

ENTREPRENEURSHIP BOOK

ACCOUNTING PROFESSION OPTION
for Rwandan Schools

Senior

6

Student Book

Kigali, 2023



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FOREWORD

Dear Student,

Rwanda Basic Education Board (REB) is honoured to present Senior 6 Entrepreneurship book for the students of Accounting Profession Option which serves as a guide to competence-based teaching and learning to ensure consistency and coherence in the learning of the Entrepreneurship. The Rwanda educational philosophy is to ensure that you achieve full potential at every level of education which will prepare you to be well integrated in society and exploit employment opportunities.

The government of Rwanda emphasizes the importance of aligning teaching and learning materials with the syllabus to facilitate the learning process. Many factors influence what you learn, how well you learn and the competences you acquire. Those factors include the relevance of the specific content, the quality of teachers' pedagogical approaches, the assessment strategies and the instructional materials available. In this book, we paid special attention to the activities that facilitate the learning process in which you can develop the ideas and make new discoveries during concrete activities carried out individually or in groups.

In competence-based curriculum, learning is considered as a process of active building and developing knowledge and meanings by the learner where concepts are mainly introduced by an activity, situation or scenario that helps the learner to construct knowledge, develop skills and acquire positive attitudes and values.

For efficiency use of this textbook, the role is to:

- Work on given activities which lead to the development of skills.
- Share relevant information with other learners through presentations, discussions, group work and other active learning techniques such as role play, case studies, investigation and research in the library, on internet or outside.
- Participate and take responsibility for the own learning.
- Draw conclusions based on the findings from the learning activities.

To facilitate you in doing activities, the content of this book is self-explanatory so that you can easily use it the self, acquire and assess the competences. The book is made of units as presented in the syllabus. Each unit has the following structure: the unit title and key unit competence are given, and they are followed by the introductory activity before the development of mathematical concepts that are connected to real world problems more especially to production, finance and economics.

The development of each concept has the following points:

- Learning activity which is a well set and simple activity to be done by students in order to generate the concept to be learnt.
- Main elements of the content to be emphasized.
- Worked examples; and
- Application activities to be done by the user to consolidate competences or to assess the achievement of objectives.

Even though the book has some worked examples, you will succeed on the application activities depending on the ways of reading, questioning, thinking and handling calculations of problems not by searching for similar looking worked out examples.

I wish to sincerely express my appreciation to the people who contributed towards the development of this book, particularly, REB staff, development partners, University Lecturers, and secondary school teachers for their technical support. A word of gratitude goes to Secondary School Head Teachers, Administration of different Universities (Public and Private Universities) and development partners who availed their staff for various activities.

Any comment or contribution for the improvement of this textbook for the next edition is welcome.

Dr. MBARUSHIMANA Nelson

Director General, REB.

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Joan MURUNGI

Head of CTLR Department

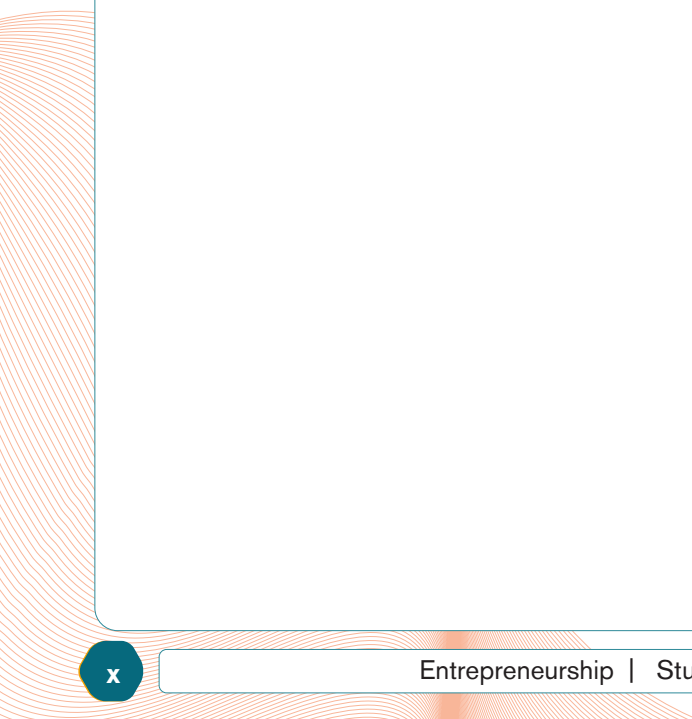
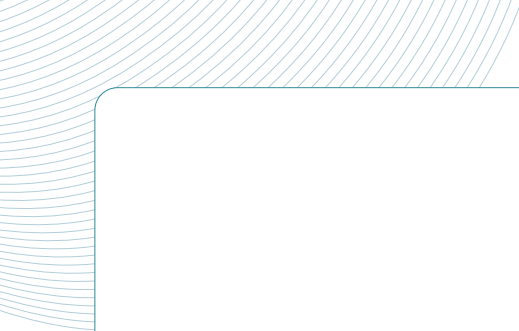
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UNIT 1

BUSINESS PLAN PITCHING

 **Key unit competence:** To be able to pitch a business plan for their projects or businesses.



Introductory activity



Think of the time when you needed financial support from someone when you wanted to solve an urgent need.

- Why did you need this financial support?
- Did you manage to get the support needed? Why? Or Why not? Explain
- How did you prepare for the first meeting with that person?
- What do you think someone should do in order to get money to start a business?

1.1 Purpose of Business plan pitching

Learning Activity 1.1



Read the statement below and answer the questions that follow.

When you have finished preparing the business plan, the next step is to find people to support you to make your dream a reality. Such support could be in form of money or people to support you any way possible. A Business Plan pitch is one of the key and reliable ways of finding support for the business. But it needs to be done in a smart way in order to convince potential investors.

Questions

From the statement above;

- What do you think a person should do after preparing a business plan?
- How do we call the process described in the statement above?
- Why do you think a person needs to perform business plan pitching?

1.1.1 Purpose of business plan pitching

Business plan pitching is a demonstration where an entrepreneur or a team of individuals must influence an investor or group of investors to finance a business.

In most cases, business plan pitching is done by people with viable business plan without financial capability to finance it. When such individuals get an occasion to interact with angel investors, they must be able to present their business endeavours in a short, precise and convincing manner.

- Business funding:** a good business plan pitch enables an entrepreneur to get funds for either start up a business or expand the already existing one.
- Attracting investors:** a good business plan pitch helps an entrepreneur to persuade potential investors for both technical and financial support.
- To share a clear picture of business:** It enables the audience to understand the business' nature of operation and strategy
- Attracting customers:** A well and persuasive presented pitch attracts potential customers.
- Business positioning:** Business plan pitching offers an opportunity for creating a good impression to investors and potential clients.
- Boosting network:** A well-presented business plan pitch persuades the targeted audience. In this process, the entrepreneur increases the level of his or her network.

- 7. Communicate the brand message:** A good pitching positions the business brand well. Therefore, offering a good platform for sharing the brand message with the targeted clients.



Application activity 1.1

Read the scenario below and answer the questions that follow

Mahoro, while in senior four together with her classmates, identified a viable business opportunity in their school community. They made a business plan which required start-up capital in order to start production and supplying eggs to the school, and the neighbouring community which was facing high cases of undernourished children. Later on, they got an opportunity of being part of the five groups invited to pitch for their business venture by Twuzuzanye Organization which supports the youth's projects through financial and technical support.

Explain why Mahoro and her team should participate in the above business plan pitching competition.

1.2 Preparation for business plan pitching



Learning Activity 1.2

Read the scenario below and answer the questions that follow.

In Ubumwe village, there is a massive campaign for economically empowering the youth. Kwigira a student in senior six and her team, have a viable business idea. Their business plan is to provide safe drinking water to their community. As dedicated students, they have content and materials they need during the presentation, however, one of their team members supposed to present seems to be in a panicky state. The interviewing panel has kept the audience unknown, but at least they are well prepared with their topic, the objectives for their project, have practiced the presentation, and have a well-prepared business plan.

Questions:

- Referring to the above scenario, identify any key things that describe the team's preparedness for the pitching.
- According to the analysis, which advice would you give the team before the pitching day and why?

- c) What steps do you think should be followed when preparing for a business plan pitch?
- d) What are the key items you would include in the business plan pitch, and Why?

1.2.1 Steps involved in the preparation of business plan pitching

Business plan pitching has to be planned well by the owners of the business venture. There are specific steps that should be followed in order to have the best persuasive pitching. They include the following:

a) Analysis of the audience

Knowing the audience, one is going to present the business plan pitch to determine the presentation, content selection, pitching techniques, approaches, and anticipation of the questions likely to be asked.

Questions to ask yourself when researching investors:



**WHAT INDUSTRIES
DO THEY INVEST IN?**



**WHAT STAGE
DO THEY INVEST IN?**



**WHAT'S THE INVESTOR'S
TRACK RECORD?**

Figure 1.1 Questions to ask

b) Select a topic

Select a topic based on the problem to solve, and the nature of the audience/potential investors. The topic should be phrased in a way that will persuade the audience.

c) Define the pitching objective

The right business plan pitching objectives enable the team to convince potential investors. This means that one must have in mind why they are pitching their business idea, and work towards delivering a successful pitch that can make them raise the capital needed.

d) Prepare the body of the business plan pitch

The content of the business plan pitch is expected to be organized in a sequential way. This therefore calls for having a clear and understandable body of it. The smarter and well-organized the content presentation, the better the chances of winning the attention of the investors.

e) Anticipate the questions from the audience

While preparing for the business plan pitching, one must anticipate the possible questions likely to be asked by potential investors. Then, list them down and brainstorm the appropriate answers to the questions. This will enable one to avoid being caught unawares.

f) Prepare the suggestions and conclusion.

It is good if you list various suggestions that make the business venture unique. The suggestions must reflect the new thing the business venture will bring to the community. Suggest to the investors the possible solutions to the problem to be solved and how they will benefit from the investment.

g) Practice pitching of business plan (Micro- pitch)

The team that intends to pitch, should get the time and practice pitching the business plan. This is important because it increases one's confidence and having an opportunity of getting feedback from teammates prior to the actual day of pitching.

1.2.2 The key items to cover in the business plan pitching



A business venture owner to be able to persuade potential investors must take note of the following in his or her business plan pitch:

a) Business idea and goals

A business plan pitch must address the business idea to be pitched for. This should be clear and precious so that potential investors are able to understand it. It must also contain SMART goals. These two aspects are very fundamental in the business pitching process. With no clear business idea and goals, it means the presentation content will be irrelevant to the audience.

b) Problem identified

The business plan pitch is developed around the identified problem. The business venture, therefore, comes to provide a solution. This is what the investors love to hear. The problem identified must be affecting the community, not a specific individual. The business idea being pitched should be worth investing in.

c) Solution

The business plan pitch should clearly show the innovative and creative solution that the business venture will execute in addressing the problem at hand. The solution should be unique and easy to implement. The more convincing solution increases the chances of persuading potential investors to invest their funds into one's business.

d) Target Market

A pitching team must understand well the target market. This calls for serious research and study, and where possible the projected market share percentages. This is very important because it will provide a guide on the financial projections. The profitability levels of the business form part of the convincing parts of the business plan pitch content. The beachhead market and general market segmentation targeted should be catered for.

e) Marketing strategy

The business plan pitch should show and describe clearly the market strategy to be used. This determines the profitable-probability level of the business venture to be invested in. The investor would like to know the marketing strategy to be employed. Therefore, it is very important to take time and make clear research and study the marketing strategy. One may have a wonderful business idea, but if the marketing strategy is poor, chances of profiting from the venture become low, hence discouraging potential investors.

f) Industry Analysis

There must be a part of industry analysis in the business plan pitch deck. For example, if the business idea deals with Renewable energy, therefore, make research on the energy sector and have data to use in the presentation.

g) Management Team

The capability of the team that will be engaged in managing the business venture is very important. Include this on the pitch deck. Potential investors wish to know if they invest in the project, will the team manage to handle the funds and generate profit.

h) Competition

Knowing and understanding the competitors is very vital to the success of a business. Therefore, potential investors would like to know if you really know the competitors. In a business plan pitch, it is very necessary to mention the competitive advantage that favours the business. The competitors' weaknesses and strengths should be analysed so that one is able to provide a unique solution that would out-compete them.

i) Current status, amount of money requested, and the projected use of funds

This is a very important section of the business plan pitch. The potential investors need to know the financial abilities of the team in order to make informed financial decisions. The financial status of the business venture should be honestly shown.



Application activity 1.2

During the vacation, you are contacted by a women's association that has a start-up business specializing in Biogas production. The business aims at supplying this biogas to all low-income earning homesteads in the village, at an affordable fee. However, they would like to raise capital from potential investors in order to be able to do so.

Questions:

- a) Write down the key activities that the association should have before pitching.
- b) Prepare a one-page guide that you will give to the association highlighting the steps they would follow and the key items they would consider in order to have a successful pitching and win the interest of the investors.

1.3 Necessary preparations for a successful Business plan pitching

Learning Activity 1.3



As a student of senior 6, you have great business ideas developed while in senior 4 and 5, even way back in the ordinary level. In senior 5, you studied about Business plan. Imagine you have an opportunity to pitch the business plan to potential investors in the community. There are several other people with business plans to pitch, so competition is high. The competition will be in two weeks' time.

- a) Explain the techniques you will employ to get you prepared and present the business plan pitch
- a) Explain the guidelines you will follow during the pitching process of the business plan

1.3.1 Techniques to pitch the business plan

Capital is a driving factor in the growth and development of a business. Therefore, it is very important to master the best ways and techniques of persuading potential investors. The following are some of the techniques one can use in a business plan pitching:

a) Writing only key points

It is very important to write points of the pitch presentation points. Avoid congesting the pitch deck with a lot of information.

b) Avoid reading directly the content

Reading the business plan pitch deck content in front of potential investors must be avoided. Speak to the audience more about the product and services. This helps them to gauge the confidence and mastery level of the person advancing for the business venture they would invest in.

c) Using visualization, pictures, symbols, colours, tables

These attract the attention of the investors and carry in a summarised and precise way much information needed by the investors. The visual impression is very important and selects wisely good colours.

d) Make it short, concise, and come to the point

Time management while pitching is very crucial. In most cases, the potential

investors have no time for a lengthy presentation. It is, therefore, important to make the business plan pitch short in order to fit into the tight schedule of the audience. It should not be more than 10 minutes. The lesser time spent during presentation the better.

e) Reacting positively to questions

When conducting business plan pitching, one must stay calm and professionally respond to any question asked with the highest level of humility. Observing ethical considerations as one is pitching is very important.

f) Using body language, voice, and appearance.

The salesman or the team representative pitching must have all the needed communication skills, the most outstanding are the use of body language, voice, and appearance. Sometimes people underscore the importance of the way they appear, while pitching, but this communicates a lot to the audience. Use the easiest language. The voice must be appropriate. Practicing before the actual pitching time helps to perfect this.

g) Trying to convince

Business plan pitching is all about persuading the investors to buy the idea and accept to provide funding. Make sure that this golden rule never goes out of the mind from the start of the pitching up to the end. Pitching is all about convincing potential investors to fund the business idea implementation.

1.3.2 Before, during and after business plan pitching

When preparing for a business plan pitching session, it is important to know that there are three stages of preparation as shown in the table below.

Preparation required for pitching

Stage	What should be done	Description
Before the pitching	Content preparation	<ul style="list-style-type: none"> – Make sure that all the needed content is prepared – Make extensive research and collect data
	Materials needed for the presentation	<ul style="list-style-type: none"> – List the materials required for presentation. These may include, supportive documents, Pitch deck presentation, projectors, computer, prototype if there is any, short video clips among others.
	Psychological preparation	<ul style="list-style-type: none"> – This concerns the emotional status of the team and the presenters. – All the team members especially those to be involved in the presentation, should be psychologically prepared. This enables them to avoid being nervous and increases their confidence. – When one is psychologically stable, he or she becomes mentally prepared for the questions from the audience and analyses questions asked. <p>This is important because it helps one to have the ability of controlling the audience, therefore, influencing to buy his or her idea.</p>
During pitching	Pitching process	<p>Now that you have all the needed content, materials and have prepared psychologically for Pitching, it is very important to take note of the following seriously during the actual pitching:</p> <ul style="list-style-type: none"> – Greetings & thank audience for the attendance – Start with the Problem / gap identified after market analysis – Business idea and goals (Solution) – Target market – Benefits to the investors & society – Amount of money requested, projected use of it, and the anticipated Returns – The call to investors – Thank the audience – Receive feedbacks

**After
pitching**

The last stage

When one has finished pitching his or her Business plan, the following actions should be taken note of:

- Analyse the recommendations given and if they fit in the line of interest, incorporate them into the pitch deck.
- Write an email to the potential investors, thanking them for sparing their time and willingly offering construction feedback during the pitching. Ask them if they are fine with you sharing the revised deck with them or securing a second chance of pitching again.
- Keep detailed notes of the interaction -- who was at the meeting, what excited them, what they were worried about, and what specific results they would want to see as evidence of success.
- Connect with them on LinkedIn, follow them on Twitter, and create a Google Alert for their names and their fund to stay abreast of their investments and interests.
- After the meeting, send a short thank-you note referencing the specific feedback/insights gained.
- If the investors mentioned what the company needs to do to be exciting for them in the future, reference it in the message.
- If and when the business reaches a success milestone, follow up on this thread and remind the investor of their past feedback.
- In addition, add the investors to the company email list, and reach out to them every now and then with updates.



Application activity 1.3

There are various challenges faced in and around the school or the community. These offer business opportunities that one can utilize to come up with a viable business idea. Among the challenges the following have been identified;

1. Most people are suffering from health problems due to a lack of physical fitness.
2. Shortage of drinking water
3. Inadequate supply of foodstuffs
4. Environmental degradation (due to excessive use of firewood)

Question:

- a) Select two of the above challenges and describe a viable business idea that would provide a sustainable solution.
- b) Explain why it is necessary to address the identified challenges.
- c) Suppose you have got an opportunity of pitching to a group of potential investors;
 - i) Describe how you would prepare for the business plan pitching: (Before, during, and after).
 - ii) Prepare the business plan pitch deck and pitch for one of the two identified viable business ideas highlighted in part (a) above.



Skills Lab 1

Refer to the business idea generated in senior four for which you developed a business plan, prepare how you will pitch the business plan to financial supporters such as BDF.



End of unit assessment 2

1. In the community there are many start-ups that are competing for a grant. Now, as a senior 6 students who has studied business plan pitching, you have realised that one of the start-ups has little or no knowledge of business plan pitching, yet with a wonderful business idea that would change the livelihood of many homesteads. By coincidence, this start-up approaches you for help.

The client, Twifashe Ltd, a start-up that developed a state-of-the-art water filtration system that is portable and uses solar energy for boiling the water in one of the sections. The filtration device is designed to be used by low-income earners who have no access to clean water and like taking tea. The product depends on solar energy for boiling water. While the start-up is self-assured that it will be able to persuade clients to purchase its device, the owners are in serious need of funds in order to start production and attain economies of scale.

Required:

The role as someone with Business plan pitching knowledge and skills is to prepare a business plan pitch deck that Twifashe Ltd can use to persuade investors to support the company.

1. a) Explain the meaning of a business plan pitching
2. b) Analyse the purpose of a business plan pitching to the growth and development of a business.
3. Identify a given business idea and prepare a business plan pitch deck for it.
4. Explain the steps involved in the preparation of a business plan pitching.

UNIT 2

MARKET STRUCTURES



Key unit competence: To be able to analyse the operations of firms under different market structures



Introductory activity

Four pictures:

Picture 1: Many buyers, one seller

Picture 2: Many sellers, many buyers of homogenous products

Picture 3: Few sellers, many buyers

Picture 4: Many sellers, many buyers of differentiated products (toothpaste, bread, water)

Study the illustrations above and answer the following questions.

- What do you see in the pictures?
- What is the difference in the pictures 1-4?
- Give examples in the community where such situations in the pictures occur?

2.1 Market structures

Learning Activity 2.1



A market is any arrangement that brings buyers and sellers into close contact to transact business with an aim of making profits. It may be a physical place, communication through telephone, fax and mails. Different markets have different characteristics, participants and conditions. Thus, markets differ in number of sellers and buyers, nature of the product, entry conditions, degree of knowledge, cost conditions, etc. There are conditions that prevail in the market which determine how the market players operate.

Questions:

- What do you understand by a market?
- Who are the market players?
- What makes different market differ? What features differentiate markets?
- What technical term is given to the conditions that prevail in the market that determine how the market players operate?
- What do you think the term 'Market Structure' means?
- What factors are based on to classify market conditions?

2.1.1 Meaning of market structures

A **market** is any arrangement that brings buyers and sellers into close contact to transact business operations with an aim of making profits.

A market structure is the way a market is arranged based on the number of buyers and sellers of a given commodity.

Examples:

- In Rwanda, Energy Utility Corporation Limited (EUCL) is the only one seller of electricity with many buyers.
- Sellers of agricultural products are as many as buyers of agricultural products.

A market structure is the environment in which a business operates and relies on factors like how competitive the market is, how easy it is for a new company to enter the market and how differentiated each company's products are.

The four main types of market structures are perfect competition, monopolistic competition, oligopoly and monopoly.

2.1.2 Factors used to classify market conditions include:

a) Definition of market condition

Market conditions relate to the attractiveness or otherwise of the overall market in which a business operates.

b) Factors Used to classify market conditions

- Nature of the product dealt with; whether homogeneous or differentiated or heterogeneous.
- Entry and exit restrictions; either free entry, limited or highly restricted.
- Cost conditions.
- Degree of consumer's knowledge of market conditions; perfect knowledge or no knowledge at all.
- Firm's ability to influence demand through advertising.
- Degree of government interference.
- Number of buyers and sellers of a commodity in the market.
- The goals of the sellers and buyers in the market.



Application activity 2.1

Case study

Company ABC is an agro-business industry producing and selling a wide variety of products including fruit juice drinks and dairy related products. Its products are primarily sold to the local, as well as regional markets:

Basing on the above case study, answer the following questions:

- What do you understand by market structures?
- What are the criteria to categorize the market?
- Do you think all markets are fair? If yes why and if not what are the unfair markets?

2.2. Categories of market structures

Learning Activity 2.2



A



B



C



D

The illustrations above represent firms from different market structures. Observe them while using the knowledge on market structures and answer the questions below:

a) Differentiate the firms by identifying their features by completing the table below.

Firm/ market	No. of buyers (few or many)	No. of sellers (few or many)	Nature of product (similar/ differentiated)	Ease of entry (easy/ restricted)	Government influence (high/no)
A					
B					
C					
D					

b) Based on the features identified above, what do you understand by the following categories of market structures?

- Perfect competition
- Monopoly,
- Monopolistic competition and
- Oligopoly

c) Which category of market structures do are represented by the firms and features identified above in (a)

d) What is the difference between perfect and imperfect markets?

Market structures are categorized into:

- Perfect markets: e.g. Perfect competition
- Imperfect markets: e.g. Monopoly, Monopolistic competition and Oligopoly.

2.2.1. Perfect competition



a) Meaning of perfect competition

Perfect competition is market structure where there are many sellers (firms) and buyers dealing in a homogeneous commodity and possessing perfect knowledge of market conditions at that particular time and perfect mobility of factors of production.

b) Features/characteristics of perfect competition

Perfect competition is said to exist where there are the following conditions or features:

- i. There are many buyers and sellers in the market.** No seller/buyer controls the market conditions independently. Each participant in the market cannot independently influence the price of the commodity. Therefore, firms under perfect competition are price takers, i.e. they take the price that is determined by automatic forces of demand and supply.
- ii. All the commodities sold are similar or homogeneous.** All firms in the industry produce the same product such that there is no way a consumer can prefer one producer's product to the other.
- iii. There is no government intervention in form of fixing prices.** All participants in the market abide by the price that is set by forces of demand and supply. Such a price, dominates the industry.
- iv. The demand curve of a perfect competitor is perfectly elastic.** This indicates constant price for the whole industry. At this point, marginal revenue is equal to average revenue which is equal to the price.
- v. The firms under perfect competition do not incur transport costs.** Under perfect competition, it is assumed that the raw materials, the firm, the consumers, are all found in the same place or locality
- vi. There is perfect mobility of factors of production from one production unit to another.** Factors of production can easily move from places of low payment to better paying places. It is further assumed that labour is easily acquired.
- vii. Buyers and sellers have perfect knowledge about the market conditions.** It is assumed that the price, quality, quantity and the location of the product in question are known by all the participants in the market.
- viii. There is no persuasive advertising.** This is because the commodities are the same and the consumers have perfect knowledge about the market conditions. There may be some informative advertisements to make the consumers aware of the products.
- ix. There is free entry and exit in the industry.** Firms can freely join the industry if they anticipate making profits and can also freely leave the industry if they make losses.

x. The major aim of firms is profit maximization. This is attained at a point where the marginal cost is equal to the marginal revenue (**MC =MR**).

c) Perfect competition in the real world

- In economics, perfect competition is a theoretical market structure where direct competition does not exist between firms or sellers. Instead, many sellers (also buyers) are present in the market that simultaneously sell an identical product at the market price. Thus, each seller has a very small share in the market with limited control over market prices.
- Perfect competition is considered the ideal market scenario as it allocates the available resources most efficiently. It is also referred to as pure competition.
- In the real world, perfectly competitive market structures do not exist. It is used as a benchmark to make a comparative analysis with real markets in economics.
- Real-world competition differs from this ideal primarily because of differentiation in production, marketing, and selling. For example, the owner of a small organic products shop can advertise extensively about the grain fed to the cows that made the manure that fertilized the non-genetically modified organs (GMO) soybeans, thereby setting their product apart from competitors. This is what's called differentiation.
- The first two criteria (homogeneous products and price takers) are far from realistic. Yet, for the second two criteria (information and mobility) the global technology and trade transformation is improving information and resource flexibility. While the reality is far from this theoretical model, the model is still helpful because of its ability to explain many real-life behaviours.
- Barriers to entry prohibit perfect competition. Many industries also have significant barriers to entry, such as high start-up costs (as seen in the auto manufacturing industry) or strict government regulations (as seen in the utility industry), which limit the ability of firms to enter and exit such industries. Although consumer awareness has increased with the information age, there are still few industries where the buyer remains aware of all available products and prices.

Examples of Perfect Competition

In the real world, it's hard to find examples of industries which fit all the criteria of 'perfect knowledge' and 'perfect information'. However some industries are close and these may include:

- Foreign exchange markets: Here currency is all homogeneous and traders will have access to many buyers and sellers and there will be

good information about relative prices.

- Agricultural markets: In some cases, there are several farmers selling identical products to the market e.g. tomatoes, pineapples, Irish potatoes, bananas, etc. and many buyers. At the market, it is not easy to compare prices.
- Internet related industries: It is easy to compare prices quickly and efficiently and entry barriers are lower.

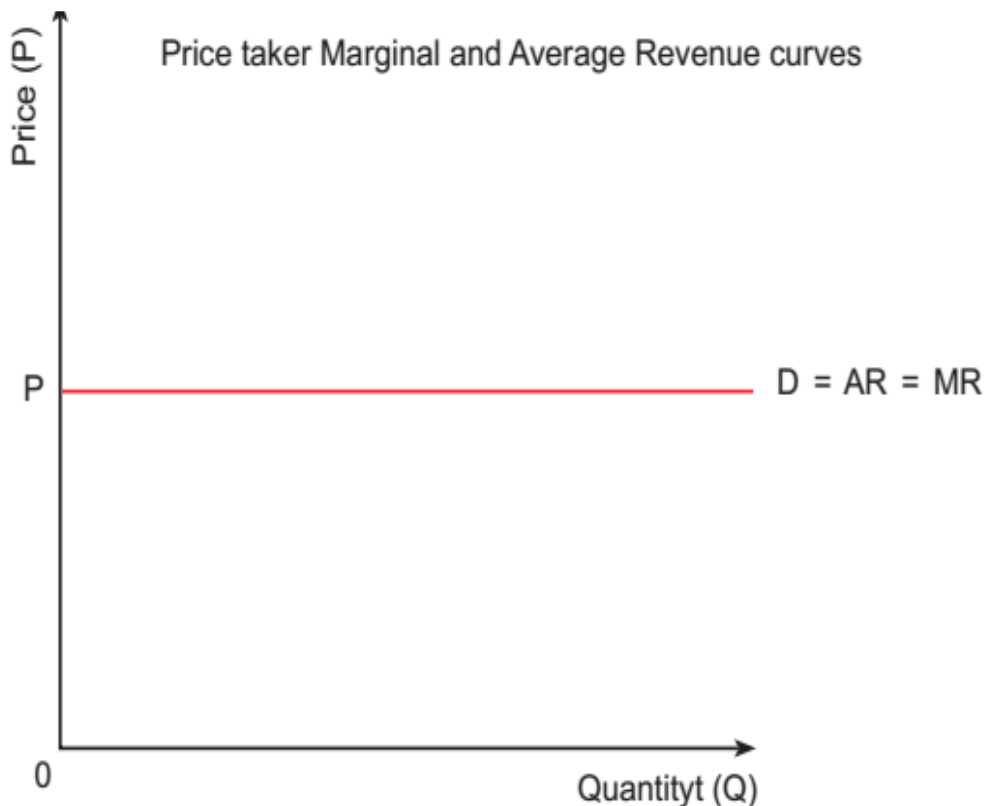
d) The demand curves for a firm under perfect competition

Each firm in perfectly competitive market faces perfectly elastic demand curve because variations in the firm's output have no noticeable effect on price.

The perfectly elastic demand curve does not indicate that the firm could actually sell an infinite amount at the prevailing price.

It only indicates that the variations in production will leave the price unchanged because their effect on total industry output will be negligible.

The firm's output variation has only a small percentage effect on industry output. The price is determined by the industry.



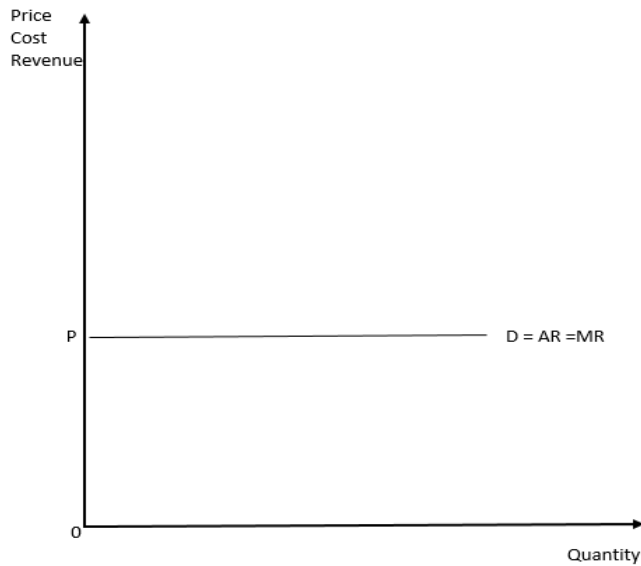


Figure 1: Demand curve under Perfect Competition Market

As shown in Figure 2.1 above, the demand curve is equal to the average revenue curve and equal to marginal revenue curve. ($D=AR=MR$)

a) Relationship between average revenue (AR) and marginal revenue (MR), price and demand of a firm under perfect competition

The AR curve is the same as MR curve under perfect competition. This is because selling an extra unit of output adds the same amount to the total revenue since the price is constant, i.e. $AR=P=D=MR$

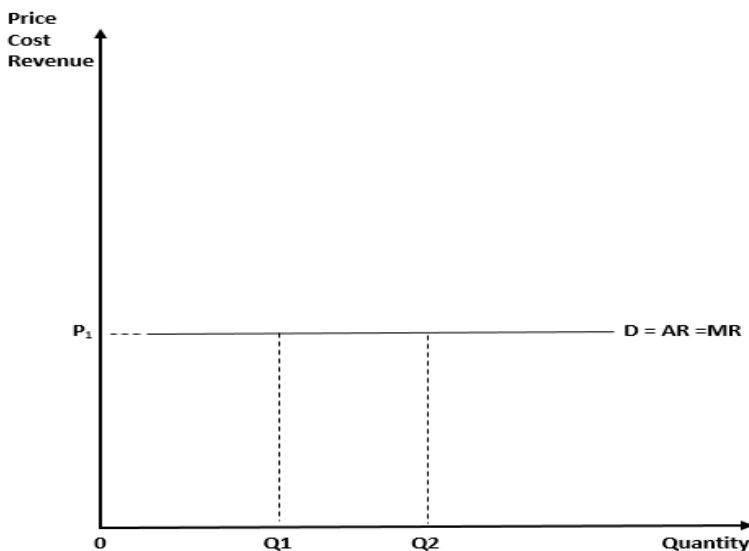


Figure 2: Relationship between Demand, Price, MR and AR

As shown in Figure 2.2, the price is equal to demand, marginal revenue and average revenue ($P=D=AR=MR$).

b) Cost curves under perfect competition

Both the Marginal Cost (MC) and Average Cost (AC) are U-shaped under perfect market competition, because of the law of diminishing returns and economies and diseconomies of scale, respectively.

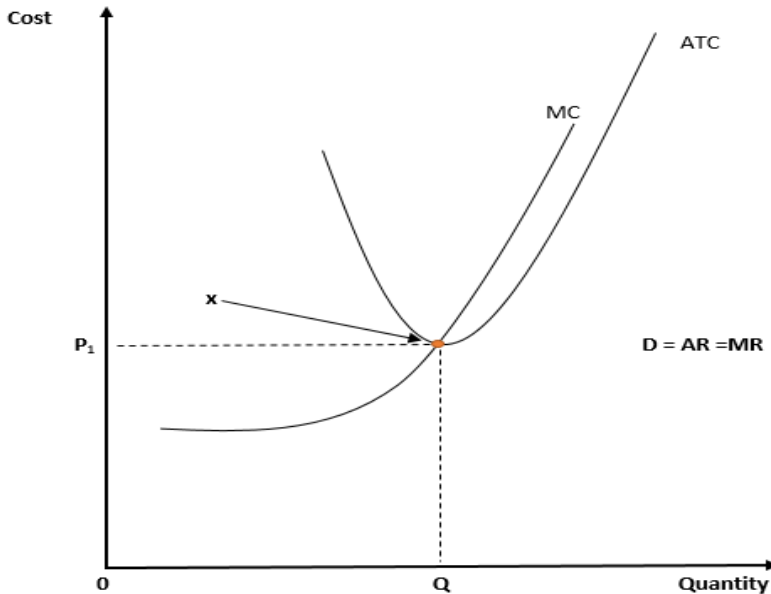


Figure 3: Relationship between Demand, Price, MR and AR

The Marginal Cost curve always intersects the Average Total Cost curve at its minimum (at point x).

From figure 2.3, the MC and AC are both U-shaped but the MC curve cuts the AC curve from its lowest point (i.e. optimum point of firm)

c) Short-run equilibrium position of a firm under perfect competition

Equilibrium can be defined as state of balance when variables under consideration have no tendencies to change.

The firm is in equilibrium at point where marginal cost (MC) is equal to the marginal revenue (MR), and it is when profits are maximized. The firm aims at producing the level of output which maximizes difference between TR and TC. This is when it pays the firm to keep output unchanged. The slope of MC must be greater than the slope of MR at the equilibrium output.

This is when the MC curve cuts the MR curve from below. For the competitive firm which is maximizing profit, we have AR, MR and MC. This can be illustrated

in the figure below

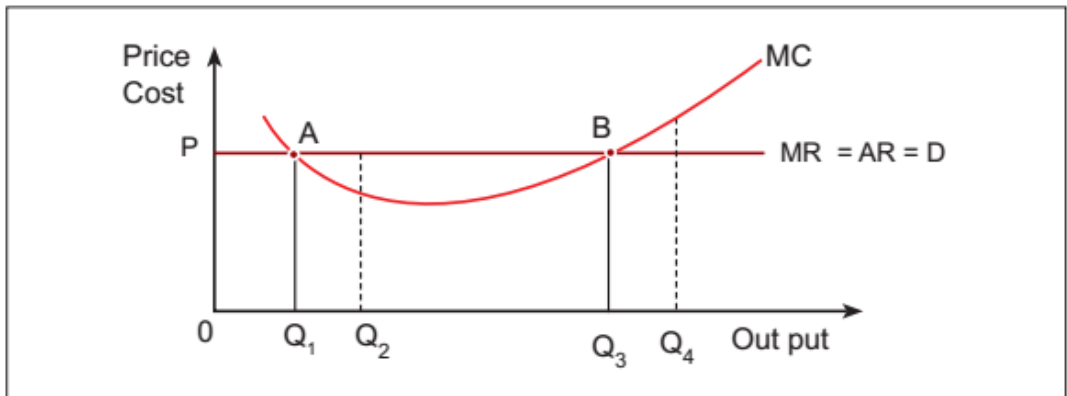


Figure 2.4: Short-run equilibrium position of a firm under perfect competition

As shown in figure 2.4, at point (output $0Q_1$), the firm is in equilibrium, i.e. $MC = MR$. However, this is not sufficient. It therefore, requires the firm to increase output to higher output e.g. $0Q_3$ in order to fetch more revenue compared to the cost incurred in its production.

At point B, the firm fulfils the sufficient condition of equilibrium by producing a high output $0Q_3$ where $MC = MR$ and MC is rising.

At equilibrium, the firm may either make abnormal profits or incur losses (sub-normal profits) depending on the level of average total cost (ATC).

d) Short-run profit maximization of business/ firm under perfect competition

In the short-run, the firm can either make abnormal profits or losses. Losses are made because the firm may be new and incurring higher costs of production.

◆ Abnormal profits in the short-run

The firm will be in equilibrium at point where marginal cost (MC) = marginal revenue (MR) and it will come under the following conditions:

- The average revenue (AR) must be greater than the average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be below the average revenue curve.
- Marginal cost curve cuts the average cost curve at the lowest point.

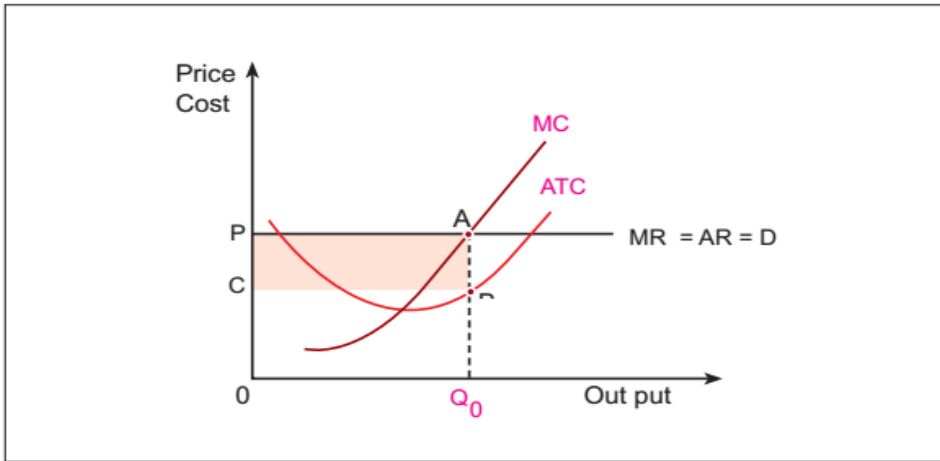


Figure 2.5: Abnormal profits under perfect competition in the short-run

As shown in Figure 2.5, the firm produces output $0Q$ at total cost $0CBQ_0$ and sells it at price $0P$ getting total revenue $0PAQ_0$, hence making abnormal profits $CPAB$.

$$\text{Profits} = \text{TR} - \text{TC} \quad 0PAQ_0 - 0CBQ_0 = CPAB$$

◆ Losses in the short-run

A firm may incur losses under the following conditions:

- The average revenue (AR) must be less than average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be above the average revenue curve.
- Marginal cost curve cuts the average cost curve at the lowest point.

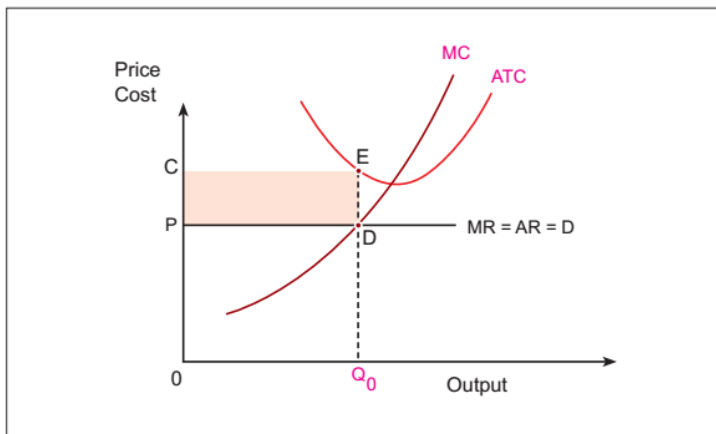


Figure 2.6: Losses under perfect competition in the short-run

As shown in Figure 2.6, the firm produces output OQ at total cost $OCEQ_0$ and sells it at price OP , getting total revenue $OPDQ_0$, hence making losses $PCED$ because the AC is greater than the AR .

$$\text{Losses} = \text{TR} - \text{TC}. \quad OPDQ_0 - OCEQ_0 = PCED$$

e) Long-run profit maximization of business/ firm under perfect competition

In the long-run, because of the abnormal profits in the short-run, other firms join the industry; hence the abnormal profits will be shared among all firms.

Therefore, each firm will get zero or normal profits as seen below. It comes under the following conditions:

- The average revenue (AR) must be equal to the average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be tangent to the average revenue line.
- Marginal cost curve cuts the average cost curve at the lowest point.

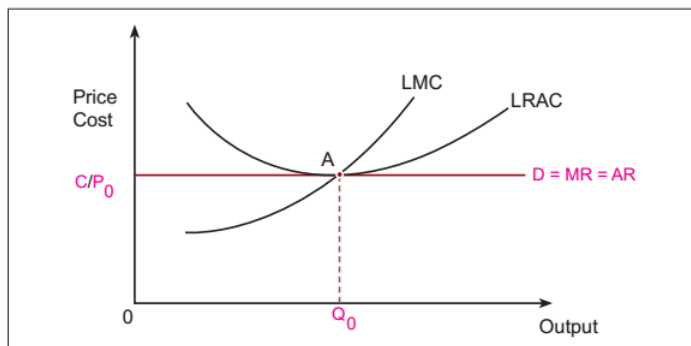


Figure 2.7: Normal profits under perfect competition in the long-run

As shown in Figure 2.7 above, the firm produces output OQ_0 at Total cost $OC/P_0 AQ_0$ and sells it at price OP_0 getting total revenue OP_0/CAQ_0 , hence making zero profits (normal profits).

$$\text{Profits} = \text{TR} - \text{TC}. \quad OP_0/CAQ_0 - OC/P_0AQ_0 = 0 \text{ (zero) profits}$$

f) Break even and shut down (exit) points of a firm/business

Break-even point is point where the firm is earning normal profits and where the average revenue is equal to average cost. The firm can only cover the costs of production without earning any profit.

Shut-down point is point below which firm cannot continue to operate because it covers only average variable cost.

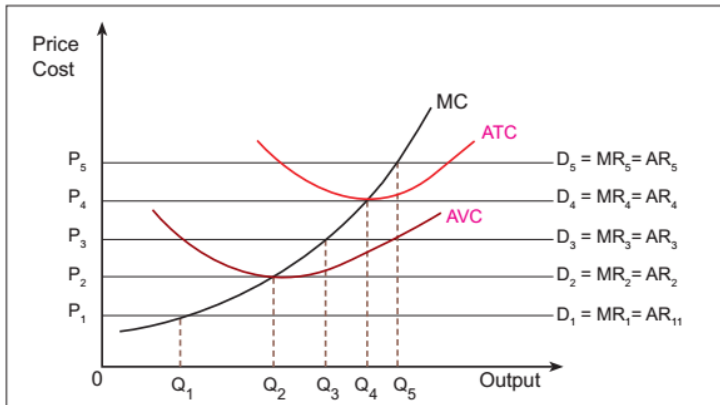


Figure 2.8: Break-even and Shut down points of a firm under perfect competition

As shown in Figure 2.8 above, in the long-run, many firms join the business because of the abnormal profits in the short-run at point OQ_5, OP_5 (**e**) and in the end, all firms get normal or zero profit at point OQ_4, OP_4 (**d**) and they are only able to cover costs of production as shown by the *ATC* curve. Point **d** is the break-even point where the firm earns normal profits.

Other firms will still join the business up to when the firm is not able to cover all the costs of production but only covers variable costs as shown by the *AVC* curve.

Point OQ_2, OP_2 (**b**) is the shut-down point where the firm only covers variable costs. Below this point (point **b**), the firm cannot continue operation.

g) Advantages and Disadvantages of Perfect competition

◆ Advantages or shortcomings of perfect competition

- Perfect competition encourages optimum use of resources because factors of production can freely move from one place to another.
- There is production of better quality goods because of competition within the industry.
- There is no wastage of resources because no advertisement costs are incurred.
- There is no consumer exploitation because prices are determined by the forces of demand and supply.
- There is a lot of output because of many suppliers and buyers.
- Producers are able to expand their firms and use modern technology because of the abnormal profits in the short-run.
- Perfect competition eliminates income inequality because in the long-run all firms earn normal profits.

- The plant is used to full capacity in the long-run. This is mainly because firms operate at the least average cost and so there is no resource wastage.

◆ Disadvantages or shortcomings of perfect competition

- Unemployment is likely to occur because of the inefficient firms leaving the production.
- Buyers have little or no choice because the goods produced are the same.
- There are no abnormal profits in the long-run, so, expansion of the firm is hard.
- Research is difficult because of little or no profits in the long-run.
- Firms aim at profit, maximization and this discourages the production of public utilities such as water supply which are vital for society but are non-profit making.
- Profits are reduced because the seller is supposed to sell at the same price as others.
- Perfect competition cannot exist in reality and so cannot be relied upon for development.

Exercise

- Referring to the community, name any businesses you know that have features of perfect competition.
- Study the table below of a firm A and answer questions that follow.

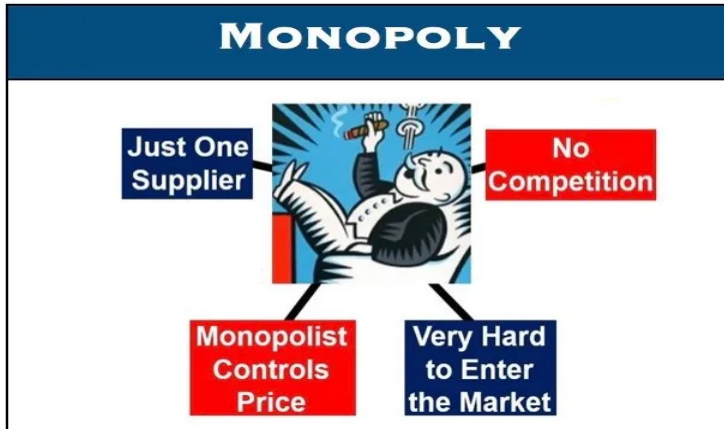
Output	Price	TR	AR	MR	TC	MC	Profits
1	100	100			120		
2	100	200			130		
3	100	300			150		
4	100	400			200		
5	100	500			300		
6	100	600			420		
7	100	700			550		
8	100	800			820		
9	100	900			1230		

Required:

- Complete the table by calculating the AR, MR, MC and profits of the firm.
- Illustrate the process of profit maximization of the firm both the short run and long run.
- Demonstrate by using graphs and calculations the breakeven and shutdown points of the firm.

d) Which market structure is the firm operating? Give reasons to support your answer.

2.2.2 Monopoly



a) Meaning of monopoly

Monopoly is market situation where there is one producer or supplier of product, which has no close substitutes and entry into the market is highly blocked

A monopoly is a supplier of a product or service that has no competitors – it is the sole provider in a market.

b) Features/characteristics of monopoly

The following are key features that are typically found in a monopoly market structure:

- **A Lack of Substitutes.** One firm producing a product or service good without close substitutes. The product is often unique.
- **Barriers to Entry.** There are significant barriers to entry set up by the monopolist. These barriers imply that under a monopoly there is no difference between a firm and an industry.
- **Competition.** There are no close competitors in the market for that product.
- **Price Maker.** The monopolist decides the price of the product since it has the market power. This makes the monopolist a price maker.
- **Profits.** The aim of the producer is profit maximization. While a monopolist can maintain supernormal profits, in the long run it doesn't necessarily make profits. A monopolist can be a loss-making or revenue-maximizing too.

c) The bases/sources/origin of monopoly (Factors which give rise to monopoly)

- **Patent rights** e.g. writers of books, where the law forbids other firms

to deal in the same commodity.

- **Ownership and control of strategic raw materials** usually under government control e.g. minerals. This leads to natural monopoly.
- **Exclusive methods of production.** This gives the producers monopoly of the skills that are needed for production. E.g. doctors.
- **Long distance among producers** where each producer monopolizes the market in his/her locality. This leads to spatial monopoly
- **Advantages of large-scale production** which do not allow small firms to compete successfully with large firms.
- **Protectionism:** This is where trade barriers are imposed on the product to exclude foreign competitors. In such cases, the home producer may become a monopolist.
- **Take over and mergers:** 'Take-over' is when one firm takes over the assets and Organisation of another whereas mergers are formed when firms combine their assets and organisations into one to achieve strong market position. Both situations may result into a monopolist firm.
- **Collective monopoly or collusive monopoly:** This is where firms come together in a formal or informal agreement (cartel) to achieve monopoly power. Such firms can fix quotas (maximum output each may put on the market). They may also set the price very low with the objective of preventing new entry of other firms. This is called **limit pricing**.

d) Supply curve of a monopolist

The supply curve of a monopoly cannot be drawn because it is a price maker and not a price taker. There is no unique relationship between the prices that the monopoly firm charge and the quantity supplied at that price.

There is no supply curve for a monopolist. This differs from a competitive industry, where there is a one-to-one correspondence between price (P) and quantity supplied (Qs). For a monopoly, the price depends on the shape of the demand curve, as shown by Figure 9 below.

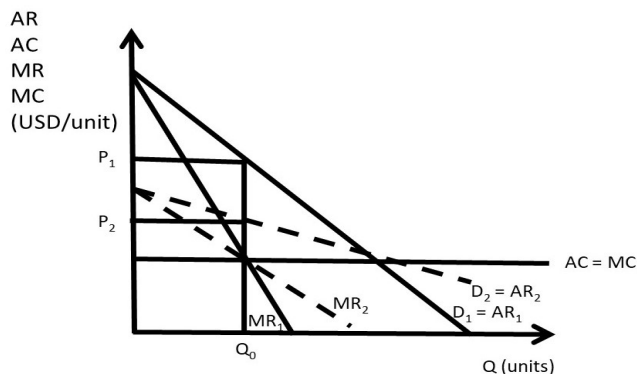


Figure 2.9: Absence of supply curve under monopoly

A mathematical “function” is defined as a one-to-one correspondence between each point in the range (x) and the domain (y). A supply curve, then, requires a single price (P) for each quantity (Q). This graph shows that there is more than one price associated with each quantity.

At quantity Q_0 , for demand curve D_1 , the monopolist maximizes profits by setting $MR_1 = MC$, which results in price P_1 . However, for demand curve D_2 , the monopolist would set $MR_2 = MC$, and charge a lower price, P_2 . Since there is more than one price associated with a single quantity (Q_0), there is no one-to-one correspondence between price and quantity supplied, and no supply curve for a monopolist.

e) Demand curve of a monopolist

Because a monopoly firm has its market all to itself, it faces the market demand curve.

Because it is the only supplier in the industry, the monopolist faces the downward-sloping market demand curve alone. It may choose to produce any quantity.

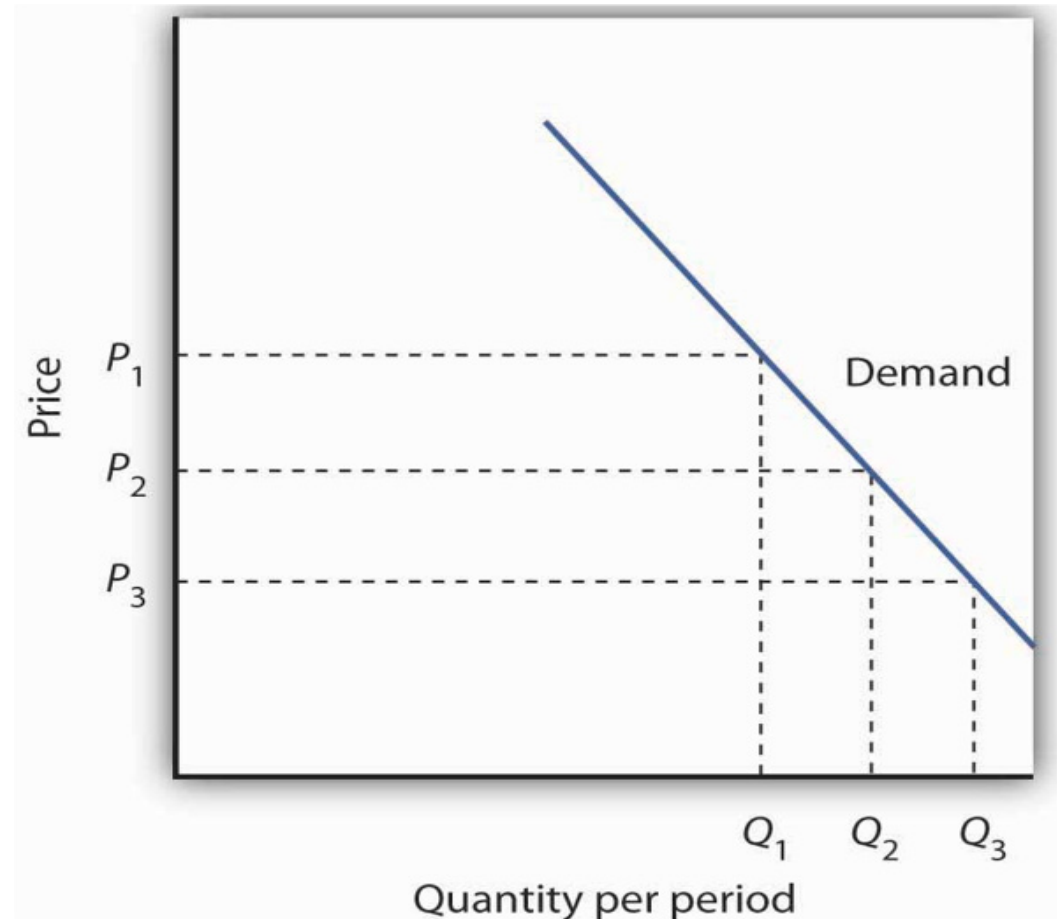


Figure 2.10: Demand curve for a monopolist

From figure 2.10, suppose that a monopoly firm can sell quantity Q_1 units at a price P_1 . If it wants to increase its output to Q_2 units—and sell that quantity—it must reduce its price to P_2 . To sell quantity Q_3 it would have to reduce the price to P_3 . The monopoly firm may choose its price and output, but it is restricted to a combination of price and output that lies on the demand curve. It could not, for example, charge price P_1 and sell quantity Q_3 . To be a price setter, a firm must face a downward-sloping demand curve.

f) Equilibrium position of firm under monopoly

The monopolist is in equilibrium at point where $MC=MR$ and the slope of MR must be less than the slope of MC at the equilibrium output. The price is fixed on the demand curve in such way that $AR=MR=MC$.

The AR curve is above the MR curve. The price is fixed at the point where the demand curve is elastic. It can be illustrated below:

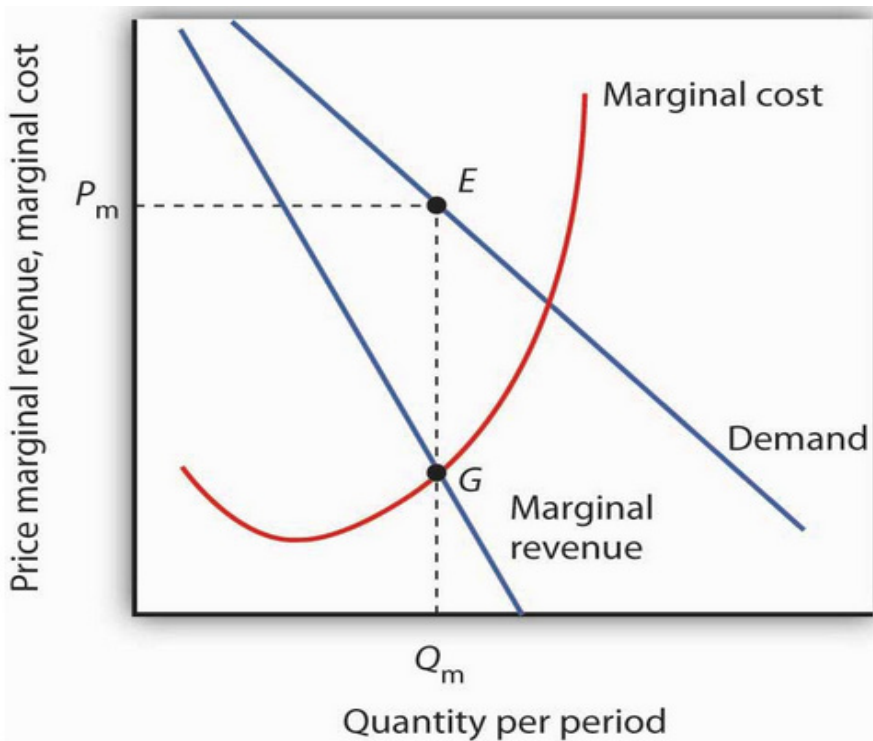


Figure 2.11: Equilibrium position of a firm under monopoly

As shown in Figure 2.11, the firm is in equilibrium at point where $MC=MR$ (point G). The monopoly firm maximizes profit by producing an output Q_m at point G, where the marginal revenue and marginal cost curves intersect. It sells this output at price P_m .

g) Profit maximization of a business/firm under monopoly in the short-run

A firm under monopoly is in equilibrium where $MC=MR$ and in the short-run, the firm can either make abnormal profits or losses. Profits are made when:

- The average revenue (AR) must be greater than average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be below the average revenue curve.
- Marginal cost curve cuts the average cost curve at the lowest point.

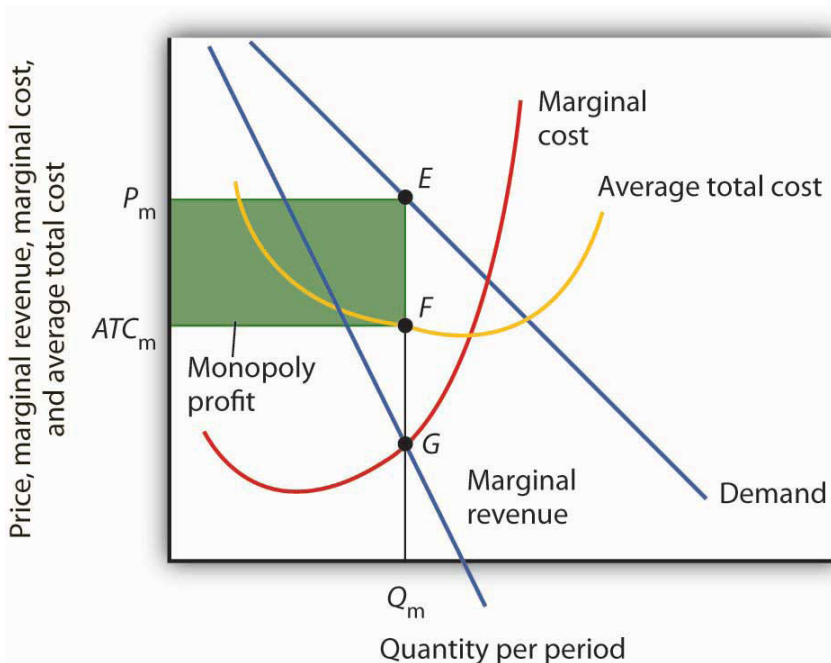


Figure 1.12: Profit maximisation under monopoly

As shown in Figure 2.12 above, the firm produces output Q_m at total cost $ATC_m F$ and sells it at price P_m getting total revenue $P_m E Q_m$, hence getting abnormal profits $ATC_m P_m E F$ (represented by the shaded region).

$$\text{Profits} = TR - TC. P_m E Q_m - ATC_m F = ATC_m P_m E F$$

h) Losses of a business/firm under monopoly in the short-run

A monopolistic firm may incur losses in the short-run under the conditions below:

- The average revenue (AR) must be less than the average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be above the average revenue curve.
- Marginal cost curve cuts the average cost curve at the lowest point.

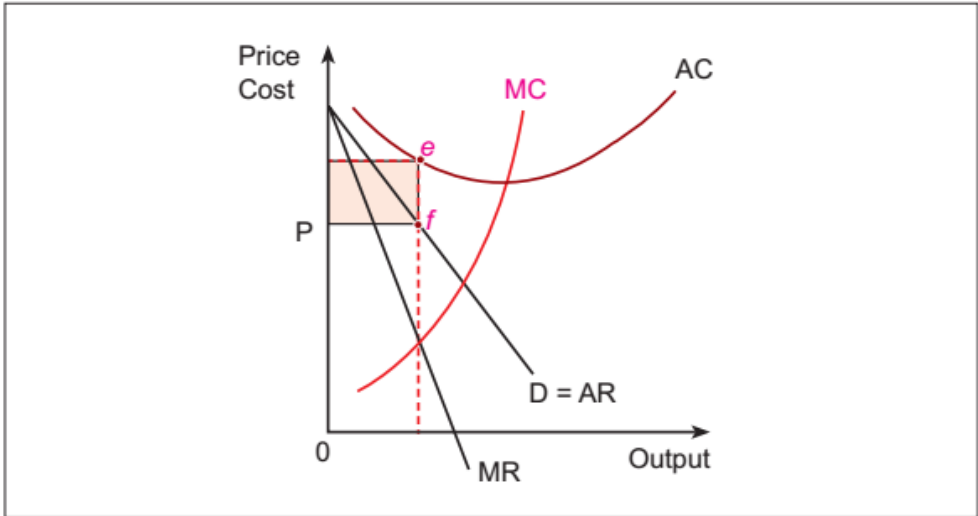


Figure 2.13: Losses of a monopoly in the short-run

To add point C on the price-cost axis and Q on output axis

As shown in Figure 2.13, the firm produces output $0Q$ at total cost $0CeQ$ and sells it at lower price $0P$, getting total revenue $0PfQ$ and thus makes losses $PCef$ (represented by the shaded region) because the costs are greater than the revenue.

i) Equilibrium position of a business/ firm under monopoly in the long-run

In the long-run, the firm under monopoly will still earn abnormal profits because it is the only firm in the production process. The firm will be in equilibrium where the long-run marginal cost curve is equal to long-run marginal revenue curve. This is shown as follows:

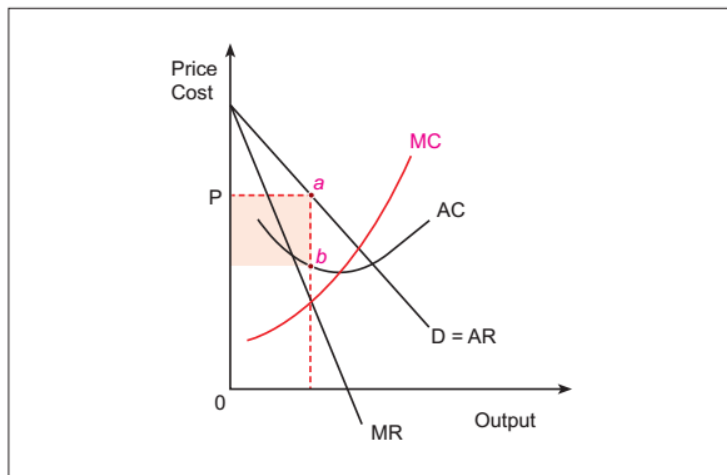


Figure 2.14: Profit maximisation of a monopoly in the long run

To add point C on the price-cost axis

In Figure 2.14, the firm produces output OQ at total cost $OCbQ$ and sells it at price OP , getting total revenue $OPaQ$ hence getting abnormal profits $CPab$.

Profits = TR-TC. $OPaQ-OCbQ= CPab$

j) Advantages and disadvantages of Monopoly

◆ Advantages of Monopoly

- There is no duplication of services and this saves resources e.g. if there is one hydroelectric power plant, there may not be the need to set up another one in the same area.
- Economies of scale can be enjoyed by the firm because it is capable of expanding using the abnormal profits earned.
- There is a possibility of price discrimination. (Parallel pricing). This refers to the selling of the same commodity at different prices to different customers which benefits the low-income earners.
- Research can easily be carried out using the abnormal profits.
- There is no wastage of resources in persuasive advertising which may increase prices.
- Public utilities such as roads, telephones, etc. are easily controlled by the government as a monopolist.
- Infant industries can grow up when they are monopolies and are protected from foreign competition.
- It encourages innovations by protecting copyright and patent owners.

◆ Disadvantages of Monopoly

- Because there is no competition, the firm can become inefficient and produce low quality products.
- Monopoly firms produce at excess capacity, i.e. they under-utilise their plants so as to produce less output and sell at a high price.
- Monopoly firms may charge higher price than firms in perfect competition.
- In case monopolist stops operating, there would be shortage of the commodity.
- Monopoly firms tend to exert pressure on the government and sometimes they can influence decision making because they are the controllers of production.
- Discrimination of consumers: This may be based on political or religious affiliation other than the factors respected by economics.
- Monopoly leads to income inequality. The monopolies who overcharge earn more compared to others.

- Restriction of choices: monopolist normally produces one type of commodity; thus consumers are denied a chance to choose among the alternatives.

k) Measures to control a monopoly

Because of the above disadvantages of monopolies, the following measures can be used to control their activities.

- The government can fix prices of commodities through price legislation
- Anti-monopoly (anti-trust) legislation, i.e. laws imposed to control monopolies: Such laws can prohibit monopolization, and collusion among firms to raise prices or inhibit competition.
- There may be nationalization of monopoly firms by the government so as to lower the prices.
- Subsidization of new firms: This can help the new firms to compete with the already established firms **favourably**.
- There may be resale price maintenance whereby the producers set prices at which sellers should sell the goods to avoid charging high prices.
- Imports may be encouraged to compete with the commodities of monopoly firms in the country.
- There may be demonstration by consumer groups especially boycotting the goods of monopolists so that the prices can be lowered.
- Government-owned firms may be set up to compete with the monopoly firms.
- Removal of deliberate monopoly bases such as protectionism and taxation to encourage competition among the firms may be an option.
- Taxation: The government can impose taxes to reduce the profits of the monopolists. Such taxes may include:
 - a) Sur tax: This is an incentive tax that provokes monopolists to increase their scale of production.
 - b) Ad valorem tax: This is a tax levied on the value of the commodity.
 - c) Specific tax: Tax charged per unit of output.
 - d) Lump-sum tax: Tax levied on the total amount produced and it does not change even if output changes.

Exercise

- a) Referring to the community, name any businesses you know that have features of monopoly market structure.
- b) Study the table below of a firm A and answer questions that follow.

Quantity	Price	TR	MR	TC	MC	Profits
1	0			100		
1	100			140		
2	90			170		
3	80			210		
4	70			250		
5	60			300		
6	50			360		
7	40			450		
8	30			550		

Required:

- Complete the table by calculating the TR, MR, MC and Profits of the firm.
- Illustrate the process of profit maximization of the firm both the short run and long run.
- Demonstrate by using graphs and calculations the breakeven and shutdown points of the firm.
- Which market structure is the firm operating in? Give reasons to support the answer.

l) Price discrimination under Monopoly

Learning Activity 2.3



Study the illustrations below and answer questions that follow.



- Name the services shown in the illustration?
- How are customers charged for the services rendered?
- The considerations followed while charging the customers in the illustration above?
- What conditions must be in place to charge customers in such way?
- What are advantages and disadvantages of charging customers in such way?

i. Meaning of price discrimination

Price discrimination exists when commodity is sold at different prices to different customers irrespective of the cost of production. It can also be referred to as parallel pricing.

ii. Forms of price discrimination

- Discrimination according to personal income: For example, income differentiation among buyers, e.g. doctors charging low prices on the poor and high prices on the rich for the same services.
- Discrimination according to age: For example, charging low prices on the young people than old people on tickets to watch football or for film show.
- Discrimination according to sex: Where different prices are charged to females and males for example, for discotheques where for ladies' nights, ladies enter for free and males are made to pay.
- Geographical discrimination for example, dumping where commodities are sold cheaply in other countries to dispose of surplus.
- Discrimination according to the time of service for example, tickets for video shows charged at high prices in afternoons when there are many people than in morning hours when there are few people.
- Discrimination according to nature of the product, for example, a soft cover book may be cheaper than a hard cover book.
- Discrimination according to the number of uses of the product, for example, electricity used for industrial purposes is cheaper than electricity for domestic use.
- Discrimination by differentiation of commodities, for example, high prices on travellers in first class in the train and low charges of other classes such as the economy class.

i. Degrees of price discrimination

First degree price discrimination: This is possible when a monopolist can determine exactly what every client will pay and sells the product or service at that price.

Second degree price discrimination: This occurs when every firm can charge product or service according to the choice of different groups.

Third degree price discrimination: This is done by different price elasticity of specific consumer group. (Investopedia)

ii. Conditions for price discrimination to be successful

- The commodity must be sold by monopolist so that even when the price is increased, the buyer has nowhere else to go.
- Elasticity of demand should be different in different markets. A higher price

should be charged in the market where elasticity of demand is lower than where elasticity of demand is high.

- The cost of dividing the markets should be very low, for example, in case of dumping costs of transport should be low.
- Buyers should not know how much is charged on others. This is possible especially where goods are sold on orders with no advertising.
- It should be impossible for buyers to transfer the commodity from where the price is low to where the price is high. This is possible especially with services of doctors, teachers, etc.

iii. Advantages & Disadvantages of Price discrimination

Advantages of price discrimination

- It enables the poor to get essential services at low prices, for example, cheap houses to civil servants and doctors charging low prices on poor patients.
- To the sellers, it increases total revenue because output sold increases.
- It is one way in which the rich subsidise the poor thus method of income distribution. The rich are charged highly on commodities while the poor are subsidised on the same commodities.
- It increases sales and consumption, for example, for air time, the first units, may be charged higher price than other extra units. Therefore, the more units of air time you use, the less the charge you would pay for extra units.
- It helps producers to dispose of surplus and poorly manufactured commodities, for example, dumping.
- Increased efficiency: The increased profits from the higher charges make the firms efficient and such profits are re-invested

Disadvantages of price discrimination

- It may encourage consumption of some commodities in undesirable excessive amounts. For example, when children are charged less for entrance in cinema halls, they may spend more time watching films than on studies or leisure.
- It increases monopoly powers of firms by limiting entrance of other firms in the market. One firm serves all categories of customers irrespective of their incomes, ages or sex.
- It can lead to low quantity of products/services, for example, in some airlines, travellers in the economy class (where fares are lower) are sometimes not well treated by airline staff like those in the first class (where fares are higher).
- Discrimination in form of dumping discourages local industries.

- Poor quality output normally arises. Such output is sold to the less privileged who can't afford high prices.
- Misallocation of resources: Price discrimination may bring about divergence of resources from their socially optimal uses to those who can reward highly.

Exercise

- Name any place or service that you use where price discrimination is practiced
- Name some forms of discrimination that are practiced in place or service identified above?
- Do you think it good to practice price discrimination in the place or service identified above? Give reasons to support the response

2.2.3 Monopolistic competition

a) Meaning of Monopolistic competition

Monopolistic competition is a market structure that has characteristics similar to that of perfect competition except that the commodity dealt with in monopolistic competition is differentiated i.e. not homogeneous. It is a market structure in which large number of firms sells differentiated products with close substitutes. Product differentiation may be in form of packing, design, quality, branding, advertising, blending, giving credit, etc. There is a need for persuasive advertising in monopolistic competition. Monopolistic competition lies between perfect competition and monopoly.

Because of product differentiation, the seller has some control over the market price. Examples of monopolistic firms are soap industry, bread.

b) Features of Monopolistic competition

- There are many buyers and several sellers.
- Firms deal in differentiated products although they remain close substitutes.
- There is a lot of persuasive and informative advertising.
- The demand curve is fairly elastic in nature because of the presence of many substitutes.
- There is production at excess capacity, i.e. production less than the required output so as to charge at a high price.

c) The firms in the industry are large but none of them dominates the market.

- The major aim is to maximize profits and this is done at point where marginal revenue is equal to marginal cost ($MR=MC$).
- Firms are price makers to some extent and price takers to a certain extent.

- There exists brand loyalty, i.e. consumers exercise a lot of loyalty by sticking on a particular commodity believing that a particular brand is superior.

d) Equilibrium position of firm under monopolistic competition in the short-run

The firm under monopolistic competition is in equilibrium when the $MC=MR$ and in the short-run the firm will either make abnormal profits or losses. For the firm to be in equilibrium:

- The average revenue (AR) must be greater than average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be below the average revenue curve.
- Marginal cost curve cuts the average cost curve at the lowest point.

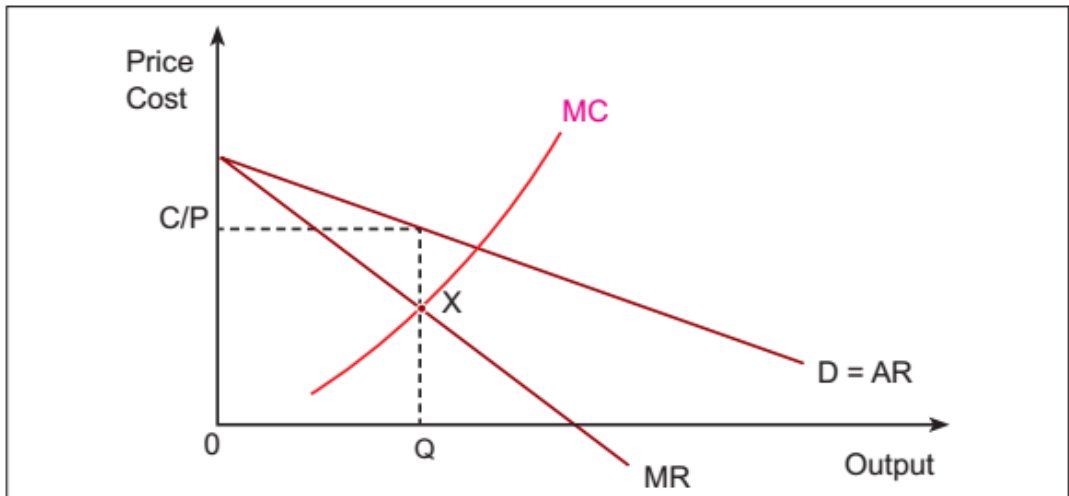


Figure 2.15: Equilibrium of a monopolistic competition firm in the short-run

Point X in Figure 2.15 above shows the equilibrium point where $MC=MR$.

e) Profit maximization of a business/firm under monopolistic competition

A firm under monopolistic competition is in equilibrium where $MC=MR$ and in the short-run the firm can make abnormal profits.

Abnormal profits are made under following conditions:

- The average revenue (AR) must be greater than the average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be below the average revenue curve.
- Marginal cost curve cuts the average cost curve at the lowest point.

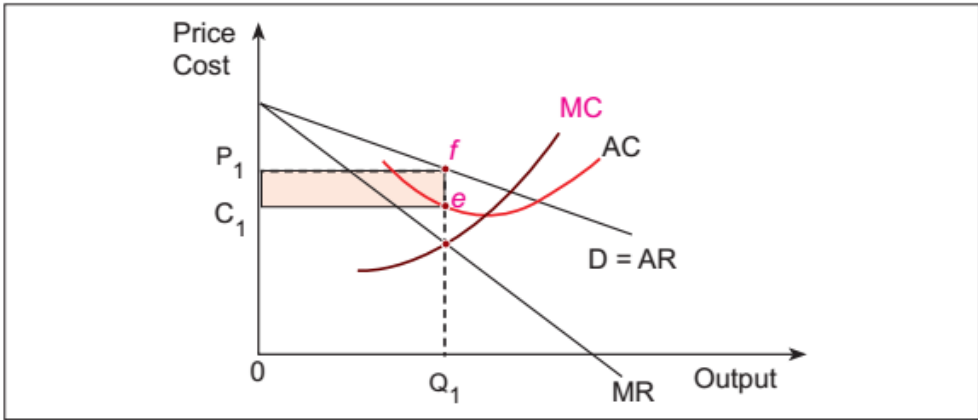


Figure 2.16: Abnormal profits of a firm under monopolistic competition

From Figure 2.16 above, the firm produces output $0Q_1$ at cost $0C_1$ and sells it at price $0P_1$, getting total revenue $0P_1fQ_1$ at total cost $0C_1eQ_1$.

Profits = TR-TC. $0P_1fQ_1 - 0C_1eQ_1 = C_1P_1fe$ (shaded region)

f) Losses under monopolistic competition in the short-run

A firm under monopolistic competition is in equilibrium where $MC=MR$ and in the short-run the firm can make losses.

Losses are incurred under following conditions:

- The average revenue (AR) must be less than average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be above the average revenue curve.
- Marginal cost curve cuts the average cost curve at the lowest point.

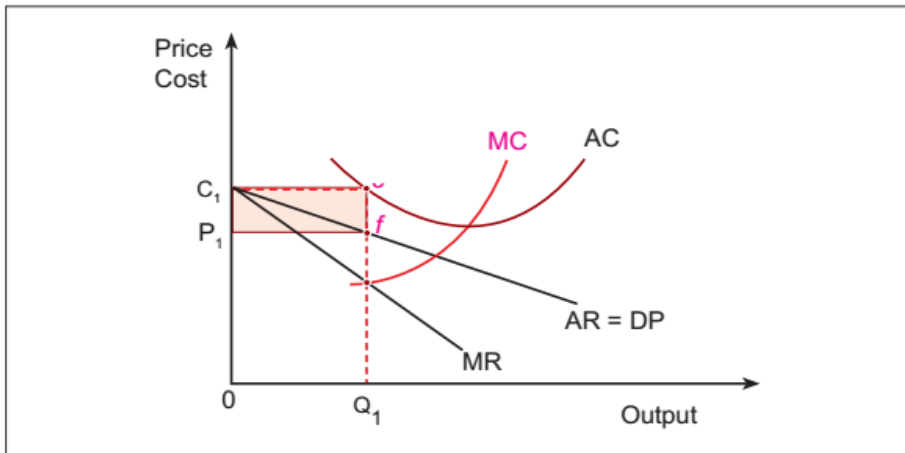


Figure 17: Losses of a firm under monopolistic competition

From Figure 2.17, the firm produces output $0Q_1$ at cost $0C_1$ with total cost $0C_1eQ_1$ and sells it at lower price $0P_1$ making total revenue, $0P_1fQ_1$.

$$\text{Losses} = 0P_1fQ_1 - 0C_1eQ_1.$$

Hence, the firm makes losses P_1C_1ef because total cost is greater than total revenue.

g) Equilibrium of the firm under monopolistic competition in the long-run

Due to the supernormal profits in the short-run, new firms join the industry with new brands. Output increases, Product differentiation increases.

Consumer choice widens but the firms reduce the level of their output since the market has remained the same. The firms that were previously incurring losses leave the industry.

Therefore, the demand curve would keep on shifting to the left until point is reached where the demand curve is tangent to the ATC (LAC) curve. Equilibrium is attained at point where Long-run Marginal Cost Curve (LMC) Long-Run Marginal Revenue (LMR).

Monopolistic firms earn normal profits in the long-run under the following conditions:

- The average revenue (AR) must be equal to the average cost (AC).
- The average revenue curve determines the price while the average cost curve determines the cost of the firm.
- Average cost curve must be tangent to the average revenue line.
- Marginal cost curve cuts the average cost curve at the lowest point.

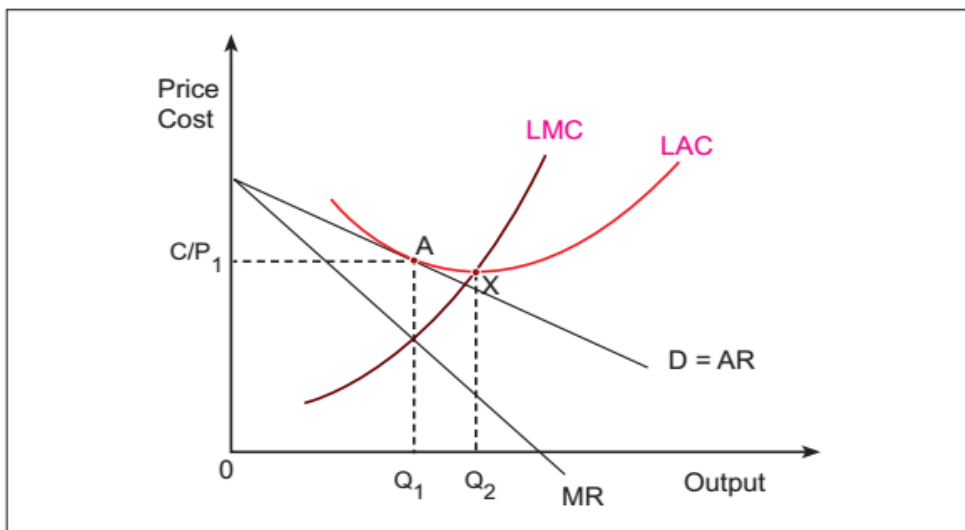



Figure 2.18: Normal profits of a monopolistic firm in the long-run

From Figure 2.18, output OQ1 is produced at a high total cost $0C/P1$ and sold at the same price $OP1/C$. The total cost is $0C/P1AQ1$ and the total revenue $OP1/CAQ1$.

Profits = TR-TC. = $OP1/CAQ1 - 0C/P1AQ1$ = Normal (Zero) profit.

The firm produces lower output Q1 as shown by point A. However, it should produce output Q2 as shown by point x where $LMC=LAC.Q2 - Q1$ is excess capacity, i.e. the difference between actual output and expected output.

h) Product differentiation under monopolistic competition



Product Differentiation	Features, warranty, durability, performance
Service Differentiation	Ordering ease, customer training
Channel Differentiation	Coverage, expertise, performance
Relationship Differentiation	Competence, courtesy, credibility
Reputation Differentiation	Perception, advertising, communication
Price Differentiation	By customer, by quantity, by segment

This is situation where producer is in position to make his or her product appear different from other products of other firms.

Product differentiation is the key aspect or aspects that distinguish a business's products or services from the competitors. Successful product differentiation leads to brand loyalty and an increase in sales.

A product differentiation strategy involves identifying and communicating the unique qualities of a product or company while highlighting the distinct differences between that product or company and its competitors.

Forms of Product Differentiation

Ideally, a product differentiation strategy should demonstrate that the product can do everything the competing choices can but with an additional benefit that is exclusive to that product. Firms may employ the following strategies to differentiate a product or service:

- ❖ **Price:** Price can be used to differentiate a product in two ways.
 - Firms can charge the lowest price compared to competitors to attract cost-conscious buyers.

- Firms can also charge high prices to imply quality and that a product is a luxury or high-end item.

❖ **Performance, durability and Reliability:** Products can be differentiated based on their reliability and durability. Some batteries, for example, are reputed to have a longer life than other batteries, and consumers will buy them based on such factors.

❖ **Location and Service:** Local businesses can differentiate themselves from their larger national competitors by emphasizing that they support the local community. A local restaurant, for example, will hire locally and may source its food and ingredients from local farmers or suppliers.

❖ Packaging, Design / shape, Branding, Color, Scent, Labelling, Salesmanship, Size, etc.

i) Advantages and Disadvantages of Monopolistic competition

Advantages of Monopolistic competition

- The consumers enjoy a variety of commodities due to product differentiation
- There is an improvement in quality because of competition
- Price is low compared to that of monopoly.
- Output is produced is more than that of monopoly firm

Problems facing Monopolistic competition

- Monopolistic produces at excess capacity that makes firm inefficient.
- Because of excessive advertising and creation of brand name, consumers spend more
- In the long-run, there is abnormal profits that make research and development impossible
- High costs on advertising and sales promotion lead to high prices charged to consumers.

2.2.4 OLIGOPOLY

a) Meaning of oligopoly

Oligopoly is market structure which is characterised by few sellers and many buyers of closely related commodities. Such commodities can either be homogeneous or differentiated.

If the commodities dealt in are homogeneous then the market is known as perfect oligopoly. If the products dealt in are differentiated, then the market is known as imperfect oligopoly.

b) Features/characteristics of oligopoly

- There are few, unequal, competing firms. Each firm, although faced with competition from other firms, has enough market power and, therefore, cannot be a price taker.
- There is non-price competition such as advertising, quality of services, etc. If one firm reduces the price, others would do the same and all firms would end up losing.
- Each firm is concerned with the activities of other firms so as to act accordingly, for example it can reduce the price when others reduce the price.
- In most cases, there is product differentiation.
- Presence of monopoly power: There are very few oligopoly firms and this makes it easy for collusion as a form of price determination leading to monopoly.
- Uncertainty: There is a lot of uncertainty in oligopoly industry, as one firm takes decision say to increase the price, it cannot be certain of the reaction of other firms.
- There is limited entry into the production process.
- There is price rigidity. Prices tend to be stable for a long period of time.
- Firms are faced with kinked demand curve, i.e. curve that has a bend (kink) and it is elastic above the kink and inelastic below the kink.
- There are price wars, i.e. when one firm reduces the price, other firms reduce theirs even lower.

c) Forms of oligopoly

- **Perfect oligopoly/pure oligopoly:** This is a form of oligopoly where there are few firms which sell homogeneous product such as petroleum companies.
- **Imperfect oligopoly:** This is a form of oligopoly where there are few firms dealing in differentiated commodities for example dealers in soft drinks, tea industry, tobacco industry etc.
- **Duopoly:** This is an extreme form of oligopoly where there are only two firms in the market.
- **Duopsony:** This is a form of oligopoly where there are two buyers in the market.
- **Oligopsony:** This is a form of oligopoly where there are few buyers in the market.

d) Price determination under Oligopoly

Under oligopoly, there is no single method of price determining but prices are determined by any of the following methods:

- **Independent pricing:** This is where each firm or seller sets its own price for profit maximization.
- **Perfect collusion:** This refers to cartel agreement where independent firms within the same industry come together to determine the price and output with the purpose of reducing unnecessary competition. An example is OPEC.
- **Imperfect collusion:** Here there is price leadership where the dominant firm decides on the price for others to either follow if it is favourable or exit the industry if it is unfavourable.

e) Non price competition under oligopoly

This is when firms compete on the basis strategies to gain the market share in the industry without lowering the price.

The forms of non-price competition used by oligopolistic firms in Rwanda include:

- Persuasive advertisement using various media such as radios, television, newspapers, etc. to make people aware of the commodity.
- Branding and blending i.e. use of appealing brand names such as Rwanda tea.
- Offering credit facilities to customers to encourage them to keep buying.
- Offering gifts and free samples to encourage them to buy more such as petrol stations giving soap to customers.
- Opening many branches in different locations in the country.
- Offering after sales services such as free delivery of purchases to customers' premises; guaranteeing spare parts all which attract customers to the firm involved.
- Sponsoring social events such as sports and music, for example Guma-Guma with Primus thus winning the market.
- Organising promotions through raffle draws which are intended to increase the number of customers who are attracted to buy the commodity in order to join the draw, for example MTN Sharama, join the millionaires club by Tigo.
- Organising trade fairs and exhibitions to make their products known to customers.
- Offer mobile shops: This is where the firm puts its products in vehicle/ bicycle and moves from place to place selling its products, for example bread firms.
- Renovation of houses of customers by rival firms.
- On the supermarkets at fuelling stations we can use the stop-shopping centres.

- Use of differentiated packaging and convenient design to customers.
- Improve on quality and introduction of new variables to increase the customers.
- Use of some slogans which attract customers to their products.

f) Demand curve of business/ firm under Oligopoly (Kinked Demand Curve)

In an oligopolistic market, firms cannot have a fixed demand curve since it keeps changing as competitors change the prices/quantity of output. The demand curve facing an oligopolist has a kink at the level of the prevailing price. This kink exists because of two reasons:

- The segment above the prevailing price level is highly elastic.
- The segment below the prevailing price level is inelastic.

The following figure shows a kinked demand curve with a kink at point P.

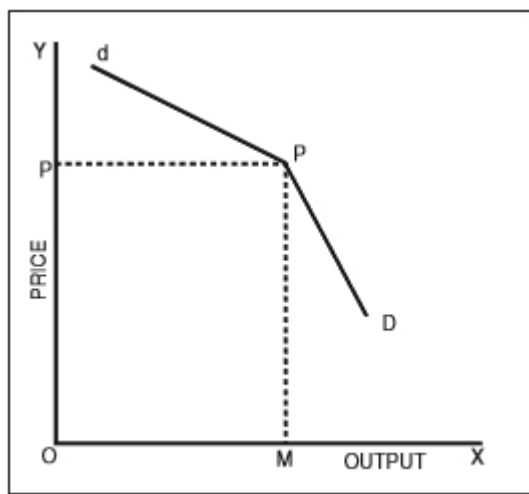


Figure 2.19: Kinked demand curve under Oligopoly

From the figure, it is seen that:

- The prevailing price level = P
- The firm produces and sells output = OM
- Also, the upper segment (dP) of the demand curve (dD) is elastic.
- The lower segment (PD) of the demand curve (dD) is relatively inelastic.

This difference in elasticities is due to an assumption of the kinked demand curve below:

- If a firm lowers the price below the prevailing level, then the competitors will follow the same.
- If a firm increases the price above the prevailing level, then the competitors will not follow the same.

g) Equilibrium position and profit maximisation of firm under oligopoly

Under oligopoly, the firm is in equilibrium where the $MC=MR$ and oligopolists make abnormal profits both in the short and long-run as shown below.

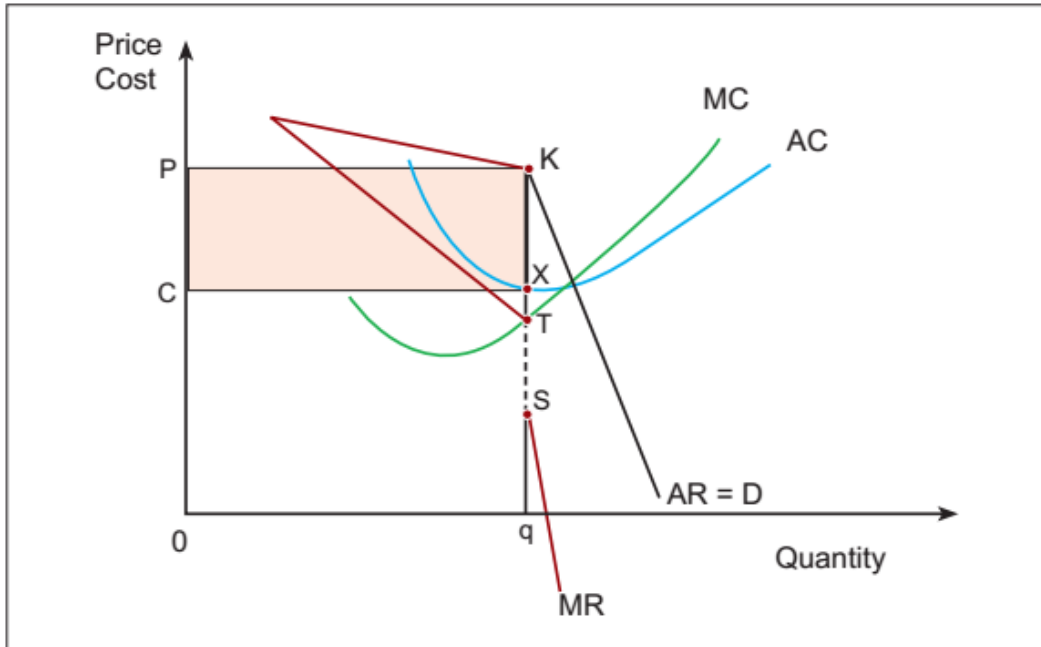


Figure 2.20: Equilibrium position and profit maximisation of a firm under

From Figure 2.20 above, the firm will be in equilibrium where its marginal cost curve cuts its marginal revenue curve from its below ($MC=MR$) and price will be depicted by the average revenue curve or demand curve of the firm.

The firm produces output $0q$ at total cost $0Cqx$ and sells it at price $0P$ getting total revenue $0PKq$.

$$\text{Profits} = \text{TR} - \text{TC}. \quad 0PKq - 0Cqx = \text{CPKx}$$

The marginal revenue curve is not continuous between sections T and S because of uncertainties. The firm is, therefore, in equilibrium at point T where $MC = MR$ and earns abnormal profits shown by the area $CPKx$.

h) Forms of product differentiation

Product differentiation refers to the process used by firms to make their products look different from other products of other firms. Under oligopoly the product can be homogeneous i.e. perfect oligopoly or differentiated i.e. imperfect oligopoly.

The product differentiation under imperfect oligopoly can take the following forms:

- **Brand name:** The names of the firms are different and this make product provided to be different
- **Shapes or design:** The products can have different shapes or designs that differentiate them from others.
- **Colour:** Different colours are used to make product different.
- **Size:** Different size are also used to differentiate products.
- **Packaging:** Packaging materials are also used to make products different.

i) Barriers into the oligopoly market

There are many barriers to enter into oligopolistic firms, and these include among others:

- **Economies of scale:** This occurs when a big firm is able to produce more quantity at less average cost, so that new business cannot compete this big firm. Then they will be discouraged to invest in that business.
- **Network effect:** To create a network with other firms can necessitate a huge amount, hence firm cannot support these amount and decide not to join the market.
- **High research and development cost:** More expenses needed for research and development also prevent other new businesses for entering the market.
- **High start-up cost:** When some costs especially non recoverable costs can limit other firms for entering into the market.
- **Ownership of raw materials:** When a firm has control over resources, this creates barriers for other firms.
- **Predatory pricing:** This consist of reducing the price in order to make competitors losing their market shares.
- **Limit pricing:** This is done by fixing low price and high output to discourage new firms willing to enter the market.
- **Advertising:** High amount spent on advertising of the product or service can prevent other new entrant businesses.
- **Brand:** Brand name creates loyalty of customers and hence discourages other new firms willing to enter.
- **Contracts, patent, and licenses:** When some firms have contract, patent and/ or license in a given product or service, it will be hard to other firms to join the market.
- **Loyalty schemes:** These are some advantages given to customers that discourage new firms fear of getting customers.
- **Switching costs:** These are costs to search new suppliers or systems

that discourage new firm to enter the new market.

j) Advantages and disadvantages of the oligopoly market

Advantages of oligopoly

- There are low prices to the consumers due to existence of intensive competition and fear of other firms' reaction.
- It eases consumer budgeting due to price stability.
- It widens consumer choice production of variety especially with imperfect oligopoly due to branding and product differentiation.
- There is production of good quality goods due to competition.
- There is increased innovation due to competition.
- There is increased output due to production on large scale.
- Stable prices are charged due to the presence of price rigidity.
- Consumer awareness of the commodity is high due to extensive advertising.
- Most oligopoly firms operate on large scale, which enables firm to enjoy economies of scale.
- Provision of gifts to customers such as books, soap, pens, etc. improves on customer welfare.
- A lot of abnormal profits earned are spent on research and development which leads to technological advancement and high standard of living in the country.

Disadvantages of oligopoly

- There is consumer exploitation through overcharging due to collusion.
- There is duplication, hence wastage of resources.
- Small firms collapse when they are outcompeted.
- There is under-exploitation of resources due to production at excess capacity.
- Industries with large firms exert pressure on government.
- Oligopoly distorts consumer choices due to excessive advertisements.
- It worsens income inequality due to limited entry of other firms.
- Some firms at times engage in price wars where each firm keeps on reducing on prices of its products to outcompete rival firms, which results into losses.
- Profits are limited due to price rigidity and this may affect further expansion.
- Firms incur high costs on advertising, which increases on the price of the commodity.

- The market structure is characterised by uncertainties about the reactions and activities of other firms, which limit the ability of an individual firm to make independent decisions.



Application activity 2.2

Provided below is a list of firms that operate under various market structures in Rwanda. Analyse them and answer questions that follow.

Growers of potatoes, Beans growers, Colgate, Close-up, Tigo, MTN, Airtel, Bralirwa, Skol, Matelas Dodoma, Rwanda Foam, Radio Rwanda, Rwanda Television, Amahoro football stadium, REG, WASAC, Market vendors.

Required:

- a) Categorize the above firms according to the different market structures.
- b) With examples of how price discrimination is practiced. Which firms practice price discrimination?
- c) With examples of how product differentiation is practiced. Which firms practice product differentiation?



Skills Lab 2

Based on the products you intend to trade in your back home business as pitched in the last skills lab;

- a) Describe the market structure you would work in and why?
- b) Describe the challenges you are likely to encounter in the market structure and how you plan to overcome those challenges?



End of unit assessment

1. (a) How are market structures categorized?
(b) What distinguishes the different firms in market structure in Rwanda?
2. (a) Describe the basis of monopoly in Rwanda. Give examples.
(b) Why do you think it is necessary to interfere with monopoly firms in Rwanda?
(c) Why do you think there is need of state monopolies in Rwanda? Give examples of state monopolies.
2. Having tackled all market structures in which firms in Rwanda operate, which would you recommend for most effective utilization of resources and solving macro-economic problems in Rwanda and why?
3. (i) Define the term price discrimination.
(ii) Explain different forms of price discrimination.
(iii) Analyse the conditions necessary for price discrimination to be successful.

UNIT 3 | FINANCIAL INSTITUTIONS



Key unit competence: To be able to evaluate the services /products offered by the financial institutions



Introductory activity



Figure A



Figure B



Figure C

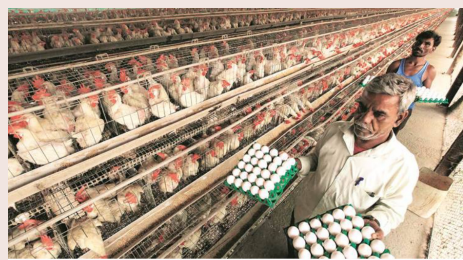


Figure D

Centuries ago, our forefathers kept money in different places. They would use small boxes, pots, and holes dug inside the houses to keep their funds. There are several reasons why they were doing it. As years passed by, things changed and laws were established in regard to keeping money. Now, old or young, people keep their funds in places legally accepted to do so.

Required:

- a) The pictures (Figures, A, B, C, and D) share a connection. Each activity shown plays a sequential influence. Describe the activity expressed in each figure and explain how they are connected.
- b) Mention the examples of figure B in Rwanda.
- c) Between A and B, which should be the best place to save the money? Explain the answer.

3.1 Meaning and role of financial institutions

Learning Activity 3.1



1. Read the case study and answer the questions that follow;

Keza started up a project of making paper bags at school having seen that a lot of paper was trashed and littered around the school compound. She sold these paper bags to the neighboring shops. She got a lot of money and felt insecure to keep it in the dormitory, so she thought of opening an account in the nearby bank. She also thought of saving the money in the bank so that it accumulates interest and also in the long run acquire a loan and expand her business by making flower vases, artefacts.

- a) Do you think Keza took a wise decision? Why?
 - b) If it were you, what would you do to feel secure with the money while at school and why?
 - c) How would you define financial institutions?
1. Differentiate banking from non-banking financial institutions.
 2. Describe the role of financial institutions in socio-economic development.

3.1.1. Meaning of financial institutions



Figure 3.2: Illustration for different financial institutions operating in Rwanda.

Financial institutions are institutions that deal in providing financial services to their clients. They offer both short- and long-term finance to entrepreneurs for their business operations. Financial institutions include; Central bank, commercial banks, microfinance institutions, merchant banks, development banks, Savings and Credit Societies and insurance companies etc.

Financial institutions provide a variety of financial services to the public which include deposits and withdraw services, loan services and financial advice to entrepreneurs among others.

3.1.2. Role of financial institutions

Financial institutions play an indispensable role in the overall development of a country. They include the following;

- c. Financial institutions play a key role in creating employment in an economy. Many people are employed in different financial institutions thus improving their wellbeing.
- d. They help to control inflation in the country by use of the monetary policy tools.
- e. They provide loans to the public which are used to start-up businesses hence improving their standards of living.
- f. They offer a safe custody for the public finances thus reducing cases of theft.

- g. Financial markets help in boosting economic growth. They encourage people to save by buying shares and bonds and then use it to invest in large projects and industries.
- h. Financial institutions do offer loans to businesses at substantial interest rates. This helps businesses to increase their production and distribution activities.
- i. They promote foreign exchange markets through supporting entrepreneurs in exporting and importing goods and services. Businesses can receive and transfer funds in other currencies.
- j. Economic growth depends on the growth of infrastructural facilities of the country. These infrastructures require a lot of funds which are funded by these financial institutions.
- k. They also help to facilitate domestic and international trade.
- l. They help to balance economic growth since all the different sectors in an economy rely on financial institutions. The primary, secondary and tertiary sector industries all need sufficient funds from these institutions.
- m. They help to attract foreign capital through the capital market authority. Foreign companies can buy shares, stocks in another country. Such as KCB, IM bank, equity bank among others.
- a. Financial systems of different countries can promote economic integration. This is when common economic policies, such as common employment laws, commercial laws are applied. For example, the East African Community (EAC).
- b. They also help in the development of new technology to be used. For instance, computers and other new technologies to be used in recording information.

In general, financial institutions play a key role in socio-economic development of any economy and no economy can run successfully without a sound financial system.



Application activity 3.1

1. Imagine you are to start up a business in your community. Which type of financial institution will you work with closely and why?
2. Write an essay on the following statement: “Financial institutions are the key engine to the development of the country”

3.2. Types of financial institutions

Learning Activity 3.2

Study the illustration given below and use it to find answers for the questions that follow:



Figure 3.3

Take time and think about the above illustration. Search on the difference existing between the two aspects shown in the image.

Questions:

- Explain the difference between Non-banking financial institutions and banking financial institutions.
- Identify two examples of Non-financial institutions in Rwanda.

Financial institutions are broadly categorised into two namely, banking financial institutions and non-banking financial institutions.

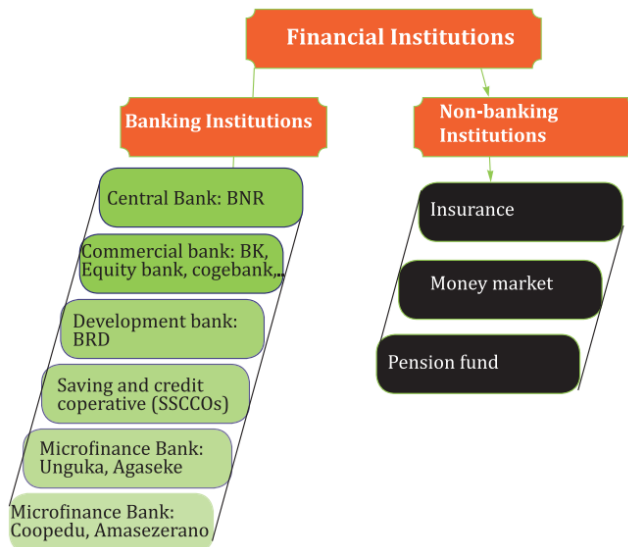


Figure 3.4: Types of financial institutions

3.2.1. Banking financial institutions

These are specialized institutions which were developed to provide finance in modern economies to deferent sectors. The institutions trade money as their major commodities and they charge a price known as interest. A financial institution is an institution that provides financial services to its clients. Banking financial institutions are of different types, which are detailed below:

a) Central bank

This is the institution that shoulders exclusively the commitment of handling the nation's currency, the money supply, and interest rates. In other words, it is involved in the inauguration and implementation of monetary and fiscal policies of the country. It is universally branded as the National bank. A typical example is the National Bank of Rwanda (Banque Nationale du Rwanda (BNR)).



Figure 3.5: National Bank of Rwanda

There are several functions played by the central banks. They are explained hereunder:

- i. Issuing of currency.** It is the only bank that has the right to issue or renew currency notes and coins.
- ii. It acts as a banker to the government by**
 - Keeping government funds
 - Paying interest on public debts
 - Marketing government securities
 - Advising the government on economic policies
- iii. It acts a banker to commercial banks in the following ways**
 - It acts as a lender of the last resort to commercial banks
 - It is a clearing house for all commercial banks. i.e. they settle their debt through the central bank.

- Every commercial bank must keep a certain percentage of its deposits with the central bank (legal reserve requirement).

iv. It is a manager and custodian of foreign currencies. That is to say, it tries to maintain the stability of its currency exchange rate in relation to foreign currencies.

v. It uses monetary policies to influence the level of economic activity.

vi. Commercial banks

vii. Credit control. Commercial banks control the lending capacity of commercial banks in order to control the amount of money in circulation so as to avoid inflation and deflation.

viii. Currying out research and publishing journals. The central bank carries out research on the performance of the economy as well as publishing annual reports on economic development, balance of payment and interstate trade which benefits the government and the public.

ix. It acts as a fiscal agent and advisor to government e.g. formulating budget, taxation, devaluation policy. 9. It controls and regulates the operation of commercial bank

x. It is a lender of last resort to commercial bank

xi. It is a banker to international institutions working in the country e.g.: WFP, Red Cross, WHO.

b) Commercial banks

Commercial banks are financial institutions that are involved in accepting deposits from the public as well as offering loans and overdrafts for purposes of registering profits.



Figure 3.6: Functions of commercial banks

Functions of commercial banks include, but are not limited to the following:

- i. Commercial banks accept and safeguard deposits from the public and a given interest is paid on the fund borrowed from the public especially when the deposits are fixed or savings deposits in nature; this excludes the current or demand deposits. Commercial banks pay interest on deposits borrowed from the public.
- ii. Commercial banks offer credit services by routing received deposits under various accounts into fruitful uses in form of loans, advances, overdrafts, and cash credits.
- iii. Commercial banks also provide facilities for transferring money from one place to another or even from one country to another.
- iv. Commercial banks also provide commercial advice to their customers. They advise them on how to use their money and business.
- v. Besides being lenders and borrowers, commercial banks perform other functions such as agent services, sales and purchases of securities, and, collection and payments of promissory notes.
- vi. Commercial banks also keep valuable possessions such as academic documents and other precious materials such as gold.
- vii. Commercial banks offer training services to the public on how to start and manage small businesses
- viii. Commercial banks are used by the central bank to regulate the amount of money in circulation through use of a number of tools such as bank rate, moral suasion, and legal reserve requirements among others.
- ix. Commercial banks offer a bank statement that shows one's account status in terms of balances.
- x. Commercial banks through giving out loans accepting deposit credits are created, therefore enabling many people to get accessibility to it hence increasing money in circulation.

Examples of commercial banks in Rwanda

- Access Bank Rwanda
- Bank of Kigali
- I&M Bank Group
- Banque Populaire du Rwanda SA (BPR)
- Compagnie Générale de Banque (Cogebanque)
- Eco bank
- Equity Bank (Rwanda)

c) Development banks



Figure 3.7: Banque de Développement au Rwanda (BRD)

These are also called development financial institutions. A development bank is a financial institution that is engaged in the provision of risk capital for economic development projects based on non-commercial principles. The good example is the Development Bank of Rwanda.

Development banks specialize in fostering socio-economic development in a country. In most cases, the private sector is supported by securing subsidized grants/loans. These are owned by the governments. Development banks source their funds from internal development funds or sometimes in given countries from national development funds.

Like any other financial institution, development banks carry a huge batch of functions. These include the following:

- i. Financial gap fillers:** Development banks extend both medium and long-term loans to various enterprises, especially to those that are engaged in a given economic sector that the government wishes to promote or develop.
- ii. Entrepreneurial gap fillers:** This is a function described by identifying specific investment projects that promote industrial business ventures. Then, the development bank executes the provision of technical and managerial support where need be. Such is done in developing countries where technical capacity is still needed.
- iii. Supporting commercial banking business:** Under normal circumstances, commercial banks are expected to provide the working capital required by the interested entities. However, sometimes it may not be possible for commercial banks to do, and it necessitates that development banks come in. especially when the concerned ventures

are connected to the socio-economic sector being promoted by the government. Development banks further help industrial enterprises to attain the needed machinery from within the country or outside the country.

iv. Joint finance: There are situations when there are mega projects that need huge sums of funds. When the commercial banks find it challenging, run to the development bank so that they can jointly finance it through the provision of loans to the owners of the project.

v. Refinancing facility: Development banks provide refinancing facilities to lending institutions, hence enabling them to be able to meet their financial needs.

vi. Credit Guarantee: Developing Banks provide a degree of protection to the lending institutions especially, when the commercial banks have a doubt about the borrower's ability to service the loan. Small-scale enterprises usually find it hard to find bigger loans due to a lack of assurance of paying. Therefore, the development Bank comes in to assist.

vii. Underwriting of securities: There are times when the borrower desires to change the loan-securing contract, and enter into a new agreement with the lender. In the case of securities involved, the development bank executes the underwriting of securities and accepting to should the risk purposely to support the enterprise.

d) Savings and Credit Cooperatives (SACCO)

These are financial institutions established on a cooperative basis. They target groups of people. In most cases, the customers are the owners of such institutions. Good examples in Rwanda include the following:

- Umurenge SACCO
- Umwalimu SACCO
- Zigama CSS
- COOPEC Zamuka

These cooperatives have contributed a lot to the socio-economic development of the country. Whereby, rural, urban, low-income earners, middle-class, and small-scale enterprises have taken good use of the savings and credit cooperatives in Rwanda.

Below are the functions of saving and credit cooperatives:

- Collecting funds from the customers in form of shares and safety is ensured.
- Providing loan facilities to its members at a low-interest rate.
- Playing an investment advisory function. Whereby, members or

- customers are advised on the best ways of investing wisely their savings.
- Contributing to the implementation of monetary policy and other policies advanced by government agencies.
- Acting as an agent to the customers: Collect cheques and funds from members and lends money to other cooperatives or banks to get more interest.
- Fostering socio-economic development of the society and the welfare of its members.

e) Specialized banks

These are financial institutions that provide financial services to a specific category of economic sectors such as agricultural, industrial, or tourism activities. These are usually not aimed at profit targets, and this explains why they are usually

There following are examples of functions played by specialized banks:

- Providing long-term loans to enterprises that are engaged in the specific economic sector.
- Contributing to the implementation of government policies such as poverty eradication
- Fostering socio-economic development with no focus on profit targets.
- To put in place operating standards and measures to align with compliance with the financial regulations.
- To execute financial management with the highest level of professionalism in the existing system.
- Complying with loans to businesses, and trading opportunities depicts policies and expected goals.
- Using credits and account agreements to attain influence and power.
- Within the required range, take the outermost induce rate floats.

3.2.2. Non-banking financial institutions

These are financial institutions that receive deposits from the public or from government and other financial institutions but do not create credit like the banking financial institutions do. Non-banking financial institutions are of different types, which are detailed below:

- 1. Insurance companies:** These collect money from the public through the sale of insurance policies. That is to say, allowing to receive the premiums. They are engaged in investing in short-term investments for example purchasing bonds. In many countries, they buy treasury bills as an act of lending to the government. They are two types:

- General insurance which deals with the loss or destruction of property such as cars, ships, and houses to mention a few.
- Health insurance which deals with medication services. These are non-banking financial institutions that provide health plans for families, individuals, workers as well as travellers.

Examples in Rwanda include: Military Medical Insurance (MMI), RSSB, etc.

- 2. Mutual funds:** These are engaged in mediating between people and the stock exchange
- 3. Pension funds:** These are also non-banking financial institutions that collect savings from employees and invest them in long-term investments. In most cases are executed by insurance companies or social security fund institutions. Good examples are:
 - The National Social Security Fund (NSSF),
 - Ministry of defence complementary Pension scheme, Prime Life Insurance Ltd (Personal Pension Scheme),
 - BNR complementary occupational pension scheme, Old Mutual Insurance Rwanda staff retirement benefits pension scheme.

Functions of non-banking institutions include the following:

- They assist in the establishment and development of various sectors especially transport and infrastructure in the country.
- Non-banking financial institutions extend specialized credit facilities to various entities especially those engaged in mega projects.
- The non-banking financial institutions aim at the creation of wealth and economic development in the country.
- The weaker sectors or sections of society need to be strengthened and fully supported, and this is one of the functions of non-banking financial institutions.



Application activity 3.2



Figure 3.7: Umurenge Sacco

In the sector, there is Umurenge SACCO. With the help of the teacher, guardian, or someone, secure an appointment with Umurenge SACCO management.

Tasks:

- Prepare questions that you will ask the employees of Umurenge SACCO engaged in financial management.
- Write down the functions played by the Umurenge SACCO and compare it with those of commercial banks.

3.3. Financial products, services and banking documents

Learning Activity 3.3



Find one of some either from the school community or at home who uses banks or Saving and Credit Cooperatives. Find out the following:

- Which bank does he or she use?
- Why did he or she decide to use the bank mentioned?
- What services or products does he or she usually receive from the banks mentioned above?

3.3.1. Financial products and services

Financial institutions provide a wide range of products and services, but they all have some in common, especially the banking ones. These include the following:



- a. Advancing loans:** Extending loans is an important function of financial institutions. The deposits received by banks are not allowed to remain idle. So, after keeping certain cash reserves, the balance is given to borrowers as loans and interest is charged on these loans.
- b. Insurance:** Insurance is one of the key financial product or services offered by financial institutions. Examples include life and general insurance schemes discussed above.
- c. Mortgages:** Banking financial institutions offer to their customers a type of loan used to purchase or maintain a home, land, or other types of real estate. The borrower agrees to pay the lender over time, typically in a series of regular payments that are divided into principal and interest. The property then serves as collateral to secure the loan. For example, Umwalimu Sacco offers this type of loan to its customers.
- d. Money market:** Financial institutions act as money market players. Money market is an organized exchange market where participants can lend and borrow high-quality debt securities.

3.3.2. Banking documents

There are several documents that are used while executing banking services. These vary depending on which service is being offered. With the new technologies, most of them have been digitalized. But still, they are documents applied, regardless of the mode of accessibility. These documents are detailed in the table below:

Bank document	Description	Pictorial expression
Deposit slip	<ul style="list-style-type: none"> – The banking document that is used by the depositors use while depositing money in their accounts – It shows the date of the transaction, the depositor's name, the account number, and the amount deposited. 	

Figure 3.8: Bank deposit slip

Withdrawal slip	This is a document used while an account holder is debiting his or her account by withdrawing a given amount of money.	
Money transfer slip	This is a form filled by the bank account holder requesting the bank to transfer money to another account either from within the same bank or from another bank.	
Bank Statement	<ul style="list-style-type: none"> - This is a document that highlights all the transactions of an account during a specific period of time. - This is usually given to the account holder. - Shows the data of transactions, - How much was either debited or credited. <p>Where applicable the purpose of the transaction.</p>	
Bankers card	<p>Debit card:</p> <ul style="list-style-type: none"> - This is an electronic card given to account holders on demand. - Use to withdraw or deposit money using an ATM 	 <p><i>Figure 3.9: Samples of debit cards</i></p>
	<p>Credit card:</p> <ul style="list-style-type: none"> - This is a type of credit facility, provided by banks that allow customers to borrow funds within a pre-approved credit limit. - It enables customers to make purchase transactions on goods and services. - This card limit is determined by the credit card issuer based on factors such as income and credit score, which also decides the credit limit. 	 <p><i>Figure 3.10: Example of credit cards</i></p> <p>Source: https://www.britannica.com</p>
Bank cheques	<ul style="list-style-type: none"> - This is a document that orders a bank to pay a specific amount of money from a person's account to the person in whose name the cheque has been issued. <p>The person writing the cheque, known as the drawer, has a transaction banking account where the money is held (bank).</p>	

Loan agreement form	<ul style="list-style-type: none"> - This is a document that shows a detailed loan repayment schedule. - It is entered into by both the borrower and the lender. - The form includes; Parties Involved, Identification Data, Loan Details, Acknowledgment, Payment, Promise to Pay, Late Charges, Default, Security, Amendments, Assignment, Governing Law, Alternative Dispute Resolutions, Entire Agreement, Ownership, Severability, Signature, And Date.
Letter of credit	<ul style="list-style-type: none"> - A document received from the bank guaranteeing that the buyer's payment to a seller will be paid as promised by the purchaser. - The bank takes the responsibility of ensuring that the seller will be paid as agreed.
Bank Pre-Advice Bank Guarantee	<ul style="list-style-type: none"> - This is associated with purchasing goods online - This is the information exchanged between two banks associated with a given transaction - Aims at safeguarding the wire transfer <p>One bank notifies the receiving bank that the bank details are correct and thereafter, after payment, and the transaction is done, the receiving bank is requested to send an acknowledgment note.</p>
Account opening form	<ul style="list-style-type: none"> - This is a document that is used when someone or a given company is opening a bank account.

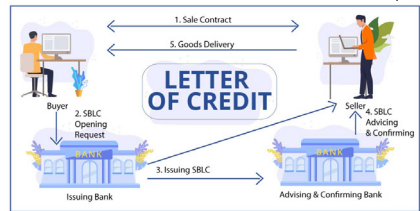


Figure 3.11: Process of a letter of credit



Application activity 3.3

Scenario 1: There are many people worldwide who are retiring from work. In Rwanda at age 65 years as of 2023, is when they are supposed to retire. However, there are many other ways one can use to ensure that his or her life is safeguarded against health problems.



Figure 3.12: Illustration for the pension

Scenario 2: There is a Megaproject being planned to take place in the community. This will be concerned with the hydroelectric power stations.

Questions:

- Using Scenario 1, show how you would use the knowledge and skills acquired as you studied Non-banking financial institutions to plan for a better leaving.
- Prepare a guide on how the Megaproject can source the funds for the construction.

Scenario 3: In the village, there is Umurenge SACCO, which has supported many people in savings funds for a better future. Now, there is a massive campaign on increasing awareness on financial products and services

Question:

- Suppose you are contracted to prepare a presentation on the above campaign, explain what would be the key points of emphasis.
- Explain why you would recommend the introduction of ATM in the village?

3.4. Financial markets

Learning Activity 3.4



Study the pictures below to answer the questions that follow.



Figure 3.13

- Describe what you think the people in both pictures are doing.
- Do you find any relationship of their activities?
- What do you understand by financial market?

3.4.1 Meaning, functions, and types of financial markets

a) Meaning and functions of financial markets

A financial market refers to the transaction that involves people and other entities trading in financial securities, bonds, equities, international currencies and derivatives. In order to understand the meaning of financial markets, it is important to be aware of their functions which are discussed below:

- The raising of capital (in the capital markets)
- The transfer of risk (in the derivatives markets)
- Price discovery
- Global transactions with integration of financial markets
- The transfer of liquidity (in the money markets)
- International trade (in the currency markets), Financial Markets are used to match those who want capital to those who have it.

A borrower issues a receipt to the lender promising to pay back the capital. These receipts are securities that may be freely bought or sold. In return for lending money to the borrower, the lender will expect some compensation in the form of interest or dividends. This return on investment is a necessary part of markets to ensure that funds are supplied to them.

b) Types of financial markets

There are different types of financial markets. The most commonly known are the following:

- i. Physical asset markets versus financial assets markets:** Physical asset markets are for physical products such as wheat, autos, real estate, computers, and machinery whereas financial asset markets, on the other hand, deal with stocks, bonds, notes, and mortgages. Financial markets also deal with derivative securities whose values are derived from changes in the prices of other assets e.g. convertible bonds.
- ii. Spot markets versus future markets:** Spot markets are markets in which assets are bought or sold for “on-the-spot” delivery (literally, within a few days) whereas future markets are markets in which participants agree today to buy or sell an asset at some future date.
- iii. Money markets versus capital markets:** Money markets are the markets for short-term, highly liquid debt securities whereas capital markets are the markets for intermediate or long-term debt and corporate stocks.
- iv. Primary markets versus secondary markets:** Primary markets are the markets in which corporations raise new capital whereas secondary markets are markets in which existing, already outstanding securities are traded among investors.

3.4.2. Capital markets

a) Meaning of capital market

A capital market is an arrangement by which financial securities are traded by individuals and institutions/organizations. The capital market is further divided into primary and secondary market. A capital market is a place in which financial securities are traded by individuals and institutions/organizations. It can be a primary market where initial public offers (IPOs) take place or a secondary market where IPOs are traded subsequently.

Primary market: The primary market is the market for new issuers or where new capital is raised. It is the market where securities are sold for the first time. At the primary market sale proceeds of the securities offered flow directly from the buyers or investors to the issuers of the securities.

Secondary market: The secondary market is the market for trading securities that have been sold or issued in the primary market and already in the hands of the public. Once securities have been successfully issued in the primary market, they are subsequently traded in the secondary market.

b) Functions of capital markets

Capital market is very important as it plays a significant role in the national economy. A developed, dynamic and vibrant capital market can immensely contribute for speedy economic growth and development.

Let us get acquainted with the important functions and role of the capital market.

- i. Mobilization of savings:** Capital market is an important source for mobilizing idle savings from the economy. It mobilizes funds from people for further investments in the productive channels of an economy. In that sense it activates the ideal monetary resources and puts them in proper investments.
- ii. Capital formation:** Capital market helps in capital formation. Capital formation is net addition to the existing stock of capital in the economy. Through mobilization of ideal resources, it generates savings; the mobilized savings are made available to various segments such as agriculture, industry, etc. This helps in increasing capital formation.
- iii. Provision of investment avenue:** Capital market raises resources for longer periods of time. Thus it provides an investment avenue for people who wish to invest resources for a long period of time. It provides suitable interest rate returns also to investors. Instruments such as bonds, equities, units of mutual funds, insurance policies, etc. definitely provides diverse investment avenue for the public.
- iv. Speed up economic growth and development:** Capital market enhances production and productivity in the national economy. As it makes funds available for long period of time, the financial requirements of business houses are met by the capital market. It helps in research and development. This helps in, increasing production and productivity in economy by generation of employment and development of infrastructure.
- v. Proper regulation of funds:** Capital markets not only helps in fund mobilization, but it also helps in proper allocation of these resources. It can have regulation over the resources so that it can direct funds in a qualitative manner.
- vi. Service provision:** As an important financial set up capital market provides various types of services. It includes long term and medium term loans to industry, underwriting services, consultancy services, export finance, etc. These services help the manufacturing sector in a large spectrum.
- vii. Continuous availability of funds:** Capital market is place where the investment avenue is continuously available for long term investment. This is a liquid market as it makes fund available on continues basis. Both

buyers and seller can easily buy and sell securities as they are continuously available. Basically capital market transactions are related to the stock exchanges. Thus marketability in the capital market becomes easy.

3.4.3. Stock exchange

a) Meaning of stock exchange

The word “Stock exchange” is made from two words ‘Stock’ and “Exchange”. Stock means part or fraction of the capital of a company, and Exchange means a transferring of the ownership; representing a market for purchasing and selling. Thus, we can describe the stock exchange as a market or a place where different types of securities are bought and sold. Securities traded on a stock exchange include shares issued by companies, unit trusts, derivatives, pooled investment products and bonds.

b) Functions of stock exchange

The stock exchange is one of the most important financial intermediaries and plays a very important role in the capital formation and economic development of the country. Hereunder are some of its functions:

- **Marketability of securities:** Easy for marketing of securities.
- **Price determination and continuity:** Since transactions take place regularly, there is conformity in dealings.
- **Mobilizing surplus savings:** When people draw their share and invest in shares, this leads to mobilisation of funds to help companies to finance their organisations.
- **Barometer of the economy:** The share prices fluctuate on stock exchanges as a result of underlying market forces.
- **Mobility of capital:** Investing in other businesses requires huge capital outlay whereas investing in shares is open to both the large and small stock investors.
- **Profit sharing and resource allocation:** As a result of stock market transactions, funds flow from the less profitable to more profitable enterprises.
- **Speculation:** The stock exchanges are also fashionable places for speculation and bring equilibrium in the prices of securities which are bought and sold by speculators.
- **Liquidity:** The capital investments are generally long term and if shareholder wants their investment back, in a physical scenario, it will result in winding up the company and selling its assets to discharge the money.

- **Corporate governance:** As stock exchanges facilitate ownership of companies to be help by a wide and varied scope of owners, companies generally tend to improve management standards and efficiency to satisfy the demands of these shareholders.

3.4.4. Capital Market Authority (CMA)

Capital Market Authority (CMA) is a public institution established by Law No.23 /2017 of 31/05/2017 responsible for developing and regulating the capital markets industry, commodities exchange and related contracts, collective investment schemes and warehouse receipts system. CMA was previously referred to as the Capital Market Advisory Council (CMAC) which was a council established by Prime Minister's Order of 28 March 2007 to initially guide the development of a Capital Market in Rwanda.

CMA's vision: To be a key contributor to Rwanda becoming a competitive financial center through mobilization of long term capital.

CMA's mission: To nurture wealth by facilitating the development of an orderly, fair, transparent and efficient capital market.

CMA's core values: Good Governance, Knowledge, Creativity and Innovation.

The Rwanda Capital Market Authority is responsible for:

- i. Implementing the Government policy on Capital Market;
- ii. Preparing draft policies on capital market;
- iii. Advising Government on policy relating to the capital market;
- iv. Promoting public awareness on the capital market and develop such market;
- v. Elaborating action plans and conducting studies in order for CMA to achieve its mission;
- vi. Formulating principles and regulations for the capital market;
- vii. Making regulations governing capital market business in accordance with the law regulating capital market in Rwanda;
- viii. Controlling and supervising all capital market activities with a view to maintain proper code of conduct and acceptable practices on the capital market;
- ix. Registering capital market business and related instruments provided for by the law regulating capital market in Rwanda;
- x. Issuing, suspending, and withdrawing licenses and approvals related to capital market business;

- xi. Seeking to achieve fairness, efficiency and transparency in the functioning of the capital market;
- xii. Protecting citizens and investors in capital market from unfair and unsound practices or practices involving fraud, deceit, cheating or manipulation;
- xiii. Monitoring, supervising, and take actions with regard to the compliance with this Law and regulations thereto related as well as with the Law regulating capital market in Rwanda and regulations thereto related;
- xiv. Co-operating and collaborating with other regulatory bodies in accordance with the provision of the Law regulating capital market in Rwanda;
- xv. Consulting concerned organs prior to making any decision to modify principles and regulations of the profession that may have impact on the functioning of the capital market;
- xvi. Keeping adequately and timely records of decisions made in the accomplishment of CMA mission;
- xvii. Accomplishing any other mission assigned by the Law regulating capital market in Rwanda.

a) Capital market business

Capital market business deals in the following business activities or operations:

- Dealing in capital market instruments;
- Arranging deals in capital market instruments;
- Safekeeping and administration of assets;
- Managing capital market instrument;
- Giving capital market advice;
- Using electronic means for giving investment instructions.

Capital market business fosters a lucrative investment which is worth investing in. Investment is a necessary condition for creating wealth. Though there are many ways of investing, putting money in buying and selling bonds or shares/ equity is highly advisable.

b) Capital market instruments

- i. Shares:** A share is a unit of ownership in a limited company and gives the holder claim over any dividends that the corporation/company may pay on it in future and on its face/ residual value in case the company is liquidated or closed. Owners of shares are called shareholders and receive dividends on their shares from the company's profits usually at the end of financial year.

ii. Instruments creating or acknowledging indebtedness

- **Debentures:** A debenture is a type of debt instrument that is not secured by physical assets or collateral. Debentures are backed only by the general creditworthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond to secure capital.
- **Debenture stock:** Loan contract issued by a company or public body specifying an obligation to return borrowed funds and pay interest, secured by all or part of the company's property. Certificates specifying the amount of stock, with coupons for interest attached, are usually issued to the lenders.
- **Loan stock:** Loan stock is shares of common or preferred stock that are used as collateral to secure a loan from another party. The loan earns a fixed interest rate, much like a standard loan, and can be secured or unsecured. A secured loan stock may also be called a convertible loan stock if the loan stock can be directly converted to common shares under specified conditions and with a predetermined conversion rate, as with an Irredeemable Convertible Unsecured Loan Stock (ICULS).
- **Bonds:** Bond is a debt instrument created for the purpose of raising capital. They are essentially loan agreements between the bond issuer and an investor, in which the bond issuer is obligated to pay a specified amount of money at specified future dates.
- **Certificate of deposit:** A certificate of deposit is an agreement to deposit money for a fixed period with a bank that will pay you interest. You can choose to invest for three months, six months, one year or five years, etc. You will receive a higher interest rate for the longer time commitment

iii. Government- owned capital market instruments

The government owned capital instruments include the following:

- **Treasury bills:** Treasury Bills (T-bills) are short term debt securities (one year or less) issued as a primary instrument for regulating money supply or raising funds via open market operations to finance the budget gap. T-bills are always issued through the country's central bank, and commonly pay no explicit interest but are sold at a discount, their yield being the difference between price and the par-value also called redemption value.
- **Treasury bonds:** A treasury bond/government bond is a debt instrument issued by a national government through the Central Bank in its capacity of Government agent, generally with a promise to pay periodic interest payments and to repay the face value on the maturity date.

c) Capital market participants

In capital market, there is a flow of funds from one group of parties (funds-surplus units) known as investors to another group (funds-deficit units) which require funds. However, often these groups do not have direct link.

The link is provided by market intermediaries such as brokers, mutual funds, leasing and finance companies, etc. Players in capital markets can be divided into investors, issuers and intermediaries.

The market intermediaries in Rwanda include the Rwanda Stock Exchange Market, licensed brokers, dealers, and sponsors. The regulator is the Capital Markets Authority.

Participant	Description
Investor	– A person or a legal entity that allocates capital with the expectation of a future financial return.
Issuer	– A legal entity (government, corporation, or investment trust) that develops; registers and sells securities to the investing public in order to finance its own operations.
Stock exchanges	<ul style="list-style-type: none">– Primary markets where corporations, government and other incorporated bodies can raise capital by channelling savings of the investors into productive ventures– Secondary markets where investors can sell their securities to other investors for cash, thus reducing the risk of investment and maintaining liquidity in the system.– Stock exchanges impose stringent rules, listing requirements, and statutory requirements that are binding on all listed and trading parties.

<p>Stock brokers</p>	<ul style="list-style-type: none"> – A stock broker is an agent who represents clients to buy or sell stocks and other securities. The term is applied to both companies that deal in securities and their brokerage. – When anyone decides to participate in the stock market, a broker is usually the first place they go. – An account is set up for the client through which he/ she trades stocks. – The broker accepts stock orders from the client and then executes these directly on the exchange. A business that engages solely in broker services interacts with the stock market for its clients only. – Every transaction made affects a client’s account. For this reason, a broker is often referred to as an “agent.”
<p>Dealers and traders</p>	<ul style="list-style-type: none"> – A stock market dealer trades equity under its own. – The business itself maintains stock holdings that are not in the name of any client. – The dealer may actually be a client of another broker, so as to trade these stocks for its own account. – “Market makers” are dealer businesses that continuously buy or sell certain securities from the public, using their own holdings for these transactions.
<p>Sponsors</p>	<ul style="list-style-type: none"> – A range of providers and entities supporting the goals and objectives of a capital market. – Invest in private companies, create demand for publicly traded securities’ – Underwrite mutual fund shares for public offerings, and issue exchange-traded funds. – Offer platforms for benefits, and more.

d) Benefits of investing through capital markets

A **capital market** is a place in which financial securities are traded by individuals and institutions or organizations. It can be a primary market where Initial Public Offers (IPOs) take place or a secondary market where IPOs are traded subsequently.

The following benefits apply both to the primary and secondary markets:

- **Access capital:** By issuing shares or debt directly to the public through the RSE private sector businesses and government can raise funds for expansion of existing business or new projects.
- **Discover the value of its business:** By listing on the RSE issuers or owners of business are able to discover the price of their securities and therefore the value of their business. This enables them to realize the market worth of their wealth.
- **Strengthens the company's status:** Raise a company's visibility and therefore, enhancing its status with customers and suppliers at home and overseas: A listing on the capital market raises the profile of a company through continuous media coverage. This is free publicity and enhances the product presence of the issuer among its customers.
- **Bargaining Power:** Have better bargaining position with financiers. Increased capitalization of an issuer over time enables the issuer to raise capital at a lower cost due to their improved rating in the market.
- **Enhance management practices:** The capital market requires a minimum level of disclosure and corporate governance and this encourages the quality of management practices.
- **Foster employee motivation:** Listed companies may easily employ executive using stock option techniques.
- **Benefits from Capital Market incentives:** New issuers take advantage of incentives provided to listed companies. This comes in the form of low costs and tax advantages to shareholders and owners of the business.
- **Use of shares as currency:** Listed companies with known market value can use their shares as currency instead of cash when taking over others.
- **Saving accumulation:** Investing in securities that are listed in the capital or stock market encourages investors to accumulate their savings in small amounts over time.
- **Source of income:** Investment in stock market provides a source of income. In every transaction made, the investors have higher chances of earning profits therefore, being able to increase their financial base.
- **Improving investment value:** Whenever the prices of securities go up, the value of investment of shareholders increases.
- **Easy to get loans:** Listed securities are easily accepted as collateral security against loans from financial institutions.
- **Way of getting cash:** Shares and bonds can easily be converted into cash in shortest time possible without losing much value.

Exercise 1

In times of financial crisis both governments and companies, use debt instruments, while the latter employs equities, and corporate companies sell off a given number of shares to the public in order to strengthen their financial abilities.

Suppose you are asked to advise a given company:

- a. What would you tell the management in the first 2 minutes of speech?
- b. Arrange a write-up you would leave them with on one page guiding them on:
 - i) Capital market instruments
 - ii) People who can help the company to benefit from capital markets
 - iii) Why the company should get involved in the capital market business investment.

Exercise 2

There are two companies, one has shares to sell, the second one has already invested in the capital market business, but unfortunately when the auditors came, they discovered that the company is being cheated. Which advice would you give?

- a. Company one (has shares) and has little information on capital markets participants
- b. Company two (the one being cheated), how it can be protected.

e) How investors are protected

Investor protection in capital market is aimed at providing fair play to investors, but it is not aimed at protecting an investor from his/her own errors of judgment or ensuring that he/she gets profits all the time. The law protects investors who have been victims of fraud, dishonesty and unfair practices. All investors face the normal market risks. The regulator in capital market is Capital Market Authority (CMA). Therefore, the investors in this case are protected as follows:

- CMA ensures that only competent and credible professionals are licensed to serve the market.
- CMA supervises all members of RSE to ensure compliance with regulatory requirements.
- CMA ensures that prospectuses of issuers have adequate disclosure

for decision making.

- CMA ensures that there are periodic reports and all price sensitive information are released once they are available.
- National public education and awareness campaigns create well informed investors.

f) How to invest in capital market

There are two ways in which an individual can invest in capital market. These are primary and secondary market transaction processes. Below is a detailed explain of each way:

i. Primary market transaction process:

- The issuer decides to raise capital through the Capital Market
- Issuer appoints advisors, sponsors/co registrar/fiscal agents/ sponsoring brokers
- Issuer prepares draft prospectus or information memorandum
- The issuer applies to CMA to list its securities on the market
- Issuer discusses the offer document with CMA and finalizes the prospectus or information memorandum
- The issuer states the offer period and offers securities to the public
- Public investors subscribe to securities during the offer period
- Offer closes and publication of allotment results

ii. Secondary market transaction process

- Buying client or selling client approaches stockbroker, opens an A/C and pays for an order; either provides funds or gives securities to broker and broker acknowledges
- If buying stockbroker has securities or sell order for securities sought or, required at ordered price, broker sells directly to the client
- If buying broker has no selling orders for securities and or price given by sellers, the broker contacts the other brokers seeking securities required.
- Buying stockbroker and selling stockbroker attends trading sessions at the trading floor. All stockbrokers attend the session and all report:
- Traded securities –prices, volumes and securities
- Buying orders outstanding positions, price, volumes and securities
- Selling orders outstanding positions, price, volumes and securities
- RSE (Rwanda stock exchange) compiles market report and distributes to the market and Public through the media.

- On settlement day, the CSD (Central Securities Depository) clears the trades for settlement of securities against funds between stockbrokers and the change of ownership takes place at T+2 (trade date plus two days). The Central Securities Depository is under the Central Bank of Rwanda.

Exercise 3

After secondary education, Mugisha saved some money. Now he is planning to invest it into capital markets. But since his company has made a lot of money, it wants to make the investment as quickly as possible.

- a. You are selected to be part of the planning board, which guide would you give them on how to invest in capital markets both at Primary and secondary capital market transaction level.
- b. Which assurance would you give to the company's top management that they will be protected?

c) Procedure to join Rwanda stock exchange

i. Requirements and process to join the Rwanda stock exchange

It is mandatory to open a Central Securities Depository (CSD) account in order to buy or sell shares of companies listed in Rwanda Stock Exchange. The Central Exchange Depository System can be compared to a bank where the records of all shareholding of listed companies are kept. It is database where investors can open accounts called Central Exchange Depository or Central Securities Depository (CSD) and debit them with shares/bonds for the purpose of trading.

The Process of Opening a CSD Account is the following:

- You will need to identify the stockbroker of choice
- Provide two (2) recent passport size photographs
- Provide your original national identity card or passport together with a photocopy.
- If you are a company, you will need to provide an original certificate of incorporation together with a photocopy.
- If you are an organization registered in any other way e.g. Society, you will need to provide the original certificate of registration and photocopy.
- You will hand in sign the form in presence of your Stockbroker
- You will be left with the duplicate of account opening form your records.
- Your Stockbroker will provide you with your own CSD account number, to be kept confidential.
- You are free to open several CSD account with different stockbrokers.

- You can migrate from one broker to another simply by completing and signing the exchange transfer form. This form is available from your broker and must be signed by your current stockbroker and your new stockbroker.

ii. Trading operations

Rwanda Stock Exchange secondary trading is conducted through a dual process. Members trade in an open outcry trading session which is conducted at the RSE Secretariat through and over the counter market the following business day, where a member is allowed to buy or sell directly to clients in their offices. Equally, members are allowed to transact with other members either face to face via any other way of communication. During the designated trading floor sessions at the RSE secretariat, all members must report all their transactions that they conducted outside the official trading session.



Application activity 3.4

Muhizi is a famous farmer known to be exemplary in Gakenke District. He always receives visitors coming to learn from him how to invest in agriculture, especially in coffee and banana farming. Muhizi is married and has 3 children. It is now over 5 years when Muhizi started struggling searching for another business in which he can invest and secure a brighter future and prepare the good heritage for his children. Currently, he has been informed that there is a capital market in Rwanda. Muhizi is very interested and would like to invest in this new business.

Required:

- a. Identify institutions and players who contribute in the good running of capital market business.
- b. Examine the contribution of each player in the process of investing in capital market.
- c. What will be the advantages for Muhizi to invest in capital market?



Skills Lab 3

Based on the knowledge acquired on financial institutions,

- a. Explain the banking and non-banking institution you intend to operate with while handling the activities of your Back-Home Business (BHB)
- b. Create a plan on how you intend to invest in the financial markets




End of unit assessment

1. Distinguish between banking financial institutions and non-banking financial institutions.
2. Explain what might happen in the economy if there were no financial institutions.
3. Assess the role of National Bank of Rwanda in the regulation of banking system.
4. Analyse the role of a microfinance institution in the development of the country.
5. Differentiate between Rwanda Stock Exchange and Capital market authority.
6. Jacqueline is a citizen from United States of America. She is looking to make investment in Bonds with Rwanda Stock Exchange (RSE).
 - i. Evaluate the impact of Jacqueline's investment on Rwanda's financial sector.
 - ii. How is Jacqueline investment protected against events that can happen?
 - iii. Why do you think you can advise Jacqueline to invest in Bonds?
7. Discuss how a vibrant and dynamic financial sector in Rwanda can contribute to the socio-economic development.

UNIT 4 HUMAN RESOURCE MANAGEMENT



Figure 4.1. A description of Human Resource Management in a company.

 **Key unit competence:** To be able to manage human resources for an organization or enterprise



Introductory activity

In a school community, there are various activities that are going on. Some are done by machines, but still, they are operated by people. From the classroom to the school gate, we see workers, their supervisors, and managers. Each employee has someone he or she is answerable to. Again, in our communities, we have seen or heard of companies or organizations with many workers. These workers work well because there is a department responsible for them.

Questions:

- Mention examples of the workers at school?
- How do these workers come to school?
- Is there somebody responsible for these workers? Who is that person?
- Which department do you think is in charge of managing the workers at a workplace?
- What do you think are the functions of that department?
- What happens at school when there are conflicts among workers? Who handles such conflicts?

4.1 Human resource management

Learning Activity 4.1



Figure 1: Human resource management

Study the figure 1 above, showing some of the activities done by a human resource department and answer the following questions.

From the illustration,

- What do you think the term resource means?
- Why are workers/employees of a business referred to as human resource?
- What is a human resource department?
- What are the main activities done by the human resource department illustrated above?
- What do you understand by following terms?
 - Human resource
 - Human resource management
 - Human resource planning
- What qualities do you think a person in charge of human resource management should possess?
- What are the main functions of the human resource management department?

4.1.1 Meaning of key concepts

While a company usually has many different kinds of assets/resources (for example workers, capital, equipment, supplies, or facilities), people are its most significant asset/resource.

1. Human Resource (HR)

A human resource is a single person or employee within an organization and part of the overall personnel or workforce of that company.

A human resource is one person within a company's overall workforce, with each person lending their skills and talents to the organization that helps in its success.

Any person willing to trade their labor, knowledge, or time for compensation in an effort to improve the organization is a human resource.

2. Human resource planning (HRP)

This is defined as the process of assessing organization's human resource needs in light of organization goals and making plans to ensure that a competent and stable work force is employed.

HRP includes estimation of how many qualified people are necessary to carry out the assigned activities to ensure that personnel supply equals to personnel demand.

3. Human resource management (HRM)

Human Resource Management is that field of management which has to do with planning, organizing and controlling various operative functions of procuring, developing, maintaining and utilizing a work force.

4.1.2 Qualities of the human resource manager

INTEGRITY	ETHICS	SELF-DISCIPLINE	COMMUNICATION
EMPATHY	PROBLEM SOLVER	CREATIVE	EXPERIENCED
STRATEGIC THINKER	TECHNOLOGICALLY UPDATED	MULTI-TASKING	LEGAL KNOWLEDGE
INTERPERSONAL SKILLS	NEGOTIATING SKILLS	INFLUENCING PERSONALITY	GOOD AT DATA INTERPRETATION

Human Resources managers are responsible for ensuring that the business runs smoothly and efficiently and that all the employees are happy and productive. To be able to do this, a human resource manager must possess certain qualities including:

- **Integrity:** A HR manager must be honest and ethical in all their dealings with employees, employers, and other stakeholders. They must be able to maintain confidentiality and trust, and also make difficult decisions that are in the business best interests.
- **Ethics:** As HR manager, it is his/her responsibility to determine that the company complies with all relevant laws and regulations. He/she also ensure that the employees are treated fairly and ethically.
- **Self-Discipline:** It is the ability to stay focused and organized under pressure and challenges. A HR manager who is self-disciplined can maintain a high level of productivity, even when working under difficult circumstances.
- **Communication:** HR managers must be able to communicate with employees at all levels of an organization, as well as with external stakeholders such as government agencies and other businesses. They must clearly articulate the organization's policies and procedures and explain them to employees in a comprehensive manner. Additionally, HR managers must be able to listen carefully to employee's concerns and feedback and take action accordingly.
- **Empathy:** Empathy allows HR managers to form all aspects of every issue and better understand employees' needs and concerns. Empathy is a significant quality in managing conflict. By empathizing with both sides, HR managers are better equipped to find solutions that satisfy everyone involved. Empathy is a key ingredient in building strong relationships with employees.
- **Problem Solving:** When it comes to managing a corporate environment, HR managers must be able to solve problems efficiently and effectively. To be able to do this, HR manager must communicate clearly and concisely with employees, management, and other stakeholders, resolve conflicts quickly and efficiently; make decisions quickly and confidently, and is flexible and adaptable to change.
- **Strategic Thinking:** The HR manager must be a strategic thinker to be successful. He/she must be able to see the big picture and develop long-term plans. He/she should think creatively and come up with ingenious solutions to problems.
- **Technologically Updated:** The ever-changing landscape of technology can be a difficult one to keep up with, especially for those in HR. A good

HR manager should always look for new ways to update their systems and processes to make things run more smoothly.

- **Multi-Tasking:** One of the essential qualities of HR manager is the ability to multitask. With the ever-evolving workforce landscape, HR managers must juggle multiple tasks simultaneously. They need to be able to stay updated with the changes and trends in the labour market while also managing employee relations, benefits, and payroll.
- **Legal Knowledge:** The legal side of human resources is also quite active. A good HR manager must have a strong understanding of employment law. They should know how to handle difficult situations such as termination, performance issues and discrimination complaints.
- **Interpersonal Skills:** HR managers must be able to build relationships with employees, resolve conflict, and manage difficult conversations. They need to understand employee needs and concerns and find ways to address them. They must identify the root cause of conflicts and find solutions satisfying all parties involved. They must have tough conversations with employees about performance or conduct issues without being confrontational or punitive.
- **Negotiating Skills:** The ability to negotiate effectively can mean the difference between getting the resources you need to support the team and not being able to deliver what you promised. A Human Resource manager must be able to read people and understand their motivations, build trust and rapport quickly, stay calm under pressure and being persuasive without being pushy
- **Intelligence:** Human Resource management requires a high degree of analytical ability before making any decision. Good judgment, intellectual honesty and keen perception are also desirable qualities of a Human Resource manager.
- **Highly motivated:** Not only should a manager be self- motivated, but also, he/she should have qualities to motivate subordinates. A Human Resource manager must know how to activate subordinates' skills, competencies and talents for better performance.
- **Emotional stability:** A Human Resource manager should have high level of emotional stability. He/she should be consistent in action and refrain from anger. He should be well-adjusted and have no anti-social attitudes. He/she must be objective in his/her approach. Objectivity implies doing things based on relevant facts and information. He/she must assess situations without any bias and prejudice. If the manager is involved emotionally in a problem, it becomes quite difficult to see the reality.

- **Leadership skills:** A Human Resource manager is the bridge between employees and organization. Hence, leadership skills such as ability to understand employees and their needs, delegate tasks, visualize the bigger picture and remain aligned to the vision of the organization are crucial.
- **Human relations quality:** A Human Resource manager should have adequate knowledge of human relations, that is, how to interact with human beings. Since he/she has to deal with people inside and outside organization, he/she must understand their nature and way of behaving. Within an organization, he/she has to develop employees and get their voluntary cooperation for effective performance. Outside of the organization, he/she has to interact with various agencies.

4.1.3 Functions of the human resource manager

Behind every successful organisation is an ever-hustling HR team. It is an integral part of any organisation and acts as a bridge between employees and the organisation.

The functions of human resource management extend way beyond just hiring and payroll processing. From basic HR functions to making a strategic decision, HR management includes every task that affects the workforce of an organization.

The primary function of human resource management is to encourage employees towards achieving organizational objectives. The basic HR functions can be broadly divided into two categories which are; Operative Functions and Managerial Functions.

a) Managerial Functions of HRM

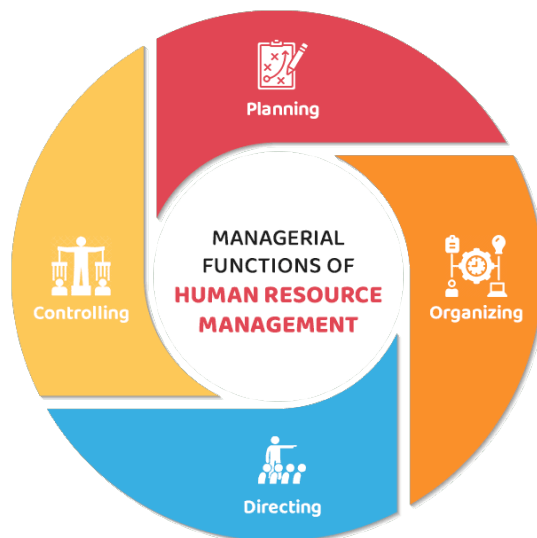


Figure 4. 2: Managerial functions of HRM

▪ **Planning**

Planning is the first and foremost managerial function of HRM. The importance of human resource planning involves determining the ways to achieve higher productivity. At the planning stage, leaders in a company also determine the requirement of resources across different organizations. In brief, HRM planning is fundamental to recruitment, retention & other skills required achieving company objectives.

▪ **Organising**

After establishing the objective and setting the plan, managers now jump to the second stage of managerial functions. The secondary function of HRM is to make available all possible resources to carry out multiple operations. The functions of HR managers include setting a framework of operative tasks by dividing the activities into functions and positions. They also assign activities as per the groups, delegate authority and responsibility as per the task.

▪ **Directing**

Implementation of a strategy depends on how convinced or motivated the employees are. Therefore, the third managerial function involved encouraging and directing people at work so that they are aligned with the organizational goal. Human resource management functions help in keeping more employees motivated by taking care of their career planning and monetary needs.

▪ **Controlling**

The last function of HRM is all about regulating the activities according to the plan. The managers now can observe and chalk out the progress as per the set standards. Further, they can also figure out deviations, evaluate and control the department wise progress with respect to operative functions and take necessary actions.

b) Operative Functions of HRM



Figure 4.3 operative functions of HRM

The functions of the human resource department performed at the mid-level are known as the operative functions. Operative functions of human resource management are directed towards the execution of plans and strategies designed by the senior managers of a company. Operative Functions of HRM includes the following:

- **Hiring Talent:** One of the primary functions of the human resources department is to hire people who are a perfect fit for the organization. Along with quick and effective hiring, the HR team also ensures smooth on boarding.
- **Orientation:** Human resources managers ensure that legal formalities are effectively completed from every employee’s side. After that, they introduce them to the company policies, principles and working culture.
- **Training and Development:** The working needs of every company differ from one another. Employees are provided with adequate training so that they are on track with the team’s requirements.
- **Employee Retention:** The HR team ensures that employees stay productive at work and deliver their best performance. They try to develop a culture of work and fun.
- **Feedback and Performance Appraisal:** Human resource management team creates a systematic process to improve productivity and work efficiency. They create a flow where employees receive

feedback from senior managers at regular intervals.

- **Provide Actionable Insights:** HR insights help the management drive important metrics for employee engagement. Performance data, employee benefits, their skills, claims, company turnover and other vital statistics can help an organisation improve its work culture and stay closer to achieving goals & objectives.



Application activity 4.1

Read the scenario below and answer questions that follow.

Chris is a sales representative for a company in the city centre. Chris has concerns about her employee benefits and enrolment form.

Lately Chris and another employee had conflicts regarding who was supposed to perform certain tasks given by the manager.

Questions:

- a) Which kind of resource is Chris to the company? Briefly explain
- b) Which department is responsible for Chris as a resource in the company?
- c) Who can Chris contact for assistance regarding her concerns?
- d) What qualities should the HRM apply in order to enable him/her resolve the conflict between Chris and her team member?
- e) Under which category of HRM function are the above concerns in (c) and (d) addressed? Explain your answer.

4.2 Recruitment process in an organization



Learning Activity 4.2

Think of any time that a worker was needed somewhere for a job. Or a time you participated in recruiting a worker for a given activity. Or a time you applied for a job anywhere. Or you imagine you are to recruit somebody to help you with home chores.

- a. What was the job or the position?
- b. What would you do or was done before the actual recruitment of the worker?
- c. What steps or process was followed during the recruitment process?
- d. How do you differentiate recruitment from recruitment process?

4.2.1 Recruitment process

Recruitment can be considered the principal function of the Human resource department.

It is a process that includes sourcing, screening, and shortlisting of capable employees for the job position.

It refers to the process of identifying the staffing need in an enterprise and then filling it.

The whole process includes identifying, attracting, interviewing, selecting, and onboarding the right candidates for the organization.

Every organization follows its own recruitment process, but there are some basic steps that are followed by most organizations, which are explained below:

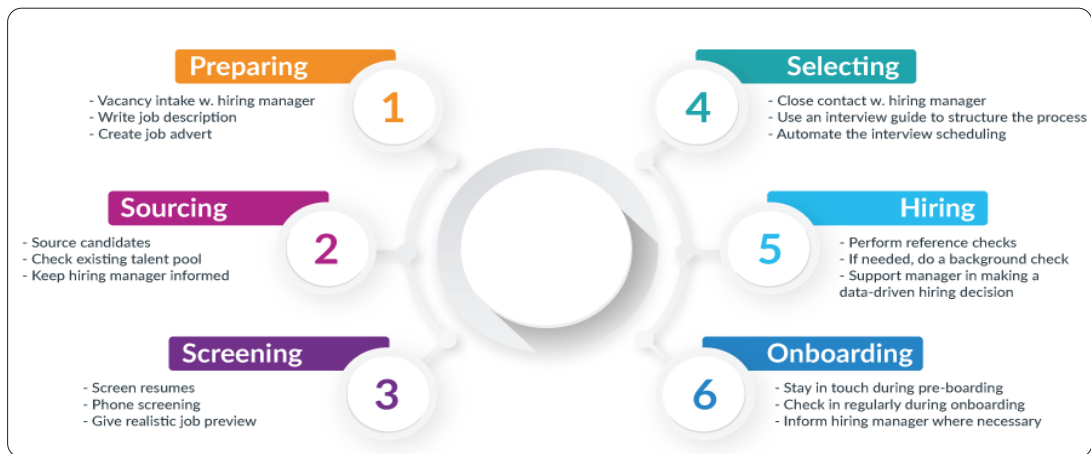


Figure 3: Recruitment Process

1. Identify the recruitment needs through job analysis

Before commencing a recruitment process, all vacancies need to be identified with whole details such as; the position is required or not, full-time or part-time employees are required, skills, knowledge and qualifications needed to perform it etc.

2. Writing or creating a right job description and job specification

The next step is making a job description disclosing the job-related details like designation, location, duties to be performed and required experience (the job specification having information regarding the skills, qualification, the area of expertise, etc).

3. Advertisement for open job vacancies

A job vacancy is advertised through newspapers, brochures, job portals, consultancies, etc. It ensures that the maximum number of relevant candidates can apply for the job.

4. Screening of job applications

After receiving the resume from the interested applicants, the next step is to arrange all the resumes according to priority and relevance. Ensure you read carefully through each application and assess each applicant in relation to the job-description and job specification

5. Initial short- listing of the candidates

Short-listing is the process of deciding which applicants should be followed up with an interview and which applicants can be immediately ruled out. It is not possible to interview every applicant. So, the organization has to sort out best-possible candidates from the applicants' pool.

6. Arrange interviews

Now it's time to fix the date, venue and interviewers for interviewing. Then, the chosen candidates will be contacted through a call, message, mail or letter for the interview.

7. Conducting interview and decision making

The last step is to conduct interviews with the best-possible candidates. Here the interviewer tries to find out the strong and weak point of a candidate so as to choose the best candidate. After completing all the interviews, the HR-department decides who will be offered the job.

8. Hiring

Hiring includes salary negotiation and issuing offer letters. HR plays a prominent role here in satisfying the candidate by negotiating the salary, benefits, and in convincing him/her to join the company. The offer letter, which is a formal document entailing the conditions of a job is sent to the candidates selected for employment.

9. Feedback

It would be better to give feedback to the rejected candidates. These candidates are always interested to know the reasons behind the rejection. If feedback is provided, those candidates will be satisfied and may come up for the next time

10. Joining & on-boarding

This is a very delicate phase of the recruitment process. The success of all the recruitment efforts so far hinges on this phase.

It includes paperwork, and other formalities, such as induction, introduction to team members, orientation, and training.

The most important goal of this phase is to make the employee feel welcome and to make sure he/she settles in comfortably with the culture of the workplace



Application activity 4.2

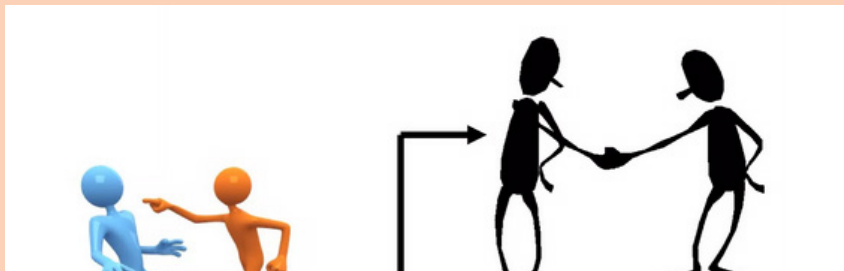
Read the scenario below and answer questions that follow.

Suppose you are a human resource manager in the business club and currently the club is involved in producing soap. One of the workers in the production department is complaining about being overloaded. The workers say the club should employ another person to help with the work.

Required:

As an HRM, prepare a plan document detailing the process that will guide you while recruiting the worker.

Learning Activity 4.3



Conflict Management

In the workplace, you find people of varying personalities, beliefs, values, and attitudes. Due to these disparities in personality, conflicts will often occur at the place of work. Unnecessary reporting and false accusations are the most common. Rumour-mongering, fights, and not wishing one another well are the order of the day. Cheap popularity has inflicted pain on many in various workplaces. Similar faculty fighting and pulling ropes is a common phenomenon. All these can be faced, and require proper conflict management. How to handle or preventing them is what is very important.

4.3 Conflicts management and resolution.

Questions:

- a) What do you think the term 'conflict' means?
- b) Mention the causes of conflict at work as highlighted in the above the paragraph.
- c) What do you understand by the term 'conflict management' mean?
- d) How can such situations/conflicts be handled or managed at work?
- e) What steps should be followed in order to manage conflicts?

4.3.1 Meaning and Causes of conflict in organization

a) Conflict

Conflict refers to a misunderstanding between two or more people over a certain ideology.

A conflict arises when individuals have different opinions, thought processes, attitudes, interests, needs and find it difficult to adjust with each other.

b) Workplace conflicts

Workplace conflict includes any type of conflict which takes place within a workplace or among workers and/or managers, potentially including conflict between employees out of work hours.

Workplace conflict occurs when there's a disagreement amongst employees due to opposing interests, personalities, beliefs, or ideas. Conflict in the workplace is natural and bound to occur when you have people of different backgrounds and perspectives working side-by-side.

c) Conflict management

Conflict management is the practice of being able to identify and handle conflicts sensibly, fairly, and efficiently.

Conflict Management involves the steps undertaken to prevent the conflict at the right time and also helps to resolve it in an effective and smooth manner.

Causes of conflict in organization

Every employee has needs and certain expectations at work, and conflict could arise in the workplace when people feel that their needs are not being met or are being ignored.

Major causes of workplace conflicts

- a. **Personality clashes:** The 'personality mix' within a team can be upset when a new member of staff joins or if two colleagues suddenly fall out. Individuals may also respond to difficult or challenging situations in an unhelpful or unproductive way.
- b. **Unrealistic needs and expectations:** Conflict at work can occur when employers ignore the needs of employees or set unrealistic expectations. For example, arranging hours that make it difficult for employees to carry out childcare responsibilities.
- c. **Business values:** Most people have very clear ideas about what they think is fair, and the organisation's procedures and policies must reflect this. For example, giving someone a fair hearing or explaining the reasoning behind a decision.
- d. **Unresolved workplace issues:** For example, an employee might ask to be moved to another team because of their manager's 'aggressive' leadership style. However, the employee may have other reasons - for example, they may blame their manager for a lack of training or career progression.
- e. **Increase in workload:** Sometimes workplace conflict happens when people feel they are being pushed too hard and resentment sets in if they feel their workload is unmanageable.
- f. **Poor communication,** including misunderstood remarks and comments taken out of context
- g. **Differences over work methods** or goals or differences in perspectives attributable to age, sex or upbringing
- h. **Competing job duties** or poor implementation of a job description for example, placing a non-supervisory employee in an unofficial position of "supervising" another employee.

4.3.2 Types of conflict management styles/methods at workplace

Different people use different methods to resolve conflict, depending on their personalities and preferences. The five most common strategies, known as the (Kenneth) Thomas-(Ralph) Kilmann model, used to resolve conflicts in the workplace include:



Figure 4.5: Styles of conflict management

◆ **Avoiding**

This method involves simply ignoring that there may be a conflict. People tend to avoid conflict when they don't want to engage in it. Avoiding allows them to ignore that there is a problem.

◆ **Competing**

Competing is an uncooperative, overly assertive method used by people who insist on winning the dispute at all costs. It's known as a win-lose strategy. This method is not often identified as bringing satisfactory resolutions, as it doesn't allow for collaborative problem-solving.

◆ **Accommodating**

This is also known as smoothing, involves one party acquiescing (accepting without hesitation), giving the opposing party exactly what it needs to resolve the problem. This method allows you to resolve a problem in the short-term while working toward a long-term solution.

◆ **Collaborating**

Like the compromising method, collaboration involves working with the other party to find a mutually agreeable solution to a problem. It's known as a win-win strategy. For example, a salesperson and client may work together to negotiate contract terms until both parties find it agreeable.

▪ **Compromising**

This strategy, also known as reconciling, seeks a mutual agreement to settle a conflict. It's known as a lose-lose strategy since both parties willingly forfeit some of their needs in the interest of reaching an agreement.

4.3.3 Steps of conflict management handling.



Figure 6: Steps to conflict management

Whether it's a conflict with a co-worker or disagreement with a supervisor, the workplace is fraught with conflicts, disputes, and disagreements that have to be ironed out. Much as we try to avoid conflict or even ignore those that exist, at some point everyone will need to employ some kind of conflict resolution skills to cope with workplace disagreements.

The following are some steps that you can use, no matter where you sit on the workplace position, to resolve workplace disagreements -

1. Set a discussion time

The first step towards settling a workplace conflict is to simply set up a time and place to discuss the issue. Without getting too much into the nature of the conflict, or who you think might be at fault, you will want to consider who is involved in or affected by the conflict, and get them to agree to a time to discuss how the entire team can work together towards a more positive environment.

2. Invite a third party

When you have a specific conflict with another co-worker, discussions or conversations can quickly devolve into a "blame game" or "he said, she said" type of back and forth. That is where a third party can help ease tensions, and

make both of you see the other side of the equation. Whether it's a co-worker, manager, or HR staff, invite a third party to the meeting that is seen as respected and neutral by both of you, and who preferable has experience resolving similar conflicts and is committed to positive outcomes.

3. Figure out the main issue

In many cases, what people think that workplace conflicts are about is quite different than the real issue at stake. So, when you discuss the issue, make sure to focus on asking questions and pin down what needs are not being met on all sides involved in the conflict. Obtain as much information as possible, and think deeply and objectively about the situation to make sure you're addressing the core issues and not just superficial ones.

4. Establish common goals

Once you have gotten down to the core problems that you and all other parties are facing, you'll need to collaborate to establish common goals in order to move past the conflict. In this stage, all sides will come to a consensus about how the conflict should be resolved. This step is critical because that when people know they are working towards a mutual goal, they are more likely to be committed to taking the necessary actions to reach that goal. Find things in common that both sides would like to see happen, and develop a simple action plan to make those happen.

5. Discuss how to meet goals

Agreeing on goals, deliverables, and an overall starting point for conflict resolution is not the end of the process (far from it, in fact). Next, you will need to dig deep and discuss how precisely you will meet those goals, as well as be honest about what barriers or challenges that all parties might face along the way. This builds on step two, and involves a lot of listening, learning about the other side, and brainstorming potential solutions until you both feel that all options have been exhausted or laid on the table.

6. Agree on a way forward

After you have effectively hashed out the goals you have mutually agreed to achieve, you will want to come to consensus on how you both see the conflict being resolved in the end. Again, focus on remedying the core problem, as often people tend to focus on fixing surface level issues only to have the conflict arise again because the root has not been addressed.

7. Determine resolution roles

Finally, make sure to drill down specifically the roles - and corresponding responsibilities - each party will play in creating a long term solution to the conflict. Make sure that all parties express aloud to each other what their commitments are, why they think this will work, and what responsibilities they have in making it happen.



Application activity 4.3

GBK limited is one of the companies where employees are not happy. Abuse by the supervisors has left nothing else but fights. The production has gone down, and the company's cash flow is diminishing day by day. Some other conflicts are kept secretively from the management. While some are masterminded by the managers.



Figure 7: Unhappy group of employees

- Identify the cause of the conflicts faced at the place of work
- Which style of conflict management can be applied to resolve the conflicts identified?
- Describe how you will apply the steps in conflict management to resolve the above disputes



Skills Lab 4

Your back home business has expanded and you realized it might require more workers to support you in its daily activities. Besides this you noticed that some funds went missing and all the workers are denying responsibility.

Required:

- Write a plan to recruit workers for your BHB
- Make a plan on how you will solve the problem

UNIT 5 | BUSINESS ETHICS



Key unit competence: To be able to describe the benefits of business ethics at the workplace



Introductory activity

Think about the paragraph below and answer the questions that follow.

“If you plant a good seed in bad soil, it will affect how it roots and grows.” In other words, the initial hard work of cultivating the soil coupled with close attention to light, water, and warmth would directly impact the quality and quantity of the future harvest.

Required:

- What do you understand from the above paragraph mean?
- What is the relationship between the paragraph and business ethics?
- How does it relate to real life?
- Describe situations at the workplace that may relate with the paragraph in the accounting profession.
- What other sayings or proverbs do you know that have the same meaning?

5.1 Importance of Business Ethics

Learning Activity 5.1



Read the Case Study below depicting certain business behaviours at a workplace and answer questions that follow.

Case study: The Importance of Business ethics

Niyo is the proprietor of NIYO Business Enterprise operating in the one of the towns in Rwanda. She loves her work and the customers love her as well. She is ever early at the job and leaves at the right time. Naturally she is an honest person. She treats clients and customers fairly and honestly. She never lies to potential clients or providing them with misleading information. She always tells them the true price of a service or product.

Niyo says she is very proud of her business and employees. She says they know how to manage their time well. They prioritize tasks, meet deadlines, and get things done. They are punctual and arrive at work on time or earlier. They are rarely, if ever, late for their shift. They work well within teams and never hold up the completion of projects. This has also been evidenced by the feedback she gets from her clients. Her employees are happy with their jobs and ensure that all of their tasks are completed. They prioritize their jobs and make sure to finish their work obligations before committing to social activities with their friends outside of work. She says you cannot see them scrolling through their social media feeds or constantly checking their mobile phones. Her employees work as a team which has improved her business image in the community not to mention increased productivity and reduced overall business costs

Required:

From the case study,

- Name the positive behaviour exhibited by Niyo at workplace
- Name some positive behaviour exhibited by the employees at the workplace
- What term would you give the behaviour exhibited by Niyo and the employees in the business?
- What do you understand by the term 'Ethics'?
- What do you think the term 'Business Ethics' means?
- What do you think the term 'workplace ethics' means?
- Why do you think it is good to behave in such a way to the business?

- h) What do you think are the effects of such ethical behaviour to;
 - i) NIYO Business Enterprise,
 - ii) Niyo,
 - iii) the employees
- d) Why do you think ethics are important in business operations?

5.1.1 Meaning of the concepts

a) Ethics

Ethics are moral principles that govern a person's behaviour or the conducting of an activity.

b) Business Ethics

Business ethics is the moral code of conduct that guides the actions and operations of an organization and the employees working in it. Business ethics aims to promote moral and ethical behaviour in the activities of organizations.

c) Workplace Ethics

Workplace ethics are the set of values, moral principles, and standards that need to be followed by both employers and employees in the workplace.

5.1.2 Importance of Ethics in Business Operations

In a business setting, ethical behaviour applies to any employee, team lead or supervisor. They should display behaviour that is honest and fair in their relationships with co-workers and their clients. A high ethical standard extends to customers as well. A reputation for positive ethical behaviour entices more potential clients, customers and partners to work with you. It also builds customer loyalty over time, creating a customer base that is likely to refer the business to others.

There are tangible and intangible benefits to maintaining ethical practices in the workplace, including:

◆ Improved employee retention

Strong business ethics often encourage managers to show appreciation for an employee's hard work. As a result, team members may be more loyal to the company and strive to be more productive.

◆ Stronger collaboration

Team members who practice business ethics have respect for one another and work well together. This camaraderie not only fosters a pleasant work environment but also helps with team collaboration and productivity.

◆ **More effective leadership**

When a manager follows business ethics, they're more likely to treat employees well. As a result, teams are more inclined to follow their lead. This minimizes discipline issues and teams' trust in managers and supervisors when tough decisions need to be made.

◆ **Increased professional value**

When you have a positive attitude toward the work and those you work with, you can increase the quality of the work. It also increases the value to the team and the company as a whole.

◆ **Gaining more customers**

Consumers are more likely to continually support businesses that care about the impact they make. Being positive influences on communities and maintaining ethical standards allows businesses to gain new customers and maintain existing ones. Existing customers are also more likely to promote the company by word of mouth.

◆ **Recruiting from a wider candidate group**

Professionals are increasingly searching for careers with businesses that are ethically and socially responsible.

- Promoting a strong code of ethics that includes social responsibility can help companies attract and retain more candidates.

◆ **Getting an advantage over similar businesses**

Businesses that promote ethics often acquire more customers than businesses in the same industry. Organizations can see advantages over their competition by considering their impact on the community.

◆ **Creating a positive work culture**

When employees agree with a company's code of ethics and social responsibility, they are more likely to feel motivated and support the organization.

- Employers who encourage employees to take action in their community also gain more approval and commitment.



Application activity 5.1

1. Using the knowledge of ethics and business ethics, read the following statements and choose which one ethical or unethical business behaviour by putting an (X)

Behaviour	Ethical	Unethical
Always arrives to work and finishes his projects on time		
Is happy to do overtime when appropriate		
Often arrives at work late and leaves early		
An employee claiming to be meeting a client at the end of the workday when instead he/she is leaving early to catch a football		
Employees bullying or harassing potential clients		
Employees engaging in sexual harassment, or bullying other workers,		
Employees appreciating the work that others employees actually performed		
A business correctly declaring taxes to RRA		
Often scrolling through social media during work hours		

2. As a senior six-year student with knowledge and skills about the importance of ethics and business ethics, refer to either the classroom, home or school and make report about the ethical behaviour you observe between the members which you will later on share with the classmates, family or head of school.

The report should include:

- The place observed
- The kind of behaviour (ethical or unethical) observed with examples
- The effects (positive or negative) of the behaviour observed
- The importance of ethics in the place observed

5.2 Business ethics towards various stakeholders

Learning Activity 5.2



Referring to the case study of Urwibutso Enterprise below and answer questions that follow:

Case study:

Urwibutso Enterprise (adapted from: <http://www.sweetpotatoknowledge.org/wp-content/uploads/2016/01/Urwibutso.pdf>)

Urwibutso Enterprise was started in 1983 by a young and dynamic Mr. SINA Gérard with a single employee. Today the local food processing company employs 421 people and maintains contracts with 3,000 farmers. It is one of the biggest businesses in its industry in Rwanda. The business started as a small Mandazi (“Doughnut”) shop located halfway between Kigali and Musanze. In 1993, the business expanded to begin production of a diversity of products. Today, it processes fruit juices, bread, yoghurt, grape and banana wines, flour, biscuits and highly recognized “Akabanga” hot chilli for local distribution and export to surrounding countries. Mr. SINA Gérard maintains high standards for the production of quality products.

Urwibutso is also a social enterprise, investing in the Nyirangarama community. Mr. SINA Gérard has established a primary and secondary school for 800 children of contracted farmers, has overseen the development of eco-tourism programs to attract tourists, provided savings programs and initiated a program to supply his farmers with livestock, free of cost. Urwibutso also employs 5 full-time agronomists to provide technical assistance on effective farming techniques.

Questions:

- a. Do you think Urwibutso Enterprise practices ethics in business? Explain your answer.
- b. By giving examples, briefly explain how Urwibutso Enterprise behave ethically towards:
 - i) Customers
 - ii) Employees
 - iii) Community/society
 - iv) Government
- e. Imagine you are a partner or shareholder in Urwibutso Enterprise, how would you want to be treated ethically?

5.2.1 Ethical behaviour towards customers



Figure 5.1: Ethics towards customers

Customer ethics are defined as a set of ethics that service providers follow to ensure that they treat their customers with respect.

Non-discrimination is one of these ethics that guarantees that every customer is treated with respect regardless of her age, religious or cultural background, race, sexual orientation, socioeconomic class or history with the company.

Customer ethics also include valuing the relationship with the customer over the sale and keeping meticulous records of all customer interactions to reduce the chance of employee errors causing problems for customers.

Businesses should act ethically towards customers in following ways:

1. Making sure customers get the best deal by honouring competitors' coupons.
2. Believing all customer claims, even those that seem exaggerated or fabricated.
3. Publishing information about how the company sources its materials.
4. Connecting all customer service callers directly to human representatives, rather than a robot-menu.
5. Rewarding loyal customers with discounts, price lock-ins and special promotions.
6. Resolving every customer problem that arises, even those that were not the company or its products' fault.
7. Tailoring the type of service each customer receives to his/her unique needs.
8. Discussing products and services in honest terms, rather than trying to upsell and oversell them.

9. Advertising honest promotions and prices and avoiding “bait and switch” advertising tactics.
10. Complying with consumer protection laws.
11. Thoroughly testing all products before they reach the market and issuing prompt recalls for every released product found to be defective.
12. Using customers’ names and terms like “sir” and “madam” when interacting with them.
13. Responding to all customer inquiries promptly.
14. Honestly assessing customers’ challenges and recommending the best solutions for them, rather than the solutions that will be the most profitable for the company.
15. Never sharing customers’ personal data without their consent.

5.2.2 Ethical Behaviours in the Workplace (Employees and Employers)



Figure 5.2: Workplace ethics

Examples of ethical behaviours in the workplace include:

◆ **Take care of company property**

You are likely to use tools, technology, equipment and supplies provided by the employer. These items are typically reserved for work use only. Follow any business ethics related to the use and maintenance of these items to ensure you are using company property respectfully.

◆ **Lawfulness**

Business ethics also includes abiding by legal regulations and obligations regarding their business activities like taxes, worker safety and employment and labor laws. Businesses that work within the boundaries of the legal system are more credible and honorable, which can establish a strong positive reputation as an employer that encourages high-quality candidates to apply for roles.

◆ **Use discretion with sensitive information**

Some workplaces and roles may interact with sensitive data or materials, which requires employees to practice discretion through careful organization, the use of passwords and other security measures.

◆ **Practice integrity**

Hold the work to a high standard of fairness, honesty and quality. You should be transparent about how well you are doing and areas you may be able to improve. Own up to the mistakes, and work to correct them as soon as possible.

◆ **Keep a high attendance**

The workplace may have an attendance and lateness policy to hold employees accountable for going to work and being on time. Showing up for work when you are expected demonstrates respect for the colleagues as well as the employer.

◆ **Respect co-workers and other office personnel**

You can communicate respect for the colleagues by treating them professionally and as you would like to be treated. Workplaces typically abide by anti-harassment laws established by the federal government.

◆ **Discuss issues with management**

There may be times when you face an ethical dilemma at work, and this particular type of issue may not be covered adequately in the employee handbook or the training on business ethics. For situations like this, you can consider discussing the issue with the supervisor, the human resources department or, if the company has one, an ethics officer.

◆ **Workplace Diversity**

A business might express fairness by placing a high importance on having a diverse workplace. Employing a diverse group of people gives the business the benefit of different perspectives and demonstrates that the company is serious about equality and treating all people with respect.

◆ Seek further ethics training

Should you need more guidance on ethical behavior at work, the company may offer further training via seminars or online courses. If you are required to take ethics training annually, be sure to do so.

5.2.3 Business ethics towards the Community/society



Figure 5.3: Business giving support to the community.

Business is expected to create wealth and employment, while society is expected to provide a conducive environment for the business to flourish. The value and ethical standards that a business adopts are the long-term assets of the organization.

There are a number of tasks that a business has to fulfill to the society to promote ethics which include:

- **Financial tasks** include laying down policies and guidelines for the proper functioning of the financial systems.
- **The environmental tasks.** With the perceptions of the consumers changing towards products that are harmful to the environment, businesses have to show their concern for the environment by producing environmentally friendly products.
- **Social task** include providing equal opportunity for all the members of the society by organizations and taking into consideration the basic human rights of an employee.
- Respecting the customs, beliefs and cultures of the community
- Protecting people's health
- Preservation of the environment

5.2.4 Business ethics towards the Government



Figure 5.4: Business support government initiatives and programs

Business should behave ethically towards the government by:

- Following the laws and regulations of the country.
- Declaring and paying all taxes honestly, regularly and on time.
- Avoid corrupting public servants.
- Making proper use of scarce resources.
- Assisting in solving national problems, like poverty, unemployment, unbalanced regional growth etc.
- Avoiding monopoly and concentration of economic power.

5.2.5 Business ethics towards the partners or shareholder



Figure 5.5: Ethics in business makes shareholders confident in their investment

Businesses need to protect the rights of shareholders to ensure the availability of sources of funds. Fair and equal treatment of all holders of common shares is one of the key ethical behaviour of a business towards shareholders by providing information regarding following rights of business owners:

- Maintaining and checking the books of accounts
- Paying dividends to shareholders
- Respecting their voting rights
- Listening to shareholders' complaints
- Respecting their right to receive dividends;
- Respecting their preemptive rights to purchase additionally placed shares;
- Respecting their right to obtain adequate information on a company's activities;
- Respecting their right to participate in the general shareholders meeting,
- Adequate disclosure in advance of all materials necessary to make informed decisions.
- Respecting their right to receive a proportionate share of a company's property, after payment of creditors, in the event of its liquidation.



Application activity 5.2

As a Senior six student with competences in business ethics, you plan to start a business after school. Based on the knowledge of ethics, you understand that for any business to be successful, it must behave in an ethical way towards all its stakeholders including customers, owners, government, society and its employees.

Required:

Briefly describe how you would ethically behave towards the following:

- a. customers,
- b. owners,
- c. government,
- d. society and
- e. employees



Skills Lab 5

You plan to implement your BHB of processing juice and you want the business to be a place where ethics and social responsibility are part and parcel of the business practices.

As a person with knowledge and skills on business ethics, develop a code of ethics and social responsibility towards:

- a) Customers
- b) Employees
- c) Society
- d) Government



End of unit assessment

Read and answer the questions below

- 1) Define the terms “ethics”, and “business ethics”
- 2) Describe how business should ethically behave towards;
 - i) Customers
 - ii) Employees
 - iii) The society
 - iv) The government
 - v) Shareholders
- 3) Describe the importance of ethics in business operations

UNIT 6

WORK SAFETY AND HEALTH



Key unit competence: To be able to apply standard health and safety practices and regulations at the workplace.



Introductory activity

Think about the proverb below and answer the questions that follow.

“Inyamaswa idakenga yicwa n’umututizi” (When not cautious, an animal can be killed by an ordinary tree cutter).

- What does the proverb mean?
- What is the relationship between the proverb and safety and health at work place?
- Describe examples of situations at the workplace that may relate with the proverb in the accounting Profession
- What are other proverbs do you know that have the same meaning?
- What should one do in order to avoid the situation portrayed by the proverb?

6.1 Safety and Health at work

Learning Activity 6.1



Study the figure below showing a workplace and answer questions that follow



Figure 1: Safety and Health at Workplace

Questions:

- Do you think the work place above is safe for work? Explain your answer.
- Do you think the workplace above provides a healthy environment for work? Explain your answer.
- What do you think the following terms means in relation to safety and health at the workplace?
 - Workplace safety
 - A healthy workplace
 - Sanitation
 - Personal hygiene
 - Workplace hygiene
- Why is it important to have a safe and healthy workplace?
- Mention any health habits that you observe at the work place (school)
- Why is it important to have good personal care and healthy habits at the workplace?
- Using the knowledge on hygiene and sanitation, give examples of personal hygiene and sanitation practices that can be practiced at:
 - Home
 - School/workplace
 - A healthy habit
 - Hygiene

6.1.1 Definition of concepts

Workplace safety refers to the limitation of elements that can cause harm, accidents, and other negative outcomes in the workplace. It represents a collection of policies, behaviours, and precautions that work to limit hazards, accidents, and other kinds of harm in a work environment.

A healthy workplace is one where workers and managers collaborate to continually improve the health, safety and wellbeing of all workers and by doing this, sustain the productivity of the business (World Health Organisation, 2009).

A healthy habit: is any behaviour that benefits physical, mental, and emotional health. These habits improve overall well-being and make you feel good.

Hygiene is the practice of keeping oneself and one's surroundings clean in order to prevent infection and disease and remain healthy and fit.

Sanitation is arrangements to protect the public health specially the provision of clean drinking water and proper disposal of sewage. Personal hygiene refers to maintaining cleanliness of one's body and clothing to preserve overall health and well-being.

Workplace hygiene refers to the standards of cleanliness that employers are expected to meet in ensuring that they provide a healthy working environment in which their staff can work, as well as clean and safe premises for members of the public to visit.

6.1.2 Importance of safety and health at workplace

A safe and healthy workplace not only protects workers from injury and illness, it can also:

- Improved health and wellbeing. The most significant and most obvious benefit of a healthy workplace is the improvement of the workforce's health and wellbeing.
- Greater productivity and performance. A business can increase productivity when employees are healthy and happy in the workplace, which results into an improvement in the performance of their employees as well as the quality of output
- Improved corporate image. When employees are satisfied with the safety and health of the workplace, it leads to an improvement in the organization's corporate image.
- It also attracts more clients. Employees in a healthy workplace are more productive, which results in higher quality output. This will attract customers and clients to the products and services of that business, bringing in higher profits.

- Increased job satisfaction. Seeing employees happy with the workplace is one of the significant benefits of a healthy workplace. When a workplace caters to the needs and wants of an employee, it reduces the turnover rates of the company
- Greater work development and learning opportunities. Employees feel appreciated when their work environment allows them to explore their capabilities and skills in their work.
- Improved employee morale. Having a healthy workplace helps employees feel safe, heard, and comfortable enough to freely work and express their creativity without feeling judged. A healthy workplace sees employees' happiness increase and motivation to continue working.
- Lower absenteeism rates. Businesses that take the time to cultivate a healthy workplace will see fewer health and sickness instances, lowering the number of absenteeism and tardiness.
- Increased employee engagement. A healthy workplace naturally increases employee engagement in the workforce, resulting in higher productivity rate, greater loyalty, better retention rates, and enhanced customer experiences.
- Lower turnover rate. Employees who are happy with their businesses work environment will be less likely to leave for another company. When turnover rates are low, it helps businesses lower costs associated with hiring new employees
- Lower workers' compensation premiums. Having a healthy workplace sees employees satisfied, motivated, and healthy. In effect, companies will see a reduction in claimed workers' compensation premiums.

6.1.3 Daily Positive health habits



Figure 6.1: Safety and health habits at work

Healthy habits include but not limited to eating well, exercising, getting enough rest and avoiding harmful substances, but also:

- Get enough sleep. A good sleep can improve the memory and concentration, boost the immune system, and help you cope with stress more easily.
- Manage stress. Stress can affect the mood and the physical health. It can cause anxiety, anger, and irritability as well as headaches, muscle pain, exhaustion, and sleeping problems.
- Find time to relax. Set aside time every day for self-care and relaxation. Make a routine for the self, so that relaxation becomes a daily ritual.
- Meditate once a day: Meditation may help you manage pain, reduce blood pressure, improve symptoms of depression and anxiety, and cope with daily stress.
- Maintaining a healthy social life. Whether it is volunteering, joining a club, or attending a movie, communal activities help improve mood and mental functioning by keeping the mind active and serotonin levels balanced.
- Maintain healthy eating habits: To get all the nutrition the human body needs, you must eat a balanced diet including dairy, grains, protein, fruits and vegetables, as well as fat.
- Get some exercise every day, even just a little. This will not only make you feel better but also make you look better. Try walking if you cannot afford another as it is a great exercise.
- General good safety habits at work
- Everyone helps keep the work environment tidy and organized
- Everyone is comfortable reporting unsafe working conditions up the chain of command
- Everyone who is required to wear PPE is wearing it the right way—and it fits properly
- Everyone knows where safety equipment is located
- Everyone who handles heavy objects uses proper lifting and carrying techniques
- Everyone know that their organization is committed to safety at the highest levels and can see posters in the break room or on the job site demonstrating this commitment
- Everyone knows where to go and what to do in an emergency
- Everyone is aware of hazardous chemicals in work area and knows where to find the Safety Data Sheets (SDSs)

6.1.4 Daily hygiene and sanitation practices

The need to maintain hygiene at your **workplace**



Figure 6.2: Hygiene and sanitation practices at workplace

Healthy hygiene and sanitation is very important for every workplace.

Below are some healthy hygiene and sanitation practices that can be practiced at the workplace:

- Provide staff with a written hygiene policy. Inform them of the intentions and expectations of a clean workplace.
- It is pivotal for a hygienic workplace to have a clean restroom well stocked with soap, toilet paper and hand towels.
- Provide items such as clean wipes, sanitizers, and tissues to help the staff maintain a clean and hygienic workspace.
- Make sure the workplace is regularly cleaned. This helps prevent the spread of infection

Before and after using the cooking supplies (including utensils) you should wash these with soap and water (preferably hot water).



Application activity 6.1

Using the knowledge and skills on hygiene and sanitation, make a weekly plan that you will follow in order to apply hygiene and sanitation practices either at home or work (school). In you include the practices you will apply and those you will avoid. Every day you will put a check/tick on the hygiene and sanitation practice applied or avoided.

Use the following template to make the plan			
No.	Practice	To apply	To avoid

At the end of the week you will assess the hygiene and sanitation practices by comparing the practices applied and those avoided. Which practices were you able to apply? Which practices did you manage to avoid?

6.2 Hazards in the workplace

Learning Activity 6.2



Figure 4: Unsafe workplace

Figure 4 above illustrates a workplace environment from one of the departments in the accounting section. Study the figure and answer the questions below.

- Is this a safe and healthy workplace?
- Name some of the things in the illustration that make the above workplace not safe or harmful to people working there.
- What do you think the term 'hazard' means?
- What do you think the term 'Workplace Hazard' means?
- Briefly explain what you understand by the following types of hazards as relates to safety and health at work
 - Hazards
 - Safety hazards
 - Chemical hazards
 - Biological hazards
 - Physical hazards,
 - Ergonomic hazards,
 - Workload hazards
- How can the workplace above be made safer? Suggest ways to eliminate the hazards identified
- Explain the acronym (SAFE), briefly describe the steps involved in preventing injuries or illness at the workplace.

6.2.1 Meaning of Hazards at the workplace

A hazard is any source of potential damage, harm or adverse health effects on something or someone. A hazard is the potential for harm or an adverse effect to for example, to people as health effects, to organizations as property or equipment losses, or to the environment.

Hazards in the workplace occur when the working environment can cause injury, illness or death. The hazards can result from many of the different aspects of the working environment world, including: equipment, dangerous materials, unsafe working practices and behaviour of people.

6.2.2 Types of hazards

Workplace hazards fall into six core types – safety, biological, physical, ergonomic, chemical and workload.



Figure 6.3 safety hazards

Safety hazards

Safety hazards can affect any employee, but these are more likely to affect those who work with machinery or on a construction site. Safety hazards include slips, trips and falls, operating dangerous machinery and electrical hazards

Biological hazards

Biological hazards are extremely dangerous. These include exposure to dangerous substances and diseases associated with working amongst animals, people, or infectious plant materials.

Physical hazards

Physical hazards can affect those who work in extreme weather conditions or in harmful environments. Workers that are exposed to continuous loud noise, radiation, sun rays and ultraviolet rays could be at risk.



Figure 6.4 Ergonomic hazards

Ergonomic hazards

Ergonomic hazards affect individuals whose work puts a strain on their body. Manual roles that require lifting or sitting for long periods can cause damage over time.

Chemical hazards

Chemical hazards mainly threaten employees whose roles expose them to dangerous liquids, solvents or flammable gases. Exposure to harmful chemicals can cause illness, skin irritation, breathing problems and, in extreme cases, death.

Workload hazards

Workload hazards include issues that could cause stress or strain, such as workload, violence or aggression. These hazards can be experienced in any job role.

6.2.3 Handling hazards in a workplace



Figure 6.5: Ways to make work safer

The best way to prevent injuries or illness in the workplace is to find the hazards that could cause injury or illness, and fix them.

The following four steps may be followed to prevent unsafe situations at the workplace using the acronym SAFE (Spot the Hazard Assess the Risk Fix the Problem Evaluate Results)

Spot the hazard

The first step in ensuring a safe workplace is to identify hazards. Hazards can be identified by:

- Asking workers and contractors in the workplace about any hazards they may have noticed
- Looking at the physical structure of the workplace: for example, stairs, desks, floor surfaces, exits, driveways
- Checking all machinery, appliances and vehicles used for work
- Examining how substances are stored, used and moved from one place to another
- Reviewing the injury records, including 'near misses' and
- Reviewing information from designers, manufacturers or suppliers of the equipment and substances in the workplace.

Assess the risk

A risk is the likelihood of a hazard causing injury, illness or damage to the health. So you need to work out which hazards are more serious than other and deal with those first.

Assess the risk associated with each hazard by determining:

- The potential impact of the hazard

- How severe could an injury or illness be?
- What's the worst possible damage the hazard could cause to someone's health?
- Would it require simple first aid only? Or cause permanent ill health or disability? Or could it kill?
- the likeliness of the hazard to cause someone harm
- Could it happen at any time or would it be a rare event?
- How often are workers exposed to the hazard?

Fix the problem

Remove the hazard completely from the workplace. Concentrate on the most urgent hazards without neglecting the simpler ones that could be easily and immediately fixed.

Hazards can be fixed by using the hierarchy of controls to remove or reduce risk in the workplace.

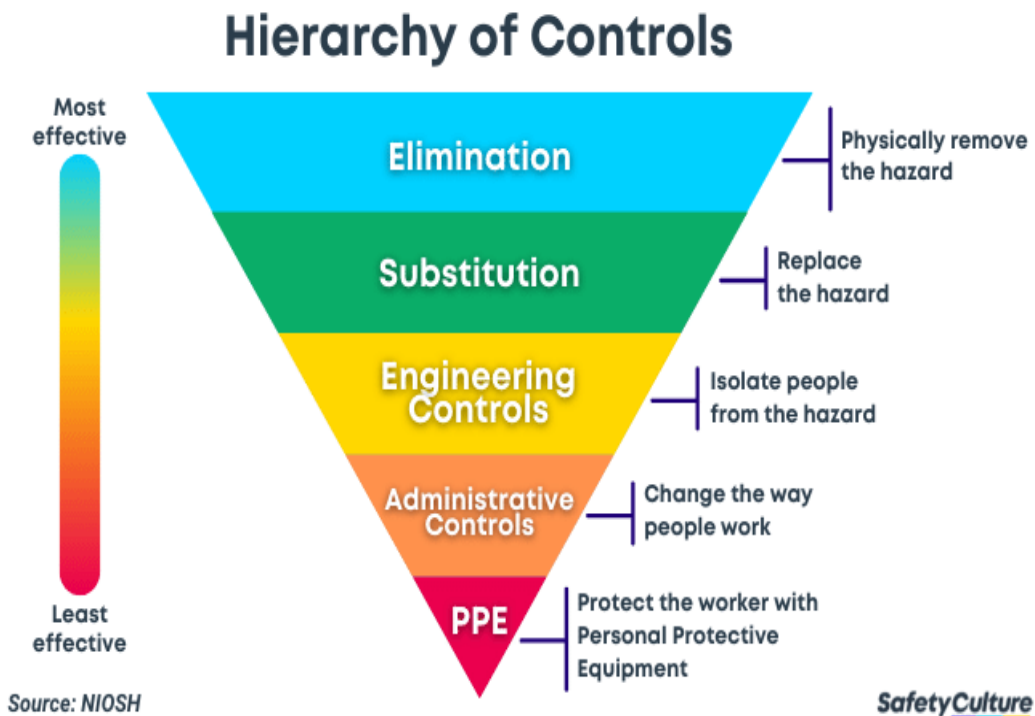


Figure 6.6: Hierarchy of controls of hazards

Eliminate the hazard

Remove it completely from the workplace. For example: repair damaged equipment. If this is not practical, then;

Substitute the hazard

Replace it with a safer alternative. For example: use a less toxic chemical; lift smaller packages. If this is not practical, then;

Isolate the hazard

Keep it away from workers as much as possible. For example: relocate photocopiers to separate, ventilated rooms; install barriers to restrict access to hazardous work areas. If this is not practical, then;

Use engineering controls

Adapt tools or equipment to reduce the risk. For example: place guards on dangerous parts of machinery; use a trolley for moving heavy loads. If this is not practical, then;

Use administrative controls

Change work practices and organisation. For example, rotate jobs to reduce the time spent on any single work task; train staff in safe work procedures; carry out routine maintenance of equipment. If this is not practical, then;

Use personal protective equipment (PPE)

For example: use hearing/eye protection equipment, hard hats, gloves and masks; train staff to use PPE correctly.

Evaluate results

- After fixing the problem, find out whether the changes have been effective.
- Get feedback from those affected by the changes and include them in any modifications to their workplace or work routines.
- Make sure the solution does not introduce new hazards.
- If the work process changes, or new equipment is introduced to a task, then the risk assessment must be reviewed.



Application activity 6.2



Figure 7: Safety and health at work

The illustration above shows some situations that may cause harm to workers or people at a workplace. Study the illustration and answer the questions below.

- Describe all the situations that can cause harm illustrated above
- Categorize the situations described above according to the types of hazards and suggest how the situation (hazard) can be managed by completing the table below

No.	Unsafe situation	Type of hazard	How to manage the situation

- Using the knowledge and skills of hazards at the workplace, identify all potential causes of harm at the school (workplace) and make a report of all the hazards identified which should include:

- All potential hazards identified
- Categories of the hazards identified
- Measures or strategies to manage or handle the hazard

6.3 Types of emergencies in a workplace

Learning Activity 6.2



Figure 8: Emergency at workplace

The figure above shows a situation at a workplace. Study the figure and answer questions that follow.

- What do you see in the figure?
- What do you think is happening in the workplace?
- How is such a situation called in terms of safety and health at the workplace?
- How can the situation illustrated above affect the workplace (people and organization)?
- Name any other situations that can occur and endangers employees, clients, or the public at the workplace
- What do you understand by the term 'workplace emergency'?
- What do you understand by the following types of emergencies as related to safety and health at work?
 - Natural emergencies
 - Civil emergencies
 - Work-related emergencies
- How can emergencies be responded to at the workplace?

6.3.1 Types of workplace emergencies

A **workplace emergency** is an unforeseen or unplanned situation that threatens the employees, customers, or the public; disrupts or shuts down the operations; or causes physical or environmental damage.


A **workplace emergency** is an event that occurs and endangers the employees, clients, or the public; or risks disrupting the workplace operations; or causes damage.

A **natural emergency** could occur as a result of flooding, severe weather such as hurricanes or tornadoes, or forest fires.

Work-related emergencies are caused by factors relating directly to the work conducted. Work-related emergencies could be things such as chemical spills, explosions, machinery malfunction, or dangerous gas releases.

Civil emergencies are emergencies that stem from civil factors. Civil factors could be things such as protests, strikes, or workplace violence or harassment, either employee-to-employee or client-based.

6.3.2 Responding to emergencies and staying healthy at work

Emergency	Response
Fire	<ul style="list-style-type: none"> – Pull nearest fire alarm. – Use stairwells to leave the building. – Do not re-enter building(s) until directed by emergency personnel. – Alert other people as you evacuate and provide assistance to others if necessary.
 Earthquakes	<ul style="list-style-type: none"> – STOP. Running is the most common cause of injury during an earthquake. – DROP. Make sure the head is not the tallest thing in the room. – COVER. Get under a desk or table to protect the self from falling objects. – HOLD. Whatever you are under, hold on tightly until the shaking stops. – After the shaking has stopped evacuate to a safe location, away from buildings. – Report the status to school officials. – Avoid using cell phone lines except for emergency calls. Use text message for other contacts.



Active Shooter

- RUN. Leave the building as quickly and quietly, if safe to do so.
- HIDE. If you can't leave, go to an area that can be locked or secured. Stay low, hidden and spread out.
- Call 911.
- If you encounter police, show the hands, follow their commands and don't make sudden movements.



Medical Emergency

- Avoid leaving injured person except to summon help.
- Do not move the injured person.
- Render first aid or CPR if you are trained and feel comfortable doing so.
- Protect the self before and after rendering assistance.
- Call 911.



Hazardous Materials

- Notify affected personnel immediately and evacuate the contaminated area.
- Move to a safe distance of at least 100 yards.
- Advise others to stay clear of contaminated area.
- Wait for further instructions from emergency personnel.
- Call 911.



Suspicious Person

- Do not let a stranger into locked or secured areas for any reason.
- Do not confront or attempt to stop any person from leaving the area.
- Move to a safe location and call 911



Suspicious Object

- Do not disturb, touch or use electrical devices near object.
- Move at least 100 yards from object.
- Call 911



Power Outage

- Remain calm and offer assistance to others.
- Take the nearest marked exit.
- Do not panic or push others while exiting.
- Call Facilities at 206-592-3260 to report power outages.

Guidelines for action in an emergency situation



Figure 6.7: Guidelines for action in an emergency situation

There are five steps that are considered to be best-practice that should be taken in the management of an emergency.

Prevention: The steps that are taken to avoid an incident or accident from occurring in the first place

Mitigation: These are measures that can reduce the risk of an emergency happening

Preparedness: The activities that are carried out to be ready to respond in the event that an emergency has occurred

Response: The actions that are taken immediately before, during and or after an emergency to save lives and reduce loss and damages.

Recovery: The actions that take place in the aftermath of the emergency situation to restore services and return to normal conditions.



Application activity 6.3

Read the statement below and answer questions that follow.

“An emergency can happen with no warning, so the best thing to do is be prepared”.

Make an emergency response plan that can be followed to respond appropriately if there is a safety hazard, an accident or an emergency in a workplace and in daily life. The plan should include steps and guidelines for the following emergencies:

- a) Fire and smoke/Natural disasters/Severe weather
- b) Personal injury or threat
- c) Gas leak/Dangerous gas releases
- d) Workplace violence or harassment,



Skills Lab 6

You have been given a job in the accounting department in one hotel after the senior six. Make a plan of how you will apply standard health and safety practices and regulations at the hotel. The plan should include:

- a) Daily Positive health habits to be practiced
- b) Daily hygiene and sanitation practices to be applied
- c) Strategies to handle hazards at the hotel
- d) Steps and guidelines to respond to emergencies at the workplace



End of unit assessment

- a) Describe the importance of good personal care and healthy habits at work.
- b) Describe any 5 healthy habits that should be practiced every day:
 - at work
 - in daily life
- c) Describe some strategies to prevent the spread of illness and contamination at the workplace and at home.
- d) Briefly describe any 5 unsafe situations that could harm people while on the job.
- e) Describe some strategies to handle unsafe situations that could harm people in any work environment.
- f) With examples, differentiate the types of hazards in the workplace.
- g) With examples, differentiate the types of emergencies at the workplace.
- h) Describe some strategies to deal with emergencies in life and in any workplace.

UNIT 7 | TEAM LEADERSHIP



 **Key unit competence:** To be able to lead a team in accomplishing a goal



Introductory activity

Think about the proverb below and answer the questions that follow.

“Umwera uturutse ibukuru bucyu wakwiriye hose” (Leaders are always taken as examples)

- What does the proverb mean and how does it relate to real life?
- What is the relationship between the proverb and team leadership?
- Describe situations at the workplace that may relate with the proverb in the accounting Profession
- What other proverbs do you know that have the same meaning?

7.1 Leadership

Learning Activity 7.1



Read the case study below about soccer and answer questions that follow.

Case study: A soccer team

Soccer is a team sport played by a team of 11 players against another team of 11 players on a field. The team has one designated goalkeeper and 10 outfield players. Outfield players are usually specialised in attacking or defending or both. The aim of each team is to move the ball up the pitch and beyond the goal line of another team's goal.

Any of a team's 11 players on the pitch can score a goal, which adds one to the team's total. Each team has a team captain who acts as the official leader both in the dressing room and on the pitch and steps in when a team's morale is low and needs inspiration to meet team objectives



Figure 1: Rwanda National Soccer Team (Amavubi), 2002

- What do you think the term team means?
- What is teamwork?
- What do you think the term 'leader' means?
- What do you think the term 'leadership' means?
- What do you think team leadership means?
- What does the term 'effective leader' mean?
- As a good leader, what qualities should the Amavubi team captain possess?

7.1.1 Definition of the concepts

a) Team

A team is a group of individuals working together to reach a common goal.

A team is also a group of people with different skills and different tasks, who work together on a common project, service, or goal, with a meshing of functions and mutual support.

For example, a soccer team is a group of 11 individual with a common goal crossing the ball over the line of the opponent's goal line.

b) Teamwork

Teamwork is the collaborative effort of a team to achieve a common goal or to complete a task in the most effective and efficient way.

For example, a soccer team works together to cross the ball over the line of the opponent's goal line.

c) Leader

A leader is "a person who influences a group of people towards the achievement of a goal". **For** example, a soccer team captain motivates and inspires the team to cross the ball over the line of the opponent's goal line.

d) Leadership

Leadership is the art of motivating a group of people to act towards achieving a common goal.

For example, a soccer team is motivated and inspired to cross the ball over the line of the opponent's goal line.

e) Team Leadership

Team leadership involves aligning a group of people towards a common goal and ensuring they have all the support they need to achieve it.

f) An effective leader

An effective leader is someone who provides guidance and support to their direct team members, the team they supervise or both.

7.1.2 Leadership qualities



Figure 7.1: Leadership qualities

Qualities of effective leaders

Many of an effective leader's traits relate to their attitudes toward their work and their team. Some traits for an effective leader include:

- **Vision:** Have a clear idea about their goals, how they want their team to perform and what success looks like
- **Empathy:** Understands that their team members are unique individuals and genuinely cares about them
- **Integrity:** Values, supports and defends their team's decisions as well as their own
- **Motivation:** Helps their team desire success and have the confidence to achieve it
- **Teamwork:** Understands the value of working together to achieve a goal
- **Open-mindedness:** Takes criticism well, gives their team members a voice and values others' ideas
- **Creativity:** Creates new ideas for goals, processes and solutions to issues
- **Patience:** Understands that some tasks take time and remains calm when challenges occur



Application activity 7.1

Read the Case Study below and answer questions that follow.

Case Study: How H.E Paul Kagame rebuilt Rwanda after the genocide?

By Didier Champion, last updated 2020

You cannot build a country by yourself. Think of Rwanda as a big project.

The Rwanda project needed a good project manager and Paul Kagame came in at the right time. Paul Kagame was the master design architect and the supervisor of the whole project. However, he could not have done it without a good team of many other people with different expertise in their fields, structural engineers, finance experts, budget managers, and so on.

As a leader, Paul Kagame set the tone for the “social transformation” of Rwanda. He inspired, motivated, and led his people by example. From the beginning, I have never doubted his work ethics and passion for Rwanda.

When you have the trust of the people, together, you can do and achieve amazing things. You set the destination and people will do what it takes to follow you. In the eyes of Rwandans, Paul Kagame has taken Rwandans to their promised land.

Paul Kagame did set an “ambitious” vision of the country, selected a good team of advisors along with many other leaders around him. He is known to be accountable to himself and the leaders. He tries to get the best out of them.

After setting the vision, he “sold” the plan to the people of Rwanda. In early 2000's, Vision 2020 was all over the radio, TV, and any billboards.

Questions:

- a) Who is the leader mentioned in the case study?
- b) What was the goal of the leader mentioned above?
- c) What did the leader do in order to achieve his goals?
- d) Why do you think in the case study he is referred to as an effective leader? Explain the qualities that he possess which enabled him to achieve the goals?

7.2 Styles and sources of power in leadership

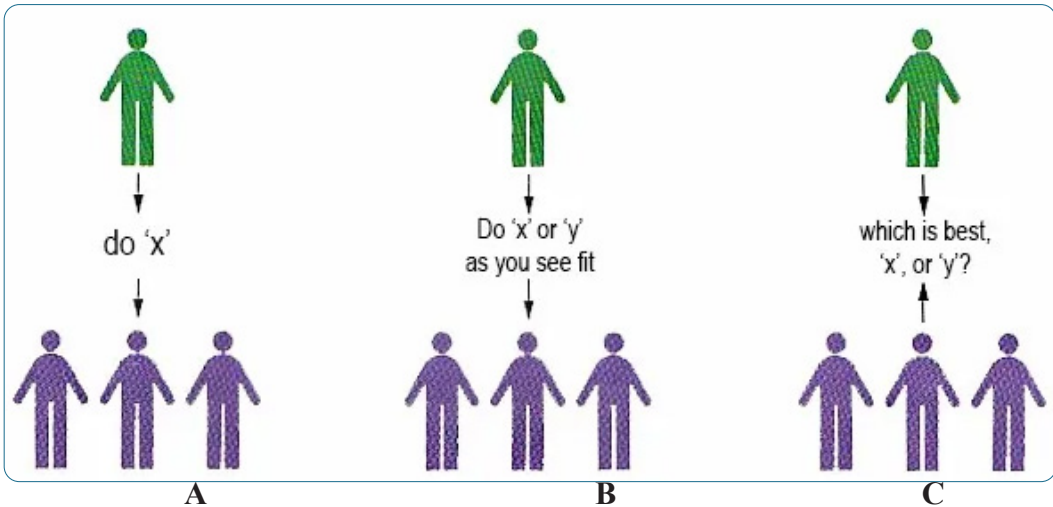


Figure 7.2 Styles of leadership

Learning Activity 7.1



1. Study and analyse figure 7.2 above and answer the following questions.
 - a) If you were a leader of the accounting department, which style (A, B or C) in the figure would you use to lead the department in accomplishing its goal? Give reasons to support your choice.
 - b) What do you think the term 'leadership style means'?
2. What do you think the following styles of leadership mean?
 - a) Transactional style
 - b) Bureaucratic style
 - c) Transformational style
 - d) Pacesetter style
 - e) Democratic style
 - f) Laissez-faire style
 - g) Autocratic style
 - h) Servant style
 - i) Visionary style
 - j) Coaching style
3. Which style of leadership is shown by A, B, or C figure 7.2?
4. Read the following paragraph and answer questions that follow.

The source of power for teachers

Teachers influence the behaviours of students at school in order to achieve academic success and discipline. They tell students how to solve a problem, or that points will be taken off if homework is late, and they respond with smiles, nods, and positive reactions to a student's answer. Students believe their teachers know everything and therefore should be respected.

Questions

- a) Why do you think student's behaviours are influenced by teachers?
- b) What strategies do teachers use to influence, direct or control students?
- c) What do you think the term 'power' means?
- d) What do you think is the source of power for the teacher?
- e) What do you think the following terms mean?
 - i. Legitimate power
 - ii. Reward power
 - iii. Expert power
 - iv. Referent power
 - v. Coercive power
 - vi. Informational power

7.2.1 Leadership styles

a) Leadership style

A leadership style is a way in which a leader accomplishes their team's objective by motivating employees to work towards the common goal and focusing on their well-being.

b) The most Common Leadership Styles are:

- **Coaching style:** A coaching leader is someone who can quickly recognize their team members' strengths, weaknesses, and motivations to help each individual improve
- **Visionary style:** Visionary leaders have a powerful ability to drive progress and usher in periods of change by inspiring employees and earning trust for new ideas
- **Servant style:** Servant leaders live by a people-first mind-set and believe that when team members feel personally and professionally fulfilled, they are more effective and more likely to regularly produce great work.
- **Autocratic style:** This type of leader is someone who is focused primarily on results and efficiency. They often make decisions alone or with a small, trusted group and expect employees to do exactly what they are asked.
- **Laissez-faire style:** This is the opposite of the autocratic leadership type, focusing mostly on delegating many tasks to team members and providing little to no supervision.

- Democratic style: A democratic leader is someone who asks for input and considers feedback from their team before making a decision.
- Pacesetter style: Pacesetter leaders are primarily focused on performance, often set high standards, and hold their team members accountable for achieving their goals.
- Transformational style: The transformational style is similar to the coach-style in that it focuses on clear communication, goal-setting, and employee motivation.
- Transactional style: Under this leadership style, the manager establishes predetermined incentives usually in the form of monetary reward for success and disciplinary action for failure. Unlike the pacesetter leadership style, though, transactional leaders are also focused on mentorship, instruction, and training to achieve goals and enjoy the rewards.
- Bureaucratic style: Bureaucratic leaders are similar to autocratic leaders in that they expect their team members to follow the rules and procedures precisely as written.

7.2.2 Sources of power

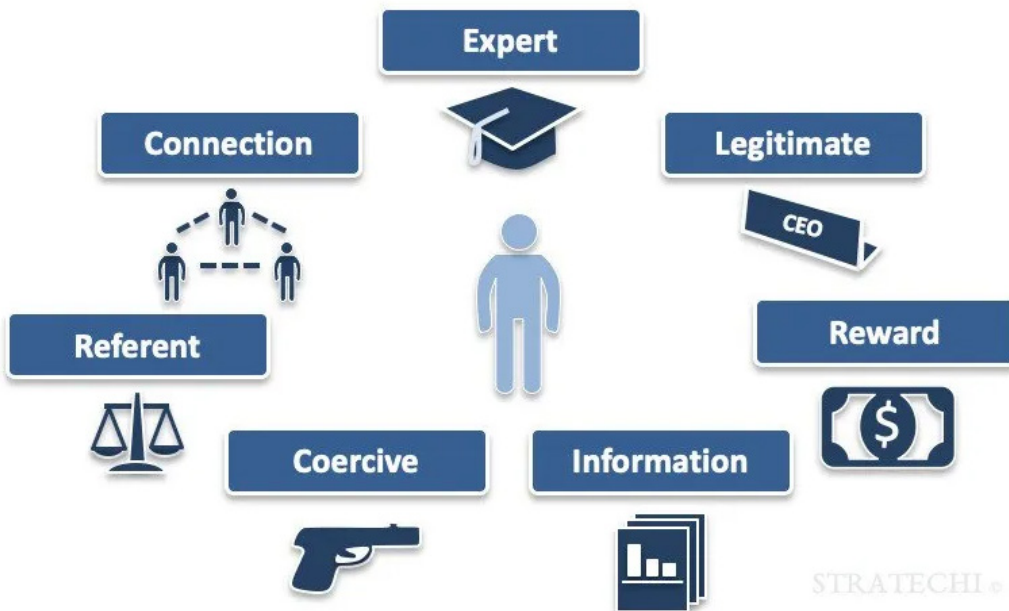


Figure 7.3 Sources of power

a) Power

Power refers to the capacity or ability to direct or influence the behaviour of others or the course of events

b) Sources of power in leadership

- **Legitimate power:** This comes from the belief that a person has the formal right to make demands, and to expect others to be compliant and obedient.

For example, teachers determine what students will study, what assignments they will complete, and what standards they must reach in order to pass and do well.

- **Reward power:** This results from one person's ability to compensate another for compliance

For example, students do what the teacher asks or tell them to do because they are motivated to get these rewards.

- **Expert power:** This is based on a person's high levels of skill and knowledge.

For example, students are willing to do as the teacher says because they recognize that the teacher knows more than they do

- **Referent power:** This is the result of a person's perceived attractiveness, worthiness and right to others' respect.

For example, students identify with the teacher and have positive regard for him or her, so they willingly do as the teacher says.

- **Coercive power:** This comes from the belief that a person can punish others for noncompliance.

For example, students respond to the teacher's power because they want to avoid any form of punishments.

- **Informational power:** This results from a person's ability to control the information that others need to accomplish something.

For example, an informational leader may be in a position to share, withhold, manipulate, distort, or conceal it.



Application activity 7.2

Read the workplace scenarios below about source of power and answer the questions that follow.

1. Mahoro is a junior manager in one of the privately owned hotels in Kigali city. She is a very good worker but her boss is always threatening her with demotions, pay cuts, layoffs, and terminations if she does not give in to his sexual demands.
2. Niyokwizerwa is a manager in one of the biggest customer care companies in the city. Her employees admire her leadership abilities such as allowing them to make decisions in certain work situations, the way she talks to the customers and therefore, has positively affected the employees' performance, as she has become a point of reference for their behaviour.
3. Gakuru is a well-loved head teacher at a certain school in Western province. His staff love him because he always gives them monetary rewards, wage or salary increments, bonuses, plaques, certificates, and gifts, praise, positive feedback, recognition, more responsibilities including a rise in status, and even a well-timed 'thank-you.'
4. Benimana is a secretary in one of the law firms in Kigali. One day her boss had to calculate taxes to be paid to RRA by the end of the day or the business will have to pay fine for late tax declaration. The boss' Microsoft Office crashed, and thinks she may have lost the files. The boss approaches Benimana to see if she can do anything.
5. Mutoni is a junior officer in the national army of Rwanda. She says in the army; an order is an order. All junior officers have to perform commands from high-ranking officers without questioning.

Questions

By completing the table below, identify which source does the leader derive his/her power and give reasons to support the answer.

Scenario	Source of power	Reasons
1		
2		
3		
4		
5		

Read the workplace scenarios below and determine with reasons the style of leadership applied;

1. Uwamahoro is the leader of an organization that provides computer services. She has realized that there is a problem with the way they advertise their business. Sitting at her desk, she lists some approaches they can take to improve their communications. She then tells the other employees what they need to do without asking for anyone else's ideas.
2. Sheja is the manager of a catering service called Best Bakery. They have been asked to prepare cakes for an upcoming wedding of the daughter of a political leader. She decides that coconut cakes will be the best and calls the staff together to discuss the order. She informs them of the order and then launches into a speech about all the advantages of making coconut cake. Others express an interest in making vanilla cakes but in the end Sheja convinces them coconut is best.
3. Charles is the owner of a successful auto mechanic workshop. A customer has brought a vehicle in that has multiple problems. He asks his team to assess the problems and get back to him with possible solutions. A few hours later they have a meeting to discuss what they have found and what they propose. They have a discussion, Jean de Dieu gives some advice and the team begins the repairs.
4. Peter runs a tailoring business in town. He has 5 employees. With an upcoming holiday, they have many orders to fulfil. Peter gathers all the employees to get their opinions on how to best manage the process so they can meet the deadlines. In the end, they decide together to divide tasks amongst themselves. Kwesi and two others were tasked with cutting and shaping the cloth while the other tailors would do the sewing. In the end they managed to keep all of their customers satisfied.
5. Keza is one of the leading members of the community youth association in a rural area. Following the illness of several community members, she decided it was necessary for community members to have better access to potable water. During weekly youth association meetings, she shared her vision and got others interested in resolving the problem. Together they researched different possibilities such as working with local government offices to mobilize resources to install a borehole (pipe drilled down to access clean water). During their association meetings, Keza always recognized the effort each individual was making. Eventually the youth were able to mobilize the resources necessary to access clean water. The youth and the community members were all inspired by her commitment and hard work to make it happen.

NB: use the table format below in answering.

7.3 Leading team



Figure 7.4: Characteristics of a successful team

Learning Activity 7.3



Read the paragraph about teamwork below and answer the questions that follow.

Teamwork: The Great Team Difference

Good teamwork is not about everyone having the same characteristics, but instead bringing together complementary personalities. A capable team must be diverse not only in skills and experience but culturally too. You want people who bring different views, perspectives and approaches to encourage innovation. That way someone's strength fills a gap of another's weakness and opens minds to alternative points of view.

Strong teams can argue solutions out, but all agree and commit to the final decision once it is made to achieve collective success. Power teams don't function on ego and control, but rather on trust and cooperation.

Team success doesn't just happen. It takes analysis, planning and bold leadership to build an effective team. A strong team ethic flows from the top down. When people see that they are respected, heard, recognized and valued, they will reciprocate with dedication and loyalty to the task.



Figure 2. Rwanda National Women Basketball Team, 2023; (*The New Times*, Tuesday, January 24, 2023)

Questions

- What do you think a 'successful team' means?
- What characteristics should a successful team have according to the paragraphs above?
- What other characteristics not mentioned in the paragraph do you think a team should have in order to be successful?
- What strategies should be applied by leaders to foster togetherness in a team or develop teamwork?

7.3.1 Characteristics of effective/successful teams

Successful teams are teams that work together as a single entity focused on a shared objective.

Irrespective of the project, industry, timeframe or ultimate goal, a successful team must have definite characteristics. If any of these are not met, the team will lack cohesion and ultimately fail to achieve its goals. The characteristics include;

a) Clearly defined goals

- A successful team fully understands and accepts the team goals.
- The team leader must ensure that all goals and objectives are communicated openly and without ambiguity.
- If goals are unclear members could pull in opposite directions leading to confusion and conflict within the team.

- Goals and objectives must be revisited regularly to monitor progress and also to introduce changes that inevitably happen.

b) Clearly defined roles

- Each team member must have a specific function and other members must understand and respect each other's roles.
- Members within a team may be able to cross-function to other roles, but each must respect their position within the team and not compete with others.

c) Team rules

- Clearly defined rules must be set and implemented from the beginning.
- These rules must apply to everyone without exception, including the team leader.
- Rules must be established around communication, delivery, respect, meeting deadlines, etc.
- There must be no vagueness or ambiguity, and all team members must be allowed to contribute to the rules.
- Once decided, everyone on the team must agree to abide by the rules.
- Mutually defined and agreed rules encourage open communication and trust.

d) Open communication

- It is the role of the team leader to foster the safe environment of open communication.
- This is not only about communicating goals and progress.
- Members must be encouraged to share ideas, challenge ideas, discuss progress and highlight potential problems before they happen.
- It is vital that people feel safe within the team and know that their input won't be met with ridicule, negative consequences or reprimand.

e) Team trust

- Trust is created when team members demonstrate care and respect for one another's feelings and value all members' perspectives
- Trust provides a sense of safety among members, feel comfortable to open up, take appropriate risks and expose vulnerabilities
- Each member must know that whatever goes down in the team stays in the team.

f) Shared accountability

- Once there is team trust, shared accountability will automatically fall into place.

- When people trust each other and know that they're in an emotionally safe environment they'll have each other's back.
- The team will develop an awareness of their own role as well as that of others to achieve team success
- Shared accountability means that there is no blaming, but rather support if something goes wrong.
- Mutual efforts to resolve problems quickly and effectively become the norm rather than blame and finger-pointing that wastes time and creates instability.

g) Mutual decision making

- Open communication, team trust and shared accountability lead to mutual decision making.
- Mutual decision making doesn't revolve around the leader making decisions and then telling the team what to do next.
- Joint decisions are made when the leader consults with the whole team, listens to their input and ideas, and then the group agrees together on the way forward.
- It is about brainstorming together to find the best solution.

h) A bold leader

- A bold leader is someone who can guide the team through the process with respect, open communication and transparency.
- A good team leader is part of the team but acknowledged and accepted by them as their leader.
- A bold leader does not direct the team with instructions supported by fear and control.
- Without strong leadership teams will eventually collapse.

i) Shared downtime

- Effective teams are inclined to bond because they have a mutual purpose.
- This often leads to people going above and beyond to achieve goals.
- Many projects are intense and have tight deadlines which results in people giving their all.
- It is important to recognize effective teams for their success by encouraging team fun.

7.3.2 Developing teamwork



Figure 7.5: Developing teamwork

a) Importance of Teamwork

- **Teamwork creates a friendly environment**, where leaders are not trying to be bosses but rather work together with members of a team.
- **Encourages flexibility** by enabling different perspectives to be considered and thus allow the team to respond to change faster.
- **Enhances problem-solving** by combining different solutions, abilities, and talents into one big productive unit and allows new ideas to flourish and goals to be achieved faster.
- **Improves productivity** since the performance and knowledge of an individual are limited compared with a group of varied skill sets.
- **Motivates the workforce and creates a healthy environment** between the team-members

b) Strategies to Work together/ developing a team

- Work with the team to develop a common goal.
- Nurture sense of belonging; focus on what team members have in common.
- Help team members to work together to efficiently solve problems
- Encourage members to set aside personal goals and desires for the benefit of the team.
- Structure the work of the team in a simple & logical fashion; distribute work fairly.
- Create an environment that supports and rewards openness, creativity, trust, mutual respect and a commitment to provide high quality services.
- Ensure all team members understand that their ideas & opinions are equally important & relevant.
- Encourage people with different abilities & personalities to work together.
- Team members have different skills and experience and so each team member must be given an opportunity and feel that their contributions are valued.

- Delegating authority and empowering the team to make decisions
- Resolve Conflict within the Team, unhelpful arguments and conflict should be tackled for the team to stay focused.

Celebrate Team Successes: encouraging team members to celebrate their success together act as an incentive to reach the next milestone or target.



Application activity 7.3

Read the scenario below from the accounting department at a workplace and answer questions that follow.

Scenario: Robbery of construction site materials

As a junior accountant in charge of the storeroom at a construction company, you realized that some of the site materials are progressively missing unknowingly. Then you decided to call all the team members for a meeting on how to resolve the problem. Among the team are the following:

Muganwa: A domineering person who wants to take over the discussions and lead the group. She thinks that she has all the answers and do not want to waste time having everybody share their ideas.

Kwitonda: A disagreeable person who has a negative attitude and resistant towards all ideas.

Umuhoza: A harmonious person who always try to make people feel relaxed and constantly trying to smooth things out between people who are disagreeing.

Mbaraga: An encouraging person who wants to make sure that everybody is heard, regardless of his or her background or ideas. Pulls group members into the conversation.

Barafinda: A person who gets very excited and loves to brainstorm and share extravagant ideas that are not always realistic.

Niyokwizerwa: A taskmaster who is always very organized and likes to stay focused on the task. She keeps bringing the group back to the practical actions that need to be taken to accomplish the task.

Questions:

- From the scenario what would be the objective or goal of the team?
- What should the leader do to ensure that the team meets its objective?
- Explain any strategies you would employ to ensure team work.

7.4 Problem solving and decision making

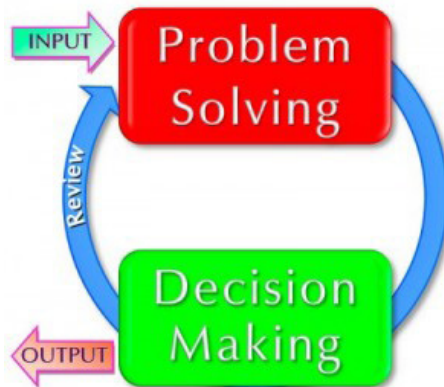


Figure 7.6: Problem solving and decision making

Learning Activity 7.4



Read the scenario below from the accounting department at a workplace and answer questions that follow.

Scenario: Low salary

Claude's younger sister Uwimana is 18 years. She works in factory in her community as the junior accountant. Her supervisor pays her a salary that is low compared to her male workmates of the same scale. When Uwimana complained, her supervisor told her that she is still young and has no need for money. Uwimana tried to show him that she needed the money but in vain.

Questions:

- What is the problem in the scenario?
- Do you think Uwimana has a right to complain? Why?
- What steps would you follow if you were to help Uwimana solve the problem?
- What steps would you follow if you were to assist the manager make the rational decision?
- What do you think is meant by 'REAL' solution?

7.4.1 Problem solving

a) Problem-solving

Problem solving is the act of defining a problem; determining the cause of the problem; identifying, prioritizing, and selecting alternatives for a solution; and implementing a solution.

b) Problem-solving skills

Problem-solving skills are the ability to identify problems, brainstorm and analyze answers, and implement the best solutions.

c) The Problem-Solving Process

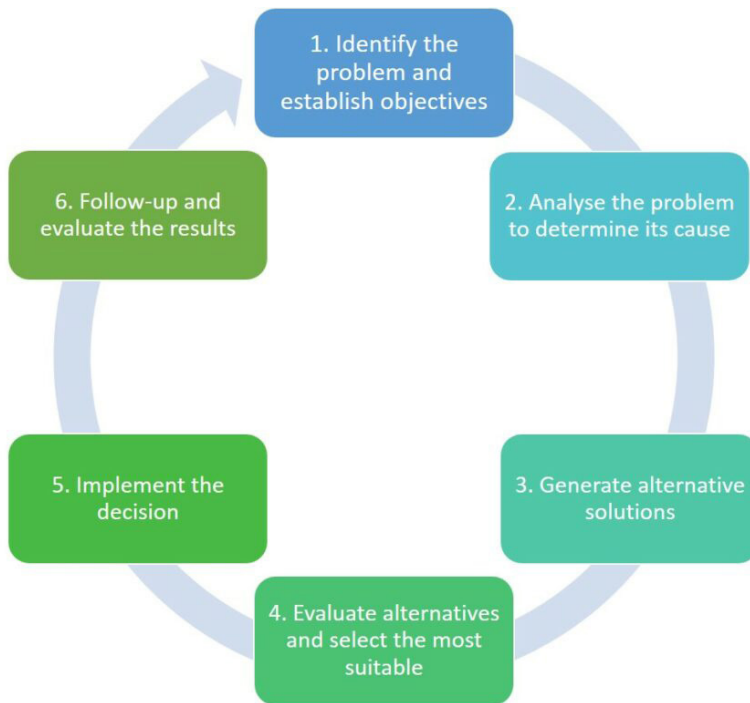


Figure 7.7: Basic Problem Solving Process

In order to effectively lead a team, leadership must guide their team members and develop problem-solving techniques. Problem solving skills allow you to:

- Notice an issue.
- Identify the root cause.
- Design an effective solution.
- Successfully implement the solution.
- Evaluate whether or not the solution worked or not.

The table below summarizes the steps involved in problem-solving process

Step	Characteristics
1. Define the problem	<ul style="list-style-type: none"> – What is the problem? – How did you discover the problem? – When did the problem start and how long has this problem been going on? – Is there enough data available to contain the problem and prevent it from getting passed to the next process step? If yes, contain the problem
2. Clarify the Problem	<ul style="list-style-type: none"> – What data is available or needed to help clarify, or fully understand the problem? – Is it a top priority to resolve the problem at this point in time? – Are additional resources required to clarify the problem? If yes, elevate the problem to the leader to help locate the right resources and form a team. – Consider a Lean Event (Do-it, Burst, RPI, Project). – Ensure the problem is contained and does not get passed to the next process step.
3. Define the Goals	<ul style="list-style-type: none"> – What is the end goal or desired future state? – What will you accomplish if you fix this problem? – What is the desired timeline for solving this problem?
4. Identify Root Cause of the Problem	<ul style="list-style-type: none"> – Identify possible causes of the problem. – Prioritize possible root causes of the problem. – What information or data is there to validate the root cause?
5. Develop Action Plan	<ul style="list-style-type: none"> – Generate a list of actions required to address the root cause and prevent problem from getting to others. – Assign an owner and timeline to each action. – Status actions to ensure completion.
6. Execute Action Plan	<ul style="list-style-type: none"> – Implement action plan to address the root cause. – Verify actions are completed.

7. Evaluate the Results	<ul style="list-style-type: none"> – Monitor and Collect Data. – Did you meet the goals defined in step 3? If not, repeat the 8-Step Process. – Were there any unforeseen consequences? – If problem is resolved, remove activities that were added previously to contain the problem.
8. Continuously Improve	<ul style="list-style-type: none"> – Look for additional opportunities to implement solution. – Ensure problem will not come back and communicate lessons learned. – If needed, repeat the 8-Step Problem Solving Process to drive further improvements.

7.4.2 Decision making process

Decision making is the process of making choices by identifying a decision, gathering information, and assessing alternative resolutions.

a) Steps to facilitate effective team decision-making

- 1 IDENTIFY** the situation, the problem, and the decision to be made
- 2 INVESTIGATE** the cause of the problem
- 3 THINK OF** different solution alternatives
- 4 SELECT** the best option
- 5 ANALYZE** the selected option
- 6 DETERMINE** the level of confidence in the decision
- 7 REPORT** the decision to the leader and/or the rest of the team



Figure 7.8 Decision making process

1. Identify the situation, the problem, and the decision to be made.

To make a good decision we should start with a common understanding of the situation we are going through:

- a) What is the problem?
- b) How relevant is it?
- c) All team members should be on the same page

5. Investigate the cause of the problem.

Once the problem has been identified, explore its origin. Understanding the root cause prevents making decisions that are only covering the symptoms

6. Think of different solution alternatives.

Now that you know more about the problem and its possible cause, it is important to think of solutions.

7. Select the best option.

Since the options have been shared with everyone, it is time to choose the best one,

8. Analyze the selected option.

Since the option has been selected, it is now important to analyze it further

9. Determine the level of confidence in the decision.

it is important to know how much confidence and commitment the team has to this decision.

10. Report the decision to the leader and/or the rest of the team (optional).

According to the level of delegation established with the leader (and if they participated), and if not the whole team participated in the decision, inform the leadership about the decision being made so that everyone is aware.

d) Characteristics of Solution to the problem

A solution that is acceptable culturally is not necessarily win/win. It is win/win when both parties feel happy with the solution and that solution is 'real'.

As far as possible all problem solving should result in a win/win solution. When

a problem does not end in a win/win solution, then there is no durable solution as there is often resentment, a desire for revenge and a hatred for the person who 'won' if you 'lost'.

Therefore, a solution should be:

- **R Realistic:** applicable not only in theory but also in practice.
- **E Effective:** the solution is an answer to the problem.
- **A Acceptable:** the solution is accepted by all of those involved.
- **L Logical:** the solution is not based on emotion but is fair.



Application activity 7.4

Read the scenario below and answer the questions that follow.

Scenario

Ntaganzwa and Niyigena both work in accounting department.

Ntaganzwa was hired a few months ago and Niyigena has been with the company for eight years. Ntaganzwa, while being a proficient worker, tends to wait until the last minute to get his work done. Niyigena works more steadily and keeps on top of her work daily. Niyigena complains that she feels she has to worry now about his work and her own. In addition, because they rely on each other's tasks, she is uncomfortable with waiting until an hour or so before a deadline when they are forced to collaborate.

Because of his behaviour and habit, Ntaganzwa is missing more work and this has upset Niyigena who says she will not work on the task

Questions:

Suppose Ntaganzwa and Niyigena are part of the team you lead and you have a goal to achieve, use the knowledge on problem solving and decision making to:

- a) Come up with a REAL solution to the problem if you are to achieve the team goals using the steps of problem solving
- b) Make a decision by using the steps to facilitate effective team decision-making



Skills Lab 7

Read the following scenario and answer the questions that follow.

You were elected as the leader of the community youth association in the area. Recently there is a strange illness that is causing diarrhoea in the community and nobody can identify the cause. Some people say it may be due to poor disposal of municipal waste, others poor hygiene and sanitation, while others say it may be due to lack of clean water.

1. As a team leader, apply the leadership skills lead the team to find a REAL solution to the problem in the community.
2. After you will make a report of how you came with the solution including:
 - a. The style of leadership applied
 - b. The source of power you applied
 - c. The strategies you used to work together to come up with the solution
 - d. The steps followed to come up with the solution



End of unit assessment

1. Read the statements below and circle the correct answer for each statement.
 - i. Leaders should always make decisions on their own without getting input from others who are not leaders.
 - A. True
 - B. False
 - ii. Effective leaders:
 - A. Are creative
 - B. Have self confidence
 - C. Are flexible
 - D. Have a positive attitude
 - E. All of the above
 - iii. A leader should choose one style of leadership and always stick to it authoritarian, persuading, consulting, or joining.
 - A. True
 - B. False



End of unit assessment

- iii. When giving instructions to a group of people, you should:
- A. Repeat the question
 - B. Ask if the question is clear
 - C. Ask someone to say the question back to you in their own words
 - D. All of the above
 - E. None of the above
2. In the community, there are so many problems affecting the community members. Using the leadership skills, you are to form a team and come up with a solution to the identified problem.

Questions:

- a) You need to choose a leader to help the team reach its goal, what kind of leader would you propose for the team? What characteristics would you look for?
- b) What style of leadership would you advise the leader to apply as he/she leads the team to reach its goal?
- c) What do you think the new leader should do in order to lead a successful team?

UNIT 8 | BUSINESS INVESTMENT



Key unit competence: To be able to make rational business investment decisions



Introductory activity

Read the paragraph below and answer questions that follow.

The most important things to consider when buying a sports player

A transfer in sports is a business transaction between two clubs which sees a player move from one club to the other. A club will often just send a scout off to have a look, and then make a judgement based on the amount of stars they get. There are a number of moving parts involved in order to complete the transfer. First of all, the two clubs must negotiate transfer fees along with any clauses, such as sell-on percentages and other financial inducements. Before a club makes any investment decision in the player, there are a number of things to take into consideration. A club will consider: mental and physical attributes, perceived quality of a player, current contract length, commercial value and potential worth, value for money, injury history/report, player potential ability and resell value, among others.

Required:

- a) Why do you think a transfer in football is termed as an investment decision?
- b) Why do you think it would not be just enough to base on what scouts get to make a transfer decision?
- c) What steps/stages do clubs follow in appraising a player in order to be able to make an investment decision?
- d) Why do you think it is important for the club to go through the process/steps describe d in the paragraph?
- e) How do clubs (techniques) appraise players before making an investment decision?

Introduction

- Decisions on investment that take time to mature have to be based on the returns that investment will make in the future. Unless the project is for social reasons only, if the investment is unprofitable in the long run, it is unwise to invest in it now.
- Often, it would be good to know what the present value of the future investment is, or how long it will take to mature (give returns). It could be much more profitable putting the planned investment money in the bank and earning interest, or investing in an alternative project.
- Capital budgeting is obviously a vital activity in business. Vast sums of money can be easily wasted if the investment turns out to be wrong or uneconomic. The subject matter is difficult to grasp by nature of the topic covered and also because of the mathematical content involved.
- However, it seeks to build on the concept of the future value of money which may be spent now. It does this by examining the techniques of net present value, internal rate of return and annuities. The timing of cash flows is important in new investment decisions and so the chapter looks at this “payback” concept.

8.1 Business Investment Appraisal

APPRAISAL TECHNIQUES

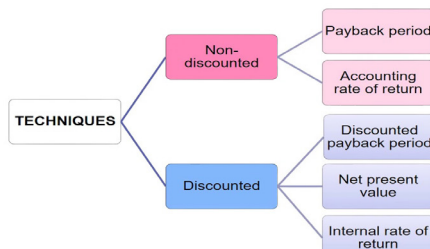


Figure 8.1: Appraisal techniques

Learning Activity 8.1



Referring to knowledge and skills of financial accounting and management accounting in senior 4 and 5, answer the questions below.

- a. Explain the following term:
 - Business investment
 - Investment decision
 - Investment appraisal
- b. What are the stages followed by a business when performing an investment appraisal?
- c. When does a business do an investment appraisal?

8.1.1 Definition of the concepts: Business investment and Business Investment Appraisal

Business investment is spending by private businesses and non-profits on physical capital—long-lasting assets used to produce goods and services. **Business investment** is about investing to make more money

Investment Decision relates to the decision made by the investors or the top level management with respect to the amount of funds to be deployed in the investment opportunities.

Investment appraisal is a process of analysing whether an investment project is worthwhile or not. It includes techniques that assess the profitability of investing in a long-term project.

Investment appraisal is an analysis conducted to help businesses and their managers in specific situations such as when:

- A firm has to decide on whether to take on a project or not.
- A firm has to decide on which project to choose.
- A largely irreversible commitment of resources associated with a project.
- A project is associated with a significant degree of risk.

8.1.2 Investment Appraisal stages

Investing in an asset, security, or project requires a lot of patience; ideally, the decision-making process should be analytical. The nature of investment decisions and the appraisal stages/steps includes:

1. Identification of investment opportunities

From an analysis of strategic choices, analysis of the business environment, research and development, or legal requirements. The key requirement is that investment proposals should support the achievement of organisational objectives.

2. Screening of investment proposals

Companies need to choose between competing investment proposals and select those with the best strategic fit and the most appropriate use of economic resources.

3. Analysing and evaluating investment proposals

This is the stage where investment appraisal plays a key role, indicating for example which investment proposals have the highest net present value.

4. Authorization and approving investment proposals

Very large proposals may require approval by the board of directors, while smaller proposals may be approved at divisional level

5. Implementing, monitoring and reviewing investments

The time required to implement the investment proposal or project will depend on its size and complexity. Following implementation, the investment project must be monitored to ensure that the expected results are being achieved and the performance is as expected. The whole of the investment decision-making process should also be reviewed in order to facilitate organisational learning and to improve future investment decisions.



Application activity 7.4

Read the scenario below and answer the questions that follow

Scenario: Advice on investment

Your friend has accumulated some savings which she would like to invest in a business project. She approaches you as someone with knowledge on investment appraisal to advise her on what she should do before investing her savings.

Required: What advice will you give to your friend before making an investment decision? Your advice should include the stages and purpose of performing each stage of the investment appraisal.

8.2 Investment appraisal techniques

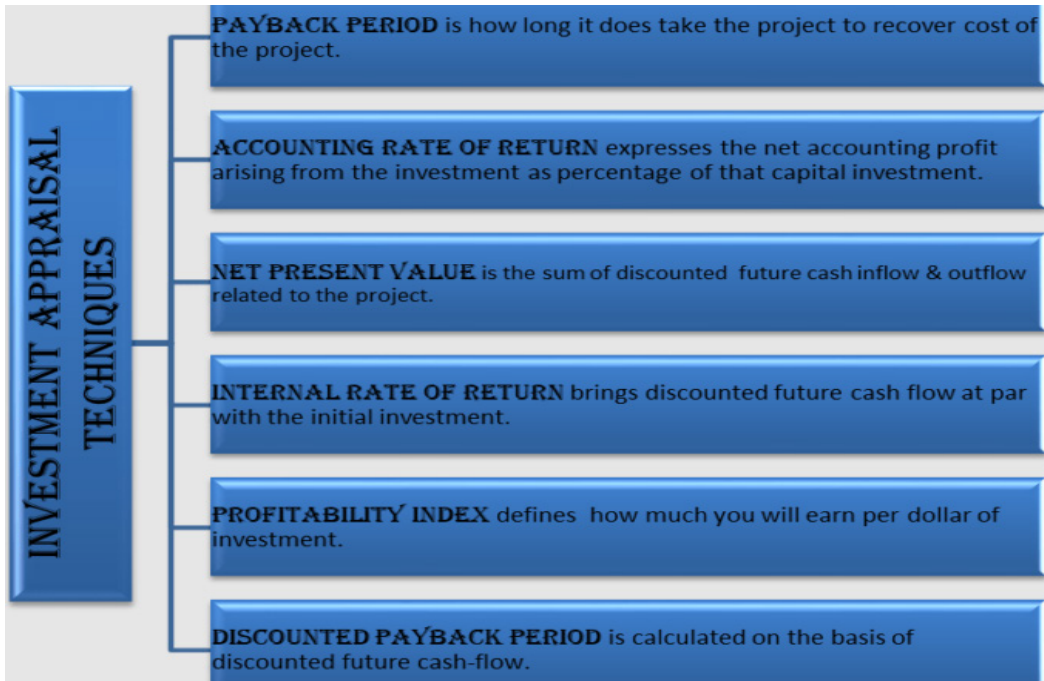


Figure 8.2: Investment appraisal techniques

Learning Activity 8.1



Read the scenarios below of a business with an investment decision to make regarding two (2) projects.

Scenario 1.

The Delta Company is planning to purchase a computer for its accounting department. The computer would cost 2,000,000FRW and would have a useful life of 10 years. The expected annual cash inflow of the computer 1,000,000Frw.

Scenario 2.

Delta Company is also planning to make the investment of 2,000,000Frw in a new project which is expected to generate the following cash inflows in six years:

Year 1: 700,000Frw

Year 4: 400,000Frw

Year 2: 600,000Frw

Year 5: 300,000Frw

Year 3: 550,000Frw

Year 6: 250,000Frw

Required:

Using the payback period appraisal technique, assist Delta Company to make an investment decision.

Briefly describe any other appraisal techniques the company can use to make an investment decision.

8.2.1 Discounted Payback Period (DPBP)

Discounted payback period is defined as the number of years required to recover the investment from discounted net cash flows.

Similar to the regular payback period except that the expected cash flows are discounted by the project's cost of capital

Discounted Payback Period =

$$\text{Year before full recovery} + \frac{\text{unrecovered cost at start of year}}{\text{Cash flow during year of full recovery}}$$

Example

An initial investment of 2,324,000Frw is expected to generate 600,000Frw per year for 6 years. Calculate the discounted payback period of the investment if the discount rate is 11%.

Steps:

Prepare a table to calculate discounted cash flow (CF) of each period

Calculate the Cash Flow Present Value Factor for each year (PVF)

$PVF = 1/(1 + r)^N$, where r = discount rate, n = current year

Calculate the Discounted Cash Flow (CF * PVF)

Calculate the Cumulative Discounted CF

Year	Cash Flows (CF)	PVF	Discounted CF	Cumulative Discounted CF
	(2,324,000Frw)	1	(2,324,000Frw)	(2,324,000Frw)
1	600,000	0.9009	540,541	(1,783,459)
2	600,000	0.8116	486,973	(1,296,486)
3	600,000	0.7312	438,715	(857,771)
4	600,000	0.6587	395,239	(462,533)
5	600,000	0.5935	356,071	(106,462)

6	600,000	0.5346	320,785	214,323
<p>DPBP = 5 + 106,462/ 320,785 ≈ 5.33 years</p> <p>Decision criteria:</p> <p>The shorter the payback period, the better.</p> <p>If the projects were mutually exclusive, the one with a shorter payback period is preferred</p>				

8.2.2 Accounting Rate of Return (ARR)

Accounting Rate of Return (ARR) is the average net income an asset is expected to generate divided by its average capital cost.

Also the average rate of return (ARR), is the average annual return (profit) of an investment. It is expressed as a percentage of the original sum invested.

$$\text{ARR (Total investment)} = \frac{\text{Average annual return (profit)}}{\text{Initial capital investment}} \times 100$$

Example 1

A firm invests 1,900,000Frw in a project with an expected return of 2,400,000Frw. The project is going to last 8 years. Calculate the Accounting Rate of Return for the project.

If the expected return is 2,400,000Frw and the project is going to last 8 years, then the average annual return is 300,000Frw.

If the average annual return is 300,000FRW and the investment is 1,900,000Frw, then the Average rate of return = $\frac{300,000}{1,900,000} \times 100 = 15.8\%$

Example 2

Calculate the ARR of a project if a firm makes an initial investment of 400,000Frw and cash flows are in the table below

Project A	Year1	Year 2	Year 3	Year 4	Average	ARR
Cash flow ()	160,000	160,000	160,000	120,000	–	
Depreciation ()	(100,000)	(100,000)	100,000)	(100,000)	–	
Profit ()	60,000	60,000	60,000	20,000	50,000	(50,000/400,000)*100
ARR = 12.5%						

Decision Criteria:

Accept: if ARR is greater than cost of capital

Reject: If ARR is less than cost of Capital

If the two projects are mutually exclusive, choose the one with higher ARR.

8.2.3 Net present value (NPV)

Net present value (NPV) is the difference between the present value of cash inflows and the present value of cash outflows over a period of time.

Net present value (NPV) is the current value of the future expected cash flows. It considers the time value of money. To calculate NPV, discounted cash flows are used.

$$\text{NPV} = \text{PV of Cash Inflows} - \text{PV of Cash Outflows}$$

$$\text{NPV} = \text{Total Present Value} - \text{Total Investment}$$

$$\text{Present Value (PV)} = \text{Return} \times \text{Discount factor}$$

$$\text{Discount factor} = 1 / (1 + r)^n, \text{ where, } r = \text{discount/interest rate, } n = \text{current year}$$

Decision Criteria:

Accept: if NPV is positive

Reject: if NPV is negative

If mutually exclusive, choose the one with higher NPV

Example 1

A firm is considering investing in a project that requires an investment 1,900,000FRW. Calculate the NPV if it is expected to give revenues as follows:

Year	Revenue (Frw)
1	200,000
2	300,000
3	350,000
4	350,000
5	400,000
6	400,000
7	300,000
8	100,000
Total revenue	2,400,000

Since total revenue is 2,400,000Frw and investment is 1,900,000Frw, then the profit will be 500,000Frw.

However, since money loses value over time, we need to consider the rate of interest. The discount factor in the table is 5%

Year	Revenue/Return (Frw)	Present value (Frw) = Return x Discount factor
1	200,000	200,000 x 0.952 = 190,400
2	300,000	300,000 x 0.907 = 272,100
3	350,000	350,000 x 0.864 = 302,040
4	350,000	350,000 x 0.823 = 288,050
5	400,000	400,000 x 0.784 = 313,600
6	400,000	400,000 x 0.746 = 298,400
7	300,000	300,000 x 0.711 = 213,300
8	100,000	100,000 x 0.677 = 67,700
Total revenue = 2,400,000		Total Present value = 1,945,950

Since total present value is 1,945,950Frw and the investment was 1,900,000Frw, then the net present value will be 45,950Frw (1,945,950 - 1,900,000)

Example 2

A firm is considering investing in a project that requires an investment 4,000,000Frw. Calculate the NPV if it expected to give revenues as follows:

Years	Cash flow	PVIF at 14%	Present Value
0	(4,000,000)	1	(4,000,000)
1	1,600,000	0.87719	1,403,390
2	1,600,000	0.76947	1,231,152
3	1,600,000	0.67497	1,079,904
4	1,200,000	0.59208	710,496
			TPV=4,424,942
Net present value at 14% = 4,424,942-4,000,000= 424,942Frw			

8.2.4 Internal rate of return (IRR)

The Internal Rate of Return is that discount rate, r , which, when applied to project cash flows produces a net present value of zero.

Generally speaking, the higher a project's internal rate of return, the more desirable it is to undertake the project.

The project with the highest IRR would probably be considered the best and

undertaken.

The internal rate of return (IRR) formula is based on the net present value (NPV) formula when it's used to solve for zero NPV. The internal rate of return formula is:

$$0 = \sum ((CF_t / (1 + IRR)^t))$$

Or

$$0 = (C_0 * -1) + CF_1 / (1 + IRR)^1 + CF_2 / (1 + IRR)^2 + \dots + CF_t / (1 + IRR)^t$$

Where:

CF_t = Net cash inflow during the period t

C_0 = Total initial investment costs

IRR = the internal rate of return

t = the number of time periods

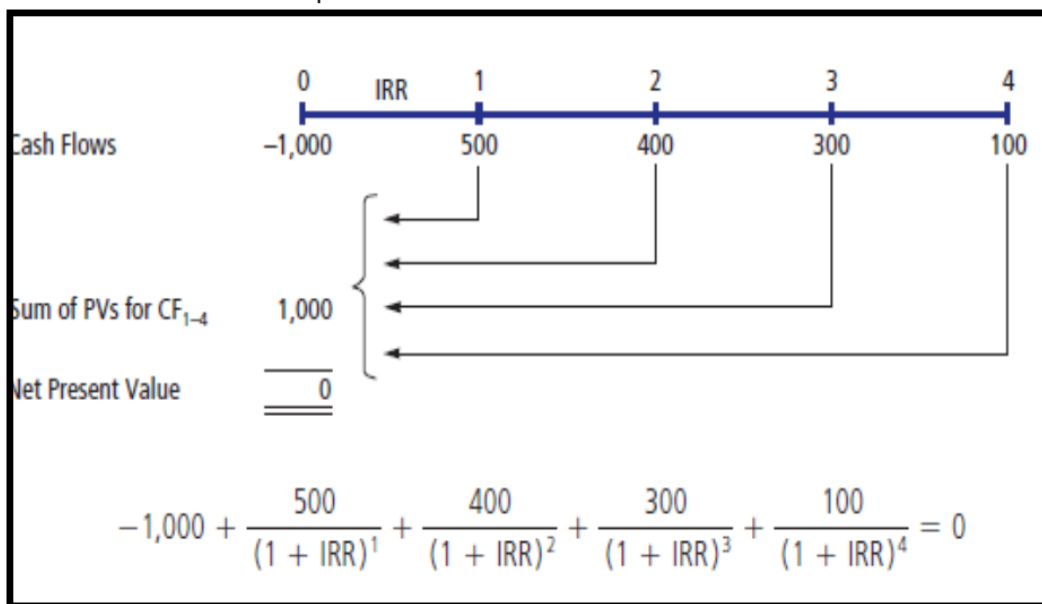


Figure 8.3: Calculation of IRR

Decision Criteria:

- Accept: If greater than cost of capital
- Reject: If less than cost of capital
- If mutually exclusive, select the one with higher IRR

Example

A company KJP Enterprises is reviewing two projects. Management must decide

whether to move forward with one, both, or neither. Its cost of capital is 10%. The cash flow patterns for each are as follows:

YEAR	Project A (FRW)	Project B (FRW)
0	(5,000,000)	(2,000,000)
1	1,700,000	400,000
2	1,900,000	700,000
3	1,600,000	500,000
4	1,500,000	400,000
5	700,000	300,000

Required:

The company must calculate the IRR for each project. Initial outlay (period = 0) will be negative. Solving for IRR is an iterative process using the following equation:

$$0 = (\text{initial outlay} * -1) + CF1 \div (1 + IRR)^1 + CF2 \div (1 + IRR)^2 + \dots + CFX \div (1 + IRR)^X$$

The company can calculate IRR for each project as:

IRR Project A

$$0 = (-5,000,000) + 1,700,000 \div (1 + IRR)^1 + 1,900,000 \div (1 + IRR)^2 + 1,600,000 \div (1 + IRR)^3 + 1,500,000 \div (1 + IRR)^4 + 700,000 \div (1 + IRR)^5$$

IRR Project A = 16.61 %

IRR Project B

$$0 = (-2,000,000) + 400,000 \div (1 + IRR)^1 + 700,000 \div (1 + IRR)^2 + 500,000 \div (1 + IRR)^3 + 400,000 \div (1 + IRR)^4 + 300,000 \div (1 + IRR)^5$$

IRR Project B = 5.23 %

Given that the company’s cost of capital is 10%, management should proceed with Project A and reject Project B.

8.2.4 Modified internal rate of return (MIRR)

The Modified Internal Rate of Return (MIRR) is a variation of the traditional Internal Rate of Return (IRR) calculation in that it computes IRR with explicit reinvestment rate and finance rate

The MIRR accounts for the reinvestment of any positive interim cash flows by using a reinvestment rate, and it also accounts for any negative cash flows by using a finance rate (also known as a safe rate)

It also allows any negative cash flows to be discounted back to the present time at the finance rate to determine how much needs to be set aside today in order to fund the future cash outflows

$$MIRR = \sqrt[n]{\frac{FV(\text{Positive Cash Flows, cost of capital})}{PV(\text{Initial Outlays, Financing Cost})}} - 1$$

Where:

FV: The future value of positive cash flows discounted at the reinvestment rate.

PV: The present value of negative cash flows discounted at the financing rate.

n: Number of periods.

Decision Criteria:

- Accept: If MIRR is greater than cost of capital
- Reject: If MIRR is less than Cost of Capital
- If mutually exclusive, select the one with higher MIRR.

Example 1:

Company X is running a two-year project. They have an initial outlay of 1,950Frw and their cost of capital is at 12%. The returns in the first year will be 1,210FRW and 1,310Frw in the second year.

To find the MIRR, you'll first need to do a basic IRR calculation of the project so that the NPV is 0 when IRR = 18.66%

$$NPV = 0 = -1950 + 1210 / (1+IRR) + 1310 / (1+IRR)^2$$

We can then work out the MIRR of the project. We will assume that the positive cash flows from the project will be reinvested at 12% which is the cost of capital. That means that the future value of the positive cash flows when t = 2 can be calculated as:

$$1,210 \times 1.12 + 1,310 = 2,665.20\text{Frw.}$$

Next, you can divide the future value of the cash flows by the present value. This is of the initial outlay, which was 1,950FRW. From here you can find the geometric return for two periods. The last step is then to adjust the ratio for the time period using the formula for MIRR.

$$MIRR = (2,665.20 / 1,950)^{1/2} - 1 = 1.1691 - 1 = 16.91\%$$

The IRR for Company X would show a very optimistic picture of the project's potential. Whereas the MIRR helps to give an evaluation that is far more realistic.

Example 2

A company made an initial investment of 1,000,000FRW for a project, expecting returns in cash worth 300,000FRW, 600,000FRW, and 900,000FRW for three consecutive years. The cost of capital and the reinvestment rate was 12%.

$$\begin{aligned}FV &= 300,000 \times (1+0.12)^2 + 600,000 \times (1+0.12)^1 + 900,000 \\&= (300,000 \times 1.25) + (600,000 \times 1.12) + 900,000 \\&= 375,000 + 672,000 + 900,000 \\&= 1,947,000\end{aligned}$$

$$PV = 1,000,000\text{Frw}$$

Using Modified Internal Rate of Return formula:

$$\text{MIRR} = (1947/1000)^{1/3} - 1 = 24.87\%$$

Example 2

A company invests 1,800,000FRW and evaluates the return worth 500,000FRW to be consistent for the next three years with an additional profit of 500,000FRW at the end of the third year. What is the Modified Internal Rate of Return of the project if the reinvestment rate is 10%?

$$\begin{aligned}FV &= 500,000 \times (1+0.10)^2 + 500,000 \times (1+0.10)^1 + 1,000,000 \\&= 605,000 + 550,000 + 1000,000 \\&= 2,155,000\end{aligned}$$

$$PV = 1,800,000\text{Frw}$$

$$\begin{aligned}\text{MIRR} &= \sqrt[3]{\frac{2155}{1800}} - 1 \\&= 6.18\%\end{aligned}$$

8.2.5 Profitability index (PI)

Investment appraisal technique is calculated by dividing the present value of future cash flows of a project by the initial investment required for the project.

The method divides the projected capital inflow by the projected capital outflow

to determine the profitability of a project. As indicated by the aforementioned formula, the profitability index uses the present value of future cash flows and the initial investment to represent the aforementioned variables.

Profitability Index (PI) = Present Value of Future Cash Flows

Initial Investment Required Or

$$PV = CF_1 / (1 + r)^1 + CF_2 / (1 + r)^2 + \dots + CF_n / (1 + r)^n$$

Where,

PV is the present value,

CF is the cash flow in a given year,

r is the discount rate, and

n is the number of years.

Decision criteria:

If the index is more than 1, then the investment is worthy because then you may earn back more than you invest in.

If the index is less than 1, then it's better to step back and look for other opportunities.

If the index is equal to 1, then it's an indifferent or neutral project. You shouldn't invest in the project until and unless you consider it better than other projects available during the period.

Example

Years	0	1	2	3	4
Project A	-25000	8000	8000	8000	8000
Project B	-25000	10000	11000	8000	5000
The cost of capital is 10%					

Project A.

Total present value = Annual cash flow x 10% annuity factor = 8000 x 3.170 = 25,360FRW

Profitability Index (PI) = TPV/Investment = 25,360/25,000 = 1.01

Project B

Year	CF	10% Factor.	PV
1	10000	0.909	9090
2	11000	0.826	9086
3	8000	0.751	6008
4	5000	0.683	3415
Total present value (TPV)			27,599
Profitability Index (PI) = TPV/Investment = 27599/25000 = 1.10			

Example 2

A company is considering two potential projects: building a new factory, or expanding an existing one. The factory expansion project is expected to cost 10,000,000Frw and generate cash flows of 2,000,000Frw per year for the next 5 years, with a discount rate of 10%. The new factory project is expected to cost 20,000,000Frw and generate cash flows of 3,000,000Frw per year for the next 5 years, also with a discount rate of 10%.

To calculate the profitability index for the factory expansion project, the present value of the future cash flows would be calculated using the following formula:

$$PV = CF_1 / (1 + r)^1 + CF_2 / (1 + r)^2 + \dots + CF_n / (1 + r)^n$$

Where PV is the present value, CF is the cash flow in a given year, r is the discount rate, and n is the number of years.

$$PV = 2,000,000 / (1 + 0.10)^1 + 2,000,000 / (1 + 0.10)^2 + \dots + 2,000,000 / (1 + 0.10)^5$$

$$PV = 7,500,319\text{Frw}$$

The profitability index for the factory expansion project is then calculated as:

$$PI = PV / \text{Initial Investment}$$

$$PI = 7,500,319 / 10,000,000$$

$$PI = 0.75$$

To calculate the profitability index for the new factory project, the present value of the future cash flows would be calculated using the same formula:

$$PV = 3,000,000 / (1 + 0.10)^1 + 3,000,000 / (1 + 0.10)^2 + \dots + 3,000,000 / (1 + 0.10)^5$$

$$PV = 11,254,790\text{Frw}$$

The profitability index for the new factory project is then calculated as:

$$PI = PV / \text{Initial Investment}$$

$$PI = 11,254,790/20,000,000$$

$$PI = 0.56$$

In this example, the factory expansion project has a higher profitability index, meaning it is a more attractive investment. The company might decide to pursue this project instead of the new factory project because it is expected to generate more value per unit of investment.

However, since both PIs are less than 1.0, the company may end up forgoing either project in favour of a better opportunity elsewhere.



Application activity 8.2

Read the scenario below and answer questions that follow.

Scenario: Entrepreneurship club

At your school, the senior 4 class has formed an entrepreneurship club. They are planning to start a project which should be both profitable but also bring back returns at the end of their senior six.

The club plans to make an investment of 1,000,000Frw in a project that projected to generate net receipts of 800,000Frw, 900,000Frw and 600,000Frw in the first, second and third years respectively with a discounting factor of 10%. Should the club go ahead with the project?

Required:

As a year six student with competences in investment appraisal, use the different investment appraisal techniques to assist the club to make the decision.



Skills Lab8

After secondary six education, you plan to start a project to put in practice all the competences acquired from studying entrepreneurship. After the business plan pitch, various investors agreed to support you with 500,000Frw. You are in a dilemma because two investors are ready to support you but in different projects. Investor A will support you only if you invested in poultry which will bring in cash flows of 50,000Frw, 60,000Frw, 120,000Frw, 200,000Frw and 150,000Frw for five years while investor B will support you if you invested in cloth trading which will bring in cash flows of 40,000FRW, 100,000Frw, 180,000Frw, 150,000Frw and 100,000Frw for five years. The investment capital will cost 10%.

Required:

- a) Use appropriate investment appraisal techniques to choose which project you will take on as your BHB project.



End of unit assessment

1. Differentiate business investment from investment appraisal
2. Name and briefly explain the different stages of investment appraisal
3. Describe the different investment appraisal techniques
4. ABC Inc. plans to buy machine A which will cost 10,000,000FRW. The expected life of the machine is 5 years. The recover value of the machine is nil. ABC Inc. is expecting a cash flow of 5,000,000FRW for the first two years, 3 million for the next 2 years & 2 million in 5th year. Operating expense is 1 million every year. Discounting rate is 10%. (Assumption: No tax) (<https://efinancemanagement.com/financial-management/capital-budgeting-techniques-with-an-example>)

Required:

Assist ABC Inc. to make a rational decision by using the different appraisal techniques

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