THE EFFECT OF STOCK VALUATION TECHNIQUES ON ORGANIZATIONAL PROFITABILITY

CASE STUDY: UNILEVER TEA COMPANY.

BY

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A RESEARCH PROJECT SUBMITTED TO THE SCHOOL OF BUSINESS AND MANAGEMENT IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A BACHELORS DEGREE IN BUSINESS ADMINISTRATION (FINANCE AND BANKING)

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DECLARATION

I MARY NJERI NJORA declare that this is my original work and it has never been produced by anyone in any other university for any award. Where the work of others has been cited, acknowledgements have been made.

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DATE......27/07/2009............

APPROVAL

I certify that this research report has been done under my guidance and supervision as a university supervisor

Signature .... Date 27/07/09.

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SUPERVISOR.

DEDICATION

I dedicate this work to a woman of honor and precious mother Priscilla Wanjiku, for her wonderful support both morally and financially that fulfilled my dreams and put me where I am today. For her great sacrifice, and to my sister Cate, for her support in prayers and encouragement, my brothers, Ephy, Pattie, and Steve, for the patience they had during my studies and who have been pouring insight and light of success to me.

Humble dedications to my friends; Shiko, who has been there for me as a sister and encouraged me to go on. Martin, without whom this work would not have been what it is. his encouragement support and inspiration. Finally to my small sister Njeri, may you reach the greatest of heights in you career.

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I would like to thank all the people who helped me in various ways to be able to complete this work.

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LIST OF ABBREVIATIONS

FIFO	First in First Out
LIFO	Last In First Out
BB	Brooke Bond
EA	East African
UTKL	Unilever Tea Kenya Limite
KSHS	Kenya Shilling
ACM	Average Cost Method

ABSTRACT

The research study was about inventory valuation and organizational profitability. The purpose was to establish the effects of inventory valuation on organizational profitability.

The researcher used Unilever Tea Kenya whereby the organization was selected randomly to represent the total population.

The necessary information was collected through the use of questionnaire, interviews where each method was applied appropriately.

The data was thereafter translated by the use of graphs, tables and pie charts. Inventory valuation techniques was recommended since it had an impact on organizational profitability.

CHAPTER ONE

1.0 INTRODUCTION

Stock option valuation is the process by which stock options are assigned a dollar value. The truth is every stock value, stock price, and securities cost you see has been carefully chosen by experts. When a company is first offering stock, especially, they use a number of techniques to determine stock valuation: LIFO (meaning last in, first out, a way of evaluating inventory and profits), market conditions, company profitability, and other factors which can affect the stock's price are carefully considered by experts before determining an initial stock price. There are innumerable stock valuation methods although the purpose of all common stock valuation is to provide an accurate dollar value for stocks; stock valuation is so complex that no one valuation model perfectly determines value stock. However, once a stock is available in the market, theoretically the process of trade eventually corrects the price by determining a value that investors are willing to pay. Just because stock valuation techniques and stock valuation software are not foolproof; does not mean that assigning dollar values to stocks is worthless. Valuation is useful when comparing stocks and many investors have found valuation very useful in determining their investments.

1.1 BACKGROUND OF THE STUDY

Accountants recognized long time ago the need for standardized practices in connection with inventory valuation for the purpose of reflecting more objectively operating results and balance sheet data contained in their reports.

Up to the middle of the nineteenth century most businesses were not too large or complex.

They carried their inventories at cost and by the first out first by method. The problem was one of physical count and extension at the last invoices prices.

Several authors of accounting books believed that the market values of assets should not be ignored and should be at least mentioned by footnote in the balance sheet.

The practice of valuing inventory at the lower of cost or market was gaining recognition in the latter part of nineteenth century due to changing economic conditions. Many authors of working works in the first decades of the twentieth century were still divided in their opinions as valuation practices for inventory.

Unilever Tea East Africa

The current Unilever Tea Kenya Ltd. started as Brooke Bond Kenya. The coming of Brooke Bond in Kenya is linked with Tom Rutter's hunting Safari in 1914. Tom was then in charge of Brooke Bond in Calcutta, India.

Unilever Tea East Africa

During the hunting mission, he realized that East Africa was a potential market for the Indian Teas.

1922 in 1922, sales office of BB India opened in Mombasa and in 1924 the company had acquired approximately 400 hectares of Land at Limuru and also built Mabroukie tea Factory.

Almost simultaneously bush clearing, roads construction, building, of houses and planting were undertaken subsequently in 1925 Kenya Tea Company Limited registered with a share capital of 1 million. BBK's first major Tea Factory in Kenya was completed at kerenga in 1927. It maintained its trademark, until December 1977, when the operation was handed over to KETEPA. BB Tanganyika Branch was established in 1941 and BB Uganda branch was established in 1944.

The 1970s saw a major expansion of BBK activities into tea estates, factories and hotels.

The name was changed to Unilever Tea Kenya Ltd. (UTKL) in 2004. Today UTK is one of the largest commercial enterprises in Kenya providing employment to more than 20 000 people. Its contribution to the economy as a foreign exchange earner has increased from Kshs. 0.25 million in 1972 to Ksh. 5.5 billion today. Its total land holding stands at 16 223 acres. UTK owns 20 tea estates, 8 factories manufacturing an average of 32 million kgs of tea per year. UTKL has pioneered tremendous advances in tea research and sustainable agriculture.

UTKL produces black, green and specialty teas for the markets far spread as Europe, US, Pakistani, Japan, the Middle East and Australia.

1.2 PROBLEM STATEMENT

This research was being carried out because stock valuation techniques in an organization affect the organizational profitability whereby the profits might be understated or overstated. If they are provided properly they increase the organization ability to maximize profits and if they are not provided they may reduce profits. Any errors in the inventory count will affect both the balance and the income statement for example an error in the physical inventory will misstate the ending inventory, current assets and total assets on the balance sheet. It therefore followed that the researcher decided to carry out the research with an aim of establishing the effects of inventory valuation methods on organizational profitability.

1.3 SCOPE OF THE STUDY

The research was carried out in Unilever Tea. Research was about stock valuation techniques and organizational profitability and the effects. The research was carried out through analysis of financial data from the financial years 2004 to 2007.

Unilever is situated in Nairobi industrial area.

1.4 PURPOSE OF STUDY

The purpose was to establish the effect of stock valuation and organizational profitability in manufacturing organizations.

1.5 OBJECTIVES OF THE STUDY

1. To examine stock valuation techniques used in Unilever Kenya

2. To establish the effects of stock controls techniques on organizational profitability in Unilever Kenya.

3. To examine the benefits of stock valuation techniques on organizational profitability

1.6 RESEARCH QUESTIONS

1. What are the types of stock valuation techniques used in Unilever Kenya?

2. Is there relationship between stock valuation and organizational profitability?

3. What are the benefits of stock valuation techniques in Unilever Kenya?

4. What are some of the effects of stock valuation techniques?

1.7 SIGNIFICANCE OF THE STUDY

The outcome of this research would benefit the following:

The researcher

Since the researcher was undertaking a bachelor degree in business administration accounting option and was a partial requirement for it award the researcher felt that the study would be of great benefit as the research would acquire skills which if she happened to be employed in any organization she would use this research and acquire knowledge about stock valuation techniques.

The Outside World

The researcher's findings would be a contribution to the body of knowledge relating to stock valuation techniques and its impact on organizational profitability in manufacturing industries. It will also form a basis for further research in the future.

1.8 THEORICAL FRAMEWORK

The research was on the effects of stock valuation techniques and organizational profitability. for example some of stock valuation techniques increase the possibility of clerical errors if consignments were received frequently at fluctuating prices as every time an issue of materials was made the store ledger clerk would have to go through his record to ascertain the price to be charged and this may result to overstating or understating profits.

Secondly when the price rise the issue price does not reflect the market price as materials were issued from the earliest consignments. Therefore the charge to production was low resulting to reduced profits in the organization.

Thirdly comparison between one job and the other job would become difficult because one job started a few minutes after another of the same type may bear a different charge for materials consumed merely because the earlier job exhausted the supply of the lower priced or higher priced materials in the stock.

Lastly some of this stock valuation techniques value their stock in hand at a price which does not reflect current market price resulting to closing stock being overstated or understated in the balance sheet. Also the techniques selected by the company may affect the ratios and financial statements subtotals evaluating the company financial statements.

1.9 Definition of Operating Terms

Inventories

They are cushions to absorb planning plans and unforeseen fluctuations in supply and demand and to facilitate production operations.

Inventory profits

Profits that results from using the FIFO cost flow assumption rather than LIFO during periods of inflation.

Raw material inventory

This is the inventory of materials ready for the production process.

Consignment

Merchandise placed by its owner on the premises of another company with the understanding that payment is expected only when the merchandise is sold and that unsold items maybe returned to the consignor.

Organizational profitability

This is the ability of a firm to earn a satisfactory income.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

Stock valuation techniques affect organizations profitability whereby a careful choice has to be made of the methods of valuing the materials issue because it influences the cost of the jobs and the value of the closing balances of materials in the stores. The importance of stock valuation techniques is to make sure that the issue price should recover the cost price of materials.

The literature review will consists of critical analysis which criticizes on how different stock valuation researchers and scholars, their contribution and how their information related to stock valuation techniques in relationship with organizational profitability.

2.1 CRITICAL ANALYSIS

The researcher views stock valuation techniques as an important element for any organization that wants to maximize profits. The organization must evaluate the need for stock valuation techniques to its employees before they start work as some techniques increases the possibility of clerical errors, if consignments are received frequently at fluctuating prices as every time an issue of materials is made, the store ledger clerk will have to go through his record to ascertain the price to be charged. This is not the only way but it is one of the many ways of improving efficiency and hence increasing organizational profitability.

According to S.P JAIN (1996) in her book Cost Accounting and Henry R. Anderson Financial and Managerial Accounting (1998) there are various techniques of valuing material issues.

Materials issued from the stores are debited to the jobs or work orders which received them and credited to the material account. Theoretically the value of materials includes all expenses up to the point of placing materials at the processing plant. Hence in order to work out correct costs of jobs all these types of expenses should be included in the value of materials issued. There are many methods of pricing materials issues, include

First in First Out (FIFO)

Under this according to David H. Marshall (1999) method material is first issued from the earliest consignment on hand and priced at the cost at which the consignment was in the stores. In other words, materials received first are issued first. The units in the opening stock of materials are treated as if they were issued first, the units from the first purchase issued next, and so on until the units left in the closing stock are valued at the latest cost of purchases. Unit costs are apportioned to cost of production according to their chronological order of receipts in the stores.

Method suitable in times of falling prices because the issue of prices of materials to jobs or works orders will be high while the cost of replacement of materials will be low. But incase of rising prices method not suitable because the issue price of materials to production will be low. **FIFO** accounting is a common method for recording the value of inventory. It is appropriate where there are many different batches of similar products. The method presumes that the next item to be shipped will be the oldest of that type in the warehouse. In practice, this usually reflects the underlying commercial substance of the transaction, since many companies rotate their inventory (especially of perishable goods).

In an economy of rising prices (during inflation), it is common for beginning companies to use FIFO for reporting the value of merchandise to bolster their balance sheet. As the older and cheaper goods are sold, the newer and more expensive goods remain as assets on the company's books. Having the higher valued inventory and the lower cost of goods sold on the company's financial statements may increase the chances of getting a loan. However, as it prospers the company may switch to LIFO to reduce the amount of taxes it pays to the government.

Advantages of FIFO Method

It is a logical method because it takes into consideration the normal procedure of utilizing first those materials which are received first. Materials are issued in the order of purchases; materials received first are utilized first.

Under this method materials are issued at the purchase price; so the costs of jobs or work orders are correctly ascertained so far as cost of materials is concerned. Thus the method recovers the cost price of materials.

Disadvantages of FIFO Method

In case of fluctuations in prices of materials comparison one job and other jobs becomes difficulty because one job started a few minutes later than another of the same nature may be issued at different prices merely because the earlier job exhausted the supply of the lower priced materials in stock.

When price rises the issue price does not reflect the market price as materials are issued from the earliest consignments. Therefore, the charge to production is low because the cost of replacing the materials consumed will be higher than the price of issue.

Last In First Out (LIFO)

Under this method according to Charles T. Horngren (1998) issues are priced in the reverse order of purchase for example the price of the latest available consignment is taken. This method is sometimes known as the replacement cost method because materials are issued at the current cost to jobs or work orders except when purchase were made long ago. This method is suitable in times of rising prices because materials will be issued from the latest consignment at a price which is closely related to the current price levels. Valuing material issues at the price of the latest available consignment will help the management in fixing competitive selling prices of the products. During inflation the last in first out method leads to overstatement of closing stock. Method was first introduced in the U.S.A during the Second World War to get the advantages of rising prices.

LIFO stands for last-in, first-out inventory tracking. This means as a business purchases its inventory, holds the inventory, and finally sells the inventory the last group of purchases will be taken off the books first. This also implies that the remaining inventory at the end of a period will be the first group or groups of purchases acquired. Assuming an inflationary economy, this method of inventory tracking will provide the lowest gross profit for the period. At the same time this method also states that the remaining inventory was purchased at the lowest price level (Mangan, 2000)

Advantages of LIFO Method

Production is charged at the recent prices because materials are from the latest consignment. Thus, effect of current market prices of materials is reflected in the cost of sales provided the materials are recently purchased.

In times of rising price LIFO Method of pricing issues is suitable because materials are issued at the current market prices which are high. This method thus helps in showing a lower profit because of increased charge to production during periods of rising prices and lower profit reduces burden of income-tax.

Disadvantages LIFO Method

Like FIFO, comparison between one job and the job will become difficulty because one job started a few minutes after another of the same type may bear a different charge for materials consumed merely because the earlier job exhausted the supply of the lower priced or higher priced materials in stock. Also because the inventory valuation on the balance reflects earlier prices, it often gives an unrealistic picture of the current value of inventory.

The stock in hand is valued at prices which does not reflect current market prices and for pricing one a single requisition more than one price is adopted.

Average Cost Method

According to S.P Jain (1996) the principle under which the average cost method is based is that all of the materials in stores are so mixed up that an issue cannot be made from any particular lot of purchases and therefore it is proper if the materials are issued at the average cost of materials in stores. Average maybe of two types:

Simple Arithmetic Average

According to Robert F. Melgs (1999) a price is calculated by dividing the total s of the prices of the materials in the stock from which the materials to be priced could be drawn by the number of the prices used in that total.

Weighted Arithmetic Average

A price is calculated by dividing the total cost of materials in the stock from which the materials to be priced could be drawn by the total quantity of materials in that stock. It takes into consideration the price and quantity of the materials in the stores.

Advantages of Average Cost Method

Method is rational, systematic and not subject to manipulation. It is representative of the prices that prevailed during the entire period rather than of the price at the beginning, end, or at one point of issue during the period because it is based on the average of the materials costs of the various lots available in the store.

Disadvantages of Average Cost Method

Issue price of materials does not represent the actual cost price of materials issued but it represents average cost of materials in stores and closing stock is not valued at current cost.

2.2 ORGANIZATIONAL PROFITABILITY

According to Henry R. Anderson (1998) profitability is the ability of a firm to earn a satisfactory income. As a goal profitability competes with liquidity for management attention because liquid assets although important are not the profit producing resources. Cash for example means purchasing power is used to buy profit producing assets such as inventory and long-term assets.

The objective of profitability relates to a company ability to earn a satisfactory income so that investors and stockholders will continue to provide capital to it. Evaluating profits is very important to determine which method is going to be used.

According to Henry R. Anderson the management of inventory for profit is one of the most complex and challenging tasks. In terms of dollars the inventory of goods held for sale is one of the largest assets of a merchandising business and inventories are important for manufacturing firms. A company inventory methods affect not only it reported profitability but also it's reported liquidity.

Accounting to David H. Marshall (1999) changes in the quantities of inventory will have an impact on profits that is dependant on the cost flow assumption used in the extent of cost changes during the year. Under first out first in whether inventory quantities rise or fall the cost of the beginning inventory is transferred to cost of goods sold because the quantity of goods sold during the year usually exceeds the quantity of beginning inventory, whereby when costs are rising, cost of goods sold will be lower and profits will be higher than in last in first out method.

When inventories quantities rise during the year and last in first out is used a layer of inventory value is added to the book value of inventories at the beginning of the year. If costs have risen during the year last in first out results in higher costs of goods sold and lower profits than first in first out.

When inventory quantities decline during the year and LIFO is used the inventory value layers built up in prior years, when inventories quantities were rising are now transferred to the cost of goods sold with cost of the most recently added layer transferred first. The effect on cost of goods sold and profits of LIFO versus FIFO depends on the costs in each value layer relative to current costs of inventory if FIFO is used. Generally costs increase over time so inventory reductions of LIFO layers result in lower cost of goods sold and higher profits than with FIFO. Rapidly rising costs result in inventory profits or phantom profits. When FIFO assumption is used because the release of older lower costs to the income statement result in higher profits than if current costs were recognized. Since taxes must be paid on these profits and cost of replacing the merchandise sold is considerably higher than the old cost users of financial statements can be misled about the firm real economic profitability. To avoid inventory profits many firms changed from FIFO to LIFO for at least part of their inventories during the years of high inflation. This change to LIFO resulted in higher cost of goods sold than FIFO and lower profits, lower taxes and more realistic financial reporting of net income.

CHAPTER THREE

METHODOLOGY

3.0 INTRODUCTION

Methodology entailed the techniques that were used by the researcher to gather information on certain problem in a given area. The researcher used various methods to gather relevant information which was used to identify stock valuation techniques and organizational profitability.

3.1 POPULATION AND SAMPLE SELECTION

During the research the author visited Unilever Kenya to acquire the relevant information .The total number of employees in Unilever Kenya is 400 out of them 100 are involved in production process and management. The company was chosen through random sampling and presented many companies.

3.2 SAMPLING METHOD

The method dealt with the procedure of gathering data selecting some sample to represent the whole population in obtaining information.

The researcher used random sampling of the selected company. Population was selected at random interviewed and questionnaires were distributed to them to fill in the appropriate information against questions given. The data to be collected in the research was analyzed and conclusions made.

3.3 SAMPLE SIZE

A sample of about 10 employees from Unilever Tea was selected to represent the population.

3.4 DATA COLLECTION METHODS

Source of data

In collecting the data the researcher used various sources which were convenient to her research and could give relevant information. The researcher classified her data into two main types of data.

(a) Primary data

This was where the researcher used first hand data from the organization. Through the primarily data the researcher gathered data from the employees and executives from the organization. The collected data was more accurate than secondary data.

(b)Secondary data

This was the data obtained from existing information i.e. journals, published books, magazines. newspapers among others. The researcher decided to use this secondary data in order to acquire information that could not be provided by primarily data. This method of collection was cheaper, reliable, accurate and faster to obtain as compared to primarily data collection method.

3.5 RESEARCH INSTRUMENTS

Questionnaire

This was a list of questions relating to a particular investigation. The researcher used written questionnaires to collect data on stock valuation techniques and organizational profitability. The questionnaires were given to some executives and some of the employees of Unilever Kenya to answer. The researcher questions were short and precise. This method was less expensive and free from bias. However the method had several disadvantages observed by the researcher for it had false answers.

Interviews

This was through face to face conversation with employees. It was an oral questionnaire where the investigator gathered data through verbal interaction with participants. The manager gave the researcher the right to interview the respective employees. Some of the employees gave the researcher information which was appropriate while others ignored due to their tight schedule which did not allow adequate conversation.

Observation

This was where the researcher observed how employees worked in respect to the time allocated for their activities. The method used in their work was easily observed. The advantage of this method was that it was easy to get information,

Accumulated data, the researcher tabulated the data into columns. That one required without interfering with the settings. Relevant information was analyzed and presented in charts, tables and graphs which were later interpreted and conclusions and recommendations drawn respectively.

3.6 DATA ANALYSIS

The data was collected from one organization representing the manufacturing firm by use of random sampling. After the collection, the data was processed and then analyzed ready for presentation. The data collected was analyzed quantitatively and qualitatively.

3.7 Data Presentation

The following steps were taken by the researcher after collection of data

i. The collected data was assembled and edited to eliminate any errors, omissions and mistakes.

ii. It was also be classified to make it clear and descriptive.

iii. The data was then be analyzed quantitatively and presented by using tables and graphs and pie charts to make it easy to understand.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.0 Introduction

This chapter covers the data presentation, analysis and interpretation of the study to find out the impact of stock valuation and organizational profitability. Unilever tea takes into consideration the application of stock valuation technique as compared to other companies.

The researcher used a number of instruments as discussed in the previous chapter to collect information from the respondents. In this chapter, the researcher clearly shows the exact number of respondents that were used to get the information and those that responded in relation to the whole percentage.

This chapter has being summarized to enable it to be understood clearly. The researcher used pie charts, tables and bar charts to present the information.

4.1 DATA ANALYSIS

As said above the researcher used one organization which represented the others in her research. The organization used is Unilever East African Tea has an average population of four hundred employees respectively.

The researcher used questionnaire and interview to gather information. The questionnaires were sent to the organization for the employees and management to fill them.

4.2 Distribution of Questionnaires

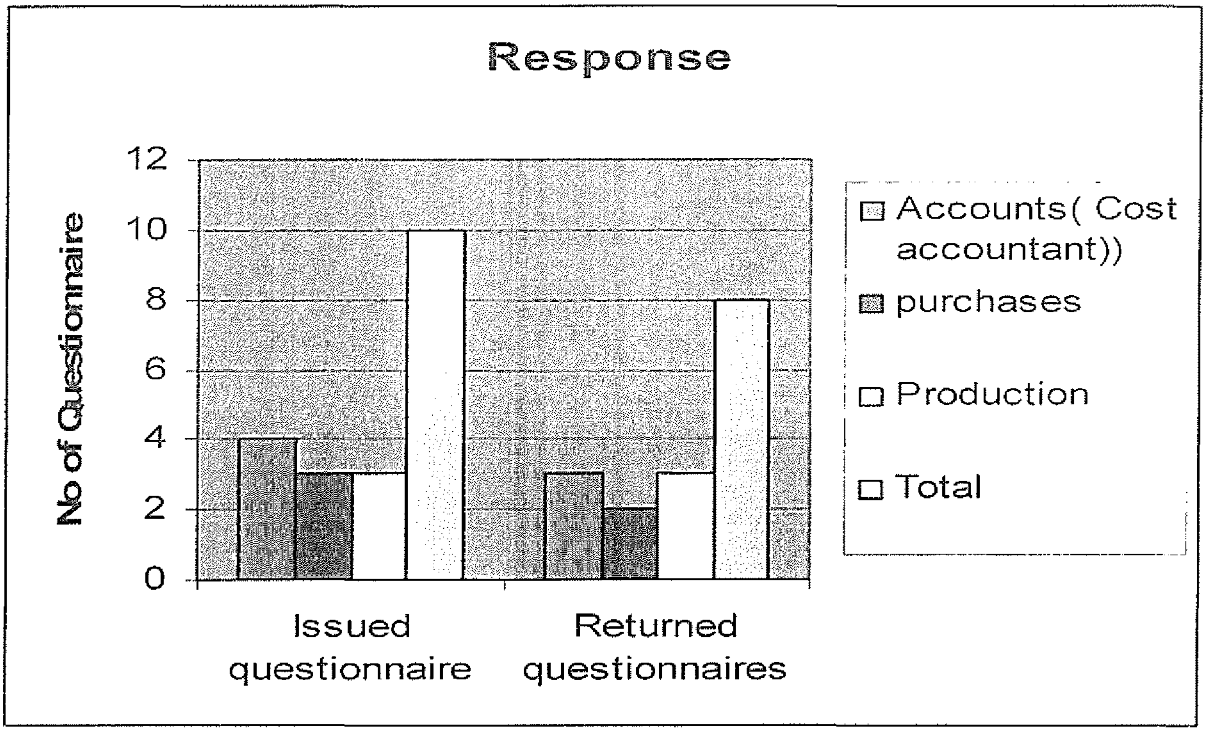
The responses from the respondents were encouraging as a total of eight questionnaires out of ten (10) distributed were duly filled and returned. The following table shows the responses received from different departments. This then represented an overall response rate of 80%.

Table 1 Responses

Departments	Issued questionnaire	Returned questionnaires
Accounts(Cost accountant)	4	3
purchases	3	2
Production	3	3
Total	10	8

Source: respondents of Unilever tea

FIGURE 1: Responses made in the study



Source: respondents of Unilever tea company

The table and the chart clearly show the number of questionnaires distributed in each department and the questionnaires that were filled and returned in the third column. The researcher distributed most of the questionnaires to the purchasing, Accounts and the production departments because the researcher saw that they were the most appropriate departments to get most relevant information in regard to the topic under study. The researcher decided to select the three departments since they deal with issue of raw materials and organizational profitability.

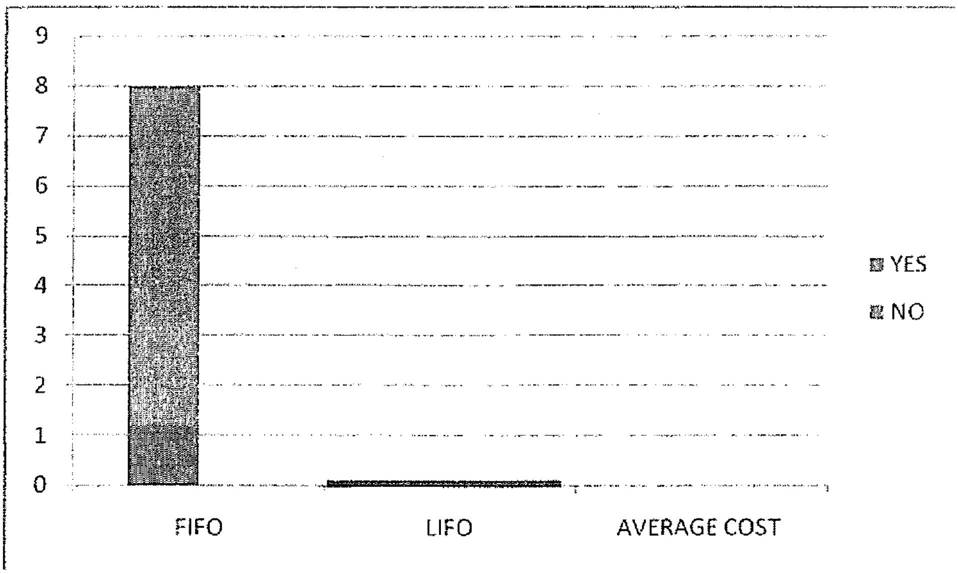
4.3 What are the stock valuation techniques used in Unilever Kenya?

Table 2: Responses on stock valuation techniques used

STOCK VALUATION TECHNIQUES	YES	NO	PERCENTAGE
FIFO	8	0	100%
LIFO	0	0	0%
AVERAGE COST	0	0	0%

Source: respondents of Unilever tea company

FIGURE 2:



Source: respondents of Unilever tea company

The table and figure above show the responses from the questionnaires obtained from Unilever tea which show the organization only applies FIFO method as compared to other methods as it results to increase in profits.

FIFO

FIFO stands for first-in, first-out inventory tracking. This means Unilever Tea purchases its inventory, holds the inventory, and finally sells the inventory the first group of purchases will be taken off the books first. This also implies that the remaining inventory at the end of a period will be the last group or groups of purchases acquired.

FIFO accounting is a common method for recording the value of inventory. It is appropriate where there are many different batches of similar products. The method presumes that the next item to be shipped will be the oldest of that type in the warehouse. In practice, this usually reflects the underlying commercial substance of the transaction, since many companies rotate their inventory (especially of perishable goods

FIFO gives a better indication of the value of ending inventory (on the balance sheet), but it also increases net income because inventory that might be several years old is used to value the cost of goods sold. Increasing net income sounds good, but remember that it also has the potential to increase the amount of taxes that a company must pay.

Assuming an inflationary economy, this method of inventory tracking will provide the highest gross profit for the period. At the same time this method also states that the remaining inventory was purchased at the highest price level.

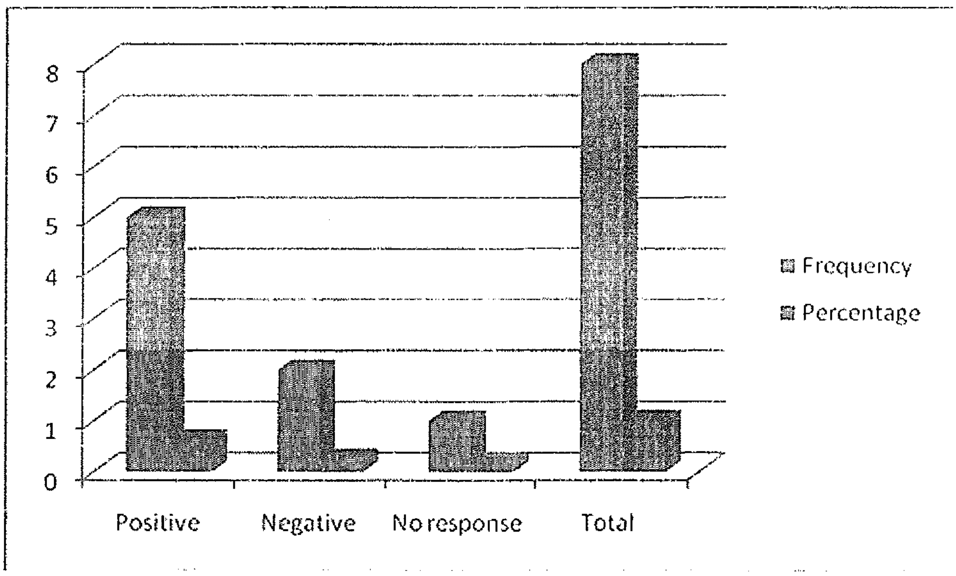
4.4 What are the effects of inventory valuation techniques?

Table 3: responses on the effects of inventory valuation techniques

Response	Frequency	Percentage
Positive	5	62.5%
Negative	2	25%
No response	1	12.5%
Total	8	100%

Source: respondents of Unilever tea company

Figure 3



Source: respondents of Unilever tea company

From the above table, five respondents gave positive effects of inventory valuation techniques; two respondents gave negative effects while only one did not respond on the issue. From the questionnaires the following were both the positive and negative effects of inventory valuation techniques.

POSITIVE EFFECTS

Effects on the profit and loss statements

The response obtained from the management shows that FIFO method results to higher profits. During inflation, this method of inventory tracking provides the highest gross profit for the period since the stock is issued at past prices at which the goods were acquired thereby reducing the value of cost of goods sold.

Effects on the balance sheet

From the data collected it also shows that FIFO has a positive effect the balance sheet of the company whereby during inflation, Unilever tea Kenya through FIFO valuation technique for reporting the value of merchandise, it bolsters their balance sheet. This is because the older and cheaper goods are sold and the newer and more expensive goods remain as assets on the company's books.

NEGATIVE EFFECTS

On the other side according to management FIFO has following drawbacks

Taxation

During inflation, this method of inventory tracking provides the highest gross profit. Unilever ends up declaring a high net profit after deduction of operating expenses. The high net profit is subjected to taxation and leads to payment of high taxes by the company to the government.

4.5 Is there relationship between stock valuation and organizational profitability?

In the study the respondents were requested to say if there is any relationship that is seen between FIFO stock valuation technique and organizational profitability

TABLE 4: Responses on the relationship between stock valuation and organizational profitability

Response	Frequency	Percentage
Yes	6	75%
No	0	-
No response	2	25%
Total	8	100%

Source: respondents of Unilever tea company

From the table above it shows that there is a relationship between inventory valuation and organizational profitability whereby six respondents stated relationship exists and none said there is no relationship while two did not respond.

Table 5: Unilever Tea Company financial data

Year	Sales(shs)	Cost of sales(shs)	Gross profit(shs)
2004/2005	353684500	185757000	167927500
2005/2006	305393400	155680060	149713340
2006/2007	339948050	177800900	162147150

Source: respondents of Unilever tea company

The above table gives the value of sales, cost of sales and gross profit figures of Unilever Tea Company for the financial years 2004-2007.

The relationship between the stock valuation techniques and organizational profitability can be established using the profitability ratio for a gross profit mark-up.

Gross profit mark-up = gross profit

Cost of sales

For year 2004/2005

$$\frac{167927500}{185757000} * 100 = 90\%$$

For year 2005/2006

$$\frac{149713340}{155680060} * 100 = 96\%$$

For year 2006/2007

$$\frac{162147150}{177800900} * 100 = 91\%$$

Since FIFO was used in the calculation and ascertainment of the cost of sales in the income statement, through the use of the gross profit mark-up ratio, the researcher established that since FIFO stock valuation leads to the under stating of the value of the cost of sales, the gross profit mark-up is high as seen above where in the year 2004/2005 it had a mark-up of 90%, in the year 2005/2006 it had a mark-up of 96% and in the year 2006/2007 it had a gross profit markup of 91%. This clearly shows that FIFO leads to the overstating of profits of the company.

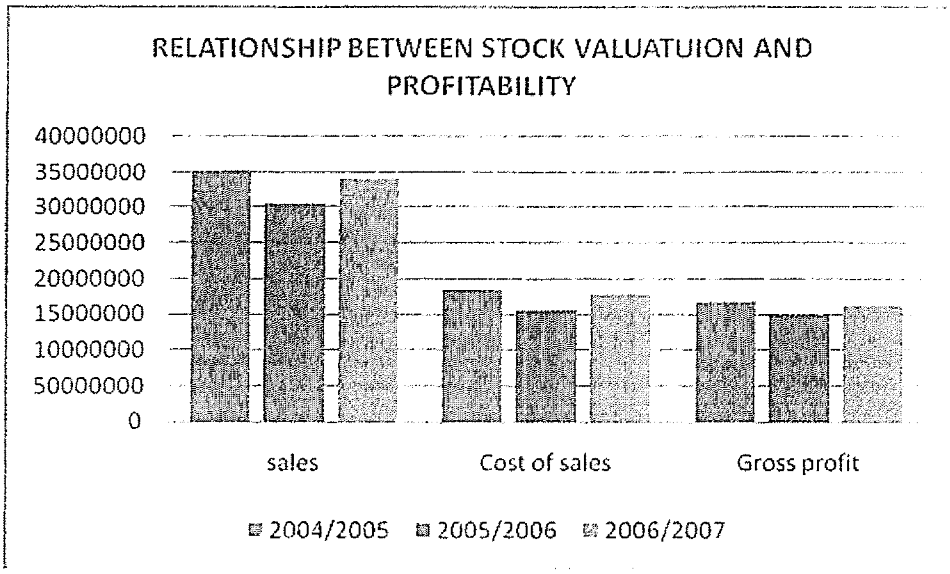
4.6 Comparison of the nature of relationship between stock valuation technique and organizational profitability.

The respondents were requested to fill in the table that showed the amount of sales, cost of sales and gross profit, in order to establish the relationship between inventory valuation and organizational profitability. The researcher used the cost of sales and gross profit to establish the relationship between them.

Table 6: Unilever Tea Company financial data

Year	Sales(shs)	Cost of sales(shs)	Gross profit(shs)
2004/2005	353684500	185757000	167927500
2005/2006	305393400	155680060	149713340
2006/2007	339948050	177800900	162147150

Source: unilever tea financial statements



Source: respondents of Unilever tea company

The above table and chart shows the relationship between stock valuation and organizational profitability whereby from both the table and chart it clearly states that the sales, cost of sales, and gross profit differs from one financial period to the other.

4.7 What are the benefits of stock valuation techniques in Unilever Kenya?

According to management there are various benefits of using FIFO method as compared to other techniques of inventory valuation whereby in Unilever Tea FIFO gives a better indication of the value of ending inventory on the balance sheet, but it also increases net income because inventory that might be several years old is used to value the cost of goods sold thereby increasing the profits of the company.

Another benefit according to management is that FIFO depicts the physical movement of goods. Unilever Tea generally use the oldest items in inventory first so they can continually roll the stock and prevent deterioration or obsolescence, in times of stable prices. FIFO has been widely used and accepted.

Another benefit is that FIFO method is chosen by Unilever because it is easier for Unilever Tea in situation when the company is faced with fluctuating production cost to determine their cost of goods sold and to price their products without under going any losses.

From the response it also shows that another benefit of FIFO is that it provides realistic inventory values on the balance sheet stating that the inventory technique can not overstate profits in the balance sheet.

Another benefit according to management of Unilever Tea is that FIFO is a logical method because it takes into consideration the normal procedure of utilizing first those materials which are received first. Materials are issued in order of purchases, so materials received first are utilized first thereby reducing the wastage of raw materials due to obsolesce.

According to management, FIFO correctly ascertains the costs of jobs or work orders so far as cost of materials is concerned since materials are issued at the purchase price. This can be in relation to **David H. Marshall (1999)** in the book **Accounting** where he stated that under FIFO method materials are issued at the purchase price; so the costs of jobs or work orders are correctly ascertained so far as cost of materials is concerned. Thus the method recovers the cost price of materials.

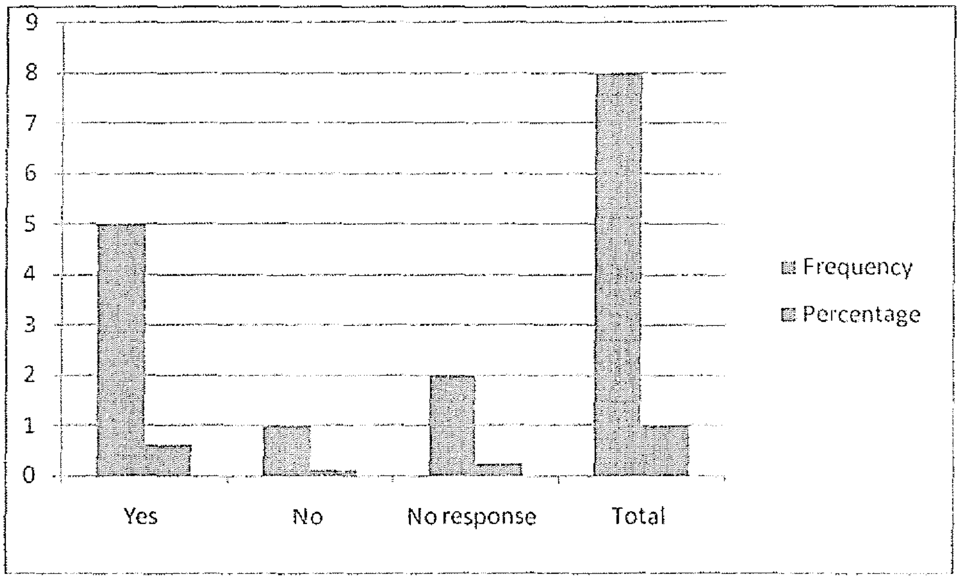
4.8 Is profitability of the organization affected by the type of inventory techniques applied?

Response	Frequency	Percentage
Yes	5	62.5%
No	1	12.5%
No response	2	25%
Total	8	100%

Source: respondents of Unilever tea company

From the table above it shows that a good number of questionnaires were answered in relation as to whether the profitability of the organization is affected by the type of inventory valuation technique applied in Unilever Tea Company. According to the response, five respondents stated profitability is affected, one stated it does not and the rest gave no response.

Figure 5



Source: respondents of Unilever tea company

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.0 INTRODUCTION

From the research study, the researcher realized that the organization that practice inventory valuation techniques has experienced improvement in the organizational profitability. However this technique of inventory valuation has not managed to improve profitability hundred percentages. This is because management does not apply them more effectively: sometimes they implement the techniques but do not follow up to ensure that the employees are applying the techniques in accordance.

5.1 Conclusion

Most organizations use recognizes inventory valuation techniques as a way through which organizational profitability can be maintained and improved.

Unilever tea uses inventory valuation techniques to obtain higher profits. It therefore follows that organizational profitability largely depends on the way and the level they apply inventory valuation techniques. The researcher observed through the use of gross profit mark-up ratio it leads to overstating the profits of a Unilever Tea Company.

Avoid wastage of materials and obsolesce of raw materials. FIFO method ensures that materials is first issued from the earliest consignment on hand and priced at the cost which that consignment was placed in the stores. In other words it means materials received first are issued first.

The researcher found that FIFO has certain advantages when it comes to reporting inventory value on the balance sheet. As the older and cheaper goods are sold, the newer and more expensive goods remain as assets on the company's books. Having the higher valued inventory and the lower cost of goods sold on the company's financial statements may increase the chances of getting a loan.

While it has some disadvantages when cost of goods sold is calculated. As the older and cheaper goods are sold, it leads to the understating of the value of cost of sales during inflation when the prices are rising, since the cost of new inventory would be high as compared to past prices.

Even with the tax disadvantage, there are still many reasons why a firm would be hesitant to immediately switch their books over to other stock valuation methods. During inflation, this method of inventory tracking provides the highest gross profit. Unilever ends up declaring a high net profit after deduction of operating expenses. The high net profit is subjected to taxation and leads to payment of high taxes by the company to the government.

The researcher also found out those organizations that use inventory valuation techniques are more efficient and results to increase in gross profits as compared to those organizations that do not apply inventory valuation.

RECOMMENDATIONS

The researcher recommends that organizations should encourage and exercise stock inventory valuation techniques. This is because it will not only help in improving organizational profitability but also ensure reduction in wastage of raw materials.

The researcher also recommends that the Company should probably pick a particular method and stick to it so there are not any wild fluctuations. This is because different methods give varying results hence lacking consistency

A Company should obviously not make a decision to use FIFO cost accounting and inventory valuation without first consulting with an accountant and/or a tax attorney.

The researcher also recommends that, those interested on this study should incorporate with many other organizations and unions in order to come up with other better inventory valuation techniques that neither overstate nor understate the profits.

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APPENDIX; 1

QUESTIONNAIRE

1. Name...

2. Address...

3. Sex (Tick where appropriate) Male ☐ Female ☐

4. How long have you worked for the organization?

   1—5 Years ☐

   6---10 Years ☐

   11---15Years ☐

5. At what level of management are in?

   Top management ☐

   Middle level management ☐

   Lower level management ☐

6. How long have you being in that position?

1—5 Years ☐

6---10 Years ☐

11---15Years ☐

7. Does your organization apply inventory valuation techniques?

Yes ☐

No ☐

8. What techniques of inventory valuation does it apply?

FIFO method ☐

LIFO method ☐

Average cost method ☐

9. Are the effects of inventory valuation techniques negative or positive?

Positive ☐

Negative ☐

10. What are the effects of inventory valuation?

....

....

....

....

11. Who is responsible in effecting stock valuation techniques?

Top Management ☐

Middle Management ☐

Lower Management ☐

12. Is profitability of the organization affected by the type of stock valuation techniques applied?

Yes ☐

No ☐

13. Is there any suggestion that you would like to make as pertaining inventory valuation techniques on organizational profitability?

Yes ☐ No ☐

14. Which criteria are used to measure organizational profitability?