DEPARTMENT OF EDUCATION

GRADE 11 BUSINESS STUDIES

MODULE 4 SMALL BUSINESS MANAGEMENT

FODE DISTANCE LEARNING

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GRADE 11

BUSINESS STUDIES

MODULE 11.4

SMALL BUSINESS MANAGEMENT

TOPIC 1: FEATURES OF A SMALL BUSINESS

TOPIC 2: METHOD OF STARTING A BUSINESS

TOPIC 3: TAXATION

TOPIC 4: INSURANCE

TOPIC 5: BUSINESS FINANCE

TOPIC 6: CONDUCTING AND EVALUATING A BUSINESS PROJECT

Acknowledgements

We acknowledge the contributions of all Primary Teachers who in one way or another helped to develop this course.

Our profound gratitude goes to the former Principal, Mr Demas Tongogo for leading FODE team towards this great achievement. Special thanks to the staff of MAL and Business Studies Department of FODE who played an active role in coordinating writing workshops, outsourcing lesson writing and editing processes.

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DIANA TEIT AKIS

PRINCIPAL

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SECRETARY'S MESSAGE

Achieving a better future by individual students and their families, communities or the nation as a whole, depends on the kind of curriculum and the way it is delivered.

This course is part and parcel of the new reformed curriculum. The learning outcomes are student – centred and allow them to be demonstrated, assessed or measured.

It maintains the rationale, goals, aims and principles of the national curriculum and identifies the knowledge, skills, attitudes and values that students should achieve.

This is a provision by Flexible, Open and Distance Education as an alternative pathway of formal education.

The course promotes Papua New Guinea values and beliefs which are found in our Constitution, Government policies and reports. It is developed in line with the National Education Plan (2005 -2014) and addresses an increase in the number of school leavers which has been coupled with a lack of access to secondary and higher educational institutions.

Flexible, Open and Distance Education curriculum is guided by the Department of Education's Mission which is fivefold:

- To facilitate and promote the integral development of every individual
- To develop and encourage an education system which satisfies the requirements of Papua New Guinea and its people
- To establish, preserve and improve standards of education throughout Papua New Guinea
- To make the benefits of such education available as widely as possible to all of the people
- To make the education accessible to the poor and physically, mentally and socially handicapped as well as to those who are educationally disadvantaged.

The college is enhanced to provide alternative and comparable pathways for students and adults to complete their education through a one system, many pathways and same outcomes.

It is our vision that Papua New Guineans harness all appropriate and affordable technologies to pursue this program.

I commend all those teachers, curriculum writers and instructional designers who have contributed so much in developing this course.

DR. UKE KOMBRA PhD
Secretary for Education

STUDY GUIDE

Step 1: Start with Topic 11.4.1, study the first sub-topic notes and do the Learning Activities as you go along. Turn to the back of your module to correct the answers of your learning activities.

Step 2: When you have completed the first sub-topic notes, then, you can move on to the next subtopic. Continue to do the Learning Activities as you go along. Turn to the back of your module to correct the answers of your learning activities.

Step 3: If you make any mistake, go back to the notes in your module and revise the notes well and try to understand why you gave an incorrect answer.

Step 4: Go to Topic 11.4.2 and repeat the same process in step 2 and step 3 until you complete your second topic.

Step 5: After completing your six topics, Then, complete each Topic Test in Assessment Book.

Step 6: After you have studied the whole module, do also the Unit Examination in the Assessment Book.

Step 7: Check through your Assessment Book, when you are satisfied, then submits your Assessment Book to your Provincial Centre for marking.

Study Schedule

Here is a study schedule. It will guide you to complete your module and its assessment.

WEEKS	TOPICS/SUBTOPICS	ASSESSMENT	COMMENTS
1-3	Topics 1 & 2	Topic 1 Test-10 marks Topic 2 Test-10 marks	
4- 6	Topics 3 & 4	Topic 3 Test-10 marks Topic 4 Test-10 marks	
7- 8	Topics 5, 6 & 7	Topic 5 Test-10 marks Topic 6 Test-10 marks Topic 7 Test-10 marks	
9		Module 11.4 Examination -50 marks	
10	Submit your assessment book to your Provincial Centre for marking.		

All the best and enjoy your studies with FODE- Business Studies.

INTRODUCTION

The purpose of this module is to develop understanding of the nature of small business enterprises in Papua New Guinea. It examines the features of a small business, motives for business entry, source of advice for business entry, and determinants that influence the success and failure of small businesses. This unit builds on the planning work undertaken by you in unit 11.3 Business Startup and Management. This unit requires you to conduct and evaluate your own small businesses.

Learning outcomes

On successful completion of this module, you can:

- Demonstrate knowledge and understanding of the establishment and operations of small businesses.
- Demonstrate an understanding of skills necessary for business
- Apply the knowledge and skills of business management in practical settings.

To achieve the learning outcomes you will:

- Implement and conduct a small business
- Apply criteria for measuring the success of the small business
- Evaluate the success of the small business

Time Frame

This unit should be completed within 10 weeks.

If you set an average of 3 hours per day, you should be able to complete the unit comfortably by the end of the assigned week.

Try to do all the learning activities and compare your answers with the ones provided at the end of the unit. If you do not get a particular exercise right in the first attempt, you should not get discouraged but instead, go back and attempt it again. If you still do not get it right after several attempts then you should seek help from your friend or even your tutor. Do not pass any question without solving it first.

11.4.1 Features of a Small Business

11.4.1.1 Ownership and Management of a Small Business

What is a 'Small' Business?

The definition of a small business will usually depend on the size and level of economic activity of a country. For example, a small business in a developed country like Australia may be regarded as a big business in a developing country like Papua New Guinea. Therefore, definitions defers from country to country.

In an attempt to define small business in different countries some key business characteristics have been developed. The most obvious aspect is the business size. Usually the following characteristics are used to determine whether a business is small or big:

- number of employees,
- annual sales volume or market share,
- value of sales turnover in a year,
- profits earned in a financial year,
- capacity of the firm's capital,
- volume and value of equipment and assets used in the business,
- whether the business is managed by the owner or by professional managers, and
- size of management and organisational structure.

According to the Papua New Guinea Ministry of Trade and Industry, a small business is one that has the following features:

Key characteristics	Specifications
Number of employees	1- 4 workers
Annual sales turnover	K30 000 – K50 000
Asset Value	K300 000 – K1 million

Table 1.1: Key characteristics of Small and Medium Enterprises (SME) as defined by the Papua New Guinea Ministry of Trade and Industry

So, a small business is one that employs between 1-4 workers; has annual sales turnover of between thirty to fifty thousand kina (K30 000 – K50 000) and an asset value of between three hundred thousand to one million kina (K300 000 – K 1 000 000).

Small businesses can be found in both the formal sector and the informal sector of the national economy. Many nationals are engaged in this sector, but expatriate business people are targeting the small and medium enterprise. So there is stiff competition in some industries like retailing.

Importance of small business to the economy

During an Asia Pacific Economic Cooperation (APEC) Ministerial meeting in 2000 it was reported that:

- Over 40 million small medium enterprises (SMEs) throughout the APEC economies account for over 90 percent of all enterprises
- Small Medium Enterprises (SMEs) employ from 32 to 84 per cent of the economies' work force,
- Small Medium Enterprises (SMEs) contribute from 30 to 60 per cent of Gross Domestic Product, and
- Small Medium Enterprises (SMEs) account for 35 per cent of exports in the region.

Since Papua New Guinea is part of APEC these statistics are relevant to our economy. Small businesses are very important to the Papua New Guinea economy because of the following reasons.

Large number of Small Medium Enterprises (SMEs) in Papua New Guinea

The exact number of small businesses operating in Papua New Guinea could not be determined given the lack of statistics on hand. However, it is estimated that over 50 per cent of the private sector in Papua New Guinea comprises of small businesses. This means there are a lot more small businesses compared to medium and large-scale businesses.

Large proportion of employment

Small enterprises contribute significantly to employment in Papua New Guinea by employing almost half of the total work force in the country. Without these small businesses the level of unemployment in Papua New Guinea will be very high.

Contribution to economic growth

Small businesses also produce between 30 to 50 per cent of the Papua New Guinea Gross Domestic Product (GDP) annually. This large contribution indicates that small businesses will continue to drive real economic development in Papua New Guinea. Because most small businesses are nationally-owned, the proceeds (profits) are kept within Papua New Guinea to contribute to the national economy.

Contribution to the Papua New Guinea Society

Small businesses contribute towards the economy and the society in general. The taxes they pay and the employment they create are important contributions to the economy. By competing with large companies they are able to limit the monopoly power of large businesses. Competition brings down prices and improves quality of products.
Small businesses are able to do that by producing tailor-made products which suit the customers' needs. For example, a shoe mender on the street provides a specialist service which bigger businesses such as TST or Best Buys are unable to perform.

Innovation is the idea of introducing something new. Small businesses are a rich source of new ideas and therefore full of inventions or introductions of new goods and services. Innovation is possibly the small businesses' most important contribution to the Papua New Guinea society.

Features of small businesses

One way of separating small businesses from big businesses is to have a closer look at key features of a small business. Generally, an enterprise is small if it consists of the following four characteristics.

1. **Less number of employees**
   Non-manufacturing firms such as retail outlets and street vendors which employ less than four (4) employees, are considered as small businesses in the Papua New Guinea. However, manufacturing firms, which require up to twenty workers, are also classified as small businesses in Papua New Guinea.

2. **Independently owned and managed (Sole Trader)**
   Small enterprises in Papua New Guinea are independently owned and operated by a small number of persons, usually one or two. The owner is generally the manager, who makes all the business decisions.

3. **Small share of the market**
   In Papua New Guinea a small business, according to the Papua New Guinea Ministry of Trade & Industry (MTI), is one that generates an annual sales of between K300 000 to K500 000. Hence, sales determine to an extent the size of their market share in the economy.

4. **Financed by the owner**
   Small enterprises normally start from scratch and often from a tiny idea initially. The owner or manager usually commits his/her personal savings or money borrowed from relatives to start the micro enterprise.

Common problems faced by small businesses

Small businesses face a lot of challenges and problems in Papua New Guinea. The common problems are discussed below.

1. **Lack of human resource development or business skills**
   Many people in Papua New Guinea do not have well-developed business skills because many of them have not been introduced to the knowledge and skills through formal learning. Apart from that, there are many adults who cannot read and write. Therefore, they feel inadequate to start and run their own businesses.
2. **Limited access to markets and networking**
   Many would-be entrepreneurs are not linked to the right market. Put it simply, they don't know where to sell their products. They are also outside of the established marketing networks, which makes it difficult to access the right market.

3. **Limited access to credit**
Many businesses are considered by banks and other lenders as too risky to lend. Therefore, their ability to raise funds externally is very slim, if not zero. Business growth is very slow and sometimes financial difficulties lead to business failure.

4. **Lack of technological development**
Technology is the most important factor for business success. Due to lack of education and limited knowledge and networking, small business owners are unable to use technology to their advantage. For example, many small businesses do not use computers. Those that do use computers are not really fully utilizing them.

5. **Limited access to business information**
Information is very important for any business. Information about banking, business registration, taxation, government support for businesses and others are usually unavailable to small businesses. Therefore, they are at a disadvantaged position.

6. **Infrastructure problems**
The infrastructure of Papua New Guinea is generally poor. Roads, bridges and rural airstrips are not so well maintained. This really makes it hard for small businesses operating in rural areas of the country. There are also many isolated parts of the country which are not accessible by road. So, small businesses operating in very remote parts of PNG are highly disadvantaged.

Financing a Small Business

For a start-up business there are two types of funding available; internal and external funding. Funds are needed to cover the start-up costs such as licenses and fees, electricity and water connection, advertising, furniture and fittings, etc. Even the initial trading stock must be purchased to start trading for trading businesses.

A. Internal

I. **Personal savings**
Money is needed to meet the startup costs covered earlier above. The cash contributed by the owner is called **owner's equity**. It usually comes from the owner's personal savings. Apart from cash, the owner can contribute other forms of assets or capital such as furniture, motor vehicle and building. When commencing a business it is always difficult to raise funds externally.

II. **Retained profits**
If the business has been in operation for some time now it is reasonable to expect some profit to be held in the business' bank account. This is called 'retained' profit. Such retained income can be used to fund further business expansion.

B. External

A start-up business has a few external sources of finance. However, these sources can be difficult to obtain except in few cases. We can categorise them under two headings; debt financing and equity financing.

Debt financing

Debt is a direct obligation to pay, usually cash, to someone (an investor or lender). The lender's money must be repaid with interest. Interest rate usually reflects the level of risk the investor is undertaking to lend money. Usually, a new business is likely to be charged a higher interest rate because of the uncertainties surrounding its ability to repay the money.

Debt financing can be advantageous. For instance, the owner still retains control of the business. He/she also maintains financial freedom and is entitled to the profits. Furthermore, the owner's debt is limited to the loan repayment period.

Debt financing also has its disadvantages. Firstly, the owner is required to make regular loan repayments even if the business does not make enough money. Penalties are applied if repayments are late or missed completely. Secondly, it is difficult to obtain a loan for a start-up business. This is because of the uncertainties involved.

Sources of external debt financing

I. **Bank lending**
Commercial banks have a range of financial products on offer to assist businesses. The main categories are: mortgage, term loans, lease finance, and bank overdraft. As mentioned earlier, it is not always easy for a startup business to obtain a commercial loan in the first one or two years. So the small business owner must develop a good reputation with commercial banks first.

II. **Trade creditors**
Some businesses from which the firm buys its goods and services do not have to be paid immediately. They usually allow trade credit for at least one month. Trade credit is an interest-free source of funds. However, this credit facility is only offered to those businesses that have established a high level of trust and reputation.

III. **Other sources**
Apart from banks and trade creditors you can also seek other sources such as:

- **Family members:** This is the next most possible source of external finance for a new startup business. It is easy to borrow from family members than from banks.
- **Friends and relatives:** Friends and relatives are often an important source of capital for a business since there exists a certain level of trust already.
- **Credit Unions:** These are financial institutions set up by employees of a company to service their financial needs. It can serve as a source of finance for a start -up business.

- **Microfinance:** Women-in-business, People's micro-bank, and other finance companies are already in the business of lending small funds to small businesses.
- **Commercial finance companies:** They mainly lend to businesses to purchase inventory and equipment. Their interest rates are high and they also require collateral or security.
- **Government's scheme:** The national government usually sets aside funds in business support schemes. Small business owners can borrow or access such funds.
- **Political grants:** Some politicians usually set aside development grants for small businesses. For example, we have the District Service Improvement Plan (DSIP) funds. Members of an electorate can apply to use those funds.

Equity financing

Equity financing does not require a direct obligation to repay any funds. It does however involve selling of a partial interest in the business. In effect, an equity investor becomes your partner in business and will have a degree of control over how your business runs.

Equity investors buy part of the business by supplying some of the capital required by the business. These investors are interested in the long term success of the business and future profitability. If they like, equity investors can sell their interest in your business to other people.

Equity investors are exposed to a high level of risk compared to debt investors. If the business fails their investment can be lost partially or fully.

Advantages and disadvantages of small businesses

Advantages

1. **Increase personal wealth**
   A small business can help its owner increase his/her personal wealth. Profit from the business can lead to increased wealth creation for the owner. This increased wealth can be used for future investments as well as to fund personal expenses such as school fees, living expenses, transportation, etc.

2. **Becoming independent**
   Some people always want to be their own bosses. People with a strong desire to be their own bosses are highly confident in their abilities to take care of themselves. All they want in life is more control over their lives. Many successful business people are also highly self-reliant and self-disciplined.

   In business, an independent person makes a personal choice to take risks. If a profit is made from the business activities, the independent person enjoys the profits. Likewise, if a loss is made, he or she suffers the loss.

3. **Contribute to national growth**

Small businesses contribute significantly in terms of GDP, employment, empowerment, standard of living and poverty reduction. GDP is the national income of a country. It is said in economics that a higher GDP leads to a higher standard of living for citizens of a country. Papua New Guinea's standard of living is currently low compared to many other Third World countries. This means that many people are living on or below the poverty line. Small businesses can help people escape from poverty and increase their personal income.

4. **Making use of skills**
   There are many people today who possess special skills such as carpentry, mechanical work and welding. These skills can be applied through direct employment, but there aren't enough jobs for every skillful person in the country.

   Self-employment is an attractive option for skillful people who do not have a fulltime, paid job. People who put to use special skills in business achieve great satisfaction in their business. They also earn an income from their activities. They have total freedom to practice these skills.

5. **Freedom of action and risk-taking**
   Self-employed people do have the freedom to make decisions and take action when needed. Making decisions and taking actions is a risky thing in business. Therefore, good entrepreneurs always try to reduce risk by making informed decisions. Most actions are based on information that is available. It is a choice they make. But that choice is helped by information such as the demand for a product, price and who to sell the product to.

Disadvantages of self-employment

1. **No automatic success**
   Being your own boss does not make you become successful very quickly. It takes more time than you think. The thought of experiencing a high level of success often misleads a lot of people into self-employment. In fact, more than half of small businesses fail in their first two years of operations. So, it requires commitment, discipline and patience in order to achieve success.

2. **Unlimited liability**
   The term '**liability**' refers to a state of being legally obliged or responsible. For example, the debts of a business represent a liability. It is important to understand what level of liability a business has. Small businesses have unlimited liability. That means if the business fails, the owner must also accept full personal responsibility for all the losses, even to the extent of losing his or her personal possessions.

3. **Shortfall in management skills**
   Self-employed people can be brilliant but they are not capable of doing everything perfectly. Running the daily affairs of the business requires good management skills. People who lack these important skills can mismanage their businesses. Mismanagement easily leads to failure in business. Businesses that are not managed

properly end up being bankrupt. Bankrupt means no having money and therefore, unable to pay debts.

4. Demands total commitment

Being self-employed requires full commitment. There are many competing interests that self-employed people may have. It is therefore important for them to balance their time carefully between their business and other interests. Sacrifices are made to other commitments such as sports and recreation, travel and family. Some people do balance their time between their business and other commitments, but many find it hard. This is another reason why some self-employed people fail.

Ownership and management of small businesses

A sole trader is a common operating structure for a small, start-up business. The next common structure for small, start-up businesses is partnership.
A sole trader is a one-person business. Individuals in Papua New Guinea can start their own business and operate as sole traders. As their operations expand, they employ one or two other persons to help out. But usually, you will find up to four workers working for a small business person.

A partnership is the next common ownership structure in Papua New Guinea. Two or more people can agree to form a partnership by contributing their capital towards the business. The profits of the business are shared among the partners according to their contribution to the business.

Because of the smallness of the business, it is usual to find one person running the business. This person is usually the owner of the business. In the case of a partnership, one partner can be appointed to run the business. Others remain as ‘silent’ partners.

Small business owners always try their best to wisely manage their businesses to make them grow. It would be quite clear to you that the underlying reason for most small business failure is poor management. Owners who go into business without good management knowledge and skills often end up in disaster. Likewise, many owners lack personal qualities and attitudes essential for survival.

A small business owner’s management skills and knowledge should include:

1. technical expertise
2. people management
3. record keeping
4. stock, cash, debtors and creditors management
5. costing and pricing
6. organizing staff.

END OF TOPIC 11.4.1.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activity 11.4.1.1: Complete the activated given.

1. Explain in your own words what is meant by the term small business.
____
____
2. Approximately what portion of PNG's population is employed by small businesses?
____
____
3. List two reasons why small business is important to Papua New Guinea's economy.
____
____
4. List one common problem faced by small businesses in Papua New Guinea today?
____
____
5. Why is it always difficult for a small business to obtain a bank loan?
____
____
6. Differentiate between 'debt' and 'equity' capital.
____
7. What is a common disadvantage of operating a small business in Papua New Guinea?
____
____
8. How important is the role of management to the success of a small business? Explain.
____
____

11.4.1.2 Market Share and Risk Factors of a Small Business

What is market share?

A market is represented by the total number of consumers or buyers for a product. As discussed above, small businesses serve a very small share of the total market. However, there are many small businesses operating throughout Papua New Guinea. More than half of the national economy is served by small businesses. That is why small businesses contribute significantly towards the national economy.
Unless a business enjoys a monopoly it is usual to see a market shared by many businesses. This is called competition. Because of competition it is hard for one small business to sell to the entire market. So really, it is possible for a small business to concentrate on a fraction of the market and keep serving that share of the market.
In order to keep the market share the business owner or manager must work hard. The owner/manager must develop a good relationship with its customers so that they continue to buy its products. Otherwise a competitor can easily take over the market share.

Risk

Risk is the possibility of suffering a loss or damage and is always present in any business venture. Most people, by nature, do not like risks. It mostly comes from the fear of failing. But you can never learn and grow as a person without failure and setbacks. Even successful people throughout history had failed at some point before reaching their goals. Thomas Edison, for example, failed many times before inventing the electrical light bulb.

No one can escape from risks because risk is ever present in our lives regardless of what we do. When you do things outside of your comfort zone there will be that fear of the unknown. Risk taking is part of life and if you are looking for success in life, you are going to take some risk to achieve it. No risk, no rewards. It is that simple.

Discussed below are four types of risks that must be considered before taking up a career in business.

Personal risks

Personal risks can involve both physical and emotional risks. Physical risks involve decisions to take an action and the risks associated with it. For instance, your best friend asks you to accompany him to a certain part of the Highlands provinces which is known for tribal fights. You must agree to take some risks if you agree to go with your friend. Emotional risk involves our thoughts and feelings. Emotional risks lie in our minds and thoughts and can only be experienced at an individual level.

Financial risks

Entrepreneurs usually take the risk to invest large sums of their own money to launch a new business idea. They have to commit their savings to the start-up business. The first one or two years usually represents the loss-making period for most start-ups. Entrepreneurs always face the risk of losing their investment in the event of business failure.

Social risks

Starting a new business venture is very demanding and takes up much of the entrepreneur's time and energy. As a result family and social commitments can suffer. Family relations can be affected when more time is given to the business. Such social risks always exist and are associated with small businesses.

Health risks

A business is a demanding activity, both mentally and physically. The typical day of an entrepreneur is filled with varied activities. Some of these activities require physical work, while others require thinking. A normal work day for an entrepreneur can extend to beyond 12 hours. It is often difficult to separate work-time from non-work-time. To the entrepreneur there is no such thing as free time, off time or holiday. Experiences show that entrepreneurs experience a high level of work related stress. Health problems do arise as a result of work pressure.

Risk taking situations

In every situation, the reward must be worth the risk one is willing to take. Otherwise, there is little to be gained from a risky behaviour. Risk can be placed on a scale or levels, ranging from no risk to total risk.

Entrepreneurs take educated, well-considered and well-researched risks. In general, all successful entrepreneurs possess certain characteristics which enable them to become successful.

Entrepreneurs see an opportunity, take up the challenges, turn them into viable businesses and see their businesses grow. But, no business success is ever guaranteed. There will always be uncertainty about whether a firm will succeed. Going into business certainly involves risking a certain amount of one's own money, credibility and time. Just how much risk a person is willing to take is an important factor in assessing business options.

Risk-taking thermometer

Figure 4.1 is a risk-taking thermometer. It shows those various levels of risk; from no-risk to total-risk. Individual business owners can be grouped under at least three categories of risk related behaviour: risk-averse people; moderate risk takers and; high risk takers. Every one of
us falls into either one of these categories.

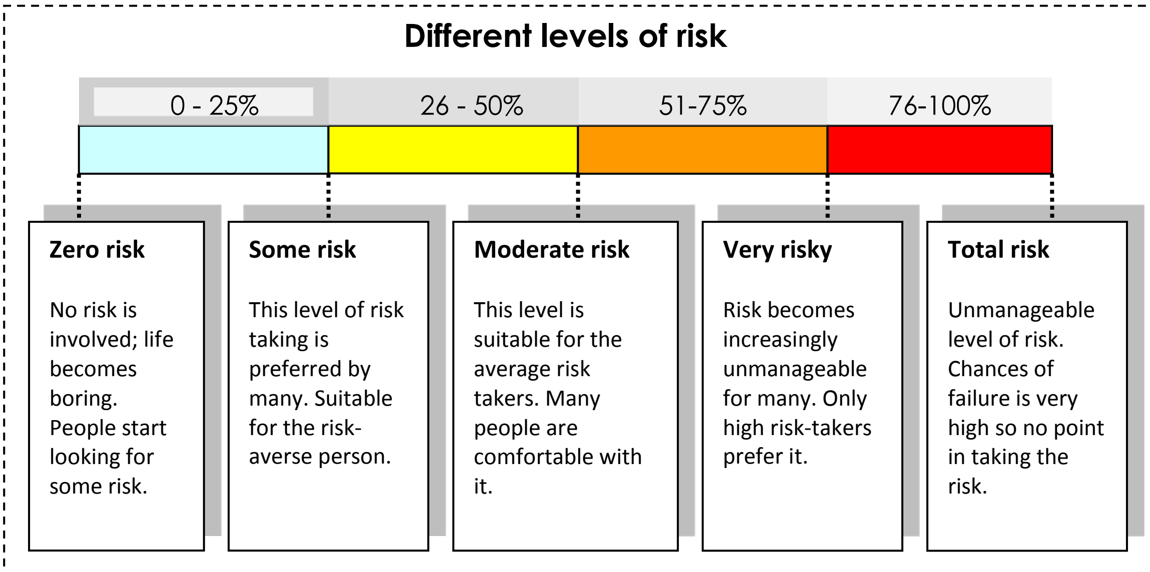

Figure 4.1: Risk-taking thermometer
(Source: Gr 11 B/S p. 131)

Risk-averse people are unwilling to bet much on their new venture. They are highly conscious of the threats and prefer investing in businesses with a proven track record.

Moderate risk takers prefer investing up to, but not beyond, a certain amount of resources. Some prefer buying an established business. Others prefer a new business that has been thoroughly researched and has better chances of success.

High risk-takers are willing to invest most of their own personal resources in new, untried business ideas. Most high risk takers prefer investing in new businesses, especially in 'cutting edge' and capital intensive markets, where the risks and returns are high. Chances of failure are much higher, although the potential return on investment can be great.

END OF TOPIC 11.4.1.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.1.2: Complete the activities given.

1. How important is market share to business success?

2. 'Success comes to those people who willingly take the risk.' Explain what this statement means to you.

3. Study the risk-taking thermometer diagram above and establish your personal risk taking level. Where on the thermometer do you fall in?

4. 'The higher the risk, the higher the return.' Explain what this statement means to you.

11.4.1.3 Motives for Business Entry

A motive is the reason why something is done or an action is taken. Every action that people take always has a motive or reason. For example, your motive for taking this course is to pass it with a good grade, or the reason why you read is to increase your knowledge.

It is true that we all have motives, but some of our motives are much stronger than others. So we often pay attention to the strongest motives first. Our strongest motives lead us to certain actions or decisions. Our motives also require that we set goals and aims. When we set out to fulfill our motives we are guided by those goals and aims we set.
People who start their own small businesses have numerous motives. These motives help them take the bold step to enter the world of business. Starting a business is always a challenging thing but it is also a rewarding exercise for many people. So in the following passages we will consider the key motives which cause people to start their own small businesses.

Main motives for business entry

1. Positive Motives

(a) Increase revenue
Revenue is the number one motive. All businesses want to increase their revenue. This is achieved through increased sales, better customer service and better marketing.

(b) Increase profit
All business owners want profit, and more profit. Profit is a powerful motivator that attracts people to business. Profit is the real reward that is available to the owner of a business.

(c) Customer satisfaction
A person with a brilliant business idea starts up a business in order to make other people happy with his/her product. When customers are happy your business will experience success in all areas. Happy customers help defend the business from competitive threats.

(d) Community support
Apart from tax and direct employment, businesses also get involved in social initiatives such as sporting, church, charity, etc. Businesses owners who experience great success feel obliged to give something back to the community. It is called **'corporate social responsibility**'.

(e) Build a culture
Business people aim to build a culture for their businesses. They aim to do things in a certain way and over time it develops into a culture. It is this culture that business people want to be associated with. For example, workers' uniforms, vehicle color and model, customer service, meeting styles, etc. are all cultures of a business.

(f) Build amazing products

Nothing represents a business more than its products. So product improvement and excellence come at the forefront of all business goals. Business people always aim to present the best product to their market so that customers can remember and value the product. Innovative products come with new opportunities for business growth.

2. Negative motives

(a) Immediate gratification

Gratification means satisfaction, pleasure, fulfillment or enjoyment. A business will always produce gratification at some stage but not immediately. People who aim for immediate pleasure or satisfaction are sometimes called 'show-offs'. Immediate gratification is a negative or bad motive for starting a business. A business is a vocation or a job. Therefore, we call it self-employment. It is not a means to show off and gain immediate or quick respect in a community.

(b) Exploitation of other humans

To exploit means to use others for one's own gain. A business should not be established in order to exploit or abuse other people. That is not a good motive. Workers should be well cared for. Customers should be well-served. The community should benefit positively from the business.

(c) Tax evasion

Every business must pay tax to the government. It is their obligation. So if a business person aims to avoid tax then that is a bad motive. Every government of the world depends on tax to provide public goods and services. It is the most important government revenue source.

(d) Environmental degradation

Every business has an obligation to protect the natural environment for future generations. Therefore, environmental care must be an important business motive. If a business intends to destroy the environment to make quick profits, then that is a very bad motive.

(e) Illegal activities such as cheating

A business should not be established in order to make quick gains. Most of these quick gains are illegal. For example, no one is allowed to trade in illegal drugs such as marijuana. Or, if there is a liquor ban in a province no one should smuggle liquor to make quick profits.

END OF TOPIC 11.4.1.3. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.1.3: Complete the activities given.

1. In your opinion, what is the common motive or reason why people start up a business?
   ____
   ____
2. List some bad motives for starting a business.
   ____
   ____

11.4.1.4 Determinants of Success and Failure of a Small Business

Success and Failure in Business

Every year thousands of small businesses are started in Papua New Guinea. Some succeed and grow while most fail. But others fail. Business success is not guaranteed, however, it comes with hard work. In this section we will study the factors of business success and failure.

Factors for Business Success

A successful business is a product of many factors such as good management. Good management is a quality of good entrepreneurs. Some of the key characteristics of successful entrepreneurs are discussed below.

1. **Drive and energy**
   Successful entrepreneurs have a very high level of energy and drive. They have the ability to work long hours without complaining. At times they can neglect their families for the sake of their business ventures. They are full of energy and are highly ambitious in their approach.

2. **Self-confidence**
   Successful entrepreneurs have a high level of self-belief. They have confidence in their ability to achieve positive results. They are always driven by the business objectives. By setting realistic and achievable goals they are able to work towards them with a high degree of self-confidence.

3. **Moderate risk-taking**
   Risk and return go hand in hand. Successful entrepreneurs take moderate and calculated risk. Nevertheless, they enjoy challenges and take pride in their efforts when they overcome those challenges. Risk is a constant part of every business enterprise. Without risk, an entrepreneur will make very little progress. If there is no risk then the returns are likely to be very low in most cases.

4. **Long-term view**
   Successful entrepreneurs have a long-term interest in making their enterprises grow over time. They believe in the continuity and growth of their infant business ventures. They always remind themselves that business is not something that someone gets into today and exits tomorrow. With a long-term interest they are able to set long term goals and objectives. Long-term and on-going success becomes the driving force for entrepreneurs.

Reasons for Business Failures

Not all small businesses make it through in their first year of operation. Studies conducted in Australia and elsewhere show that around fifty percent of small businesses fail in their first two years of operation. In Papua New Guinea this figure could be higher.

Below are some common reasons for business failure in Papua New Guinea.

1. **Mismanagement**
   Poor business management practices cause business failure. Managers who lack the skills and experience in areas such as stock control, financial control, staff control and supervision and time management cannot manage a business well.

2. **Sales and inventory problems**
   Some owners-managers do not know how to manage their stock or raw materials. They either buy low quality stock or run out of existing stock quickly. They sometimes buy too much of some slow-moving items and end up tying much of the cash in stock. Not having the right or required stock on hand is also a problem. All these problems arise out of bad stock recording and control.

3. **Lack of planning**
   Proper planning is critical to business success. Businesses that are backed up by proper planning often experience success. Therefore, before committing any hard-earned cash it is wise to plan out the business on paper. If it cannot work on paper then there is little or no chance that it will work in reality. A business plan presents information such as assessment of the owner's skills and ability, a decision on the market and the product idea, initial market research, the level of competition and pro-forma financial statements such as profit and loss statement.

4. **Inadequate records**
   Keeping proper business records is so critical to business success. Through business records, the owner-manager will determine the progress and success rate of the business. Most entrepreneurs lack the skills for record keeping. However, they still experience some success because they use their heads better than written records. In general, proper record keeping is highly recommended for all businesses. Bookkeeping, as it is known in business, is the job of accountants or bookkeepers. All business transactions must be systematically recorded. The important records to be kept include: cash book, journals, bank book, profit and loss statement and balance sheet.

5. **Negligence**
   In Papua New Guinea it is common to find that business owners neglect their small businesses. They are either on vacation or attending to personal, family or other obligations. Their small businesses are left in the hands of other people, usually workers and relatives. This is a bad business practice. It is an entrepreneur's obligation to be physically present at the business site. Entrepreneurs must treat

themselves as workers. They should therefore come to work on time, be present at all times and pay themselves a regular wage.

Asian entrepreneurs operating in Papua New Guinea serve as good examples for local entrepreneurs. There is a need for an attitude change – from being casual and relaxed to being everything to the business enterprise.

6. **Not separating business and personal activities**
   A business, once started, becomes a separate entity. That means it has its own status and existence. Since it has a separate existence it should be treated differently. The activities of the business should not be mixed with the owner's personal life. Many entrepreneurs fail to separate their lives and activities from their businesses. As a result their businesses becomes either stagnant or fail.

Nepotism or Wantok system in tokpisin is a very strong social system in Papua New Guinea. It is tied in with such activities as bride price, compensation payments, pig killing and other customary ceremonies and obligations. Wantok system also requires that everyone helps one another in times of need. This system sometimes leads to business failure when entrepreneurs fail to set a limit for themselves. Many promising small businesses in the country have fallen victim to the 'wantok system'.

END OF TOPIC 11.4.1.4. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.1.4: Complete the activities given.

1. State one (1) main reason for business success in Papua New Guinea
   ____
   ____
2. State one (1) main reason for business failure in Papua New Guinea.
   ____
   ____
3. If you were to start your own business, what three things would you avoid in order to experience business success?
   ____
   ____

NOW WRITE THE TOPIC TEST FOR UNIT 11.4.1. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOK.

11.4.2 METHODS OF STARTING A BUSINESS 1

11.4.2.1 Advantages and disadvantages of starting a new business

In this section we will look at the advantages and disadvantages of starting a new business. You should remember that starting up a new business is just one of many ways of getting into business. The others are also presented in the diagram below for your information. In this topic we will only concentrate on the first one – starting up a new business.

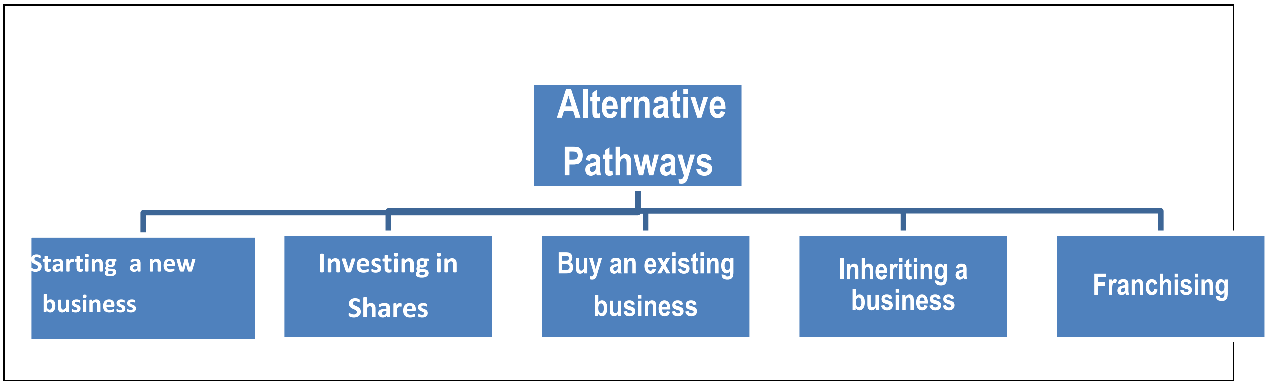

Figure 4.2: Pathways to business: (Source: Gr 11 B/S p. 135)

Starting a new business

Starting up a new business is the most popular method in our country. This option comes very easily to the minds of people. Many successful entrepreneurs have indeed started from new businesses. Like other methods starting a new business has its advantages and disadvantages. The table below summarises these advantages and disadvantages.

Advantages	Disadvantages
Owner determines growth and direction of the business.	Difficulty in raising initial capital
Flexibility	Small market share
Cost minimisation	Cash flow problems
New lifestyle goals	Learning curve expenses

Table 4.1: Advantages and disadvantages of starting a new business

Advantages of starting a new business
Determine growth and direction
A new start-up business offers the owner total control over the enterprise. The products, the target customers, the organisational design and culture and the financial plan of the business can all be determined by the entrepreneur. The overall direction of the business can entirely be planned and carried out by the owner.

Flexibility
It is easy to build a new business venture to fit the needs of both the owner and the market. This is often not possible with existing businesses, where established systems, strongly held

organisational procedures, and defined ways of operating exist. From this point of view, a new business is seen to be more flexible. It has a greater ability to innovate or be creative.

Cost minimisation
Many new small businesses can start trading at a lower cost. They do not have the ongoing costs that their established competitors have. For instance, purchasing an existing business may result in the new owner paying for additional, unwanted items, such as goodwill or good reputation and existing stock on hand.

New lifestyle goals
A new business can be the start of a new lifestyle and goals. For example, many people seek self-employment in order to become their own bosses and achieve financial freedom. For others, a new business may bring with it the opportunity to work more convenient hours, to spend more time with their family or to work from home. Many people also aspire to build an asset that they can pass onto their children.

The disadvantages of starting a new business

Raising capital
Financing a business venture can be difficult. Many financial institutions are unwilling to lend to unknown enterprises, even if the idea is good. New businesses are at risk of failure when there is insufficient cash and other resources to continue.

Small market share
A new business starts without any immediate customer base of its own. A lot of money and resources must be spent initially to reach a target customer base. Usually, due to the financial limitations, many small businesses struggle during their start-up stage to attract enough customers. This can weaken the strength of the business.

Cash flow problems
Lack of capital and customers can create severe cash flow shortage during the early days of a new venture. This cash flow shortage may exist for a few months, or even several years. When cash flow is tight, a sudden, unexpected change in the business environment such as interest rates increase or additional unplanned expenses can cause business failure.

Learning curve expenses
Because a new enterprise involves untried work, the owner will have to invest time, effort, and money to learn how to get the business working effectively. This is referred to as the 'learning curve'. The learning curve period may be short or longer depending on the past experiences of the entrepreneur. Developing a name and brand, deciding on suitable premises, recruiting and training necessary staff and developing an initial marketing campaign are part of the learning curve. Such expenses are necessary but do not generate immediate sales for the business during the start-up stage.

Factors to consider when starting a new business

Before commencing the business the following factors must be considered. The answers to each of these questions are important.

1. Start-up type
- Will the business be started from scratch, or will an existing business be bought?

2. Man-power or labour
- Will there be a need to employ other people in the business?
- If so, what kind of skills should they possess?
- Is it easy to find workers with the required skills in the local area?

3. Equipment or resources
- What type of equipment will this business idea need?
- How much of these equipment will be needed, and where will they be obtained?
- How much will these equipment cost?

4. Organisation of the business
- How many sections will be created in the business?
- Who will take care of each section?
- What will be the tasks for each person, and how will those tasks be coordinated?

5. Type of business control
- What type of business organisation is preferable – sole trader, partnerships or corporation?
- Who will be responsible for decision making, controlling, monitoring and managing?

6. Location
- What is the most suitable area to locate the business?
- Can a suitable location be found within the local area?

7. Finance
- Where will the money come from to start up your business idea?
- How much money is needed to start up or expand your business idea?
- What are the major costs involved in your business idea?

8. Supplies
- Where will the business get its supplies such as raw materials?
- Are there enough suppliers in the local area?
- How much is each supplier charging?

Costs of a start-up venture

Regardless of the type of venture being explored, some costs are common to all new enterprises. Any starting business will need to meet the following costs:

- licences and permits required to operate;
- working capital;
- communications equipment (telephone, computer, fax, etc.);

- operating plant and equipment;
- staff recruitment expenses;
- insurance;
- raw materials (or trading stock);
- rental of premises (unless working from the owner’s home); and stationery.

Five alternative pathways to business were identified but only one – starting a business from scratch – has been discussed here. The other four will be discussed later.

END OF TOPIC 11.4.2.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.2.1: Complete the activities given.

1. What is one difficulty faced by people who start up a business from scratch?

   ____

2. State an advantage of starting up a new business.

   ____

   ____

3. List two (2) key factors to consider when starting up a new business.

   ____

   ____

11.4.2.2 Planning to Start a New Business

What is a plan?

A plan is like a road map that guides someone to reach his or her destination. Planning is an important factor for business success. In Papua New Guinea, many small businesses fail due to lack of planning. Many people do not prepare a business plan before starting up their businesses.

Planning involves writing on paper, all the details of what the business intends to do and how the business will conduct its activities. This plan should show how a business idea will be put into operation. A business plan is, therefore, essential for the reasons stated below.

1. The plan gives a clear idea and direction in a step by step manner
2. The plan will always be required if you wish to borrow money from a bank
3. The plan gives an indication of whether an idea will work out in practice or not.

Business objectives and goals

A business objective is a general statement of what a business intends to achieve. It usually has a long-term view. A goal, on the other hand, is for a short term. It is a more precise and detailed statement of intent, usually measurable targets with a short-term date of completion.

Business goals and objectives are always related. Goals are short term and usually derived or taken out of the objectives. For example, profitability is a common business objective. It is a long term objective. A goal can be drawn out from that objective. For example, the goal for the first half of the year is to make a profit of K50 000. Goals are realistic while objectives are general or broad statements.

Importance of location

One of the key determinants of business success is business location. A good location will enable a business to attract more customers.

A good location usually offers high exposure to customers – existing and new customers. For example, businesses located in heavy traffic areas are likely to generate greater sales. A heavy traffic area is where a large number of people travel frequently such as busy streets, market areas and bus stops.

Choosing the right location for a business is often a difficult task. Not only must the owner take into account the importance of high visibility, but also the type of activity the business will be involved in. For example, motels would need to be located close to beaches, airports and main highways where passing tourists are likely to be attracted. Butchers and bakeries are likely to be located close to supermarkets in order to attract the passing families carrying out their weekly grocery shopping.

Factors to consider when considering business location

Choosing the best location will involve the business owner deciding upon which location or site has characteristics suitable to the business in question. Discussed below are several key factors or characteristics that need to be considered before a location decision is made.

Access, visibility and convenience
The location must be accessible to customers so that they are able to enter and leave the business area with ease. The site should be accessible by footpath and have car parking available. The site should also allow easy access for the delivery of materials and goods.

Customer demand and population trends
Retail and service businesses need to be located near potential customers. The factors affecting the local population are important. The factors of local population are such as the age of the population, their income levels and occupations, how many children in each household and how many cars each family owns are all key indicators. These things determine which groups in the population are likely to be targeted as customers.

Competition
Locating near competitors could be an added bonus because similar businesses in the same area often attract many customers. This is particularly true in areas with a high population. However, the closeness of competitors could also be damaging. For example, too many jewelry stores in a small suburban shopping center might cause stiff competition.

Cost of the location
The decision of where to locate depends on the costs of the site. Monthly rental or lease payments must be considered carefully. Provincial and local level governments also charge for connection and use of basic services and utilities such as electricity, water and sewerage. These cost factors must be taken into account before deciding where to locate.

Site layout and physical facilities
The chosen site must meet the specific requirements of the business. The floor plan should be of a required size. The site should also have areas available for toilets and store facilities. Retail businesses would require stock storage space as well as sufficient lighting and space for displaying stock to customers.

Town planning regulations

The 'zoning' laws in force in a particular area state which areas may be used for certain business activities, and which areas are reserved for residential or other purposes, for example, parks, playgrounds, etc. Factories may only operate in certain areas, usually some distance away from residential areas.

Law and Order
If there is a lot of crime in a particular area, it will add to the cost of business. The cost of insurance, security, alarm system, high fence and the risk involved must be taken into account.

The future

The business owner should also try and consider the impact that potential future factors may have on the location. For example, any future changes to roads, nearby shopping centers, public transport services, and housing may all either increase or decrease the value of the business, making the business a fantastic future prospect or a nightmare to sell.

Different types of business and their requirements of location

Manufacturing

Businesses that are involved in manufacturing usually require more space. They also require their own set-up in terms of equipment layout, machine set up and storage areas. Manufacturers such as factories are found closer to the source of raw materials for ease of transportation. You would also expect manufacturing firms to locate closer to main wharves and highways for ease of transportation.

Retailing

Retailers must be located close to where people live. Most of them are found in urban centers. However, small-scale retailers such as canteens and stores are found in villages and squatter settlements of urban centers. Large-scale retailers Brian Bell are conveniently located close to bus stops and other central locations. They are also located close to the warehouses and wharves for ease of transportation.

Extraction of raw materials

Businesses that are involved in the extraction industry are located close to where the resources are. Most of them are on-site, meaning that machines, tools and workers are found in one area where the resources are. The extraction industry is always attached to the natural environment. For example, fishing vessels are always out at sea looking for fish. Fishermen spend most of their time at sea. On the other hand, oil and gas companies are found operating in the middle of thick jungles, away from civilization.

Service

The service sector is varied. There are various categories of service providers. Businesses involved in this sector are often located close to the customers. Also, service providers are located mostly in urban centers. Some service providers such as airline companies only operate where there are airports. Buses, taxis and other forms of land transport, on the other hand, need roads to operate on. Schools need building space to operate. Lawyers and accountants need office spaces to operate in. So, different services have their specific requirements, but they all operate close to their customers.

Business Goals and Responsibilities

Business goals

Apart from the profit motive all businesses have other aims or goals. Some businesses have more goals than others depending on their size and structure of ownership. Let us consider some of them below.

Financial returns

Every business is set up in order to make a profit – more profit indeed. But not all businesses make the same amount of profit. Some even make a loss at times. Generally, the higher the profit, the better it is for the business. **Profit** is defined as 'the difference between revenue and expenses'.

Economic textbooks refer to profit maximisation as the ultimate aim of all businesses. Many businesses aim to achieve the highest possible level of profit or to maximise profit. But, under normal conditions, profit maximisation is rarely achieved. Some businesses realise this and aim to make a satisfactory level of profit each year. They set realistic profit targets to achieve. Therefore, profit satisfaction is a realistic business goal.

Positive cash flow

Cash flow is a critical and ongoing business concern. A business can make a profit but that does not mean there is sufficient cash on hand to pay for expenses and debt obligations when needed. It is the availability of actual cash that matters most to the survival of any business. So always maintaining a positive cash flow becomes another important business goal.

Return on Investment

Return on Investment (ROI) is important for all businesses as it indicates the return on the capital invested. It is usually a percentage of profit over capital invested in any given period. ROIs can be either short-run or long-run. Under short-run ROI businesses are under pressure to generate large amounts of cash and make a clear profit quickly. Some businesses accept a long-run ROI as it allows them time to develop at a reasonable pace.

Production effectiveness and efficiency

Production or output is determined by the fixed resources that a business has. As an increasing quantity of resources is used marginal output eventually declines. This is referred to as the law of diminishing returns. The law of diminishing returns is studied in economics. This is particularly important for businesses that aim to achieve the highest level of production that is possible. For example, in an agriculture business, if more and more workers are working in the same field with a fixed amount of capital and fertilizer then at a certain point output cannot be increased any further. The field has reached its optimal or most economic output level. Any additions of labour and resources will barely increase the output.

Businesses always aim to increase their production efficiency. That means producing the right goods or services, at the right time and for the right consumers. Price and quality also matter. As long as cost is controlled the business and its customers can benefit.

Business Responsibilities

Social responsibility

All businesses have certain social responsibilities to fulfil. This is called Corporate Social Responsibility (CSR). Corporate Social Responsibility (CSR) is also known as Cooperated Culture. Businesses are expected by consumers, pressure groups and even the government to be conscious of the environment. Today's consumers are equally interested in ethical and socially responsible business practices. They are increasingly becoming 'socially and ecologically conscious' in their behaviour.

CSR requires businesses to achieve a balance between their customers, the society and profitability. CSR firms always strive to generate profits, obey the law, be ethical and be good corporate citizens. CSR covers four broad areas: economic, legal, ethical and philanthropic. Philanthropy is the effort put in by businesses to increase the wellbeing of humankind through charity and donations. Businesses should decide how best to fulfil each of the four elements of CSR.

Sustainable development

One of the best practices of CSR is sustainable development. Sustainability refers to the type of development 'that meets present needs without affecting the ability of future generations to meet their needs.

Sustainability is not just concerned with environmental issues but also with the social, economic and cultural issues of the society. It also covers the fair distribution of economic benefits, human rights, community involvement and product responsibility. Businesses globally are being challenged to consider the longer-term benefits of the society rather than the short-term pursuit of profit, individual enjoyment and consumption.

Satisfying stakeholders

Employees, lenders, trade creditors, tax agents, suppliers and the government can influence the activities of a business in various ways. The table below provides the common stakeholders of a business. Each stakeholder contributes uniquely to the business and also expects something from the business in return.

Stakeholders	**Function**
Shareholders	Own the business
Financial bodies	Provide business funds
Employees	Provide labour and skills
Trade unions	Organise labour and seek to influence pay
Managers	Provide organisation and control
Government	Legislate and regulate the business environment
Customers	Consume the products
Suppliers	Provide raw materials

Table 4.2: Shareholders and their functions

END OF TOPIC 11.4.2.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.2.2: Complete the activities given.

1. Why is location important in business?

   ____

   ____

2. How are business goals different from business responsibilities?

   ____

   ____

3. Is profit always the number one business goal for every business? Explain.

   ____

   ____

11.4.2.3 Planning a Product or Service for a New Business

The starting point

Every successful business starts from a good idea. As potential entrepreneurs you should work on developing your own ideas. The idea must always be related to who you are. That means you should evaluate yourself to see if your idea matches your abilities, experiences and lifestyle. An idea could stem from something that you are exposed to daily. Or it may be your hobby which you might like to turn into a business. Even an opportunity you identify can be the starting point.

However, as a potential entrepreneur, it may be difficult to research your business idea. This is true if you have never been exposed to any business industry before. In such a case, you will need to seek additional information to test whether your idea will work out. Go to a library near you to find more information about your business idea. Books and other written materials contain useful information. Watch the daily news on television, listen to the radio, and read the newspapers regularly. These sources do provide useful information.

Product

Every business in the world – whether new or existing - produces or sells a product. The product is the center of every business. Every new business starts off with a product idea. A product can be a good or a service. A good has physical attributes such as size, colour, shape, and taste. A service, on the other hand, does not have much tangible attributes, yet it is a product. A service is performed or provided in order to solve a consumer need. A good also serves to solve a consumer need.

The concept of a product goes far beyond the tangible or physical attributes such as size, content, shape, or color. Products can also include many intangible attributes or non-physical attributes such as price, brand, manufacturer's reputation, installation and warranty. A product's intangible attributes are important because customers not only choose a product for its looks but also for other reasons such as quality, customer service and convenience.

Product mix

Businesses rarely offer only one product for sale. In most cases, businesses offer a variety of goods and services and this is called a firm's product mix. A business has the flexibility to alter its product mix at any time. This is usually achieved by altering any of the following three aspects of the business' product mix:

- its product line
- its product breadth
- its product depth.

A business' **product line** normally refers to the group of similar products that a business sells or produces. On the other hand, **product breath** refers to the number of product lines a business carries. For example, a fashion outlet may have a good product breath if it also sells clothing accessories such as beads, hats, jewelry, shoes, watches and perfumes. Similarly, **product depth** refers to the total number of items within a business' product line. For the fashion shop, it might include having an assortment of sizes, brands, colors, and models for its range of clothing and accessory lines.

Businesses can alter their **product mix**, by expanding the number of product lines or by adding depth within a particular product line. For instance, Coca-Cola has introduced depth within its Coke product line by offering 500 ml, 1 liter, and 2 liter size bottles.

Commerce

Commerce involves the distribution and sale of goods and services. This is done through storing, transporting, advertising, providing finance, selling and many other related activities. Truck drivers, dock workers, bank clerks, insurance clerks and shop keepers are examples of commercial workers. Commercial services are important for business as they help in bringing the finished goods to the consumers.

Direct services

Doctors, policemen, footballers and singers are also part of tertiary production. They don't produce goods, but supply services, which help to satisfy our needs and wants. Some of these services are vital for the society.

The cost of providing basic services is too high. Therefore, the government subsidizes the high cost by paying for such services on behalf of the people. This situation is gradually changing in the country. Some services, previously provided by the government, are now taken over by private providers. Today, we have private hospitals, clinics, mobile phone companies, radio stations and airline companies. In the near future we might see a lot more private businesses offering direct services to consumers.

Product categories

A variety of goods and services are made available by producers. These goods and services are categorised under either capital or consumer goods and services. These two categories cover almost all goods and services produced in any society. Different types of goods and services are produced in different places. This is due to differences in the climate, the size, structure and skill of labour force, demand and other factors.

Capital goods are needed to produce other goods and services. Some capital goods are fixed while others are not. Fixed capital lasts for a long time. Buildings, warehouses, tools, trucks and machinery are examples of capital goods. Working capital is used in the production of other goods. Money is a good example of a working capital.

Consumer goods and services are produced for people to consume. Consumers purchase these goods and services to satisfy their needs and wants. Different foodstuffs such as rice, tinned fish, kaukau and fruits are examples of consumer goods.

In developed countries such as Japan and Australia, there are more service providers. It is estimated that nearly 80 percent of all businesses in developed countries are involved in providing services. The opposite is found in developing countries such as Papua New Guinea.

Product function and benefit

There are many types of products. But they are grouped according to their functions and benefits. Below are general groups that help the seller understand the products and sell them better.

Durable products

Durable products last for a long period of time before they are replaced. Products such as cars, electrical goods, and machines are examples of durable goods.

Non-durable products

These products or goods can only be used once or a few times before they are replaced. Food and office stationery items fall into this category.

Service products

Services represent intangible products. The benefit and satisfaction of services do not take any physical form. Items such as banking services, insurance, holidays and travel are examples of service products.

Identify target market for a product

A target market is identified using the information gathered through the market research or survey. Market research is therefore an important step to undertake before the target market is identified. A target market will ensure that all resources and attention is focused or directed towards it. Knowing the target market will help a business produce the right goods or services to meet the demand. It is no use producing something that does not have a customer. That will be a waste of time and resources.
Details of the target market can be obtained by asking the following questions:

- Who are the customers?
- Where do they live?
- How many products will they require?
- What is their income level, and does their income fluctuate during the year?
- Are they already buying from another supplier? If so, are they happy with that supplier?
- How much are they willing to pay now for my product?

END OF TOPIC 11.4.2.3. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.2.3: Complete the activities given.

1. What is a product? ____
2. What is product line? ____
3. What is product breadth? ____
4. What is product depth? ____
____

11.4.2.4 Market Survey and Competition

What is Competition?
Competition is the rivalry among sellers trying to achieve business goals such as profit, sales volume and high return on investment. The economic definition is 'the effort of two or more parties acting independently to secure the business of a third party by offering the most favorable terms.'

In theory, competition causes commercial firms to develop new products, services and technologies, giving consumers greater selection and better products. Greater selection generally causes lower prices for the products. In economics, the absence of competition is called **monopoly**. If there is very little competition, it is called **oligopoly**.

Competition is generally accepted by market economies like PNG, Australia, New Zealand USA, and many others. Competition happens through the market process. If there is little or no competition prices will be very high.
Competition results from **scarcity**. Scarcity means there is never enough to satisfy all human wants. It occurs 'when people strive to meet the criteria that are being used to determine who gets what.' The competitive process tends to move resources to where they are most needed, and to where they can be used most efficiently for the economy. For competition to work effectively, it is 'important that prices accurately signal costs and benefits.'

There are three levels of economic competition as explained below.

1. Direct competition
This is the narrowest form of competition and is also called brand competition. It is where products that perform the same function compete against each other. For example, a brand of packet of 1kg Trukai rice competes against a packet of 1kg Jasmine rice in the supermarket.

2. Substitute competition
This is where products that are close substitutes for one another compete. For example, butter competes with margarine, mayonnaise and other various sauces and spreads.

3. Budget competition
This is the broadest form of competition. It includes anything that the consumers might want to spend their available money on. For example, a family that has K1000 available may choose to spend it on many different items which can all be seen as competing with each other for the family's available money.

Elements to consider in competition

Even in highly free market economies there are restrictions or limitations to competition. For example, competition is restricted in the case of a government monopoly such as Air Niugini, Telecom PNG or PNG Power. Secondly, tariffs or other restriction measures may be applied by governments to reduce competition. Depending on respective economic policies, the pure form of competition is non-existent or is restricted by respective economic policies.

The key elements of market competition are demand and supply. Demand and supply affect prices. If the demand for a product is high, its price is also expected to increase unless there is an oversupply of the product. So the elements of demand, supply and price go hand in hand in determining competition.

Generally, humans compete against each other to obtain the resources needed. Price is a mechanism that controls who gets what and how many as individuals compete.

How to compete with competitors

In order to compete against other businesses you must know exactly what customers demand or want. This requires some form of research or survey. The next step is to find out how many of a product consumers want. If only a few people want a certain product then it may not make economic sense at all to sell it.

The next step is to determine the price of the product. This price is what customer will pay to obtain the product. If the price is high, the product will be less demanded. So setting the right price is an important requirement.

Once a product and its price are determined the business must develop and carry out an effective marketing plan. Information about the product must be sent out to potential customers. This is done through advertising and public relations.

Ongoing market surveys must be conducted to determine whether the product is still needed. If customers demand a change in the product or its price the business should respond to it. It is all about satisfying the customers and keeping them happy.

END OF TOPIC 11.4.2.4. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.2.4: Complete activities given.

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1. How does competition help businesses? ____
2. How does competition help consumers? ____

How can a market survey help a business in competition? _________________________

NOW WRITE THE TOPIC TEST FOR TOPIC 11.4.2. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOK.

11.4.3 METHODS OF STARTING A BUSINESS – 2

11.4.3.1 Investing in Existing Business

Investment

Investment is a term used to describe the use of money and property to earn an income. People or institutions that own properties and money allow others to use them in return for a payment are called **investors**. Income from ownership can be further classified into different categorise depending on the assets owned.

Different categories of investment

1. **Owning properties, land or equipment**

   People can own properties such as house, land or equipment and allow others to use them for a fee. This fee is usually called **rent**. The landlord or property-owner charges a regular rent on the use of the property. The tenant or user has to pay the amount according to the written agreement. Rent becomes the income for the landlord. Rents can be earned on either fortnightly or monthly basis. Owners also receive higher fees for lending their equipment such as a motor vehicle to customers to use.

2. **Income from the ownership of money**

   Some people have extra money that they do not need immediately. This money can be put into a variety of uses to earn an income. They could lend this extra money to others and receive an income known as **interest**. Most people allow banks to use their money in return for an interest. Interest is calculated as an annual rate.

3. **Investing in shares and debentures**

   The person who buys and owns shares is called a shareholder. When companies make a profit at the end of the year, all or part of that profit is distributed to the shareholders as their return or income. This income is called a **dividend**. Sometimes, companies make a loss. In such cases, shareholders do not receive any dividend for that period.

People can also invest extra money in companies by buying **debentures**. A debenture is a type of fixed-interest security. It is issued by companies, who act as borrowers. The word, debenture comes from the Latin word 'debeo', meaning 'I owe'.

Debentures are issued to the general public through a prospectus and are secured by a trust deed. A trust deed states the terms and conditions of the fundraising and the rights of the debenture-holders. Companies that normally issue debentures are finance companies and large industrial companies. Debenture-holders' funds are invested with the borrowing company as secured loans. In return people who invest are paid interest.
So you can see that a shareholder is different from a debenture holder.

- A shareholder is paid dividends on the profits; a debenture-holder is paid interest.
- A debenture-holder is more secured than a shareholder. When a company goes bankrupt, than debenture-holder has preference over the shareholder in claiming for his/her interests over the company's assets when sold.
- A debenture-holder is paid interest on the debentures, regardless of whether the company makes a profit or not.
- The shareholder enjoys higher dividends if company makes a huge profit. However, the debenture holder will get a fixed interest.
- Debentures are issued for fixed periods, but if a debenture-holder wants to get his or her money back, the securities can be sold. On the other hand a shareholder can sell his/her shares anytime.

4. Investment Trusts

An investment trust is a form of collective investment. Investment trusts function as public limited companies. Investors pool their money together under an investment trust by purchasing a fixed number of shares that are on offer from the trust company. The company board will delegate responsibility to professional fund managers to invest in the stock market.

Investment trust shares are traded on stock exchanges like those of public companies. Investment trusts can hold a variety of assets such as listed equities, government/corporate bonds, real estate and private companies.

Investment objectives include: growth, income and capital preservation. Risk profile involves the level of diversification through assets and risk factors. The grouping of trusts by the above characteristics or criteria is known as a classification. The grouping of trusts according to a given classification allows investors to compare similar trusts to see which ones yield more returns.

5. Share or stock

A share is a unit of ownership that represents an equal proportion of a company's capital. It entitles its holder to an equal claim on the company's profits and an equal obligation for the company's debts and losses. The capital of a company is divided into shares. Shares can be broadly divided into two categories – equity and preference shares.
Equity share is also called ordinary share or common stock. Equity or ordinary shareholders are the real owners of a company. They are entitled to the profit of the company. They also have the voting rights during the company's annual general meetings (AGM) and other official meetings.

A person who owns **preference stock** is entitled to a fixed income whether a company makes a huge profit or not. They are not entitled to vote during company AGMS and other official meetings. If a company goes bankrupt, the preferred shareholders are the first to get refunded.

Shares are bought and sold through established stock exchanges such as the Port Moresby Stock Exchange and the Sydney Stock Exchange. When someone buys a share, he/she buys a part of the business. So he or she is called a **shareholder**.

Shares belonging to established public companies are usually traded on the stock market. An investor who chooses to be a shareholder can contact a specialist called '**stockbroker**' to buy the shares of a company of his/her liking. The stockbroker is a specialist in buying and selling shares.

When the shares are offered for sale directly by the company for the first time – called Initial Public Offering (IPO) – they are offered in the 'primary market.' After this IPO, the stocks will have to be traded in the secondary market which is the stock exchange.

Two types of stock or share investments

There are two categories of stock or share investors. The first group is called '**stock speculator'** and the second group is known as '**stock investor'**. These stock traders aim for one thing in common: income. But they try to earn their income in two different ways.

1. **Stock speculator**
   Stock speculators usually try to gain profit from short-term price movements with trades lasting anywhere from several seconds to several weeks. A stock speculator is usually a professional. Most of them have clients and act as money managers or advisers with the intention of adding value to their clients' finances.

   Individuals or firms trading equity or stock on the stock markets as their principal capacity are called stock traders.

2. **Stock investor**
   A stock investor is a firm or an individual who purchases stocks to hold them for an extended period of time, usually several months to years. Stock investors commonly use a strategy known as 'buy and hold' strategy. Stock investors will buy stock and hold them for a very long time to earn dividends and to earn from a rise in the market price of these shares.

Advantages of investing in shares

1. Interest rate is higher than commercial banks interest rate but lower than equity price.
2. Share investors are protected from the eyes of the public. Nobody knows their worth.
3. Dividend – the cash reward for investing in shares – is usually paid out at the end of a financial year. The larger the unit of shareholding the more money shareholders earn.
4. Bonus issues – free shares – are given to existing shareholders. Sometimes a company can declare a bonus as well as a dividend. This is a double gain.
5. Investors can sell their shares easily if they choose to do so.

6. Price of shares move up or down responding to the forces of demand and supply. If the share price moves up you can make a capital gain through capital appreciation. This can make someone so rich overnight. For example, a company's stock traded last year for K6.00 per share. Due to good performance, a unit costs K48 a year later. This is a very massive increment in the value of the stock. If you had bought 50 000 units of shares at K6 per share last year, it means you spent K300 000. At the current value of K48 per share, if you sell your shares, your return would be 48x50 000, which is equal to K2.4 million. Thus your capital has appreciated from K300 000 to K2.4 million.

Disadvantages of investing in shares

1. It may take a long time before the rewards of investment can be realized.
2. Because of the unpredictable nature of the stock market, stock price can crash due to one reason or another. Sometimes share prices drop so much that an investor loses money in terms of share value. For example, after a series of plane crashes in 2014 the share prices for Malaysian Airways dropped. Investors have lost the value of their stock.
3. Sometimes corporations go into liquidation, thereby eroding the investments of ordinary shareholders. A liquidated company can die with the investors' money.
4. Fraudulent stock brokers are unfaithful to their clients. They may collect your money but end up investing in their own names or divert your money for their selfish gains.

Public companies selling shares in Papua New Guinea

The concept of stock market and investing in stock has been around in PNG for some time now. However, not many people were able to participate in it fully due to various factors. The national government has approved the establishment of the Port Moresby Stock Exchange as a way of encouraging Papua New Guineans to invest in shares. The table below presents the publicly listed companies. Their shares are trading on the Port Moresby Stock Exchange (POMSoX)

No.	Company Name	Listing Code
1	Airlines of Papua New Guinea	CGA
2	Bank South Pacific Limited	BSP
3	Bank South Pacific Notes	BSPHA
4	City Pharmacy Limited	CPL
5	Coppermoly Limited	COY
6	Credit Corporation (PNG) Limited	CCP
7	Highlands Pacific Limited	HIG
8	Indochine Mining Limited	IDC
9	Interoil Limited	IOC
10	Kina Assets Management Limited	KAM
11	Kina Petroleum Limited	KPL
12	Marengo Mining Limited	MMC
13	New Britain Oil Palm	NBO

14	New Guinea Energy	NGE
15	New Guinea Islands Produce Company	NGP
16	New Crest Mining Limited	NCM
17	Niuminco Group Limited	NIU
18	Oil Search Limited	OSH
19	Steamships Trading Company Limited	SST

Table 4.3: Public Companies listed on POM Stock Exchange

END OF TOPIC 11.4.3.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.3.1: Complete the activities given.

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1. What is a share? ____
2. Who is a shareholder?
   ____
3. What category of companies is allowed to trade their shares on the stock exchange?
   ____
4. What is the difference between a 'share' and a 'debenture'?
   ____
   ____
5. How can a potential investor buy shares in a public company?
   ____
   ____

11.4.3.2 Buying an Existing Business

Methods of business valuation

Buying an existing business

One way a business owner can reduce the workload and risks involved in getting into business is to buy an existing business (going concern). In buying an existing business, the owner is purchasing the location, premises, equipment, staff, customer base and goodwill already established by the previous owner.

The major advantage of buying an existing business is that it will already have a regular customer base. Therefore, sales to existing customers will provide immediate income to the new owner. However, the amount of success a business enjoys often depends on the personality and experience of the owner. So if the previous owner goes, some of the customers may go with him/her. This is often true for businesses like restaurants and hair salons.

The other potential problem inherent in buying an existing business is that the purchaser is often stuck with the previous owner's decisions regarding the choice of stock, equipment, fittings and perhaps employees. An existing business may even cost more because of its existing client base and reputation.

Potential businesses can be found in a number of ways. Business brokers can advertise the sale of a business in the newspaper or online advertisement. Accounting firms can also become agents to sell off businesses. Some businesses are liquidated through bankruptcy. Liquidate means to shut down a business and pay off its liabilities through its assets. The business will stop trading any more.

How to value a business

Before purchasing an existing business the potential owner must know a thing or two about how to value it. Here are three methods of valuing an existing business.

1. Capitalising method

This method is based on the 'expected future profit'. Under this method, the price of a business is based on the likely profit to be made.

Step1. Past financial statements must be carefully examined to see if profits have been made.

Have profits been increasing or decreasing over time? Apart from accounting records the buyer should insist on seeing other records such as the bills paid to suppliers and bank deposits for the past year. Purchase records should also be checked against the sales records.

Step2. Decide on the rate of return required for investing money in the business. The rate of return in this situation is known as the capitalised rate. The capitalised rate will be influenced by how much their money could earn if invested in alternative ways. The formula for the capitalised rate is:

$$\textit{Capitalised value} = \frac{\textit{Expected profit}}{\textit{Capitalised rate (rate of return)}}$$

For example: what would be the capitalised value if the expected profit for a business is K100 000 and the rate of return is 25 per cent (25%)?

$$\begin{aligned} CV &= \frac{100\ 000}{25\ \%} = \frac{100\ 000}{25/100} \\ &= 100\ 000 \div \frac{25}{100} \\ &= 100\ 000 \times \frac{100}{25} \\ &= \frac{10\ 000\ 000}{25} \\ &= K400\ 000 \end{aligned}$$

Remember, 25% is the same as 25/100
The division (÷) operation is used because 25% is placed under 100 000

Multiply with 100/25 which is the reciprocal of 25/100

Divide 25 into 10 000 000 to get the answer

In this example, the capitalised value is four hundred thousand (K400 000).

Let us discuss one more example again. Let us say that the same business above has a rate of return at 10%. What would be the capitalised value?

$$\begin{aligned} CV &= \frac{100\ 000}{10\ \%} = \frac{100\ 000}{10/100} \\ &= 100\ 000 \div \frac{10}{100} \\ &= 100\ 000 \times \frac{100}{10} \\ &= \frac{K10\ 000\ 000}{10} \\ &= K1\ 000\ 000 \end{aligned}$$

Remember, 10% is the same as 10/100
The division (÷) operation is used because 10% is placed under 100 000

Multiply with 100/10 which is the reciprocal of 10/100

Divide 10 into 10 000 000 to get the answer

In the second working out at 10%, the capitalised value is one million (K1 000 000).

When the capitalised rate is higher, the capitalised value of business becomes lower. So, the higher the capitalised rate, the lower will be the capitalised value. These two rates are also influenced by the level of risk involved. Smaller businesses, for example, have high risk. Therefore, investors would want a high capitalised rate to obtain a high return on their investment.

2. Appraised value

Appraise means to value. Valuation is undertaken by calculating the value of the net assets of the business. These assets include: stock, equipment, fixtures, premises, the business' goodwill and also the trading debts owed to the business. Stock must not decrease in value and must still be saleable if it is sold at its original price.

Buyers should make sure that all trade creditors have been paid what is owed to them. It is not a good idea to accept liabilities when buying a business. If they are included, their value must be subtracted from the value of the assets. This will enable the real value of the business to be determined. Make sure to confirm that all back taxes have been paid. Buyers must also ensure that none of the assets they are purchasing have been used as security for loans that the seller has not yet repaid.

If the selling price for a small business is greater than the value of its physical assets, the difference may be the value of the firm's goodwill. This asset represents the ability of the business to earn greater profits than if it were a business which had just been established. Many small businesses for sale, however, will not have much goodwill. Some may even have 'ill-will', which is a liability, rather than an asset.

Earnings based (cash flow) valuations

Some purchasers are more concerned about the future potential of a business. In this sense, future earning power and the ability to produce cash income are most important. There are two approaches considered below.

3. Return on Investment (ROI)

Return on Investment (ROI) is a commonly used valuation technique or tool. This technique is believed to involve both the risk and return in its selling price. It works on a formula which includes the estimated future profit. Hence,

Selling price = Net annual profit x (100/ROI)

Since the level of risk varies from industry to industry, it is usual to find different ROIs for different businesses. A higher level of risk is often associated with a higher level of ROI. However, because of the high level of risk involved, the selling price is likely to be low. On the other hand, safer businesses tend to produce a lower ROI, but can command a higher selling price. This is because an enterprise in a low-risk field should reasonably and consistently produce a profit, year in year out. In other words:

low risk = low return = high selling price, and
high risk = high return = low selling price.

For example, the selling price of a business making K100 000 profit in a high-risk industry with an ROI of 50% will be:

K100 000 x (100/50) = K200 000

If that same industry was highly stable and secure, and the required ROI consequently was set at the much lower rate of 10 % then the purchase price would be K1 000 000. (100 000 x (100/10) = 1 000 000)

Discounted cash flow

A common but more complex analytical tool is the use of discounted cash flow (DCF) models. This model reduces (discounts) the future cash income generated by the business to its original value. This procedure is governed by the assumption that: “the valuation of the business is equal to the sum of the present value of its estimated future net cash flows”. In other words, if a business is expected to generate a healthy cash flow stream for the next 10 years, how much is that prospective cash worth in today’s kina terms?

The future cash flow stream usually includes both annual cash flows and the terminal value expected when the business is sold. Such a valuation approach gives an active perspective of the firm, since the selling price is based on future cash-creating activities. A discounted cash flow can be estimated using the following formula:

$$\text{Net Present Value} = \frac{CF^t}{(1+r)^n} + \text{Terminal value}$$

where: CF^t = expected cash flow in period t

r = required rate of return, or discount rate

n = number of periods considered in the analysis

Terminal value = value of the business after the forecast period.

For example: What would be the value of a business which has a constant stream of annual income of K30 000 each over three years with a discount rate of 10% and a terminal value of K50 000?

$$NPV = \frac{CF1}{(1+r)\ n} + \frac{CF2}{(1+r)\ n} + \frac{CF3}{(1+r)\ n}$$

$$= \frac{30\,000}{(1+.1)1} + \frac{30\,000}{(1+.1)2} + \frac{80\,000}{(1+.1)3}$$

Note: 50 000 terminal value is added to 30 000 in year 3 (50 000 + 30 000 = 80 000)

$$= \frac{30\,000}{1.1} + \frac{30\,000}{1.21} + \frac{80\,000}{1.331}$$

$$= K27\,272.7 + K24\,793.4 + K60\,105.2$$

NPV = K112 171.30

Therefore, the present value of the business used in the above example is K112, 171.30. This is based on a constant stream of income at K30 000, at a discount rate of 10%, plus a terminal value of K50 000.

Advantages of buying an existing business

- Workload and risks of a start-up business will be avoided.
- In buying an existing business, the owner is purchasing the location, premises, equipment, staff, and customer base.
- Goodwill is already established by the previous owner.

- The business will already have a regular customer base.
- Sales to existing customers will provide immediate income to the new owner.

Disadvantages of buying an existing business

There are some disadvantages of buying an existing business. Here are some of them.

- One may end up buying a business that may have a bad reputation with the customers.
- The business may be in debt. That's why the owner may want to sell it off.
- The location may no longer be suitable due to changes in the area.
- The equipment may be out dated or worn out and may cost a lot of money to replace.
- Much of the stock may no longer be saleable.
- Customers loyal to the previous owner may leave when the owner sells the business
- Purchaser is stuck with previous owner's decisions regarding choice of stock, equipment, employees, etc.

The purchase contract

The actual price paid will depend on the bargaining position of the two sides. For instance, the owner desires to sell while the buyer also has a desire to buy. They both have a mutual intention to transact or exchange something for another.

When the seller is so desperate to sell, the buyer is said to be in a stronger position to bargain. On the other hand, if the buyer is desperate to buy, the seller is in a stronger position to bargain. Prices can rise above the normal value of the business in such cases.

A contract or agreement is reached once the buyer and seller reach a consensus on the price and other details. This contract should contain the necessary information such as:

- the debt level and who is liable for them;
- what becomes of the assets leased from financiers;
- the likelihood of the seller setting up a new business of the same type next to the one he or she just sold off; and
- other necessary points that should be covered by both parties.

Legal agreements

Any type of business, whether big or small, has to be guided by some form of contract. A **contract** is an agreement made between two or more parties. In that agreement the rights and obligations of both parties are covered. If one of the parties fails to fulfil certain obligations then the other party will stand on the legal right that was established and enforce it through the courts.

All business transactions or activities involve some form of agreement. The major legal agreements or contracts include the following:

- Purchase contract
- Franchise agreement
- Lease agreement
- Partnership deed

END OF TOPIC 11.4.3.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.3.2: Complete the activities given.

1. What would be the capitalised value if the expected profit for a business is K350 000 and the rate of return is 20%?

____

____

2. What would be the value of a business which has a constant stream of income of K100 000 over three years with a discount rate of 10% and a terminal value of K50 000?

____

____

3. State one advantage and one disadvantage of buying an existing business.

____

____

11.4.3.3 Purchase Contracts and Business Inheritance

Purchase Contract

A purchase contract deals with the main bargaining point concerned with fixing an agreed price for a purchase. The actual price paid for the business will depend on the bargaining position of the parties involved. Price may not entirely depend on the value of the business transaction involved. In a purchase contract the seller's desire to sell may be stronger than the buyer's desire to buy. At other times it may be the other way around. But when both the seller and buyer are determined to buy and sell, bargaining is less tedious. Tedious means becoming boring or not interesting because the processes involved are long and they repeat all the time.

A purchase agreement or contract creates a legally binding contract between the buyer and the seller. Also, they are generally related to the sale and purchase of goods, rather than services. Both the buyer and the seller are locked into this legal contract.

Purchase agreements can cover transactions for the sale of nearly every type of goods. Generally, purchase agreements are used for the sale or purchase of goods that are worth a substantial amount of money; say K1000 or more. Purchase agreements are very common for the sale of a home or other types of real estate.

What is included in a Purchase Agreement?

A well-written purchase agreement should include all information that is relevant to the transaction. It should be clearly written so as to avoid any misunderstanding. Some information that should be contained in a basic purchase agreement may include:

- Buyer and seller information, such as names, phone numbers, addresses, etc.
- Contact information for any witnesses or co-signers
- The type of sale and the product or goods involved
- Price and quantities of the sale
- The date of the agreement and the terms related to duration
- Terms of delivery and shipping if applicable
- Dates covering the fulfillment of various conditions and requirements
- Whether the agreement can be revised in the future
- Whether litigation is an option in the event of a legal dispute.

Thus, purchase agreement usually outlines the various conditions that each party needs to fulfill in order for the sale to be completed

Absolute versus Conditional Purchase Agreements

An absolute purchase agreement is basically similar to a receipt as it does not place any restrictions or conditions on the buyer. It simply states the basic terms of the transaction. This may be used for the purpose of keeping records of the transaction, and if a return on the product is needed.

In comparison, a conditional purchase agreement generally has to do with security deposits and the securing of loans. Conditional purchase agreements generally allow the seller the right to take possession of an item or piece of property that was used in securing a loan. An example of this is when a home is offered as a security for a real estate mortgage.

Disputes over absolute or conditional purchase agreements can often lead to lawsuits. In most cases, the legal remedy includes a ‘damages award’ intended to reimburse the non-violating party for any economic losses incurred.

Legal assistance

Purchase agreements are used very commonly, from simple transactions to complex business or real estate agreements. If you need assistance in drafting or reviewing a purchase agreement, you should speak with a lawyer immediately. Your lawyer can help you with the various aspects of the purchase agreement, to ensure that your interests are being met fully. Also, in the event of a legal dispute, your lawyer can represent you in court if you need to file for damages award.

Goodwill

Goodwill is an asset to a business. It is the positive reputation or image that a business has. Also, it is the added value that the business has created during the years of operation. At the time of selling a business, goodwill is usually considered and included in the price. It is the reputation of the business. If a business has been profitable over the years, it has a good reputation. Likewise, if a business has served its customers well over the years, it has a good reputation. Also, if the workers are generally happy with the business/employer it has a good reputation. Such a positive image is very good for the business. A buyer of such a business will have little difficulty in continuing to run the business.
Some businesses have a negative image or reputation with their customers, workers, banks, etc. Such businesses have what is called ‘ill-will’. A business with an ill-will is likely to have a reduced value. It can be sold off at a price lower than its usual price.

Inheriting a business

Inheriting a business is less common in our country. This is because of PNG’s short modern history. In developed or western countries it is a tradition entrenched in their culture. Nevertheless, it is one way of getting into the world of business.

What causes business inheritance? It could be a family business that is passed on from parents to their children. Secondly, the sudden death of the business owner can create a vacancy in the business for another person to become the principal owner. In PNG, when a business person dies, it is usually the spouse or the children (whoever is stronger and more active) who take over the business. Sometimes this can lead to ownership and management struggles, particularly where there is no written will or agreement in place. A business can even end up being split up between the beneficiaries – spouse, children and relatives.

Inheriting a business is the most sweat-free form of becoming a business person. The person who inherits a business only takes over assets and wealth built by someone else. Children of wealthy parents are the main beneficiaries of their parents' wealth.

In many cases children or spouses who inherit a business are naturally prepared for it knowing that they will eventually inherit the wealth. Some parents groom their children through formal education to take over the role of business manager or owner.

In some exceptional cases the type of business left behind by previous owners may not be preferred by the new owner whose interest may be in a different field or trade. Also, the location of the business may not be suitable or the nature of the business may conflict with the new owner's values, interests and passion.

Doing business is very demanding. It demands more time and commitment from the owner or proprietor. Not everyone has the passion and patience to put up with the demands of running a business. Not everyone is built to manage a business either.

Management of an inherited business is critical to business success. The dreams built by the former owner may not be shared by the inheritors, leading to mismanagement and business failure. Some businesses provide vital goods and services to the society. Consumers depend a great deal on such businesses. If those vital businesses fold or wind up the society eventually suffers for some time until such time another business comes in to fill the gap.

Advantages and disadvantages of inheriting a business

Advantages

- It is a sweat free way of going into business. The hard work was already done.
- With an established value and reputation the new owner has the flexibility to develop the business further.
- Raising capital will be very easy because of the assets of the business.
- The new owner can even sell the business if he/she wishes to.

Disadvantages

- Inheriting a business also involves risks or threats.
- Management problems can develop, particularly where the new owner lacks the skills to assume responsibility over the business.
- Workers may dislike the new management or lack trust and respect for the new owner
- New owner/manager will experience frustration and stress as he or she tries to get used to the art of running a business.
- The business may conflict with the new owner's lifestyle, profession, career, interests,values and passion

END OF TOPIC 11.4.3.3. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.3.3: Complete the activities given.

1. What is a contract? ____
2. Why is a purchase contract necessary when the sale involves a valuable item? ________

____

3. State one advantage and one disadvantage of inheriting a business. _________________

____

NOW WRITE THE TOPIC TEST FOR TOPIC 11.4.3. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOK

11.4.4 FRANCHISING

11.4.4.1 What is franchising?

Franchising is a French word meaning 'free', and is often used as a noun. At its simplest, a franchise is an arrangement whereby the originator of a business product or operating system (the franchiser) gives a prospective new business owner (franchisee) the right to sell these goods and/or to use the business operations system on the franchisor's behalf.

The main benefit of the system franchise is that all aspects of organising and operating the business have already been pre-tested and successfully implemented by the franchisor. The viability of the franchise has also been assessed in advance.

Because it is a successful and wide-spread business model, many countries, including the United States and Australia, have laws regulating franchise businesses. Businesses such as Macdonald's and Pizza Hut are famous franchise names in the United States, Australia, New Zealand, India, Brazil, China, South East Asia, Europe, Africa, and many other countries and regions of the world. Some of these countries and regions have better laws than others to regulate the franchise business sector.

Background

The United States is a leader in franchising. Franchising gained popularity in the 1930s when it was used for fast-food restaurants, and later, motels at the time of the Great Depression. As of 2005, there were 909,253 established franchises, generating $880.9 billion of output and accounting for 8.1 percent of all private, non-farm jobs. This amounts to 11 million jobs, and 4.4 percent of all private sector output.

Below are some famous, U.S. based franchises:

1. McDonald's
2. 7-Eleven Inc.
3. Subway
4. Dunkin's Donuts
5. Great Clips
6. Jani-King
7. Pizza Hut

The above franchises have franchise outlets right across the world, turning over billions of dollars each year. In the U.S. alone, it is estimated that nearly 40% of all businesses are franchises.

Operating a franchise

This is like operating a business of your own but selling someone else's product. Fast food chains are a good example. Operating a franchise will not be as risky as starting a business from scratch. This is because the business owner will not need to set up a market for a range of products that are well-known and well-advertised.

Franchising has become a popular form of business system globally over the last 20 years or so. But it is still relatively new in many industries and countries. It exists in such diverse fields as petrol retailing, motor vehicle distribution, real estate sales, personal services, professional practices, fast food and retail sales.

Advantages and Disadvantages of Franchising

Advantages	**Disadvantages**
The business is well known and the community is familiar with the products being sold.	The franchise may be restricted in the way in which the business may be operated.
The franchise has the support of an experienced management team and benefits from the sophisticated marketing and promotion guidelines of the parent company.	Payments demanded by the franchisor may drain the resources of the business, especially if profits aren't high enough.
A representative of the company gives management training.	Degree of assistance provided may not always be adequate.
Advertising and distribution is provided.	Contracts for the length of franchise may make a business franchise feel restricted and trapped.

Table 4.4: Advantages and disadvantages of franchising

Franchise Agreements and Fees

Franchise Fees

Three important payments are made to a franchisor:
(a) a royalty for the trademark,
(b) a reimbursement for the training and advisory services given to the franchisee, and
(c) a percentage of the individual business unit's sales.

These three fees may be combined in a single 'management' fee.

A franchise usually lasts for a fixed time period (broken down into shorter periods, each requiring renewal). Agreements typically last from five to thirty years. A franchise is merely a temporary business investment involving renting or leasing an opportunity; not the purchase of a business. It is classified as a wasting asset due to the fixed term of the license.

A franchise can be exclusive, non-exclusive or 'sole and exclusive'. Although franchisor revenues and profit may be listed in a franchise disclosure document, no law requires an estimate of franchise profitability, which depends on how intensively the franchisee works the franchise. Therefore, franchisor fees are typically based on 'gross revenue' from sales and not on profits made.

The franchise agreement

It is important that all details of a franchise arrangement are included in a written franchise contract. The franchise agreement should include details such as:

- the cost of franchising;
- how exclusive the franchise will be;
- what the franchiser will supply;
- sale of the franchise; and
- bringing a franchise to an end.

Details of a franchise agreement

1. **Cost of the franchise**

The franchise costs may include a lump sum fee at the beginning and a percentage royalty payment on the basis of sales. Some franchisors earn their income mainly from the sale of their products to the franchisees. Other franchisors earn all their profits from selling ingredients, supplies and equipment to their franchisees.

If there are franchise costs, the franchisee should find out exactly what these costs cover. If there is a fairly high charge at the beginning, this may cover many of the start-up costs of the business. These start-up costs should include:

- complete operating manuals;
- on-the-job training and help from experts from head office;
- an opening supply of goods; and
- equipment and shop fittings for the business.

2. **How exclusive is the franchise?**

Total expected sales will depend on the size of the market area. An exclusive franchise is one that gives the franchisee the sole right to sell to a particular geographical area. In some cases the franchisor will keep the right to sell in the franchise area as well. It may also retain the right to set up more than one franchise in a particular area. Franchisees should know exactly how 'exclusive' their franchise will be. In other words, they should know exactly how many franchises have been sold to other people in the same area.

3. **What the franchisor will supply**

In some franchise arrangements, the franchisor supplies all the goods to be sold. It may also supply equipment, and fixtures and fittings. This arrangement is satisfactory, provided a regular supply is maintained and there isn't a cheaper source of supply available elsewhere. The franchise agreement should state if the franchisee can purchase supplies elsewhere. It should also state if the franchisee is allowed to sell goods of his/her own choice.

4. **Winding up a franchise**

There should be a clause in the agreement concerning how a franchise contract may be brought to an end. The franchise agreement should state clearly:

- for how long the agreement runs;
- whether or not the franchise agreement can be altered; and
- reasons why the franchisor may bring the franchise to an end.

Many franchisors keep the right to buy back a business outlet at the end of the contract period. If the franchise agreement is suddenly brought to an end, the franchisee may receive little or no compensation for having developed the business.

The normal practice is for the franchise agreements to be written by the franchisor. The firm will have drawn up a fairly standard contract to be offered to all franchise members. A franchise agreement is a legal contract, which outlines the rules and regulations within which the franchise must operate. It is therefore important to have expert advice (from a lawyer, if possible) to help in explaining the clauses of a franchise contract. A prospective franchisee should have the agreement thoroughly checked by a solicitor to ensure that the agreement is in the best interest of the franchisee. Before considering franchising, it would be advisable to consult legal and relevant business advice.

Importance of written franchise contract

A franchisor has legal ownership over the product. A franchise always involves a written agreement that lays down the conditions of operation.

Profitability, positive cash flow and overall success of a franchise business depends on the franchise agreement. If a regular commission is paid to the franchisor, the franchisee should receive continuous advice and assistance from the franchisor.

An exclusive franchise sale is one that gives the franchisee the sole right to sell in a particular area. In some cases, the franchisor will keep the right to sell one or more franchise licenses in the same area. Therefore, franchisees should know how 'exclusive' their franchise will be in the same city or town.

In a franchise arrangement, the franchisor supplies all goods to be sold apart from the necessary equipment, fixtures and fittings. This arrangement can work for the franchisee as long as there is a regular supply of stock and is relatively cheaper. The franchise agreement should also state if the franchisee can purchase stock elsewhere and sell the goods of his or her choice.

Under the same agreement the franchisee should be allowed to sell the franchise license in order to recoup his or her investment. However, franchisees do not have the complete freedom to sell the license as and when they wish.

Finally, ending a franchise should also be covered in the franchise contract. The franchisee should know how long the franchise should be run. It should also be made clear in the agreement if a franchise license can be renewed upon expiry.

END OF TOPIC 11.4.4.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.4.1: Complete the activities given.

1. Define the term 'franchising' in your own words. ________________________________
   ____
2. State one advantage and one disadvantage of franchising. ________________________
   ____
3. Differentiate between the terms 'franchisee' and 'franchisor'. ___________________
   ____
4. Why is a franchise agreement important to both the franchisee and the franchisor?
   ____
5. List at least five items that should be included in a franchise agreement.
   ____
   ____

11.4.4.2 Types of Franchising

There are three basic types of franchise; trade name franchise, product distribution franchise and pure franchise.

1. Trade name franchise

The trade name (product) franchising system has evolved from suppliers or manufacturers creating sales contracts with dealers to buy or sell their products or product lines. In this relationship the dealer (franchisee) acquires the trade name, trademark, and/or product from the supplier or manufacturer. The franchisee identifies with the supplier through the product line. This method of franchising consists primarily of distribution by a single supplier of manufactured products to dealers who then in turn resell this to the end consumer. This franchising approach has been used extensively in the auto and truck industry (e.g. Toyota, Kubota, Mack and Kenworth), soft drink bottling industry (Coca Cola and Pepsi), and tyre (e.g. Good Year and Bridgestone), and gasoline service station (e.g. Inter Oil, Puma Energy, and Mobile) industries.

2. Product distribution franchise

A product distribution franchise licenses the franchisee to sell specific products under the manufacturer's brand name or trademark through selective, limited distribution network. This system is commonly used to market automobiles (e.g. Toyota, Nissan and Mazda), gasoline products (e.g. Exxon, Texaco, and Puma Energy,), soft drinks (e.g. Pepsi Cola and Coca-Cola), cosmetics and other products.

A product distribution franchise provides a business operator the right to sell a particular set of goods. The franchisee is used as a distribution channel for a good or service, and is largely independent. The franchisor's role is to ensure that sufficient stock is available. It also makes sure that the franchisee is selling the product at a satisfactory price and providing customers with suitable after-sales service and support.

3. Pure franchise

A pure (comprehensive or business format) franchise is a very detailed agreement. It provides the franchisee with a complete business format, including a license for a trade name, the product or service to be sold, the physical plant, the methods of operation, a marketing strategy plan, a quality control process, a two-way communication system, and the necessary business services. This means that the franchisee purchases the right to use all the elements of a fully integrated business operation.

Pure franchise will usually include: pricing, production processes, marketing, staff recruitment, remuneration, training and evaluation, product offering and promotional methods, record keeping, operating hours, use of different suppliers, store layout and fittings, staff uniforms, and so on. A well-known example of a business system franchise in PNG is Ela Motors.

A pure franchise is the most rapidly growing of all types of franchise and is common among fast-food restaurants, lodging establishments, business service firms, car rental agencies, educational institutions, beauty aid retailers, pharmacies, and other promising growth industries.

Basis for franchising

Franchising is one of the only means available to access venture capital without the need to give up control over the operation of the chain and build a distribution system for servicing it. After the brand and formula are carefully designed and properly executed, franchisors are able to sell franchises and expand rapidly across countries and continents using the capital and resource of their franchisees while reducing their own risk.

There are also risks for people who are buying the franchises since failure rates are higher for franchise businesses than independent business startups. Therefore, it is important for today's franchise seekers to be aware of that fact. They must be prepared to face failure, but mostly important, they must have alternative plans in place to deal with potential failure.

Obligations

Each party to a franchise has several interests to protect. The franchisor is involved in securing protection for the trademark, controlling the business concept and securing know-how. The franchisee is obligated to carry out the services for which the trademark has been prominent or famous.

There is a great deal of set procedures required. The place of service has to bear the franchisor's signs, logos and trademark in a prominent place. The uniforms worn by the staff of the franchisee have to be of a particular design and colour. The service has to be in accordance with the pattern followed by the franchisor in the successful franchise operations. Thus, franchisees are not in full control of the business, as they would be in retailing.

A service can be successful if equipment and supplies are purchased at a fair price from the franchisor or sources recommended by the franchisor. A coffee brew, for example, can be readily identified by the trademark if its raw materials come from a particular supplier.

The franchisee must carefully negotiate the license and must develop a marketing or business plan with the franchisor. The fees must be fully disclosed and there should not be any hidden fees. The start-up costs and working capital must be known before the license is granted. There must be assurance that additional licensees will not crowd the 'territory' if the franchise is worked according to plan. The franchisee must be seen as an independent merchant. It must be protected by the franchisor from any trademark infringement by third parties. A franchise lawyer is required to assist the franchisee during negotiations.

Often the training period – the costs of which are in great part covered by the initial fee – is too short in cases where it is necessary to operate complicated equipment, and the franchise personnel have to learn on their own from institutional manuals. The training period must be adequate, but in low-cost franchises it may be considered expensive. Many franchisors have set up educational programs online to train staff. This is in addition to providing literature, sales documents and email access.

Also, franchise agreements carry no guarantees or warranties. Franchise contracts tend to favor the franchisor because of the non-negotiable contracts that franchisees are required to acknowledge. Contracts are renewable at the sole option of the franchisor.

Examples of franchise agreements existing and/or operating in Papua New Guinea

In Papua New Guinea there are several franchise business units currently in operation. Most of these businesses are in the fast food industry although a few are engaged in other industries. The first industry that is commonly franchised is the fuel or gasoline service stations. Inter Oil, Puma Energy, Mobil are the common names in Papua New Guinea now. The second industry is fast food. Ken Mighty Chicken (KMC), Kentucky Fried Chicken (KFC), Burger King and McDonalds all operate in PNG now. In the Automobile industry, Ela Motors Toyota is a franchise, so are other car dealers. It even includes second hand car dealers who import directly from Japan.

Franchising is a promising business in PNG. It is worth the risk because the rewards are also good. The only drawback is that Papua New Guineans do not have the necessary information to venture into franchising. Franchise chains exist in developed countries like Australia, U.S.A. and New Zealand. There are also franchise opportunities in South East Asian economies and China. It requires considerable time and resources to seek out franchise agreements. But, as the PNG economy grows franchise chains and outlets are likely to be drawn to us.

END OF TOPIC 11.4.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.4.2: Complete the activities given.

1. Explain what a trade name franchise is?
2. What is a product distribution franchise?
3. Explain the term 'pure franchise'.
4. Why do you think some franchises fail?
5. State one obligation of the franchisee.
6. State one obligation of the franchisor.

NOW WRITE THE TOPIC TEST FOR TOPIC 11.4.4. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOKLE

11.4.5 TAXATION

11.4.5.1 What is Taxation?

Tax is compulsory payment paid by individuals and business to the government. It is the main source of revenue for the government. This revenue is used to fund government expenditures each year. The government's income and expenditures are usually shown in its annual budget.

The government collects its tax from a variety of sources using different means and rates. It uses different methods of collecting taxes. It is therefore important that the government makes it clear to all tax payers how these taxes are calculated. It is also important that the government informs everyone in the country who is to pay tax and how this is done. These are usually contained in the form of tax policies of the government.

Classes of tax

There are two main classes of tax – direct and indirect tax. Direct tax is paid directly by the tax payer to the government. Income tax and wages tax are examples of direct taxes. On the other hand Goods and Services Tax (GST), interest withholding tax and customs duty are not paid directly to the government. Instead, consumers pay these taxes through businesses and other organisations. This is then remitted or passed on to the government. That is why such taxes are grouped under the category of indirect tax.

Import tax – Customs duties

This tax is paid on all imported goods. The importer pays this tax either directly or indirectly to the government. Importers such as supermarkets may pass all or part of this tax onto consumers. If consumers have to pay this tax then it becomes an indirect tax. However, not all importers pass this tax onto consumers. Businesses and individuals that import capital goods such as motor vehicles pay the import tax directly to the government through customs agents.

The government also determines which imported goods need to be taxed. Basic goods such as tinned fish and rice are not taxed heavily. The government does not charge tax on essential goods like medicines and other hospital drugs. On the other hand, machinery and other luxury goods are taxed heavily according to their uses or application.

Income tax

The government uses progressive rate of tax to collect tax from individuals, businesses and other organisations that earn an income. The amount of tax to be charged depends on the amount of income earned as well as what type of income is earned.

Individuals who earn a regular income such as wages and salaries have to pay wages and salaries tax to the government. Businesses pay taxes based on the profit they make. There are other types of income such as rent, interest and dividend. Individuals, businesses and other organisations that earn these types of income also pay income tax to the government.

Income tax paid by individuals, businesses and organisations is based on a 'progressive' tax system. This means that the tax applied is based on the level of income earned, with higher rates being applied to higher income earners. For example, a person who earns a higher wage or salary also pays a higher income tax. In this way the government tries to make it fair to every tax payer.

Provincial government tax

Provincial governments in this country also collect their own tax. This is because they also need to raise their own revenue in order to provide goods and services to people living in the provinces. All individuals, businesses and organisations do pay some form of tax to the provincial government. All provincial governments have their own internal revenue sections that are responsible for collecting these taxes. Motor vehicle registration fee is an example of a tax that goes to Provincial Governments.

Local Councils and Urban Authorities

Local level government councils and urban authorities also have their own taxes to collect. The common taxes collected by this level of government include water and garbage collection bills. Local councils and urban authorities, however, depend a lot on national government funding to provide their share of the community services.

Business tax

Income tax is levied by the Internal Revenue Commission (IRC) on taxable income generated by a business or an individual. Sole traders do not normally complete a separate tax return for their incomes. Rather, they use their personal income tax return to report business incomes and allowable deductions. Partnerships must complete a partnership tax return to show their income and deductions and how the profit or loss was shared among the partners.

Corporations are also required to complete and lodge their tax returns. Because of its structure a corporation must comply with various requirements while declaring its taxable income. All corporations are covered under the PNG Company's Act (1997).

END OF TOPIC 11.4.5.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11. 4.5.1: Complete the activities given.

1. What is tax? ____
2. Who pays tax? ____
3. Name at least three (3) types of tax applied in Papua New Guinea. ___________________
4. State one advantage and one disadvantage of Import Tax. __________________________

11.4.5.2 Taxation of Sole Proprietorship and Partnership

Sole traders and partnerships are required by law to:

- account for income tax
- account for business expenses that are claimed as deductions
- keep business records and pay tax
- collect and remit group tax from employees

Income tax

Income tax is charged on the income earned by an individual or a corporation. Employees who receive a regular income are also required to pay income tax. However, different tax rates are used in determining the income tax for businesses and workers. Those whose annual income falls below the tax threshold are exempted from income tax.

Sole Traders and Partnerships

Sole traders and partnerships pay tax in a similar way. They do not pay tax directly like corporations and business groups do. Instead the income of sole traders and partnerships are taxed in the hands of each partner as personal income tax using the wages and salaries tax table.

Sole traders, whose source of income is mainly from the business, are taxed based on the personal tax rates. The taxable income of a sole trader is calculated as follows:

- income is calculated for tax purposes
- personal income tax rate is applied on the taxable income to calculate tax payable
- tax rebates are deducted if individuals submit the dependants rebate or if the individual is entitled to receive it.

Partnerships

A partnership is required to submit to the Internal Revenue Commission (IRC) a return of the income of the partnership. However, the partnership is not liable to pay income tax on its overall income. Individual partners pay their own tax based on whatever portion of the profit they receive. It is their responsibility to submit their individual personal income tax returns. IRC is not concerned with how the partners' individual share of profit is broken up. It may be seen as salary, interest or dividend. In this case, if a partner receives a salary it is not subjected to salary or wages tax. However, the total of the partners share is subjected to personal income tax.

If a partnership makes a loss then this loss is distributed to the partners for allowance or a deduction against their individual assessable income. If this results in an individual having a net loss, this may be carried forward. The loss is therefore recorded against individual partners rather than the partnership itself.

Consider the following example:

A partnership consists of two members, A and B. Member A receives two thirds of the profits while member B receives one third of the profits. A receives a salary of K100 000 and interest on capital contributed of K60 000. Member B receives a salary of K50 000 and interest on capital of K60 000. Net profit for the year 2014 is K660 000.

	Member	Salary	Interest	Profit distribution	Total
The shares to each partners are:	A	100 000	60 000	440 000	600 000
	B	50 000	60 000	220 000	330 000

Table 4.5: Partnership income distribution

What Internal Revenue Commission (IRC) is more concerned with is the taxable income of both partners. In this case, partner A's taxable income is K600 000. Partner B's taxable income is K330 000. So tax can be calculated once this taxable income is determined as shown in the example above.

Personal income tax rates

It is usual for the national government to revise its tax rates from time to time. Sometimes the rates fall; other times the rates increase. The table below provides the rates applicable in 2007 as set by the IRC. These rates have since been revised over the years, but we use it for discussion purposes here.

PNG Income Tax Rates - 2014			
Taxable income bracket		**Total tax on income below bracket**	**Tax rate on income in bracket**
From		To	
K	K	K	K
0	7000	0	0
7 001	18 000	2 420	22%
18 001	33 000	6 920	30%
33 001	70 000	19 870	35%
70 001	250 000	91 870	40%
250 001	No limit	No limit	42%

Table 4.6: Personal income tax rates – January 2014

Let us apply the above table in the following examples to see how it works.

Example 1: A businessman earns a taxable income of K18 000 from his sole trader business. According to the above table the tax payable on this income is: (22/100 x K18 000) = K2420

Example 2: A partnership with two (2) partners has a taxable income of K36 000. This income is split equally between the partners and each partner receives K18 000. Tax payable by each partner is:

Tax by partner 1	2420
Tax by partner 2	+ 2420
Total Tax Paid by Partnership	4840

Example 3: A sole trader has made a profit of K36 000 in one year. Tax to be applied on this income, based on the tax table is as follows:

Tax on K33 000	6920
Tax on excess K3 000 (3000 x 30%) (3000 x 30/100) (= 900)	+ 900
Total tax payable	7820

In example 2 and 3 above, the level of income is the same, except that example 2 is of a partnership business while example 3 is of a sole trader. The difference between these two business structures in terms of the tax paid on their income is as follows:

Sole trade tax minus (-) partnership tax = tax savings by partnership
K7820 – K4840 = K2980

As indicated in the second example above a partnership structure can be advantageous over a sole proprietorship in terms of the tax savings. It allows partners to split the business' income and pay less tax. It is much cheaper than what sole traders pay on the same income level.

Advantages of tax

The current tax structure used in PNG favors some businesses more than others. The obvious one is the partnership business structure. This is proven by the example we saw above. Sole traders can also benefit by declaring their living expenses if that is their only means of income. The government can consider tax concessions from time to time, making it convenient for small businesses. Sole traders whose income falls below a certain level are exempted from income tax unless they strictly register with the IRC.

A corporate tax structure is complicated and requires in-depth study. But, in brief, the government allows companies tax holiday, particularly if they are involved in crucial sectors or industries. Also companies receive tax concessions as well as claiming for allowable deductions.

END OF TOPIC 11.4.5.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11. 4.5.2 Complete the activities given.

1. Why is tax return important to a business? ____
2. How are sole traders and partnerships taxed?
   ____
3. Find out from a small business in your area if it pays any tax. If it does, find out how much it
   has paid for the last financial year? ____
4. A partnership makes a gross profit of K500 000 in one year. Its allowable deductions amount to K100 000. It has 4 partners who have equal shares in the business. Apply the personal income tax rate to find out the business's tax liability_______________________

11.4.5.3 Taxation of Business Group and Companies

Business groups and companies are required by law to:

- account for income tax
- account for business expenses that are claimed as deductions
- keep business records and pay tax
- collect and remit group tax from employees

Tax is a business liability. A tax liability is the amount of tax a business is required to pay. Tax liability varies from business to business. It also depends on the type of business unit.

All registered businesses must, therefore, register with the Internal Revenue Commission (IRC) to obtain a tax file number. The Internal Revenue Commission (IRC) branches in the provinces monitor some taxes paid by businesses such as Goods and Service Tax (GST). It is required by law that financial statements clearly show the profits or losses. Income statements are used to determine the tax liability of any business.

Most of the monitoring and recording is kept by the IRC headquarters in Port Moresby. The Commissioner General and the IRC aim to achieve the objectives of the tax law by ensuring that all tax payers comply with the current tax laws. The act is amended every year based on the government's tax policies.

Corporations and Business Groups

Corporations and business groups remit tax directly to the government (IRC) through its tax collecting agencies. This tax is calculated based on their net profit. Members or shareholders receive their share of the profit after tax has been deducted. Corporations and business groups pay tax differently from sole traders and partnerships based on current corporate income tax rates. In Papua New Guinea, the corporate income tax rate is set at 30%.

For example:
Central Farmers Limited has a trading income of K600 000 for 2014 financial year. Total expenses amount to K250 000, leaving K350 000 as its net profit. The corporate income tax on this net profit is: K350 000 X 30% = K105 000.

Central Farmers Limited has a tax liability of K105 000 from an income of K600 000 for the 2014 financial year.

Dividend withholding tax

All corporations pay dividend withholding tax to the government. It is based on the dividends distributed to the shareholders of a corporation. This tax is not the same as income tax paid by a corporation on its earnings or profit. Corporations and individuals get a tax credit called dividend rebate to reduce the tax payable on their income.

The dividend withholding tax levied on corporations in Papua New Guinea is 17 per cent. By law dividend withholding tax must be deducted from individual shareholders before the dividend payment. This tax only applies if the corporation will declare and pay out a dividend from its profits.

Example 1:
A public corporation has a taxable income of K250 000. Its directors decided to distribute K150 000 to the shareholders. Tax payable will be:

Corporate income tax (K250 000 X 30%)	K75 000
Dividend withholding tax (K150 000 X 17%)	K25 500
Total tax liability	**K100 500**

Example 2:
Madang Traders declare a net profit of K200 000. The directors agree to keep 50% of the profits (after corporate tax) in the corporation. The remaining 50% will be distributed as dividend to shareholders. Tax payable will be:

Corporate income tax (K200 000 X 30%)	K60 000
Net profit after tax (K200 000 – K60 000)	**K140 000**

Sum to be distributed as dividend before dividend withholding tax:

K140 000 X 50%	K70 000
Dividend withholding tax (K70 000 X 17%)	K11 900
Net amount distributed as dividends	**K58 100**

Dividend withholding tax is remitted or transferred to the IRC within 21 days following the month in which dividends were paid.

Capital Gains Tax

Businesses make a capital gain whenever an asset is sold at a higher price than its market value or its original purchase price. Because capital gain is a form of income the firm must pay a capital gains tax to the government. Assets which may increase in value over time include real estate, antiques, jewellery and the goodwill of a business. This tax is an expense to the business and must be accounted for properly.

Learning Activities 11. 4.5.3 Complete the activities given.

1. When is a company obliged to pay dividend withholding tax? ________________________
2. What is the current corporate income tax rate in Papua New Guinea? ________________
3. A company makes a gross profit of K500 000 in one year. Its allowable deductibles amount to K100 000. Apply the corporate income tax rate to find out the company's tax liability. ____

11.4.5.4 Provisional Tax, Goods & Services Tax and Allowable Deductions

Goods and Services Tax (GST)

Goods and Services Tax (GST) is a broad-based tax of 10 per cent on most goods and services consumed in the country. It is based on the supply of goods or services, including advice, information and real estate. When a business registered for GST makes a taxable supply, 10 per cent of the payment received for that supply is GST.

Businesses with an annual turnover of K50 000 or more and non-profit organisations with an annual turnover of K100 000 or more must register for GST. Those with a lower turnover are not required to register for GST, although they may do so if they wish to.

For instance, Brian Bell limited sells a television set (TV) for K500. A 10 per cent GST will be added to this selling price. The customer will end up paying K550 (10% of K500) for this TV. This is the sales tax based on the retail price of the TV set. Brian Bell is required to collect all GST paid by consumers and remit or transfer them to the government by the 23^{rd} day of each month.

All registered businesses must apply for a GST number from the IRC if their sales exceed two hundred thousand (K200 000) in any one year. This registration gives them the right to collect and transfer GST to the government.

Provisional tax

Unlike other forms of tax, businesses are required to pay their income tax one year in advance. It is normally assumed that income for the business in the current year will be similar to the previous year’s income. In Papua New Guinea the financial year runs from 1 January to 31 December.

It takes the IRC up to three months or longer before the assessment is completed and a notice of assessment is sent out to the tax payer. To ensure that businesses pay tax on the income earned within the year the provisional tax – a form of advance payment is applied. The business will then have to adjust its own records after it receives the notice of provisional tax.

Below is a fully-worked example of provisional tax.

Bunny started his private company in 2012. His taxable income for 2012 – 2014 is as follows:

Year	Taxable income (K)
2012	100 000
2013	80 000
2014	120 000

(Net income for 2012 = 100 000)		
Taxable payable in 2013:		30 000
add provisional tax for 2013		30 000
Total tax payable - 2013		60 000
(Income for 2013 = 80 000)		
Tax payable in 2014:		
Tax payable for 2013	24 000	
add provisional tax for 2014	24 000	
	48 000	
less credit for provisional tax paid in 2013	-30 000	
Total tax payable - 2014		18 000
(Net income for 2014 = 120 000)		
Tax payable in 2015:		
Tax payable for 2014	36 000	
add provisional tax for 2015	36 000	
	72 000	
less credit for provisional tax paid for 2014	24 000	
Total tax payable - 2015		48 000

Fringe benefits tax

Businesses that provide benefits to their employees are required to pay a fringe benefit tax to the IRC. Fringe benefits usually include motor vehicle allowances, housing allowances, interest-free loans, meals & accommodation, and discounted airline transport. Again, this is not an expense to the business or employer. It is an expense to the employees who receive fringe benefits. The employer is responsible for deducting this tax from its workers and remits it to the Internal Revenue Commission (IRC) regularly.

Training guarantee

Training guarantee is a national scheme aimed at encouraging employers to engage their workers in on-going, on-the-job training. Businesses must spend a certain amount each year on employee-related training to develop employee's skills at the workplace. This is an allowable business expense. Rates used to determine the amount to be spent on employee-related training vary, depending on the minimum cut-off wage bill as determined by the IRC. Interested businesses should find out exactly from the IRC how they can benefit from tax savings by engaging their workers in staff training programs.

Allowable expenses and deductions

Allowable deductions are expenses incurred during the process of running the business. These expenses are necessary for the generation of the assessable income. Not all classes of expenses are allowable or tax deductible. The Income Tax Act clearly specifics the allowable expenses.

Allowable expenses or deductions are necessary expenses for a business to operate and earn an income. Therefore, most of the deductions allowed for tax purposes in Papua New Guinea are:

(a) Purchase of trading stock and materials – cost of purchasing supplies that are later sold. It also includes materials used in construction or processing of goods.
(b) Wages and salaries paid to employees – labour cost.
(c) Power and fuel expenses – cost of electricity and fuel.
(d) Administration and other general expenses – includes telephone charges, maintenance of equipment and even stationery.
(e) Rent and rates – includes building and land rentals.
(f) Interest – interest paid on money borrowed from banks and other financiers.
(g) Depreciation – the cost of wear and tear on assets is also an allowable deduction.
(h) Bad debts – are debts that must be written off because they cannot be recovered by the business.
(i) Losses of previous years – are any loss made in previous years. This loss is carried forward to the current year. Firms can claim for such losses through paying a less tax until the loss is fully covered.

Non allowable deductions

Non-allowable deductions are expenses incurred in the process of running a business. However these expenses are not deducted from the assessable income before determining the taxable income. Some of the non-allowable deductions are as follows:

(a) Capital expenditure – purchasing of capital items such as motor vehicles.
(b) Losses and expenses of a private or domestic nature.
(c) Expenses incurred in producing exempt income.

END OF TOPIC 11.4.5.3. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.5.4: Complete the activities given.

1. Make a list of some non-allowable deductions. ____________________________________
2. Explain in your own words how provisional tax works in PNG. ________________________

What is a fringe benefit tax? Give an example. ____________________________________

11.4.5.5 Salary & Wage Tax

Salary and wages tax

Tax requirements and formalities

Wage or salary earners all over the world are obligated to pay income tax. Public and private sector workers pay income tax directly to the government. However, not every person in a particular country is employed in the formal sector. Those people engaged in the informal sector do not pay direct taxes to the government. They pay taxes indirectly to the government through the GST system.

Concepts such as salaries, wages, tax declaration, tax return and tax deduction form will be discussed further.

Salaries and wages (PAYE)

Tax paid by employees is sometimes referred to as 'pay-as-you-earn' (PAYE) tax. Tax is deducted, based on the amount of income a person receives each fortnight. This system is called a progressive rate of taxation and it is applied in Papua New Guinea.

Usually on the pay day the worker receives the net wage or salary. All other allowable deductions such as tax have been already calculated and deducted. The deducted tax is sent to the IRC as was discussed earlier in the chapter.

The table below provides the Personal income tax rates for residents of the country. It is important to interpret the table correctly in order to apply the correct tax liability for an individual.

PNG Income Tax Rates - 2014			
Taxable income bracket		**Total tax on income below bracket**	**Tax rate on income in bracket**
From		To	
K	K	K	K
0	7000	0	0
7 001	18 000	2420	22%
18 001	33 000	6 920	30%
33 001	70 000	19 870	35%
70 001	250 000	91 870	40%
250 001	No limit	No limit	42%

Table 4.7: Personal income tax rates – January 2014

Here is an example of how the above tax table is applied.

Example 1:	Taxable income K40 000		
	Tax payable on the first K33 000	=	6920
	Tax on excess of K7 000 at 33%	=	2310
	Total tax payable	=	K 9230

Example 2:	Taxable income	6 000
	Tax payable	Nil

Example 3:	Taxable income = K15 000	
	Tax payable on first K7001	2 420
	Tax payable on remaining K7999	
	K7999 x 22%	1 759.78
	Total tax payable:	K4 179.78

Tax declaration

It is a must for all employees to fill out the wage or salary declaration form and hand it over to their employers. This form should indicate the number of dependants the employee has so that tax will be deducted. Those who fail to do so will end up paying more tax than others who have completed the form. The employer's responsibility is to send the original copy of the form to the IRC office.

A new declaration should be submitted to an employer when an employee:

- commences employment with an employer
- begins to maintain a dependant that was not included on the previous declaration
- stops maintaining dependant who was included on the previous declaration
- receives additional (or less) employer allowances/benefits to those listed on the previous declaration.

Tax declaration form

The tax declaration form has all the necessary details for employees to fill in details like; the type of work the employee does, name of the employer, business address of the employer and dependants to be included. After a tax declaration form is lodged, rebates for dependents will be made for every pay period. However, new declarations may not be used to recalculate tax for fortnights that have already passed. For this reason, it is important for employees to lodge a declaration form immediately when they begin work with a new employer.

Dependent tax rebates

A tax rebate is a reduction made from the taxable income. This is usually allowed for wage earners as well as others, who usually have close relatives and family members to take care of. The following category of dependents is allowed by the government for a tax rebate:

- Spouse (husband or wife) of the tax payer.
- Legal children under the age of 16 years.
- Fulltime students who are between the ages of 16-25 years of age.
- The immediate parents of the tax payer.
- A brother, sister or the child of the tax payer who is permanently incapable with disabilities or serious illnesses.

However, in some cases, a tax payer may not claim for a dependant who is also an income earner. A dependent who earns over K1 040 per annum or more than K40 per fortnight is not eligible to be considered as a dependent. The rates applicable for dependent rebates for personal incomes are as follows:

- First dependent: 15% of tax payable, but not exceeding K450 or below K45
- For the second, third and fourth dependent: 10% of the gross tax payable, but not exceeding K300 or below K30.

The following table presents some examples of how dependent rebates are calculated. The income tax rates for 2007 are used for the calculations below. Calculations for example 1 are as follows:

- Of the K10, 000 annual amount, K6600 is non-taxable. So, the remaining K3, 400 is taxed at the rate of 25% which gives us K850. That's the tax that is due to be paid.
- Because this wage earner has 1 dependent the dependent rebate according to tax law is 15%. So calculating 15% of K850 gives us K127.50
- The actual tax to be paid now is K722.50. We arrive at that figure by subtracting K127.50 from K850.

	E.g. 1 K10 000	**E.g. 2 K15 000**	**E.g. 3 K20 000**	**E.g. 4 K25 000**
	K	**K**	**K**	**K**
Gross tax payable	850	2 100	3 425	4 925
Number of dependents	1	2	3	3
15% on first dependent or minimum of K45 and maximum of K450	127.50	315	450	450
10% on second dependent or minimum of K45 and maximum of K450		210	342.50	450
10% on third dependent or minimum of K45 or maximum of K450			342.50	450
Total dependent rebate	127.50	525	1 135	1 350
Net tax payable	722.50	1 575	2 290	3 575

Table 4.8: Income tax rebates

The maximum amounts allowed to be claimed for each dependent is K450. The minimum rebate allowed for each dependent is K45. If the amount calculated using the given percentages is more than these minimum and maximum figures, then the stated amounts (i.e. K45 and K450) are applied.

The more dependents there are, the less tax that will be payable to the government. The current tax law allows for three (3) dependents. This depends on the tax payer. A dependent rebate will be allowed if the tax payer fills in the wage tax declaration form.

For fortnightly wage and salary earners, employers are required to use the wage and salary table to deduct the appropriate tax as prescribed by the IRC. Employees that lodge a dependent declaration are entitled to a rebate or reduction in their tax liability.

The **tax declaration form** is usually sent through the employer to the IRC. On this form the tax payer is allowed to indicate the number of dependents he or she has. It will ensure that the tax payer receives the right dependents rebate. However, if the employee fails to fill out a tax declaration form, then the employer is required by law to deduct tax at non-declaration rates. These rates are much higher.

For non-wage or salary earners the IRC expects voluntary lodgement of tax returns. The rates shown in table above must be correctly applied to determine the tax liability.

Taxes deducted from salaries and wages

Employers must deduct salaries and wages tax from the wages of all their employees. Every fortnight the employer goes through certain procedures of deducting the employee's tax. The employer must:

- calculate gross wages for each employee
- calculate salaries and wages tax payable by each employee
- deduct salaries and wages tax (and other deductions) from the gross wages of each employee in order to calculate the net wages.

After these calculations the employer then remits all the tax deducted from the employees to the Internal Revenue Commission (IRC). The deductions are made from the gross income. After all the deductions are made, the employee receives the net income. The employer deducts the tax and remits to the IRC office by the 7th day of each month (for tax deducted in the previous month).

The Internal Revenue Commission (IRC) provides the employers with the correct tax calculation rates in the form of a table. This table must be followed closely by all employers when calculating the tax liability of each employee.

Calculating fixed incomes

Salary:
A salary is normally quoted as a yearly or annual amount. This amount is divided by 26 fortnights in a year to determine the fortnightly salary.

Example:

John, a teacher, earns K13 500 per annum as his salary each year. He has no dependents. His fortnightly amount will be:

K13 500/26 = K519.23

The income before any deductions is known as gross income. The amount that remains after all deductions are made is known as the net pay. John's gross income each year is K13, 500. To determine his net income we need to take into account the common deductions such as tax.

Income tax is also deducted on this amount each fortnight. We will need to refer to the same personal income tax table given earlier above to determine the appropriate amount.

For the first K6, 600 a tax of K1, 650 is deducted each year. A tax rate of 25% is applied on the excess of K6, 900 K6, 900 (25/100) = K1, 725 Total tax payable is therefore: K3, 375 John's annual salary after tax is K10, 125

Usually there are other deductions which are made to workers' salaries. These deductions are not always the same for every employee.

Wages:

Usually quoted as an hourly rate, overtime is also paid at specified rates. In Papua New Guinea currently, wage rates are normally negotiated between the employer and the employee. The minimum wages determination of 2014 allows K256 per fortnight for 80 hours work based on the minimum approved rate of K3.20 per hour.

The normal working week in Papua New Guinea is made up of between 40 – 42 hours. So we could calculate the hourly wage rate if we know the weekly minimum wage rate.

Example:
Paul is a labourer. His weekly wage is K45. He works 40 hours each week. What is his hourly rate?

Hourly rate = Weekly rate/Total hours worked per week
= K45/40
= K1.13 per hour

Overtime rates

There are approved overtime rates for workers who work longer than the required 40-42 hours per week. The rates as approved by the Department of Labour and Employment are as follows:

- On weekdays and Saturdays the overtime rate is one and half time the normal hourly rate
- On Sundays and public holidays the overtime is twice the normal hourly rate

Example:
Paul's wage rate per hour is K1.13. In one week he worked overtime as follows:

- 5 hours on Monday (5-10pm)
- Normal hours worked in a fortnight is 40 hours

What will be his total pay, including overtime?

Overtime = Number of hours X Hourly rate X 1.5
= 5 X 1.13 X 1.5
= K8.47

Normal Pay = 40 hours X 1.13 X 2 = K90.40

Total pay for the fortnight = K90.40 + K8.47
= **K98.87**

What would be Paul's annual income based on the above information? We simply multiply his normal fortnightly amount by 26 fortnights.

K90.40 X 26 = K2350.4

According to the income tax table Paul will not pay any income tax because his income level is below the tax threshold of K6600. The income level below which no tax is charged is referred to as the **tax-free threshold**. It is set by the national government when it hands down the national budget each November. Therefore, the tax free threshold does not remain fixed each year.

END OF TOPIC 11.4.5.5. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.5.5 Complete the activities given.

1. What is the free tax threshold for Papua New Guinea in 2014? ______________________
2. Explain 'tax rebates' in your ownwords.____
3. Why is it important to fill out a wage or tax declaration form? ______________________
4. A Lawyer earns K1 500 per fortnight. Calculate the tax to be applied on this income using the 2014 personal income tax table. ____
5. How much tax will the Lawyer pay if she has lodged a declaration for two dependents?
6. Assume that the Lawyer did not lodge a dependent's declaration for. How much tax will she pay now? ____

NOW WRITE THE TOPIC TEST FOR TOPIC 11.4.5. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOKLET

11.4.6 INSURANCE

11.4.6.1 Fundamentals of Insurance

Insurance

Insurance simply means the sharing of risks. Risk is the possibility of something bad happening. So insurance is to do with getting protection in case something bad happens. There are many bad things that can happen to us such as injury, falling sick, losing a house in fire and death. Bad things can happen to anyone anytime without any warning. Businesses and organisations also face a lot of risks.

It is possible to share the risks that individuals and organisations face. This is achieved by putting money into a fund as a way of risk sharing. The fund is often controlled and managed by an insurance company. When a member of the contributing fund suffers a loss, he/she can be compensated using the money in the fund.

The two main forms of insurance existing in Papua New Guinea are life insurance (or life assurance) and general insurance. Life insurance is mainly to do with providing security to families in the event that a policy holder dies. A sum of money is paid to the dependents. Endowment and whole life insurance are two policies covered by life insurance. General insurance covers a wide variety of non-life financial risks such as fire, marine, accident, burglary and natural disasters. It is also concerned with shorter term risk coverage and only a percentage of premiums paid are returned when a claim is made.

General Insurance Principles
Insurance cover

In insurance the protection that someone or a business gets from an insurance company is called ‘cover’. It is called insurance cover and is only valid as long as premium payment is current. If the insurance cover expires, the required premium must be paid in order to renew the cover.

Insurance premium

Premium is the cost of insurance which is paid by an individual or an organisation depending on the level of risk involved. It also depends on the value of the item to be insured. Therefore, always remember that ‘the higher the risk the higher the premium’. If the risk is high then the chances of a loss occurring is also high. It also means that a high risk will carry a high loss. And when the loss is high the compensation will also be high.
The insurance company uses the premium to pay compensation when a claim is lodged. Part of the premium is also invested by the insurance company to earn extra money. Because insurance companies are businesses, they use the premium to make profit from it.

Compensation

Compensation is the money paid to the individual or organisation who has suffered a loss due to something bad happening. Compensation can only be paid to someone or an organisation which has insurance cover. In order to receive compensation, the insured party should lodge an application when a loss is suffered. Depending on that application, the compensation will be paid out.

Indemnity

An insurance agreement is reached between the insurance company **(insurer**) and the person or individual applying to take out insurance (**insured**). This agreement or contract is called an indemnity contract. Indemnity means that protection or cover is guaranteed. Under this agreement the insurer will compensate the insured for any loss suffered. The insured person or organisation will receive an amount of money exactly equal to the loss suffered and no more. The insured party is said to be indemnified when compensation is paid out.

Cost of insurance

As mentioned earlier premium payments are calculated on the basis of the asset value. Items of high value will also require a higher premium while items of low value also will require a low premium. To make the job of the insurance companies easier the premium payable is calculated as a certain percentage of the amount insured.

Example 1
Kilroy owns a truck worth K10 000. So he insures the truck at this value. Let ussay the premium is calculated at 5% of the amount insured. The premium payable would be:

10 000 X 5/100 = K500

What if Kilroy cannot afford to pay the full K500 as insurance premium? Well, insurance companies have certain policies that enable people like Kilroy to insure part of the asset value. Let's say Kilroy can only insure half of the value of his vehicle. In other words the amount insured will be K5000. So, the premium will be:

5000 X 5/100 = K250

Kilroy has paid a lower insurance premium. What will happen if his truck is completely destroyed in a nasty car accident? Kilroy will not be fully compensated for the loss. He will only receive compensation for half of the total value of his truck because this is how much insurance he bought. So, Kilroy will receive:

10000 X ½ = K5000

What if Kilroy's truck is partly destroyed? The insurance company will send an independent assessor to find out the exact cost of the damage. Then an appropriate amount will be paid out as compensation.

Example 2:
Kilroy has insured the full value of his truck. The truck suffers 50% damage. Fifty per cent will mean that the truck lost half of its value through the accident. Therefore, this is the amount that the insurance company will indemnify. Therefore, the compensation is:

10 000 X 50% = K5 000

Example 3:
What if Kilroy insured half of the truck's value and the truck loses 50% of its value in an accident? That means only K5000 of the truck's value is insured. And because the truck suffered 50% damage the compensation paid will also be half of the insured value. The compensation is:

5000 X 50% = K2500

Voluntary and Compulsory Insurance

A business can obtain various types of insurance. All insurance types fall under compulsory or voluntary insurance. The tables below provide for the main insurance types that fall under the two main categories.

COMPULSORY INSURANCE	
Workers compensation	The national government requires all employers to register and pay a fee based on the number of workers. This insurance provides medical cover for any injuries received by employees while at work.
Third-party motor vehicle insurance	All vehicles must be registered and insured against personal injury to any party caused by motor vehicle accidents. This scheme is administered through the Motor Vehicle Insurance Limited (MVIL). This insurance does not cover damage to the vehicle.

VOLUNTARY INSURANCE	
Burglary	Cover is provided for the property of the business and for clients' property left on the premises
Cash	Cash can be insured in a variety of ways – on the premises, in transit, at home or as handled by staff. (Fidelity insurance covers embezzlement or misappropriation of funds)
Fire and flood	This insurance covers the business premises in the event of fire or other disasters (e.g. floods, storms). Some specific items may need separate cover – plate glass windows and doors, documents, stock, water damage from sprinklers, roof leak, etc.
Goods in transit (and export)	Cover is provided for goods on the move while they are still the property of the business and therefore the responsibility of the business.
Key personnel	A business may have special employees, without whom the business could not operate – for example a top chef, pilot or salesperson. This insurance provides cover for the business in case the key personnel become incapacitated.
Loss of profit	A business cannot operate as usual because of some event. This insurance will

	provide some compensation for loss of profit or business due to the forced lack of trading.
Machinery breakdown	Cover may be necessary to pay for repairs to machinery and equipment and to compensate for losses due to the failure of equipment.
Professional indemnity	A business proprietor may need to be covered against the likelihood of legal action by a client for services rendered.
Product liability	Protection is provided for the manufacturer of a product against legal action which arises because some loss is suffered by the product user and is caused by a problem with the product.
Public risk or public liability	This is possibly one of the most important forms of insurance as it provides cover for personal injury to members of the public who may be injured by events which occur on the business premises. These injuries can be serious. Therefore, this insurance usually provides indemnity for a substantial amount of money.

Compulsory insurance

Accident insurance

This is a common type of insurance which many Papua New Guineans know of. Accident insurance provides cover against injuries through accidents. There are many different ways through which accidents can happen. However, in this country injuries are categorised under three main types:

- workers compensation insurance
- personal accident insurance
- motor vehicle insurance.

Because injuries can be of any measure the government of Papua New Guinea has determined various rates (percentages) for different categories of injuries, including death. The nature and extent of the injuries is supported by a Doctor's (medical) report as proof before compensation is paid out. All insurance companies apply the same rates across the country. The table below gives an indication of some of these rates used in Papua New Guinea.

Body part	**1994 K35000 X (%)**
Permanent and incurable loss of mental capacity resulting in total inability to work.	100
Total and incurable paralysis of the limbs	100
Total loss of sight of both eyes	100
Total loss of sight of one eye	50
Total loss of hearing	75
Total loss of speech	75
Total loss of senses of smell and taste	50
Loss of arm at or above elbow	90
Loss of arm below elbow	80
Loss of both hands	100
Loss of hand and foot	100
Loss of hand or loss of thumb and four fingers	80
Loss of thumb	35

Loss of forefinger	25
Loss of middle finger	20
Loss of ring finger	20
Loss of little finger	14
Total loss of movement of joint of thumb	15
Loss of distal phalanx of thumb	17
Loss of distal phalanx of forefinger	11
Loss of distal phalanx of other	9

Table 4.9: Workers insurance schedule (Source: PNG National Legislation, page 39)

Workers compensation insurance is a compulsory type of insurance for all workers. It is the responsibility of the employer to take out this insurance for all workers. If an employee is injured while at work then he or she will receive some compensation. It is a must that the employer takes out this insurance cover for all employees.

Example
John is a carpenter of a construction company. In 2013, while at work he chopped off his left arm below the elbow with an electric saw. According to the table above he is able to claim up to K28 000 (80% of K35 000). This is how compensation is determined.

Personal accident compensation is suitable for anyone who is self-employed. Workers can also take out this insurance against any injuries that may be sustained outside of the work environment. In both cases similar rates like those given in the table above are applied.

Third party

People who own cars and trucks are required by law to take out the third party insurance. It is compulsory for all vehicle owners. Third party insurance does not cover the vehicle owner. Rather, it covers other people such as passengers riding on the car or those walking along the roadside. Here, the insurance company is the first party and the motor vehicle owner is the second party. The general public is the third party.

Third party insurance does not protect the owner of the vehicle or the vehicle. Therefore, other suitable types of insurance such as comprehensive motor vehicle insurance can be taken out for the vehicle. Also, personal insurance can be taken out to cover the vehicle owner or the driver.

END OF TOPIC 11.4.6.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.6.1: Complete the activities given.

1. What is insurance? ____
2. How is insurance premium calculated? _______________________________________

   ____
3. What are the three main categories of accident insurance? ______________________
4. Joe insures his PMV truck fully for K10 000. His truck is burnt to ashes after 3 months. He bought the truck for K60 000. Do you think Joe will claim some compensation? If so, how much? ____
5. Maria sustained a permanent head injury while working for a construction company. What would her workers' compensation claim be? _____________________________
6. Peter took out third party compulsory insurance for his private car. Five months later he crashes his car and got killed in that accident. Will he be compensated by the insurance company? Explain your answer ____________________________________

11.4.6.2 Life Insurance

What is life insurance?

Life insurance is a protection against loss of income that would result if the insured person passed away. The named beneficiary receives the compensation proceeds and is thereby safeguarded from the financial impact of the death of the insured. It is therefore a voluntary insurance policy.
The goal of life insurance is to provide a measure of financial security for a family after the head of the family dies. So, before purchasing a life insurance policy, one should consider his or her financial situation and the standard of living he or she wants to maintain for the dependents or survivors. For example, who will be responsible for funeral costs and final medical bills? Would the family be relocated? Will there be adequate funds for future or ongoing expenses such as mortgage payments and education? Life insurance must be evaluated annually as situations change or as health status changes.

Life policies are legal contracts and the terms of the contract describe the limitations of the insured events. Specific exclusions are often written into the contract to limit the liability of the insurer; common examples are claims relating to suicide, fraud, war, riot, and civil commotion.

Life-based contracts tend to fall into two major categories:

a. Protection policies – designed to provide a benefit in the event of specified event, typically a lump sum payment. A common form of a protection policy design is term insurance.
b. Investment policies – where the main objective is to facilitate the growth of capital by regular or single premiums.

Health insurance coverage

Living a healthy lifestyle is a long-term safeguard against costly medical bills. But even the most careful amongst us can fall ill due to the uncertainty of life. That is where insurance companies come in to provide protection. Medical insurance provides options for people, to protect them with comprehensive health insurance plans that assist in reimbursing their hospitalization, diagnosis, surgery and other related expenses incurred while they are hospitalized as a result of sickness or accident. The benefits depend on the type of insurance plan chosen.

END OF TOPIC 11.4.6.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.6.2 Complete the activities given.

1. What is life insurance? ____
2. How is the premium for life insurance calculated? ______________________________
3. Why is medical insurance important for people? ________________________________

11.4.6.3 Fire Insurance

What is fire insurance?

Fire insurance is used to cover damage to property caused by fire. Fire insurance is a specialized form of insurance beyond property insurance. It is designed to cover the cost of replacement, reconstruction or repair beyond what is covered by the property insurance policy. Policies cover damage to the building itself and can also cover damage to nearby structures, personal property and expenses associated with not being able to live in or use the property if it is damaged.

Home owners and property owners may consider fire insurance in addition to a property insurance policy. A good practice would be to record the value of the property and its contents. A fire insurance policy may contain exclusions based on the cause of the fire, such as not covering fires caused by wars.

Fire insurance is a contract under which the insurer, in return for a premium, agrees to indemnify the insured for the financial loss which may be suffered due to destruction or damage to property or goods, caused by fire. It is for a specified period. The loss can be ascertained only after the fire has occurred. The insurer is liable to compensate the insured for the actual amount of loss not exceeding the maximum amount fixed under the policy.

In the fire insurance policy, 'fire' means the production of light and heat by combustion or burning. Thus, fire must result from actual ignition and the resulting loss must be proximately caused by such ignition. The phrase 'loss or damage by fire' also includes the loss or damage caused by efforts to extinguish fire.

Learning Activities 11.4.6.3 Complete the activities given.

1. What does fire insurance cover? ____
2. Is fire insurance necessary for a business? Explain your answer. ___________________

11.4.6.4 Marine Insurance & Accident Insurance

What is Marine Insurance?

Marine insurance covers the loss or damage of ships or cargo held in transit before reaching the final destination. When goods are transported by mail or courier, shipping insurance is used instead.

A marine policy typically covers only three-quarters of the insured's liabilities towards third parties. The typical liabilities arise in respect of collision with another ship, known as 'running down', and wreck removal. In the 19^{th} century, ship owners banded together in mutual underwriting clubs known as Protection and Indemnity Clubs (P&I), to insure the remaining one-quarter liability amongst themselves. Underwriting is referring to the act of signing and accepting liability under an insurance policy especially on shipping. Underwriting clubs are still in existence today and have become the model for other specialized and non-commercial marine and non-marine insurance cover.

Specialist policies

Various specialist policies exist, including:

1. New-building risks: This covers the risk of damage to the hull while it is under construction.
2. Open Cargo or Shipper's Interest Insurance: This policy may be purchased by a carrier, freight broker, or shipper, as coverage for the shipper's goods. In the event of loss or damage, this type of insurance will pay for the true value of the shipment, rather than only the legal amount that the carrier is liable for.
3. Yacht Insurance: Insurance of pleasure craft is generally known as 'yacht insurance' and includes liability coverage.
4. War risks: Generally hull insurance does not cover the risks of a vessel sailing into a war zone. The war risks areas are established by the London-based Joint War Committee, which has recently moved to include the Malacca Straits as a war risks area due to piracy. If an attack is classified as a 'riot' then it would be covered by war-risk insurers.
5. Increased Value (IV): Increased Value protects the ship owner against any difference between the insured value of the vessel and the market value of the vessel.

Cargo insurance

Cargo insurance is underwritten on the Institute Cargo Clauses, with coverage on an A, B, or C basis; A having the widest cover and C the most restricted. Valuable cargo is known as 'specie.' Institute Clauses also exist for the insurance of specific types of cargo, such as frozen food, frozen meat, and particular commodities such as bulk oil and coal. Often these insurance conditions are developed for a specific group as is the case with the Institute Federation of Oils and Seeds and Fats Associations which are used for the insurance of shipments of cocoa, coffee, cotton, fats and oils, hides and skins, metals, oil seeds, refined sugar, and tea and have been agreed with the Federation of Commodity Associations.

Salvage

The term 'salvage' refers to the practice of rendering aid to a vessel in distress. It is obviously in the underwriter's interest to encourage assistance to vessels in danger of being wrecked. A policy will usually include 'sue and labour' clause which will cover the reasonable costs incurred by a ship owner while avoiding a great loss.

At sea, a ship in distress will typically agree to 'Lloyd's Open Form' with any potential salvor. The Lloyd's Open Form (LOF) is the standard contract, although other forms exist. The LOF is headed 'No cure – no pay', the intention being that if the attempted salvage is unsuccessful, no award will be made. The Lloyd's Open Form, once agreed, allows salvage attempts to begin immediately. The extent of any award is determined later.

A ship captured in war is referred to as a prize, and the captors entitled to prize money. Again, this risk is covered by standard policies.

Accidental death and dismemberment insurance (AD&D)

This is a policy that pays benefits to the beneficiary if the cause of death is accidental. This is a limited form of life insurance which is generally less expensive.

Accidental death

Accidental deaths are a leading cause of death in many countries of the world. In the event of an accidental death, this insurance will pay benefits in addition to any life insurance but only up to a set amount total regardless of any other insurance held by same insurer, held by the client. This is called double indemnity coverage and is often available even when accidental death insurance is merely an add-on to a regular life insurance plan. Some of the covered accidents include traffic accidents, exposure, homicide, falls, heavy equipment accidents and drowning.

Common exclusions

Every insurer maintains a list of events and circumstances that disqualifies the insured's entitlement to his or her accident death benefit. Death by illness, suicide, non-commercial radiation, war injury, and natural causes are generally not covered. Similarly, death while taking any non-prescribed drugs or alcohol is most likely exempt from coverage. Overdose with toxic or poisonous substances and injury of an athlete during a professional sporting event may disqualify the right to claim too.

Some insurance carriers will tailor their clients' coverage to include some of the above risks, but every such extension will be accompanied by increased premiums.

Due to these restrictions, the process of claiming the benefit may be relatively lengthy; the deceased client may have to undergo autopsy and the accident may have to be officially investigated before a claim is approved by the insurer.

Dismemberment

Fractional amounts of the policy will be paid out if the covered employee loses a body limb, sight or permanent paralysis because of an accident. The types of injuries covered and the amount paid differs by the insurer and they are clearly stated in the insurance policy. Workers are covered by the workers compensation policy.

Coverage types

There are four common types of group Accident, Death and Dismemberment plans offered in mostly developed nations:

1. Group Life Supplement – the Accident, Death and Dismemberment is included as part of a group life insurance contract. The benefit amount is usually the same as that of the group life benefit;
2. Voluntary – Accident, Death and Dismemberment is offered to members of a group as a separate benefit and premiums are generally paid as a payroll deduction;
3. Travel Accident (Business Trip) – the Accident Death and Dismemberment benefit is provided through an employee benefit plan and provides protection to workers while they are travelling on official duty travel. The entire premium is usually paid by the employer;
4. Dependents – Some group accident death and dismemberment plans also provide coverage for dependents.

END OF TOPIC 11.4.6.4. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.6.4 Complete the activities given.

1. What is marine insurance? ____
2. Why is marine insurance important for an import/export business? _______________
3. Who determines the premium that is to be paid for marine insurance?____________
4. What does the term 'salvage' mean? _______________________________________

11.4.6.5 Motor Insurance

Motor Vehicle Insurance

Motor vehicle insurance is insurance purchased for cars, trucks motorcycles, and other road vehicles. Its primary use is to provide financial protection against physical damage and/or bodily injury resulting from traffic collisions. It also protects against liability that could arise from the specific terms of vehicle insurance. To a lesser degree vehicle insurance may additionally offer financial protection against theft of the vehicle and possibly damage to the vehicle, sustained from things other than traffic collision.

Today there is widespread use of automobiles in our cities and towns. Cars are relatively very fast and dangerous. Also, the number of automobiles on the road is very high. Therefore, the chance of injury and death caused by cars and trucks is very high. Motor vehicle insurance is a way of ensuring that injured victims could get compensated in an accident, and vehicle owners can get compensated for damage or loss of their vehicle.

Public policies

In many countries it is compulsory to have vehicle insurance before using or keeping a motor vehicle on public roads. Most countries relate insurance to both the car and the driver, however, the degree of each varies greatly. Comprehensive and Third Party insurance is sold separately to cover property damage and cover can be for events such as fire, theft, collision and other property damage.

Third party property insurance covers damage to someone else’s property or vehicle, but not your own vehicle. Comprehensive insurance covers damage to your own property or vehicle as well as someone else’s.

Compulsory Third Party Insurance

Compulsory Third Party Insurance is linked to the registration of a vehicle. It goes with the vehicle ownership when a vehicle is sold and already registered. It protects the vehicle owner against claims for liability in respect of the death or injury to people caused by the vehicle.

Third party insurance covers the cost of all reasonable medical treatment for injuries received in the accident. If a death is caused by the vehicle, the relatives of the deceased can claim compensation from the insurance company. However, it does not cover the vehicle itself or the owner of the vehicle. It is only for the third party which is the general public.

Comprehensive Motor Vehicle Insurance

Comprehensive insurance covers fire, theft, vandalism and damage to the vehicle. It also covers damage caused by the driver to the vehicle. This is usually the most expensive type of insurance. However, because vehicles are valuable assets insurance is a way of protecting their value against any damage or loss.

Coverage levels

Motor vehicle insurance can cover some or all of the following items:

- The insured party (medical payments)
- The insured vehicle (physical damage)
- Third parties (car and people, property damage and bodily injury)
- Third party, fire and theft
- The cost to rent a vehicle if yours is damaged
- The cost to tow your vehicle to a repair facility
- Accidents involving uninsured motorists

Premium Calculation

Depending on the country and its laws, the insurance premium can be either mandated by the government or determined by the insurance company. Premiums are usually determined in accordance with a framework of regulations set by the government. Often, the insurer will have more freedom to set the price on physical damage coverage than on mandatory liability coverage.

When the premium is not mandated by the government, it is usually derived from the calculations of an actuary, based on statistical data. The premium can vary depending on many factors that are believed to have an impact on the expected cost of the future claims. These factors can include the car characteristics, the coverage selected, the driver's profile and the usage of the car.

Auto repair insurance is an extension of car insurance available to all car owners. It covers the natural wear and tear on a vehicle. Some vehicle owners may decide to buy the insurance as a means of protection against costly breakdowns unrelated to an accident. In contrast to more standard and basic coverage such as comprehensive motor vehicle insurance, auto repair insurance does not cover a vehicle when it is damaged in a collision, during a natural disaster or through vandalism. Vandalism is the act of destroying public properties by opportunists. Opportunist is someone who takes advantage of situations to behavior or act undisciplined way to bring destruction to public properties.

END OF TOPIC 11.4.6.5. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.6.5 Complete the activities given.

1. Are passengers of a PMV truck covered by any insurance at all? __________________
2. What is comprehensive motor vehicle insurance? ______________________________
3. Who determines the premium for third party insurance? ________________________

NOW WRITE THE TOPIC TEST FOR TOPIC11.4.6. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOK

11.4.7 BUSINESS FINANCE

11.4.7.1 Networks & Business Connection for Finance

What is networking?

Networking is about making connections and building long lasting and mutually beneficial relationships. Successful people such as politicians, salespersons, senior executives or community leaders can tell you that the single skill that helped them excel in their career is networking.

Relationships are the foundation for success. People do business with those they like and trust. Networking provides the most productive and enduring way to build relationships. To succeed you must continually connect with new people, cultivate growing relationships and control your network. It is through networking that you will gain necessary knowledge and skills.

The ability to network is one of the most important skills any entrepreneur can have. It is a necessary part of meeting clients to grow the business. But many people are put off by the idea of networking, thinking it requires special personalities and skills. Good networkers are ordinary people who love to meet new people and socialise with them. They are the kind of people who love to hang out with strangers and try to create relationships with them.

Now that you have an idea of what networking is all about, take an objective look at your own interactive abilities. Do you consider yourself shy and regard networking groups as threatening? Do you tend to do all the talking in a conversation? Do you give other people referrals and ideas without a thought to your own personal gain? Can people count on your word?

Many people go to networking events, but very few know how to network effectively. Networking is more than just getting out and meeting people. Networking is a structured plan to get to know people who will do business with you or introduce you to those who will.

How to succeed at networking

The best way to succeed at networking is to make a plan, commit to it, learn networking skills and execute your plan. To make the best plan, ask yourself: What do I want to achieve? How many possible customers do I want per month? Where do my customers and prospects go to network with others? What business organisations would benefit my business? How can I build my image and my business's image? What would I like to volunteer to do in the community?

For example, you can make a five-year networking plan by listing your five best customers, five targeted prime prospects and five targeted organisations. You then, set goals for involvement in each organization by determining how much time you will need to commit to each organization and customers, and decide what kind of results you will expect.

Now that you have a plan, get committed. Tell yourself that you will devote enough time and effort to make it work. The next task of networking is about getting out there and testing reality and learning the task of networking effectively. To network effectively means to meet and talk about your business to the different groups of people (possible customers) and out of this, you should produce good results.

Typically, ineffective networkers attend several networking groups but visit with the same friends each time. Obviously, this behavior defeats the entire purpose of networking. If you stick with familiar faces, you never meet anyone new. And since most people stay within their circle of friends, newcomers view the organization as a group of cliques or very close-knit friends. This is one reason people fear going to new organisations by themselves. They are afraid no one will notice them.

Importance of networking to business finance

First time entrepreneurs or start-up business people rely mostly on their personal savings to finance their businesses. Many people find this to be the most limiting factor for their small businesses. There are people with very fantastic business ideas that never get implemented because of the lack of finance. Even convincing friends and family members to invest in a brilliant business idea is very hard.

Networking can be a way out for entrepreneurs. Through effective networking a small business person can meet people who can offer advice, referrals to finance sources and even offer financial assistance. Networking provides a perfect opportunity to market a business idea to possible funders or donors.

Venues of Networking

A meeting or a conference can serve as a perfect opportunity to meet potential sources of help. A business meeting is a very suitable venue for networking. It may be awkward at first but you have nothing to lose and everything to gain if you attend such high profile meetings with the sole purpose of networking. You may meet a bank executive who may have the ability or power to help you. You may meet a business person who likes your idea and is willing to share the risk. Politicians and high ranking government officials also frequent such high profile meetings. So you really have to go with the right attitude and aim to meet at least five (5) people whom you can network with. Remember, opportunities are there. It is what you do to take advantage of them that matters.

END OF TOPIC 11.4.7.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.7.1: Complete the activities given.

1. Why is good networking ability such an important characteristic? _______________
2. How can you prepare for networking if you are going to a conference or a gathering where important people are to attend? _______________________________________
3. List some possible venues or sources of networking for a small business. __________

11.4.7.2 Government Agencies

What is a government agency?

A government agency is an extension of the government. It could be an organization, a school, an institution, research institution, or any such set ups. Government agencies are set up and funded by the government. People who work in government agencies are called 'public servants' and they are paid by the government.

There are many government agencies in Papua New Guinea that have been established with goals, aims and objectives. Each year their operations are funded by the government so that they can achieve their missions, aims and objectives. Most of their missions, aims and objectives are to do with providing goods and services to the public. Information is one important service some agencies provide which people can use for various purposes.

The government's main aim is to develop the country. This overall national aim is achieved through its numerous agencies. All agencies of the government are aligned to the overall national goals such as development, good health, education and economic prosperity.

Business-related government agencies

Today, governments in many countries provide a wide range of both financial and advisory support services. Many governments have recognised the importance of Small and Medium Enterprises (SMEs) in the economy by developing SME master plans. Such planning concerns issues such as enterprise formation, survival and growth and general business assistance. Many countries agree that the success of their economies depend largely on the growth and development of small and medium enterprises.

The government recognises the important contribution made by entrepreneurship to the national economic growth. Therefore, it tries to stimulate business start-ups and growth by providing financial and informational assistance. Government assistance comes in various forms. The key areas of business assistance are covered below.

- Policy framework and support
- Business start-up assistance
- Business development
- Infrastructure support
- Trade assistances
- Tax concessions

Key government agencies

Investment Promotion Authority (IPA)

Generally, different help areas are available from different government departments. However, entrepreneurs do not always have sufficient time or knowledge of government systems to access all of these services. As a result, most countries now provide an agency that can act as a 'gateway' to other arms of government. Such 'gateway' bodies act as integrated facilities for general business advice, suggestions for improvement, and referrals to other government schemes or departments for help.

The IPA is a gateway body for businesses in Papua New Guinea. It is a Government agency established to promote business and investment in the country. General information and application forms for licenses and business registration are provided by the IPA. It also provides general investment information to foreign business interests as well as local businesses. Such advice can be suitable for all types of businesses including, foreign investors.

By law every business operating in the country must register their names and declare the activities undertaken. This legal requirement is aimed at properly controlling business activities in the country. Without such control all types of business activities will pop up everywhere. Even illegal businesses can become widespread in the country.

Business Development Officers

The national government, through the Ministry of Commerce and Industry, has established business development offices in almost every province of PNG. These offices are placed under the care of business development officers. Their job is mainly to provide advice and support to local businesses in their respective provinces. People wanting to start up their own businesses can consult these officers.

They also help carry out business policies of the national government. Some national organisations also work with the provincial commerce officers to help carry out government policies. The IPA, for example, works through these officers to register business names. The office of commerce or business development falls under the direct control of each provincial administration.

National Development Bank (NDB)

This is the government's bank aimed at achieving broad-based economic growth by supporting the growth of businesses. This bank has been operating in the country under various names such as Agriculture Bank and Rural Development Bank. It does not accept deposits directly from the public but only lends for various purposes. However, recently, in line with the national government's SME policy, the bank opened up its micro bank called Peoples' Micro Bank to accept deposits and lend money to small businesses and low income owners.

The national government provides funds to the bank annually through its national budget. Citizens of the country can obtain loans from the bank for various business activities.

The main types of services provided by National Development Bank (NDB) are:

- short term hire purchase for equipment and vehicle financing;

- large scale loans for commercial and rural development;
- small scale loans for agriculture development initiatives; and
- mini loans for micro business activities.

Microfinance

Microfinance schemes refer to the provision of financial services for rural development. Its main aim is to reduce poverty in the country and functions on the belief that financially disadvantage people should be able to access financial services just like anyone else. Microfinance institutions encourage people to, firstly, save their money. Borrowing money comes after some money is saved. Loans can also be made easily with commercial banks and other financial institutions.

Microfinance is a very friendly financial service provided for the people. A person can open a savings account with a minimum of K1. Members can also borrow from the microfinance institutions with very little security or personal equity. For example, with PNG Microfinance the borrower is required to contribute a minimum of two per cent of the loan amount. The rest is paid for by PNG Microfinance. Loan repayment periods are also longer than what other financial institutions require.

Nearly every established financial institution is unwilling to lend money to the small entrepreneurs at the start. This is because a lot of risk is involved. Many grassroots people are unable to start their business ventures because of the lack of finance. Even those engaged in the informal sector require finance to expand. But they cannot borrow from established banks. Micro finance is a new concept aimed at helping ordinary people to establish their own small businesses.

The national government started a number of micro finance institutions to encourage people to save and borrow money. The Liklik Dinau Abitore Trust, Bougainville Micro finance Scheme, PNG Microfinance Company and National Micro Bank Company are some of the examples. PNG Microfinance and Peoples' Micro bank are two successful institutions operating in the country today. They are popular among the rural people because they are well suited to their needs. People can borrow from microfinance institutions with very little security and at low interest rates. Loan repayment periods are also longer than those of other financial institutions.

Papua New Guinea Cooperative Societies

Cooperative movements started in this country in the 1940s and performed well. However, due to various factors this movement died out over time. Recently, in 2000, the national government revived cooperative movements by establishing the Papua New Guinea Cooperative Societies under the (Amended) Act 1985.

The cooperative concept is well suited to PNG as most citizens live in rural areas and practice subsistence agriculture. They do not have the capital to start their own business ventures. But they have the land and their free labour or sweat equity. Through a cooperative these people can combine their resources and engage in commercial activities. They can purchase assets and carry on a business venture easily if they are committed.

Cooperatives are seen as a means to reduce poverty, improve living standards and increasing business activities. There are regional offices throughout the country that have been established in order to assist those who wish to form cooperatives. A cooperative can only be formed by citizens of the country. It can take on just about any form of business activity as long as members agree.

The regional offices provide advisory services as well as helping to register new cooperatives. Cooperatives are encouraged to prove their capabilities before seeking financial or other forms of support from the PNG Cooperative Societies. A soft loan can be obtained by successful cooperatives to help out with their activities. A soft loan is a loan that is paid over long period of time with little interest and non-security.

Industry Corporations and Associations

There are many small businesses involved in growing, processing and exporting various cash crops such as coffee, cocoa and copra. One of the government's aims is to ensure that these cash crops are continuously cultivated and exported by PNG farmers. In order to promote this objective the national government established industry boards, corporations and associations in the country.

Coffee Industry Corporation (CIC) is one of those organisations found in the country. It provides technical support and advisory services to local coffee farmers. Cocoa and Coconut Industry Corporation provides technical support and advisory services to the coconut industry. The Oil Palm Industry Corporation is another body set up to regulate, monitor and promote the activities of the oil palm industry in the country.

There are many small businesses involved in producing the main cash crops. The government relies heavily on the export earnings from these crops. Therefore, it has passed respective Acts in parliament to regulate the industry boards and corporations. These bodies develop price-stabilising mechanisms to minimise the effects of drops in commodity prices. Without such intervention farmers will be drastically affected by drops in international commodity prices.

Independent Consumer and Competition Commission (ICCC)

The Independent Consumer and Competition Commission (ICCC) was established by the national government in 2002 after it expanded the roles of the organisation formerly known as Consumer Affairs Council (CAC). Its overall objective is to make sure that there is proper competition taking place between businesses in the country. At the same time it tries to make sure that consumer rights and responsibilities are protected.

If a small business owner feels that there is unfair competition in the market place then it can report to the ICCC. The Independent Consumer and Competition Commission (ICCC) will then investigate and try to implement possible solutions. Larger firms, in particular, do have certain advantages which enable them to charge lower prices on their products. However, there should be some control on it to promote fair competition in the market place. The Independent Consumer and Competition Commission (ICCC) can stop big businesses from price-fixing and monopolistic practices. A monopoly has the potential to destroy small businesses in the country. Monopoly refers to a situation where only one company controls the industry or provides the supply of a good or service.

END OF TOPIC 11.4.7.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.7.2: Complete the activities given.

1. Do you think the national government is doing enough to promote the development of business in the country? Explain your position. ______________________________
2. Is the National Development Bank helping many Papua New Guinean business people to secure small loans for their businesses? Explain. _________________________________
3. How important is the role of the ICCC to small businesses in the country? ____________
4. Describe the main functions of IPA. ____
5. List the main industry boards or corporations found in PNG and the industries they represent. ____
6. This year the international prices of most commodities such as coffee, oil palm and cocoa dropped to very low levels and rural farmers are severely affected. Suggest some possible ways in which the various industry boards and corporations can help in this situation. ____

11.4.7.3 Small Business Development Corporation

Purpose of SBDC

The Small Business Development Corporation (SBDC) is the single largest government-funded agency responsible for business development in Papua New Guinea. It can be seen as a large advice centre offering assistance to many businesses throughout the country. SBDC can provide business counselling as well as serving as an information centre. It also conducts seminars and training sessions all over the country.

The training programs and seminars cover topics such as:

- information and communication technology
- business planning;
- management;
- advertising;
- taxation;
- business registration;
- services available for the small business sector; and
- banking.

These are very important areas of business which every small and medium sized business need to operate successfully. There are various divisions within the SBDC that take care of administration, training and policy. The training section plays an important part in imparting business knowledge to the public. Currently there are some courses in business management, entrepreneurship and other areas which are on offer. Anyone can register to enrol and study. Upon completion of the program, participants are awarded certificates in the various programs. Participants can use these certificates as support documents when applying for small business loans.

Policy Implementation

Small Business Development Corporation (SBDC) is part of the Ministry of Commerce & Industry and it has the responsibility of implementing government policies. One of those policies which the SBDC played a major part was the developing and implementing of the Small and Medium Enterprise (SME) Policy. This policy aims at promoting small and medium enterprises (SMEs) at the grassroots level.

The government has tasked the SBDC to protect the small and medium enterprises. SMEs are sometimes referred to as the cottage business activities. The SBDC works with other agencies such as the Investment Promotion Authority (IPA) to ensure that reserved businesses are not being taken up by foreigners.

The SBDC also partners with institutions such as schools, colleges, universities and research institutions to promote small business. Schools, for example, are helping to implement a program known as Know-About-Business (KAB). This is a program which has International

Labour Organisation (ILO) backing. Colleges and universities offer programs which have some relevance to SMEs.

Financial Grants

The SBDC occasionally makes soft loans to small businesses under its credit guarantee scheme. This is mainly to help small businesses to get started. Currently, business grants are placed under the care of the National Development Bank (NDB). It also links with micro finance institutions such as Women in Business and PNG Microfinance where certain funding is diverted to those financial institutions to administer.

END OF TOPIC 11.4.7.3. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.7.3: Complete the activities given.

1. Who owns the SBDC? ____
2. What is the main purpose of the SBDC? _______________________________________
3. Do you think the SBDC is doing enough to promote business development in PNG? If not, then what alternatives do you suggest? ______________________________________

11.4.7.4 Financial Institution - Banks

The role of Financial Institutions

The economy of any country functions with money. But money itself is not enough to take care of the economy. It takes skills, knowledge and expertise to enable the economy to function. Different types of financial institutions with different roles make sure that money flows freely in an economy. Some of these key roles are explained below.

1. Providing Finance

Finance refers to the physical notes and coins as well as other financial products used by financial institutions. Shares, bonds and currency trading are examples of other financial products that financial institutions deal with. Throughout this chapter we will use the terms ‘money’ and ‘finance’ to mean the same thing.

Almost all financial institutions provide money to those who need it. Those who need finance include; individuals, governments and businesses. Some financial institutions can play both roles; lending money to those who need it and accept deposit from others. Other financial institutions only give out money as loans. However, all financial institutions deal with money and this is what they all have in common.

2. Provisions for Storing and Lending Money

Storing of money is the same thing as saving money in business. Saving money is important for economic growth. The government tries to encourage people to save their money in banks and other financial institutions. Money that is saved in financial institutions can be used by businesses and individuals to start up new or expand existing businesses.

Most financial institutions allow for storing and lending of money. As a store house, individuals, businesses and governments can store their money safely. Interest is also paid on the money that is saved in financial institutions. People and business organisations benefit from financial institutions by earning an interest while keeping their money safe.

Some financial institutions provide a high rate of interest on deposited money. This is done mainly to attract people to save money. The money deposited can be borrowed by other people and organisations that need it. Therefore, the more deposits financial institutions receive the more money they have to lend.

3. Lending Money

Many aspiring and business-minded people in the country have difficulty starting up their businesses. They simply do not have enough money to start up and continue their business operations. Because of the lack of finance many good business ideas cannot be started up. Financial institutions can lend money for business start-ups. They also provide finance for established businesses that need extra money.

The common types of loans that are offered by financial institutions include: personal loans, mortgage and business loans. Financial institutions try to make their services as friendly as possible to those who need it. However, some people could not borrow from financial institutions because of lack of loan security. A security is something of value that a borrower is required to place against a bank loan.

Main Functions of Commercial Banks

Commercial banks are the only ones that take in deposits from the public. They make up most of the country's financial system. They also operate current or cheque accounts for customers. Commercial banks use the depositor's money to lend to other individuals and organisations. Currently there are five commercial banks operating in the country. These commercial banks are; Bank South Pacific (BSP), Australia-New Zealand Banking Group (ANZ), Westpac Bank, Maybank, and Bank of Hawaii. Except for BSP the other four banks are foreign-owned.

Maybank is a Malaysian bank. Its operation in Papua New Guinea was bought off by Kina Securities of Papua New Guinea in the year, 2015. Bank of Hawaii has United States of America ownership. ANZ and Westpac are Australian owned commercial banks.

Papua New Guinea Banking Corporation (PNGBC) was the largest and the only government owned commercial bank with the most number of branches. Many of these branches served the rural areas too. Later on, the Papua New Guinea Banking Corporation (PNGBC) was sold and therefore, it does not function any longer. Bank South Pacific (BSP) on the other hand is a privately owned national bank. It only operates in places where there is good profit to be made.
The key benefits that commercial banks have are:

- They have the necessary resources such as capital to maintain their operations in the country.
- Their larger branch network can enable banking services to reach many people in the country.
- They have the ability to respond to customer needs, including the need of small businesses.
- They have a lot of experiences in debt collection.

The National Development Bank

The Papua New Guinea National Development Bank is included in this category mainly because it is a non-deposit taking institution. It was first established in 1976, as the Development Bank of PNG. The government continues to allocate grants to the bank through its annual national budget. However, through its Peoples' Microbank, people can deposit money.

Since the 1970s the National Development Bank has offered four types of lending programs. They are:

- short term hire purchase for equipment and vehicle financing
- large scale loans for commercial and rural development
- small scale loans for agriculture development initiatives
- mini loans for very small amounts to purchase outboard motors.

In 2007, the Somare government changed the bank's name to the National Development Bank. This was also to reflect the changing role of the bank.

11.4.7.5 Industrial and Professional Associations

Private sector assistance

The private sector continues to play a vital role in promoting the growth of business in the country. This sector continues to improve product quality and set standards or benchmarks for businesses in the country. Some private sector organisations also provide assistance to new and small firms, as do several charitable and not-for-profit organisations. There are organisations and bodies whose aim is to assist the development of new business ventures. Others are more interested in supporting existing businesses.

Business Incubators

This is a form of business assistance to mostly small businesses. It is common in developed countries. Usually, it is a dedicated physical space provided to help businesses get established and become profitable. The typical incubator is a building with business advisers and workspaces for entrepreneurs. A centre manager, experienced in working with new and growing entrepreneurial ventures, is usually in charge of the incubator.

The focus of an incubator is on helping businesses to successfully enter the market place and be firmly established. Firms can rent space on a weekly or monthly basis, but not necessarily commit themselves to long - term leases. As the phrase 'incubator' might suggest, tenants are expected to 'leave the nest' within 2 to 3 years after which time they should be independent and commercially be able to practically operate.

Incubators often represent a mix of public and private support. In many cases, the initial funding for the establishment of an incubator is provided by government, but on-going management of the centre is contracted out to a private sector adviser or community organisation.

The typical services offered by an incubator are:

- Access to convenient, reasonably priced tenancies. Incubator rentals do not have many of the difficult conditions or long-term lease obligations found in many commercially run centres.
- In-house business services. These include receptionists, secretarial services conference and meeting rooms, photocopier, fax and postage services and access to bookkeeping and word processing professionals.
- Business advisory services. The manager of the centre will usually work alongside tenants to help them solve specific problems, or to develop their range of generic business skills.
- Business support. Operating alongside other entrepreneurs gives owner/managers an immediate network of fellow businesspeople, providing mutual support and sharing ideas and knowledge.

Chamber of Commerce

Chambers of commerce exists in nearly all regions and provinces throughout the country. Business houses are members of these bodies. The PNG Chamber of commerce is the national body. All provincial chambers are affiliated to this mother body.

A Chamber of commerce can help businesses by providing useful networking opportunities. These include business and legal advisory services, industrial relations services, award updates and skill development activities.

Commerce chambers also provide a voice for businesses in the legal and political environment. The PNG Chamber of commerce does challenge the government over unfriendly business policies or the deteriorating law and order situation in the country. The chambers can collectively influence public policy on behalf of the business community in the country.

Papua New Guinea Manufacturers' Council

This organisation was established by manufacturers in the country to help promote their activities and interests. This body provides assistance to members in areas such as industrial relations, legislation and regulations for international and domestic trade, finance and business management. It also works closely with government agencies to implement government policies relating to the manufacturing industry. Because the manufacturing industry in our country is small this body has an important task of promoting it.

Small businesses that are involved in manufacturing can apply for membership with this body. Networks can be formed through which advice, assistance and product recognition can be obtained.

The Rural Industries Council

This body was set up mainly by businesses operating in the rural areas. Its functions are similar to the other bodies covered above, in that the interests of its members are promoted. Rural industries deal with the most vital segment of the nation's economy as more than 85 per cent of the nation's population live in the rural areas.

Despite the large concentration of the nation's population in the rural areas the level of business activity there is very low. The rural industries council tries to help in assisting with local business development in the rural areas. It also draws the government's attention to the lack of proper infrastructure and other business support services which are non-existent in the rural areas.

11.4.7.6 Other Financial Institutions

The Central Bank of Papua New Guinea

The Central Bank or Bank of Papua New Guinea was set up by the government before independence in 1975. It operates very differently from commercial banks and other financial institutions. The Central Bank is the government's bank. It is controlled by a Board of Directors appointed by the government.

The Central Bank carries out the monetary policy of the government. That means it controls the amount of money in the country. It also controls the amount of money that other banks lend to borrowers. This control is very important for our economy. If too much money floats around in the economy, prices of goods will rise and this will cause inflation.

The Central Bank can also use the monetary policy to increase the amount of money in the country. This is done mainly to encourage people to spend more money on goods and services. The result of this should be increased employment and production.

The Central Bank carries out the monetary policy through the control of commercial banks and other lending institutions in the country. The Central Bank may at times ask commercial banks to deposit sums of money with the Central Bank. This will result in less amount of money available in the banks to lend. It may also ask commercial banks and other lending institutions to reduce their interest rates so that more people can borrow money from them. It can further ask commercial banks and other financial institutions to raise or lower their interest rates. If banks charge high interest rates, less people will borrow money. This will lead to less spending. On the other hand, lower interest rates will encourage more public spending and production.

The Central Bank's key responsibilities are:

- It issues the nation's currency – Kina and Toea.
- It controls the value of kina against other countries' currencies.
- It handles the bank accounts of government departments.
- It controls the transfer of money in and out of the country.
- It keeps track of the country's public debt and arranges for these debts to be repaid.
- It holds the country's reserves of gold and foreign currencies.
- It issues licenses to gold buyers and other financial institutions.
- It regulates and monitors all commercial banks, superannuation funds and savings and loans societies in the country.

Merchant banks

A merchant bank is a traditional term for an investment bank found in the United States. These banks are also called Accepting and Issuing Houses in the United Kingdom.

Merchant banks are the oldest forms of banks that were formed during the Middle Ages by Jewish settlers in Italy and later in Poland and Germany. They deal with the commercial banking needs of international finance, long term company loans, and stock underwriting. A merchant bank does not have retail offices where one can go and open up a savings or cheque account. Therefore, it is sometimes called a wholesale bank. Merchant banks deal mostly with each other and also with other large financial institutions.

The most familiar role of the merchant bank is stock underwriting. A large company that wishes to raise money from investors through the stock market can hire a merchant bank. The merchant bank will take control and underwrite or guarantee the shares. The merchant bank determines the number of stocks to be issued, the price at which the stock will be issued, and the timing of the release of the new stock. It also files all the required paperwork with the various authorities and markets the new stock.

Today there are many different classes of merchant banks. However, they undertake similar functions. Merchant banks operate behind the scenes and away from the public.

Finance companies

Finance companies are financial institutions that provide finance to businesses and individuals to buy assets. Finance companies do this mainly through leasing and hire purchase. There are a number of finance companies in operation in Papua New Guinea.

The common finance companies operating in Papua New Guinea are:
- Nambawan Finance Ltd
- AGC Pacific Finance Ltd
- MBF Finance Ltd
- IndoNiu Finance Ltd
- Resource and Investment Finance Ltd
- Welfare Funds Ltd
- Life Insurance Company Ltd
- Credit Corporation Ltd

Finance companies provide leasing finance to businesses that want to buy assets. Assets may include: trucks, PMVs, earthmoving equipment, computers, boats and outboard motors and properties.

A hire purchase agreement is similar to a lease agreement. A minimum deposit has to be made at the beginning based on the price of the item. The period of repayment is usually within 12, 18 or 24 months. Interest is usually charged at around 18 – 35 percent flat rate. As soon as a minimum deposit is made the purchaser takes immediate possession of the item. However, the financer is the legal owner of the item. The purchaser enjoys possession and use of the item. After full repayment the item can then be owned.

Savings and Loans Societies

Savings and Loans Societies are savings institutions created by members of the same or similar background – at least 20 people. Its purpose is to encourage people to pool their money together to help themselves later. Members must first agree to save certain amount for some time before they can borrow. Members are allowed to borrow from the saved funds at very low interest rates.

Savings and Loans Societies can also invest members' savings in other areas. Common investments include; buying property, shares and bonds and making interest bearing deposits (IBD) with commercial banks.

Examples of successful Savings & Loans Societies operating in Papua New Guinea include:

- Teachers Savings & Loans Society
- Police and State Services Savings & Loans Society
- Air Niugini Savings & Loans Society
- Alekano Savings & Loans Society
- Kokopo Savings & Loans Society
- Nasfund Contributors Savings & Loans Society

Superannuation and Pension Funds

The National Superannuation Fund (NASFUND) is a retirement savings scheme for private sector workers and employees of some statutory bodies. There are rules which make it compulsory for all employers and employees to contribute to this fund. For example, all businesses that employ 20 or more employees are required to contribute to a superannuation scheme. By law employers contribute 8.4 percent while the employee contributes 6 percent of the employee's gross wage or salary.

The Nambawan Super Limited (NSL) is a retirement savings scheme for public servants or government workers. It operates in the same way as NASFUND. Government workers are entitled to contribute to this retirement scheme while they remain as employees of the state. This money will benefit them when they retire or leave their jobs. Under this scheme the government contributes 8.4 percent while the employee contributes 6 percent based on the employee's gross wage or salary.

Both Nambawan Super Limited (NSL) and National Superannuation Fund (NASFUND) have respective Board of Trustees set up by the government to monitor the management of these funds. The management team is appointed by the Board to manage the fund. Retirement funds are being invested in properties, shares, and interest bearing deposits and other investment opportunities. The income received from these investments is then distributed among its members as interests and dividends. This increases the members' wealth over time.

Stock Brokers

Stock brokers can be individuals or organisations. Their key function is to act as middle persons between companies and investors. For example, a company may be looking for new investors to buy its shares. But it may not have the resources or the knowledge to find the right shareholders. An easy way out is to obtain the services of a stock broker. Individual shareholders can also arrange through a stock broker to sell their shares.

Stock brokers have a lot of inside information about the stock market – i.e. buying and selling shares. Almost all stock brokers are attached to stock markets such as the Port Moresby Stock Exchange, Sydney Stock Exchange and New York Stock Exchange. They possess inside knowledge of the companies that trade on the stock exchange. They also know the daily prices of the shares. With such information they are well equipped with the right information to help investors to buy or sell their shares.

Stock brokers usually charge a fee called commission for bridging the gap between investors and the companies that trade their shares to the public.

Business Angels

This source of capital is non-existent in our country. However, it is the fastest growing source of finance in developed countries as well as emerging economies in the Asia Pacific region. 'Angel' investors are usually wealthy and retired people who invest in entrepreneurial ventures, usually at the start-up stage. Many business angels provide cash to young businesses and take equity in return. They are a good source of finance for entrepreneurs who could not obtain capital from other debt or equity financiers.

Apart from providing start-up capital business angels can also offer special expertise and business advice. They often invest in industries in which they have some background experience. The best business angel is one that can contribute significant experience, knowledge, and networking opportunities, as well as the cash needed for business growth.

Venture capital

Venture capital (VC) is the money provided by professional business people. They invest alongside owners and management in young, rapidly growing businesses that have the potential to generate high returns on investment. Some venture capitalists invest as limited partners in a business. Most venture capitalists have no relationship with any other financial institutions. They are therefore called "private independent VC firms".

Venture capitalists will help businesses grow, but they eventually seek to leave in 3 to 7 years. They buy an interest in an entrepreneur's idea, nurture it for a period of time, and then sell their investment. Given the risks involved they carefully screen the technical and business merits of the proposed venture. This is very important as not all applicants for venture capital are successful.

END OF TOPIC 11.4.7. 6.NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT

Learning Activities 11.4.7.6: Complete the activities given.

1. What are the key functions of the Central Bank of Papua New Guinea?
   ____
2. What is the main aim of setting up a savings and loans society?
   ____
3. How do stock brokers make money or income? ____________________________________
____

NOW WRITE THE TOPIC TEST FOR TOPIC 11.4.7. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOK.

11.4.8 CONDUCTING AND EVALUATING A BUSINESS PROJECT

11.4.8.1 Market Analysis

Market Analysis

Market analysis is made up of two separate words. The term 'market' means the same thing as customers of a business. Analysis means to examine, or study. It also means to investigate, break down or enquire. So, market analysis means: 'to break down the components of a market to study or examine it.' It is a structured enquiry into the various elements of a market in order to really understand it better.

Market analysis involves three key areas or elements of a business' marketing plan. They are:

1. Market segment
2. Market profile
3. Segment marketing strategy

Specific areas of the market segment that require analysis are: geographic, demographic, psychographic, and behavior. Basically, this analysis covers where the customers live, their personal details, their likes and dislikes and how they behave towards the product.

Specific areas of the market profile that require analysis are: revenue potential, market share potential and profitability potential. The important thing here is that this analysis is about the future performance of the market.

Specific areas of the segment marketing strategy are: market leader versus product line extension, mass marketing versus targeted marketing, and direct versus indirect sales.
Further market analysis can be carried out following the initial analysis above. This is usually part of the strategic marketing plan. The most important and common areas are as follows:

- Situational analysis – where is the business now?
- Market objectives – where does management want the business to go?
- Marketing strategies – what should the business do to achieve its objectives?

Situational analysis involves the study of the market characteristics and the success factors. It also involves the study of the level of competition, the environmental conditions, technology and problems and opportunities. The marketing objectives point to the direction where the owner or manager of the business wants to take the business to. Its analysis involves the kind of product to be produced, who to sell to and how much to sell.

Finally, marketing strategies are the means through which the marketing objective will be met. So, analyzing the strategies involves the marketing mix. These are;

- product strategy
- pricing strategy
- promotion strategy and
- distribution strategy

Strategic Marketing

Strategic marketing is all about planning to achieve business goals. It is a plan of the future. It covers planning, implementation and evaluation of the marketing activities.

The planning process requires a proper assessment of the needs of the market. It also needs management's commitment towards planning to satisfy future market needs. Strategic marketing brings together the different elements of the marketing process.

Strategic marketing is also a process of identifying the strengths, weaknesses, threats and opportunities of a business. This process leads to the selection of a suitable target market. This is followed by the marketing mix. The implementation of the marketing mix requires good coordination, monitoring and enough resources.

The final stage of the strategic marketing process involves reviewing of the marketing plan. Corrective measures must be taken if the plan has not been implemented as planned.

Although aspects of strategic marketing plan vary from business to business, there are several elements that are common in the plan such as;

1. Description of the target market
2. Review of the competition
3. Description of products you offer
4. Marketing budget
5. Pricing strategy

Market Research Strategy

Market research involves finding out a range of things such as current demand, level of satisfaction, additional product benefits needed and customer service. Market research will also help identify new demand for an existing product, or a new product.

A business owner must have a plan of how to research the market. For example, what product aspects will the research attempt to identify? Or, how often is a market research needed. Even the budget for market research must also be included in the plan.

Because a market research costs money, it must be well planned and performed. It also requires time to carry out a market survey. The research tools such as questionnaires, budget, product samples and personnel must be carefully planned for.

Market research for new product

If a business develops a new product, it is advisable to test the demand for that product. The demand can be determined through a market survey. By asking a sample population a series of questions on paper and analyzing their responses the business can see if the product has a market or not. It costs money to do that. Apart from the questionnaire a prototype or sample of the product must be on hand for customers to see, test, feel, taste and smell.

Market research for existing product

It is common practice for businesses to conducts surveys for their existing line of products. This is done through interaction with the existing customers. A set of questions, for example, are developed for the customers to answer. These questions could be in relation to any aspect of the product such as price, quality, availability and competition. The responses gathered from customers can help a business to adjust its marketing activities in order to keep its market share.

END OF TOPIC 11.4.8.1. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.8.1: Complete the activities given.

1. Define the word 'strategy' in your own words. ___________________________________
   ____
2. What is market strategy? ____
   ____
3. How does a market strategy help a business? ______________________________________
   ____
4. What is market research? ____
   ____
5. Why is market research important to a business? __________________________________
____

11.4.8.2 Sales Performance Analysis

Planned Sales and Actual Sales

The difference between planned and actual sales is called 'variance.' It is an accounting term that can be referred to seeing a variance as positive or negative, depending on the outcome itself.

A positive sales variance is where:

- If you sell more than you planned, that's good. If profits are higher than planned, that's also good. So for sales and profits, variance is actual results less planned results (subtract planned from actual).
- For costs and expenses, spending less than planned is good, so positive variance is when the actual amount is less than the planned amount. To calculate, subtract actual costs (or expenses) from planned costs.

Negative variance:

- When sales or profits are less than planned, that's bad. You calculate variance on sales and profit by subtracting planned from actual.
- When costs or expenses are more than planned, that's also bad. Once again, you subtract actual results from the planned results.

Specific details

This presentation of variances shows how important good analysis is. In theory, the positive variances are good news because they mean spending was less than budgeted. The negative variances mean spending was more than the budget. For example, there was a K5000 positive variance in advertising in January. That means that K5000 less than planned was spent. In February, K7000 positive variance was recorded for literature (brochures, sales pamphlets and others). That means in February K7000 less than planned was spent. In March advertising recorded a negative variance of K3000. That means K3000 more was spent than was planned.

Among the larger single variances for an expense item in a month shown in the illustration was the positive K7000 variance for the new literature expense in February. Is this good news or bad news? Every variance should stimulate questions.

- Why did one project cost more or less than planned?
- Were objectives met?
- Does a positive variance reflect a cost saving or a failure to implement?
- Does a negative variance reflect a change in plans, a management failure, or an unrealistic budget?

Management must find a way to gather significant information to answer important questions such as those asked above.

Adjusting the sales plan

If the sales variance is negative do you change the plan? That's where the management comes in to get the people together and talk about it. Why are sales so much less than planned? Were the assumptions wrong? Was the plan too optimistic? Has something happened – new competition, for example, or new technology, or something else – to change the situation as it was planned?

What about the people? Here is where you have to manage expectations and follow up. Do you have metrics on sales presentations, leads and close rates? Have the people been performing, but just not getting the sales? Was your assumption wrong?

END OF TOPIC 11.4.8.2. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11. 4. 8.2: Complete the activities given.

1. What is a sales variance? ____
2. How can a negative sales variance be corrected? _________________________________
3. Whose job is it to adjust the sales plan? ____

11.4.8.3 Evaluating a Statement of Income & Expenditure

What is an income statement?

An income statement (US English) is sometimes called a profit and loss statement (UK English). It is also known by other names such as revenue account, statement of financial performance, operating statement, or statement of operations. It is one of three key accounting records; the others being the balance sheet and cash flow statement. A statement of income and expenditure provides a historical account of all income and expenditure transactions. It therefore covers the financial performance of a business for a period of time, just like the cash flow statement. Its aim is to show how profitable a business was for any given time period.

Revenue

Revenue comes from the main activity of the business. Under the 'accrual basis of accounting' (as opposed to 'cash method'), revenues are recorded when they are earned, not when the company receives the money. Recording revenues when they are earned is the result of one of the basic accounting principles known as the 'revenue recognition principle'.

For example, if Peter sold 1,000 items in December for K4 per item, he has technically earned a revenue totaling K4,000 for that month. He sends the invoice to his clients for this amount and his terms require that his clients must pay by January 10. Even though his clients won't be paying until January 10, the accrual basis of accounting requires that the K4000 be recorded as December revenues, since that is when the sales took place. After expenses are matched with these fees, the income statement for December will show just how profitable the business was in doing its business in December.

When Peter receives the K4000 from his customer in January 10, he will make an accounting entry to show the money was received. This K4000 of receipts will not be considered to be January revenues, since the revenues were already reported as revenues in December when they were earned. This K4000 of receipts will be recorded in January as a reduction in 'Accounts Receivables'.

Expenses

Let us continue with the same example of Peter to consider the second part of the income statement – expenses. The December income statement should show expenses incurred during December regardless of when the business actually paid for the expenses. For example, if Peter hires someone to help him with the December sales, and he agrees to pay him K500 on 3 January, that K500 expense needs to be shown on the December income statement. The actual date that the K500 is paid out doesn't matter. What matters is when the work was done – when the expense was incurred – and in this case, the work was done in December. The K500 expense is counted as December expense even though the money is paid in January 3. The recording of expenses with the related revenue is associated with another basic accounting principle known as the 'matching principle.'

We must see here that the K500 of wages expenses on the December income statement will result in a matching of the cost of the labour used to sell the items in December with the revenues from selling the items in December. This matching principle is very important in measuring just how profitable a business was during a given time period.

In order to earn revenues in December, the business had to incur some business expenses with December, even if the expenses won't be paid until January. Other expenses to be matched with December's revenues would be such things as fuel for the delivery car and advertising spots on the radio, for example.

One thing that we need to be clear here is that an income statement does not report cash coming in – rather its purpose is to (1) report the revenues earned by the business's efforts during the period, and (2) report the expenses incurred by the business during the same period. The purpose of the income statement is to show a business's profitability during a specific period of time. The difference (or 'net') between the revenues and expenses for a business is referred to as the 'bottom line' and is labeled as either 'Net Income' or 'Net Loss'.

END OF TOPIC 11.4.8.3. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning activities 11.4.8.3: Complete the activities given.

1. What is an income statement? ____
2. Define ‘income’ and ‘expenses’. ____
3. How is profit calculated?

   ____

11.4.8.4 Evaluating a Profit and /or Loss Statement

Profit and/or loss statements

Profit and/or Loss Statements are prepared at regular intervals during a small business' life, usually on monthly, 6 monthly and yearly basis. Profit or loss is calculated by comparing revenue and expenses over a period of time. Small businesses earn revenue by selling products or services such as 'fees' charged by a doctor or 'sales proceeds' from a kai bar. On the other hand, expenses are costs and charges that small businesses pay in the process of operating the business. Examples of expenses are 'rent' paid by the firm and 'wages' of employees.

It is July at the Toy City – the opening day for business. Toy City opens its doors to customers for business. At the end of trading for the month of July, Joe, its owner, wishes to calculate the amount of profit he has made. He supplies the following information:

- The records show that the total income received from customers for the purchase of toys is K9 000 and K1, 000 is owed by the local Kindergarten school for toys purchased on credit.
- He has spent K500 in wages, K200 in electricity bills, K250 to fix the roof, K250 in loan interest and K500 in rent.
- Joe also calculated that the toys he has sold cost him K6, 000 to buy.

Consider the example of The Toy City.

A trading business will always produce a profit and/or loss statement to show how much profit has been made from the trading side of the business; that is, from the sale of goods. It is also important to determine the net profit, which takes into account the other operating expenses or overheads which a business has to pay. The Toy City's Profit and Loss Statement is shown on the next page.

THE TOY CITY
PROFIT AND LOSS STATEMENT
For the month ending 31 July 2014

Income				
Cash	K 9 000			
Credit	1 000		K10 000	
Less Cost of Goods				6 000
Gross Profit				4 000
Less **Expenditure**				
Wages		500		
Electricity bills	200			
Roof repair		250		
Loan interest		250		
Rent		500	1 700	
NET PROFIT				K 2 300

Figure 4.3: Profit and Loss Statement

Analysing the profit report

The profit and loss statement gives the entrepreneur information about whether the firm has been successful in selling its products. Every kina figure in the profit report tells a particular story.

END OF TOPIC 11.4.8.4. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT PAGE

Learning Activities 11.4.8.4: Complete the activities given.

1. What is a profit and loss statement? ____
2. When is a profit and loss report prepared? ______________________________________

11.4.8.5 Evaluating a Balance Sheet

The Balance Sheet

The balance sheet is sometimes called the statement of assets and liabilities. The balance sheet contains assets, liabilities and owner's equity. Assets can be either fixed or current. Likewise, liabilities can be either long term or current.

Let us continue with the example of Toy City which we considered above. Toy City opened its store in town in July 2014.

Toy City is a shop that specialises in children's' toys. The proprietor, Joe Banana, has listed the assets and the debts of the business. He has also grouped these items further under current and non-current items. Joe used K10 000 of his own savings and borrowed K5 000 from the bank to finance his business. The bank loan will be repaid over two years. He has purchased K7 000 worth of stock (toys), some fixtures and fittings (shelves, etc.) for K1 500 and a cash register for K500. He has decided to rent the premises.

THE TOY CITY
STATEMENT OF ASSETS AND LIABILITIES
As at 30 July 2014

<u>NET WORTH</u>				
Capital				**K10 000**
Represented by:				
<u>ASSETS</u>				
<u>Current Assets</u>				
Cash at bank	**6 000**			
Stock of toys	**7 000**	**13 000**		
<u>Non-current Assets</u>				
Fixtures and fittings	**1 500**			
Cash register	**500**	**2 000**		
Total Assets			**K15 000**	
***Less* <u>LIABILITIES</u>**				
<u>Current Liabilities</u>	**0**			
<u>Non - current Liabilities</u>				
Bank Loan (Due 30/12/2010)		**5 000**		
Total Liabilities		**<u>K 5 000</u>**	**<u>K10 000</u>**	

Figure 4.4: Statement of Assets and Liabilities

The statement above shows the value of assets, the level of liabilities and the value of Joe's net worth in the business at the time of opening the toy shop.

END OF TOPIC 11.4.8.5. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT

Learning Activities 11. 4.8.5: Complete the activities given.

1. What is a balance sheet, and what information does it present?
   ____

2. Differentiate between assets and liabilities. ______________________________________

11.4.8.6 General Evaluation in Business

Evaluation of small business performance

Managers need to carefully evaluate the business' performance at least once a year. Owners are particularly interested in knowing the value of their investment.

Management uses monthly or yearly financial reports such as the profit and loss statement and balance sheet to determine whether the business is performing according to expectations. This is one reason why proper financial records need to be kept in a small business. The accountant analyses these reports to measure the strengths and weaknesses of the business' performance.

The most common method is to compare the business' performance to some other standards, for example:

- comparing business results to those of past years or to budgeted figures
- comparing the business' results to those of other businesses involved in a similar activity; and
- calculating various ratios and percentages for items in the business' profit and loss statements and balance sheets.

Analysing the Profit and/or Loss Report

The profit and loss statement gives the small business owners and managers information about whether the firm has been successful in selling its products. Every kina figure in the profit report tells a particular story and management can gain extra information by expressing each figure as a percentage of the sales figure. Consider the following example for Elsa's sports shoes.

Elsa's Sport Shoes
Profit and Loss Statement for year ending 31 December 2016

Revenue	K		K		Percentage of sales		
Sales				100 000		100%	
Less Cost of sports shoes			35 000		35%		
Gross profit				65 000		65%	
Less other expenses:							
Rent		15 000					15%
Wages		18 500					18.5%
Advertising		13 000					13%
Clerical expenses	3 500					3.5%	
Total expenses			50 000		50%		
Net profit			**15 000**		**15%**		

Figure 4.5: Profit and Loss Statement

The profit and loss statement for Elsa's sports shoes show that Elsa sold K100 000 worth of shoes during the year. However, K35 000 was spent on purchasing the sports shoes, which left Elsa with K65 000 gross profit. Elsa's other expenses totaled K50 000, leaving her with a K15 000 profit.

1. Gross profit to sales percentage

$$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1} \Rightarrow \frac{65\,000}{100\,000} \times \frac{100}{1} = 65\%$$

The above percentage illustrates that if Elsa was selling her sports shoes for K100 each, she would be receiving K65 from each sale after she pays K35 for the actual purchase of the shoe. This percentage can help show if there has been a change in either the selling or the purchase price of stock.

2. Other expenses to sales percentage

Example:

$$\frac{\text{Advertising}}{\text{Sales}} \times \frac{100}{1} \Rightarrow \frac{13\,000}{100\,000} \times \frac{100}{1} = 13\,\%$$

This percentage shows that Elsa is paying 13 toea of each sales kina for advertising expenses. If this percentage were much higher than that for previous years, Elsa would have some cause for concern.

3. Net profit to sales percentage

Example:

$$\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1} \Rightarrow \frac{15\,000}{100\,000} \times \frac{100}{1} = 15\%$$

Net profit to sales is a very important indicator of how profitable the business is in relation to sales. In this case, Elsa is taking home 15 toea from each K1 of sales. If Elsa was earning more than 15% net profit to sales last year, she would have some cause for concern and should take immediate action to improve this situation.

Analysing the Balance Sheet

To the small business owner, the balance sheet not only shows the assets and liabilities of the business, it reveals by how much the firm's capital has increased. A firm's capital (or proprietorship) normally increases as a result of increased profits made by the business during the year.

Through careful analysis of the balance sheet, managers and owners of small businesses are able to determine the health of the firm's financial position and compare it with other similar businesses. Furthermore, analysis of the firm's financial position will allow the owner to determine whether the assets owned by the business have been used successfully to earn a profit and whether the business has an adequate level of liquidity (available cash) necessary to pay debts on time.

Consider the previous example of Elsa's sports shoes. We can use Elsa's balance sheet to illustrate how a small business' balance sheet would be analysed.

Elsa's Sports Shoes
Balance sheet as at 31 December 2016

Assets	**K**	**Liabilities**	**K**	
Bank	5 600	Creditors		25 000
Debtors	11 400	Loan – AB Finance (due 2016)		24 000
Stock of shoes	16 000	**Proprietorship**		
Furniture and equipment	85 000	Capital	54 000	
		add Net profit	15 000	69 000
Total Assets	118 000	Total equities		118 000

Figure 4.6: Balance Sheet

Elsa started the year with an investment in the business of K54 000, however, because the business made a K15 000 profit during the year, Elsa's investment in the firm has now increased to K69 000. Careful analysis of the balance sheet can help Elsa determine if her K54 000 investment has been worthwhile or whether she would have earned more by investing her capital elsewhere.

1. Return on owner's investment (ROI)

Example:

$$\frac{\text{Net profit}}{\text{Owners investment}} \times \frac{100}{1} \Rightarrow \frac{\text{K15 000}}{\text{K54 000}} \times \frac{100}{1} = 27.8\%$$

The return on owner's investment compares the amount of net profit earned to the original amount invested by Elsa. In this case, for every K100 Elsa has invested, she is earning K27.80 as a return (profit). This percentage is of particular use to Elsa because she could compare her 27.8% return to other similar investments including bank interest and bond rates. High ROI figures are associated with successful and profitable businesses.

2. Return on total assets (ROA)

Example:

$$\frac{\text{Net profit}}{\text{Total assets}} \times \frac{100}{1} \Rightarrow (\text{ 54 000/100 = 540 x 27.80}) = \frac{15\ 012}{118\ 000} = 12.7\%$$

Elsa can also determine the success of her investment by considering the business' return on its total assets. The return on total assets measures how efficiently and effectively the business assets have been used. The return of 12.7% illustrates the every K100 of assets owned by Elsa has earned the business K12.70 profit. Usually a poor ROA means that the business assets are not being used productively.

3. Liquidity: Working capital ratio

Example:

$$\frac{\text{Current assets}}{\text{Current liabilities}} = \frac{5\,600 + 11\,400 + 16\,000}{25\,000} = 1.32:1$$

The working capital ratio highlights Elsa's short-term liquidity, or rather, her business' ability to repay short-term debts with short-term assets. Elsa's only short-term debts (current liabilities) are her creditors, which would normally need to be repaid within a month or two (K25 000). Likewise, Elsa has access to K33 000 worth of short-term assets (current assets), which she would normally be able to convert into ready cash within few months, i.e. bank, debtors, and stock of shoes.

The above ratio illustrates that Elsa's liquidity is satisfactory but certainly not strong. Currently Elsa's business has only K1.32 of short-term assets ready to repay every K1 of short-term liabilities. Small businesses with larger working capital ratio tend to have strong liquidity and therefore safer in the short-term from financial disaster.

4. Gearing

Example:

$$\frac{\text{Total liabilities}}{\text{Total equities}} \times \frac{100}{1} = \frac{49\,000}{118\,000} \times \frac{100}{1} = 41.5\%$$

Gearing is a measure, which highlights whether a small business' success will be short-lived or will last for many years. Gearing shows the type of finance the owner has used to purchase the business' assets. Elsa's business has a 41.5% gearing ratio which means that 41.5% of the finance has been provided by outsiders (liabilities) whilst Elsa has contributed the remaining 58.5% from her own funds. Therefore, Elsa controls the business because she owns the majority (58.5%) of its assets. Some small businesses have higher gearing because they seek to borrow more funds so that they can expand the business by buying more assets. However, higher gearing carries more risks and makes a business less financially stable in the long-term. In other words, if a business cannot pay back all its liabilities when they are due, it may be forced into bankruptcy.

Non-financial indicators

Apart from the financial indicators that we have covered above, a business must also look for some non-financial indicators. These indicators are as important as the financial indicators because they contribute towards the success or failure of a business.

Staff Turn-over

A business must evaluate its staff turn-over rate. Labour **turnover** is commonly measured by the ratio of the number of workers who left the firm during a certain period (normally 6 months or a year) to the average number of workers employed during the same period. If this is relatively constant over time then the organisation can predict the recruitment needed to keep all existing positions occupied. For example: out of 200 workers employed by a firm for one year, 50 workers left within the same year. This will give us a ratio of 1/4, which when interpreted, will produce a staff turnover rate of 25% for the firm (50/200 X 100 = 25%).

A high rate of staff turn-over would mean that workers are leaving soon after their engagement. A low rate means that workers are remaining in the business for a long time. It is an important consideration as it reveals to the owners or managers a pattern of employment. A high turn-over would mean many things. But one conclusion can be that staff are unhappy with the business; that's why the leave. On the other hand, a low staff turn-over would send a signal that workers are happy with their employment.

Sales Turn-over

For trading businesses stock movement is a very important area of analysis for the manager or owner. A high sales turnover means that more stock is sold in a given period. A low sales turn-over means that stocks are not selling fast enough. If there is a low turn-over management must take some steps to increase sales. Remember, sales are needed in the calculation of profit. Therefore, a business must generate a respectable level of sales in order to remain in business.

360 Degrees Reporting

Businesses now have a greater responsibility in reporting their activities to the wider society apart from their owners or shareholders. This is called 360 degrees reporting. Business, while aiming to make a profit, must be ethically and socially responsible. Consumers these days prefer dealing with products that come from ecologically friendly companies or manufacturers.

A business must always evaluate its activities regularly. In line with that a business must try to listen to its customers. Customers' feedback is very important when it comes to key areas such as product quality, service quality and friendliness of staff.
Below are two key, non-financial indicators. They are important for every business to consider.

Ethics

Ethics refers to ‘what is right’ or the ‘right behaviour’. Ethical business practices are therefore becoming an important part of the business world. There is a direct link between good ethics, market share and profitability. Businesses that clearly demonstrate a high level of ethics also tend to enjoy a bigger market share. Their profits also increase as a result.
Consumers have become increasingly aware of the social and ethical issues, such as the ethics of marketing to children, fair trade with third-world suppliers, the ecological impact of business, and good corporate citizenship. Business ethics is closely related to corporate social responsibility (CSR). Companies looking to establish a trustworthy image and long-term relationship with their customers must consider CSR seriously. This will help them meet their customers’ wider expectations, and maintain a competitive advantage over other competitors.

Sustainable Development

One of the best practices of CSR is sustainable development. Sustainability refers to the type of development:

> *that meets present needs without affecting the ability of future generations to meet their needs.*

The concept of sustainability has received increased attention from governments, businesses, community-based organisations and the society at large. Sustainability is not just concerned with environmental issues but also with the social, economic and cultural issues of the society. It also covers the fair distribution of economic benefits, human rights, community involvement and product responsibility.

Businesses globally are being challenged to consider the longer-term benefits of the society rather than the short-term pursuit of profit, individual enjoyment and consumption. The short-term gain of individual organisations needs to be balanced against the consequences and gains for society at large.

Importance of Non-financial Indicators

The above mentioned indicators are examples of non-financial indicators which are important for a business to consider. Every business should consider its performance against the above set of criteria. A business must be conscious of these areas as they affect its status and credibility in the society. Consumers are part of the society and they can make decisions which can affect business profit if they think that a business is only interested in profit and not other important areas such as the environment.

END OF TOPIC 11.4.8.6. NOW DO YOUR LEARNING ACTIVITIES ON THE NEXT

Learning Activities 11.4.8.6: Complete the activities given.

1. Which report does management use to evaluate a business' financial position and financial stability? ____
2. Explain what you understand by the following terms:

a. Return on owner's equity:
____

b. Return on total assets:
____

3. Why is it risky for a business to have a high gearing ratio? __________________________
4. State the ratio, which indicates a business' short-term liquidity.
____
5. Explain why small business managers need to evaluate a business' performance on a regular basis. ____

NOW WRITE THE TOPIC TEST FOR TOPIC 11.4.7. THE TEST IS OUT OF 10 MARKS AND CAN BE FOUND IN YOUR ASSESSMENT BOOK.

SUMMARY

A business is a living entity. It starts, grows and experiences highs and lows. The key business objective is remaining alive. There are many ways to go into business. You can start a business from scratch or buy an existing business. You can even consider a franchise type business operation. Investing in shares offers another pathway.

Every business is required by law to pay tax to the government. Businesses must keep proper records to determine the correct income in order to pay the required income tax. Workers in the country also pay income tax. Tax rates for individuals and businesses are determined by the government. Tax is the government's main source of revenue.

Running businesses involve risks, therefore, the insurance industry comes in to provide different classes of insurance products. This is a key service to businesses, organisations and individuals. It protects the policy holder against possible loss.

Small businesses face many difficulties ranging from access to finance to management skills deficiency. Networking is an effective way to find contacts through which help can be sought. Business finance can be obtained through effective networking. Even sales can be boosted through networking.

The government tries to help businesses through its agencies such as SBDC and IPA. Private sector organisations also try to help by way of advice to businesses. Such support is crucial for business growth in the country.

Small business owners are obliged to evaluate their business performances each year. This helps in terms of giving feedback and taking corrective measures to improve business performance. Business records and financial statements are needed to evaluate business performance.

Business evaluation reveals very meaningful indicators of the performance of the business. Business owners can learn a lot from the performance and undertake corrective measures if necessary.

Answers to Learning Activities

Learning Activity 11.4.1.1

1. Explain in your own words what is meant by the term small business.
   A small business is one that employs between 1-4 workers; has annual sales turnover of between thirty to fifty thousand kina and an asset value of between three hundred to one million kina.

2. Approximately what portion of Papua New Guinea's population is employed by small businesses?
   Almost half OR 50% of the total work force in the country

3. List two reasons why small business is important to PNG's economy.
   I. *Large number of SMEs in PNG*
   II. *Large proportion of employment*
   III. *Contribution to economic growth*
   IV. *Contribution to the PNG Society*

4. List one common problem faced by small businesses in Papua New Guinea today?
   - *Lack of human resource development or business skills*
   - *Limited access to markets and networking*
   - *Limited access to credit*
   - *Lack of technological development*
   - *Limited access to business information*
   - *Underdeveloped and deteriorating infrastructure*

5. Why is it always difficult for a small business to obtain a bank loan?
   Banks consider small businesses as too risky to lend, unless they have proven themselves to the banks. Start-up enterprises do not have the necessary requirements to secure a commercial loan. Therefore, it is difficult initially to get a bank loan.
6. Differentiate between 'debt' and 'equity' capital.
   Debt comes with an obligation to repay the money where as equity has no obligation to repay. However, equity requires a part of the business ownership.

7. What is a common disadvantage of operating a small business in PNG?
   - *No automatic success*
   - *Unlimited liability*
   - *Lacking management skills*
   - *Demands total commitment*

8. How important is the role of management to the success of a small business? Explain.
   Management is an important element of business success. It is management that plans, provides direction, takes the lead, controls the operations and makes the important decisions. Workers look upon management to lead them to achieving business goals.

Activity 11.4.1.2

1. How important is market share to business success?
   A business must have a market share. It must have its customers to sell to. If there is no market then the business will not survive. The market is really the customers.

2. 'Success comes to those people who willingly take the risk.' Explain what this statement means to you.
   This means that risk is part of success. Risk, by the way, is the possibility of something bad happening such as business failure. So successful business people are willing risk takers. They know that success comes with some level of risk. If there is no risk, there will be less or no success.

3. Study the risk-taking thermometer diagram above and establish your personal risk taking level. Where on the thermometer do you fall in?
   The answer to this question depends on your own definition of personal risk. There is really no right or wrong answer to this question.

4. 'The higher the risk, the higher the return.' Explain what this statement means to you.
   Risk and return go hand in hand. If the risk of doing business is high, the corresponding return must be also high. This is the general principle. If an investment is very risky, the return from that investment must also be high enough to attract investors.

Learning Activity 11.4.1.3

1. In your opinion, what is the common motive or reason why people start up a business?
   - *Increase revenue*
   - *Increase profit*
   - *Customer satisfaction*
   - *Community support*
   - *Build a culture*
   - *Build amazing products*

2. List some negative motives for starting a business.
   - *Immediate gratification*
   - *Exploitation of other humans*
   - *Tax evasion*
   - *Environmental degradation*
   - *Bad practices such as cheating*

Learning Activity 11.4.1.4

1. State one main reason for business success in Papua New Guinea.
   - *Drive and energy*
   - *Self confidence*
   - *Moderate risk taking*
   - *Long term view*

2. State one main reason for business failure in Papua New Guinea.
    - *Mismanagement*
    - *Sales and inventory problems*
    - *Lack of planning*
    - *Inadequate records*
    - *Negligence*
    - *Not separating business and personal activities*

3. If you were to start your own business, what three things would you avoid in order to experience business success?
   You should provide your answer to this question based on the information you have read so far. Look at the factors for business success given in this reading thus far in order to answer this question.

Activities 11.4.2

Activity 11.4.2.1

1. What is one difficulty faced by people who start up a business from scratch?
   - *Difficulty in raising capital*
   - *Start with a small market share*
   - *Face cash flow problems*
   - *Money spend trying to learn - learning curve expenses*

2. State an advantage of starting a new business.
   - *Owner determines growth and direction of the business*
   - *Flexibility*
   - *Cost minimisation*
   - *New Lifestyle goals.*

3. List two key factors to consider when starting up a new business.
   - *Start-up type*
   - *Labour requirements*
   - *Equipment or resource requirements*
   - *Organisation structure*
   - *Location*
   - *Finance*
   - *Supplies*
   - *Cost of start up*

Activity 11.4.2.2

1. Why is location important in business?
   A good location will bring in increased numbers of customers. A high volume of customers will bring in more sales for the business. This will lead to more profit.

2. How are business goals different from business responsibilities?
   A business goal is not the same thing as a business responsibility. A goal is something that the business aims to achieve over time. A responsibility, on the other hand, is something such as an action which a business must take.

3. Is profit always the number one business goal for every business?
   No. Not every business aims for a higher profit all the time, though it is one of the most important goals. Other equally important goals such as increased market share and increased customer satisfaction.

Activity 11.4.2.3

1. What is a product?
   A product can be a good or service. It can be tangible or non-tangible, but it must have some benefit which customers require or need. A product, therefore, is something of value.

2. What is product line?
   A business' product line normally refers to the group of similar products that a business sells or produces.

3. What is product breadth?
   Product breadth refers to the number of product lines a business carries.

4. What is product depth?
   Product depth refers to the total number of items within a business' product line.

Activity 11.4.2.4

1. How does competition help businesses?
   Businesses become very creative when faced with the need to gain competitive advantage, so that they can survive and prosper.

2. How does competition help consumers?
   - *Sellers sell at cheaper prices to attract customers*
   - *Sellers offer better quality to attract customers*
   - *Sellers sell a variety to attract customers*

3. How can a market survey help a business in competition?
   - *Will find out what exactly customers want/need and tailor the product for them*
   - *Find out what customers think or prefer so that a business can use that information to outperform its competitors.*

Activities 11.4.3

Activity 11.4.3.1

1. What is a share?
   The word share means part ownership in business. A share or part-ownership can be purchased by investing in a company that sells its shares. It gives the right to someone to become an owner of a company.

2. Who is a shareholder?
   Shareholders are people who have purchased shares of a company and is rightfully the owners of that company.

3. What category of companies is allowed to trade their shares on the stock exchange?
   Public companies are allowed to trade their shares on the stock exchange. These are companies that are listed on the stock exchange such as the Port Moresby Stock Exchange.

4. What is the difference between a 'share' and a 'debenture'?
   - *A debenture is different from a share.*
   - *A debenture is a type of fixed-interest security. It is issued by companies, who act as borrowers, in return for investing money.*
   - *Debenture-holders' funds are invested with the borrowing company as secured loans. In return people who invest are paid interest.*

5. How can a potential investor buy shares in a public company?
   - *One way is to purchase shares when a company makes an initial public offering (IPO).*
   - *Another way is to ask a stock broker to purchase it for them by going to the stock market.*

Activity 11.4.3.2

1. What would be the capitalised value if the expected profit for a business is K350 000 and the rate of return is 20%?

   C.V. = Expected Profit/Rate of Return
   C.V. = 350 000/20%
   C.V. = K1 750 000

2. What would be the value of a business which has a constant stream of income of K100 000 over three years with a discount rate of 10% and a terminal value of K50 000?

$$\text{Net Present Value} = \frac{CF_t}{(1+r)_t} + \text{Terminal value}$$

$$NPV = \frac{CF_1}{(1+r)_n} + \frac{CF_2}{(1+r)_n} + \frac{CF_3}{(1+r)_n}$$

$$= \frac{100\ 000}{(1+.1)_1} + \frac{100\ 000}{(1+.1)_2} + \frac{150\ 000}{(1+.1)_3}$$

$= \frac{100\ 000}{1.1} + \frac{100\ 000}{1.21} + \frac{150\ 000}{1.331}$

= K90 909.90 + K82 644.60 + K112697.20

NPV = K286 250.89 (round up to K286 250. 90)

3. State one advantage and one disadvantage of buying an existing business.

Advantages:

- *Workload and risks of a start-up business will be avoided.*
- *In buying an existing business, the owner is purchasing the location, premises, equipment, staff, and customer-base.*
- *Goodwill already established by the previous owner.*
- *The business will already have a regular customer base.*
- *Sales to existing customers will provide immediate income to the new owner.*

Disadvantages:

- *One may end up buying a business that may have a bad reputation with the customers.*
- *The business may be in debt. That's why the owner may want to sell it off.*
- *The location may no longer be suitable due to changes in the area.*
- *The equipment may be out dated or worn out and may cost a lot of money to replace.*
- *Much of the stock may no longer be saleable.*

Activity 11.4.3.3

1. What is a contract?

   A contract is a written agreement. It is an agreement between two people or parties. Most contracts are legally binding, meaning that either party can sure the other in court for breaching it.

2. Why is a purchase contract necessary when the sale involves a valuable item?

   It is necessary because of the value of the item or the price paid for the item. The contract saves both the buyer and the seller from any faults or problems that may arise from the sale of the item. Also, it gives confidence to both parties that the deal is a legally binding one.

3. State one advantage and one disadvantage of inheriting a business

   Advantages

   - *It is the easiest way of going into business. The hard work was already done and the* *foundation was set.*

- *With an established value and reputation the new owner has the flexibility to develop the business further*
- *Raising capital will be very easy because of the assets of the business*
- *The new owner can even sell the business if he/she wishes to. And it will be easy selling it too.*

Disadvantages

- *Inheriting a business also involves risks or threats.*
- *Management problems can develop, particularly where the new owner lacks the skills to assume responsibility over the business.*
- *Workers may dislike the new management or lack trust and respect for the new owner.*
- *New owner/manager will experience frustrations and stress as he or she tries to get use to the art of running a business.*
- *The business may conflict with the new owner's lifestyle, profession, career, interests, values and passion.*

Learning Activities 11.4.4

Activities 11.4.4.1

1. Define the term 'franchising' in your own words.

   At its simplest, a franchise is an arrangement whereby the originator of a business product or operating system (the franchisor) gives a prospective new business owner (franchisee) the right to sell these goods and/or to use the business operations system on the franchisor's behalf.

2. State one advantage and one disadvantage of franchising

Advantages	Disadvantages
The business is well known and the community is familiar with the products being sold.	The franchise may be restricted in the way in which the business may be operated.
The franchise has the support of an experienced management team and benefits from the sophisticated marketing and promotion guidelines of the parent company.	Payments demanded by the franchisor may drain the resources of the business, especially if profits aren't high enough.
A representative of the company gives management training.	Degree of assistance provided may not always be adequate.
Advertising and distribution is provided.	Contracts for the length of franchise may make a business franchise feel restricted and trapped.

3. Differentiate between the terms 'franchisee' and 'franchisor'.
   - *Franchisee is the independent business that obtains the right or license to operate a franchise. The franchisee operates on behalf of the franchisor and keeps the profits but pays a regular fee to the franchisor.*
   - *Franchisor is the owner or originator of the franchise business and license or trademark.*

4. Why is a franchise agreement important to both the franchisee and the franchisor?

The franchise agreement is a formal agreement signed by the franchisor and franchisee. It outlines the terms, conditions, roles, responsibilities and rights of both parties. One or the other party can bring the franchise to a close if this agreement is breached. However, the agreement protects both parties and helps them to operate successfully.

5. List at least five items that should be included in a franchise agreement.
   - *the cost of franchising;*
   - *how exclusive the franchise will be;*
   - *what the franchiser will supply;*
   - *sale of the franchise; and*

- *bringing a franchise to an end.*

Activities 11.4.4.2

1. What is a trade name franchise?
   Here the franchisee obtains a trade name or trade mark from the manufacturer. It identifies the franchisee with the supplier through the product line.

2. What is a product distribution franchise?
   A product distribution franchise licenses the franchisee to sell specific products under the manufacturer's brand name or trademark through selective, limited distribution network.

3. Explain the term 'pure franchise'.
   A pure (comprehensive or business format) franchise is a very detailed agreement. It provides the franchisee with a complete business format, including a license for a trade name, the product or service to be sold, the physical plant, the methods of operation, a marketing strategy plan, a quality control process, a two-way communication system, and the necessary business services.

   Pure franchise will usually include: pricing, production processes, marketing, staff recruitment, remuneration, training and evaluation, product offering and promotional methods, record keeping, operating hours, use of different suppliers, store layout and fittings, staff uniforms, and so on.

4. Why do you think some franchises fail?
   - *Some franchise businesses fail because of the restrictions placed by the franchisor.*
   - *Others fail because of the fee payments that have to be paid to the franchisor on a regular basis. When profit margins are low, this fee can kill a franchise.*
   - *Competition in an area may be too high, forcing a franchise to close.*

5. State one obligation of the franchisee.
   - *Pay a license fee*
   - *Pay franchise fees regularly as covered in the contract*
   - *Protect the trade mark and its reputation*
   - *Ensure that the operation is standardised to the satisfaction of the franchisor*

6. State one obligation of the franchisor.
   - *Provide basic training to the franchisee*
   - *Not to license another franchisee in the same town or area to avoid competition.*
   - *Provide follow up service, maintenance and technical advice.*
   - *Set up educational programs for the employees of the franchisee*
   - *Be fair to the franchisee.*
   - *The necessary equipment must be provided for the operations*

Learning Activities 11.4.5

Activities 11.4.5.1

1. What is tax?
   Tax is the portion from the income of people as well as businesses that the government collects. It is an expense to the income earner, but revenue to the government.

2. Who pays tax?
   Tax is paid by nearly everybody living in a country, including all businesses.

3. Name at least three (3) types of tax applied in Papua New Guinea
   - *Personal income tax*
   - *Company tax*
   - *Dividend withholding tax*
   - *Goods and Services Tax (GST)*
   - *Capital Gains Tax*
   - *Import Tax*
   - *Airports and Highways Toll*

4. State one advantage and one disadvantage of import tax.
   Advantage:
   Import tax is;
   - *paid by the importer. If the importer is a business, this tax is a deductible expense. So the business will not be double taxed when it pays income from its profit.*
   - *good for the government as it contributes to its annual revenue.*
   - *Sometimes used by the government as a tool to control the import of certain categories of products such as imported used cars from Japan.*

   Disadvantage:
   - *Import tax increases the price of the imported goods. This high price is passed on to consumers in the country.*

Activities 11.4.5.2

1. Why is tax return important to a business?
   A tax return is a regular task that all formal businesses are expected to perform each year, particularly towards the end of a financial year. A tax return advises the government on how much tax a business has paid or is to pay up. It is a requirement for all companies and other forms of businesses that have obtained a tax number from the IRC.

2. How are sole traders and partnerships taxed?
   Sole traders are taxed based on the profit they make. Partnerships are also taxed based on the profit they make. Their income is taxed by the IRC using personal income tax rates, and not the company tax rate.

3. Find out from a small business in your area if it pays any tax. If it does, find out how much it has paid in the last financial year

   You can do that yourself. It is only for your information.

4. A partnership makes a gross profit of K500 000 in one year. Its allowable deductions amount to K100 000. It has four partners who have equal shares in the business. Apply the personal income tax rate to find out the business's tax liability.

   Total Net Profit = K400 000
   Each Partner's Share = K100 000 (K400 000/4)
   Partner 1's Tax Liability:
   First K70 000 = K19870
   Remaining K30 000 = K10500 (30000X35%)
   Tax Liability = K30370
   Tax Liability: Tax paid by all four partners
   K30370 X 4 = K121480

Activities 11.4.5.3

1. When is a company obliged to pay dividend withholding tax?
   When it declares a dividend for its shareholders

2. What is the current corporate income tax rate in PNG?
   It is 30 percent of the annual taxable corporate income

3. A company makes a gross profit of K500 000 in one year. Its allowable deductions amount to K100 000. Apply the company tax rate to find out the company's tax liability.

   Tax Liability:
   Net Profit = K400 000
   Corporate income Tax Rate = 30%
   Tax = K120000 (K400 000 X 30/100)

Activities 11.4.5.4

1. Make a list of some non-allowable deductions.
   - Capital expenditure
   - Losses and expenses of private nature
   - Expenses incurred in producing exempted income

2. Explain in your own words how provisional tax works in Papua New Guinea.
   This tax applies to companies. Companies pay tax in advance based on what was paid as tax last year. It is estimated based on how much profit they expect to make. Adjustments are made later when the actual income is calculated and known.

3. What is a fringe benefit tax? Give an example.
   This is the tax collected from employees who receive other special benefits apart from their salary. These sideline or fringe benefits are separately taxed using different tax rates set by the IRC.

Activities 11.4.5.5

1. What is the free tax threshold for Papua New Guinea in 2014?
   K7000 is the tax free income threshold. It means that any income that is from as low as K1 to as high as K7000 per annum is not taxed. People earning income that is equal to K7000 or less are exempted from income tax.

2. Explain 'tax rebates' in your own words.
   A tax rebate is a reduction made from the taxable income. This is usually allowed for wage earners as well as others, who usually have close relatives and family members to take care of.

However, in some cases, a tax payer may not claim for a dependant who is also an income earner. A dependant who earns over K1 040 per annum or more than K40 per fortnight is not eligible to be considered as a dependant.

3. Why is it important to fill out a wage or tax declaration form?

- *The tax declaration form has all the necessary details for employees to fill in details like; the type of work the employee does, name of the employer, business address of the employer and dependants to be included.*
- *After a tax declaration form is lodged, rebates for dependents will be made for every pay period.*
- *It is important for employees to lodge a declaration form immediately when they begin work with a new employer.*

4. A lawyer earns K1500 a fortnight. Calculate the tax to be applied on this income using the 2014 personal income tax table.
   Total Annual Salary of Lawyer = K39000 (K1500 X 26)
   Tax applied on K33000 = ***K6920***
   Tax applied on remaining K6000
   K1800 *(K6000 X 30%)*
   Total Tax Applied:
   K8720 *(K6920 +K1800)*

5. How much tax will the lawyer pay if she lodged a declaration for two dependents?
   Gross Tax Payable: ***K8720***
   Dependent rebate (15%) for first dependent = K1308
   Dependent rebate (10%) for second dependent = K872
   Total Rebate = ***K2180***
   Net Tax Payable = ***K6540***

6. Assume that the lawyer did not lodge a dependent's declaration form. How much tax will he/she pay now?
   The Lawyer will have to pay the full K8720 as calculated in question 18 above. He/she will pay an extra K2180 in tax to the government; money which he/she could have saved.

Learning Activities 11.4.6

Learning Activities 11.4.6.1

1. What is insurance?
   Insurance is the protection that businesses pay for against risks.

2. How is insurance premium calculated?
   Premium is calculated on the basis of risk involved and the value of the thing, asset and person to be insured.

3. What are the three main categories of accident insurance?
   - *Workers compensation insurance*
   - *Personal accident insurance*
   - *Motor vehicle insurance.*

4. Joe insures his PMV truck fully for K10 000. His truck is burnt to ashes after 3 months. He bought the truck with K60 000. Do you think Joe will claim some compensation? If so, how much?
   Yes he will get a compensation of K10, 000, the amount of insurance coverage on his truck. The truck got burnt when its insurance was still current.

5. Maria sustained a permanent head injury while working for a construction company. What would her workers' compensation claim be?
   K35000 (K35000 X 100%)

6. Peter took out third party compulsory insurance for his private car. Five months later he crashes his car and got killed in that accident. Will he be compensated by the insurance company? Explain your answer.
   No, he will not be compensated because third party insurance is only for passengers other than the driver or the owner of the vehicle.

Activities 11.4.6.2

1. What is life insurance?
   Life insurance is a protection against loss of income that would result if the insured person passed away. The named beneficiary is thereby safeguarded from the financial impact of the death of the insured. It is a voluntary insurance policy.
   The goal of life insurance is to provide a measure of financial security for a family after the head of the family dies.

2. How is the premium for life insurance calculated?
   Below are some of the key factors:
   - *Person's age*
   - *Person's health status*
   - *Risk taken by person who seeks life insurance*
   - *Income level*

- *Location where the person seeking life insurance lives*

3. Why is medical insurance important for people?
   It helps to cover the cost of treatment and medicines when an insured person is sick. The medical bill is usually high these days, so medical insurance can be a way to help relieve someone from this high bill.

Activities 11.4.6.3

1. What does fire insurance cover?
   Fire insurance is used to cover damage to property caused by fire. It is designed to cover the cost of replacement, reconstruction or repair within the limits of what is covered. Policies cover damage to the building itself and can also cover damage to nearby structures, personal property and expenses associated with not being able to live in or use the property if it is damaged.

2. Is fire insurance necessary for a business? Explain your answer
   Yes, it is very important for businesses. Fires can start anytime and anywhere. Fires can be caused by factors such as lightening, electric fault, gas stove, matches, candles, etc. In a country like PNG where destruction by fire is frequent, it is important to secure every business and property against fire

Activities 11.4.6.4

1. What is marine insurance?
   Marine insurance covers the loss or damage of ships or cargo held in transit before reaching the final destination.
   A marine policy typically covers only three-quarters of the insured's liabilities towards third parties. The typical liabilities arise in respect of collision with another ship, known as 'running down', and wreck removal.

2. Why is marine insurance important for an import/export business?
   - *Every import/export business must consider taking out marine insurance if they deal with goods because of the risk involved.*
   - *Ships can sink, trucks can run off the road, air planes can crash, etc. so it is important to protect the cargo that is in transit.*
   - *Marine insurance protects against loss of cargo.*
3. Who determines the premium that is to be paid for marine insurance?
   Usually the insurance company decides how much premium is paid depending on the value of the items to be shipped and the risks involved.

4. What does the term 'salvage' mean?
   It means to try and take back or recover some things from being destroyed. It is used often with marine insurance.

Activities 11.4.6.5

1. Are passengers of a PMV truck covered by any insurance at all?
   Yes, they are covered by the insurance policy called 'Third Party Insurance'.

2. What is comprehensive motor vehicle insurance?
   This is the insurance that protects the vehicle from any damage or destruction from various causes.

3. Who determines the premium for third party insurance?
   The Government determines the insurance premium, and all vehicle owners have to pay up every year as part of the vehicle registration process.

Learning Activities 11.4.7

Activities 11.4.7.1

1. Why is good networking ability such an important characteristic?
   Networking enables a business person to find help, advice, markets, etc. This is an important skill which must be developed.

2. How can you prepare for networking if you are going to a conference or a gathering where important people are to attend?
   - *Decide who to meet*
   - *Predict who will attend*
   - *Prepare a list of questions to ask*
   - *Prepare a list of topics to discuss/share with others*
   - *Be in good attire; dress well*
   - *Have self-belief*
   - *All in all, know what you want out of that networking meeting before you attend.*

3. List some possible venues or sources of networking for a small business.
   - *Business conferences*
   - *Graduation ceremonies*
   - *Church gatherings*
   - *School meeting/parents & citizen meetings*
   - *Book launching*
   - *Political functions*

Activities 11.4.7.2

1. Do you think the national government is doing enough to promote the development of business in the country? Explain your position.
   This question requires your own answer. Therefore, there is no correct or incorrect answer. However, you must provide some solid reasons for your position or answer.

2. Is the National Development Bank helping many Papua New Guinean business people to secure small loans for their businesses?
   The answer is most likely to be 'yes'. The NDB is playing its part to help SMEs in PNG. However, if you think otherwise, you should provide your reasons for it too.

3. How important is the role of the ICCC to small businesses in the country?
   The ICCC monitors the price of goods and services. It also ensures that there is good competition in the market. Competition enables prices to be reduced, and this helps the ordinary consumers.

4. Describe the main functions of IPA.
   - *The IPA, as its name says, is a promoter of investment in PNG.*
   - *It registers companies, businesses and other groups in PNG.*

- *It provides certificate of registration to registered organisation.*
- *The fee it collects becomes government revenue.*

5. List the main industry boards or corporations found in PNG and the industries they represent.
   - *Coffee Industry Corporation (CIC)*
   - *Copra Industry Board (CIB)*
   - *National Fisheries Authority*
   - *National Forestry Authority*

6. This year the international prices of most commodities such as coffee, oil palm and cocoa dropped to very low levels and rural farmers are severely affected. Suggest some possible ways in which the various industry boards and corporations can help in this situation.
   Industry boards and corporations can provide price stabilisation for their farmers by at least paying the farmers a good price for their crops. In this way farmers are not totally affected by the low prices. At least the price is good enough to sustain their lives while awaiting increases in price.

Activities 11.4.7.3

1. Who owns the SBDC?
   SBDC is a government agency set up to develop the growth of small and medium enterprises in PNG. It was established through an Act of Parliament.

2. What is the main purpose of the SBDC?
   Answer should be same as question 10 above.

3. Do you think the SBDC is doing enough to promote business development in PNG? If not, then what alternatives do you suggest?
   There is no correct or incorrect answer to this question.
   Your answer should be based on your own observation and opinion of what SBDC is doing now to develop small and medium enterprise in Papua New Guinea.
   As always, you must provide solid reasons for your answer.

Activities 11.4.7.4

1. Assume that the national government is planning to increase its funding for rural industries
   through the National Development Bank. Farmers and other businesses operating in the rural areas will be targeted. Do you think this move will produce the needed results? Explain your position.
   - *The answer could be either 'yes' or 'no'.*
   - *Yes, because the NDB has branches in all provinces through which rural farmers can access those funds.*
   - *However, from past experiences, not every farmer gets to benefit from such initiatives. Only a few farmers end up benefiting while the rest miss out for whatever reasons only known to the NDB.*

2. Is it always easy for a small business to obtain a commercial loan from commercial banks in
   Papua New Guinea? Explain your answer.
   No. It is not easy. Small businesses go through very strict processes in order to secure loans.
   The requirements are so demanding that the majority of small businesses find it hard to secure loan funds.

3. List down some ways in which commercial banks and micro finance institutions are trying to help small businesses in the country.
   - *Provision of vital information to people*
   - *Creating special services for small and medium enterprises*
   - *Allowing businesses to open up bank accounts*
   - *Removing some restrictions placed on business banking*
   - *Rollout programs such as ATM machines, EFPTOS machines, Phone Banking, etc. Such banking products are meant to help everyone including SMEs.*

4. Should the government of PNG provide direct funding to all small and medium enterprises
   operating in Papua New Guinea? Explain your answer.
   - *The answer can be both 'yes' and 'no'.*
   - *Yes because it will directly help SMEs. Many SMEs are struggling to stay in business. Such funding will help them.*
   - *No, because it will make people lazy. It is another form of giving free handout and will only go to promote a free handout mentality.*
   - *Also, if not controlled well, chances of abusing the process by greedy politicians and executives is high.*

Activities 11.4.7.5

1. What is a business incubator, and how important is its function in developing small businesses?
   A business incubator is a private or public service provider for SMEs. This service enables small businesses, in particular, to operate using facilities such as building, typing and advice until such time they are matured enough to move out and run on their own.

2. Do you think the PNG Manufacturers Council help business in Papua New Guinea?
   Yes it does. It tries to help by influencing governments to develop good policies for manufacturing.

Activities 11.4.7.6

1. What are the key functions of the Central Bank of PNG?
   - Banker to commercial banks and other financial institutions
   - Controls monetary policy, money supply and interest rates.
   - Controls and monitors foreign exchange
   - The government's bank – keeps government funds

- Regulator of other financial institutions in the country.

2. What is the main aim of setting up a savings and loans society?
   To help members of the group access financial services such as savings as well as borrowing.

3. How does a stock broker make his/her money or income?
   T*hrough the selling and buying of stock on behalf of their clients (investors). He/she charges a commission for selling and buying for his/her clients.*

Answers to Activities 11.4.8

Activities 11.4.8.1

1. Define the word ‘strategy’ in your own words.
   A strategy is a plan. It is usually about the medium to long term of an organization such as a business, a school, a church, etc.
   A strategy is developed by the top management of an organization.

2. What is market strategy?
   A marketing strategy is a long term marketing plan. It involves answering questions such as: who will be the customers, what products will they need, how much will it cost to produce it, how will the product be distributed to the customers and how much are the customers willing to pay.

3. How does a market strategy help a business?
   Like all good plans, a marketing strategy helps a business to focus its attention and resources on what to do in order to achieve success.

4. What is market research?
   A market research is an activity planned and carried out to find out particular details about both existing and potential customers. It is also intended to find out information about customers, competitors, products, demand levels, etc. Its focus is on the future.

5. Why is market research important to a business?
   A market research helps a business to stay in competition, especially if the level of competition is high. Also, a market research enables a business to tailor its products to suit the particular needs or demands of the customers.

Activities 11.4.8.2

1. What is a sales variance?
   A sales variance is the difference between planned sales volume and actual sales volume.

2. How can a negative sales variance be corrected?
   - *Manager can increase marketing activities*
   - *Manager can employ more people to do marketing*
   - *Manager can change the product features to suit customer needs*
   - *Manager can increase marketing budget*

3. Whose job is it to adjust the sales plan?
   It is the sales manager’s duty to adjust the sales plan.

Activities 11.4.8.3

1. What is an income statement?
   It is a statement of income earned by a business. This income is matched against the expenses incurred in earning the income. The difference can be either a profit or a loss.

2. Define 'income' and 'expenses'.
   - *Income is money coming into the business through sales and other activities*
   - *Expenses is money leaving the business. Expenses are incurred in order to earn the income.*

3. How is profit calculated?
   By simply subtracting the expenses from the income of the business for the current period.

Activities 11.4.8.4

1. What is a profit and loss statement?
   A profit and loss statement is the same thing as an income statement. Income statement is used in USA while profit and loss statement is used in UK. Countries of the world can follow either of these two. However, they must consistently use it and not change it.

2. When is a profit and loss report prepared?
   A profit and loss report is usually prepared at the end of a trading period, usually at the end of one financial year. The financial year in PNG runs from January to December. Every country has its own financial year.

Activities 11.4.8.5

1. What is a balance sheet, and what information does it present?
   A balance sheet is a snap-shot of the financial health of a business. It presents two things: (1) what a business owes, and (2) what a business owns. What a business owns should be equal to contribution from the owner as well as contribution from others.

2. Differentiate between assets and liabilities
   - *Assets are things of value that a business owns*
   - *Liabilities are the claims that others make on the business. It could be the bank that lends to the business or trade creditors that sell on credit to the business.*

Activities 11.4.8.6

1. Which report does management use to evaluate a business' financial position and financial stability?
   - *It uses the balance sheet.*
   - *It can also use the cash flow statement.*

2. Explain what you understand by the following terms:
   (a) Return on owner's equity
   The return on owner's investment compares the amount of net profit earned to the original amount invested by the owner of the business. High ROI figures are associated with successful and profitable businesses.

   (b) Return on total assets

This is used to determine the success of the investment by considering the business' return on its total assets. The return on total assets measures how efficiently and effectively the business assets have been used. Usually a poor ROA means that the business assets are not being used productively.

3. Why is it risky for a business to have a high gearing ratio?
    - Gearing is a measure, which highlights whether a small business' success will be short-lived or will last for many years. Gearing shows what portion of the finance is contributed by outsiders (liabilities). If the gearing ratio is high, it means most of the finance comes from outside sources. The risk of a high gearing is that regardless of whether the business is earning a profit or not, it is obligated to pay its debt obligations when they fall due. If it cannot, it may have to declare bankruptcy or insolvency, or its creditors may seize the assets it has offered as loan collateral. It is dangerous too because outsiders can control the business or dictate to the owner of the business what to do.
    - *Some small businesses have higher gearing because they seek to borrow more funds so that they can expand the business by buying more assets. However, higher gearing carries more risks and makes a business less financially stable in the long-term. In other words, if a business cannot pay back all its liabilities when they are due, it may be forced into bankruptcy.*

4. State the ratio, which indicates a business' short-term liquidity.
    It is called the: Working Capital Ratio. Working capital ratio measures a business' ability to repay short-term debts with short-term assets. It compares short term assets with short term liabilities.

5. Explain why small business managers need to evaluate a business' performance on a regular basis.
    A business is a delicate organization involving so many functions, activities, roles and responsibilities. There are many events (transactions) taking place every day. So through regular monitoring and evaluation the performance of the business is kept under control. The main goal is to generate a profit, so by carefully monitoring and controlling the business events, a profit is likely to be made. On the other hand, if left on its own, a business can run down or go bankrupt.

NOW YOU MUST COMPLETE ASSIGNMENT 4. THEN SEND IT TO THE PROVINCIAL CO-ORDINATOR FOR MARKING

GLOSSARY

Word	Page	Word	Page
Appraised value	48	Merchant bank	108
Balance sheet	120	Micro finance	98
Capital goods	38	Monopoly	40
Cash flow	34	Networking	95
Chamber of commerce	105	Oligopoly	40
Competition	40	Owner's equity	13
Consumer goods	38	Plan	31
Contract	50	Preference stock	44
Cooperative societies	100	Product mix	36
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Life insurance	86	Tax evasion	23
Liquidity	124	Tax liability	69
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Market analysis	112	Trade creditor	14
Market share	18		

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- http://www.pomsox.com.pg/share_performance.aspx

STUDENTS AND MARKER'S COMMENTS

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FODE PROVINCIAL CENTRES CONTACTS

PC NO.	FODE PROVINCIAL CENTRE	ADDRESS	PHONE/FAX	CUG PHONES	CONTACT PERSON		CUG PHONE
1	DARU	P. O. Box 68, Daru	6459033	72228146	The Coordinator	Senior Clerk	72229047
2	KEREMA	P. O. Box 86, Kerema	6481303	72228124	The Coordinator	Senior Clerk	72229049
3	CENTRAL	C/- FODE HQ	3419228	72228110	The Coordinator	Senior Clerk	72229050
4	ALOTAU	P. O. Box 822, Alotau	6411343 / 6419195	72228130	The Coordinator	Senior Clerk	72229051
5	POPONDETTA	P. O. Box 71, Popondetta	6297160 / 6297678	72228138	The Coordinator	Senior Clerk	72229052
6	MENDI	P. O. Box 237, Mendi	5491264 / 72895095	72228142	The Coordinator	Senior Clerk	72229053
7	GOROKA	P. O. Box 990, Goroka	5322085 / 5322321	72228116	The Coordinator	Senior Clerk	72229054
8	KUNDIAWA	P. O. Box 95, Kundiawa	5351612	72228144	The Coordinator	Senior Clerk	72229056
9	MT HAGEN	P. O. Box 418, Mt. Hagen	5421194 / 5423332	72228148	The Coordinator	Senior Clerk	72229057
10	VANIMO	P. O. Box 38, Vanimo	4571175 / 4571438	72228140	The Coordinator	Senior Clerk	72229060
11	WEWAK	P. O. Box 583, Wewak	4562231/ 4561114	72228122	The Coordinator	Senior Clerk	72229062
12	MADANG	P. O. Box 2071, Madang	4222418	72228126	The Coordinator	Senior Clerk	72229063
13	LAE	P. O. Box 4969, Lae	4725508 / 4721162	72228132	The Coordinator	Senior Clerk	72229064
14	KIMBE	P. O. Box 328, Kimbe	9835110	72228150	The Coordinator	Senior Clerk	72229065
15	RABAUL	P. O. Box 83, Kokopo	9400314	72228118	The Coordinator	Senior Clerk	72229067
16	KAVIENG	P. O. Box 284, Kavieng	9842183	72228136	The Coordinator	Senior Clerk	72229069
17	BUKA	P. O. Box 154, Buka	9739838	72228108	The Coordinator	Senior Clerk	72229073
18	MANUS	P. O. Box 41, Lorengau	9709251	72228128	The Coordinator	Senior Clerk	72229080
19	NCD	C/- FODE HQ	3230299 Ext 26	72228134	The Coordinator	Senior Clerk	72229081
20	WABAG	P. O. Box 259, Wabag	5471114	72228120	The Coordinator	Senior Clerk	72229082
21	HELA	P. O. Box 63, Tari	73197115	72228141	The Coordinator	Senior Clerk	72229083
22	JIWAKA	c/- FODE Hagen		72228143	The Coordinator	Senior Clerk	72229085

SUBJECT AND GRADE TO STUDY

GRADE LEVELS	SUBJECTS/COURSES
Grades 7 and 8	1. English 2. Mathematics 3. Personal Development 4. Social Science 5. Science 6. Making a Living
Grades 9 and 10	1. English 2. Mathematics 3. Personal Development 4. Science 5. Social Science 6. Business Studies 7. Design and Technology- Computing
Grades 11 and 12	1. English – Applied English/Language& Literature 2. Mathematics - Mathematics A / Mathematics B 3. Science – Biology/Chemistry/Physics 4. Social Science – History/Geography/Economics 5. Personal Development 6. Business Studies 7. Information & Communication Technology

REMEMBER:

- For Grades 7 and 8, you are required to do all six (6) courses.
- For Grades 9 and 10, you must study English, Mathematics, Science, Personal Development, Social Science and Commerce. Design and Technology-Computing is optional.
- For Grades 11 and 12, you are required to complete seven (7) out of thirteen (13) courses to be certified.

Your Provincial Coordinator or Supervisor will give you more information regarding each subject.

GRADES 11 & 12 COURSE PROGRAMMES

No	Science	Humanities	Business
1	Applied English	Language & Literature	Language & Literature/Applied English
2	Mathematics A/B	Mathematics A/B	Mathematics A/B
3	Personal Development	Personal Development	Personal Development
4	Biology	Biology/Physics/Chemistry	Biology/Physics/Chemistry
5	Chemistry/ Physics	Geography	Economics/Geography/History
6	Geography/History/Economics	History / Economics	Business Studies
7	ICT	ICT	ICT

Notes: You must seek advice from your Provincial Coordinator regarding the recommended courses in each stream. Options should be discussed carefully before choosing the stream when enrolling into Grade 11. FODE will certify for the successful completion of seven subjects in Grade 12.

CERTIFICATE IN MATRICULATION STUDIES		
No	**Compulsory Courses**	**Optional Courses**
1	English 1	**Science Stream:** Biology, Chemistry, Physics
2	English 2	**Social Science Stream:** Geography, Intro to Economics and Asia and the Modern World
3	Mathematics 1	
4	Mathematics 2	
5	History of Science & Technology	

REMEMBER:

You must successfully complete 8 courses: 5 compulsory and 3 optional.