stages of a product's life cycle and the accompanying characteristics

Stage	Characteristics
1. Introduction stage	1. costs are very high 2. slow sales volumes to start 3. little or no competition 4. demand has to be created 5. customers have to be prompted to try the product 6. makes no money at this stage
2. Growth stage	1. costs reduced due to economies of scale 2. sales volume increases significantly 3. profitability begins to rise 4. public awareness increases 5. competition begins to increase with a few new players in establishing market 6. increased competition leads to price decreases
3. Maturity stage	1. costs are lowered as a result of production volumes increasing and experience curve effects 2. sales volume peaks and market saturation is reached 3. increase in competitors entering the market 4. prices tend to drop due to the proliferation of competing products 5. brand differentiation and feature diversification is emphasized to maintain or increase market share 6. Industrial profits go down
4. Decline stage	1. costs become counter-optimal 2. sales volume decline or stabilize 3. prices, profitability diminish 4. profit becomes more a challenge of production/distribution efficiency than increased sale

The graphical representation of the product life cycle is shown in Figure 1.2.

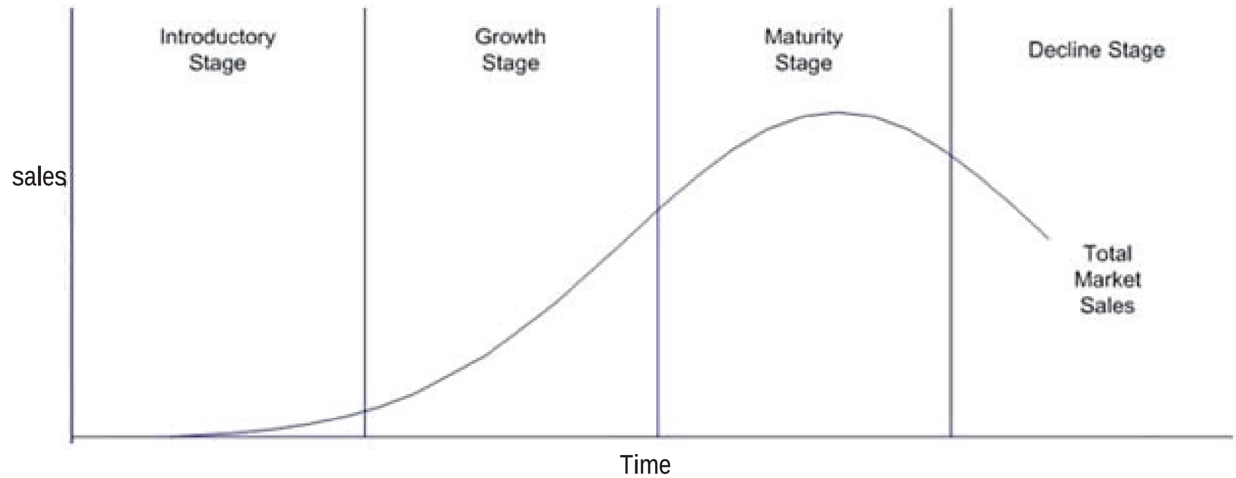


Figure 1.2 Product Life Cycle

Duration of stages: Some would argue that the length of each PLC phase is closely related to marketing decisions and not simply a natural cycle. Effective marketing should be able to extend and sustain the growth or maturity of a product offering. Equally, ineffective marketing would hasten its decline.

Activity: 4

- **Discuss the trends of profitability of a product under the different stages of PLC.**

1.4.2 Price

All profit making organizations and many non-profit organizations must set prices on their products or services. Price goes by many names: rent for house, tuition for education, and a fee to physician or dentist, fare for taxi, interest for money, premium for insurance, honorarium for guest lecturer, dues for trade association, salary for an executive, commission for a salesperson, wage for a worker, bribe for a bureaucrat etc.

In the narrowest sense, price is the amount of money charged for a product or service. More broadly, price is the sum of all the values that consumers exchange for the benefits of having or using the product or service.

Price is the only element in the marketing mix that produces revenue; all other elements represent costs. Price is also one of the most flexible elements of the marketing mix as it can be adjusted easily. The following subtopics discuss price and non-price competition, pricing objectives and the different approaches to pricing.

The Meaning and Use of Price

As we have mentioned before, value is given up and received through the marketing process. Price is the exchange value of a good or service in the market place. We tend to think of price as set of amount of money that can be exchanged for particular product at given time and under given circumstances. Yet; a good or service can also be exchanged for a different product through trading or bartering. At times the price results from negotiations between buyer and seller. But in many business situations, the seller fixes the price.

Product, place, and promotion create value for buyers and result cost to the marketer. In contrast, price captures value from buyers of the firm. It is how the firm recovers its costs for other parts of the marketing mix.

Price thus serves as the function of allocater. First, it allocates goods and services among those who are willing and able to buy them. It answers the basic economic question of for whom to produce? That depends on prices. Second, price allocates financial resources (sales revenue) among producers according to how well they satisfy customers' needs. And third, price helps customers to allocate their own financial resources among various wants satisfying products.

Price and Non-price Competition

Before the price of a product can be set, an organization must decide on the basis on which it will compete—on the basis of price alone or some combination of the factors. The choice influences pricing decisions as well as other marketing mix variables.

Price competition occurs when a seller emphasises the low price of a product and sets a price that equals or beats competitors' prices. To use this approach most effectively, a seller must have the flexibility to change prices often and must do so rapidly and aggressively whenever competitors change their prices. Price competition allows a marketer to set prices based on demand for the product or in response to change in the firm's finances. Competitors can do likewise, however, which is a major disadvantage of price competition. They, too, can quickly match or outdo an organization's price cuts. In addition, if the circumstances force a seller to raise prices, competing firms may be able to maintain their lower prices.

Non-price competition is based on factors other than price. It is used most effectively when a seller can make its product stand out from competition by some unique features. These include product quality, customer service, promotion, packaging, or other features. Buyers must be able to perceive these distinguishing characteristics and consider them desirable. Once customers have chosen a brand for non-price reasons, they may not be as easily attracted to competing firms and brands. In this way, a seller can build customer loyalty to its brand.

Pricing Objectives

Before setting prices for a firm's products, management must decide what it expects to accomplish through pricing. That is, management must set pricing objectives that are in line with both organizational and marketing objectives. Of course, one objective of pricing is to make profit. But this may not be a firm's primary objective. One or more of the following factors may be just as important.

Survival: A firm may have to price its products to survive either as an organization or as a player in a particular market. This usually means that the firm will cut its price to attract its price, even if it then must operate at a loss. However, such a goal can hardly be pursued on a long-term basis, for consistent losses would cause the business to fail.

Profit maximization: Many firms may state that their goal is to maximize profit, but this goal is impossible to define or to achieve. What, exactly, is the "maximum profit"? How does a firm know when it has been reached? Firms that wish to set profit goals should express them as either specific Birr amounts or percentage increases over previous profits.

Market share goals: A firm's market share is its proportion of total industry sales. Some firms attempt, through pricing, to maintain or increase their share of the market. To gain market share, firms will set price as low as possible.

General Approaches to Pricing

The three major approaches to pricing are the cost-based approach, the buyer-based approach and the competition based approaches.

Cost-Based Pricing

Cost-plus Pricing: The simplest pricing method is cost-plus pricing- adding a standard mark up in the cost of the product.

Procedure: To understand mark-up pricing, you must understand the steps followed by a firm when using the technique:

- Estimate the sales volume;
- Estimate product unit cost at the estimated sales volume;
- Determine the mark-up rate to be used;
- Calculate unit-selling price by applying the mark-up rate to the product cost.

Example: Price the following product using straight mark-up pricing:

Given:

Estimated Sales Volume = 1,000 units
Estimated Unit Cost = Birr80
Mark-up Rate = 20%

Calculate Unit Selling Price:

Unit Selling Price = Cost + (Mark-Up Rate x Cost)
= Birr 80 + (0.20 x Birr80)
= Birr 80 + Birr16
= Birr 96

Breakeven Analysis and Pricing: Setting price to break even on the costs of making and marketing a product.. Break-even point is a point in a graph or mathematical model where cost equals revenue. For any product, the **break even quantity** is the number of units that must be sold for the total revenue (from all units sold) to equal the total cost (of all units sold). **Total revenue** is the total amount received from the sales of a product. We can estimate projected total revenue as the selling price multiplied by the number of units sold.

The costs involved in operating a business can be broadly classified as either fixed or variable costs. A **fixed cost** is a cost incurred no matter how many units of a product are produced or sold. Rent, for example, is a fixed cost. It remains the same whether 1 unit or 1,000 units are produced. A **variable cost** is a cost that depends on the number of units produced. The cost of fabricating parts for a television is a variable cost. The more units produced, the higher the cost of parts. The **total cost** of producing a certain number of units is the sum of the fixed costs and the variable costs attributed to those units.

If we assume a particular selling price, we can find the breakeven quantity either graphically or by using a formula. Figure 1.3 graphs the total revenue earned and the total cost incurred by the sales of various quantities of a hypothetical product.

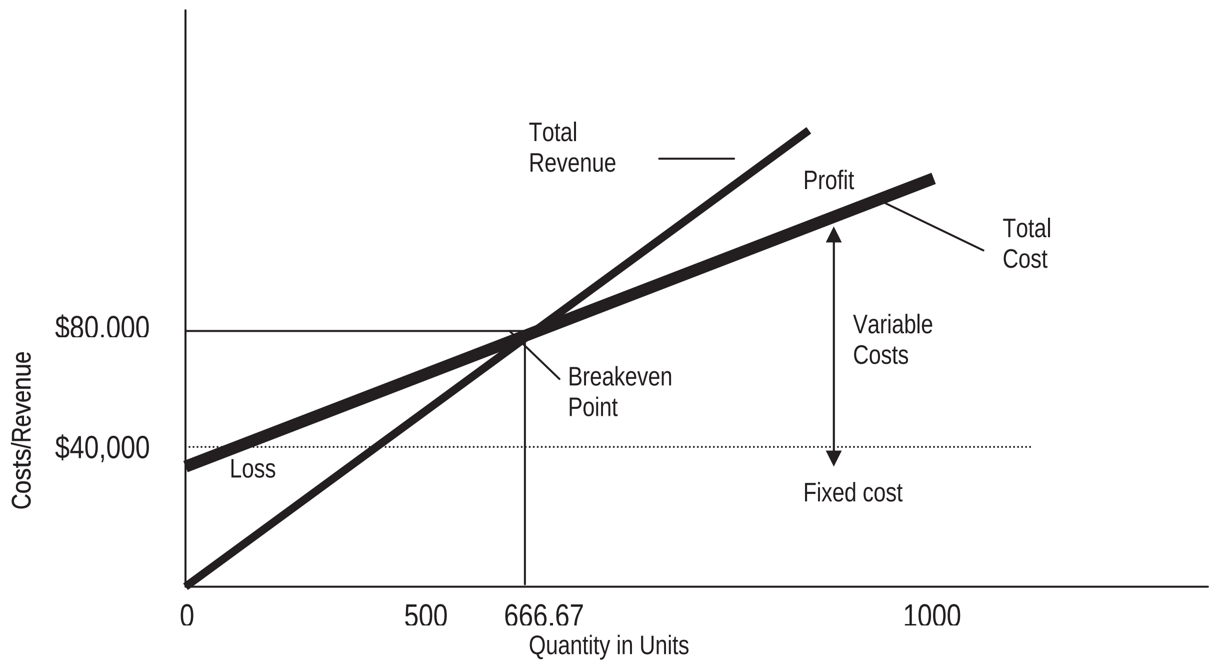


Figure 1.3 Breakeven analyses.

With fixed costs of Birr 40,000 variable costs of Birr60 per unit, and a selling price of Birr120, the break even quantity is 666.67 units. To find the breakeven quantity, first deduct the variable cost from the selling price to determine how much money the sale of one unit contributes to offsetting fixed costs. Then divide that contribution into the total fixed costs to arrive at the breakeven quantity. If the firm sells more than 666.67 units at Birr120 each, it will earn a profit. If it sells fewer units, it will suffer a loss.

Calculating Break-Even Revenue: To calculate break-even Birr that is the amount of revenue needed to cover both fixed and variable costs so your business neither makes nor loses money–use the following formula:

$$\frac{\text{Fixed Costs}}{1 - (\text{Variable cost per unit/Selling Price per unit})} = \text{Break-even Revenue.}$$

Example: Calculating Break-Even Revenue for the example given

$$\frac{\text{Birr } 40{,}000}{1-(60/120)} = \text{Birr } 80{,}000$$

So, this company needs revenues of Birr80,000 just to cover costs. If it doesn't have enough business at these rates, it loses money by being in business. If it makes more than Birr80,000 in revenue, it's making money.

Calculating Break-Even Units

To determine how many units must be produced and sold to break-even, use the following formula:

$$\text{Break-even unit} = \frac{\text{Fixed Costs}}{\text{contribution margin}}$$

Where unit contribution margin = Selling Price per Unit – Variable cost per unit

Example: Calculating Break-Even Number of Units

In our example, the number of units required just to cover costs is 667.

$$\frac{\text{Birr } 40{,}000}{\text{Birr } 120 - \text{Birr } 60} = 666.67 \text{ units}$$

Target rate- of -return pricing: It is similar to the mark up pricing in that profit volumes are added to estimated costs. However, profit figures are note calculated based on the cost of labour and material required to provide the product. Instead, profit is calculated based on the financial investment required to provide the product, the return needed to attract that investment, and estimated sales volume.

Procedure: Follow these steps to determine price using rate -of –return pricing approach.

- Determine desired rate of return on investment;
- Estimate investment required;
- Estimate level of sales;
- Estimate unit cost at the projected sales level;
- Calculate desired unit profit;
- Calculate unit-selling price(estimated cost +desired profit)

Example: Price the following product using rate of return pricing approach.

Given: Desired rate of return =20%

Estimated investment required =Birr 600,000

Estimated sales =5,000 units

Estimated unit cost =Birr 80.

Calculate:

A. Desired profit volume .

B. Profit per unit.

C. Unit selling price.

Solution:

A. Desired profit volume =desired rate of return ×estimated investment required.

=20%×Birr 600,000

=**Birr 120,000**

B.Profit per unit = $\frac{\text{desired profit volume}}{\text{Estimated sales}} = \frac{\text{Birr } 120{,}000}{5{,}000 \text{ units}}$ = **Birr 24 per unit**.

C.unit selling price = unit cost +unit profit =Birr 80 +Birr 24 =**Birr 104**

Activity 5

- **What is the number of units to be produced if the firm desires to make a profit of Birr10,000 assuming the fixed cost, variable cost per unit and selling price per unit are Birr50,000, Birr10 and Birr20 respectively**

Value-Based Pricing: An increasing number of companies are basing their prices on the product's perceived value. Value-based pricing methods use buyers' perceptions of value, not the seller's cost, as the key to pricing. Value-based pricing means that the marketer cannot design a product and marketing program and then set the price.

Competition-Based Pricing: Consumers will base their judgments of a product's value on the prices that competitors charge for similar products. The common methods are going-rate pricing and sealed-bid pricing.

Going-Rate Pricing: In the going-rate pricing, the firm bases its price largely on competitor's prices, with less attention paid to its own costs or to demand. The firm might charge the same, more, or less than its major competitors depending on its strategy.

Sealed-Bid Pricing: Competition-based pricing is also used when firms bid for jobs. Using sealed-bid pricing**,** a firm bases its price on how it thinks competitors will price rather than on its own costs or on the demand. The firm wants to win a contract, and winning the contract requires pricing less than other firms.

Activity: 6

- **What is price and how do marketers set their prices as you see in your locality?**

1.4.3 Place/Distribution

- ***How do producers reach their customers?***

There are a number of channels for the distribution of goods. In this part of the lesson, we will discuss the distribution channels for consumer and industrial goods.

Distribution Channels for Consumer Goods

Consumer products are goods and services purchased by individuals for personal consumption. The typical channels of distribution for consumer goods are the following.

- **Producer to Consumer**. This channel, often called the direct channel, includes no marketing intermediaries. Practically all services, and a few consumer goods, are distributed through a direct channel. Producers sell directly to consumers for several reasons. Firstly, they can better control the quality and price of their products. Secondly, they don't have to pay such as through discounts for the services of intermediaries. Thirdly, they can maintain closer ties or relations with consumers.
- **Producer to Retailer to Consumer.** A **retailer** is a middleman that buys from producers or other middlemen and sells to consumers. Producers sell directly to retailers when retailers can buy in large quantities. This channel is most often used for products that are bulky, such as furniture and automobiles, for which additional handling (movement of goods)) would increase selling costs. It is also the usual channel for perishable products, such as fruits and vegetables, and for high-fashion products that must reach the consumer in the shortest possible time.
- **Producer to Wholesaler to Retailer to Consumer.** This channel is known as the *traditional channel* because many consumer goods (especially convenience goods) pass through wholesalers to retailers. A **wholesaler** is a middleman that sells products to other firms. These firms may be retailers, industrial users, or other wholesalers. A producer uses wholesalers when its products are carried by so many retailers that the producer cannot deal with all of them.

- **Producer to Agent to Wholesaler to Retailer to Consumer.** Producers may use agents to reach wholesalers. Agents are functional middlemen that do not take title to products. Agents are compensated by commission (a certain percentage such as 2%) paid by the producers. Usually, such products are not expensive and they are frequently purchased items. Such channel is used for inexpensive products such as sugar or seasonal products such as Christmas cards. When the producers do not have their own sales forces, they use this channel of distribution.
- **Multiple Channels for Consumer goods**. Often a manufacturer uses different distribution channels to reach different market segments. A manufacturer uses multiple channels, for example, when the same product is sold to consumers and industrial users. Multiple channels are also used to increase sales or to capture a larger share of the market. With the goal of selling as much merchandise as

possible, Addis Tyre Factory markets its tires through its own outlet (of course only in Addis Ababa) and other retail outlets as well through independent wholesalers and retailers. The pictorial representation is shown in figure 1.4.

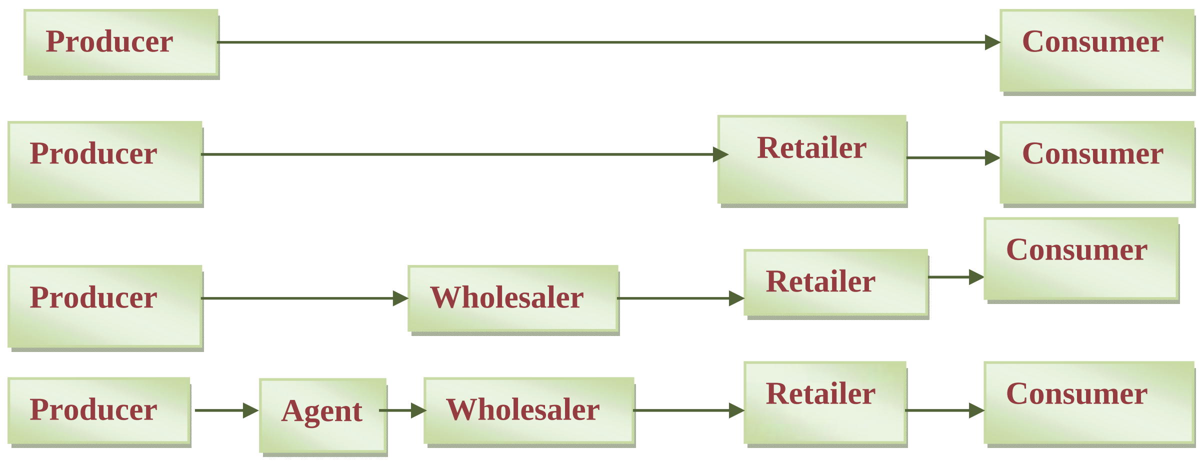


Figure 1.4 Channels of consumer Products

Channels for Industrial Products

Industrial product is a product bought for resale, for making other products, for use in a firm's operations. Producers of industrial products generally tend to use short channels. You will learn the two that are most commonly used.

- **Producer to Industrial User.** In this direct channel, the manufacturer's own sales force sells products directly to industrial users. Heavy machinery, airplanes, and major equipment are usually distributed in this way. The very short channel allows the producer to provide customers with expert and timely services, such as delivery, machinery installation, supply of spare parts, and repairs.
- **Producer to Agent Middleman to Industrial User.** Manufacturers use this channel to distribute such items as operating supplies, accessory equipment, small tools, and standardized parts. The agent is an independent intermediary between the producer and the user. Generally, agents represent sellers.

The summary of the channels of distribution industrial products is shown in Figure 1.5.

Figure 1.5 Channels of Industrial Products

Channel Decision

How does a producer decide to which distribution channels (and which particular intermediaries) to use? Like every other marketing decision, the decision for channel choice should be based on all relevant factors. These include the firm's production capabilities and marketing resources, the target market and the buying patterns of potential customers and the product itself. The factors for choice of channel of distribution are discussed here below:

Factors for Choice of Channels of Distribution

In making decisions with respect to its channels of distribution, management should carefully analyze its market, its product, its middlemen and the company itself.

Product Consideration: The total value of a product influences the amount of funds available for distribution. Management must also consider the cost of freight and handling in relation to the total value of the product. If the product is perishable, then it necessities short channel of distribution. If it is technical in nature, it will often be distributed directly to the industrial users.

Company Considerations: The financial strength of a firm sets limits on which marketing tasks can be handled and which ones should be delegated to intermediaries. Also the past channel experience of the company affects channel design. The company's product mix influences its channel pattern. The wider the company's products mix the greater the ability of the company to deal with its customers directly.

Middlemen Consideration: A producer should select middlemen who will provide the marketing services that he himself is unable to perform. Sometimes, the middlemen whom a producer desires may not be valuable. As a result the manufacturer may have to alter entire channel.

Cost: Cost is the most important point that must be considered while choosing suitable channel. Cost must be measured with respect to functions performed by middlemen.

Channels of competitors: Competitors are those that produce identical or related products. The producer's channel design is also influenced by the channels of competitors' costs. .

Moreover, environmental conditions such as legal and economic factors have an impact on choices of channel of distribution. Based on these factors, the company's distribution strategy can be intensive, selective or inclusive, market coverage.

i. Intensive distribution is the use of all available outlets for a product. The producer that wants to give its product the widest possible exposure in the market place chooses intensive distribution.

ii. Selective distribution is the use of only a portion of the available outlets for a product in each geographic area. Manufacturers of goods such as furniture, major home appliances, and clothing typically prefer selective distribution.

iii. Exclusive distribution is the use of only a single retail outlet for a product in a large geographic area. Exclusive distribution is usually limited to very prestigious products. It is appropriate, for instance, for specialty goods such as expensive jewellery.

Activity: 7

- **Identify the six common types of channels and also list the factors for the choice of channels of distribution**.

1.4.3.1 Marketing Intermediaries

As stated earlier, there are agents, wholesalers and retailers between producers and customers performing different marketing functions. A marketing organization that links a producer and user within a marketing channel is called a **middleman** or **marketing intermediary.** Wholesalers and retailers as well as their functions will be discussed in this session.

1.4.3.1.1 Wholesalers

Wholesaler is a middleman that sells products to other firms. Wholesale transactions are all transactions except the transaction with the ultimate consumer. Wholesalers may be the most misunderstood of marketing intermediaries. Producers some times try to eliminate them from distribution channels by dealing directly with retailers or consumers. Yet, wholesalers provide a variety of essential marketing service. Although wholesalers can be eliminated, their functions cannot be eliminated. The basic functions must be performed by other channel members or by the consumer or ultimate user. Eliminating a wholesaler may or may not cut distribution costs.

Reasons for the Use of Wholesalers

Manufacturer use wholesalers because they are not only more efficient and economical for manufacturers but also for consumers. Wholesalers also perform important functions to retailers. You may ask the basic question of why we use intermediaries such as wholesalers.

The first reason for the use of wholesalers is to **improve exchange efficiency**. There are certain costs associated with an exchange such as negotiation, preparing invoices, assisting customers in product selection and the like. We, therefore, need to try to reduce the number of transactions (exchanges). Without an intermediary, each buyer has to negotiate and exchange with each seller. With one intermediary, each buyer negotiates with one intermediary and each seller negotiates with one intermediary as opposed to many buyers.

The second reason is that intermediaries are **specialists** in the exchange process, provides access to and control over important resources for the proper functioning of the marketing channel.

Wholesaler's Services to Manufacturers

Some of the services wholesalers perform for producers are similar to those they provide to retailers. Others are different which are discussed below.

- **Providing an Instant Sales Force.** A wholesaler provides its producers with an instant sales force so that producers' sales representatives need not call on retailers. This can result in enormous savings for producers. This is because producers rely on wholesalers to sell and distribute their products to retailers.
- **Reducing Inventory Costs.** Wholesalers purchase goods in large quantities from manufacturers and store these goods for resale. By doing so, they reduce the amount of finished goods inventory that producers must hold. This will in turn reduce the cost of carrying or holding inventories.
- **Assuming Credit Risks.** When producers sell through wholesalers, it is the wholesalers who extend credit to retailers, make collections from retailers, and assume the risks of non-payment. These services reduce the producers' cost of extending credit to customers and the resulting bad-debt expense.
- **Furnishing Market Information.** Just as they do for retailers, wholesalers supply market information to the producers they serve. Valuable information accumulated by wholesalers may concern consumer demand, the producers' competition, and buying trends.

Wholesaler's Services to Retailers

Wholesalers help retailers by buying large quantities and then selling to retailers in smaller quantities and by delivering goods to retailers. They also stock -- in one place-the variety of goods that retailers would otherwise have to buy from many producers. And wholesalers provide assistance in three important areas. These are promotion, market information and financial aid.

- **Promotion.** Some wholesalers help promote the products they sell to retailers. These services are usually either free or performed at cost. Wholesalers, for example, are major sources of display materials designed to stimulate emotional buying. They may also help retailers build effective window, counter, and bin displays. They may even assign their own employees to work on the retail sales floor during special promotions.
- **Market information.** Wholesalers are a constant source of market information. Wholesalers have numerous contacts with local businesses, foreign suppliers and agents. In the course of these dealings, they accumulate information about consumer demand, prices, new developments within the trade, and even industry personnel. Most of this information is transmitted to retailers informally, through the wholesaler's sales force. However, some wholesalers distribute bulletins or newsletters to their customers as well. This information is very important to retailers for decision-making.
- **Financial Aid.** Most wholesalers provide a type of financial aid that retailers often take for granted. By making quick and frequent deliveries, wholesalers enable retailers to keep their own inventory investments small in relation to sales. Such indirect financial aid reduces the amount of operating capital retailers need. In some trades, wholesalers extend direct financial assistance through long-term loans. Others extend sales on credit basis to retailers.

Types of Wholesalers

Wholesalers generally fall into three categories. They are merchant wholesalers; commission merchants, agents and brokers; and manufacturers' sales branches and sales offices.

- **Merchant Wholesalers.** A **merchant wholesaler** is a middleman that purchases goods in large quantities and then sells them to other wholesalers, or retailers and institutional, farm, government, professional, or industrial users. Merchant wholesalers usually operate one or more warehouses at which they receive, take title to and store goods. These wholesalers are sometimes called *distributors or jobbers*.

Merchant wholesalers may be classified as **full-service or limited service wholesalers**. The classification is based on the number of services they provide. A full-service wholesaler performs the entire range of wholesaler functions described earlier. These functions include delivering goods, supplying warehousing, arranging for credit, supplying promotional activities, and providing general customer assistance.

Full service wholesaler consists of general merchandise wholesaler, limited line wholesaler, and speciality-line wholesaler. A **general merchandise wholesaler** deals in a wide variety of products, such as drugs, hardware, non-perishable foods, cosmetics, detergents, and tobacco. A **limited-line wholesaler** stocks only a few product lines, but carries numerous product items within each. **Product line** is a group of similar products that differ only in relatively minor characteristics. A **speciality-line wholesaler** carries a select group of products within a single line. For example, a wholesaler that carries children's clothing can be considered as a speciality wholesaler.

As opposed to the full-service wholesaler, a **limited-service wholesaler** assumes responsibility for a few wholesale services only. Other marketing tasks are left to other channel members or consumers. For instance, if we take **Cash and Carry wholesaler**, customers pay and furnish their own transportation service. It does not also provide credit service to its customers. The other is **Mail Order Wholesaler** that uses catalogues instead of sales force to sell its products.

- **Commission Merchants, Agents and Brokers.** Commission merchants, agents, and brokers are functional middlemen. Functional middlemen do not take title to products. They perform a small number of marketing activities. For their service, they are paid a commission that is a percentage of the sales price.

A **commission merchant** usually carries merchandise and negotiates sales for manufacturers. In most cases, commission merchants have the power to set the prices and terms of sales. After a sale is made, they either arrange for delivery or provide transportation services.

An **agent** is a middleman that expedites, exchanges, represents a buyer or a seller, and often is hired permanently on a commission basis. When agents represent producers, they are known as sales agents or manufacturer's agents. As long as the products represented do not compute, a sales agent may represent one or several manufacturers on a commission basis.

A **broker** is a middleman that specializes in a particular commodity, represents either a buyer or a seller, and is likely to be hired on a temporary basis. Brokers may perform only the selling function or both buying and selling, using established contacts or special knowledge of their fields.

- **Manufacturers' Sales Branches and Sales offices.** A **manufacturer's branch is,** in essence, a merchant wholesaler that is owned by a manufacturer. Sales branches carry inventory, extend credit, deliver goods, and offer help in promoting products. Their customers are retailers, other wholesalers, and industrial purchasers.

Because sales branches are owned by producers, they stock mainly the goods manufactured by their own firms. Selling policies and terms are usually established centrally and then transmitted to branch managers for implementation.

A **manufacturer's sales** office is essentially a sales agent owned by a manufacturer. Sales offices may sell goods manufactured by their own firms and also certain products of other manufacturers that complement their own product lines.

Activity: 8

- **Identify the major functions that wholesalers can perform to the producers and retailers.**

1.4.3.1.2 Retailers

A retailer is a middleman that buys from producers or other middlemen and sells to consumers. Retailers are the final link between producers and consumers. Retailers sell not only goods but also such services as repairs, haircuts, and tailoring. Some retailers sell both goods and services. For example, an automobile dealer may sell automobiles and maintenance service to its customers. Generally, retailers can be classified as store and non-store retailers.

Classes of Store Retailers

Retailers can be classified in different ways. The common classifications are on the bases the number of stores owned, control of outlets and size and number and kinds of products carried. Brief discussions of retailers are given below:

Retailers according to number of stores owned and operated by a firm. One way to classify retailers is by the **number of stores owned and operated** by the firm. **An independent retailer** is a firm that operates only one retail outlet. The majority of retailers in Ethiopia are independent. One-store operators generally provide personal service and a convenient location.

A **chain retailer** is a company that operates more than one retail outlet. By adding outlets, chain retailers attempt to reach new geographical areas. As sales increase, chains may buy merchandise in larger quantities and thus take advantage of quantity discounts. They also get more power in their dealings with suppliers in terms of services they get.

Retailers according to Control of Outlets

Another way of classifying retailers is by the **control of outlets**. According to the control of outlets, retailers are classified as corporate/ chain stores, voluntary chains and cooperative chains.

Corporate Chains/Chain Stores are two or more outlets that are commonly owned and controlled, have central buying and merchandising, and sell similar lines of merchandise. They appear in all types of retailing. But, they are strongest in department stores, variety stores, food stores, drugstores, shoe stores, and women's clothing stores. They achieve economies of scale through central buying for different stores. This allows them to take advantage of quantity discounts. They also have advantages in promotion and management by sharing the costs to many stores.

Voluntary Chains are wholesaler-sponsored group of independent retailers that engage in-group buying and common merchandising. The wholesaler sponsor often provides training programs, computer and accounting assistance to members of the chain.

Cooperative Chains are retailer-sponsored groups formed by independent retailers to run their own buying organization and conduct joint promotion to their products.

Retailers according to size and the kind and number of products carried

Still, **another way to classify in-store retailers is by size and the kind and number of products carried.** The most common ones in this category are department stores, discount stores, Catalog and Warehouse Showrooms as elaborated below:

- **Department Stores.** These large retail establishments consist of several sections, or departments, that sell a wide assortment of products. According to the American system, a department store is a retail store that (1) employs twenty-five or more persons, and (2) sells at least home furnishing, appliances, family apparel, and household linens and dry goods. Each must be located in the different parts of the stores. Department Stores are service oriented. They provide credit, delivery, personal assistance, liberal returns policies, and pleasant shopping atmospheres.

- **Discount Stores.** A **discount store** is a self-service, general merchandise outlet that sells goods at lower than usual prices. These stores can offer lower prices by operating small profit margins, by locating large retail showrooms in low rent areas, and by offering minimal customer services. To keep prices low, discount stores operate on the basic principle of high turnover of such items as appliances, toys, clothing, automotive products, and sports products. To attract customers, many discount stores also offer some food and household items at low prices.

- **Catalog and Warehouse Showrooms.** A **catalog showroom** is a retail outlet that displays well-known brands and sells them at discount prices through catalogs within the stores. Colourful catalogs are available in the showroom and sometimes by mail. The customer selects the merchandise, either from the catalog or from the showroom display. The customer fills out an order form provided by the store and hand the form to a clerk. The clerk retrieves the merchandise from a warehouse room that is adjacent to the selling area.

- **Warehouse showrooms** are retail facilities with five basic characteristics: (1) large, low-cost buildings, (2) warehouse materials-handling technology such as crane or ladder, (3) vertical merchandise displays, (4) large on-premises inventories, and (5) minimal service. Furniture retailers use such systems. These operations employ few personnel and offer few services.

- **Convenience Stores.** A convenience store is a small food store that sells a limited variety of products but remains open beyond normal business hours. Their prices are high since they are open for long hours such as up to midnight or sometimes even for 24 hours.

- **Supermarkets.** A **supermarket** is a large self-service store that sells primarily food and household products. It stocks canned, fresh, frozen, and processed foods, paper products, and cleaning goods. Supermarkets may also sell such items as housewares, toiletries, toys and games, drugs, stationery, books, and magazines, plants and flowers, and a few clothing items. Supermarkets are large-scale operations that emphasize low prices and one-stop shopping for household needs.

- **Superstores.** A **Superstore** is a large retail store that carries not only food and non-food products normally found in supermarkets but also additional product lines such as housewares, hardware, small appliances, clothing, personal care-products, garden products, and automotive merchandise. Superstores also provide a number of services to entire customers. Typically, these include automotive repair, snack bars and restaurants, film developing, and banking.

- **Warehouse Clubs.** The **warehouse club** is a large-scale, members-only establishment that combines cash-and-carry wholesaling features with discount retailing. For a nominal annual fee, small retailers may purchase products at wholesale prices for business use or resale. Warehouse clubs also sell to ultimate consumers. Instead of paying a membership fee, individual consumers pay about 5 percent more on each item than do small-business owners. Individual purchasers can usually choose to pay yearly dues for membership cards that allow them to avoid the 5 percentage mark-up. Warehouse clubs can offer a broad range of merchandise, including perishable and non-perishable foods, beverages, books, appliances, house wares, automotive parts, hardware and furniture. However, they provide limited services to keep their price lower than discount stores and supermarkets. They use direct mail for advertising.

- **Traditionally Speciality Stores.** A **traditional speciality store** carries a narrow product mix with deep product lines. Traditional speciality stores are sometimes called *limited-line stores*. If they carry depth in one product category, they may be called *single-line retailers*. Speciality stores usually sell such product as clothing, jewellery, sporting goods, computers, flowers, baked goods and books. Speciality stores can be classified further by the narrowness of their product lines. For example, a clothing store is a single-line store; men's clothing store is a limited line store but men's custom shirt store is a super-speciality store.

- **Off-price Retailers.** Off-price retailers are stores that buy manufacturers' seconds, overruns, returns, and off-seasonal merchandise at below-wholesale prices and sell them to consumers at deep discounts. Off-price retailers sell limited lines of national brand items, usually clothing, shoes or house wares. But they offer limited customer services. Manufacturers may use their own outlets to sell overstocks and unsold merchandise from other retail outlets at deep discounts.

- **Category Killer.** A **category killer** is a very large speciality store that concentrates on a single product line and competes by offering low prices and an enormous number of products. These stores are called category killers because they take business away from smaller, high-cost retail stores.

Retailers can also be classified by Amount of Service they provide. This is because different products require different amount of service some customer services preference vary.

- **Self-service Retailers:** In such retailer stores, customers are willing to perform their own "locate-compare-select" process to save money. Self-service is the basis of discount operations and typically is used by sellers of convenience goods such as supermarkets and nationally branded, fast-moving shopping goods such as catalog show rooms.
- **Limited-service Retailers:** Provide more sales assistance because they carry more shopping goods about which customers need information. Their operating costs are higher resulting in higher prices.
- **Full-service Retailers:** Salespeople assist customers in every phase of the shopping process. They carry usually more specialty goods for which customers like to be "waited on." They provide more liberal return policies, various credit plans, free delivery, home serving, and extras such as lounges and restaurants. More services result in much higher operating costs, which are passed along to customers as premium or higher prices.

Retailers can be classified by type of Store Cluster in the different localities.

Most stores today cluster together to increase their customer pulling power and to give consumers the convenience of one-stop shopping. Customers get what they want in these centres. The main types of store cluster are central business district, shopping centres, community and Neighbourhood Shopping Centres. In some cases these are known as planned shopping centres.

- **Central Business District.** They are retail clusters with department stores, speciality stores, banks, and movie theatres. They are usually located in downtowns.
- **Shopping Centres.** Shopping centres are groups of retail businesses planned, developed, owned, and managed as a unit.
- **Regional Shopping Centres:** A regional shopping centre usually has large department stores, numerous speciality stores, restaurants, movie theatres, and sometimes-even hotels. It carries most of the merchandise offered by a downtown

shopping centre. The largest shopping centres contains between 40 and 100 stores attracting customers from wide area.

- **Community Shopping Centres:** A **community shopping centre** includes one or two department stores, along with convenience stores. They normally contain a branch of a department store, supermarket, speciality stores, and sometimes a bank.
- **Neighbourhood Shopping Centres:** They generally contain 5-15 stores. They are close and convenient for consumers. They usually contain a supermarket, perhaps a discount sores, and several service stores, dry cleaner, self-service laundry, drugstore, video-rental outlet, barber or beauty shop.

Activity: 9

- **Visit any retail stores in your nearest market. List the services it provides by asking the shopkeeper. Classify the retailer into one of the retailers discussed in the previous section.**
- **List and explain the marketing intermediaries.**

Kinds of Non Store Retailing

Non-store retailing is selling that does not take place in conventional store facilities; consumers purchase products without visiting a store. Non-store retailers use direct selling, direct marketing and vending machines.

- **Direct Selling. Direct selling** is the marketing of products to customers through face-to-face sales presentation at home or in the work place. There are two kinds of direct selling: door-to-door and party plan sales.

Door-to-door selling means going directly to the customers' home for sale. It gives consumers the opportunity to buy at home or another convenient non-store location. However, with the changing roles of women (women now working outside home), direct selling firms find new ways of making contact with potential customers. As the result office-to-office and house sales parties appear in the place of door-to-door retailing.

Party-plan/Home-sales parties: In this plan, a host invites some friends to a party and will make a sales presentation. This creates more favourable selling conditions than door-to-door as the guest gets to shop in a friendly, social atmosphere. Benefits of direct selling include product demonstration, personal attention and convenience.

The disadvantage is that direct selling is the most expensive form of retailing due to higher costs for sales commission. This resulted in higher prices for customers.

- **Direct Marketing**. Direct marketing is the use of the telephone and nonpersonal media to communicate product and organizational information to customers, who can then buy products by mail or telephone. Catalog marketing, direct-response marketing, telemarketing, television home shopping, and online marketing are all types of direct marketing.

With **catalogue marketing,** an organization provides a catalogue from which customers make selections and place orders by mail or telephone. For example, magazines, newspapers and other products can be marketed using catalog marketing.

Direct-response marketing occurs when a retailer advertises a product and makes it available through mail or telephone orders. Customers normally use a credit card to make purchases. Sending letters, samples, brochures, or booklets to prospects on a mailing list are forms of direct-response marketing.

Telemarketing is using the telephone to perform marketing-related activities. Advantages of telemarketing include improving customer service, speeding up payment on past-due accounts, raising funds for non-profit organizations, and gathering marketing information from actual or potential customers.

Television home shopping displays products to television viewers, who can then order them by mailing a toll-free number and paying by credit card. However, there must be shopping cable channels to use this method. The most common products sold through television home shopping are electronics, clothing, housewares, and jewellery

Online retailing presents products on customers' computer screens. Customers purchase products by ordering them through their terminals and modems or by telephone.

- **Automatic Vending. Automatic vending** is the use of machines to dispense convenience goods automatically when customers deposit the appropriate amount of money. Vending machines do not require sales personnel. They permit twenty-four-hour service. They can be placed in convenient locations in office buildings, educational institutions, hotels and service stations. The machines make available a wide assortment of goods such as candy, cigarettes, soups, sandwiches, fresh fruits, chewing gum, postage stamps, hot and cold beverages, perfume and cosmetics. Machines offer banking service around the clock.

Activity: 10

- **Which one of the non-store retailing methods are found near your school for the selling of goods to customers.**

1.4.3.2 Warehousing

Warehousing is the set of activities involved in receiving and storing goods and preparing them for reshipment. Goods are stored to create time utility; that is, they are held until they are needed for use or sale. Warehousing includes the following activities:

- ***Receiving goods***--- The warehouse accepts delivered goods and assumes responsibility for them.
- ***Identifying goods***--- Records are made of the quantity of each item received. Items may be marked, coded, or tagged for identification.
- ***Sorting goods***--- Delivered goods may have to be sorted into different classes before being stored.
- ***Dispatching goods to storage***--- Items must be moved to specific storage areas, where they can be found later.
- ***Holding goods***--- The goods are kept in storage under proper protection until needed.
- ***Recalling, selecting, or picking goods***--- Items that are to leave the warehouse must be efficiently selected from storage.
- ***Marshalling Shipments***--- The items making up each shipment are brought together, and the shipment is checked for completeness. Records are prepared or modified as necessary.
- ***Dispatching Shipments***--- Each shipment is packaged suitably and directed to the proper transport vehicle. Shipping and accounting documents are prepared.

Types of Warehouses

Warehouses may be classified in different ways. But the most common and simple method of classification is according to ownership. A firm may either use its own warehouse or rent space in public warehouses. A **private warehouse** is owned and operated by a particular firm. It can be designed to serve the firm's specific needs. It is often built for specialized user needs. However, the organization must take on the financing the facility, determining the best location for it, and ensuring that it is used fully. Generally, only companies that deal in large quantities of goods can justify private warehouse.

Public warehouses offer their services to all individuals and firms with fee. Public warehouses operate in a manner similar to the common carriers in transportation. That is they provide services on a fee basis to a number of users. Public warehouses are good for users who need to expand or contract (reduce) storage space in a short period of time. Most are huge, one-story structures on the outskirts of major cities, where truck transportation is easily available. They provide storage facilities, areas for sorting and marshalling shipments, and office and display spaces for wholesalers and retailers. Public warehouses will also hold and issue receipts for goods used as collateral for borrowed funds. Public warehouses provide general purpose storage spaces.

Public warehouses can also be classified into five categories.

- **Commodity warehouses**. These are warehouses that limit their services to certain commodity groupings. They may specialize in storing and handling such as commodities as lumber, cotton, tobacco, and grain.
- **Bulk-storage warehouses.** Some warehouses offer storage and handling of products in bulk, such as liquid chemicals, oil, highway salts, and syrups. Mixing products and breaking bulk may also be part of the service.
- **Cold-storage warehouses.** These are controlled, low-temperature warehouses. Perishables such as fruits, vegetables, and frozen foods, as well as some chemicals and drugs require this type of storage for preservation.
- **Household goods warehouses.** These are warehouses for storage and handling of household articles and furniture. The major users are household manufacturers and moving companies.
- **General Merchandise Warehouses.** These warehouses handle a broad range of merchandise. The merchandise does not require special facilities or special handling equipment.

Bonded Warehouses are used for items to be imported or exported. They are owned by the government. Bonding arrangements are made with the government for certain goods such as tobacco and liquor, on which taxes or duties are paid. The arrangement is between the owner of merchandise and the government. In this arrangement, the goods cannot be removed from the warehouse unless to another bonded warehouse until the required taxes or duties are paid. The owner of the goods benefits by not having to pay the taxes or duties until the time the goods are sold. This minimizes the capital required in inventories or goods.

Activity: 11

- **Go to your nearest warehouse of any manufacturing organization. Identify the list of warehousing activities by asking the manager of the warehouse. Your teacher will help you in the preparation of interview guides.**

1.4.3.3 Transportation

Transportation is simply the shipment of products to customers. The greater the distance between seller and buyer, the more important is the choice of the means of transportation and the particular carrier. For transportation, three things are necessary. Firstly, a vehicle; secondly medium of movement like land, water or air or terminal; and lastly power to run the vehicle must exist.

A firm that offers transportation service is called a **carrier**. A *common carrier* is a transportation firm whose services are available to all shippers. Railroads, airlines, and most long-distance trucking firms are common carriers. *A Contract carrier* is available for hire by one or several shippers. Contract carriers do not serve the general public. A *private carrier* is owned and operated by the shipper.

In addition, a shipper can hire agents called *freight forwarders* to handle its transportation. Freight forwarders pick up shipments from the shipper, ensure that goods are loaded on selected carriers. They also assume responsibility for the safe delivery of the shipments to their destinations.

The Postal Service offers also *parcel delivery.* The posts office provides complete geographic coverage at the lowest rates, but it limits the size and the weight of the shipments it will accept. The Ethiopian postal service, for instance, provides express mail services for delivery of some goods. This method is commonly used for mail orders.

The six major criteria used for selecting transportation modes are **cost, speed, dependability, load flexibility, accessibility and frequency**. Cost includes both variable and fixed costs. Speed is measured by the total time that a carrier possesses the products. The duration includes the time for pick up and delivery, handling, and movement between point of origin and destination. Usually there is direct relationship between cost and speed. This is, faster modes of transportation are more expensive. A transportation mode's dependability is determined by the consistency of service provided by that mode. Load flexibility is the degree to which a transportation mode can provide appropriate equipment and conditions for moving specific kinds of products and can be adapted for moving other kinds of products. For example, certain types of products may need controlled temperatures or humidity levels. Accessibility refers to a transportation mode's ability to move goods over a specific route or network. Frequency refers to how often a marketer can ship products by a specific transportation mode. Whereas pipelines provide continuous shipments, railroads and waterways follow specific schedules for moving products from one location to another.

Mode of Transportation

The common modes of transportation are (a) road, (b) railroads, (c) airplanes, (d) waterways and (e) pipelines. In developing countries like ours, animal transport is the dominant one.

a) Road

i) Animal transport. In ancient time, man used to carry goods on his/her head and her back. This is still common in developing countries like Ethiopia. Then he/she used animals like asses, horses and mules for carrying goods. These animals are the major transportation means in rural Ethiopia and even in cities and towns including Addis Ababa.

ii) Trucks. The trucking industry consists of common, contract, and private carriers. Trucks can handle freight quickly and economically, and they carry a wide range of shipments. Many shippers favour this mode of transportation. This is because it offers door-to-door service, less stringent packaging requirements than ships and airplanes, and flexible delivery schedules. Currently, truck transportation is the most popular transportation amongst all other modes in Ethiopia. Trucks are also necessary for goods to reach the railway station, port or airport. However, for domestic transportation purposes, roads are the major instruments of transportation.

b) Railroads. Recently, electrified railway is rebuilt in Ethiopia from Addis Ababa to Djibouti and new light railway is constructed in Addis Ababa. In the developed nations, there is keen competition between trucks and railway because they are both land transports. Railroads provide facility for quick transport of perishable goods like eggs, milk, vegetables and fruits. Breakage and spoilage of goods in transit is less because of less vibrations of vehicle affected by weather conditions.

c) Waterways. Cargo ships offer the least expensive but slowest form of transportation. They are used mainly for bulky, non-perishable goods such as iron ore, bulk wheat, motor vehicles, and agricultural implements. Of course, shipment by water is limited to cities located on navigable waterways. The common modes of transportation in waterways are rivers, canals, and sea:

i) Rivers: Provide a safe way for the carriage of goods and passengers. Transportation of heavy goods is very easy and cheap to places located on the bank of river. In Ethiopia, Baro is the only river that provides transportation services. Other rivers in Ethiopia cannot provide transportation because of the difficulty of the geographic terrains.

ii) Canals also provide a convenient highway for the carriage of goods and passengers. Egypt gets millions of dollars from Suez Canal per day.

iii) Sea. Sea transport is the biggest mode of transport between one country and another. Foreign trade is dependent mostly on maritime transport. As stated above, it is the cheapest mode of transport.

d) Airplanes. Air transport is the fastest but most expensive transportation. All certified airlines are common carriers. Supplemental or charter lines are contract carriers. It saves much time and inconvenience for the carriage of passengers and goods. Because of the high cost, lack of airport facilities in many areas, and reliance on weather conditions, the share of airlines is the least in many countries. Construction of runways is also very expensive.

e) Pipelines. Pipelines are a highly specialized mode of transportation. They are used primarily to carry petroleum and natural gas. Pipelines have become more and more important for those countries that have high demand for petroleum products.

Activity: 12

- **Which mode of transportation is the most common in Ethiopia? What are the possible reasons for that?**

1.4.4 Marketing Promotion

Promotion is an organization's communication with external publics, especially customers and potential customers. The basic purpose of promotion is to inform persuade and remind. Promotion is the function of informing, persuading and influencing the consumers' purchase decisions.

1.4.4.1 The Promotional Mix

Components of promotional mix are advertising, personal selling, sales promotion and publicity.

a. Advertising: Advertising consists of all the activities involved in presenting to a group, a non personal oral or visual sponsored message regarding a product, service or idea. The message is transmitted through one or more media and is paid for by an identified sponsor. The media include news paper, magazine, television and radio.

Advantages of advertising: The most common advantages of advertising are the following:

- Flexibility, it allows you to focus on a small, precisely defined segment.
- Cost efficient, it enables a company to reach a large number prospects at a low cost per person.
- Allows the message to be repeated, and can improve public image.
- Allows for repeating the message, lets the buyer receive and compare the messages of various competitors.
- Allows for dramatization.
- Also used to build a long-term image of a product.
- Trigger quick sales.

Disadvantages of advertising: Advertising also has the following disadvantages:

- Absolute Birr outlay is very high.
- Rarely provides quick feedback, or necessarily any feedback.
- Less persuasive than personal selling.
- Audience does not have to pay attention.
- Indirect feedback (without interactivity).

b. Personal Selling: It is a seller's promotional presentation conducted on a person to person basis with the potential buyer. It is a direct, face-to-face form of promotion.

c. **Sales promotion:** Incentives, inducements and point-of-sale material designed to stimulate trade and/or consumer demand. For example, free samples, discount vouchers and competitions.

d. **Internet and on-line marketing:** Electronic media are used, as opposed to traditional methods. The approach can be targeted (as per direct marketing), e.g. e-mail marketing, or involve advertising on the Internet.

e. **Publicity:** Publicity includes activities to promote a company or its products by planting news about it in media not paid for by the sponsor. Presently, public relations is replacing that of publicity. Public relations deals with building good relations with the company's various publics by obtaining favourable publicity, building up a good " corporate image," and handling or heading off unfavourable rumours, stories and events. The major functions of public relations are press relations, product publicity, public affairs, lobbying, investor relations and development.

Activity: 13

- **Explain the difference between newspaper and magazine and radio/tv advertisement.**

1.4.5 Marketing Management

Who wants in the class to specialize in Marketing Management? Do you think marketing management practice is matured in Ethiopia?

Marketing management is one of the many specialized areas of management. Remember that marketing is a philosophy to guide the whole firm toward satisfying customers at a profit. **Kotler defines marketing management as the analysis, planning, implementation and control of programs designed to create, build, and maintain beneficial exchanges with target buyers for the purpose of achieving organizational objectives**. Thus, marketing management involves managing demand, which in turn involves managing customer relationships.

Perreault and McCarthy defined marketing management as the process of (1) Planning marketing activities; (2) directing the implementation of the plans, and (3) controlling these plans. Planning, implementation and control are the basic jobs of all managers – but here it is related to marketing managers. Marketing planning includes setting objectives, evaluation of opportunities, creating marketing strategies, and preparing marketing plans and development of marketing programs on marketing mix. Implementation entails putting plans and programs into effect. On the other hand, controlling of marketing plans and programs deals with measurement of results and evaluation of progress.

The detail discussion on marketing management is beyond the scope of this text book. Some of you may specialize in marketing management when you join universities next year. But, an economy dominated by small businesses such as in Ethiopia, employers require management graduates in general areas to perform many of the major functions of organizations. However, in developed nations, marketing management is one of the prestigious fields of management studies. As a result, marketing managers are highly paid ones among other professionals.

Summary

This unit addresses the basics of marketing and its basis functions as well as the marketing mix. **Marketing** is defined as a social and managerial process by which individuals and groups obtain what they need and want through creating and exchanging products and value with others.

Market is a mechanism that brings buyers and sellers of product together.. Markets may be classified as consumer markets, industrial markets, reseller markets, government markets and institutional markets.

The **functions** of marketing include buying, selling, transporting, storing, financing, standardizing and grading, risk taking and gathering market information. These marketing functions are also performed by middlemen such as wholesalers or retailers.

Marketing mix is the mixture of marketing variables that an organization can manipulate to approach the target market. They are known as the four P's; namely product, place (distribution), promotion and price. A product is everything one receives in an exchange, including attributes and expected benefits. The product may be a manufactured item, a service, an idea, or some combination of these. The sales and profit volumes of a product can be estimated using the concept of the product life cycle. A channel of distribution (place) is a sequence of marketing organizations that directs a product from the producer to the ultimate user. Different products require different channels of distribution. The main ones are direct and indirect (which may be long or short) or both. .

Promotion is the function of informing, persuading, and influencing the customer's purchase decision. The basic components of promotion are advertising, personal selling, sales promotion and publicity as well as Internet advertising.

Review Questions

Part I. Choose the best answer from the given alternatives.

1. The process of creating value for building relationships with customers in order to capture value back from them is ___________.
   a. Utility
   b. Social Commerce
   c. Transactional
   d. Marketing
   e. Buying power
2. When a gap exists between existing state and your desired state, you have a/an ________.
   a. Value
   b. need
   c. want
   d. benefit
   e. demand
3. The exchange of value between parties is a/an __________.
   a. Purchase
   b. transaction
   c. transition
   d. sale
   e. none of the above
4. The company's marketing mix consists of the following EXCEPT.
   a. Promotion
   b. place
   c. product
   d. production
   e. price
5. Decisions on where to have your products available for purchase by the customer would fall under the marketing mix element known as _________.
   a. Price
   b. promotion
   c. product
   d. place
   e. production

Part II. Define and explain the following terms.

A. Marketing
B. Market
C. Exchange
D. Transaction
E. Middleman
F. Agent
G. Wholesaler
H. Retailer
I. Telemarketing
J. Warehousing
K. Transportation
L. Advertising
M. Personal selling
N. Publicity
O. Public relations

Part III. Answer the following questions.

1. What is the difference between publicity and public relations? What is the purpose of each?
2. What are the most common channels for consumer products? For industrial products?
3. Identify three kinds of full-service wholesalers. What factors are used to classify wholesalers into one of these categories?
4. Which distribution channels would producers of services most likely use? Why?
5. Many producers sell to consumers both directly and through middlemen. How can such a producer justify competing with its own middlemen?
6. Identify and describe the major ingredients of a promotional mix.
7. What is the major role of promotion?
8. What are the four stages of product life cycle? How can a firm determine which stage a particular product is in?
9. Why most firms introduce new products?
10. Describe each of the classification of industrial products.
11. What is the primary function of price?
12. Which pricing strategies are used mainly for new products?
13. Which media of advertising do businessmen in your locality use most frequently?

PART IV.GROUP WORK

Form group of five to ten students in your class and visit one business organization and identify what type of product pricing approach it follows and why?

Unit 2

COMMUNICATION

Unit Outcomes

At the end of this unit, students will be able to:

- recognize concept of communication.
- differentiate the various methods of communication.
- prepare business letters.

Introduction

Communication is very important for two basic reasons. Firstly, communication is important for managerial tasks or duties such as planning, organizing, directing and controlling. Secondly, communication relates an organization to the external environment such as customers, suppliers, government offices, competitors, etc. The purpose of this unit is to give a brief explanation of communication in organizational and personal contexts. The major emphasis here will be on communication effectiveness using different media.

Contents of the Unit

In order to be able to achieve the above objectives, you will learn the following topics:

- Definition of communication and business communication;
- Methods of communications
- Effective formats of business message
- Business report writing and business reports
- Other common reports and their heading
- Writing curriculum vitae

2.1 Definition of Communication and Business Communication

- *What do you understand when we say communication?*

Remember the definition of business you did learn in grade 11. When communication is applied in business we say business communication. Therefore, in this context we used business communication or simply communication interchangeably. The application of communication for administrative purposes is also called administrative communication.

We can define communication or business communication as the transmission of information and understanding through the use of common symbols.

If mutual understanding does not result from the transmission of symbols, there is no communication. These symbols may be letters, numbers, pictures, facial expressions, reports, audio, video, and the like. Or communication occurs when an exchange of messages results in shared meaning. In other words, for communication to exist, the idea in the mind of the sender must be identical or at least similar to the idea in the mind of the receiver. Otherwise, there is no communication.

In organizations, the flow of information can be considered like the flow of blood in the human body. Every member of an organization is a link in the information chain. One of your first priorities as an employee should be to make sure that you are sending and receiving the messages required to help your group function effectively.

To be effective communicator in your organization or your life, you should constantly ask the basic question of communications namely "**WHO? WHAT? WHERE? WHEN? WHY? HOW?**"

- **WHO** are the senders/receivers of this communication?
- **WHAT** is the core thought- the key idea, the main point – of this communication?
- **WHAT** relates the core thought to both the sender's and receiver’s purposes?
- **WHERE** does the message strengthen relationships between sender and receiver?
- **WHEN** was the message sent and received (or when will it be sent and received)?
- **WHY** was the message (or why will it be) sent?
- **HOW** does the message use sources and information?
- **HOW** was the message (or how should it be) worded?
- **HOW** was the message (or how should it be) transmitted?

Activity: 1

- **Why one should ask the WH (who, what, where, how) questions in communication?**
- **Define communication using your own words.**

2.1.1 Importance of Communication

Success in an organization depends to a great degree upon the ability of the manager to understand other people. Managers can understand their employees through proper communication. Your ability to clearly write, listen, and speak determine also your success in life wherever and whoever you will be. Employers require their employees to have excellent communication skills in writing, speaking and listening. Getting acceptance of policies, winning cooperation of others, getting ideas and instructions clearly understood, and bringing about desired changes in performance also depend upon efficient communication in an organization. To specifically state the importance of communication in organizations, the followings points require special mention.

1. **Communication facilitates efficient and smooth running of an organization**. Common causes of organizational inefficiency are related to poor communication. But, effective communication enables an organization to secure cooperation between persons and assures performance and achievement of objectives.

2. **Communication brings higher productivity at minimum cost.** Communication is important to enhance the morale (willingness to work) of the employees. It also helps for proper supervision to make employees interested in their work. These functions in effect help an organization to increase productivity and to minimize cost. Productivity is producing more and more output with the usage of less and less resources (material, labour, capital and knowledge) in the organization. Poor communication may cause accidents, resources wastage, low morale and in effect low productivity.

3. **Facilitate democratic management.** Democratisation is becoming very popular in most countries of the world. This has necessitated democratic style of leadership in most organizations in the new millennium. Thus, communication enables participation of members of the organization in decision making. This democratic style of leadership promotes the support and understanding of superiors (bosses) and subordinates and work towards their common objectives.

4. **Communication binds people together.** It introduces the sense of cooperation and produces the will to work very hard. It helps to establish and disseminate objectives of an organization that brings people with different interests together. It serves as bondage to bring people together for common cause.

5. **Communication facilitates management processes.** Management is the process of planning, organizing, directing and controlling. Such managerial processes can be facilitated through effective communications.

6. **Communication is the basis for decision making.** The quality of decisions in an organization depends on the amount and quality of information, which is effected through communication, available to managers. Effective communications is also important to proper implementation of plans. Most plans are not implemented in Ethiopia mainly due to poor communication.

Activity: 2

- **What are the effects of poor communication systems in an organization?**
- **What are the effects of good communication systems in an organization?**

2.1.2 Process of Communication

There are different models of the communication process. But, for our purpose, the following diagram is used to explain the process. As shown in figure 2.1, the process of communication can be broken down into basic elements. These are the communicator, encoding, the message, the medium, decoding, the receiver, noise, and the feedback. The following diagram shows communication process as a simplified model.

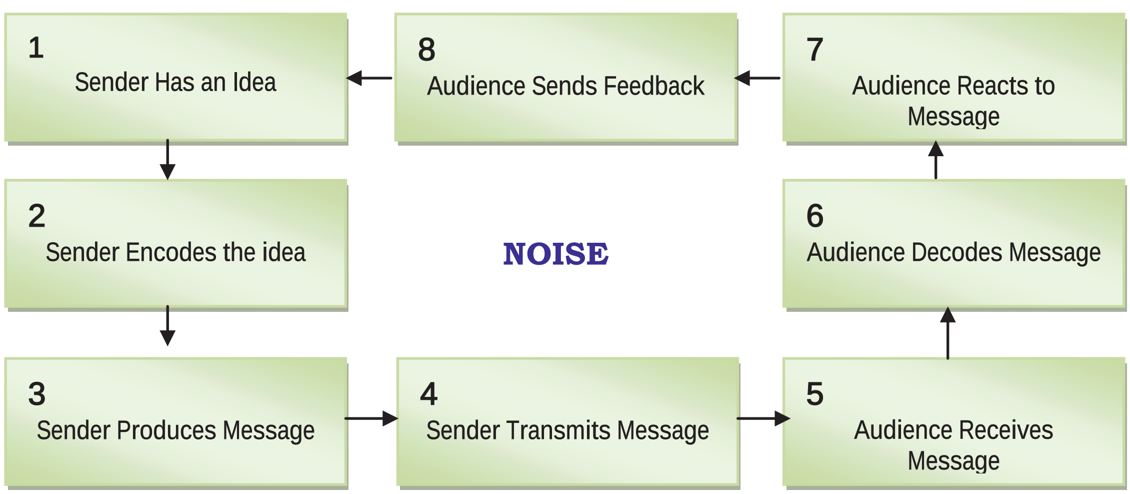


Figure 2.1 The communication process

By viewing communication as a process, such as the above, you can identify and improve the skills that you need to be more successful.

1. The sender has an idea.
2. The sender encodes the idea as a message.
3. The sender produces the message in a transmittable medium.
4. The sender transmits the message through a channel.
5. The audience receives the message.

6. The audience decodes the message.
7. The audience responds to the message.
8. The audience provides feedback.

The following process of communication is another model which can be seen from the receiver, sender and medium of communication perspective with more elaboration.

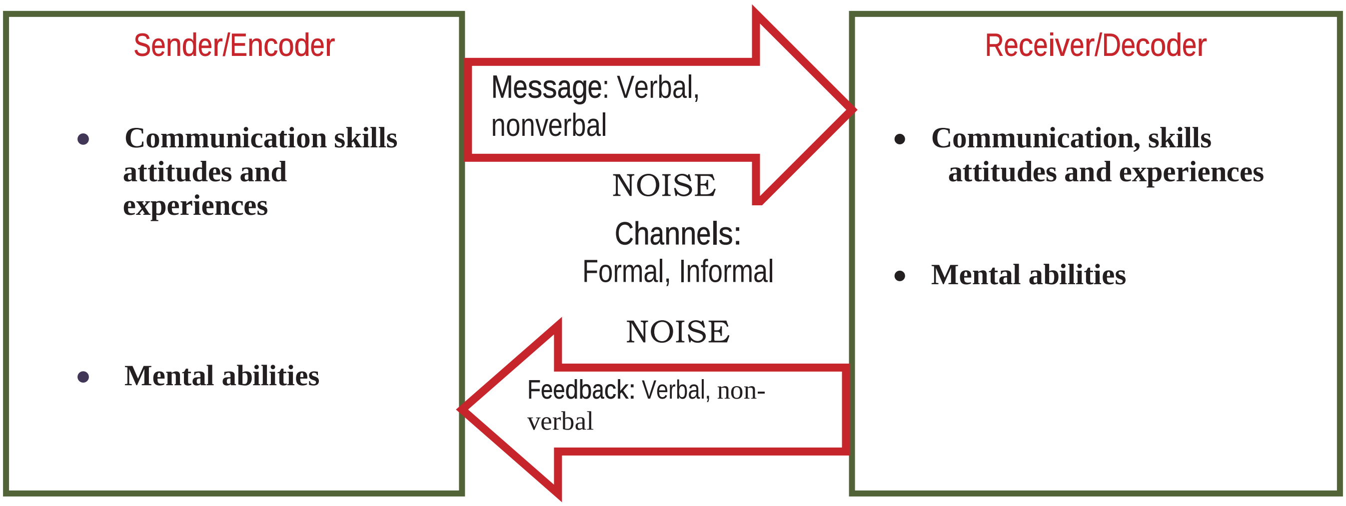


Figure 2.2 A model of the communication process

a. The communicator. The communicator is the person who intends to make contact with the objective of passing information or idea to the other. Your teacher in front of you is a communicator. However, communicators in an organization can be managers, non-mangers, departments, or the organization itself. Managers communicate with other managers, subordinates, supervisors, customers, and parties outside the organization.

b. Encoding. Idea is abstract and intangible and its transmission requires the use of certain symbols. Probably, you may use some code to communicate with your friends somewhere and some place. A code in this case is a language known only by you and your friend. The sender may used verbal, nonverbal or written means of coding his/her message.

c. The message. The result of the encoding process is the message. The purpose of the communicator is expressed in the form of messages. The messages can be either verbal or nonverbal.

d. The medium. The medium is the carrier of the intended message. Communicators provide information to their receivers by a variety of means. These include face-to-face communication, telephone, short mobile messages (SMS), group meetings, computers, memos, policy statements, reward systems, bulletin boards, production schedules, company publications, and sales forecasts.

e. Decoding. Decoding refers to the process by which receivers translate the message into terms meaningful to them. If the message in the mind of the sender and the message in the mind of the receiver are the same, then, understanding takes place. Otherwise, there is no communication.

f. The receiver. Receiver is the person to whom the message is meant for or sent. Communication requires a receiver who must be taken into account when a communicator attempts to transmit information.

g. Noise. Noise is any element or condition that disturbs or interferes with effective sending and receiving of information. Disturbances can occur at any point in the communication process. The sender may use unclear symbols. The receiver may not be ready to receive message. The telephone line may be noisy. The image in the television screen may be vague. The memos may be poorly produced.

h. Feedback. Feedback enables the communicator to determine if the message has been received and if it has produced the intended response. One-way communication processes do not allow receiver-to-communicator feedback. Two-way communication processes, however, do. Feedback may come in many ways. Your teacher may ask questions regularly to measure your level of understanding. Tests and examinations are given to measure level of understanding in the class. Your teacher may observe your facial expressions as a feedback for adjusting his/her teaching style. All these are examples of feedback mechanisms to the communication process in the classrooms. In organizations, periodic reports, performance reports, accounting reports, audit reports and the like serve as feedback for managers to make adjustments in managing their organizations.

Activity: 3

- **Identify and explain the basic elements of communication process and give examples for each.**
- **What types of feedback do you use when you talk to your friends?**

2.2 Methods of Communication

- *Can you tell us the common methods of communication?*

Classification of communication should be seen as an essential prerequisite of the analysis of communication. We can classify communication by **media, by direction** and by **degree of formality**.

2.2.1 Communication by Media

This classification divides communication into verbal (spoken), non-verbal (face, tone of voice, physical presentation, gestures), written and numerical. The spoken word/verbal lacks the permanence of the written word. However, it is more rapid and flexible in terms of adjusting to the circumstances. Moreover, the spoken word can be supported by non-verbal communication such as body language. The non-verbal communication such as body language will reinforce the spoken message. But, written communication is formal, permanent and must be kept properly in the organization.

Activity: 4

- **Identify the different nonverbal languages that you use to communicate in your locality.**
- **State the advantages of written communication.**

2.2.2. Communication by Direction

The following figure shows the direction of communication in an organization.

The shape of any organization structure is similar to the shape of a pyramid as shown in Figure 2.3. This is known as the **hierarchy of management**. In terms of the hierarchy of management, the pyramid is divided into three levels; namely, top management, middle management and operational management. Within this structure, communications takes place. In this context, communication can be **downward**, **upward**, **horizontal** and **one/two** way communication. **Downward communication** follows the authority-responsibility relationship in the organization chart. It usually takes the form of giving instructions, directions, assigning duties, or

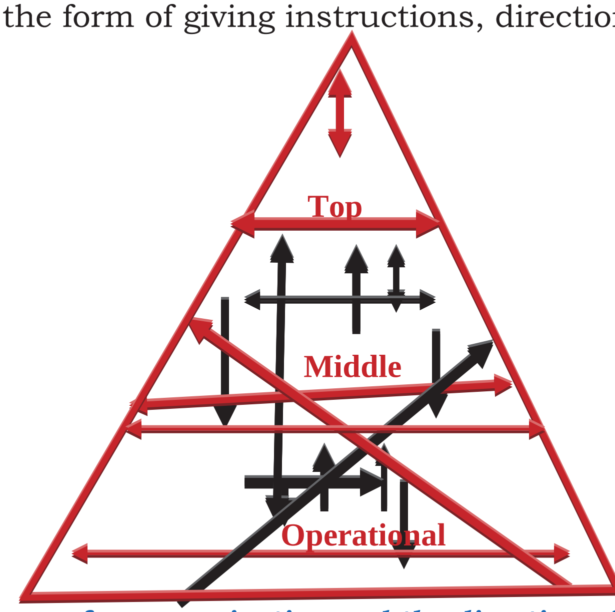


Figure 2.3 Shape of an organization and the direction of communication

(note that the flow of message follows the direction of the arrows).

providing information to those delegated to perform a task. **Upward communication** takes the form of reporting back results, making suggestions or perhaps airing grievances and complaints (dissatisfactions).

Horizontal communication: refers to contacts (formal or informal) between people at the same level within the organization. It is usually coordinative in nature and usually involves sharing information, resolving conflicts and solving problems across the organization structure.

A further aspect of direction relation is whether communication is one way or two ways. When there is no facility for a reply (feedback), it is called **one-way communication.** An advertisement or information posted on a notice board is an example of one-way communication. One-way communication within an organization is associated with authoritarian (dictatorial) style of leadership. In the authoritarian or dictatorial leadership style, the authority of the leader is being preserved unchallenged. For simple communication, a one-way channel might prove satisfactory. However, it carries with it the danger of being misunderstood. This is because there is no facility for checking and it may cause dislike. Feedback built into two-way communication is a feature of democratic leadership style. The facility for feedback is important for ensuring that the message is fully understood and to enable subordinates to contribute to the process of decision making. However, it is slower than one-way communication.

Activity: 5

- **Identify the organization chart of your school and mention the types of communication in the organization in terms of direction by giving examples.**

2.2.3 Communication by Degree of Formality

Communication can be classified as formal and informal. **Formal communication** is arranged, approved or official. **Informal communication** is unofficial, unplanned communication outside the organization's formal channels. Informal groups in an organization use the informal channel for communication purpose. Informal groups may be formed due to similarities in age, sex, language, ethnic background, interest, family background and the like. It is a mistake to equate formal communication with the written form and informal with the spoken and nonverbal forms. When a superior warns or reprimands a subordinate by means of the spoken word, it is formal communication. A joke in written form passed around the office is informal communication.

Activity: 6

- **What is the difference between informal and formal channels of communication? Are there informal groups in your class?**
- **What methods do organizations use a common means of communication?**

2.3 Effective Formats of Business Messages

Business Communication involves various formats, or layouts, or written messages. The following are discussed in this part of the material:

1. Business Letters and Business Letter Formats (2) form letters (3) Office Notes and Message Forms, (4) Memorandum and (5) News Releases. Let us discuss one by one.

2.3.1 Business Letter's Common Components

This topic briefly explains the mechanical and physical details of business letters. All of the components are discussed in the following.

a. **Heading.** The heading contains the writer's address and the date of the letter. The writer's name is not included and only a date is needed in headings on letterhead stationery.

b. **Inside Address.** The inside address shows the name and address of the recipient of the letter. This information helps prevent confusion. In the inside address, include the appropriate title of respect of the recipient; and copy the name of the company exactly as that company writes it. When you do have the names of individuals, remember to address them appropriately as Mrs., Ms., Mr., Dr., Ato., W/o., W/t., and so on.

c. **Salutation.** Salutation is equivalent to good morning or good afternoon or good evening of oral communication. The salutation directly addresses the recipient of the letter and is followed by a colon (except when a friendly, familiar, sociable tone is intended, in which case a comma is used). Note that in the simplified letter format, the salutation line is eliminated altogether.

d. **Subject or Reference Line.** In some cases, the subject line replaces the salutation or is included with it. The subject line announces the main business of the letter. It should be brief but explanatory.

e. **Body of the Letter.** The actual message of the letter is contained in the body of the letter which is placed between the salutation and the complimentary close. It contains several paragraph texts. But in business, the body should be very short even sometimes one sentence is acceptable.

f. Complimentary closing. The "Sincerely yours" element of the business letter is called the complimentary closing. Other common ones are "Sincerely yours," "Cordially," "Respectfully," or "Respectfully yours." Note that only the first letter is capitalized, and it is always followed by a comma.

g. Signature Block. Usually, you type your name four lines below the complimentary close, and sign your name in between. If you are a woman and want to make your marital status clear, use Miss, Ms., or Mrs., W/t., W/o., in parentheses before the typed version of your first name. Whenever possible, include your title.

h. End Notations. Just below the signature block are often several abbreviations or phrases that have important functions.

1. **Initials.** The initials that are all in capital letters are those of the writer of the letter, and the ones in lower case letters just after the colon are those of the typist.
2. **Enclosures.** To make sure that the recipient knows that items accompany the letter in the same envelope, use such indications as "Enclosure," "Encl.," "Enclosures (2)." For example, if you send a curriculum vitae and writing sample with your application letter, you'd do this: "Encl.: CV and Writing Sample." If the enclosure is lost, the recipient will know.
3. **Copies.** If you send copies of a letter to others, indicate this fact among the end notations also. If, for example, you were upset by a local merchant's handling of your repair problems and were sending a copy of your letter to the organization, you'd write this: "cc: ABC Business Bureau."
4. **Following Pages.** If your letter is longer than one page, the heading at the top of subsequent pages can be handled in one of the following ways:

If you use letterhead stationery, remember not to use it for subsequent pages. However, you must use blank paper of the same quality, weight, and texture as the letterhead paper.

Activity: 7

- **Go to the secretary or typist of your school and identify the parts of the letter from any letter sent by your school to any organization such as Education Bureau.**
- **Observe one of the letters posted on the notice board of your school. Draw its structure and identify its common parts?**

Business Letter Formats

If you are writing a business letter, select one of the common formats. These include the block letter, the semi-block letter, the alternative block letter, and the simplified letter.

Which one of these formats to use depends on the ones commonly used in the organization or the situation in which we are writing. Use the simplified letter if you lack the name of an individual or department to write to.

The Block format: In the block format, paragraphs are unindented. All letter elements are flush with the left margin.

Modified block: In this style of letters, paragraphs are unindented. The return address, reference line, date, complimentary closing, and signature block are right of centre. The remaining elements are flush with the left margin.

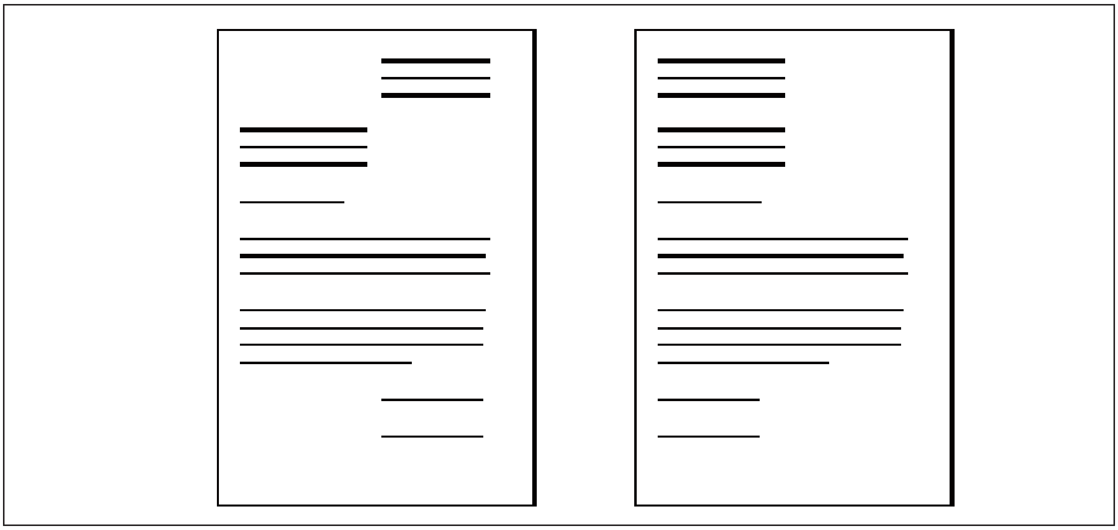
Semi-block: Paragraphs are indented usually an equivalent of five spaces. The return address, reference line, date, complimentary closing, and signature block are right of centre. The remaining elements are flush with the left margin.

Simplified: Paragraphs are unindented. The salutation and complimentary closing are omitted. All elements are flush with the left margin.

The following pictures show what a one-page business letter should look like. There are three accepted styles. The horizontal lines represent lines of type.

Modified Block Style

Block Style



Semi block Style

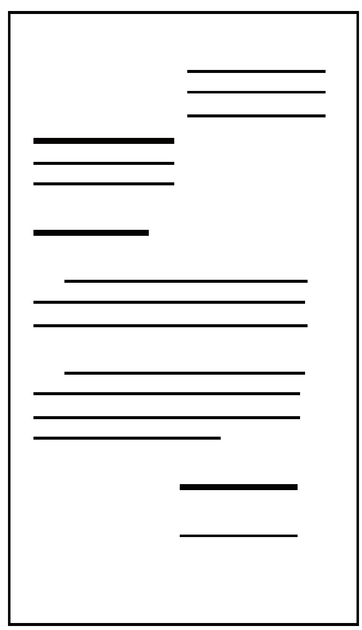


Figure 2.4 Styles of business letters

(a)

KIP Publisher
P.O.Box 579
Addis Ababa
Ethiopia

Ref. № ******
January 15, 2002

ZLM Business Group (b)
P.O.Box 1234
Addis Ababa
Ethiopia

Dear Sirs: (c)

We are interested in the purchase of the following items:

1. Personal computer latest product;
2. Floppy diskette;
3. Television set; (d)
4. Table for the computer;.

(e)
Kindly let us have your quotation indicating the price, terms of payment, delivery time etc.

Yours faithfully, (f)

Sosina Tesfaye (g)
Purchasing Manager

tp/BW (h)
Enc. Terms and conditions of payment

Activity: 8

- **Identify the components of business letter indicated by the given numbers in the letter.**

Principles of Business Letter Writing

Writing business letters and memos differs in certain important ways from writing reports. Keep the following advice in mind when you write and especially when you revise your business letters or memos.

a. **State the main business, purpose, or subject matter right away.** Let the reader know from the very first sentence what your letter is about. Remember that when business people open a letter, their first concern is to know what the letter is about, what its purpose is, and why they must spend their time reading it.

b. **If you are responding to a letter, identify that letter by its subject and date in the first paragraph or sentence.** Busy recipients who write many letters themselves may not remember their letters to you. To avoid such problems, you must identify the date and subject of the letter to which you respond.

c. **Keep the paragraphs of most business letters short.** The paragraphs of business letters tend to be short, some only a sentence long. Business letters are not read the same way as articles, reports, or books. Usually, they are read rapidly. Big, wide, crowded paragraphs over ten lines, which require much concentration, may not be read carefully — or read at all.

d. **Classify the contents of your letter.** When you "compartmentalize" the contents of a business letter, you place each different segment of the discussion each different topic of the letter — in its own paragraph.

e. **List or itemize whenever possible in a business letter.** Listing spreads out the text of the letter, making it easier to pick up the important points rapidly. Lists can be handled in several ways such as using bullets.

f. **Find positive ways to express bad news in your business letters.** Often, business letters must communicate bad news. Bad news can be conveyed in a tactful way. Doing so reduces the chances that business relations with the recipient of the bad news will end.

g. **Focus on the recipient's needs, purposes, or interests instead of your own.** Avoid a self-centred letter focusing on your own concerns rather than those of the recipient.

Activity: 9

- **Compose a business letter to the school administrator stating that the quality of chalk delivered to your school is very poor.**

2.3.2 Form Letters

Identical or nearly identical messages, based on a master draft and send to more than one person, are called **form letters**. The number of copies to be mailed depends upon the task and the budget for each message.

Dear Sirs:

This is to introduce ______________________________ who is a student in our school. He/she is assigned to make practical study on ____________________________ in your organization/company.

We thank you in advance for any assistance extended to him/her.

Sincerely,

Mohammed Yimer

Director, Menilik II Preparatory School

2.3.3 Office Notes and Message Forms

Perhaps the least formal kind of written business message is a brief note of information requiring no permanent record. Although informal, such notes speed up communication within the same organization. They may be typed or handwritten (legibly); they may be printed forms that the sender merely completes. Annex C at the end of this unit shows an example for interoffice message form.

2.3.4 Memoranda

Memorandums or memoranda or memos are structured more formally than are notes. A memo has basically a four-part heading:

TO: (receiver's name)

FROM: (Sender's name)

SUBJECT: (Message core thought or file reference)

DATE: (month, day, year, even the time of day when appropriate to the message)

Sample memo is given below for better understanding about its nature.

To: Students taking business education

From: Teachers of the course

Subject: Examination on General Business Education

Date: June 20, 2012

Please note that there will be mid-examination on the course General Business Education on June 20, 2012 at 2:00 p.m. in the school hall.

Activity: 10

- **Compose a memo on behalf of your teacher to the Director of your school asking for arrangement of transportation service to your trip to visit one of the Factories/ Colleges in your locality.**
- **Read a Newspaper and identify the major news in the issue and identify the essence of the content.**

2.3.5 News Releases

Another business communication format is that of the news release intended for most media transmission by radio/TV broadcasts, newspaper stories, and magazine articles.

2.4 Business Report Writing and Business Reports

The discussion in this part of the textbook deals with business reporting. Business reporting is one of the many components of written communication. Business reporting is one of the most critical stages of many events in the business world.

2.4.1 Main Parts of a Report

A report can be largely divided into the following parts: 1. Cover, 2.Title page, 3. Summary of the report, 4. Table of contents, 5. Introduction to the report, 6. Main body of the report, 7. Conclusions, 8. Recommendations, 9. Annex, appendices and references. Let us look at each of the parts in brief and see how to present them so that we have an effective report.

1. **Cover:** The cover is the first encounter with the report and has to be eye-catching. The cover also serves to enhance the image of the organisation. In case of reports prepared by students, the cover page and the title page is usually the same.
2. **Title Page:** The title should be precise and convey the main objective of the study or the project. This page could also include subtitles, which gives more information about the project.
3. **Summary:** This is the most important part of the report. The summary should contain the main point of the report. The entire information carried in the report must be conveyed in its essence.
4. **Table of Contents:** This section gives the broad contents of the report and the flow of information in the report. The arrangement of topics and the flow of information should be logical. The arrangement of topics is logical if ideas naturally follow each other.
5. **Introduction:** This section should give the background information on the report. It should give an explanation as to why the particular study or project is undertaken. It should also give the prevailing facts at that point of time.
6. **Main Body of the Report:** This discusses the project in depth. This will include the steps taken for the research/report, the actual research carried out and the data collected and used for the study.
7. **Conclusion:** This section must give the results of the report. This should be very objective. This section must contain only the conclusions and not the recommendation as the user might like to decide for him/her based on the conclusions of the report.
8. **Recommendation:** This section is to be included if specific recommendations are asked for. The author/report writer can give out his/her opinion and must suggest the specific course of action to be taken to act on this report.
9. **References and Appendices:** These are put up at the end of the report if they are required.

Activity: 11

- **Identify and briefly explain the components of business report.**
- **Form a group consisting of three to five members and elect a group leader. Go to the library and identify any report on any subject matter preferably business. Using the report as a reference, identify the main parts of the report by stating the page numbers.**

2.5 Other Common Reports and their Headings

In any organization there are different business reports depending on the nature, size, product lines and available manpower in the organization. However, for this purpose we shall see the most common reports and their recommended headings of common reports.

2.5.1 Meeting Reports

There are many meetings of management, committees, board of directors and the like in any organization. The meetings of such committees must be documented and the possible headings are stated as follows:

1. Group/date/place of meeting;
2. Chart of follow-up actions and persons responsible by date;
3. Those present and those absent in the meeting from the meeting respectively;
4. Agenda items (topics of discussions);
5. Discussion of each agenda item in terms of background, discussion, action plan;
6. Next meeting and proposed agenda.

2.5.2 Progress Reports

Different tasks or projects may be assigned to persons, departments, task forces, groups and committees. The progress of the task or project should be reported to management. This report is normally known as Progress Reports and the content of progress report is as shown below.

1. Projects completed including final against plan (data) and learning to be shared.
2. Projects in process including status against plan (data) and issues/concerns and recommendations/implications.

2.5.3 Trip Reports

Managers and employees may organize some trips to actually see and observe the operations, physical settings; activities and operations of an organization for further understanding. Such trips must be reported to management of the organization. The headings of trip reports include date of trip/destination; purpose of the trip, background; details such as Who? What? Findings/results, implications, conclusions/ recommendations, follow up, and attachments (other documents to be included as part of the main reports that can be referred).

Activity: 12

- **Organize any short trip with your teacher and prepare trip reports in-group consisting of three to five members. You can visit any project started at or nearby or laboratory of your school.**

2.6 Writing Curriculum Vitae (CV)

Your CV is the description of your self. Your curriculum vitae (CV), or resume, is one of your first selling tools. Keep it short, simple and to the point. A CV should contain (1) Personal details such as (a) Full name, (b) Address, (c) Phone, (d) Fax, (e) e-mail, (f) Date of birth, (2) Qualifications, (3) work experience. Items from (a) to (f) are simple but item 2 requires special mention.

Qualifications: State your qualifications by starting with the most recent such as course level achieved and when it took place, name of institution.

Work experience: Starting with the most recent/most relevant, first include your job title, start and finish dates.

Skills: Highlight specific skills, knowledge or attributes starting with most impressive/most relevant to the particular job application.

Achievements: This is where you can include activities over and above job experience and study that show constructive use of your spare time. You can include things like positions held on committees, charity work, public speaking, competitions etc.

Hobbies and Interests: Use this section to show that you have interests outside the job.

Referees and References. Referees are considered more important these days than letters of reference, although it is good to have both. Always ask for a reference after having worked for someone, even if it is only a few days or in a voluntary capacity.

2.6.1 Writing your CV

Writing perfect CV requires some experience and creativity. But, it must be true because potential employers may ask your referees to check the accuracy of the information stated in the document. See Annex A at this end of this unit for sample CV for writing your CV.

2.6.2 Writing Your Cover Letter

A cover letter is a vital part of your job application. Many employers make their first selection on this basis. It should be a clear, comprehensive and concise account proving why you are the best person for the job. You should use it well to complement your CV. See Annex B to see for sample cover letter.

Activity: 13

- **Prepare your CV and write an application or cover letter to an organization that has advertised for a vacant position close to your school.**
- **What types of questions do employers normally ask during employment interview? Discuss this in class.**

2.7 Preparing for an Interview

An interview can be a disturbing experience. However, considered presentation and preparation is half the work done before you even get there. Here are some points on how to make the procedure run smoothly.

Appearance: Employers want to see signs of an organised personality. Therefore, choose a smart tidy outfit that you feel comfortable wearing. It is usually wise to make a mistake on the side of caution and dress conservatively.

Preparation: Before the interview, try and find out the basics about the company. You can do this by checking to see if they have a web site (not common in Ethiopia), looking in the library where there are usually a number of research publications on companies (still limited even at university level), or asking if there is written information available on the company or organisation.

On arrival

- Double-check the address. Plot out your route the night before.
- Arrive early. Give yourself plenty of time to find a taxi or bus and get into the building without rushing.

Interview guidelines

- Do not sit until you are offered a chair.
- Smile, be attractive and listen carefully.
- Maintain eye contact when you talk.
- Do not interrupt over the interview.

Activity: 14

- **Explain briefly the preparations for job interview.**

Summary

Communication is the transmission of information and understanding through the use of communication symbols. These symbols may be letters, numbers, pictures, facial expressions, and the like. The role of communication is to facilitate internal functions and relate the organization with the external environmental elements such as customers, suppliers, government, lenders and the like.

For effective communications, communicators should ask the basic questions of communication such as who, what, where, when, why and how. On the other hand, the basic elements of communication process are the communicator, encoding, the message, the medium, the receiver, decoding noise and feedback

Communication may be classified by media such as verbal, non-verbal, written and numerical, by direction such as downward, upward, horizontal, diagonal, one-way or two way, by degree of formality as formal and informal communication. Business report is very important for business decisions. The main parts of the business report are cover, title page, summary, table of contents, introduction, main body of the report, conclusions, recommendation and references and appendices.

The formats of business messages are business letters, form letters, office notes and messages, memorandum and news release. The main components of business letter includes heading, inside address, salutation, subject line, body of the letter, complimentary closing, signature block, end notations, initials, enclosures, copies.

Curriculum vitae are the descriptions of oneself. Curriculum vitae should contain personal details, qualifications and work experiences. Curriculum vitae may be prepared based on the requirements of employers. Applicants for vacancy should prepare themselves for interview including their dressing,. and for the interview the interviewee should follow the procedures of appearance ,preparation, on arrival and interview guidelines .

Review Questions

Part I. Choose the best answer from the given alternatives.

1. Which one of the following is not an element in the communication process?
   a. Sender
   b. Receiver
   c. Noise
   d. Feedback
   e. none of the above
2. The communication between the school director and your business teacher is an example of
   a. Upward communication
   b. Downward communication
   c. Horizontal communication
   d. a and b.
   e. b and c
3. The policies, instructions and orders that flow from Woreda Education Bureau to your school is an example of
   a. Upward communication
   b. Downward communication
   c. Horizontal communication
   d. a and b.
   e. b and c
4. The suggestions that students and teachers give to the school administration is an example of
   a. Upward communication
   b. Downward communication
   C. Horizontal communication
   d. a and b
   e. b and c
5. The description of oneself is
   a. Curriculum Vitae
   b. Interview
   c. News Release
   d. Form Letter
   e. None

Part II. Define and explain the following terms.

a. Communication
b. Receiver
c. Communicator
d. Medium
e. Encoding
f. Message
g. Decoding
h. Noise
i. Feedback
j. Body language
k. Nonverbal communication
l. Downward communication
m. Upward communication
n. Horizontal communication
o. Diagonal communication
p. One-way communication
q. Two-way communication
r. Formal communication
s. Informal communication
t. Referee

Part III. Answer the following questions.

1. What are the basic questions that a communicator should ask before starting communication?
2. Explain the importance of communication in an organization.
3. Explain the elements of communication using communication process model.
4. What types of messages are communicated using downward communication?
5. Explain the difference between one-way and two-communication methods.
6. What is the difference between formal and informal communication channels?
7. What are the major components of business reports?
8. Outline the major components of minutes of a meeting.
9. What are the physical components of business letters?
10. What are the main purposes of form letters?
11. Outline the content of curriculum vitae.
12. What is cover letter? What things should be considered in writing business letters?

PART IV GROUP WORK

Form group of ten students and write short note whether there exists good or poor communication b/n teachers and students in the learning and teaching processes in the school and discus it with the school principal.

Annex A: Sample CV

CURRICULUM VITAE

1. PERSONAL DETAILS

- **Name:** ***********************
- **Date of Birth:** DD/MM/YYYY
- **Sex:** *****
- **Marital Status:** *****
- **Nationality:** Ethiopian
- **Address:** P.O.Box *******
  Tel *********
  E-mail: ********
  Addis Ababa, Ethiopia

2. EDUCATION

1998-2000- Diploma in Purchasing and supply Management, Addis Ababa Commercial College, Addis Ababa

3. WORK EXPERIENCE

2000-2001 Assistant purchaser, ABC Trading, Addis Ababa
2001- present Purchasing Clerk, ABC Trading, Addis Ababa

4. SKILLS

Computer skills in word, Access, Excel, PowerPoint

5. ACHIEVEMENT

I served as observer during kebele election during 2000 election.

6. HOBBIES AND INTERESTS

Listening music, reading books on romantic areas, visiting historical cites and writing short stories for radio programs.

7. REFERENCES

- Workie Tolosa, Lecturer, Addis Ababa University, School of Commerce, tel. **********
- Mohamed Kebede , Lecturer, Addis Ababa University, School of Commerce, tel. **********
- Bogale Mengistu, Addis Ababa University, School of Commerce, tel. **********

Other testimonials and credentials will be furnished on request.

Annex B: Sample Cover Letter

February 20, 2011

Sosina Tesfaye
P.O.Box ****
Tel. ********* Off.
Mobile *********
Addis Ababa
E-mail: *************

Manager, Human Resources and Administration
KIP PLC.
Addis Ababa

Dear sir/Madam:

I am writing this letter in response to your advertisement on the "The Daily Monitor", dated 8th February, 2011 for the post of Procurement Officer.

I graduated from the Addis Ababa University, College of Commerce, majoring in Purchasing and supply Management.

Since my graduation, I have been working as assistant buyer and purchasing clerk in one of the business organizations in Ethiopia.

I have also good experience in working as data entry personnel in one of business organizations dealing in export-import business. Recently, I am also working as freelance writer in one of national newspapers in the areas of purchasing ethics.

Copies of my academic credentials, curriculum vitae and three references are enclosed.

Could you, therefore, consider my application for the position of Procurement Officer? I would be pleased to appear for an interview or test at your earliest convenience.

Hoping to hear from you at the earliest, I remain,

Yours faithfully,

Sosina Tesfaye

Enclosure: Copies of my academic credentials, curriculum vitae and three references are enclosed.

Annex C. An Interoffice Messages to Speed Administrative Action.

Date ___________________

Refer to ____

Indicate by check mark:

- RUSH – immediate action required.
- Your comments, pleased.
- Please note and see me about this at ___________.
- Please answer, sending me copy of your reply.
- Please prepare reply for my signature.
- To be signed.
- For your information.
- Please note and file.
- Please note and send to main files.
- Please note, initial, and return to me.

1. ________________________ 3. ____________________________

2. _________________________ 4. ____________________________

Remarks

____

____

Signed

____

Unit 3

TRADE

Unit Outcomes

At the end of this unit, students will be able to:

- understand the concept of trade.
- recognize the concepts of domestic and foreign trades.
- realize the necessary conditions to act as a trader.

Introduction

The growth of world trade offers tremendous potential for Ethiopian business organizations that are engaged in buying and selling goods and services in overseas markets. But success in the international trade requires better quality products, competitive price and increased productivity. There are different facets to international trade such as different currencies, trade terms, risks and ways of financing the deal, etc.

These complexities require imaginative trading strategies that address the challenges facing companies pursuing business opportunities overseas. Therefore, to undertake a successful business in the international market, there must be a good understanding of the required procedures and principles. The purpose of this unit is to give a brief explanation of foreign trade and its procedures. Additionally, in order to have a clear picture about foreign trade, there is a need for a brief discussion on domestic trade particularly transaction related issues.

Contents of the Unit

In order to be able to achieve the above objectives, you will learn the following topics:

- Definition of Trade
- Foreign Trade

3.1 Definition of Trade

- *How many of you in the class are interested to do business in your life? Why?*

Business people face the problem of finding a person who is willing and capable of buying products. This is a major problem of business because producers may not be in a position to get a person who has the need, interest and the power to buy a product. On the part of the buyer, the problem is getting the right producers which do have the necessary product features with regard to quality, quantity, price and other factors. Ideally, if you want to trade, you must find someone who has what you want and you must also have what he wants and the two of you agree on values and then it can be said transfer of exchange has taken place.

Trade is one of the major components of business which is mainly responsible for distribution and sales, Also traders perform the basic functions of transportation, facilitating payment, taking risk and providing information for facilitating trade. Trade solves this basic and fundamental problem of commerce. Thus, the literal meaning of trade can be stated as follows:

Trade is the business of buying, selling or exchanging goods, within a country or between countries.

3.1.1 Trade

Trade can be sub-divided, firstly, on the **basis of operation**. Accordingly, we find internal trade and international trade. Secondly, the classification can also be based on the **unit of sale**. Thus, we find wholesale trade and retail trade which are explained briefly.

i) Internal Trade: Internal trade, also known as home trade, consists of buying and selling of goods and services within the boundaries of a country. Payments are usually made in national currency or through the national banking system. The internal transportation system is utilized for the movement of goods. Large numbers of middlemen are not generally involved. Government regulations are not varied and rigid. Internal trade may be conducted on either of the wholesale or retail bases (see the explanation of wholesale and retail trade in the marketing unit).

ii) International Trade: International trade, also called foreign trade, refers to the exchange of goods and services between two or more countries. International trade may be further sub-divided into import, export and entrepot trade.

a) **Import Trade:** consists procuring of foreign goods for home consumption.

b) **Export Trade:** consists in the supply of domestic goods for foreign use. Ethiopia exports coffee, hides and skins, flowers, oil seeds and pulses to foreign countries mainly to western nations.

c) **Entrepot Trade:** involving the import of foreign goods for re-exporting them to foreign consumers and making a profit in deal. For instance, United Emirates is a major re-exporter of many of the products of far eastern and western countries to the African market including Ethiopia.

3.1.2 Aids to Trade

Trade cannot prosper unless it is supported by an infrastructure. Various auxiliary services are important to facilitate trade. The exchange process is not always smooth. There is long distance between sellers and buyers. There is risk of loss during transit. There is time gap between production and demand. Customers may not get information about the product, price and cost. All those activities which help trade in overcoming these problems are called **aids to trade.** A brief discussion about these activities is given below even though some of them are covered in detail in the marketing part.

1. **Banking**: Banking provides a means through which payments for purchasing and selling of goods can be made. It pools resources from individuals in the form of savings and deposits and make them available to those who can use theses resources profitably.
2. **Transportation:** As stated earlier in marketing part of this textbook, transportation ensures a smooth and uninterrupted flow of goods from producers to wholesalers, to retailers, to customers.
3. **Insurance:** It provides a cover against the loss of goods in the process of transit and storage.
4. **Warehousing:** As stated earlier, warehousing creates time utility. It maintains goods in perfect condition until they are required by customers.
5. **Advertising:** Advertising provides information to customers and other middlemen.
6. **Packaging and packing:** They protect goods from damage during transportation.

3.1.3 Inland Transactions

What are Transactions? Transactions are the occurrence of events or of conditions which result in exchange of goods and services. As stated in marketing unit, when the exchange takes place, it takes the form of transaction. When this happens, we say a trade of value takes place. For transaction, there must be at least two things of value, agreed upon conditions, a time of agreement and a place of agreement. All business transactions are carried out by four groups of people, namely: the producers, the wholesalers, dealers or merchants, the retail dealers or shop-keepers and the consumers.

The business transactions need some important documents (papers) or letters. These papers are very useful for facilitating exchange of goods and services. They are (a) the enquiry, (b) the quotation, (c) the order, (d) the invoice, and (e) the document of payment for the goods.

The Enquiry: it is letter sent by the buyer to the seller asking for the price of goods that he/she thinks of buying. In other words, it is a request for information and should state types of goods, at what prices goods can be obtained, and terms of delivery and payment. A letter of enquiry states definitely the requirements, the approximate quantity, whether the seller should pay certain costs (e.g. carrying i.e. transportation).

Quotations: It is an offer to sell certain goods at a price under conditions that are clearly stated. The quotation contains conditions in such points like;

- Subject to acceptance within 7 days of the date of quotation;
- The quantity, quality, price, terms of delivery and payment including sample of the product;
- The quotation should be numbered and a copy of it is kept on file.

Activity: 1

- **Explain the difference between enquiry and quotation.**

The Order/Indent: Order is the document sent by the buyer to the seller for the supply of goods. The order must contain full particulars of the goods required with terms of delivery and payment. The order may be written as a letter or in printed form like quotations. The order must clearly state the terms and conditions under which goods will be acceptable and payment may be effected. However, some sellers will state their own terms and conditions instead of accepting that of the buyers.

The Invoice (Executing the Order): After the order is received from the buyer, the seller prepares a document known as an invoice. Every organization is unique and it has its own procedures depending on its needs and resources.

The Document of Payment for the Goods (The Payment)

Buyers should pay sellers for the goods or services by using various means of payment. These documents of payments are cash, cheque, promissory note, etc.

A diagram showing all of the five documents in buying transactions between sellers and buyers are given in the following diagram.

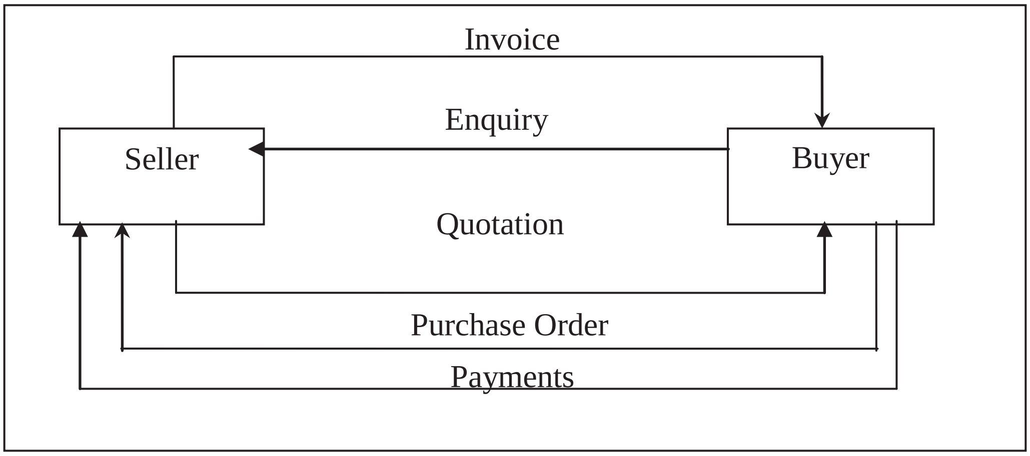


Fig. 3.1 Flow of Transaction Documents

Rights of Traders

The business documents stated earlier are business contracts between buyers and sellers. However, businesses often give their standard terms and conditions of business (T&C's) low priority until a dispute arises. Nine times out of ten it is too late to do anything about it at this stage. Often T&C's are out of date, inappropriate, ambiguous, unlawful, or, (as in many cases), non-existent.

The first thing to note about terms and conditions (T&Cs) is the difference between business-to-business (B2B) trading relationships and business-to-consumer (B2C) relationships. In B2B traders have a lot more freedom to agree whatever they want than with B2C relationship. Irrespective of what the T&C's say, in B2C relationships consumer law will override to protect certain consumer rights, and imply certain others if traders are silent about them. It is for this reason that it is very important to tailor the T&Cs to the customer base to afford the maximum protection, whilst making sure that traders don't overreach. If traders trade in both B2B and B2C markets, they may even want to have a different set for each. To protect themselves from possible problems, traders should consider at least two issues: **timing and Proper Notice.**

Timing: Classic bad example is T&Cs on the back of the invoice. As invoices are characteristically delivered after the contract has been made, the terms are generally unenforceable. Ensure your T&Cs are brought to your customer's attention at the earliest opportunity. Consider setting out your terms in your brochures, catalogues or other marketing material, and certainly on your order/quotation forms and acknowledgement of order (if applicable).

You must be able to demonstrate that you have done enough to draw the consumer's attention to the T and Cs. Accordingly, a consumer should be required to acknowledge that he or she has read and agrees to the terms as part of the purchasing process. However, laws to protect consumers' rights are rarely enforced in developing countries because of weak capacity in law enforcement and non-existence of organized groups to protect the rights of consumers by taking the issues to the court.

Capabilities of a Trader

Consider any successful businessman. Often in the beginning, success came by simply working harder, putting in more hours, taking on more personally. Doing what ever it takes. But, this may not lead the trader to permanent success.

Compare a professional athlete with a trader. For a professional athlete, losing is not an option. Unfortunately, in trading, losing is mandatory. Losing the right way is what matters, proper amount on appropriate trades. Once a trade has stopped, it is a loss and the trader moves on. The trader knows that what matters is process that delivers winners over a period of times. What is significant is not what happens on one trade. To the athlete, losing is not acceptable. It must be avoided at all costs at all levels.

So what is helpful for a trader? Learning the whole process of trading is most important. Learning from those who have been through (beginning to an end) it, or having the ability to learn and adapt quickly as traders go. Having the mindset of having a plan, being able to adjust that plan in the proper way at the proper time, and carrying out the plan until the results are reached. Then, constantly evaluating the process, eliminating mistakes and being mindful of the need to change and be flexible.

Unfortunately, it may be difficult to get traders with such extraordinary qualities with businessmen in developing countries like ours given our tradition. But, we expect such people to emerge in the future.

Activity: 2

- **Explain the difference between the purchase order and invoice**
- **Explain the major documents involved in domestic transactions.**

3.2 Foreign Trade

- ***Why Ethiopian is involved in foreign trade? What if there is not foreign trade?***

As stated earlier, foreign trade is a trade, which one-country carries on with another country, which is beyond the national boundaries. Foreign trade encompasses all business activities that involve exchanges across national boundaries. Thus, a firm is engaged in foreign trade when it buys some portion of its input from, or sells some portion of its output to, an organization located in a foreign country.

3.2.1 Absolute and Comparative Advantage

Some countries are better equipped than others to produce particular goods or services. The reason may be a country's natural resources, its labour supply, or even customs or a historical accident. Such a country would be best off if it could specialize in the production of such products, because it can produce them most efficiently. The country could use what it needed of these products and then trade the surplus for products that could not produce efficiently by its own. For Example, Saudi Arabia has, thus, specialized in the production of crude oil and petroleum products; South Africa, in diamonds; and Australia, in wool. Each of these countries is said to have an absolute advantage with regard to a particular product. **An absolute advantage is the ability to produce a specific product more efficiently than any other nation**.

One country may have an absolute advantage with regard to several products, whereas another country may have no absolute advantage at all. Yet, it is still worthwhile for these two countries to specialize and trade with each other.

To see why this is so, imagine you are the president of a successful manufacturing firm, and you can accurately type ninety words per minute. Your assistant can type eighty words per minute but would run the business poorly. You, thus, have an absolute advantage over your assistant in both typing and managing. But you cannot afford to type your own letters because your time is better spent in managing the business. That is, you have a comparative advantage in managing. **A comparative advantage is the ability of a nation to produce a specific product more efficiently than any other product.**

Your assistant, on the other hand, has a comparative advantage in typing because he or she can do that better than managing the business. So you spend your time managing, and you leave the typing to your assistant. Overall, the business is run as efficiently as possible, because you are each working in accordance with your own comparative advantage.

The same is true for nations. Goods and services are produced more efficiently when each country specializes in the products for which it has a comparative advantage. Moreover, by definition, every country has a comparative advantage in some products. However, countries want to produce each and every product for self-sufficiency strategies and needs. As a result, they restrict importation of many items to their markets and at the same time they encourage export of their products to other countries to generate hard currency. For example, Ethiopia levies no export customs duty except on coffee. But there is import customs duty almost on all products to be imported to Ethiopia.

Activity 3

- **Explain the concepts of absolute and comparative advantages and give examples for your explanation.**

3.2.2 Trade Restrictions

As it will be discussed later in this unit, countries restrict either the import of specific products or on trade with particular countries. The measures may be imposition of high customs duties, economic embargo, quantity limit and restriction of hard currency available for import. Some of the commonly used trade restrictions are explained as follows:

1. **Customs Duties:** These are taxes levied by the government on imports and exports. Note that customs duties are different from excise tax, which is the tax levied on domestic products. The two types of tariffs are **revenue tariffs** and **protective tariffs**; both have the effect of raising the price of the product in the importing nations, but for different reasons. Revenue tariffs are imposed solely to generate income for the government. Protective tariffs, on the other hand, are imposed to protect a domestic industry from competition by keeping the price of competing imports high or higher than the price of similar domestic products.

   Customs duties are levied in the following ways;

   a) **Ad valorem:** The tax is calculated on the value of the goods imported or exported. On the imports, it is the value of the goods at the port of entry, which is the C.I.F. value (C.I.F.), Cost, Insurance and Freight. On the exports, it is the value of the goods at the port of origin.

   b) **Specific:** This shows that tax is levied on the quantity of the goods imported or exported such as 100 Birr per ton for some type of goods.

2) **Additional taxes and non-tariff barriers.** There are also some additional taxes other than the usual customs duties that are discussed below briefly**.**

a) **Customs Surcharge**: This is an additional duty of so much percent on all customs duties. It enables the government to raise the charges without changing the ordinary rates as changing the ordinary rates frequently is expensive. It is certain percentage of the customs duty. When the government faces financial problems in certain extraordinary problems like war, it levies customs surcharge to increase its revenue to finance the problem.

b. **Other Taxes:** Barriers can be tax or non-tax barriers. These are taxes levied by the local authorities, such as port authorities or municipalities on all imports and exports that are stated as certain percentages of customs duties.

c. **Non-tariff barriers:** A non-tariff barrier is non-tax measure imposed by a government to favour domestic over foreign suppliers. Non-tariff barriers create obstacles to the marketing of foreign goods in a country and increase costs for exporters. The following are a few examples of government-imposed non-tariff barriers:

- An **import quota** is a limit on the amount of a particular good that may be imported into a country during a given period of time. The limit may be set in terms of either quantity or value of the goods. This system has been very common during the previous government for certain items such as automobiles.
- An **embargo** is a complete halt to trading with a particular nation or in a particular product. The embargo is used most often as a political weapon rather than economic reasons.
- A **foreign-exchange control** is a restriction on the amount of a particular foreign currency that can be purchased or sold. By limiting the amount of foreign currency importers can obtain, a government limits the amount of goods importers can purchase with that currency. This has the effect of limiting imports from the country whose foreign exchange is being controlled.
- A nation can increase or decrease the value of its money relative to the currency of other nations. **Currency devaluation** is the reduction of the value of a nation's currency relative to the currencies of other countries. Devaluation increases the cost of foreign goods, while it decreases the cost of domestic goods to foreign firms. Ethiopia has reduced the value of Birr from Birr2.07 in 1991 to Birr 5 around 2000 and now (2010) the value of $1 is between Birr 13 and Birr 14 as of revising this material it is between Birr 20 and Birr 21..

- **Bureaucratic red tape (excessive procedure)** is subtler than the other forms of non-tariff barriers. Due to the excessive procedures designed for controlling purposes, bureaucratic procedures can frustrate many importers and exporters.

Activity: 4

- **Explain the difference between ad valorem and specific methods of levying customs duties.**
- **List at least three major types of items that can be exported by Ethiopia.**
- **Visit your nearest bank and ask its role in the foreign trade.**

Reasons for Trade Restrictions

As to the need for or against trade restrictions, there are two groups that advocate their own reasons. There are a number of justifications for each groups of advocates. As stated earlier, various reasons are advanced for trade restrictions either on the import of specific products or on trade with particular countries. Political considerations are usually involved in trade embargoes. Other frequently cited reasons for restricting trade include the following:

- ***To equalize a nation's balance of payments***. This may be considered necessary to restore confidence in the country's monetary system and in its ability to repay its debts. A nation's **balance of payments** is the total flow of money into the country minus the total flow of money out of the country, over some period of time. This concept is different from **balance of trade** i.e., balance of trade is the total value of its exports minus the total value of its imports, over some period of time.
- ***To protect new or weak industries.*** A new, or infant, industry may not be strong enough to withstand foreign competition. Temporary trade restrictions may be used to give it a chance to grow and become self-sufficient.
- ***To protect national security.*** Restrictions in this category generally apply to technological products that must be kept out of the hands of potential enemies. For example, strategic and defence-related goods such as sophisticated intelligence communication equipment and mass destructive weapons may not be exported to unfriendly nations by the developed nations of the west particularly of the USA.
- ***To protect the health of citizens.*** Products may be embargoed because they are dangerous or unhealthy (for example, farm products contaminated with insecticides).

- ***To retaliate for another nation's trade restrictions.*** A country whose exports are highly taxed by another country may respond by imposing tariffs on imports from that country.
- ***To protect domestic jobs.*** By restricting imports, a nation can protect jobs in domestic industries. However, protecting these jobs can be expensive.

Reasons Against Trade Restrictions

According to the advocates of this group, trade restrictions have immediate and long-term economic consequences both within the restricting nation and world-trade patterns. These include the followings.

- ***Higher prices for consumers.*** Higher prices may result from the imposition of tariffs or the elimination of foreign competition, as described above.
- ***Restriction of consumer's choices.*** Again this is a direct result of the elimination of some foreign products from the marketplace and of the artificially high prices that importers must charge for products that are still imported.
- ***Misallocation of international resources***. The protection of weak industries results in the inefficient use of limited resources. The economies of both the restricting nation and other nations eventually suffer because of this waste.
- ***Loss of jobs.*** The restriction of imports by one nation must lead to cut backs and the loss of jobs in the export -oriented industries of other nations.

Activity: 5

- **Are you in favour of trade restrictions or against it? Why?**

3.2.3 Nature of Foreign Trade

As it has been discussed earlier, foreign trade is different from domestic trade in many ways. However, the basic features of foreign trade are (i) it is always on wholesale basis and (ii) it requires special procedure because of a number of reasons.

Reasons for Special Procedure in Foreign Trade

The reasons for the need to follow special procedures in the foreign trade are many and varied. But the basic reasons are listed as follows:

1. Each country is a distinct political and economic unit with its own currency, laws and tax systems. These actually create obstacles in the way of free movement of goods and payment for the same.
2. Different countries have different languages and customs. Therefore, there is a need for studying the foreign market before entering foreign trade. The most

important skill in a foreign country is language that the native can speak it fluently at the age of three.

3. The need for financial resources because of the long interval between the time when the goods are dispatched from one country and received by the importer in another country.
4. Because of the long distance between the country supplying the goods and the country receiving them, goods are exposed to greater risks.
5. The existences of trade barriers such as tariff and import restrictions which are other important factors in foreign trade. Trade barriers are discussed in the ensuing topics of this unit. Because of the reasons mentioned above and other reasons stated below, foreign trade requires documents.

Activity: 6

- **Why exporters / importers follow special procedures?**

3.2.4 Documents and Special Terminologies

Due to the involvement of many parties and the need for special procedure in the foreign trade, there are a number of documents with special terminologies. One to succeed in the foreign trade, he has to be familiar to certain terminologies and documents and their definitions are given in this part of the textbook. .

i) Mate's receipt: When goods are taken up by a steamer, the exporter or his transit agent will hand over to the captain of the ship a copy of the customs declaration as well as a copy of the shipping order. The mate of the ship then issues a Receipt called **Mate's receipt**'. This receipt is termed '**clean**' when it does not contain any adverse remarks regarding the condition of packing at the time the goods are received on board the steamer. It may be noted that it is not in the interest of the exporter to have '**foul**' mate's receipt.

ii) Transport or shipping Documents. There are different transportation documents.

a) Bill of Lading (B/L): It is an official receipt of the shipping company acknowledging receipt of goods on board the steamer and contains the terms and conditions on, which it has agreed to carry the goods to the port of destination. In fact, it is a receipt for the goods shipped and serves as an evidence of the contract of carriage.

It is also a document of title to the goods and transferable by endorsement and delivery. When the goods are sold under an arrangement where the importer agrees to pay the freight, then, the Bill of Exchange is taken out without payment of freight and is marked **'freight forward' or 'freight to be paid'**. In such cases, the freight becomes payable by the importer at the port of destination. It is also a guide to carrier's staff in handling the shipment.

This document may be issued in two forms: the Straight Bill of Lading and the Order Bill of Lading. The **straight Bill of Lading** is a bill that provides for delivery only to the party named in the Bill of Lading and to no one else. In this case, the carrier or his agent must be certain that the party receiving the goods is actually the party named in the bill. On the other hand, the **Order Bill of Lading** is a negotiable instrument which provides for delivery to a named party or his order (anyone he may designate) by endorsement of the Bill of Lading. Goods transported under negotiable Bill of Lading are not to be released by the transport company until the bills of lading have been surrendered bearing the endorsement of the party claiming the goods.

b) Special Types of Bill of Lading. Different types of Bill of Lading are also common such as ocean bill of lading, inland bill of lading, airway bill and postal parcel receipt that are discussed below:

Ocean Bill of Lading: This is a document that covers the movement of goods by sea and may be issued in either straight or order form. Steamship companies issue such bills of lading in sets consisting of one or more originals and bearing a clause that says that the cargo will be released upon presentation of one of the originals, thus, making valueless the remaining originals of the complete set. It has been the most common practice to issue ocean bills in sets of three originals. However, there is a trend in international trade to issue one or more original bills of lading. See Annex A in this unit for Bill of Lading document.

Inland Bills of Lading: These are issued by railroad lines or truck lines and can also be drawn in either straight or order form. Unlike ocean carriers, the inland carrier never issues more than one originals of such bills.

Airway Bill: is a receipt for goods carried by air and often referred to as an "Air consignment Note". Airway bill is generally issued by air carriers for merchandise to be delivered to a party at some named destination. See the sample Airway Bill in Annex B at the end of this unit.

Parcel Post Receipts: which are issued by the postal service and are non-negotiable and merchandise is deliverable to the addressee only. It is a post office receipt for goods dispatched by mail. The receipt is evidence of dispatch only.

iii) Insurance policy Certificate: The exporter arranges for the insurance of the goods against the usual perils of the sea. He gets the insurance policy against payment of premium, which is usually, a percentage of the insured value (10% to 20% above the invoice value covering the probable duty payable or the imports and other incidental expenses involved).

The terms of contract between the importer and the exporter should define the responsibilities for arranging insurance coverage whilst the goods are in transit and what risks are to be covered. See Annex C for sample Insurance Certificate.

iv) Certificate of Origin: This is a document which states the country (countries) of origin of goods. It enables the importer to get advantage of special treatment. Due to special trade agreements between countries, goods sent from friendly country to another generally receive preferential treatment in import duties. For example, European Union provides customs duty exemptions to Ethiopian commodities. The supplier should complete it and may have to be authenticated by a chamber of commerce or other authorized body in the exporter's country. The certificate should include the name and address of the exporter, the manufacturer (if different), the importer, a description of the goods and the signature and the seal of the authorising organization.

v) Consular Invoice: It is a document of verification of customs duties given by the trade consul of the importing country residing in the exporting country. The consular invoice along with other documents will be sent by the exporter to the importer. The purpose of the document is to facilitate the calculation of the custom duties by the authorities of the importing country without taking more time.

vi) Certificate of Health: Agricultural and animal products may require a certificate stating that they comply to the importing country's health regulations. This certificate must be authorized and signed by the health authority in the exporter's country.

Vii) Pack List: Where there are several packages in one consignment, an invoice is usually accompanied by a packing list which details the contents of the package and may also show their weights and measurements.

Activity: 7

- **Identify the different documents used in foreign trade and explain the purpose of each one.**

3.2.5 Foreign Inquiries and Quotations

Both enquiries and quotations should contain full details of the goods required, their description, catalogue number or trade, size, weight, or other distinguishing features as well as the quantity, the time and method of delivery, packing and packing size, the firm period of price, delivery place and date.

The quotations also include the price and terms of sale. In case of first enquiry, it is usual to make some investigation regarding the financial position of the client. It can be done by means of a banker's reference if the bank's name is supplied by the enquirer or by means of a trade reference or inquiry with some firm(s) who had business dealing with the potential supplier. The documents should also specify the terms of shipment and payment.

Price Terms (Terms of Shipments)

The following are payment terms which are given by International Chamber of Commerce (ICC). These are listed in the order of decreasing cost and responsibility to the seller (exporter) or alternatively in order of increasing cost and responsibility to the buyer (importer).

1. **DDP- Delivered Duty Paid (at Named Place Of Destination)**

   All costs of shipment of the goods, including duty, are paid up to the point of delivery at the named place in the country of importation. The buyer is responsible only for accepting delivery and all obligations are those of the seller.

2. **DDU- Delivered Duty Unpaid (at named place of destination)**

   The buyer is accepting the risk associated with the goods failing to clear customs. However, seller pays the taxes and the export duty.

3. **DEQ- Delivered EX Quay (duty paid at named port of destination)**

   Costs of delivery, duty to be paid, to the named port of destination are borne by the seller. All obligations subsequent to Customs clearance are the responsibility of the buyer.

4. **DES- Delivered Ex Ship (at named port of destination)**

   The seller is responsible for costs of delivery on board of the vessel, at the named port of destination. The buyer assumes all risks and responsibilities including duty, from a point immediately prior to importation.

5. **DAF- Delivered at Frontier (at named place)**

   The seller is responsible to make the goods available at the frontier with all subsequent costs, including duty, being the obligation of the buyer. This term applies to all modes of transport but most commonly used for goods being carried by road and rail.

6. CIP- Carriage and Insurance Paid (to named place of destination)

Costs of carriage and insurance of the goods to the named destination are the responsibility of the seller. The buyer becomes responsible for all costs and risks, including duty, from the named place of destination up to his/her own address. This term applies to all modes of transport.

7. CIF- Cost, Insurance and Freight (at named port of destination)

The seller is responsible for cost of goods, freight and marine insurance to named port of destination. The buyer is responsible for all costs, including duty, subsequent to delivery on board at the port of destination. This term applies to sea or inland waterway transport only.

8. CFR- Cost and Freight (at named port of destination)

The same as that of the CIF except the buyer is responsible for marine insurance.

9. FOB- Free on Board (at named port of shipment)

The seller's responsibilities are to include all costs of delivery until goods are delivered over the ship's rail at the named port of shipment. The buyer is, therefore, responsible for all costs subsequent to loading on board. This term applies to sea or inland waterway transport only.

10. FAS – Free Alongside Ship (at named port of shipment)

The seller is obliged to deliver goods alongside the vessel on the quay or to a lighter at the name port of shipment. The buyer is, therefore, responsible for clearing the goods for export and all subsequent costs, charges and insurance. This term applies to sea or inland waterway transport only.

11. FCA - Free Carrier (at named place)

The seller is responsible for delivery of goods, cleared for export, into the charge of the carrier nominated by the importer at the named place, usually on inland clearance depot. The buyer is responsible for all risks and costs including the costs associated with the appointment of carrier. Often the seller will assist with this appointment but with the buyer's risk and expense. This term applies to all modes of transport.

12. EXW – Ex Works (at named place)

The seller is responsible for making the goods available to the buyer at the seller's own premises. The buyer is therefore accepting full responsibility for transportation of the goods and has maximum liability. The sellers quoting these terms have minimal time and cost implications but may be making their goods less competitive as the buyer will need to calculate all additional transportation costs in addition to the contract price.

Activity: 8

- **Explain the difference between domestic and foreign quotations and purchase orders.**

3.2.6 Foreign Terms of Payment

- *What differences can you see when one pays to a foreign company and a domestic company?*

A variety of payment methods are used in international trade transactions, which have their own advantages or disadvantages. The common terms of payment are (a) Letter of Credit, (b) Advance payment, (c) Open Account, (d) Payment on Collection Basis (such as Bill of Exchange) and (e) Consignment Sales which are discussed very briefly.

1. **Letter of Credit:** The letter of Credit typically is issued by the importer's bank, that is, the issuing bank. The issuing bank's L/C signifies that the bank agrees to pay the importer's obligation to an exporter resulting from a sales agreement; contingent on receiving documentation proving that shipment was made. In return for the L/C, the importer warranties that he or she will pay the bank the sales amount and any fees.

The L/C is crucial to exporters if a foreign customer is not well known or if the customer's credit is suspect for any reason. The L/C substitutes the issuing bank's credit and reputation for those of the importer.

The issuing bank sends the L/C covering the amount of the sale to the exporter's bank (called the paying bank) in the exporter's country. The paying bank, in turn, sends the L/C to the exporter. When shipment is made, the exporter presents its sight or time draft along with proof- of-shipment documents to its (paying) bank. The exporter's bank then pays the seller, debits the account of the importer's bank, and sends the shipping documents and the draft on to the importer's bank. Upon receipt of the documents and draft; alternatively, with a time draft, the importer's account is debited on maturity) and conveys the documents, representing title to the goods to the importer. The following diagram shows the above description in schematic model.

As shown in Figure 3.2, based on an agreement by an American computer manufacturer (exporter) to sell computer equipment to an Ethiopian buyer (importer), illustrates the transactions.

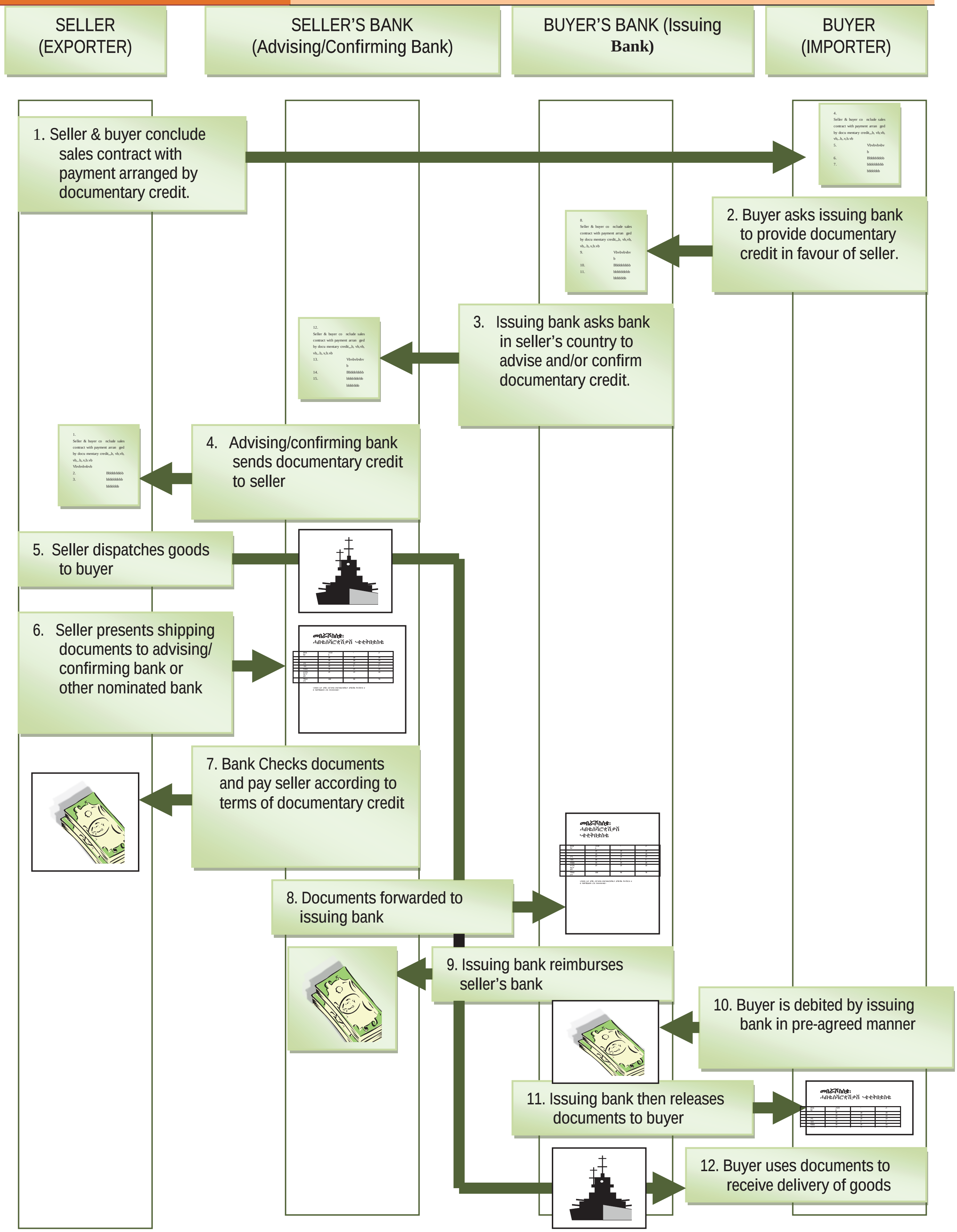


Figure 3.2 A typical path of letter of credit

L/C may be confirmed or unconfirmed and revocable or irrevocable. Confirmed irrevocable L/Cs bear the guarantee of payment by both the issuing and confirming (paying) banks. An unconfirmed irrevocable L/C bears the guarantee of the issuing bank only, and a revocable L/C carries only importer's promise to pay and does not carry either bank's guarantee.

The Letter of Credit must specify the value of the credit, the time limit for submitting documents, (which in turn limits the time for shipment), mode of dispatch, i.e., by road, rail, sea, air or parcel post: whether partial shipment are allowed, etc.

2. **Advance payment (cash in advance)**: In this method, the buyer makes advance payment. This method often is used when the buyer is unknown to the seller. The method places the financing burden entirely on the buyer; once the buyer has made the cash payment, he/she has no assurance that the seller will fulfil his obligations.

3. **Open account:** Instead of either receiving funds prior to shipment (cash in advance or at the time of shipment (irrevocable letter of credit), the exporter may be requested to ship on open account terms.
   - The exporter who agrees under this method of payment will ship the goods without receiving of a bank assurance of payment, but will get paid under the usual payment terms of the buyer usually not more than 180 days following the invoice date.
   - Payment on open account offers the least security to an exporter.

4. **Payment on Collection Basis**:
   - Payment on collection basis is the most widely used payment method in the purchase and sale of goods and services in foreign market.
   - The bank acts only as an agent of the exporter -- its power and responsibilities are limited accordingly.
   - Under this arrangement, the seller forwards financial and commercial documents through his bank (remitting bank) to the buyer's bank (collecting bank).
   - The seller includes with the documents the draft drawn on the buyer for collection. To initiate a trade collection, the exporter will draw a draft (also called "Bill of Exchange") on the buyer who will honour the draft when it is presented to him (pay it or accept if it is a term draft) after the importer's order has been shipped. One of the methods of payment on collection basis is the bill of exchange.

Bill of Exchange: Bill of Exchange is defined as an unconditional order in writing, addressed by one person (the drawer) to another (the drawee), signed by the drawer requesting the persons to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum in money to or to the order of a specified person or to the bearer (the payee). To be negotiable, the draft (draft is the alternative name for Bill of Exchange) must

- Be drawn by the beneficiaries on parties specified in the credit.
- Be signed by the drawer.
- Contain an unconditional order to pay a certain sum in money.
- Be payable on demand or at a definite time (tenor).
- Be payable to the drawer properly endorsed.
- Not exceeding the credit amount or remaining balance of the credit.

There are three types of arrangement for collection of bill of exchange which are discussed below:

- **Sight Draft Collections:** Under a sight draft arrangement, documents forwarded through the seller's bank to the buyer's bank overseas only can be released to the buyer upon payment of the draft. A sight draft offers more protection than a time draft, especially when the exporter is selling to a foreign buyer for the first time or when the credit worthiness of the customer is unknown. This payment method has advantages to both the buyer and the seller.

- **Time Draft Collection:** Using this method, the seller draws a draft on the buyer payable on a specified due date or a certain number of days after sight or after bill of exchange date. The time draft and documents are forwarded through the seller's bank to the buyer's bank overseas with instructions to deliver documents against acceptance only. A time draft exposes the exporter to more risk than a sight draft because the buyer is in possession of the merchandise, without paying, from the date of acceptance. The seller must be certain that the buyer is capable of paying on the maturity date and that the political and economic conditions of the country are stable enough to ensure that payment will be made without significant delay. To accept the draft, the buyer signs across the face of the draft and indicates the date accepted.

- **Clean Draft Collection:** Under this payment method, the seller presents only his/her draft to the bank for collection; the shipping and other documents are sent directly to the buyer. This method lacks the protection of a documentary collection.

5. **Consignment Sales**: The goods may be shipped "on consignment" whereby the buyer receives the goods but makes payment to the seller only if and as the goods are sold by the buyer. However, ownership (title) of any unsold goods remains with the shipper.

The payment mechanism adopted depends on a number of factors, which are usually taken into account when the underlying commercial contract is negotiated. Factors include:

- The amount of trust that the exporter and importer have in each other.
- The credit worthiness of the buyer.
- The bargaining power of the respective parties.
  Conditions imposed by a third party, e.g. credit insurer
- Import/export regulations (in certain countries). However, the most commonly used payment used in Ethiopia is letter of credit which is criticized to be very cumbersome.

In the foreign terms of payment, there are more risks for the seller of goods than for the buyer.

Some of the main risks in international trade are:

1. **Country Risk:** depends on the political, economic, legal and social stability of the country that are engaged in trade.
2. **Importer Risk:** The common risks are; non-payment of invoices, delayed payment of invoices and insolvency of buyer.
3. **Industry risk:** include demands of particular products, recession in particular industry, competitive products/pricing.
4. **Foreign exchange:** risk includes fluctuation in exchange rates affect pricing and profit.
5. **Exporter Risk:** Problems in producing correct documentation, failure to supply goods in accordance with the sales contract.
6. **Transportation risks:** are risk associated with the mode of transport, e.g. Marine risks, storage facilities in ports.

   Many of these risks can be insured against or mitigated through the payment mechanism. However, reducing your own risks may result in your counter parties having to accept a greater degree of risk and may increase costs of both parties which had an impact upon competitiveness.

Activity: 9

- **Identify and briefly explain the five methods of payment in foreign trade.**
- **Explain the role of banks in foreign trade.**

3.2.7 A Note on Customs Duty Estimation Procedure in Ethiopia

As stated earlier Governments encourage exports but discourage imports. One means of discouraging imports is levying customs duties. The method of estimation of customs cost (customs estimate) of commodities in Ethiopia is based on general principles of customs estimate according to world practice and shall apply to commodities imported to customs territory of Ethiopia. The procedure for customs duty estimation is explained very briefly here:

1. The merchant must get quotations from the exporter.
2. The importer has to open Letter of Credit in favour of the foreign exporter. In order to establish a Letter of Credit, the buyer first sends a request to his banker so that the bank will give assurance for payment of a specified sum of money to the supplier. The bank in turn makes arrangement with their agents or the suppliers' bank.
3. The customs Authority, based on the request of the importer to import goods, carries out pre-shipment inspection of goods at the exporter's country. The inspection includes, among other things, standards, quality, prices and conformance as to the regulations of the country.
4. The importer files declaration copy to the customs authority along with shipping documents. These include Bill of Lading, Invoices, Freight Sheet for freight paid by the consigner, packing list, Certificate of Origin, Insurance Certificate if insured by the consigner and the like. The declaring person at the customs Authority of Ethiopia declares the customs cost. The importer has to deposit the customs duty in the specified account.
5. The Customs Authority transfers orders to the port authority to allow movement of goods to the specified bonded warehouse of the customs authority. Currently, the order can be communicated online to the port authorities using its own Wide Area Network or hardcopy as the case may be.
6. Examination of goods is carried as to whether the goods imported conform to the items indicated in the purchase order or in the clear report finding of the pre-shipment inspection report.
7. Document scrutiny for proper tariff rate, nature of goods and other issues will be the next step.
8. Discrepancy report may be produced by the Customs Authority if there is any discrepancy between what has been delivered and declared in the declaration file. Additional customs duty payment or refund of the difference between the actual and deposit amount can be effected using the customs notification copy.

For the purpose of customs estimation, Customs Authority uses the concept of entry regime. According to the entry regime, goods are classified as (1) dutiable goods that requires dutiable import declarations for payment of customs duty, (2) Duty free import declarations for diplomats, students returning from their study leaves abroad, International Organizations in which Ethiopia is a member, etc. and in such cases there is no payment of customs duty; (3) Duty Relief Import Declarations that include Investment Import Declarations, Government Import Declarations, NGOs, Temporary imports such as for exhibitions and foreigners working in major projects in Ethiopia. Government offices may not pay customs duty but the Ministry of Finance may deduct the equivalent amount from their annual budgets. Group (4) is the duty drawback category. If an importer imports certain goods to further process and export the finished goods, the customs authority refunds the customs duty paid earlier for the semi-finished goods/raw materials/finished components imported. But this fact must be communicated to the Ethiopian Customs Authority.

3.2.8 Methods of Entering International Trade

A firm that has decided to enter international markets can do so in several ways.

1. **Licensing** is a contractual agreement in which one firm permits another to produce and market its product and to use its brand name in return for a royalty or other compensation. Licensing is especially advantageous for small manufacturers wanting to launch a well-known domestic brand internationally.
2. **Exporting:** A firm may also manufacture its products in its home country and export them for sale in foreign markets.
3. **Joint ventures:** A joint venture is a partnership formed to achieve a specific goal or to operate for a specific period of time. A joint venture with an established firm in a foreign country provides immediate market knowledge and access, reduced risk and control over product attributes.
4. **Totally Owned Facilities:** At a still deeper level of involvement in international business, a firm may develop totally owned facilities, that is, its own production and marketing facilities in one or more foreign nations.
5. **Strategic Alliances:** Strategic alliances, the newest form of international business structure, are partnerships formed to create competitive advantage on a worldwide basis. They are very similar to joint ventures. For example, the automobile and computer industries are working together in strategic alliances.
6. **Trading Companies:** provide a link between buyers and sellers in different countries. Trading company buys in one country at the lowest prices consistent with quality and sells to buyers in another country.

7. **Counter trade:** Counter trade is essentially an international barter transaction in which goods and services exchanged for different goods and services.
8. **Multinational Firms:** A multinational enterprise is a firm that operates on a worldwide scale without ties to any specific nation or region. The multinational firm represents the highest level of involvement in international business. It is equally "at home" in most countries of the world. In fact, as far as the operations of the multinational enterprise are concerned, national boundaries exist only on maps. It is, however, organized under the laws of its home country.

Activity: 10

- **Why there is limited foreign investment in Ethiopia?**
- **Developing countries like Ethiopia are facing capital outflow to developed nations. What are the basic causes for this new reality?**
- **Explain the role of international trade to the development of nations.**

Summary

Trade is the business of buying and selling or exchanging goods and services, with in a country or between countries. Trade can be subdivided, firstly, on the basis of operation as internal trade and international trade. Secondly, trade can be classified according to the unit of sale as wholesale trade and retail trade.

Transactions are the occurrence of events or conditions which result in exchange of goods and services. The producers, wholesalers, retailers, and consumers or customers carry out transactions. The business transactions require documents including enquiry, quotation, purchase order, invoice and document of payment.

The bases for foreign trade are the traditional theories of Economics, namely absolute and comparative advantages. Foreign trade is undertaken always on the wholesale basis and it requires the involvement of many parties. Because of political, distance, legal, customs, language and other features, foreign trade requires special procedure to be followed. Foreign inquiries and quotations must contain full details and particulars of goods such as descriptions, catalogue number, size, weight and other distinguishing features and the quantity, the time and method of delivery, packing and packing size, the firm period of price and other details.

The common terms of payment in the foreign trade are letter of credit, cash in advance, open account, bills of collection and consignment. They do have different degrees of risk for the exporter and importer. There are also different ways of entering into the international trade ranging from licensing to multinational firms.

Review Questions

Part I. Choose the best answer from the given alternatives.

1. The highest risk for the exporter is in
   - a. Letter of credit
   - b. Bill of exchange
   - c. Advance payment
   - d. Consignment sales
2. If Somalia exports Ethiopian coffee to the international trade such business is known as
   - a. Wholesale trade
   - b. Retail trade
   - c. Export trade
   - d. Import trade
   - e. Entrepot trade
3. The payment terms that forces the buyer to bear the maximum responsibility is
   - a. DDU
   - b. DES
   - c. DAF
   - d. EXW
   - e. FOB
4. Which one of the following is not part of trade?
   - a. Banking
   - b. Insurance
   - c. Advertising
   - d. Inland trade
   - e. Transportation
5. The most secure for the importer of a foreign trade is
   - a. Letter of credit
   - b. Open account
   - c. Consignment sales
   - d. Bill of exchange
   - e. None

Part II. Define and explain the following key terms.

a. Trade
b. Foreign trade
c. Enquiry
d. Quotation
e. Invoice
f. Postal order
g. Money order
h. Cheque
i. Bill of Exchange
j. Franco
k. C.I.F
l. Letter of Credit
m. Open account
n. Customs duties
o. Certificate of Origin
p. Irrevocable Letter of Credit
q. Issuing Bank
r. Paying Bank

Part III. Answer the following questions.

1. Why countries encourage export and discourage import trade?
2. Mention the reasons against import restrictions.
3. What is the difference between domestic trade and foreign trade?
4. What is the difference between comparative and absolute theories of trade?
5. Distinguish ad valorem from specific types of customs duty levying methods.
6. What is the difference between Straight Bill of Lading and Order Bill of Lading.
7. Mention any three methods of entering into foreign trade.
8. What is the difference between open account and advance payment methods of payment in foreign trade?
9. Explain the entry regimes as to the Ethiopian context

PART IV. Group Work Form group of five students and write the history of trade in Ethiopia by referring different sources and present it to the class.

Annex A: Sample Bill Of Lading

BILL OF LADING FOR COMBINED TRANSPORT AND PORT TO PORT SHIPMENTS

Shipper
CHERSONI ANTONIO
VIA CANCELLO 542
CANCELLO SCALO (CE) - ITALY
P.IVA 00326040615

Consignee
TO ORDER OF
BANK
INTERNATIONAL DIVISION
ADDIS ABABA - ETHIOPIA

Notify Party and Address (leave blank if stated above)
XYZ COMPANY
TEL.09228070
ADDIS ABABA - ETHIOPIA

Pre-Carriage by* | Place of Receipt by Pre-Carrier*

Vessel: JOLLY BIANCO 253 | Port of Loading: NAPOLI

Port of Discharge: DJIBOUTI | Place of Delivery by On-Carrier*

Custom Ref. | B/L No: THRUSERV07

Shipper's Ref.

F/Agent's Ref.

Reference No.

THROUGH TRANSPORT B/L

COPY NOT NEGOTIABLE

E.S.L.

የኢትዮጵያ ፡ ንግድ ፡ መርከብ ፡ ኮርፖሬሽን ።

THE ETHIOPIAN SHIPPING LINES CORPORATION

አዲስ ፡ አበባ ።

ADDIS ABABA

Pre Carriage Payable at | On Carriage Payable at

Marks and Nos. | Container No. | Number and kind of packages: Description of Goods | Gross Wt. (Kg) | Measurement

PARTICULARS OF GOODS ARE THOSE DECLARED BY SHIPPER

FIAT 682 N4
CHASSIS: 075206

1 UNIT
USED DUMP TRUCK
YEAR OF MANIFACTURE 1977
ORIGIN OF GOODS ITALY
FREIGHT PAYABLE AT DESTINATION
TRANSIT TO ETHIOPIA
FINAL DESTINATION:
A.A. RAIL WAY CUSTOM WAREHOUSE
A.A.ETHIOPIA

KOS : 9.240

PAL / PAL

FREIGHT COLLECT

Freight and charges
Interest shall be payable at 2% above Bank lending rate at place of payment, per annum, shall be paid on any freight and charges remaining unpaid after due date of payment.

Received, in apparent good order and condition unless otherwise stated, the Goods or Containers or other packages said to contain Goods herein mentioned to be transported subject always to the exceptions, limitations, provisions, conditions and liberties contained herein and whether written, printed or stamped on the front or reverse hereof, from the place of receipt or the port of loading, whichever applicable, to the port of discharge or the place of delivery, whichever applicable.

All agreements or freight engagements for shipment of the Goods are superseded by this Bill of Lading.

In Witness whereof the Master or Agents have affirmed to the number of original Bills of Lading one of which being accomplished the other (s) to be void.

....For the Carrier

Issued at Genoa date 15 Oct 2001

Freight payable at

Number of original Bs/L
3/THREE

(CONTINUED ON REVERSE SIDE)

Goods of a dangerous or damaging nature must not be tendered for shipment unless written notice of their nature and the name and address of the sender have been previously given to the Carrier, Master or Agent of the vessel and the nature is distinctly marked on the outside of the package or packages as required by statute under heavy Penalties. A special stowage order giving consent to shipment must also be obtained from the Carrier, Master or Agent of the vessel. Shippers will be liable for all consequential damage and expense if all the foregoing provisions are not complied with.

* Applicable only when document used as combined transport

Annex B: Domestic Bill of Exchange (Foreign is also the same except some units such as $)

(a) BILL OF EXCHANGE

Addis Ababa, 10 Oct. 2001 (b) AMOUNT: Birr. 125,000.***00*** (g)

At 60 Days After Sight (f) PAY AGAINST THIS

TO THE ORDER of Ourselves (h)

THE SUM OF One Hundred Twenty Five thousand Birr (g)

FOR VALUE Received

TO: FOR AND ON BEHALF OF (C)

(c) International Buyers Limited Addis Ababa Exporters Limited

(e) 12th Floor,
Dembel City Center, Addis Ababala
Addis Ababa

________________ **(sign)**

Sosina Tesfaye (d)
Managing Director

A bill contains:

a) The name of the form -Bill of Exchange
b) Date -10 Oct. 2001
c) The Receiver - International Buyers Limited
d) The signer - Sosina Tesfaye
e) The address of the receiver - Dembel City Center, Addis Ababa
f) Terms of the date - 60 Days
g) The amount - One Hundred Twenty Five Thousand Birr

Unit 4

BUSINESS RECORDS KEEPING AND FINANCIAL REPORTS

Unit Outcomes

At the end of this unit, students will be able to:

- understand the nature of accounting.
- identify the importance of accounting.
- understand how to record business transactions.
- prepare the three basic financial reports namely: Income Statement, Capital Statement and Balance Sheet.

Introduction

The primary purpose of this unit is to explore the nature of accounting information and the environment in which it is developed and used. The unit emphasizes the financial reporting process, including the role played by financial statements. The basic financial statements-, Income Statement, Capital Statement and Balance Sheet will be discussed, as well.

Contents of the Unit

In order to be able to achieve the above objectives, you will learn the following topics:

- What is accounting?
- Importance of Accounting
- The Beginning Balance Sheet
- Recording the Opening Entry
- Posting the Opening Entry
- Income and Expense Accounts
- The Six-Column Work Sheet
- The Financial Statements
- The Petty Cash Fund

4.1 What is Accounting?

Some people think of accounting as a highly technical field, which is practiced and understood only by professional accountants. Actually nearly everyone practices "accounting" in one form or another on almost a daily basis. Whether you are paying school fees, preparing reports for large organizations or selling goods in retail shops, you are working with accounting concepts and accounting information.

Accounting is the process of identifying, measuring, recording, and communicating economic information about an organization or other entity, in order to permit informed judgments by users of the information.

Bookkeeping is the process of keeping records in a prescribed manner. It encompasses the record-keeping aspect of accounting and therefore provides much of the data to which accounting principles are applied in the preparation of financial statements and other financial information. Obviously, accounting goes much beyond bookkeeping to satisfy the needs of users including activities such as processing, summarizing, reporting and interpreting the financial reports.

A person who earns a living by recording financial activities of a business is called an accounting clerk. Accounting clerks are often referred to as Bookkeepers. A person who earns a living by undertaking activity of accounting is called accountant.

Accounting and Bookkeeping Distinguished

Accounting is the process of identifying, measuring, recording, and communicating economic information about an organization or other entity, in order to permit informed judgments by users of the information. Bookkeeping is the process of keeping records in a prescribed manner. It encompasses the record-keeping aspect of accounting and, therefore, provides much of the data to which accounting principles are applied in the preparation of financial statements and other financial information. Obviously, accounting goes much beyond bookkeeping to satisfy the needs of users including activities such as processing, summarizing, reporting and interpreting the financial reports.

Personal record keeping often uses a simple single-entry system, in which amounts are usually recorded in column form. Such entries include the date of the transaction, its nature, and the amount of money involved. Record keeping of organizations, however, is based on a double-entry system, whereby each transaction is recorded on the basis of its dual impact on the organization's financial position or operating results or both.

4.2 Importance of Accounting

The basic purpose of accounting is to provide decision makers with information useful in making economic decisions such as investment , taking a loan ,deleting a loss incurring department or not. These decisions concern the allocation and use of scarce economic resources, such as money and labor. The manner in which we allocate and use economic resources shapes the world's economies. Just as there are many different types of economic decisions, there are many types of accounting information.

Types of accounting (Specializing Areas in Accounting)

As a specialized field of study, Accounting will have the following types of specializing areas:

a. **Financial Accounting**: this is an area in accounting devoted to the preparation of financial statements and the provision of information to external users of accounting information. It is governed by what are called generally accepted accounting principles to facilitate comparability of financial statements of different periods and different organizations.

b. **Cost Accounting:** is an area of accounting that emphasizes the determination and control of cost of producing goods and services and it will help the company achieve different cost classifications and analyses (both actual and prospective costs). It is primarily concerned about manufacturing processes and production of tangible finished goods.

c. **Management Accounting:** this is an area of accounting that is concerned about the provision of financial information of internal users of accounting information. It uses both actual and estimated data in assisting management in daily operations and in planning future operations.

d. **Auditing:** is an area of accounting that is concerned about providing attestation and verification services that reports prepared by business enterprises are authentic and dependable in material respects. This is evaluated in their adherence to generally accepted accounting principles. In addition to retaining external auditors (who are called public accountants) most companies will employ internal auditors who will determine whether the various units are following management's policies and procedures.

e. **Tax Accounting:** is an area of accounting that encompasses the preparation of tax returns (reports) for the different governmental units about taxable amounts and the consideration of the tax consequences of proposed business transactions and or alternative courses of action. Hence, it guides companies of legal ways of minimizing taxes and other areas of taking tax advantages. Accountants in this specializing area shall be familiar with the tax statutes affecting their employers and clients and shall keep up to date on court decisions on tax related cases.

f. **Accounting Information Systems (AIS):** is an area of accounting that is concerned with the analysis, design, implementation and revision of procedures for the accumulation, processing and reporting of financial data to various users. Accountants specializing in this area will apply different components of information technology in well designed information system to collect and process financial data into useful information, to provide timely and accurate financial information for decision makers and to safeguard company properties including its data.

g. **Fund Accounting:** also called not for profit accounting, fund accounting is an area of accounting that specializes in recording, reporting and planning the operations of nonprofit, governmental and most nongovernmental entities such as hospitals, schools, etc. It will help management to adhere to restrictions and other requirements imposed by law, other institutions or individual donor groups.

h. **International Accounting:** is concerned with the special problems associated with the international trade of multinational business organizations. This area of accounting has increased in importance because of increase in the number of international companies in response to globalization and expansion of international trade. Accountants specializing in this area shall have familiarity about the influences that custom, law, and taxation of various countries will place on international operations and accounting principles.

i. **Accounting Instruction:** this is an area of accounting that involves the teaching of accounting at various levels. It involves research, publications and related activities that are intended to integrate accounting theory with accounting practice. Certain accounting concepts and principles govern the accounting practices.

Accounting Concepts and Principles

Concepts and principles are the best possible guidelines in the preparation and reporting of financial statements. In a small business enterprise, the business is managed by the owners themselves and financial reports are used by the owner managers. But, when companies grow in size and complexity management and outsiders became clearly differentiated and from the latter group came demand for accurate financial information for use in judging the performance of management. In addition, when the size and complexity of the business unit increased, the accounting problems involved in the issuance of financial statements became more complex. With these developments comes the need for a framework of concepts and generally accepted accounting principles to serve as guidelines for the preparation of the basic financial statements.

Accounting information is processed based on generally accepted principles and practices in order to bring uniformity and comparability in the reports prepared by different organizations. Such principles are collectively called *generally accepted account-*

ing principles (*GAAP*). They may be entitled as concepts, assumptions, standards or principles. Such principles unlike the principles in natural sciences are subject to change and revision. Some of the basic principles are the following:

1. **Business Entity Concept**: the business entity concept assumes that the affairs of an enterprise shall be separate from the affairs of the owners, other business enterprises and creditors etc. Hence, each enterprise is considered as a separate economic unit that has its own objectives, resources, and obligations regardless of its legal form.
2. **Continuity principle/Going Concern Concept**: the continuity principle assumes that a business enterprise starter once started will continue indefinitely for unlimited period of time earning profit. This doesn't mean the business will be eternal. But it assumes that the business will continue until unknown future. Of course, it is possible to assume that a business enterprise will have a limited life span. However, the way accounting information is recorded, processed and reported will be totally different under the two assumptions.
3. **Periodicity Principle**: the periodicity (time period) principle argues that the life of an organization is divided into arbitrary time periods of reporting. Though the company's true picture is measured between the beginning and the end of its life, because decisions are made before that, companies always prepare and report periodic performance to the users. Such arbitrary time period may be a period of one month, one quarter, semiannual period or a period of one year.
4. **Monetary Unit of Measurement**: the monetary principle assumes that accounting information is always expressed in terms of money. Money is a common factor and feasible unit of measurement in accounting to compare the operations of different types of business organizations.
5. **Cost Principle**: the cost principle assumes that goods and services acquired to be used in business operations shall be recorded at cost. Cost is the agreed amount between an independent buyer and an independent seller. A single item may have different monetary values at different times. Hence, the basis of recording and reporting is the cost of the item.

Activity: 1

- **Describe the importance of accounting by taking a particular business enterprise in your locality.**
- **What types of assets do business organizations own when they start business?**

4.3. The Beginning Balance Sheet

The Balance Sheet is the main report of overall financial condition. It shows the assets, liabilities and capital of a company at a particular date, usually on the last date of a fiscal year. The balance sheet shows what a company owns or controls and what the source of the assets are.

In accounting a business form that lists (1) what is owned, (2) what is owed, and (3) what a business is worth on a specific date is called a **balance sheet**. Because the purpose of a balance sheet is to show the financial position of a business on a particular date, it is sometimes known as a **position statement**. After a business knows what it owns, what it owes and what it is worth a balance sheet is prepared. The balance sheet has three main sections: Assets, Liabilities and Capital which are explained briefly.

4.3.1 Assets

All of the valuable resources that a business has gathered together for its use or what businesses or individuals own are called Asset. Assets are of two types: **current Assets** and **Fixed Assets**. Assets used to support the day-to – day operations of a company are **Current Assets or Working Capital**. These assets normally can be converted into cash, sold or used within a short time, usually a year or less. Cash and other assets that will be turned into cash or quickly consumed in the operation of a business are called current assets. Current assets include such things as cash, Accounts receivables, inventory and supplies. **Accounts receivables** are the amounts owed to the company for goods or service provided to customers but money not yet received. They are current assets because they represent the cash expected in a short time. **Inventories** are goods held on hand for production process or for sale to final consumers. **Supplies** are items such as stationeries, which can be consumed within a year or less. **Fixed Assets** are relatively permanent goods or resources owned by a company. Most companies do not expect to turn out their fixed assets into cash on a regular basis. Examples include factories, office buildings, durable equipment and other long lasting facilities of a business. The fixed assets of a company provide the long-term setting in which operations take place. In sum what is owned and has got value (sales value or use value) is referred to as asset. Note that, for example, a table no more useful at home and cannot command price in the market is not an asset in that it does not have value.

4.3.2 Liabilities

The sums the company owes to other businesses or individuals are called liabilities. Liabilities consist of the claims of its creditors against its assets. Debts that are owed and payable within a short time are classified as **current liabilities**. Amounts owed to trade creditors- such as purchases of merchandise on account with in short period of time is classified as current liabilities. For example, if merchandise is purchased on account to be paid within 30 or 40 days, the liability is a current liability. All liabilities that will come due and be payable within one year should be treated as current liabilities.

Debts that will not be due for several years are called **long term liabilities**. Examples of long-term liabilities are money borrowed from bank, which will be paid over long period of time such as 5 years or more.

4.3.3 Capital

The amount that remains after total liabilities are subtracted from the total assets is called **capital** .Sometimes it is also known as proprietorship.

For example:

Total assets of Ato Teshome Tesfaye Company..............Birr 72.000.00
Less total Liabilities (amount owed from bank and persons) 2.000.00
Equals the amount of the owner's (Ato Teshome's) capital....... 70.000.00

Activity: 2

- **Give examples of assets at your school.**
- **Identify assets that are possessed by your family**

4.3.4 Accounting Equation

Since all the assets of a business are subject to claims by its creditors and owners, total assets should equal the total claims of creditors and owners. The claims against assets are called **equities**. There are two types of equities. They are the equity of the creditors and the equity of the owners. The total amount of the assets should be equal to the total amount of liabilities plus the amount of the proprietorship. In other words, the total assets or what is owned should equal to the total equities. The statement that assets equal liabilities plus capital is known as the **accounting equation** and expressed as follows:

Assets = Liabilities + Capital

The accounting equation can be stated as follows:

What is owned (Asset) by Ato Teshome Company

Cash 5,000.00

Inventories 6,000.00

Accounts Receivables........................ ...4,000.00

Total Assets 15,000.00

Loan (liabilities)

Loan from commercial Bank of Ethiopia ...6,000.00

Ato Teshome Capital 9,000.00

Total liab & capital...............................15, 000.00

Total Assets (15,000.00) = Total Liabilities (6,000.00) +Total Capital (9,000.00).

Regardless of whether a business grows or contracts, this equality between the assets and the claims against the assets is always maintained.

Activity: 3

- **If total assets are three times (thrice) the total liabilities and total capital is Birr 400,000 calculate the total liabilities and total assets.**

4.3.5 Body of the Balance Sheet

The body of a balance sheet has three sections that show; (1) What is owned, (2) what is owed, and (3) What the business is worth, i.e.

- Assets are listed on the left-hand side of the balance sheet .
- Liabilities are listed on the right hand side of the balance sheet.
- Capital is listed on the right hand side of the balance sheet.

Diagrammatically, it means the following:

Balance Sheet

Assets (1) **What is owned**	**Liabilities (2)** **What is owed** **Capital (3)** **What the business is worth**
Left hand side (Debit)	**Right hand side (Credit)**

Steps in preparing a balance sheet

1. Write the heading on three lines; center each item in the heading
   The heading of a balance sheet contains three lines:

Line 1: WHO? Name of business ➔ **Haregewoin Aboye Beauty Salon**

Line 2: WHAT? Name of the form ➔ **Balance Sheet**

Line3: WHEN? Date of the form ➔ **December 31, 2010**

2. Prepare the assets section on the left-hand side, as follows:
   - Write the word Assets in the center of the first line of the wide column on the left.
   - List the name and amount of each asset, using a brief title to describe it. Begin on the next line.
3. Prepare the liabilities section on the right-hand side, as follows:
   - Write the word liabilities in the center of the first line of the wide column on the right.
   - List the name and amount of each liability, using a brief title to describe it. Begin on the next line.
   - Rule a single line across the amount in the amount column directly under the last amount.
   - Write the total of the liabilities in the amount column and label these amount total liabilities.
4. Prepare the capital section on the right-hand side, beneath the liabilities as follows.
   - Skip one line and write the word capital in the center of the wide column.
   - Write the name of the owner and the word capital on the next line.
   - On a separate sheet of paper, find the amount of the capital by subtracting the total liabilities from the total assets.
   - Write the amount of the capital in the amount column on the same line as the name of the owner.
5. Determine if the balance sheet is "in balance" and complete its preparation as Follows:
   - Rule a single line across the amount column on the right-hand side directly under the amount of the capital. Rule a single line across the amount column on the left-hand side on the same line as the single line on the right-hand side.
   - Add each column and compare the totals. The two totals should be the same. If the two totals are the same, this proves that the total of the assets equals the combined total of the liabilities and the capital. (If the final totals are not the same; the error or errors must be found and corrected.)

- Record the totals directly under the addition line on each side. Do not skip a space.
- Write the words Total Assets on the same line as the left-hand total.
- Write the words Total Liabilities and Capital on the same line as the right-hand total. If necessary, the words on this line may be abbreviated to Total Liab. and Cap.
- Rule double line across both amount columns directly under each total. The double lines show that the work is completed and that the balance sheet is "in balance."

Haregewoin Aboye Beauty Salon
Balance Sheet
December 31, 2001

Assets		**Liabilities**	
Cash	650.00	Ato Teshome Tesfaye Co.	150.00
Operating Supplies	250.00	Commercial Bank of Ethiopia	850.00
Beauty Salon Equipment	3600.00	Total Liabilities	1000.00
Office Furniture	500.00	**Capital**	
		Haregewoin Aboye ,capital	4000.00
Total assets	5000.00	Total liab and cap	5000.00

Activity: 4

i. Find the missing amount in the bookkeeping equation for each of the items listed below.

Item	Assets	=	Liabilities	+	Capital	Answers
a.	Birr 10,000	=	Birr 4,000	+	?	________
b.	6,000	=	?	+	4,500	________
c.	?	=	23,000	+	4000	________

ii. The following are the assets and liabilities of M. Dry Cleaners owned by Ato Kebede Gemechu.

Assets			Liabilities	
Cash	Birr	844.00	W/o Ayelech G/Selassie Co.	Birr 110.00
Delivery Equipment		2,266.00	W/o Bizunesh Tilahun Co.	785.00
Office Equipment		480.00		
Dry Cleaning Equipment		1660.00		

Instruction: **Prepare a balance sheet for M. Dry Cleaners. Use the date September 1 of the current year.**

- *How do business organizations maintain information about what they have before they start operations or business activities?*

4.4 Recording the Opening Entry

Normally, a new accounting system should begin with a balance sheet that shows the financial condition of the business at the time the new system is started. A balance sheet, however, is written on a piece of paper, which may be misfiled or lost. Therefore, the information shown on the balance sheet should be recorded in a permanent record book. A book in which the records of a business is first written is called a **journal**. Each record in a journal is called **an entry**. The entry that records the information shown on a beginning balance sheet is called an **opening entry**.

4.4.1. The Source of a Journal Entry

The entry that the bookkeeper makes in a journal is usually taken from some business paper. The business paper from which a journal entry is made is called a **source document** like receipt, memo, sales invoice, purchase invoice and beginning balance sheet. The source document for making an opening entry is the beginning balance sheet.

4.4.2. Types of Journals

Businesses use different kinds of journals. Some journals are used to record only one type of entry such as entries for sales or entries for purchases. A journal that is used to record only one type of entry is called a **special journal**. A journal that is used to record entries that cannot be recorded in special journals is called a **general journal**.

4.4.2.1. The General Journal

The all purpose two-column journal is called the general journal or simply the journal, can be used for entries that do not fit into any of the special journals. For example, adjusting and closing entries are recorded in the general journal. By the way in the absence of special journals, all transactions are normally recorded in the general journal. The two-column general journal, shown below, is used by the Haregowin Aboye Beauty Salon to record its beginning balance sheet.

General Journal **Page No.___**

Date		Account Title	Post Ref.	Debit	Credit

4.4.2.2. Two-column General Journal

When a beginning balance sheet is recorded in a two-column general journal, the amounts on the left-hand side of the balance sheet are recorded in the left-hand amount column of the journal. The left-hand amount column of a two-column general journal is called the **debit column**. The amounts on the right hand side of the balance sheet are recorded in the **right-hand** amount column of the journal. The right-hand amount column of a two-column general journal is called the **credit column**.

4.4.2.3. The Source Document for the Opening Entry

The beginning balance sheet of the Haregewoin Aboye Beauty Salon, in the preceding discussion is the source document from which the opening entry is made in the general journal.

Parts of a journal entry: Every journal entry has four parts: (1) a date (2) a debit part (3) a credit part and (4) a brief description of the source document.

4.4.2.4. Steps in Recording the Opening Entry

The steps in recording the opening entry of the general journal of Haregewoin Aboye Beauty Salon are as follows:

***Step 1:* Date of entry:** Write the date of the opening entry in the Date column as follows:

a. Write the year in small figures at the top of the column.
b. Write the month below the year on the first line in the first column.
c. Write the day of the month on the first line in the second column immediately after the name of the month.

***Step 2:* Debit part of the entry:** Write the debit part of the entry as shown below:

a. Write the name of each asset at the extreme left edge of the Account Title column
b. Write the amount of each asset in the Debit column.

***Step 3:* Credit part of the entry:** Write the credit part of the entry as shown below:

a. Write the name of each liability and the name of the proprietor, followed by the word Capital, in the Account Title Column. Indent each name about one-half inch from the left edge of the Account Title column. Indenting these items helps to separate the debit part of the entry from the credit part.
b. Write the amount of each item in the Credit column

***Step 4:* Source of the entry:** Write a brief description of the source document as shown below.

a. Write a brief description of the source document in the Account Title column immediately below the last credit column.
b. Indent each line of the description about one inch from the left edge of the Account Title column.

The purpose of the description is to identify the source of the journal entry in case reference must be made to the source document.

General Journal **Page 1**

Date		Account Title	Post Ref.	Debit	Credit
2010					
Dec.	1	Cash		650.00	
		Operating supplies		250.00	
		Beauty salon equipment		3600.00	
		Office Furniture		500.00	
		Ato Teshome Tesfaye Co.			150.00
		Commercial Bank of Eth			850.00
		W/ro Haregowin Aboye			
		Capital			4000.00
		Dec.1 balance sheet			

Activity: 5

Africa Garage is owned and operated by W/o Degitu Tollesa.The record shows the following assets:

Cash .... birr 567.00
Supplies 300.00
Garage Equipment 3,861.00
Office Equipment 740.00
The Garage owes Belay Company Birr 641.00 and Dagnachew Sapre parts Birr 217.00. The amount of W/o Degitu Tollessa's capital is Birr 4,610.00.
Use September 1 of the current year as the date.

Instructions:

a. **Prepare a balance sheet for W/o Degitu Tollessa Garage.**
b. **Record the opening entry on page 1 of a General Journal.**

4.5 Posting the Opening Entry

The Opening entry in a journal is a complete record of the assets, the liabilities and the proprietorship at the time an accounting system is installed. The system, however, should show not only accommodate what a business has- assets, liabilities and proprietorship but also the change that occur in these items.

As a business carries on its day-to-day operations, changes occur in the value of its assets, liabilities and proprietorship. Goods and services are bought and sold. Cash is received and paid out. Debts are owed and paid. When the business makes a profit, the amount of the proprietorship increases. When the business incurs a loss, the amount of the proprietorship decreases. An accounting form that is used to sort and summarize the changes caused by business operations is called **an account**. A group of all accounts is called a **ledger**.

4.5.1. Standard Forms of Account

There are several forms of account. One of the standard forms of account, a two-column account, is shown below.

Account Title **Account No.______**

Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit

The standard form of account is divided into a left half and a right half. Each half of an account is ruled alike. The left-hand side of an account is called the debit side. The right hand side of an account is called the credit side.

The amount column on the left-hand side has the heading Debit. The amount column on the right-hand side has the heading Credit. The headings of all the other columns are the same on each side of an account.

When amounts are recorded in the Debit column of an account, the account is said to be **debited**. When amounts are recorded in the Credit column of an account, the account is said to be **credited**.

4.5.2 Chart of Accounts

There is an account in the ledger for each item on the beginning balance sheet. The name given to an account is called the **account title**. The account title is written at the top of the account. The number given to an account to show its location in the ledger is called an **account number**. Since the accounts are arranged in the ledger in numerical order, they can be located quickly. A list of account titles that shows the arrangement of the accounts in the ledger and the number assigned to each account is called a **chart of accounts.** The part of the chart of accounts of Haregewoin Aboye Beaty Salon needed for this unit is shown blow.

Haregewoin Aboye Beauty Salone

Chart of Accounts

(1) Assets	**Account No**	**(2) Liabilities**	**Account No.**
		Ato Teshome Tesfaye Co.	21
Cash	11		
		Commercial Bank of Eth.	22
Operating Supplies	12		
Beauty Salon Equipment	13	(3) Capital W/ro Haregewoin Cap.	31
Office Furniture	14		

The first digit of each account number tells in which division of the ledger the account is placed. In the partial chart of account given above, all asset account numbers begin with 1; all liability account numbers begin with 2; the capital account numbers begin with 3. The second digit of each account number tells the position of the account within its division of the ledger. For example, the account number for office furniture is 14. This number shows that the office equipment account is in the first division of the ledger, the asset division, and that it is the fourth account in that division.

4.5.3. Posting the Opening Entry to the Ledger

Each of the amounts in the opening entry is transferred to the proper account in the ledger. Transferring the entries in a journal to the accounts in a ledger is called **posting**.

Steps in posting the opening entry:

The steps required in posting from journal to ledger are diagrammed and explained below.

General Journal **Page 1**

Date		Account Title	Post Ref.	Debit	Credit
2010		Cash		650.00	
Dec.	1	Operating supplies		250.00	
		Beauty salon equipment		3600.00	
		Office Furniture		500.00	
		Ato Teshome Tesfaye Co.			150.00
		Commercial Bank of Eth.			850.00
		W/o Haregowin Aboye Capital			4000.00
		Dec.1 balance sheet			

Step 2

Step1

Account Cash **Account No.11**

Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit
2010 Dec.1	Balance Step 3		650.00				

Step 1: **Write the amount of the cash debit, 650, in the Debit column of the cash account in the ledger as shown above.**

In manual bookkeeping, the amount is written first because it is the most important part of the entry.

Step 2: **Write the date of the journal entry, 2010, December 1, in the Date column of the ledger account as follows:**

a) Write the year, 2010 at below of the Date column line.

b) Write the month, December, in the first column under the heading Date on the same line as follows.

The year and the name of the month are written only once on the side of the account that is used.

c) Write the day of the month, 1 in the column immediately after the name of the month.

Step 3: **Write the word Balance in the Items column of the account.**

Bookkeepers distinguish between the beginning amount in an account and the amounts recorded later as a result of normal business operations. The beginning amount or balance in the cash account is therefore labeled with the single word Balance in the Items column.

General Journal **Page 1**

Date		Account Title	Post Ref.	Debit	Credit
2010		Cash	11	650.00	
Dec.	1	Operating supplies		250.00	
		Beauty			
		salon equipment	Step 4	3600.00	
		Office Furniture		500.00	
		AtoTeshome			
		Tesfaye Co.		Step 5	150.00
		Commercial Bank			
		of Eth.			850.00
		W/o Haregowin			
		Aboye Capital			4000.00
		December 1			
		balance sheet			

Account Title: Cash **Account No.11**

Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit
2010 Dec.1	Balance	J1	650.00				

Step 4: **Write J1 in the post. Ref. Column of the cash account. J1 is written in the post.** Ref. column of the account to show that this debit to cash came from page 1 of the general journal. J is the abbreviation for general journal. Post. Ref. is the abbreviation for posting Reference.

Step 5: **Return to the journal and write in the post Ref. column of the journal the account number of the account, 11 to which the item was posted.**

Writing the number 11 in the post Ref. column of the general journal shows that this item was posted to account number 11 and that all the details of the posting of this line have been completed. For this reason, the post. Ref. figure in the journal is written as the last step in posting. When the bookkeepers are interrupted in posting, the proper use of post. Ref. number enables them to resume their posting quickly at the right place.

Posting the remaining debit items of the opening entry

The same steps used in posting the first debit item of the opening entry are followed in posting the remaining debit items. Each account is a separate page of the ledger.

Account Title: Operating supplies **Account No. 12**

Date		Item	Post Ref.	Debit	Date		Items	Post Ref.	Credit
2010 Dec	1	Balance	J1	250.00					

N.B. Other debits shall be posted in the same way.

Posting the credit items of the opening entry

The credit items in the general journal are posted in the same manner as the debit items, except that the credit items are posted to the credit side of the accounts. The five steps in posting the first credit item are illustrated in the diagram that follows.

General Journal **Page 1**

Date		Account Title	Post Ref.	Debit	Credit
2010		Cash	11	650.00	
Dec.	1	Operating supplies	12	250.00	
		Beauty salon equipment	13	3600.00	
		Office Furniture	14	500.00	
		Ato Teshome Tesfaye Co.	21	Step 5	150.00
		Commercial Bank of Eth.	22		850.00
		W/o haregowin Aboye Capital	31		4000.00
		Dec.1balance sheet			Step 1

Step 2

Account Title: Ato Teshome Tesfaye Company Account No.21

Date		Item	Post Ref.	Debit	Date		Items	Post Ref.	Credit
					2010 Dec	1	Balance	J1	150.00
							Step 3	Step 4	

N.B. Others credits shall posted in the same way

Use of Post Reference numbers

The numbers in the posting reference columns in the journal and in the ledger are useful for cross reference. Anyone looking at an entry in the journal can find the number of the account to which the journal entry was posted. With this information the bookkeeper can quickly locate the account in the ledger. Also anyone looking at an item in the ledger can find the number of the journal page from which the posting was made.

Activity: 6

a. The balance sheet on July 1 of Dechassa Plumbing and Heating, owned by w/o Birkti Tesfu is as follows:

Dachassa Plumbing and Heating

Balance sheet

July 1, 2010

Assets			Liabilities		
Cash	1,140	00	Bayou Heating Comp	550	00
Plumbing Supplies	1,360	00	Plumbing Service Com	141	35
Office equipment	280	00	Total Liabilities	691.	35
Plumbing equipment	1,445	50			
Truck	2,895	50	**Proprietorship**		
			Birikti Tesfu Capital	6429	65
Total Assets	7,121	00	Tot. Liab. And Cap.	7,121	00

Instructions:

i. Record the opening entry for Dachassa plumbing and Heating on page 1 of a general journal. Use July 1 of the current year as the date.

ii. Open accounts in a ledger for all the account titles listed on the balance sheet. Number the accounts as follows: Asset accounts, 11 to 15; liability accounts 21 and 22 and the proprietor's capital account, 31.

iii. Post the opening entry.

- ***How do business owners know that they are generating profit or incurring loss during their business operations?***

4.6. Business Transactions

As a business conducts day-to-day operations, changes occur in the value of its assets, liabilities, and capital. Goods and services are bought and sold. Cash is received and paid out. Debts are incurred and paid.

An exchange of property or services is called a business transaction. Each business transaction causes a change in the amount of some balance sheet items. An accounting system must show not only what a business has, but also the changes in its assets, its liabilities, and its capital.

Analysis of Business Transactions

When accountants get business paper for transactions, it is necessary to answer the following questions:

- **What happened**? What kind of business took place? Did we charge our customer for something, get money for something, buy something, etc.?
- **What accounts will change**? An account (Asset, Liability, Owner's Equity) is where we keep information on anything we wish to know about individually. For example, we have an account for money (cash) where we keep track of the increases, decreases and balance. Any time there is a transaction, at least two accounts will change.
- **How will they change**? Will the account increase or decrease?
- **Do they get a Debit or Credit** ? T-accounts may help you in the analysis. It is a method to help the analysis. It is a method to help your thoughts process without the formality of general journal entries. The actual recoding and posting of expense and income transactions are treated in following topic.

4.7. Income and Expense Accounts

Most businesses are in operation for the purpose of earning a profit. To make a profit, a business must engage in business transactions that increase its proprietorship. For example, owners of hotels receive cash from renting rooms; medical Doctors receive fees for services performed, Beauty salons receive from hairdressing, farmers sell their products and so on and so forth. An increase in proprietorship that results from the operation of the business is called **income.** Income is sometimes called revenue.

All income transactions cause an increase in proprietorship. A business may have several kinds of income. For example, in addition to receiving income from room sales, some motels receive income from restaurant operations and from selling beverages. All income increases are recorded on the credit side.

All businesses have operating costs. For example, a business pays for electricity, rent, telephone service and other costs. Operating costs decrease proprietorship. A decrease in proprietorship that results from the operation of the business is called an **expense**.

All expense transactions cause a decrease in proprietorship. A business may have a variety of expenses. For example, most Beauty Salons pay for telephone, water, electricity and advertising. All increase in expense accounts are recorded on the debit side because they had a negative impact on the activity of the business.

4.7.1 Income Transactions

The following transactions illustrate the income and expense accounts.

Transaction No. 1: December 20, 2010 received cash, Birr 75.00 from sales of beauty salon service.

The steps required to analyze the transaction is shown as follows:

Step 1: Determine the name of accounts affected: Cash and sales

Step 2: Determine the classification of each account affected.

Cash is an asset account and Sales is an income account.

Step 3: Determine how the balance of each of these account is changed.

a) Haregowing Aboye Beauty Salon has more cash as a result of receiving birr 75 from its sales of one day. The balance of the cash account, an asset account is increased by 75 birr. The balance side of every asset account is the debit side. The cash account is therefore debited for the amount of the increase, birr 75.

b) The income of Haregewoin Aboye has been increased by birr 75 as a result of receiving cash from service rendered by Beauty Salon. The balance side of every income account is the credit side. Therefore. The income sale is credited for the amount of the increase birr 75.

Account: Sales **Account No.41**

Date		Item	Post Ref.	Debit	Date		Items	Post Ref.	Credit
					2010				
					Dec	20			75.00

4.7.2 Expense Transactions

The following topic deals with the steps in analyzing expense transaction.

Transaction number 2: December 30, 2010 paid cash 200.00 for rent of the house for December.

Analyzing Transaction No. 2

The steps in analyzing transaction No. 2 are:

Step 1: Determine the names of the accounts affected: Rent expense and cash

Step 2: Determine the classification of each account affected.

Rent Expense is an expense account and Cash is an asset account.

Step 3: Determine how the balance of each of these accounts is changed.

a) The operating expenses of Haregewoin Beauty Salon have been increased by 200 birr as a result of paying the monthly rent. The balance side of any expense account is the debit side. Therefore, the expense account, Rent expense, is debited for the amount of the increase, birr 200.00.

b) Haregewoin Beauty Salon has less cash as a result of having paid the monthly rent. The balance of the cash account, an asset account, is decreased by 200.00 birr. All decreases in any account balance are always recorded on the side opposite of the balance side. The cash account is therefore credited for the amount of the decrease, birr 200.00.

Activity: 7

Analyze the following transactions:

a. Paid cash, Birr 13.00 for telephone expense.

b. Received cash, Birr 243.00 from delivery income.

c. Paid cash, Birr 12.50 for advertising expense.

d. Paid cash, Birr 2.00, for washing the delivery truck. (Use Delivery Truck Expense.)

e. Paid cash, Birr 3.50, for leather work gloves. (Use Miscellaneous Expense)

4.8. The Six-Column work Sheet

The analysis to determine the profit or the loss of a business is made on a single sheet of paper with six or more amount columns. Accounting paper with a number of amount columns that are used for analysis purpose is known as a **work sheet (Working paper)**.

The length of time for which an analysis of business operations is made is called a **fiscal period**. The fiscal period may be any length of time desired such as four weeks, or (a month), three months, six months or one year.

The six amount columns of the work sheet are composed of pairs of Debit and Credit columns under the major sections headings of Trial Balance, Income statement and Balance sheet.

The proof of the equality of the debits and the credits in the ledger is called a **trial balance**. A trial balance is taken to prove the accuracy of the ledger. In the income statement section, the amount of each expense is listed in the debit column and the amount of each income, in the credit column. When the income is larger than the expenses, the amount of the difference is called **net income**. When the expenses are larger than the income, the difference is called **net loss**.

The balance sheet section shows the amount of each asset in the Debit column, and the amount of each liability and the amount of the proprietorship in the credit column.

Preparing a Six-Column Work Sheet

The steps listed below should be followed when preparing a work sheet.

Step 1: Write the heading on three lines; center each item in the heading

a) Write the name of the business→ Haregewoin Aboye **Beauty** salon.
b) Write the name of the form→ Work sheet, on the second line.
c) Write the length and the closing date of the fiscal period for which the analysis is made→for month Ended December 31, 2010, on the third line.

Step 2: Write the column headings, the column headings of the six-column work sheet are Account Titles, Account Number, Trial Balance Debit and Credit, Income statement Debit and Credit, and Balance sheet Debit and Credit.

Step 3: Record the trial balance. When a work sheet is prepared at the same time a trial balance is taken, the trial balance is recorded directly on the work sheet. In this section all accounts with debit balance will be recorded on the debit side and all accounts with the credit balance are recorded on the credit side.

Step 4: Extend the balance sheet items into the balance sheet section as follows:

a) Extend the amount of each asset from the Trial Balance Debit columns in the Balance sheet Debit column.
b) Extend the amount of each liability and the proprietorship from the Trial Balance Credit column in the Balance sheet Credit column.

Step 5: Extend the income and expense items into the Income Statement section, as follows:

a) Extend the amount of each income from the trial Balance Credit column into the Income Statement credit column.
b) Extended the amount of each expense from the Trial Balance Debit column into the Income Statement Debit column.

Step 6: Total the Income Statement columns and the Balance sheet columns.

a) Rule a single line across the Income statement columns and the Balance sheet columns to indicate addition.

b) Add each column and write the totals on the same line as the Trial Balance totals.

Step 7: Calculate and record the net income (or the net loss).

a) subtract the smaller total in the Income Statement columns from the lager total, as follows:

If the total of Income Statement credit column (income) is greater than the total of Income Statement Debit Column (expenses) the difference is net income. If total of Income statement Debit Column (expenses) is greater than total of Income Statement credit column (income) the difference is Net Loss.

Step 8: Extend the net income (net loss) into the Balance sheet column.

a) Extend the amount of the net income, into the Balance Sheet Credit column to show the increase in proprietorship as a result of the net income earned by the business during the time.

b) If there is a net loss for the month, the proprietorship is decreased. The amount of a net loss is therefore extended into the Balance Sheet Debit column because this is the column in which deductions in proprietorship must be shown.

Step 9: Rule double lines below the final totals of the Income Statement columns and the Balance sheet columns. The double lines show that all work has been completed and is assumed to be correct.

Haregewoin Aboye Beauty Salon
Work Sheet
For the Month Ended December 31, 2010

Account Titles	Acct. No	Trial Balance Debit	Trial Balance Credit	Income Statement Debit	Income Statement Credit	Balance Sheet Debit	Balance Sheet Credit
Cash	11	2834.00				2834.00	
Operating Supplies	12	250.00				250.00	
Beauty Salon Equipment	13	3600.00				3600.00	
Office Furniture	14	500.00				500.00	
Ato Teshome Tesfaye Com.	21		150.00				150.00
Commercial Bank of Ethiopia	22		850.00				850.00
W/o Haregewoin Aboye Cap.	31		5092.00				5092.00
Sales	41		1318.50		1318.50		
Advertising Expense	51	18.00		18.00			
Fuel Expense	52	73.50		73.50			
Miscellaneous Expense	53	31.50		31.50			
Rent Expense	54	35.00		35.00			
Utilities Expense	55	68.50		68.50			
Total		7410.50	7410.50	226.50	1318.50	7184.00	6092.00
Net Income				1092.00			1092.00
				1318.50	1318.50	7184.00	7184.00

Activity: 8

The account balances in the ledger of XYZ Company, on November 30 of the Current year, the end of a fiscal period of one month, are:

Cash…………	**Birr 1,444.80**	**Ato Belay Tilahun, Capital …………**	**Birr 8,638.85**
Automobile………	**2,800.00**	**Sales ………………………………**	**1,501.00**
Equipment ……..	**4,110.00**	**Insurance Expense ………………….**	**30.00**
Office Furniture ……	**987.10**	**Miscellaneous ……………………..**	**34.80**
Office Machines ….	**714.10**	**Rent Exzpense …………………… …**	**10.00**
Arega Company …..	**40.00**	**Salary Expense ……………………..**	**275.00**
Tsehay Company ….	**349.25**	**Utilities Expense ……………………**	**18.80**
Dereje Company …..	**95.50**		

Instruction: Prepare a six-column work sheet for XYZ Company.

4.9. The Financial Statements

Information about the operations of a business for a fiscal period is summarized on the work sheet. The work sheet does not show this information in its most convenient form. For this reason, financial reports are prepared in a form that gives more meaning to the information. The most commonly used financial reports are (1) The Income Statement (2) Capital statement (3) The Balance Sheet.

4.9.1 The Income Statement

An income statement is an accounting report that shows the revenue and expenses during a certain period of time. One of its main purposes is to show the profit or loss resulting from operations. The income statement is often called a "**profit and loss account**" or an "**operating statement**." It shows income and expenses. It reports the financial results of a period of operations, usually a month, a quarter, half year or a year. The income statement has three main sections: **income, expense and net income (net loss)**.

4.9.2. Preparing the Income Statement

The information needed to prepare an income statement is found in three parts of the work sheet.

4.9.2.1. Heading of the Income Statement

Each income statement covers a definite fiscal period. The fiscal period is the same as that shown on the work sheet from which the statement is prepared.

The heading of the income statement of Haregewoun Abouye's Beauty Salon includes:

Line 1 – Name of the Business → Haregewoin Aboye Beauty Salon

Line 2 – Name of the form → Income Statement

Line 3 – Length of the accounting period→ For the month ended Dec. 31, 2010.

4.9.2.2. Income Section of an Income Statement

The information for preparing the income section of the income statement is obtained directly from the Income Statement credit column of the work sheet.

4.9.2.3. Expense section of an income statement

Expenses are usually subdivided into selling and general or administrative expenses. Selling expenses are incurred as a direct result of the sales activities of the firm. Such items as salaries of sales clerk, advertising and delivery costs are examples of selling expenses. General expenses are costs connected with the general operation of the business. Office salaries such as salary paid for a secretary, rent, taxes and office supplies are examples of general or administrative expenses.

The information for preparing the expense section of the income statement is obtained directly from the Income Statement Debit column of the work sheet.

Activity: 9

- **Mention possible expenses that would be incurred by garages.**
- **Mention possible expenses that are incurred at your home.**

4.9.2.4. Net Income

The difference found by subtracting the total operating expenses from the gross revenue of the business is known as the **net Income**. In some instances the total operating expenses may exceed the gross revenues. Should this occur, the difference between these two amounts would be known as **net loss**. The final figure on an income statement and the one that represents the results of all operations of a business is the net income or net loss. The amount of the net income shown on the income statement should, of course, agree with the amount of the net income shown on the work sheet.

Activity: 10

Calculate the net income or net loss.

a.	**Total Revenue (Income)**	**5600.00**
	Total Expenses	**7200.00**
b.	**Total Revenue (Income)**	**4500.00**
	Total Expenses	**3700.00**

4.9.2.5 Preparing the Income Statement

Steps in preparing the Income Statement

Five steps are followed in preparing the income statement:

1. Prepare the heading

- Write the heading on three lines; center each item in the heading.

2. Prepare the revenue section.

- The heading of the revenue section of an income statement is the word revenue. The heading is written on the first line, beginning at the vertical line at the left. The title of the revenue account, a sale is written on the second line, indented about one-half inch. Since Haregewoin Aboye Beauty Salon receives revenue from sales only, the amount of the sales is also the total revenue. The amount of sales is therefore written in the second amount column which is used for totals.

3. Prepare the expense section.

- The heading of the second section of the income statement is the word expenses. This heading is written at the left margin. The titles of each of the individual expenses are listed. Each account title is indented one-half inch from the vertical line. The amount of each expense account is written in the first amount column of the income statement. A single line is drawn across the first amount column to indicate the addition of all expense amounts. The words total expenses are written on the line beneath the last expense account title and the amount of the total expenses is written in the second amount column.

4. Figure out the net income (net loss).

- A single line is ruled across the second amount column to indicate subtraction of the total expenses from the total revenues. The result is written beneath the single ruled line in the second amount column. The word Net Income or Net Loss is written at the left margin.

5. Rule the Income Statement.

- Double lines are ruled across the amount columns to show that all work has been completed and is assured to be correct.

Haregewoin Aboye Beauty Salon
Income Statement
For month ended December 31, 2010

Revenue		
Sales		1318.50
Expenses		
Advertising Expense		
Fuel Expenses	18.00	
Miscellaneous Expenses	73.50	
Rent Expenses	31.50	
Utilities Expenses	35.00	
Total Expenses	68.50	226.50
		1092.0
Net Income		

Activity: 11

Using the following information, prepare an income statement:

Sales	**20,000.00**
Expenses:	
Advertising Expenses	**5,000.00**
Fuel Expenses	**3,000.00**
Miscellaneous Expense	**4,000.00**
Rent Expenses	**2,000.00**
Utilities Expenses	**850.00**

Additional Information:

The Name of the Enterprise: Balcha Duferra Clinic

The Date: For the Month Ended October 31, 2010

4.9.3 The Balance Sheet

The information needed to prepare a balances sheet is found in three parts of the work sheet. They are (1) The Heading, (2) the Account Titles column, and (3) the Balance sheet columns. The heading of the work sheet contains the name of the business and the date for which the balance sheet is prepared. The Account Titles column supplies the names of the accounts listed on the balance sheet. The Balance sheet columns of the work sheet contain all the amounts needed in preparing the balance sheet.

Haregewoing Aboye Beauty Salon
Balance Sheet
December 31, 2010

Asset		**Liability**	
Cash	2834.00	Ato Teshome Trsfaye Co.	150.00
Operating supplies	250.00	Commercial Bank of Ethiopia	850.00
Beauty Salon Equipment	3600.00	Total Liabilities	1000.00
Office Furniture	500.00	**Capital**	
		W/o Haregewoin Aboye, Capital	6184.00
Total Assets	7184.00	Total Liab. And Capital	7184.00

4.9.4. The capital statement

At the end of the fiscal period, the owner of a business is interested in learning what changes occurred in proprietorship. A financial report that summarizes the changes in the proprietor's capital that have occurred during the fiscal period is called **capital statement**. The owner of the business can review the capital statement to determine if and why the capital is increasing or decreasing. Changes in the amount of capital occur:

a. When Additional capital is invested.

b. When cash, merchandise or other assets are withdrawn.

c. .When the business earns a profit or incurs a loss from its operation.

Data needed to prepare the income statement are: 1) the beginning balance of capital, 2) additional investment made during the fiscal period and 3) the withdrawals during the fiscal period 4) the net income or net loss for the fiscal period.

For example W/o Haregewoin Aboye's beginning capital was Birr 4,000.00 at the beginning of the fiscal year. During the time of the operation she added additional capital amounting to Birr 1,000.00. She has withdrawn Birr 1000.00 from the business at the end of the fiscal year. The income of the statement of the business shows that the net income is Birr 1092.00. Accordingly the capital statement of the company can be prepared using the following steps:

Step 1: Write the heading on three lines.

Line 1: the name of the business →Haregewoin Aboye beauty Salon.

Line 2: the name of the report→ Capital Statement.

Line 3: the fiscal period covered by the capital statement→For the Month ended December 31, 2010.

Step 2

- Write the words, Hargewoin Aboye, Capital, December 1, 2010 at the extreme left of the wide column
- Write the amount of capital, in the first amount column.

Step 3

- Write the words plus additional investment on the net line at the extreme left of the wide column to show that an amount is added to the beginning capital.
- Write the amount of the additional investment, in the first amount column on the line immediately below the beginning capital.

Step 4

- Add the amount of the beginning capital and the amount of the additional investment and write the total, in second amount column .
- Write the word, Total, at the extreme left of the wide column.

- Write the amount of the net income, in the first amount column.

Step 5

- Write the words Net Income for December 2010 at the extreme left of the wide column

Step 6

- Write the words less withdrawal for December 2001 in the wide column, Indented about a half inch.
- Write the amount of the withdrawals in the first amount column.

Step 7

- Subtract the amount of the withdrawals from the amount of the net income.
- Write the net increase or decrease at the extreme left of the wide column. If the net income exceeds the withdrawals the amount it is called net increase in capital. If the Withdrawals exceeded the net income the amount is called net decrease in capital.

Step 8

- Add the net increase or subtract the net decrease to /from the total and write the sum in the second amount column.
- Write Haregewoin Aboye capital, December 31, 2010 at the extreme left of the wide column to identify the amount.
- Rule double lines across both amount columns

Haregewoin Aboye Beauty Salon
Capital Statement
For Month Ended December 31, 2010

Haregewoin Aboye Capital, December 1, 2010	4000.00	
Plus :Additional Capital	1,000.00	
Total		5000.00
Net Income for December, 2001	1092.00	
Less :Withdrawals for December, 2001	1000.00	
Net Increase in Capital		92.00
Haregewoin Aboye, Capital, December 31, 2001		5,092.00

Activity: 12

Using the following information, prepare the capital statement for the month ended September 31, 2010.

Haimanot Olango capital, September 1, 2010	**Birr**	**15,000**
Additional capital		**2,000**
Net Loss		**3,000**
Withdrawals		**1,000**

Additional Information

The name of the Business: Haimanot Olango Repair Service

- ***Do you think that business owners should record every small payments in their respective accounts? What will be the problems if they do so?***

4.10 The Petty Cash Fund

A company may make minor cash payments during a certain period for which the voucher system is not feasible. Such payments are not made haphazardly for they are minor because they will be major when accumulated. Hence, there must be some mechanism of handling such payments. This is done by establishing a petty cash fund. A *petty cash fund* is a fund of some amount established to make minor cash payments. It is established by withdrawing cash from the bank account and placing it in the custody of some responsible individual called petty cash custodian or cashier. In establishing a petty cash fund, the petty cash account is debited and the cash in bank account is credited.

Example: On June 5, 2011 LM Co established petty cash fund of Br 520 and placed it in the custody of the main secretary. The entry to record the establishment is:

2011 Petty Cash............520
June 5 Cash in bank.........520
To establish petty cash fund.

If the company uses the voucher system, the establishment of the petty cash fund will be done in two steps:

Petty Cash...............520
Voucher payable... 520

The cash withdrawal from the bank is recorded as follows:

Voucher Payable... 520
Cash in bank 520

When payments are made from the fund, no journal entry is made except memorandum information. The petty cash cashier inserts a voucher or petty cash receipt in the fund. When the fund reaches a certain minimum balance, it is replenished by a cash withdrawal from the bank account. The entry to record the replenishment of the fund debits various expenses indicated in the voucher and credits the cash in bank account.

Example: Assume the petty cash fund of LM Co shows the following composition on June 15, 1991:

- Urgent supplies................Br 150
- Miscellaneous expenses.... 110
- Urgent merchandise.......... 220
- Amount of cash in the fund is determined to be Br 22.5

The entry to replenish the fund is:

Supplies expenses	150	
Miscellaneous expenses	110	
Purchase	220	
Cash in Bank		477.5
Cash short and over		2.5

To replenish of the petty cash fund.

Summary

The systematic Recording of the financial operations of a business or of an Individual is called bookkeeping. A Book in which the records of a business are first written is called a Journal. The name given to an account is called the account title. The number given to an account to show its location in the ledger is called an account number.

An increase in proprietorship that results from the operation of the business is called Income. A decrease in proprietorship that results from the operation of the Business is called an expense. Analysis paper on which the financial condition of a business is summarized is called a work sheet. The length of time for which an analysis of business Operations is made is called a fiscal period.

The income statement shows the financial progress of a business over a period of time. The balance sheet shows the financial condition of a business on a specific date. A financial report that summarizes the changes in the proprietor's capital that have occurred during the fiscal period is called capital statement. On the other hand, income statement reports the financial results of a period of operations.

Review Questions

Part I. Choose the best answer from the given alternatives.

1. One of the following is not the purpose of accounting
   a. Providing information for decision makers
   b. Summarizing financial affairs of a company
   c. Providing bulk data of day to day records of a company
   d. Invaluable input for business development
   e. None of the above
2. Identify the wrong statement from the following
   a. Accounting and bookkeeping are one and the same
   b. Bookkeeping is the recording phase of accounting
   c. The accountant often supervises the bookkeeper
   d. Accounting goes beyond reporting financial information by providing comparisons and other analysis
   e. None of the above
3. One of the following is internal user of a company
   a. The owners
   b. The creditors
   c. Employees and their trade unions
   d. The production manager
   e. None of the above
4. One of the following didn't contribute to the development of accounting internationally
   a. Industrial revolution
   b. Corporate organizations
   c. Income tax laws
   d. Government influence of business affairs
   e. None of the above
5. The organization that converts raw materials into finished goods is
   a. A merchandising business
   b. A manufacturing business
   c. A service giving business
   d. Organized only as a corporation
   e. None of the above
6. A statement that reports the operating results of a company is a/an
   a. Balance sheet
   b. Income statement
   c. Owner's equity statement
   d. Cash flow statement
   e. None of the above
7. An accounting principle that states that affairs of a business organization shall be kept separate from the affairs of the owner or those of other business organizations is
   a. Going concern concept
   b. Cost principle
   c. Business entity concept
   d. Periodicity principle
   e. Monetary principle

Part II. Define and explain the following key terms.

a. Net loss
b. Net income
c. Bookkeeping
d. Work sheet
e. Liability
f. Expense
g. Asset
h. Fiscal period
i. Proprietor
j. General Journal Income
k. Special journal
l. Journal
m. Entry
n. Source document

Part III. Answer the following questions.

1. State the bookkeeping equation that is true of all completed balance sheets.
2. Why should the information on the beginning balance sheet be recorded in a permanent record book?
3. What is a purpose of writing a brief description of the source document in the opening entry?
4. Why is the word Balance written in the Items column of the ledger account when posting each item of the opening entry?
5. Give three examples of business transactions that increase proprietorship?
6. Why is a separate ledger account kept for each kind of item?
7. Why is the amount of the net loss that is obtained from the Income Statement columns of the work sheet extended to the Balance sheet Debit column?
8. What is the primary use of the financial statements?
9. How does the heading of Balance sheet differ from the heading of the Income Statement?
10. What is the purpose of preparing the Capital Statement?

IV. Project

A. Hill owns and operates a service giving business enterprise, Hill Photographic Studio. The chart of accounts is given below.

Hill Photographic Studio
Chart of Accounts

Balance Sheet Accounts		Income Statement Accounts	
(1) Assets	**A/C No.**	**(4) Revenue**	**A/C No.**
Cash	11	Sales	41
Accounts Receivable	12	**(5) Expenses**	
Supplies	14		
Prepaid Rent	15	Salary Expense	52
Photographic Equipment	18		
(2) Liabilities		Miscellaneous Expense	59
Accounts Payable	21		
(3) Capital			
A. Hill, Capital	31		
A. Hill, Drawing	32		

The following business transactions were completed during the month of March, 2011.

March 1. The owner invested the following assets in the enterprise: Cash, Birr3,500; Accounts Receivable, Birr950; Supplies, Birr1,200; and Photographic Equipment, Birr 15,000. There were no liabilities transferred to the business.

1. Paid Birr2,400 on a lease rental contract, the payment representing three months' rent of quarters for the studio.
4. Purchased additional photographic equipment on account from Palmer Photographic Equipment Inc. for Birr2,500.
5. Received Birr850 from customers in payment of their accounts.
6. Paid Birr125 for newspaper advertisement.
10. Paid Birr500 to Palmer Photographic Equipment Inc. To apply on the Birr2,500 debt owed them.
13. Paid receptionist Birr575 for two weeks' salary.
16. Received Birr1,980 from sales from the first half of March.
20. Paid Birr650 for supplies.
27. Paid receptionist Birr575 for two weeks' salary.
31. Paid Birr69 for telephone bill for the month.
31. Paid Birr175 for electric bill for the month.
31. Received Birr1,870 from sales for the second half of March.
31. Sales on account totaled Birr1,675 for the month
31. Hill withdrew Birr1,500 for her personal use.

Required:

1. Analyze and record the transactions in a general journal.
2. Post to the ledger using four column accounts.
3. Prepare a Trial Balance.
4. Prepare financial statements (Income statement, capital statement and balance sheet). Assume that there is no adjustment during on March 31,2011

Glossary

- ***Absolute advantage:*** ability to beat competition**:** the ability of a provider of goods or services to conduct business more profitably or efficiently than any competitor.
- ***Accountant:*** somebody who maintains the business records of a person or organization and prepares forms and reports for tax or other financial purposes.
- **Accounting**: the activity, practice, or profession of maintaining the business records of a person or organization and preparing forms and reports for tax or other financial purposes.
- ***Accounting Equation:*** BUSINESS balance sheet equation; a fundamental balance sheet equation, such as liabilities + net worth = assets.
- ***Ad valorem:*** according to value**;** in proportion to the value of something.
- ***Advertising:*** public promotion of something**;** the public promotion of something such as a product, service, business, or event in order to attract or increase interest in it.
- ***Agent:*** somebody representing another; somebody who officially represents somebody else in business.
- ***Assets:*** owned items; the property that is owned by a person or organization.
- ***Balance Sheet:*** a statement showing the assets and liabilities of a company or institution at a particular time.
- ***Bookkeeping:*** the activity or profession of recording the money received and spent by a person, business, or organization.
- ***Business:*** commercial activity which involves the exchange of money for goods or services.
- ***Bill of Exchange:*** a document setting out an instruction to pay a particular person a fixed sum of money on a particular date or when the person requests payment.
- ***Bill of Lading:*** a list of merchandise being transported, especially by ship, together with the conditions that apply to its transportation.
- ***Broker:*** commercial agent; somebody who is paid to act as an agent for others, e.g. in negotiating contracts or buying and selling goods and services.
- ***Chain store:*** one of series of stores**:** one of a series of retail stores, especially department stores or supermarkets, owned by the same company.
- ***Commission merchant:*** agent working on commission**;** an agent who buys and sells goods for others and is paid on a commission-only basis.
- ***Communication Channel:*** a course or means of communication or expression.
- ***Comparative advantage:*** business more efficient production**:** a higher relative efficiency in the production of a particular good in one country or company as opposed to another.
- ***Cost:*** the amount of money spent in producing or doing something.

- ***Debit:*** column for recording debts or expenses; a column on the left of an accounting statement where debts and expenses are recorded.
- ***Direct marketing:*** selling directly to customers**;** methods of marketing by which a company deals directly with its end customers, including mail order by catalog, direct mail, telephone sales, or the advertising of goods.
- ***Discount store:*** store selling discounted merchandise; a store that sells merchandise at prices that are reduced from those recommended by the manufacturers.
- ***Department store:*** big store; a large store that sells a wide range of goods in separate departments.
- ***Door to door:*** to all houses in area; going from one house to the next, usually in order to sell things, to collect money for charity, or to solicit support in an election.
- ***Chart of accounts:*** a chart explaining the numerical codes identifying the ledger accounts in an accounting system.
- ***Check/Cheque:*** a small printed form that, when filled out and signed, instructs a bank to pay a specific sum of money to the person named on it.
- **Certificate of Origin**: document stating source of goods**:** an official document stating what country a consignment of goods has come from.
- **Communication:** the exchange of information between people, e.g. by means of speaking, writing, or using a common system of signs or behavior.
- ***Complimentary closing:*** end of letter; the part of a letter, e-mail, or similar communication immediately before the signature, expressing the sender's sentiments, e.g. "Sincerely yours".
- ***Credit:*** account payments column**;** the right-hand side of an account record, where payments to the account are recorded.
- ***Current assets:*** cash and convertible assets**;** available cash and other assets that could be converted to cash within a year.
- ***Current liabilities:*** Liabilities to be cleared within year**;** business liabilities that are due to be cleared before the end of the financial year.
- ***Customs:*** duties on good**;** taxes payable on imports and exports.
- ***Embargo:*** official ban**;** any official restraint or prohibition.
- ***Exchange:*** giving and receiving**;** the action or process or an instance of exchanging something for something else or for something the same.
- ***Expense:*** money spent on something; the amount of money spent in order to buy or do something.
- ***Export:*** selling of goods abroad**;** the selling of goods to other countries.
- ***Feedback:*** response**;** comments in the form of opinions about and reactions to something, intended to provide useful information for future decisions and development.

- ***Fixed assets:*** permanent owned thing; an asset of a business that is central to its operation and is not traded.
- ***Form letter:*** standard letter; a printed letter that is sent out to a large number of people, e.g. one dealing with a frequently arising complaint, or one used in advertising.
- ***Free alongside ship:*** delivered to dockside but not loaded: with the cost of delivery to the dockside included, but not the cost of loading onto a ship.
- ***Income:*** money received over period; the amount of money received over a period of time either as payment for work, goods, or services, or as profit on capital.
- ***Income Statement:*** a financial statement showing the profit or loss sustained by a company during a particular period, including all items of income and expenditure.
- ***Inside Address:*** address on business letter; the name, title, and street address of the person to whom a business letter is written, as it appears on the letter above the salutation.
- ***Insurance:*** financial protection against loss or harm; an arrangement by which a company gives customers financial protection against loss or harm such as theft or illness in return for payment premium.
- ***Import:*** something brought from abroad; something that is brought into one country from another, usually for commercial or industrial purposes.
- ***Inquiry:*** act of asking; a request for information.
- ***Insurance Policy:*** contract of insurance; a written contract between an insurance company and a person or organization requiring insurance against loss or harm.
- ***Invoice:*** request for payment; a written record of goods or services provided and the amount charged for them, sent to a customer or employer as a request for payment.
- ***Journal:*** a book for recording daily transactions, especially in double entry bookkeeping, using a formulaic style to ensure their correct entry in a ledger. ***Journalize:*** to keep a journal, or record something in a journal
- ***Letter of Credit:*** document allowing somebody to draw money: a letter from a bank, usually for presentation to another branch or bank, authorizing it to issue credit or money to the person named.
- ***Ledger:*** Financial record book: a book or page with columns for debits and credits, on which to transcribe financial records.
- ***Ledger entry:*** an entry made in a ledger.
- ***Liability:*** something for which somebody is responsible, especially a debt.
- ***Market:*** gathering for buying and selling; a gathering in a public place for buying and selling merchandise or farm products, especially one held regularly.
- ***Media:*** the various means of mass communication considered as a whole, including television, radio, magazines, and newspapers, together with the people involved in their production.

- ***Memo:*** a written communication similar to a letter but without the formal address blocks at the beginning, especially one that is circulated to people within an office or organization.
- ***Middleman:*** man who buys and sells goods; a trader, especially a man, who buys goods from a producer and then sells them to retailers or consumers.
- ***News release:*** information supplied to reporters**;** an official statement or account of a news story that is specially prepared and issued to newspapers and other news media for them to make known to the public.
- ***Open account:*** sale without debt contract; an arrangement by which sales are made with no formal debt contract. The buyer signs a receipt, and the seller records the sale in a ledger.
- ***Packing:*** act of putting things into containers; the task of putting things into containers, usually for storage or transport
- ***Petty cash:*** money for small expenses**:** a small amount of money kept, e.g. in an office, and used to cover minor everyday expenses.
- ***Posting:*** the activity of making entries in a ledger.
- ***Price:*** cost of something bought or sold; the amount, usually of money, that is offered or asked for when something is bought or sold.
- ***Product:*** something that is made or created by a person, machine, or natural process, especially something that is offered for sale.
- ***Promotion:*** the act or process of making a product, cause, or organization more widely known or more successful.
- ***Purchase Order:*** a document containing a request for goods sent by a company to a supplier.
- ***Quota:*** maximum permitted number or amount; a maximum number or quantity that is permitted or needed.
- ***Record:*** document containing history; the document or book that bears the history of something.
- ***Resume or Curriculum Vitae:*** a summary of somebody's educational and work experience, for the information of possible future employers.
- ***Retail:*** sale to consumers**:** the selling of goods directly to customers.
- ***Risk:*** chance of something going wrong**:** the danger that injury, damage, or loss will occur.
- ***Salutation:*** opening greeting; the opening phrase of a letter or speech, used to address the recipient or audience, e.g. "Dear Sir or Madam" or "Ladies and Gentlemen".
- ***Satisfaction:*** fulfillment, the fulfillment of a need, claim, or desire.
- ***Surcharge:*** extra charge**:** an excess or extra charge.
- ***Tariff:*** duty levied on goods; a duty levied by a government on imported or exported goods.

- ***Telemarketing:*** selling or promoting goods and services by telephone.
- ***Trade:*** the activity of buying and selling, or sometimes bartering of goods.
- ***Trade barrier:*** inhibitor to trade; something such as a tariff or boycott that a nation imposes to limit or burden trade.
- ***Transaction:*** instance of doing business**:** an instance of doing business of some kind, e.g., a purchase made in a shop or a withdrawal of funds from a bank account.
- ***Transportation:*** a means of traveling or of carrying somebody or something from one place to another.
- ***Trial Balance:*** a statement used to check that the debits and credits in a double-entry bookkeeping ledger are equal.
- ***Wants:*** desire something**:** to feel a need or desire for something.
- ***Warehousing:*** stockpiling of security**:** the accumulation of a security in the hope that demand will push the price up as a result of the reduced supply on the open market.
- ***Wholesale:*** sale of goods to retailers**:** the business of buying goods in large quantities and selling them especially to retailers for resale.
- ***Working capital:*** current assets minus liabilities**;** the amount of current assets that remains after current liabilities are deducted.