

**MAY 2016 PROFESSIONAL EXAMINATION  
CORPORATE STRATEGY, ETHICS & GOVERNANCE (2.6)  
EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

**EXAMINER'S REPORT**

**STANDARD OF THE PAPER**

The standard of the paper was good. It compares favourably with those of November, 2015. 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 May 2016 was slightly better. However, 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 CANDIDATE**

Some of the candidates demonstrated lack of knowledge of the subject matter. Also, some of them provided incorrect responses to questions. It is worrisome that some of the candidates could not prepare cash budget.

## **CORPORATE STRATEGY, ETHICS & GOVERNANCE QUESTIONS**

### **QUESTION ONE - Case Study**

#### **RICHWARD LIMITED**

##### **Background**

Mr. Kwesi Bonku is the Managing Director of Richward Ltd, a small haulage contracting company, which he founded 15 years ago. Originally, Mr. Bonku was a heavy goods vehicle driver himself, working for other contractors, but he had the intent of establishing his own business. Having received his pension, he acquired an articulator truck and began to work from home. Over time the business expanded and now Richward Ltd operates a fleet of 15 heavy goods vehicles. Five of the current fleet of trucks was acquired in the last financial year, replacing older units which were becoming too expensive to maintain. The Company now employs 20 full-time and varying number of part-time driver mates. The part-time staff work as and when required.

Mr. Bonku acquired two plots of land six years ago and built a house on it, which he and his family occupy. In addition, he built a garage with facilities for minor servicing and repairs on the same site. Living on site has enabled him to offer a 24-hour service to clients. Consequently, movement of the trucks in and out of the site occurs at all times of day and night. There have been objections raised by the residents in the neighbourhood to disturbance and the local Radio Stations has at various times reflected this criticism.

In addition to the haulage business, the company also obtained license and established a driving school. This had proved to be a successful diversification as there is a regular stream of customers. This training takes place mostly in Richward Ltd's own garage facilities. It became clear to Mr. Bonku that the land on which the garage facility is built was inadequate for the needs of his growing business.

##### **Acquisition of land**

One year ago, Mr. Bonku entered into negotiations to lease some land which would be more than satisfactorily for the company's operations. The land is situated on an industrial estate five kilometres from the existing facility. In addition, there is room to build a workshop facility which would be adequate for the needs of the fleet. Following agreement of a lease arrangement, which was concluded just before the completion of the last financially year, Richward Ltd occupied the land on which there were no building erected or utilities supplied. Since taking possession of the land, a large security fence has been erected and a small portable cabin placed on site. Water and electricity services have been supplied and negotiations are taking place for the

installation of a large diesel tank adequate to service other vehicles besides those of Richward Ltd.

### **Accounting**

Mr. Bonku recruited Mrs. Efua Dadson, a part-time accountant, four years ago. Prior to Mrs. Dadson's arrival, Richward Ltd applied a policy of paying all invoices immediately on receiving them. As debtors were frequently taking over and above the credit period (30 days) allowed, Richward Ltd suffered a cash flow shortage, which resulted in a large bank overdraft.

Mrs. Dadson introduced some basic financial accounting procedures into the company. In addition to exercising some control on Richward Ltd expenditure, Mrs. Dadson has reduced the debtors' collection period to about half its former level. Creditors are now paid when the invoices fall due rather than immediately upon their receipt. Such control had been lacking prior to her arrival at the company.

The company faces strong competition for haulage contract work. Typically, haulage contractors operate on a low-margin basis and smaller companies often sub-contract from large-scale hauliers. Richward Ltd carries haulage for a variety of customers as well as undertaking some subcontracting. Much of the haulage work the company carries out is seasonal.

One of its top clients, Grace Ltd, recently appointed a new transport manager. The new Manager of Grace Ltd. has begun to employ other hauliers besides Richward Ltd. Over the last two months, the haulage work Richward Ltd has received from Grace Ltd has reduced by about a third.

In order to address the competition, Richward Ltd recently diversified into the sale of hydraulic oil. Sales have been running at a steady rate of 50 gallons each month for some time, but the company is dissatisfied with this level of sales and from next month June 2016, the company intends to advertise actively. This is expected to increase sales by 10 gallons per month from June to October inclusive after which it will remain steady at 100 gallons per month.

Each gallon costs GH¢1,500 and sells for GH¢2,000. All purchases are on one month's credit and sales on two month's credit. The company feels that, to give a good service to customers, it must have sufficient inventory at the end of each month to meet the whole of the following month's sales.

Additional non-current assets (a delivery van to help cope with the increased sales) will be bought and paid for in July 2016 at a cost of GH¢15,000. Corporate tax of GH¢25,000 is due for payment on 1<sup>st</sup> August, 2016. The balance of cash at 31<sup>st</sup> May, 2016 is planned to be GH¢30,000.

Operating costs will rise to cash payments totaling GH¢10,000 each month. The advertising will cost GH¢20,000 in June and GH¢10,000 for each month from July to September inclusive, payable one month in arrears.

The Accountant has not yet had a cash budget prepared for the rest of the year, but she feels that the sales expansion plans are likely to lead to cash flow problems. Suggestions have been made that, if her fears are justified, it might be possible to overcome the problem by increasing the creditor payment period to two months and buying inventory as it is used (i.e. zero inventory at month ends).

**Required:**

- a) Assess the nature of competitive forces of Richward Ltd. **(8 marks)**
- b) Present a SWOT Analysis for Richward Ltd. **(8 marks)**
- c) Advise Mr. Bonku on the strategic management accounting information which should be provided to assist future decision making and cost control. **(8 marks)**
- d) Prepare a cash budget for Richward Ltd Limited for the six months ending 30<sup>th</sup> November 2016, showing the planned cash position at the end of each month; on the basis of the original planned credit and inventory holding periods. **(6 marks)**
- e) Redraft your cash budget to reflect the suggested alterations to these planned periods. **(5 marks)**
- f) Suggest what other aspects Richward Ltd Limited should consider to solve the expected cash flow problem, should the suggested solution be unachievable. **(5marks)**

**(Total: 40marks)**

## QUESTION TWO

- a) The Balanced Scorecard approach has been embraced as an effective model for generating information to assist management in formulating and achieving strategic policies. It emphasizes the need to provide management of an organisation with a set of information which addresses all relevant areas of performance in an objective and unbiased fashion.

You are the Management Accountant of McGinate Incorporated, a local printing and publishing house located in the regional capital of Ashanti. Your CEO has asked you to brief him further on the balanced scorecard approach.

**Required:**

In a memo to the CEO:

- i) Describe **FOUR** perspectives of a balanced scorecard. **(8 marks)**
- ii) Explain **THREE** problems usually associated with the use of this approach for strategic management. **(6 marks)**
- b) *Management by objectives (MBO)* is a process of defining objectives within an organisation so that management and employees agree to the objectives and understand what they need to do in the organisation in order to achieve them. The essence of MBO is participative goal setting. In order for MBO to work effectively in an organisation, objectives agreed on must possess certain inherent characteristics.

**Required:**

Identify and explain **THREE** of these inherent characteristics and how they facilitate Management by objectives (MBO). **(6 marks)**

**(Total: 20 marks)**

### QUESTION THREE

- a) Strategy evaluation is a key aspect of the strategic management process. It allows management to assess the efficiency and effectiveness of the chosen strategies before their implementation.

**Required:**

Discuss the following criteria for evaluating corporate strategic options.

- i) Suitability
- ii) Acceptability
- iii) Feasibility

**(12 marks)**

- b) Management perception about the global environment is an important factor in shaping its orientation or philosophy in developing a general strategic profile in the international arena.

**Required:**

Identify and explain **FOUR** management orientations in the management of international business.

**(8 marks)**

**(Total: 20 marks)**

### QUESTION FOUR

- a) During strategy implementation, important management issues need to be reviewed for their appropriateness for the new strategy. Many organisations fail to achieve their strategic objectives not because they do not develop the right strategies but because many issues are not resolved during the implementation. They may not have the right organizational structure, a fitting culture, an efficient leadership while communication may be poor.

**Required:**

Discuss the importance of each of the following in successful strategy implementation:

- i) Effective communication
- ii) Strategic leadership

**(5 marks)**

**(5 marks)**

- b) You have been consulted by the CEO of Infinity Graphix, a designing and publishing company, to clarify some strategic management terminologies to aid him to finish a proposal for consideration by the company's board of directors.

**Required:**

Using relevant examples, explain the following types of modular organisation structures.

- i) Outsourcing.
- ii) Offshoring.
- iii) Shared servicing.

**(6 marks)**

- c) Explain **TWO** limitations that are associated with offshoring. **(4 marks)**

**(Total: 20 marks)**

**QUESTION FIVE**

- a) You have recently been appointed head of corporate affairs of a reputable company that operates in the upstream sector of the petroleum industry in Ghana. In a recent management meeting, a disagreement arose among executives regarding the nature of the company's philosophy and strategy towards social responsibility. In order to resolve the disagreement, you have been asked by the company's board of directors to submit a position paper that will enable it to formulate an appropriate corporate social responsibility strategy for the company.

**Required:**

In a brief report to the board, **make a clear case for** Corporate Social Responsibility (CSR) to help your company's board formulate an appropriate CSR strategy. **(10 marks)**

- b) Explain **TWO** strategies your company could adopt for managing its social responsibility. **(4 marks)**

- c) You recently qualified as a professional accountant and received promotion in your company. One of your key responsibilities is to prepare management accounts to facilitate management decision making. You require important sales information from the sales department to incorporate into the final figures. Unfortunately, due to staff sickness and other inefficiencies, the sales report for the month has been delayed. Thus, you will not receive the information until few hours before the accounts are due for presentation to the Chief Finance Officer.

In a related situation, while on lunch break, you overheard the marketing manager asking another employee in the finance department to advise her on some investment decisions she has to make. She has recently inherited a

considerable sum of money and would like your colleague to calculate her inheritance tax as well as capital gains tax liabilities.

**Required:**

Identify the fundamental ethical principle(s) that could be in breach and justify why they may constitute a breach. **(6 marks)**

**(Total: 20 marks)**

## QUESTION SIX

- a) You are the Chief Operations Officer and a member of the board of directors of a reputable firm that has operations in all ten regions of Ghana. The board is currently deliberating on a strategy to decentralize the administrative function in order to promote flexibility in administration across all the operational areas of the company. You feel strongly that this move will be detrimental to the prospects of the company and has therefore spoken against it. The Chairman of the board has, therefore, asked you to submit a short memo to argue out your position.

**Required:**

In a memo to the Chairman of the board, explain **THREE** reasons why you believe your company should maintain the current centralised administrative department. **(6 marks)**

- b) One of the important tasks in the formulation of corporate strategy is stakeholders' analysis.

**Required:**

Explain the term *stakeholders* and identify **TWO** groupings of stakeholders.

**(4 marks)**

- c) A new entrant into an industry will bring extra capacity and more competition and so could, in turn drive down profits. The strength of the threat posed by new entrants is likely to vary from one industry to another and depends on the strength of the barriers to entry and the likely response of existing competitors to the new entrant.

**Required:**

Identify and explain **FIVE** determinants of barriers to entry to new entrants into an industry. **(10 marks)**

**(Total: 20 marks)**



## CORPORATE STRATEGY, ETHICS & GOVERNANCE SCHEME

### QUESTION ONE

a) The five competitive forces related to the business of Richward Ltd are:

1. **Rivalry amongst existing competitors**

Richward Ltd faces strong competition for haulage contract work and it appears that there are several firms operating in the market. Profit margins are low, which indicates that work is undertaken at low prices. A major customer, Grace Ltd, uses other haulers, which suggests that competition for business is fierce. Richward Ltd is facing strong competition from existing competitors. The strong nature of competition is also exacerbated by low switching costs of customers.

2. **Threat of a new market entrant**

The main constraints on setting up a road haulage business will be obtaining a license and having sufficient capital to purchase or lease a tractor unit and trailer. Finance for such an operation will be readily available. The only other significant entry barrier might be low profit margins. It appears that, overall, the road haulage industry has few major entry barriers so this will always be a threat to established business such as Richward Ltd.

Note: Any of the points under barriers to entry that is well explained may be considered – capital requirements, low switching costs of customers, degree of differentiation, economies of scale, knowledge requirements, etc.

3. **The power of customers**

The customer of Richward Ltd will be primary organisations that employ skilled people who know the road haulage industry and how to negotiate contracts. As there are many competing businesses in the trade, this puts the customers in a strong bargaining position. This is shown by the fact that Richward Ltd's major customer Grace is using other hauliers and is, no doubt, assessing its supplier's prices and performance. The power of customers in the market is strong; this poses a serious threat to Richward Ltd.

Note: Other points which may be considered are switching costs, concentration risks (demand), number of competing firms, negotiating skills, profit margin of customers.

#### 4. Power of suppliers

The main suppliers to Richward Ltd will provide vehicles, other plant and equipment, formal services and labour. It is unlikely that any supplier is in a strong monopolistic situation, except possible providers of capital. Richward Ltd is in an established position and while it remains profitable will probably be able to obtain reasonable amounts of capital. The power of suppliers does not appear to be very strong.

#### 5. The threat of a substitute product

The main substitute for road haulage services is freight carried by the railway industry. The current dire state of this industry means that rail freight cannot be considered a serious threat to Richward Ltd.

Note: Other points which may be considered are switching costs, concentration risks (demand), number of competing firms, negotiating skills, profit margin of customers.

Overall, Richward Ltd's competitive position is not strong as it faces a number of competitive threats.

**1.5 marks for each well explained point and 0.5 for conclusion  
[8marks]**

#### b) SWOT Analysis for Richward Ltd.

##### **Strength**

- Richward Ltd is an established business with an experienced management team
- Bonku lives on site enabling Richward Ltd to offer a 24-hour service to customers
- The company acquired a lease on a new site that has quite a lot of potential
- The company has diversified into truck driver training which reduced dependence on road haulage for income.
- Replacement of old trucks and other equipment. This increases the efficiency of operations.

##### **Weaknesses**

- Richward Ltd's existing site is too small, so it will have to locate the new site that requires more capital and will disrupt business operations.
- Richward Ltd currently does not have an effective management accounting system, which means Richward Ltd's managers make decisions without having sufficient information

- The company is too dependent on Grace Ltd, which account for majority of its business

### **Opportunities**

- The enlarged premises will enable the company to attract new business and offer new services e.g. overnight trailer parking and a vehicle repair service.
- Richward Ltd should be able to establish stronger links with existing customers, which should help to retain their business.
- Location of land/business premises.

### **Threat**

- The most serious threat facing Richward Ltd is the loss of Grace Ltd's custom. In the last two months one third of this business has already been lost.
- There are a large number of competitors working on low profit margins and this forces price down. There appears to be little prospect of Richward Ltd being able to increase its prices.
- Local residents are opposing operations from the current site and the company is receiving bad publicity in the local press.

**2 marks each for each element of SWOT**

**[8marks]**

### c) **Advice to Mr. Bonku**

#### *Competitor Information*

- Information about competitors can be very useful as it provides a benchmark against which Richward Ltd's performance can be compared.
- Budgeting will provide information to forecast patterns and trends. This will be very useful when making decisions and setting objectives and targets e.g. market growth rates.

#### *Financial information*

- *Investment appraisal*  
Information can be provided to evaluate each capital investment project undertaken by Richward Ltd. This will be very useful when developing the new site.

- **Variance analysis**  
This is a very important management accounting control tool. The expected costs and revenues will be forecast and actual costs and revenues compared with them. Variances can then be identified and investigated to find their cause. This will establish some of Richward Ltd's strengths and weaknesses.
- **Customer account profitability**  
Costs incurred by Richward Ltd can be related to each customer and the profit generated by each customer calculated. This will be very important information used by Richward Ltd's managers to make decisions relating to each customer e.g. Grace Ltd.
- **Quoting prices**  
Most of Richward Ltd's customers will be other organisations. They will expect a price to be agreed before awarding a contract to a supplier. Management accounting can supply the information for quoting competitive and realistic prices when negotiating with customers.

**Any 4 points at 2 marks each**  
**[8marks]**

d)

**RICHWARD LTD:  
CASH BUDGET FOR SIX MONTHS ENDING NOVEMBER 2016**

	JUNE	JULY	AUG	SEP	OCT	NOV
	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000
<b>Receipts</b>						
Accounts Receivable	100	100	120	140	160	180
<b>Payments</b>						
Accounts Payable	90	105	120	135	150	150
Van		15				
Corporate tax			25			
Operating costs	10	10	10	10	10	10
Advertising		20	10	10	10	
	100	150	165	155	170	160
Net Cash Flow	0	(50)	(45)	(15)	(10)	20
Opening Cash Balance	30	30	(20)	(65)	(80)	(90)
Ending Cash Balance	30	(20)	(65)	(80)	(90)	(70)

*Workings*

	APR	MAY	JUNE	JULY	AUG	SEP	OCT	NOV
Sales(Gallons)	50	50	60	70	80	90	100	100
Sales(Value) @ 2			100	100	120	140	160	180
Purchases (Gallons)		60	70	80	90	100	100	100
Purchases (Value) @ 1.5			90	105	12	135	150	150

**Any 50 ticks @ 0.1 plus 1 professional mark for presentation**

**[6marks]**

e)

	MAY GH¢'000	JUNE GH¢'000	JULY GH¢'000	AUG GH¢'000	SEP GH¢'000	OCT GH¢'000
<b>Receipts</b>						
Accounts Receivable	100	100	120	140	160	180
<b>Payments</b>						
Accounts Payable	75	75	90	105	120	135
Van		15				
Corporate tax			25			
Operating costs	10	10	10	10	10	10
Advertising		20	10	10	10	
	85	120	135	125	140	145
Net Cash Flow	15	(20)	(15)	15	20	35
Opening Cash Balance	30	45	25	10	25	45
Ending Cash Balance	45	25	10	25	45	80

**Any 50 ticks @  
0.1 mark**

**[5marks]**

- f) Suggested ways of improving the cash situation of Richward Ltd
- Raising new capital
  - Ploughing back profits
  - Raising new loans
  - Leasing or renting non-current assets instead of buying them
  - Raising prices
  - Selling for cash
  - Asking for an extended period from creditors
  - Cutting down costs

**Any 5 points @ 1 mark**

**[5marks]**

**Total = [40marks]**

## **EXAMINER'S COMMENTS**

### *Case Study*

This was a compulsory question. Some of the areas examined included competitive forces, SWOT analysis, financial information for decision making and cash budget. The candidates did well in discussing the competitive forces and SWOT analysis. A few of them deviated and wrote on forces in the external environment instead of the competitive forces.

## **QUESTION TWO**

a.

### **MEMO**

**To:** The Chief Executive Officer

**From:** Management Accountant

**Date:**

**Subject:** Balanced Scorecard

### **Introduction**

This memo is to describe the four perspectives of the balanced scorecard and the major problems inherent in its application to corporate strategic management.

- i. **Description of the four perspectives of the balanced scorecard**
  - **Financial perspective** – The financial perspective of the balance scorecard answers the question, 'how do we as an organisation look to shareholders?' Thus, it addresses the question on how the organisation should create value for its shareholders in order to succeed financially. It covers traditional measures such as growth, profitability and shareholder value, with measures set through talking directly to the shareholders. Financial performance

measures indicate whether the company's strategy, implementation, and execution are contributing to bottom-line improvement.

- **Customer perspective** – The customer perspective of the balance scorecard is a means by which management translates its overall mission statement on customer service into specific measures that reflect the factors that really matter to customers. It answers the question of how the organisation should appear to its customers in order to achieve its vision. It helps management to pay attention to customers' concerns such as cost, time, quality, performance, reliability and service.
- **Internal business process perspective** – This perspective addresses internal business processes for which the organisation must excel at in order to meet or exceed customer expectations and achieve financial objectives. Internal measures for the balanced scorecard should stem from the business processes that have the greatest impact on customer satisfaction – factors that affect quality, employee skills, and productivity. It also attempts to identify and measure the organisation's core competencies and critical technologies needed to ensure continued market leadership.
- **Innovation and learning perspective** – This perspective is a means of recognising that the targets for success keep changing due to intense global competition and other environmental factors. Thus, it is an attempt to measure the continual improvement of the organisation with regards to existing products and processes. Thus, measures may include the ability of the company to introduce entirely new products with expanded capabilities as well as innovative processes that delivers better value to customers. In brief, it answers the question of how the organisation can continue to create value and maintain its competitive position through improvement and change. **(4 points @ 2 marks each = 8 marks)**

ii. **Major problems associated with the application of the balanced scorecard**

- **Conflicting measures** – The balanced scorecard sometimes presents conflicting measures. A typical example is research funding and cost reduction. While research is a means of ensuring innovation and learning it leads to cost accumulation which may reflect in high prices for customers. Thus, it is often difficult to determine the balance which achieves the best results.
- **Selecting measures** – Not only do appropriate measures have to be devised but the number of measures used must be agreed. Care must be taken that the impact of the results is not lost in a sea of information. The innovative

- **Expertise** – Measurement is only useful if it initiates appropriate action. Non-financial managers may have difficulty with the usual profit measures. With more measures to consider, this problem will be compounded. Measures need to be developed by someone who understands the business processes concerned.
- **Interpretation** – Even a financially-trained manager may have difficulty in putting the figures into an overall perspective.
- **Management commitment** – The scorecard can only be effective if senior managers commit to it. If they revert to focusing solely on the financial measures they are used to, then the value of introducing additional measures will be reduced. In this context, do not overlook the cost of BSC. There will be costs involved in data-gathering and in measuring the performance of additional processes.
- **Lack of aggregate performance measure** - The balance scorecard doesn't provide a single aggregate summary performance measure; for example, part of the popularity of ROI or ROCE comes from the fact that they provide a convenient summary of how well a business is performing.
- **No direct link with shareholder value** – In comparison to other measures used in value-based management (such as economic value added or EVA) there is no direct link between the scorecard and shareholder value.
- **Culture** – Introducing the scorecard may require a shift in corporate culture; for example, in understanding an organisation as a set of processes rather than as departments.
- **Imbalance between short-term and long-term perspective** - Implementing the scorecard will require an organisation to move away from looking solely at short-term financing measures, and focus on longer-term strategic measures instead. This usually leads to an imbalance between the long and short-term perspectives by management.

Signed

(Any 3 points @ 1.5 marks each = 4.5 marks  
[1.5 professional marks for correct presentation of memo])



- b. For objectives to facilitate the implementation of management by objectives (MBO) it should possess the 'SMART' characteristics. SMART is the mnemonics representing the following:
- i. **Specific:** An objective must be a clear statement of what the organisation is trying to achieve, and must be easy to understand. For an objective to enhance MBO, it should avoid any form of ambiguities. For example, managers may set an objective to increase sales, profit or customer satisfaction.
  - ii. **Measurable:** This means objectives should include some quantifiable element. This way, performance can be monitored and evaluated against the objectives. Measuring performance against objectives is a key element of control in organisation.
  - iii. **Achievable:** For MBO to be effective, targets set should always be realistic. If objectives set by management cannot be achieved, those required to achieve the target will not be motivated by it. It may even discourage them, because they know the target can never be reached anyway, no matter the level of effort they put in. To work well, employee must believe that their efforts can be successful.
  - iv. **Agreed:** Sometimes, the 'A' is explained as agreed. In this sense, objectives or targets set need to be the consensus reached by the different people who are involved in the process. There is no need to impose targets on employees since it could discourage them from making any attempt to achieve it. The essence of MBO is participative management.
  - v. **Relevant:** An objective is relevant if it relates to an organisation's mission, and will help it fulfill that mission. Thus, objectives must necessarily flow from the organisation's mission otherwise it will lead to avoidable conflicts in its achievement.
  - vi. **Realistic:** Sometimes, the 'R' is explained as realistic. In this regard, the explanation will be the same as in achievable/attainable.
  - vii. **Time-related:** All objectives or targets should state quite clearly when they should be achieved. Managers and/or employees need to know exactly how long they have so that they can plan accordingly. When objectives are time-specific, it enables management to judge whether or not the objective has been achieved. This characteristic also facilitates management function of control. For example, if an organisation has an objective 'To increase sales revenue by 5%' how will managers know the time period over which this sales increase is expected. **(Any 3 points @ 2 marks each = 6 marks)**

## EXAMINER'S COMMENTS

The first part of this question tested the candidates on the balance scorecard and the problems associated with its implementation. The Second part was on the qualitative characteristics of long range objectives. It was popular and the performance was good.

## QUESTION THREE

- a. Below is a **discussion** of the rational model for evaluating strategic options.
- i. **Suitability:** Suitability relates to the **strategic logic** of the strategy. The strategy must be consistent with the company's current strategic position and its operational circumstances. Suitability of strategic options can be viewed from many angles. For instance, a strategic option can be considered as suitable if it exploits company strengths and distinctive competences while rectifying internal weaknesses. Also, suitable strategies should neutralize or deflect environmental threats and help the firm to seize opportunities. They must fit with the company's mission and objectives.

Other questions to ask in evaluating the suitability of strategic options bother on whether they fill the gap identified by gap analysis and whether they generate or maintain competitive advantage over competitors. Management must also ensure that the strategy or strategies involve an acceptable level of risk as well as suit the politics and corporate culture.

It is important for a company to also consider three overall important strategic issues when assessing the suitability of an option.

- Does the strategy fit with any existing strategies which the company is already pursuing, and which it wants to continue to pursue?
  - How well does the option actually address the company's strategic issues and priorities?
  - Will the option contribute to a sustainable competitive advantage for the company, in the light of the competitive environment?
- ii. **Acceptability:** The acceptability of a strategy relates to whether the chosen strategy of the firm is acceptable to its stakeholders. The key stakeholders will be those with high power and high interest in an organization or a strategy. It is particularly important that any potential strategy is acceptable to these key stakeholders.

The level of risk and return associated with the strategy are likely to be critical in determining how acceptable it is. Some considerations in terms of evaluating the acceptability of strategy are discussed below:

**Financial considerations:** Strategies will be evaluated by considering how far they contribute to meeting the dominant objective of increasing shareholder wealth. The financial considerations of a chosen strategy would usually be evaluated using investment appraisal ratios and other benchmarks such as return on investment, profits, growth, earnings per share, cash flow, price/earnings and market capitalization.

**Customers:** It is important that the chosen strategy fulfills the expectations of customers. In other words, the strategy must produce value for customers at reasonable prices for it to succeed. Customers may object to a strategy if it means reducing service or raising price but, on the other hand, they may have no choice but to accept the changes.

**Staff** has to be committed to the strategy for it to be successful. If staff are unhappy with the strategy – or with any organisational changes which result from it – they could either resist the strategy, or else leave the organisation completely.

**Suppliers** have to be willing and able to meet the input requirements of the strategy for the strategy to be considered as acceptable.

**Government:** A strategy involving a takeover may be prohibited under legislation designed to prevent anti-competitive behaviour (e.g. the creation of monopoly). It is important to evaluate the chosen strategy in terms of whether it is acceptable within the framework of the law or government policy. Government regulations and policy may stem from tax laws, employment law, environmental laws, competition laws, etc.

**The public:** The environmental impact may cause key local stakeholders to protest. Will there be any pressure groups who oppose the strategy?

**Risk:** Different shareholders have different attitudes to risk. A strategy which changes the risk/return profile, for whatever reason, may not be acceptable.

- iii. **Feasibility:** Feasibility is a criterion that is used to evaluate whether the potential strategic option can in fact be implemented. It helps to answer the question, 'Is the strategy doable?' In this regard, it is important to assess

whether there is enough money as well as the ability to deliver the goods/services specified in the strategy. Management should also assess whether it has the ability to deal with the likely responses that competitors will make. Other questions that need answering in terms of assessing feasibility relates to whether the company has access to technology, materials and resources to carry through the strategy and whether there is enough time to implement the strategy.

Feasibility must be assessed using both quantitative and qualitative analysis. Quantitative approaches include funds flow analysis and breakeven analysis. Resource deployment analysis is a qualitative analysis that helps the organisation to make a wider assessment of feasibility in terms of resources and competences. The resources and competences required for each potential strategy are assessed and compared with those of the firm. In this regard, a two stage approach may be followed. The first is to find out whether the firm has the necessary resources and competences to achieve the threshold requirement for each strategy and secondly, whether the firm has the core competences and unique resources to maintain competitive advantage.

**[3 points well discussed @ 4 marks each = 12 marks]**

**b. (i) Management orientation and organisation for engaging in international business are as follows:**

1. Ethnocentrism orientation
2. Polycentrism orientation
3. Regiocentrism orientation
4. Geocentrism orientation

1. **Ethnocentrism orientation:** This is a home country orientation and it's based on the philosophy that the culture of the home country is superior to that of other countries. The approach, thus, ignores any inter-country differences which exist. Essentially, ethnocentric companies will tend to exhibit the following features:

- Market the same products with the same marketing programmes in overseas countries as at home.
- Centralize the marketing function in the home country
- Standardize the marketing mix
- Carry out no local market research or adaptation of promotion.

As a result of the above, market opportunities in the overseas markets may not be fully exploited and foreign customers may thus be alienated by the approach. Ethnocentric companies usually focus on its domestic market and sees exports as

secondary to domestic marketing. One significant advantage in using this approach is the economies of scale that accrues to the company.

2. **Polycentrism orientation:** The polycentrism orientation is based on a philosophy that is exactly in contrast with the ethnocentrism orientation. This orientation believes that each country's culture is unique. Based on this philosophy, the following features of polycentric companies become evident:
  - It adapts totally the product and the marketing programme to each local environment
  - It establishes largely independent local subsidiaries who are free to formulate their own objectives and plans
  - It decentralizes its marketing management function
  - It invests massively in marketing research in order to be responsive to the local markets.

The result of the above is major increases in turnover. However, loss of economies of scale can seriously damage profitability. Ethnocentric companies tend to think of themselves as having multiple identities, what is usually referred to as multinational corporations.

3. **Regiocentrism orientation:** This is a synthesis of ethnocentrism and polycentrism orientations. It is based on the philosophy that there are both similarities and differences between countries that can be incorporated into regional objectives and strategies. Thus, with the approach market segmentation is fulfilled on the basis of similarities in terms of regions. A regiocentric company will find economic, cultural or political similarities among regions in order to cover the similar needs of potential consumers. For instance, nations like India, Pakistan and Bangladesh possess a strong regional identity that can be exploited using same products and strategies. The significant features of regiocentric companies are:
  - It uses an integrated approach to marketing that is based on regional blocks.
4. **Geocentrism orientation:** This orientation is similar to regiocentrism orientation. The only difference is that it fails to recognise similarities and differences among regional blocks. Thus, the target of geocentric companies, also known as global companies, is to target consumers who have similar tastes and preferences wherever they may be found on the globe. The main idea of this approach is to borrow from every country what is best. It treats the issues of standardization and adaptation on their merits so as to formulate objectives and strategies that exploit markets fully while minimizing company costs. The aim is to create a global strategy that is fully

responsive to local market differences. The essential features of a global company are as follows:

- It uses an integrated approach to marketing management.
- It gives due consideration to each country's condition without allowing any specific country's culture or condition to dominate.

**(4 points @ 2 marks each = 8 marks)**

**(Total: 20 marks)**

### **EXAMINER'S COMMENTS**

This question was in two parts. Part (a) of the question examined candidates about the rational model for evaluating strategic options. In part (b), the candidates were required to explain management orientation and organization for engaging in international business as well as the drivers of change in globalization. The candidate did well in explaining the rational model for evaluating strategic options and the drivers of change for globalization. Most of the candidates could not explain the management orientation for engaging in international business. They rather wrote on marketing orientation. The points the candidates missed include:

1. Ethnocentrism orientation
2. Polycentrism orientation
3. Regiocentrism orientation
4. Geocentrism orientation

1. **Ethnocentrism orientation:** This is a home country orientation and it's based on the philosophy that the culture of the home country is superior to that of other countries. The approach, thus, ignores any inter-country differences which exist. Essentially, ethnocentric companies will tend to exhibit the following features:

- Market the same products with the same marketing programmes in overseas countries as at home.
- Centralize the marketing function in the home country
- Standardize the marketing mix
- Carry out no local market research or adaptation of promotion.

As a result of the above, market opportunities in the overseas markets may not be fully exploited and foreign customers may thus be alienated by the approach. Ethnocentric companies usually focus on its domestic market and sees exports as secondary to domestic marketing. One significant advantage in using this approach is the economies of scale that accrues to the company.

2. **Polycentrism orientation:** The polycentrism orientation is based on a philosophy that is exactly in contrast with the ethnocentrism orientation. This orientation believes that each country's culture is unique. Based on this philosophy, the following features of polycentric companies become evident:
- It adapts totally the product and the marketing programme to each local environment
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  - It decentralizes its marketing management function
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- It uses an integrated approach to marketing management.

- It gives due consideration to each country's condition without allowing any specific country's culture or condition to dominate.

## QUESTION FOUR

### a. Effective communication

The role of communication during strategy implementation is very critical to the implementation of strategy. Effective communication is needed for successful strategy implementation.

Communication is effective when it is directed to appropriate people who need to make certain decisions or use it to perform their routine tasks. Furthermore, it must be accurate, complete and timely and must convey meaning in a cost-effective manner. **(1 mark)**

- (i) Strategy has to be communicated to all stakeholders. It is important that proposed strategy is known and understood by all especially managers and employees. Understanding the strategy will enable them to accept their roles and become committed to its implementation. Inadequate information on adaptive changes, insufficient instructions and poor feedback on performance can reduce the success of strategy.
- (ii) Communication is required for planning, coordination and control.
  - Management decision-making requires data for planning. Managers are at the center of a communications system, providing or receiving data planning and implementation.
  - Interdepartmental coordination depends on information flows. All the interdependent systems for purchasing, production, marketing and administration can be **synchronized** to perform the right actions at the right times to cooperate in accomplishing the organisation's aims.
  - Through effective communication, employees receive instructions, rules and procedures in order to help them perform their tasks. Knowing what to do and why motivates and challenges them to their tasks and makes them more effective.
  - Distributors and customers must be aware of changes in product characteristics and new products being introduced into the market. The organization must



communicate the appropriate information on these issues to them in order to encourage the storage and use of the modified or new product.

- Shareholders must be informed of the introduction of a new strategy particularly as this may affect their dividends. The acceptance of the strategy by shareholders means that management has the authority to use their money in a desired manner and account for it.

**Any 4 points @ 1 mark  
(4 marks)**

### **Strategic and effective leadership**

Leadership involves influencing others to behave in a desired manner. Strategic leaders are needed to drive the organization towards the achievement of its strategies. Among others, strategic leaders must possess social skills, entrepreneurial skills and must be visionary.

**(1 mark)**

Their importance in strategic management evolves in the following functions:

- i) They clarify the strategic intent of the organization by helping stakeholders to embrace change. They do this by setting forth a clear vision for the organization.
- ii) Leaders shape and refine the organizational structure and make it function effectively to accomplish strategic intent.
- iii) Leaders also shape organizational culture. They promote values and beliefs that are useful to the current strategy.
- iv) They inspire confidence and energize their followers to enthusiastically achieve the organisation's mission.
- v) They assign responsibilities, allocate resources and supervise the performance of employees in a manner that helps the organization to achieve its strategic objectives.

**Any 4 points @ 1 mark (4 marks)**

### **b. Distinction among the three types of modular organisation structure**

- i. **Outsourcing:** Outsourcing involves an organisation contracting out certain internal business functions to a third party. In outsourcing, the external third party is located within the same country as the outsourcing entity. The outsourced function is usually considered be a non-critical activity within the value chain of the firm. A bank hiring out its security or cleaning services to external security or cleaning companies is a typical example of outsourcing.

- ii. **Offshoring:** Offshoring is a form of outsourcing. It, however, differs from traditional outsourcing to the extent that it involves an external entity – i.e. the third party – which is based in a different country that provides an organisation with a particular product or process which had previously been provided in-house. An example of Offshoring will be a financial institution operating in the United Kingdom but has a customer call centre operated in India.
- iii. **Shared servicing:** Shared servicing is an alternative to outsourcing. In this structure, an organisation establishes shared service centres to consolidate the transaction-processing activities of many operations with the organisation. Shared service centres aim to achieve significant cost reductions whilst improving service levels through the use of standardized technology and processes. A typical example of shared servicing would be a very large University that centralizes its IT support function or its HR support function instead of decentralizing among the various colleges of the University.

**(3 points @ 2 marks each = 6 marks)**

**Limitations of Offshoring are:**

- i) It can affect the quality of a firm's product or services offered since the use of third parties breaks the direct link between the firm and its customers.
- ii) It can lead to bad publicity to the firm in the home market when consumers perceive moves to offshore operations as leading to domestic jobs losses.
- iii) It could lead to loss of control since it increases the scope for third parties not to meet agreed service levels.

**(Any 2 points @ 2 marks each = 4 marks)**

**(Total: 20 marks)**

**EXAMINER'S COMMENTS**

This question was in three parts. Part (a) of this question required candidates to explain the importance of communication and leadership in strategic management. In part (b), the candidates were to explain meaning of the following concepts: outsourcing, offshoring and shared servicing. The final part (c) required the candidates to explain advantages and limitations of offshoring.

A good number of the candidates attempted this question and the performance was average. Most of the candidates could not explain shared servicing and the advantages and limitation of offshoring. The points the candidates could not explain include:

**Shared servicing:** Shared servicing is an alternative to outsourcing. In this structure, an organisation establishes shared service centres to consolidate the

transaction-processing activities of many operations with the organisation. Shared service centres aim to achieve significant cost reductions whilst improving service levels through the use of standardized technology and processes. A typical example of shared servicing would be a very large University that centralizes its IT support function or its HR support function instead of decentralizing among the various colleges of the University.

### **Advantages of Offshoring**

- i) It helps the firm to save costs.
- ii) It enables the firm to focus on its core activities.
- iii) It enables the firm to access and utilize the specific skills and other endowments of other countries which may not be widespread in its own countries.
- iv) It may increase the flexibility of a firm's operations as agreements with third parties to supply a service can be established for the short and long term.

### **Limitations of Offshoring**

- i) It can affect the quality of a firm's product or services offered since the use of third parties breaks the direct link between the firm and its customers.
- ii) It can lead to bad publicity to the firm in the home market when consumers perceive moves to offshore operations as leading to domestic jobs losses.
- iii) It could lead to loss of control since it increases the scope for third parties not to meet agreed service levels.

## QUESTION FIVE

a.

### REPORT

**To:** The Board of Directors

**From:** Corporate Affairs Manager

**Date:**

**Subject:** A Case for Corporate Social Responsibility

#### Introduction

Following the impasse among members of the board on the nature of the company's philosophy and strategy on corporate social responsibility, this report was commissioned to make a case for corporate social responsibility in order to help the board to formulate an appropriate CSR strategy. Below are the arguments in favour of CSR.

- i. **Customer expectations** - There is an increasing expectation from consumers and other stakeholders that businesses will act in a more socially responsible manner. This is a global expectation. For example, from the food they eat, to the coffee they drink and the clothes they wear, consumers are becoming more aware of the origins of the everyday things they buy, and they want to buy products that are responsibly sourced.

Given that one of the key success factors for a business is the ability to offer customers what they want, then offering products and services which are deemed to be socially responsible could help boost sales. In this respect, CSR could provide opportunities to enter new markets or develop new products.

- ii. **Brand name** - Being seen as socially responsible can help enhance a business's reputation and therefore its brand. Customers may prefer to deal with a business they feel is socially responsible rather than with one which is not. Therefore, CSR could actually be a source of differentiation for a business.
- iii. **Lower environmental costs** - If firms improve the efficiency of their energy usage, for example, then as well as making lower emissions they will also have lower cost bases. If firms can achieve a lower cost base through the efficient use of resources, this could help them create or improve their competitive advantage.  
More generally, firms could also find it is less costly to regulate their own activities voluntarily than ignoring social responsibility in the short term

and then having to comply with statutory regulations (in the form of taxes or fines, for example) which may be imposed on them later.

- iv. **Trade opportunities** - If firms are perceived as not being socially responsible, they may find it harder to attract trading partners, or support from nations and local communities where they might want to invest.
- v. **Access to staff** - Similarly, the way firms are perceived to treat their employees may affect their ability to attract staff. For example, firms that are perceived to offer good working conditions are likely to be able to appeal to a higher caliber of staff than firms which are perceived to offer unfavourable working conditions. In turn, a firm which is able to attract (and retain) high quality staff may be able to generate competitive advantage over a firm which is less able to recruit good quality staff.
- vi. **Investment and funding** - A firm's reputation may also affect its ability to attract finance, particularly from ethical investors. For example, obtaining a listing on the FTSE4Good (index of companies that meet globally recognised corporate responsibility standards) is likely to help a firm attract finance from ethical investors.
- vii. **Sustainable business** - Taken collectively, the arguments in favour of CSR suggest that a socially responsible business is likely to be able to operate for longer in society than a less responsible one. In turn, if the business can expect more years of cash flows in the future, it might be reasonable to expect the value of the company to be higher than that of one whose future is perceived to be less secure.

Signed

(Any 4 points @ 2 marks each = 8 marks)

(2 professional marks for correct presentation of a report)

b. **Strategies for managing corporate social responsibility**

- i. **Proactive strategy:** This is a strategy which a business follows where it is prepared to take full responsibility for its actions. It does so without being forced to do so by regulators and enforcing agencies. A company adopting this strategy would, thus, take steps to recall a product from the market after it discovers a fault in that product. It does this in order to avoid injury or damage to consuming public.
- ii. **Reactive strategy:** This strategy involves allowing a situation to continue unresolved until the public, government or consumer groups find out about it. Unlike the proactive strategy, a company employing the reactive

strategy will only withdraw a faulty product if it is forced to do so by regulators, the public or strong consumer groups – by which time the consuming public may have suffered some damage already.

- iii. **Defence strategy:** A company that adopts this strategy would take steps to minimize or attempt to avoid additional obligations arising from a particular problem which have occurred as a result of its negative actions.
- iv. **Accommodation strategy:** An accommodation strategy involves a company taking responsibility for actions, probably when one of the following happens:
  - Encouragement from special interest groups
  - Perception that a failure to act will result in government intervention

(Any 2 points @ 2 marks = 4 marks)

c. **Fundamental ethical principles**

In the first instance, the ethical issue at stake is **integrity**. Integrity ensures that professional accountants are straightforward and honest in all professional and business relationships. It also implies that accountants fair dealing and truthfulness. In this regard, presenting wrong or erroneous information that can misinform and mislead management will be a breach of the accountant's integrity.

While you, as a professional accountant, may have time to include the information in the management accounts, it is unlikely that you will be able to check its accuracy as well since you are constrained with time. Therefore, you risk misinforming the finance director of the month's sales which will constitute a breach of integrity.

In the second instance, the ethical issues at stake are **professional competence and due care**. Accountants have a continuing duty to maintain professional knowledge and skill at a level required to ensure that clients or employers receive competent professional service. It is expected of professional accountants to act diligently in accordance with applicable technical and professional standards when providing professional services.

With reference to the scenario, unless the employee is a tax expert, it is unlikely that he would have sufficient competence to calculate the tax liabilities. Providing financial advice may be a minefield, and one may need to be qualified under the financial services regulations before one could do so.

Even if the employee did have the required competence, it is probable that he could not offer due care as any advice he gives would be on-the-spot, and thus not have been able to look into the matter in enough detail.

**(2 points @ 3 marks each = 6 marks)**

**(Total: 20 marks)**

### **EXAMINER'S COMMENTS**

The first part of this question examined candidates on corporate social responsibility. The second part asked candidates to explain strategies for managing corporate social responsibility. The third part was on fundamental ethical principles.

The question was attempted by a good number of candidates and the performance was good, however, a few of them wrote on corporate social responsibility activities such as construction of roads, schools instead of the strategies.

### **QUESTION SIX**

- a. This question simply demands from students to explain **three (3)** advantages associated with a centralised administration office.

### **MEMO**

**To:** Chairman

**From:** Chief Operations Officer

**Date:**

**Subject:** Reasons for maintaining a centralised administration office

The following are reasons why the company should maintain its current centralised administration office structure:

- i. **Consistency** - Maintaining the current centralised administration office would continue to ensure consistency throughout the organisation with regards to administrative tasks. This consistency is needful in ensuring a common organisational identity and culture. For example, the current centralised administration structure ensures that the same account codes are used no matter which part of the organisation submits an invoice. This way, everyone uses the same data and information.
- ii. **Security and control** - The current centralised administration structure gives better security and control over operations and it is easier to enforce standards throughout the organisation.

- iii. **Economies of scale** – The current centralised administrative structure offers the advantage of economies of scale and thus contributes to the reduction of overhead costs. For example, in purchasing computer equipment for the entire organisation, lower prices can be bargained for in addition to other benefits since a greater purchase volume positions our company to bargain for lower prices.
- iv. **Better understanding of operations** – A centralised administration office puts Head Office in a better position to know and understand the operations of the other units within the regions. This facilitates a better strategic planning of the entire organisation.
- v. **Expert staff** – Since administration staff are in a single location more expert staff are likely to be employed. This ensures that career paths are more clearly defined than in a decentralised system.

Signed

**(Any 3 points @ 1.5 marks each = 6 marks)**  
**(1.5 professional marks for correct presentation of a memo)**

- b. A person, group or organization that has interest or concern in an organization. Stakeholders can affect or be affected by the organization's actions, objectives and policies.

### **Groupings of stakeholders**

When identifying stakeholders it is not enough to focus on the formal structure of the organisation. It is necessary to have a look at informal and indirect relationships too. There are a number of ways of classifying stakeholders according to criteria based on how stakeholders relate to organisational activities. A useful model for this purpose is to visualize the stakeholder environment as a set of inner and outer circles. The different classifications of organisational stakeholders are:

1. Internal and external stakeholders
2. Narrow and wide stakeholders
3. Primary and secondary stakeholders
4. Active and passive stakeholders
5. Voluntary and involuntary stakeholders
6. Legitimate and illegitimate stakeholders
7. Financial and Non-financial stakeholders

#### **1. Internal versus external stakeholders**

Here, stakeholders are distinguished depending on whether they are part of the organisation – i.e. have a formal working relationship with the organisation – or



are external to the organisation. Internal stakeholders include employees, management and board of directors, and possibly trade unions. External stakeholders include customers, competitors and suppliers. It could also include all other groups which do not form part of the internal organisation's structure.

## **2. Narrow versus wide stakeholders**

This classification describes the degree to which the stakeholder group is affected by the activities of the organisation.

*Narrow stakeholders* are used to describe stakeholders who are most affected or who are most dependent on organisational output. Examples of such stakeholders include shareholders, employees, management, customers and suppliers.

*Wide stakeholders*, on the other hand, refer to those who are less affected or dependent on the organisation's output. This category includes government and its agencies, the wider community and non-dependent customers.

## **3. Primary versus secondary stakeholders**

This classification distinguishes stakeholders based on the extent of influence of the organisation on the stakeholder and vice versa.

*Primary stakeholders* refer to stakeholders that have a direct influence on the company and without whom it would be difficult to operate. They are fundamental to the company's profitability and health. The government and its agencies, shareholders, board of directors, management and other employees as well as customers fall into this category.

*Secondary stakeholders*, in contrast, are those who have a limited direct influence on the organisation and without whom the company would survive – though with little success. They are generally described as groups that the company depend on for success. Secondary stakeholders describe relationships that arise because of specialised interests. Examples of secondary stakeholders include communities where companies are located, the media, lobbyists, competitors, etc.

## **4. Active versus passive stakeholders**

This classification distinguishes between those that seek to participate in organisational activity and those that do not.

*Active stakeholders* refer to those that wish to participate in the activities of the organisation. It includes management and employees, but may also include regulators, environmental pressure groups and suppliers.

*Passive stakeholders* describe those that do not wish to participate may include shareholders, local communities, government and customers.

#### 5. **Voluntary versus involuntary stakeholders**

This classification of stakeholders removes the element of choice associated with active and passive participation. It sub divides the active group into two elements.

*Voluntary stakeholders* refer to those stakeholders that choose to be involved in organisational decision making. It involves groups such as management, employees' environmental group and active shareholders. These stakeholders can withdraw their interest in the short-term.

*Involuntary stakeholders* are those that do not choose to be involved in organisational decisions, but become involved for a variety of reasons. This could include regulators, key customers, suppliers, government, natural environment and local communities. They cannot withdraw in the short-term to medium-term.

#### 6. **Legitimate versus illegitimate stakeholders**

This classification describes the degree to which the claim of the stakeholder is considered a valid claim. It can be a subjective classification with debate surrounding certain group's claims, and can lead into the concept of whether stakeholders are recognised by the organisation or not.

*Legitimate stakeholders* are those who have an active economic relationship with an organisation, such as customers and suppliers, are called.

*Illegitimate stakeholders* are those without such a link where there is no case for taking their views into account when making decisions are called. Typical examples of such group are terrorist organisations.

#### 7. **Financial versus Non-financial stakeholders**

*Financial Stakeholder:* They are those with a financial relationship with the organisation, in other words should financial problems occur to the organisation, then these stakeholders will suffer. Examples are shareholders and other investors, creditors and suppliers.

*Non-Financial Stakeholders:* They're interested in how the organisation behaves and are often more powerful than the financial stakeholders due to the influence they have over it. Examples are Media, Activist groups and Regulators.

(1 mark for explanation of stakeholders and 1.5 marks each for any correct categorization of stakeholders = 4 marks)

c. **Determinants of barriers of entry to potential new entrants into an industry**

- i. **Economies of scale:** High fixed costs often imply a high breakeven point, and a high breakeven point depends on a large volume of sales. If the market as a whole is not growing, new entrants into the industry would have to capture a large slice of the market from existing competitors. This is expensive. Thus, if significant scale economies are already enjoyed by existing firms, potential new entrants experience strong barrier to entry into the industry.
- ii. **Product differentiation:** The degree to which existing firms have succeeded in differentiating their respective products or services from the competition determines how strong the barrier to entry for potential new entrants. Existing firms may have built up a good brand image and strong customer loyalty over a long period of time. A few firms may promote a large number of brands to crowd out the competition.
- iii. **Capital requirements:** The amount of capital required to enter an industry determines the extent of difficulty new entrants face in their quest to enter the industry. When investment requirements are high, the barrier against new entrants will be strong, particularly when the investment would possibly be high-risk.
- iv. **Knowledge requirements:** As well as high capital requirements, knowledge and know-how are also a barrier to entry. It is much more difficult to enter an industry which requires significant specialist knowledge, and skills, than an industry where no specialist skills are required.
- v. **Switching costs:** Switching costs refer to the costs that a customer would have to incur by switching from one supplier's products to another's. Switching costs is a composite of three costs namely: time, money and convenience. Switching costs are usually higher for industries with greater extent of product differentiation. If switching costs are high, new entrants into the industry experience a strong barrier to entry since they have to invest heavily in differentiating their product and also creating awareness for its products so as to build its own loyal customers. The barrier is even stronger where the market is saturated.
- vi. **Access to distribution channels:** Distribution channels carry a manufacturer's products to the final consumer. New distribution channels

are difficult to establish and existing distribution channels hard to gain access to. Existing distributors are usually reluctant to accept new products to market since they are unsure of their acceptability and patronage by the final consumers. Thus, usually potential new entrants face significant barriers to entry where access to distribution channels is difficult.

- vii. **Cost advantage of existing producers, independent of economies of scale:** Sometimes existing producers in the industry enjoy significant cost advantages which are independent of economies of scale such as patent rights, experience and know-how effects, government subsidies and regulations and favoured access to raw materials. If these advantages are significant for existing producers it contributes to the strength of barrier to entry for new entrants. Existing producers find it easier to engage in price wars to ward of potential new entrants.

**(Any 5 points @ 2 marks each = 10 marks)**  
**(Total: 20 marks)**

#### **EXAMINER'S COMMENTS**

The first part of this question asked candidates to explain four advantages associated with a centralized organization structure. The second part examined candidates on the determinants of barriers of entry to potential new entrants into an industry. A good number of the candidates attempted this question and the performance was generally good.