

**NOVEMBER 2016 PROFESSIONAL EXAMINATIONS  
CORPORATE STRATEGY, ETHICS & GOVERNANCE (PAPER 2.6)  
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME**

**STANDARD OF THE PAPER**

The standard of the paper was good. It compares favourably with those of May, 2016. Candidates were required to attempt the case question and any other three questions. There were no ambiguities, typographical or other errors in the paper. The marks allocation was fair and marks were allocated to each sub-question. All the questions were within the scope of the syllabus.

**PERFORMANCE OF THE CANDIDATES**

Overall, the performance of candidates in the November 2016 examination was low. A good number of the candidates performed poorly because they did not prepare very well for the examination. Part of the reason for the poor performances may be due to the policy that allow candidates to write across levels.

**Strengths of Candidates**

The main strength was that almost all the candidates attempted the required number of questions.

**Weaknesses Demonstrated by Candidates**

Some of the candidates demonstrated lack of knowledge of the subject matter. Also, some of them provided incorrect responses to questions. Some of the candidates did not differentiate between competitive forces and general or external forces of environment.

## CORPORATE STRATEGY, ETHICS & GOVERNANCE QUESTIONS

### QUESTION ONE

#### CASE STUDY: ALPHA MINERAL WATER LIMITED

##### **Introduction**

Alpha Mineral Water Limited is one of the many companies producing bagged and bottled mineral water. The company was established in 2010 and has grown rapidly. Mr. Kwasi Kwakye has served as the managing director since the inception of the company. He is an accomplished entrepreneur and has received many awards both at home and abroad.

##### **The Industry**

The competition in the bagged and bottled water industry revolves around pricing as each producer attempts to use penetration pricing strategy in order to capture maximum market share. Most of the materials used in the industry are imported.

A decade ago, the industry had few players. Currently, there are numerous companies with low exit rate. The industry for most part of its existence, has remained unregulated and does not require huge initial capital. Since the inception of production of bagged and bottled mineral water, the government has been battling rubber pollution in major urban centres. The drainage systems are often choked with used plastic materials, which are not biodegradable. To address this menace, government is considering a special tax to raise money to clear the waste. Again, a bill is before parliament which when passed into law would require all to use biodegradable materials for packaging their products.

Based on the concern expressed by the government over the years, a new body known as Plastic Waste Regulatory Authority was set up early 2015 to regulate the industry. The regulator is expected to enforce certain minimum standards to sanitise the industry and minimise the effect of its activities on the environment. This measure, according to the experts, will restrict new producers entering the sector.

The bagged and bottled mineral water produced is sold to corporate bodies in the form of water dispensers and bottled water. Also, they supply water to households and retailers through key distributors. The margins of the key distributors are very low and only make reasonable profit on huge volumes. As a result, the key distributors tend to resist any price hikes by the producers. The past experience shows that anytime price increases, demand slows down as alternative sources of drinking water are sought by consumers. Again, some bulk distributors who perceive producers as raking in so much profit have ventured into production of bagged and bottled water in the past. Corporate

clients are also cutting their expenditure on water. There are some companies that have commenced importation of bottled mineral water for their own use.

Most of the companies in the industry depend on only two sources of water - Ghana Water Company (GWC) or bore hole. The industry water demand constitute 8% of GWC output. The producers have also not formed any association to deal with issues affecting them collectively. The water supply is increasingly becoming erratic, unreliable and very expensive with the withdrawal of government subsidies, further squeezing the margins of the sector. The working conditions of most of the workers in the sector is nothing to write home about and it has been difficult negotiating for better conditions, since they did not belong to any labour union. However, with the passage of the new labour law, it has become easier for the workers to join existing labour unions. As a result, most of the workers now belong to Industrial Workers Union.

The producers within the sector have a fair share of the market and no single company dominates the market. The market survey conducted indicates that the highest market share of the leading companies is 10%.

### **Expansion Plans**

Alpha Mineral Water Ltd currently has presence only in Accra and its surrounding settlements. The company is proposing to expand its operations to four regional capitals in the country. The details of the proposed investment is presented as follows:

The company has estimated investment outlays of GH¢200,000 fixed capital items. This outlay includes GH¢25,000 to be expended to acquire the land for the factory. The rest of the amount will be incurred on water processing and packaging plant that will be depreciated on straight-line basis over five years with scrap value. At the end of fifth year, the company will sell off the assets for GH¢60,000. Additional initial investment is expected to be made in receivables and inventory of GH¢50,000 and the short-term payables of GH¢20,000 will be generated by the project. No further investment would be made in working capital during the project life and the initial investment would be recouped at the end of the fifth year.

The Board of Directors have tasked the Finance Director to advise the Board on whether to lease or buy the plant using a bank loan.

The company could purchase the plant for cash using a bank loan on which the current rate of interest is 20% before tax. The trade-in value is GH¢20,000. If the plant is purchased, the company can claim tax depreciation allowance of 25%, on a reducing balance basis over the plant's five year life.

The company could lease the plant under an agreement which would entail payment of GH¢52,000 at the end of each year for the next five years. The tax authorities allow lease payment for tax purposes.

The corporate rate of tax is 25% and tax is payable one year in arrears. The company's required rate of return is 15%.

**Required:**

- a) Assess the general environment in which Alpha Mineral Water Ltd operates. **(12 marks)**
- b) Analyse the nature of competition faced by Alpha Mineral Water Ltd. **(12 marks)**
- c) Advise management on the best option between lease or buy. Support your advice with relevant calculations. **(12 marks)**
- d) Explain **TWO** other factors you will consider in reaching your conclusion in (c) above. **(4 marks)**

**(Total: 40 marks)**

**QUESTION TWO**

The Boston Consulting Group (BCG) Growth Share Matrix is a model which plots Strategic Business Units' (SBUs) market growth and relative market share.

Many public sector organisations are now experiencing increasing levels of competition for the supply of their services. This competitive environment has resulted in the need for such public sector organisations to develop analytical techniques which previously operated mainly within the private sector.

**Required:**

- a) Explain how the BCG Growth Share Matrix could be used to analyse, business portfolio and strategic options. **(12 marks)**
- b) Explain how a corporate parent can use envisioning and intervention as strategies for value creation for its Strategic Business Units. **(8 marks)**

**(Total: 20 marks)**

**QUESTION THREE**

At its recent Annual General Meeting, management of NTM was highly criticized for two major scandals that occurred in the organization during the year. In one case, newspapers reported that the management of the company connived with officials at the port to undervalue imports in order to pay lower taxes. In the other case, it was reported that the accountant leaked information to his friend who was bidding for a contract in the company. The Board Chairman, who is also the Chief Executive Officer

of the company apologized for these incidents but did not disclose that the company had been sued in respect of the first case. He went on to promise the shareholders that the fortunes of the company would change dramatically by the end of the new year as the company was going to start exporting its products to Europe within the next few weeks.

**Required:**

- a) Identify and explain **THREE** situations that are in conflict with the International Federation of Accountants (IFAC)'s Code of Ethics. **(6 marks)**
- b) Explain **FOUR** disadvantages of the CEO acting also as the Chairman of the Board. **(8 marks)**
- c) Identify **FOUR** principal duties of Board of Directors. **(6 marks)**

**(Total: 20 marks)**

**QUESTION FOUR**

- a) The following statements were made by the chief executive officers of four companies about corporate social responsibility stance of their respective companies, in Mercyland, at a ball to honour companies that were socially responsible in the just ended year.
  - i) "Keener Ltd has invested heavily in digital communities in villages of Mercyland to create new market opportunities and promote community economic development. On the business side of the deal, Keener has partnered with local business leaders, community groups, and NGOs to create web-based services for education, healthcare, and agriculture needs of the people. Keener Ltd has created an executive level corporate citizenship committee and several tiers of multi-functional committees to support citizenship in the company's lines of business."
  - ii) "Standard Ltd primary social responsibility is to assure our shareholders of the short term financial success of the company. Expecting us to exercise social duties beyond this can undermine the authority of government. As a company we have met all government regulations concerning society and nothing more is expected of us."
  - iii) "Poor Ltd is increasingly moving from simply complying with environmental laws to taking more practical actions to winning the public's trust through interactions and dialogue with other stakeholders. The company recognises the fact that engaging and addressing concerns of other stakeholders will result in long-term financial benefit to the shareholders. We are aware that company's operations sometimes affect society negatively and we take steps to promptly

address issues stakeholders bring to our attention. This is currently enhancing our reputation.”

- iv) “High Ltd has come to accept the legitimacy of the expectations of stakeholders other than shareholders and we have built their expectations into our organisation’s stated vision, mission and strategic direction. We recognise that without appropriate relationships with groups such as suppliers, customers, employees, government and society at large, High Ltd will not be able to function. As a company, our long term survival depends on protecting our environment and promoting social equity as well as economic or financial performance.”

**Required:**

Identify and discuss the *corporate social responsibility stance* each company is as stated by their respective CEOs. **(12 marks)**

- b) Establishment of internal audit function plays a crucial role in effective corporate governance system. Internal audit function exists to perform a number of activities including review of the accounting and internal control systems, identification of significant business and financial risks, performance of value-for-money audits and safeguarding company’s assets. External auditors may from time to time rely on the work of internal audit function in forming audit opinion. However, in doing so external auditors would have to assess the work of internal audit they want to place reliance on.

**Required:**

Discuss **FOUR** criteria that will determine the extent of reliance to be placed on the work of internal audit work by external auditors. **(8 marks)**

**(Total: 20 marks)**

## QUESTION FIVE

- a) Walter Institute is a research organization with branches in five African countries. The majority shareholder, Mr. Walter though not recognized in the company’s organizational structure, is actively involved in management. He gives directives and instructions to management and employees which are sometimes in direct contravention with the policies of the organization. Customers, employees and management are often affected in various ways by the decisions of Mr. Walter.

Preparations are underway to get the company listed on the Ghana Stock Exchange and a consultant is needed to advise on the improvement of the weak corporate governance status of the company.

**Required:**

- i) Identify **FOUR** stakeholders of the company and explain the nature of the interests of each in the company. **(4 marks)**
  - ii) Explain to Mr. Walter what is meant by good corporate governance, including the problems it is intended to address. **(4 marks)**
- a) Mr. Kwaku Sintim is the founder and managing director of Starline Fruits Ltd. Starline is a private limited liability company, which was established six years ago. Its line of business include growing different kinds of fruits, processing and distributing them to supermarkets across the country. Mr. Sintim, together with the company's board, has intimated on the need for the company to expand beyond its current operations in Ghana. You have been consulted by the company's management to advice on its quest to participate in the global market.

**Required:**

Discuss **FOUR** factors that must be considered by the board of Starline Fruits and Processing Ltd. before choosing a suitable mode of entry into international markets. **(12 marks)**

**(Total: 20 marks)**

## QUESTION SIX

Mr. Obed Kyei is the Marketing Director of Gaspo Furniture Supplies, a medium-sized company which specializes in manufacturing office furniture. The company is located in Kumasi, because of the availability of timber.

Mr. Kyei has proposed to the managing director the need for the company to diversify into the manufacture of household furniture. If the proposal is accepted, the company would have to develop a suitable marketing strategy in order to match the competition.

**Required:**

- a) As a strategist, advise the company on **FOUR** marketing strategies it can adapt to market its new product. **(12 marks)**
- b) Discuss how strategies can be used to create and sustain competitive advantage. **(8 marks)**

**(Total: 20 marks)**

## MARKING SCHEME

### QUESTION ONE

(a)

Analysis of general environment of Alpha Mineral Water Ltd using Economic, Political, Environment and Legal.

#### **Technological Factors**

The technological factors raised include the following issues:

- **Use of biodegradable plastic** – the passage of law requiring the use of environmentally friendly biodegradable plastic reflects improvement in the technology as far as plastic is concerned. The industry rely heavily on plastic as one of its core inputs in the production process.
- **Efficient and state of the art** – since the industry compete on the price basis it implies that the participants operate on low-cost leadership strategy which calls for efficient production process. This means that the industry needs cutting edge technology as far as its production process is concerned in order to lower cost and achieve competitive advantage.

#### **Political factors**

The political factors relate to the actions and policies of the government and other political actors such as opposition political party activism. The case before us raises a number of political issues worthy of consideration.

- **Removal of subsidies** – this will result in higher cost of living in the economy. It will raise cost of doing business in the Alpha Mineral Water Ltd and will also affect households and individuals. This will make the countries businesses less competitive compared to other foreign business that may be enjoying subsidies from their governments.
- **Political instability** – removal of subsidies is likely to result in agitations and demonstrations from the citizens who are likely to feel the negative impact in terms of increase cost of living. Any such political upheaval will have negative consequences for the economy as a whole.
- **Taxation policy** – The government appears to have appetite for taxes. It has introduced a bill in parliament, if passed into law, require companies to use biodegradable plastic as well as considering introduction of special tax to deal with



plastic pollution. This will further worsen cost of doing business in the economy and will make businesses less competitive.

- **Establishment of Industry regulator** – setting up of the industry regulator to deal with hitherto unregulated industry will have implication for the cost of doing business in the economy.

### **Legal factors**

These factors deal with various laws government passes to deal with the conduct of business in an economy. In this particular case the following legal issues arise:

- **Special Tax** – The government is considering the introduction of special tax to raise necessary funds to deal with the plastic waste challenge facing the urban centres. This is a major threat to the industry operators as this will result in higher cost of production with limited chance to pass on the effect to the consumers due to price sensitivity.
- **Labour laws amendments** – since the new law reduces the hiring period of casual labourers from 18 to 6 months and also make it easier for the workers to join trade unions imposes further cost of doing business in the economy. Unionised workers can demand for high salaries and also hiring more workers on permanent basis withal its related costs.
- **Law setting up regulator for the industry** – this is perceived to limit rate of new businesses entering the industry and existing ones may face high demands on them.

### **Environmental Factors**

These factors relates to how the natural or physical environment is affected by the actions and activities of businesses.

- **Pollution of environment** – the case clearly state how the used sachet and bottles are becoming a nuisance to the environment. The plastic are not biodegradable.
- **Floods** – choked drains have resulted in serious floods that affect lives and property in the urban centres.
- **Pollution of water bodies** – serious pollution of environment can affect waters bodies dotted around the country and can even affect their long term sustainability.
- **City Authorities budget** – high cost of running the cities.

**(3 mark each for any 2 points discussed under each influence = 12 marks)**

b)

Nature of competition in the industry refers to five forces analysis and in this particular case each of the forces will be examined.

### **Threat of new entrants**

The competition in an industry get intense when the barriers to entry are weak hence many businesses are able to enter the industry. In the case there are number of factors that show that industry is easily entered.

- **Capital requirements** – given the fact that the industry has grown from one to over two hundred producers and the assertion that the capital requirements are generally low makes the industry highly competitive.
- **Product differentiation/standardised product** – the case suggest that basis of competition is price which implies that producers in the industry do not differentiate their products or in other words the product of the industry is standardised which will make competition very keen.
- **Switching cost** – it appears that consumers face very low switching costs since water is not any technical and sophisticated product. Hence consumers can easily switched from one producer to another without any major cost. This makes competition much more severe.
- **Knowledge requirements** – no special skill or knowledge is required to operate in this industry hence competition will be more intense.

### **Bargaining power of buyers**

The group of buyer can be power or less power depending on a number of factors. In this particular the industry faces two buyer group – thus corporate buyers and bulk distributors. A number of factors in the case make the buyer groups power.

- **Low switching costs** – it will not cost buyers corporate and bulk distributors buyer groups to switch from one producer to another. This makes buyer group very powerful relative to the industry.
- **Buyers face standardised/undifferentiated product** – “all water be water”. This simply means that sachet water or bottle water from one producer is not much different from the next producer hence consumers are really indifferent as to which producer produces what. This makes buyer group very power.
- **Threat of backward integration** – from the case some bulk distributors are actually venturing into production by bypassing already existing producers and this makes the buyer group very powerful.

- **Low profit margins** – in the case bulk distributors clearly face low profit margins and so are very sensitive to price increases by producers of Pure Water.

### **Bargaining power of suppliers**

The supplier group provide the inputs into the production process of the industry. There supplier group include the labour, providers of water and electricity. These supplier groups will be more powerful and hence intensify competition with the following conditions.

- **Few or dominant supplier group** – currently apart from the few producers who have their own water supply, most industry players depend on Alpha Mineral Water Ltd Water Company which is the sole supplier aside drilled bore hole. This makes powerful as it can afford to hike prices without much input from the industry.
- **Limited alternative sources of supply** – Currently bore hole drilling is the only available alternative for the industry. But since majority of the producers depend on TWC it may suggest that there could be challenges with owning one's bore hole which may include locating favourable site and cost of drilling minimum required number of bore holes to supply sufficient water.
- **Suppliers' product is an important input to buyer's business** – without supply of raw water sachet and bottle water will not be produced. It is an indispensable input into the industry.
- **Unionisation of labour** – will make wage negotiation tougher and makes the labour supply input powerful.

### **Rivalry among existing firms**

This force deals with how the exist firms in an industry contend for the market share. The case points a number of situation that give rise to intense competition among rivals.

- **Declining/negative growth** – since the industry is declining it will make the fight for remaining market share much intense.
- **Equally balanced competitors** – from the case it appears that there no one particular firm that dominates the market and since they all have fair share of the market each firm can respond to any price cut by the competitor.
- **Many producers** – there are over 200 producers in the industry and this makes them weak especially when they have not form any cartel or association to regulate the price.
- **Low switching cost** – the industry products have no or very low switching costs. This makes the competition keen since each producer would have to make effort to retain the existing customers so they are not taking over by other competitors.

### Threat of substitute products

These talks about alternatives to the industry products. In the case it is clear that there are substitutes from imported sources, TWC and other water bodies.

- **Availability of substitutes** - there are readily available substitute sources to the industry. Some corporate clients are importing sachet and bottle water, TWC is available as well as other water bodies.
- **Low switching cost** - There is low switch cost in moving from the industry source to other sources available.

(3 mark each for any 2 points discussed under each 4 forces = 12 marks)

### c) Determination of the best option between lease and buy

#### Buy Option Analysis:

Calculation of depreciation allowance and the related tax savings:

Year	Value at start of year	25% Depreciation	25% Tax Savings on Depreciation Allowance
1	175,000	43,750	10,938
2	131,250	32,813	8,203
3	98,438	24,609	6,152
4	73,828	18,457	4,614
5	35,371=(73,828-18457-20,000)	35,371	8,843

#### Calculation of the buy option NPV:

	Year						
	0	1	2	3	4	5	6
Purchase cost (GH¢)	(175,000.00)						
Tax savings on depreciation allowance(GH¢)		-	10,937.50	8,203.13	6,152.34	4,614.26	8,842.77
Trade-in value(GH¢)						20,000.00	
Net cash flow(GH¢)	<b>(175,000.00)</b>	-	<b>10,937.50</b>	<b>8,203.13</b>	<b>6,152.34</b>	<b>24,614.26</b>	<b>8,842.77</b>
Discount factor @ 15%	1	0.8696	0.7561	0.6575	0.5718	0.4972	0.4323
Present Value (GH¢)	(175,000.00)	-	8,270.32	5,393.69	3,517.62	12,237.64	3,822.97
<b>NPV of Buy option (GH¢)</b>	<b>(141,757.76)</b>						

### Lease Option Analysis:

Calculation of NPV of lease option. (Method 1):

	Year					
	1	2	3	4	5	6
Lease payment (LP) (GH¢)	(52,000.00)	(52,000.00)	(52,000.00)	(52,000.00)	(52,000.00)	-
Tax savings on lease payment (25%*LP) Tax payable 1 yr. in arrears (GH¢)	-	13,000.00	13,000.00	13,000.00	13,000.00	13,000.00
Net cash flow (GH¢)	<b>(52,000.00)</b>	<b>(39,000.00)</b>	<b>(39,000.00)</b>	<b>(39,000.00)</b>	<b>(39,000.00)</b>	<b>13,000.00</b>
Discount factor @ 15%	0.8696	0.7561	0.6575	0.5718	0.4972	0.4323
Present Value (GH¢)	(45,217.39)	(29,489.60)	(25,643.13)	(22,298.38)	(19,389.89)	5,620.26
<b>NPV of Lease option (GH¢)</b>	<b>(136,418.14)</b>					

Calculation of NPV of lease option. (Method 2):

Year	Items	Cash Flow (GH¢)	Discount factor @15%	PV (GH¢)
1-5	Lease payments	(52,000)	3.3522	(174,312.07)
2-6	Tax savings	13,000	2.9149	37,893.93
	<b>NPV of lease option</b>			<b>(136,418.14)</b>

#### Decision:

Since the lease option results in the least cost of GH¢136,418.14 against buy option cost of GH¢141,757.76.

**(0.15mark each for each tick = 12 marks)**

**d)** Lease or buy are not purely a matter of calculations. The following are qualitative considerations in arriving at a decision:

- **Effect on cash flow** – the organisations liquidity at the time the decision is made may be important. If the business is suffering cash flow difficulties, lease payments may offer a smoother cash flow than one big lump sum.
- **Cost of capital** – the decision on whether to obtain use of the asset may be dependent upon appraisal method or cost of capital used. A decision not to invest taken using the company's overall cost of capital may be reversed if a significantly lower cost of leasing is used in the cash flow.
- **Running expense** – lease or buy calculations normally assume that running costs are the same under each alternative. This may not be so. Expenses like maintenance and insurance may differ between the alternatives.
- **Trade in value** – the organisation will gain (uncertain) benefits of a trade-in value if it chooses the purchase option.
- **Effect on reported profit** – annual profits are reported on accrual basis, after the deduction of depreciation. The effect of the alternatives on reported profits should be considered since this could, if significant, affect dividend policy and valuation of shares.
- **Alternative uses of funds** – Lease or buy decision will not be taken in isolation. If the business has limited funds available, there may be better uses for those funds than obtaining the asset, even if the asset does yield net positive cash flows.

(2 mark each for each for any 2 points = 4 marks)

(Total: 40 marks)

## EXAMINER'S COMMENTS

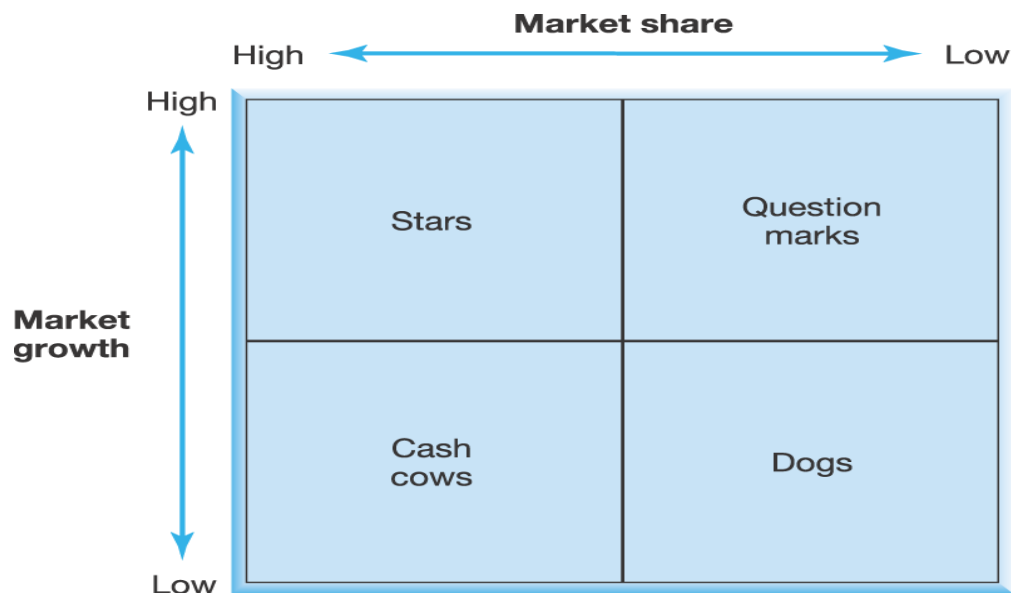
### *Case Study*

This was a compulsory question. Some of the areas examined included competitive forces, external forces of environment and lease or buy analysis. The candidates did well in discussing the competitive forces and external forces of environment. A few of them deviated and wrote on competitive forces under forces in the external environment and forces of external environment under competitive forces. Most of them could not attempt the aspect that with lease or buy analysis and a few of them who attempted it also performed poorly.

## QUESTION TWO

### MATRIX

(a) Most products, markets and even industries pass through clear stages of a life cycle. The position of a product can range from its introduction to the market, through a period of growth in sales and profits until its saturation, decline and eventual obsolescence. Ideally, a company needs a balanced range of products passing through different stages of the life cycle. The BCG Growth Share matrix is one of the methods used to analyse the balance of the product portfolio and illustrate the expected changes in the cash flow as products move through the various stages. The model is deliberately simplistic in that it focuses on cash flow and uses two variables, market growth and market share. As a generalisation, the cash characteristics of the products are defined by the quadrants into which they fall:



The matrix identifies four types of product or service: dogs, cash cows, problem children (question marks) and stars, and suggests appropriate strategies for each.

- **Cash cows** are high share SBUs operating in a low growth industry and should be generating substantial cash inflows. The period of high growth in the market has ended, (the product life cycle is in the maturity or decline stage), and consequently the market is less attractive to new entrants and existing competitors. Cash cow products tend to generate more cash than is needed to sustain their market

positions. These businesses should be a source of substantial amounts of cash that can be channeled to other areas.

- A **star** product has a high relative market share in a high growth industry. This type of product may be in a later stage of its product life cycle. A star may be only cash neutral despite its strong position, as considerable expenditure will be required to defend its position against competitors. Failure to support a star may lead to the product losing its leading market share position, slipping eastwards in the matrix and becoming a problem child. A star, however, represents the best future prospects for an organisation. As the growth rate for a star slows, it will drop vertically in the matrix into the cash cow quadrant and its cash characteristics will change.
- A **problem child or question mark** is a low market share product in a high growth industry. Substantial net cash input is required to maintain or increase market share in the face of strong competition. The planner must decide whether to market more intensively or get out of this market. The questions are whether this product can compete successfully with adequate support, and what that support will cost.
- **Dogs** are low share SBUs in low growth markets. They are often cash users and can perpetually absorb cash, because of the investment required to maintain position. An organisation with such a product can attempt to appeal to a specialised market, delete the product or harvest profits by cutting back support services to a minimum.

Once the products are analysed using the model, a strategy for improving overall market share can be developed. Most organisations take cash from the cash cows to fund both development of future SBUs, and those problem children that have the potential to gain share to achieve star status. **(3 marks each for the 4 points = 12 marks)**

#### b) **Roles of a corporate parent**

A corporate parent plays three value creating roles in managing its business units.

- **Envisioning corporate intent**

This is the process of creating a clear vision of corporate intent (what the organization wants to do). Creating a clear vision will help to avoid wasteful activities, provide a clear understanding of the organisation's activities to external stakeholders and potential investors and help managers to know what is expected of them.

- **Intervening to improve performance or developing business strategy**

In this role, the corporate parent has the responsibility to monitor and control the performance of its business units against respective plans, targets and intentions. It also has to develop the business units' capabilities, provide training and coaching services as and when necessary and promote collaboration among the units in order to achieve synergy. **(2 marks each for 6 marks)**



In order to play these roles effectively, the corporate parent may adopt any of the following approaches:

- **Portfolio management** where they will create value by applying financial discipline. That is keeping their own costs low.
- **Synergy management** by focusing or paying attention to economies of scope through the sharing of competences and resources by the business units.
- **Parental development** by developing their own competences to improve their SBUs' performance.

(Any 2 points for 2 marks)

(Total: 20 marks)

### EXAMINER'S COMMENTS

The first part of this question tested the candidates on the Boston Consulting Group (BCG) Growth Share Matrix and how they could be used to analyze business portfolio and strategic options. The Second part was on corporate parent and how they could use envisioning and intervention as strategies for value creation for its strategic business units. The first part was popular and the performance was good. Most of the candidates could not write on the second part with the exception of a few who just listed some few points.

### QUESTION THREE

a)

- (i) In the first situation, the fundamental principle of **integrity** was violated. Accountants are required to act with integrity (honesty and truthfulness) while they are performing their duties. By allowing customs official to undervalue the imports, the accountant's behavior which can be described as bribery of an official and cheating of the state pointed to his dishonesty.
- (ii) The second situation was an issue of **confidentiality**. Any information that is withheld from the public during a bidding process is supposed to be kept as a secret. Revealing this information to anyone who is not supposed to have it violates the fundamental principle of confidentiality.
- (iii) The CEO's refusal to disclose information relating the court suit violates the principle of **disclosure**. Governance regulations and codes require that organisations make disclosures about the board, internal control reviews, going concern status and relations with stakeholders.

(2 marks each for 6 marks)

(b) **Disadvantages of CEO acting as a Chairman of Board of Directors**

- (i) Combining the role of CEO and Board Chairman increases the workload of the individual making him or her less efficient.
- (ii) The individual may become too powerful and overbearing on other members of the board, thereby dictating the pace of activities.
- (iii) Conflict of interest situations are likely to arise where the CEO can easily force through his executive decisions at the board level though they may not be in the best interest of the organization.
- (iv) Decisions taken by the board may not be based on well-deliberated opinions and as a result, may not be the best under some circumstances.

(Any 4 points @ 2 mark = 8 marks)

c)

**Principal Duties of Board of Directors**

- **Provide continuity for the organization** by setting up a corporation or legal existence, and to represent the organization's point of view through interpretation of its products and services, and advocacy for them
- **Select and appoint a chief executive** to whom responsibility for the administration of the organization is delegated, including: to review and evaluate his/her performance regularly on the basis of a specific job description, including executive relations with the board, leadership in the organization, in product/service/program planning and implementation, and in management of the organization and its personnel and to offer administrative guidance and determine whether to retain or dismiss the executive.
- **Govern the organization by broad policies and objectives**, formulated and agreed upon by the chief executive and employees, including to assign priorities and ensure the organization's capacity to carry out products/services/programs by continually reviewing its work.
- **Acquire sufficient resources for the organization's operations** and to finance the products/services/programs adequately.
- **Account to the shareholders (in the case of a for-profit) or public (in the case of a non-profit) for the products and services of the organization and expenditures** of its funds, including: to provide for fiscal accountability, approve

the budget, and formulate policies related to contracts from public or private resources and to accept responsibility for all conditions and policies attached to new, innovative, or experimental products/services/programs.

**(Any 4 points @ 1.5 = 6 marks)**

**(Total: 20 marks)**

### **EXAMINER'S COMMENTS**

This question was in three parts. Part (a) of the question examined candidates on situations that are in conflict with the International Federation of Accountants (IFAC)'s Code of Ethics. Part (b), examined the candidates on the demerits of the Chief Executive Officer acting as the Chairman of the Board. In Part (c), the candidates were required to identify principal duties of Board of Directors. The candidates did well in all the three parts, though most of the candidates did very well in Part (b).

### **QUESTION FOUR**

- i) Keener Ltd is pursuing *shapers of society* corporate social responsibility stance. Shapers of society stance regard financial considerations as of secondary importance or a constraint. These are activists, seeking to change society and social norms. Here the social role is the *raison d'être* of the business. Such organisations may see their strategic purpose as 'changing the rules of the game' through which they may benefit but by which they wish to assure that society benefits. In this role it is unlikely that they will be operating on their own: rather they are likely to be partnering with other organisations, commercial and otherwise, to achieve their purposes. The Keener Ltd has put Mercyland community at the centre of its purpose.
- ii) Standard Ltd is pursuing the *laissez-faire* stance of corporate social responsibility. The laissez-faire view represents an extreme stance. Proponents argue that the only responsibility of business is to make a profit and provide for the interests of shareholders. It is for government to prescribe, through legislation and regulation, the constraints which society chooses to impose on businesses in their pursuit of economic efficiency. Organisations should meet these minimum obligations but no more. Expecting companies to exercise social duties beyond this can, in extreme cases, undermine the authority of government.
- iii) Poor Ltd is pursuing *enlightened self-interest* stance of corporate social responsibility. *Enlightened self-interest* is tempered with recognition of the long-term financial benefit to the shareholder of well-managed relationships with other stakeholders. The justification for social action is that it makes good business sense. An organisation's reputation is important to its long-term financial success. Given

that employees see it as important that their employer acts in a socially responsible manner, a more proactive stance on social issues also helps in recruiting and retaining staff. So, like any other form of investment or promotion expenditure, corporate philanthropy or welfare provision might be regarded as sensible expenditure. The avoidance of 'shady' marketing practices is also necessary to prevent the need for yet more legislation in that area. Managers here would take the view that organisations not only have responsibility to their shareholders, but also a responsibility for relationships with other stakeholders (as against responsibilities to other stakeholders).

- iv) High Ltd is pursuing a *forum for stakeholder stance* of corporate social responsibility. A *forum for stakeholder stance* explicitly incorporates multiple stakeholder interests and expectations rather than just shareholders as influences on organisational purposes and strategies. Here the argument is that the performance of an organisation should be measured in a more pluralistic way than just through the financial bottom line. Companies in this category might retain uneconomic units to preserve jobs, avoid manufacturing or selling 'anti-social' products and be prepared to bear reductions in profitability for the social good. Some financial service organisations have also chosen to offer socially responsible investment 'products' to investors. These include only holdings in organisations that meet high standards of social responsibility in their activities.

(3 marks each for 4 points=12 marks)

#### b) Extent of Reliance to be placed on the work of the Internal Audit

- i. **Organisational status** - internal audit's specific status in the organisation and the effect this has on its ability to be objective. Ideally, internal audit function should have a direct line of communication to the entity's main board or audit committee, and be free of any other operating responsibility. External auditors should consider any constraints or restrictions placed on internal audit.
- ii. **Scope of function** - the nature and extent of assignments which internal audit performs. External auditors should also consider whether management and the directors act on internal audit recommendations and how this is evidenced.
- iii. **Technical competence** - whether internal audit work is performed by persons having adequate technical training and proficiency as internal auditors. External auditors may, for example, review the policies for hiring and training the internal audit staff and their experience and professional qualifications, also how work is assigned, delegated and reviewed.

- iv. **Due professional care** – whether internal audit work is properly planned, reviewed and documented. The existence of adequate audit manuals, work programmes and working papers may be considered, also consultation procedures.

**(2 marks each for any 4 points=8 marks)**

**(Total: 20 marks)**

### **EXAMINER'S COMMENTS**

This question was in two parts. Part (a) of this question required candidates to explain corporate social responsibility stance. With reference to a case, candidates were to identify and explain the corporate social responsibility stance each company was pursuing as stated by their respective CEO's. Though candidates were able to write on the stance, few of the students missed up the stance and their related companies. In part (b), the candidates were to discuss the criteria that will determine the extent of reliance to be placed on the work of internal audit by external auditors.

A good number of the candidates attempted this question and the performance was average. Most of the candidates could not explain the extent of reliance to be placed on the work of the internal audit. Some of the points that the candidates missed include:

**Organizational status:** internal audit's specific status in the organization and the effect this has on its ability to be objective. Ideally, internal audit function should have a direct line of communication to the entity's main board or audit committee, and be free of any other operating responsibility. External auditors should consider any constraints or restrictions placed on internal audit.

**Scope of function:** the nature and extent of assignments which internal audit performs. External auditors should also consider whether management and the directors act on internal audit recommendations and how this is evidenced.

**Technical Competencies:** whether internal audit work is performed by persons having adequate technical training and proficiency as internal auditors. External auditors may, for example, review the policies for hiring and training the internal audit staff and their experience and professional qualifications, also how work is assigned, delegated and reviewed.

**Due professional care:** whether internal audit work is properly planned, reviewed and documented. The existence of adequate audit manuals, work programme and working papers may be considered, also consultation procedures.

## QUESTION FIVE

(a)

i) The key stakeholders are customers, employees, directors and management, suppliers, competitors, lenders and financiers, regulators, government and the community.

### **Interests of stakeholders:**

**Shareholders** – wish to see a good return on their investment and a stable future.

**Employees** – wish for a steady job and decent pay/conditions

**Directors/management** – wish to comply with their responsibilities as well as having similar interests to other employees.

**Customers** – look for appropriate, safe and reasonably priced products plus excellent customer service

**Suppliers** – are interested in sales volume and price, fair payment terms and long-term relationships.

**Competitors** – are keen to ensure there is vigorous but fair competition in the market.

**Lenders and financiers** – are keen for security and to see repayment of their investment in line with the agreed terms.

**Regulators** – wish to see the company complying with relevant rules and engaging with ideas for further improvement

**Government** wishes to see a stream of tax income plus a company which is a good corporate citizen.

**The community** – is interested in the company providing employment and preserving/supporting the environment.

**(Any 4 identified and explained @ 1= 4 marks)**

ii) There is *good corporate governance* when an organization is properly directed and controlled. This involves two issues – good performance in terms of value creation, resource utilization, risk management; and conformance which means complying properly with relevant regulations and being accountable and trustworthy. The company should operate in a manner that serves the best interests of its stakeholders including its shareholders and investors by performing well economically.

Good corporate governance is intended to manage the agency problem which is that directors act as agents of the company but may find their interests conflicting with those of the company. Directors are in a privileged position and are likely to act to serve their interests at the expense of shareholders and other stakeholders. **(4 marks)**

b) It is important for the management of Starline Fruits to consider many factors before deciding on which mode of entry into the international market would be suitable. The factors are discussed as follow:

- i. **The firm's marketing objectives:** It is important for management of Starline Fruits to consider its international marketing objectives relating to how much it wants and can sell in overseas markets - i.e. volume - the timescale and coverage of market segments. If Starline Fruits management expects overseas sales to be low in volume, or if the products are only to be on sale for a limited time period, then setting up an overseas production and distribution facility would be inappropriate. In this case, exporting might be an appropriate strategy. On the contrary, if management intends to cover a large segment of overseas markets as well as operate for a long time then establishing an overseas production and distributing outlet would be an appropriate mode of entry.
- ii. **The firm's size:** A small firm is less likely than a large one to possess sufficient resources to set up and run a production facility overseas. It is important for management of Starline Fruits to consider whether the resources of the company could provide the investment capital and organisational ability to set up an overseas production facility. It would also need to consider whether it can support the costs of continuing operations. If not, then overseas production facility would be precluded as an appropriate entry mode. Management would have to consider a mode of entry that requires a relatively lower investment in terms of cost and human resource ability.
- iii. **Mode availability:** A firm might have to use different methods of entry to enter different markets. Some countries only allow a restricted level of imports, but will welcome a firm if it builds manufacturing facilities which provide jobs and limit the outflow of foreign exchange. It is important for management to consider the policies of different overseas governments through research. This will inform it of what kinds of entry modes are available for it in each overseas market it seeks to enter.
- iv. **Mode quality:** In some cases, all modes may be possible in theory, but some are of questionable quality or practicality. The lack of suitably qualified distributors or agents, for instance, would preclude the export, direct or indirect, of high technology goods needing installation, maintenance and servicing by personnel with specialist technical skills. Whatever mode management are considering, it is important for them to put it to the practicality test.
- v. **Human resources requirements:** Starline management would have to consider the human resource requirements for whichever mode it wants to use. HR requirements vary according to which method of entry is used. For instance, if it would be difficult for Starline Fruits Ltd. to recruit suitable international marketing staff at home or overseas, they may have to resort to indirect exporting or the use of agents based overseas, which in this case would be the only realistic option.
- vi. **Market feedback information:** It is important for management to consider the effectiveness of receiving feedback information on its marketing efforts in overseas

markets. In some cases a firm can receive feedback information about the market and its marketing effort from its sales staff or distribution channels. In these circumstances direct export or joint ventures may be preferred to indirect export.

- vii. **Learning curve requirements:** Management of Starline needs to be clear about its future involvement in international business. If it intends a heavy future involvement in overseas markets, then it would be necessary for it to gain the experience that close involvement in an overseas market brings. They would, therefore, have to select mode(s) of entry that would offer them the opportunity to experience international business management for themselves. This argues against the use of indirect exporting as the mode of entry.
- viii. **Risks:** There are risks involved in operating in overseas market such as the risk of expropriation, risk of political instability, etc. Management would have to assess the nature of the risks in particular overseas markets in order to inform them which mode offers the lowest risks. For instance, some firms might prefer the indirect export mode as assets are safer from expropriation.
- ix. **Control needs:** Starline management should assess the level of control it seeks to retain over its overseas operations. For instance, production overseas by a wholly owned subsidiary gives a firm absolute control while indirect exporting offers only limited control over the marketing mix to the exporter.

**(Any 4 points @ 3 marks each = 12 marks)**

**(Total: 20 marks)**

### **EXAMINER'S COMMENTS**

The focus of this question was on stakeholders of a company and the nature of their interest in a company. Candidates were also to explain corporate governance and the problems it is intended to address. The final part of this question examined candidates on factors that must be considered by a board before choosing a suitable mode of entry into international markets.

The question was attempted by a good number of candidates and the performance was good, however, a few of them could not write on the factors to be considered before choosing a suitable mode of entry.



## QUESTION SIX

(a) *There are a number of approaches which can be used in answering this question. Candidates might focus on aspects such as market and environmental analysis or on segmentation, targeting and positioning. Marks will be awarded as to how appropriate their approach is to improving the situation for Gaspo. However it is expected that most candidates will apply the marketing mix model, the most commonly used to this scenario.*

It would appear that Obed needs to develop an appropriate marketing mix to facilitate the entry into this new Ghanaian market segment. This mix usually comprises four elements – product, place, price and promotion. These need to be integrated together, to mutually reinforce the impact of a marketing offensive and not in isolation where one aspect may counteract the influence of another. For example the development of a luxury brand image (promotion) will be harmed if a price strategy concentrates on a low or a ‘penetration’ price.

The *product* needs to be focused on a domestic/household market. A utilitarian office approach may not fit in well with the prevailing household image. Quality may have a higher priority here. The style of the furniture will also need to match the furniture in the rest of a household – there may need to be a choice between classical and modern styles. Furthermore size may be more critical. Houses are frequently smaller than offices so the furniture may need to be more compact.

It may be advantageous not only to supply the finished products but the company could add value by providing both design and installation services. This, of course, will require a stronger Ghanaian presence. This could be achieved by having a good distribution network (*place*). Although the products are manufactured in India because of the lower costs, the customer will be looking for a presence locally. Stock must be available locally so as to avoid delays in order processing. This will provide reassurance. Furthermore potential customers will wish to see examples of the products, layout and workmanship before they commit themselves to purchase. *Gaspo* will need to have a number of showrooms in major centres where business is expected. Not only will these be depots for supply but they will also act as centres for marketing. This will be an expensive facility, offsetting the cheaper labour costs. The company will have to ensure that these new markets can generate sufficient revenue to compensate for these increased costs.

These showrooms will be part of the *promotion* element of the mix but they will have to be complemented by other media activities. Advertisements in furnishing or household style magazines could attract new customer groups. It may also be possible to buy mailing lists of people who work from home. Directors of small companies and self-employed individuals frequently receive direct mail from financial institutions about banking services and also offers from IT suppliers. Why not information about office furniture and other services? The company should also be aware of the benefits of promotion by using the world-wide web.

*Price* also needs to be considered as a competitive tool in this new venture. The price must not be so low that prospective purchasers question the quality of the product. However it must also be remembered that in certain circumstances this furniture cannot be offset against tax as a cost as it can in a *bona fide* company transaction. Therefore the company needs to be careful not to price itself out of the market. They have to be aware of what competitors are offering. It may be sensible to have competitive prices for the furniture but charge a premium for the design and installation work.

*[There are no precise solutions as to how the marketing mix is to be determined. Candidates may propose different approaches. These will be accepted, assuming that there is an inherent logic in their application and that they are not inconsistent with a candidate's premises and the objectives of the company]*

**(4 points at 3 marks each= 12 marks)**

**(b)** A company, which has acquired a competitive advantage, should not relax its vigilance. In business nothing is permanent and competitors will soon retaliate. There are a number of methods by which a company can attempt to maintain its position.

- If the company's strength is built on being a **low-cost producer** it must attempt to continue to get low cost supplies by buying in bulk, ensuring regular deliveries to avoid heavy stock-holding costs. It must control its labour costs and continue to innovate so as to maintain production advantages by simplifying the production process. It must keep overheads low and ensure low distribution costs. However if a company's competitive position is derived from its ability to differentiate its products or services it must ensure that it maintains its lead in marketing by emphasizing a strong brand identity, a strong corporate image and by having technological superiority. This can be done by enhancing its research capability and in designing unique products.

- It is also critical to be aware of **customer needs** and so **marketing research** is an important input. Companies can also maintain their advantage if they can develop and build prohibitive switching costs into their products/services. These costs which tie a customer to a supplier can include financial links, the supply of materials and the supply of specialist services (in the case of *Gaspo* it could be the provision of design and installation services).
- As mentioned earlier the **development of a strong brand name** can tie consumers more closely to the supplier. Patents and trademark legislation can also protect the competitive advantage of certain companies although there are sometimes difficulties in certain markets where intellectual property rights are not always fully protected.
- However companies who rely mainly on the law to protect a competitive advantage run the risk that they may become reactive, hanging on to what they have. These firms would be well advised to continue to **seek 'new' strengths either in marketing or manufacturing** rather than rely on the protection of 'old' strengths.  
(2 points at 4 marks each = 8 marks)

(Total: 20 marks)

#### EXAMINER'S COMMENTS

The first part of this question asked candidates to explain four marketing strategies to consider in marketing a new product. Candidates used different approaches to answer this part. The second part examined candidates on how strategies can be used to create and sustain competitive advantage. A good number of the candidates attempted this question and the performance of the first part was generally good while the second part was not answered adequately.