MAY 2018 PROFESSIONAL EXAMINATIONS
CORPORATE STRATEGY, ETHICS & GOVERNANCE (PAPER 2.6)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

STANDARD OF THE PAPER

The standard of the paper was good. It compares favourably with those of previous sittings. 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

The performance was below expectation especially as all the questions were within the scope of the syllabus. There was no significant improvement in the candidate's performance. Some of the candidates performed poorly because it was evident from their scripts that they did not prepare very well for the examination. It appears most of the candidates did not read the study manual.

NOTABLE STRENGTHS AND WEAKNESS OF CANDIDATES

The main strength was that almost all the candidates attempted the required number of questions. A few of them demonstrated good understanding of the subject matter. The weakness of the candidates was that some of them provided incorrect responses to questions. Another weakness is problem of transfer of learning. In question one for example, most of the candidate could not compute basic financial ratios as indicators of financial soundness or otherwise of the two failed banks.

QUESTION ONE

SHOCKS IN THE GHANAIAN BANKING INDUSTRY

Introduction

The news on August 14, 2017 to the effect that the licenses of two indigenous banks - UT Bank and Capital Bank have been revoked came as a surprise to the Ghanaian business community, since the two banks had won numerous awards for performing well in the industry. The two banks were taken over by GCB Bank Ltd. In the 2011 Ghana Banking Awards, UT Bank was adjudged the Bank of the year. Capital Bank was also adjudged the Best Growing Bank, and Best Bank in Deposits & Savings in 2016. A press statement issued by Bank of Ghana (BoG) read in part as follows: "The Bank of Ghana has revoked the Licences of UT Bank Ltd and Capital Bank Ltd. This action has become necessary due to severe impairment of their capital. The two banks have high non-performing loans. UT Bank and Capital Bank were deeply insolvent, meaning that their liabilities exceeded their assets, putting them in a position not to be able to meet their obligations as and when they fell due". This revocation was in line with Section 123 of the Banks and Specialised Deposit Taking Institutions (SDIs) Act 2016 (Act 930). The Act states that "when a bank is in distress, the Bank of Ghana revokes its license, possesses the bank, appoints a receiver and then put it up for sale". In this case, GCB Bank Ltd acquired the banks, while Bank of Ghana appointed PricewaterhouseCoopers (PWC) as the receiver.

To avoid a run on other banks and to minimise instability in the financial sector, all deposits and selected assets of the two Banks were transferred to GCB Bank Ltd, thereby assuring the depositors of their funds. The combined deposits of the two banks were estimated to be over GH¢2 billion, which far exceeds available liquid assets

As at the close of February 28, 2018, GCB Bank Ltd had successfully completed the full integration of the systems of the erstwhile UT Bank and Capital Bank by retaining 22 out of the 53 branches based on their location and accessibility to customers as well as absorption of more than half of permanent staff of those Banks. The acquisition of the two failed Banks by GCB Bank has increased its branch network across the country to 183.

The Ghanaian Banking Industry

The number of banks operating in Ghana had increased from 25 in 2010 to 34 as at the close of 2017. To outwit increasing competition in the industry, a wide array of products and services are being offered by the banks in order to attract customers. The accounts opening process has been simplified across the industry and makes it easier to open account with any bank. The non-banking financial institutions are offering higher returns/yields on deposits compared to that of the banks making deposit mobilization in the industry more difficult and expensive. However, the rates offered by the commercial banks on loans are, generally much lower than that available in the non-banking financial services segment. The major risk facing the industry is the quality of assets (loans), as reflected in high Non-Performing Loans (NPL) ratio, which edged up from 17.3% to 22.7% in December 2016 and 2017 respectively. In response to worsening NPL ratio, banks are tightening credit risk stance by cutting back on loans and advances portfolio and redirecting the funds to the money market and government securities even though the rates on those securities have been trending downward from 2017.

Another significant change in the industry is the switch from IAS 39 to IFRS 9 Financial Instrument – recognition and measurement effective January 1, 2018. The new standard changes measurement of impairment from historical credit loss to expected credit loss model, which recognises life-time expected credit loss based on forward looking information. This is anticipated to result in higher provision for loan losses and further impairment of the capital of banks.

Extract of selected Financial Soundness Indicators of the Ghanaian Banking Industry for the year end 2014 was as follows:

	%
Net interest income growth	12.7
Cost to income ratio	56
Asset utilization ratio	8.8
Return on Equity	30.8
Profit after tax growth	66.5

The rise and fall of UT Bank and Capital Bank

The two defunct banks started as non-banking financial institutions and, subsequently, acquired banking license. They entered the banking landscape with legacies of expensive funds and huge NPL, making them less competitive. Since the collapse of the two banks, the media space has been agog with discussions by financial experts on the reasons for the failure of the two banks. Questions have been asked of the regulatory and supervisory role of the Bank of Ghana, since the failure was not an event, but a failure of processes over time. The integrity of the clean audit opinions issued by the external auditors on the two banks over the years have been questioned. At the time of the collapse in 2017, the two defunct banks had for the previous year not published their financial statements.

Below is extracts of the financial statements of one of the defunct banks.

Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2014.

	2014	**2013**
	GH¢000	**GH¢000**
Interest income	226,346	187,888
Interest expense	(154,022)	(116,231)
Net interest income	72,324	71,657
Net fees and commissions income	28,517	34,865
Other operating income	42,710	18,051
Operating income	143,551	124,573
Operating expenses	(99,962)	(87,045)
Impairment charge	(26,934)	(24,110)
Profit before taxation	16,665	13,418
Taxation	(4,881)	(2,980)
National Stabilisation levy	(819)	(681)
Profit for the year	10,955	9,757
Other Comprehensive income		
Total Comprehensive income	10,955	9,757

Statement of Financial Position as at 31 December, 2014

	2014 GH¢000	2013 GH¢000
Cash and balances with Bank of Ghana	128,818	103,835
Due from other Banks and financial institutions	55,119	73,639
Loans and advances (Net)	1,197,423	917,053
Other assets	78,132	56,553
Income tax assets	469	2,061
Investment securities	124,489	135,296
Goodwill	10,397	10,397
Property, plant and equipment	27,434	30,426
Intangible assets	6,131	7,096
Total assets	1,628,412	1,336,336
Total current liabilities	1,272,056	1,056,994
Non-current liabilities	217,935	150,672
Total liabilities	1,489,991	1,207,666
Total shareholders' fund	138,421	126,670
Total liabilities and shareholders' fund	1,628,412	1,336,336

Regulator's action

Some recent measures by the Bank of Ghana to address vulnerabilities in the financial sector include: increase of minimum capital from GH¢120 million to GH¢400 million effective December 31, 2018 and a temporary freeze on issuance of new licenses in 2018. In July 2016, the Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930) was passed by Parliament to tighten regulation of the banks. The Act limits the powers of Bank of Ghana in granting waivers to the banks, especially single obligor, which limits the risk of exposure to a single customer. Again, the Act imposes heavier sanctions for regulatory breaches.

To improve the quality of risk management, corporate governance and internal control practices in the banks, Bank of Ghana has issued directive to the banks to implement Basel II/III Capital Framework effective June 30, 2018. This imposes stringent requirements for capital measurement.

Addressing the annual dinner of the Chartered Institute of Bankers (Ghana) on December 2, 2017, the Governor of the Bank of Ghana made some remarks about the failure of the two defunct banks. Exhibit 1 below contains portions of the said speech.

Exhibit 1

"Despite the improved regulatory environment and supervisory frameworks, we have witnessed the dissolution of two banks this year. While no systemic challenges to the financial sector arose from the dissolution, it is useful to understand the underlying factors and reposition the sector to avoid the same mistakes in the years ahead.

Let me be upfront and say that though the failure of the two banks was due to significant capital deficiencies, the underlying reason was poor corporate governance practices within these institutions. In this instance, we saw the dominant role of shareholders who exerted undue influence on management of the banks, leading to poor lending practices. This was also reinforced by weak risk management systems and poor oversight responsibility by the

boards of directors. Some of the examples of recklessness that led to the failure of the two banks include:
Co-mingling of the banks' activities with their related holding companies. For instance, one bank was paying royalties for the brand name, even at a time that the bank's financial performance was abysmal and could not pay dividends. Interestingly, the royalties were approved by four (4) out of seven (7) members of the Board without the consent of the other significant minority shareholders including an International Financial Institution. As a result, the international institution placed a notice on its website abrogating all relationships with the Bank and this led to most of the foreign lenders cutting off their credit lines to the Bank and recalling their credits thereby creating serious liquidity squeeze to the bank.

Also, very high executive compensation schemes were being operated by the affected banks which were not commensurate with their operations. The risk and earnings profile of the banks could not support the compensation schemes.

Non-Executive Directors of the banks compromised their independence and fiduciary duties to serve as checks on Executive Directors. This was because rewards such as business class air tickets were being granted to them annually.
Interference by Non-Executive Directors in the day-to-day administration of the banks weakened the management oversight function of executive directors. Some non-Executive Directors were also acting as consultants to the same banks with no clear mandate, which gave rise to conflict of interest situations.

Non-adherence to credit management principles and procedures as the banks were heavily exposed to insiders and related parties. There was also no evidence of interest payments on these investments. The investments were therefore impaired, but some members of the Board at the time accepted the responsibility to pay off the said amount through a board resolution.
Diversion of funds to holding companies and their related parties was widespread. In the case of one Bank, placements could not be traced to the bank's records though some customers showed proof of their investments with the Bank. Irregular board meeting also accounted for the weaknesses in the board oversight.

In all of these cases, one thing was clear, and that is, the banks could not delineate themselves from their past practices as finance houses. They followed the same practice of borrowing from high net worth persons at a very high costs without any plans to bring themselves in line with the industry norm"

Required:

a) Assess the ***social, legal and economic*** environment of the Ghanaian banking industry. **(9 marks)**

b) Discuss **FOUR** corporate governance practices that the Directors of the two defunct banks failed to adhere to. **(10 marks)**

c) Using the selected Financial Soundness Indicators of the banking industry as benchmark, assess the ***operational efficiency*** and ***profitability*** of the selected defunct bank for the year end 2014 based on the financial statements above. **(15 marks)**

d) What role could the Board Audit Committee have played to avert the collapse of the banks? **(6 marks)**

(Total: 40 marks)

QUESTION TWO

a) You have been recently employed as a Finance Manager of a large manufacturing company. At its first management meeting, the Director of Finance presented information on management's intention to takeover one of the company's key suppliers. An old school friend of yours works as an accountant for the targeted company. The Finance Director knows and has asked you to try and find out anything that might help the takeover, but it must remain confidential.

Required:
Identify and explain **THREE** ***fundamental ethical principles*** that could be breached in the above scenario. **(12 marks)**

b) Corporate social responsibility (CSR) requires that organisations give back to the society by way of investing part of their profits in socio-economic activities of their host communities. Companies adopt different strategies to realising their CSR obligations to the host communities.

Required:
Identify and explain **FOUR** strategies for managing Corporate Social Responsibility in organizations. **(8 marks)**

(Total: 20 marks)

QUESTION THREE

a) Addie Supermarket Ltd. is a large supermarket chain operating in six regions in Ghana. It is the vision of management to make Addie Supermarket a household name in South Sahara Africa within the next ten years. In its last management meeting, the following objectives were set in pursuant to its vision:

- To ensure the loyalty of its customers – i.e. to generate lifetime loyalty.
- To ensure its prices are at least 2 percent cheaper than the average of rival supermarkets – i.e. to create value for customers.

Required:

i) Identify **TWO** critical success factors (CSFs) for each of the above objectives set by Addie Supermarket management. **(4 marks)**

ii) In order to measure how well it is performing against the CSFs, the supermarket needs to set key performance indicators (KPIs). For each of the CSFs identified above, identify **TWO** KPIs to aid management in tracking the delivery of the CSFs. **(6 marks)**

b) Effective implementation of corporate strategies in an organization is largely dependent on how well organizational members understand the chosen strategies. However, the desirability of the direct announcement of a strategy depends on several factors.

Required:
Identify and explain **FOUR** factors that should be considered before choosing an approach to communicate corporate strategy in an organization. **(6 marks)**

c) Protecting the physical environment by business organizations comes with costs that can be very significant to deal with. Notwithstanding, environmental protection will yield enormous long-term benefits for business organizations.

Required:
Explain **TWO** ways in which business and environmental benefits can be achieved.

(4 marks)
(Total: 20 marks)

QUESTION FOUR

a) Ghana's model of corporate governance is based on the UK model, which is a single, or unitary board. The unitary board is made up of a mix of executive and non-executive directors. All directors have the right to participate in board decision making. Other countries operate dual board model (for example, Germany, which has a management board and a supervisory board) or even a three-board model, which operates in Japan. All participants in the single board have legal responsibility for management of the company and strategic performance.

Required:
Compare and contrast ***unitary board structure*** and ***dual board structure***. **(12 marks)**

b) The intensity of competition among rival firms within an industry will affect the profitability of the industry as a whole. Within the past decade, the Ghanaian telecommunication industry has witnessed intense competition, taking several forms. You are a strategic management consultant and have been invited as guest lecturer in one private university to discuss the intensity of competition among rival firms in the telecommunication industry.

Required:
Discuss **FOUR** factors that could be responsible for the intensity of competition among rival firms within the telecommunication industry in Ghana**.** **(8 marks)**
(Total: 20 marks)

QUESTION FIVE

a) The Agyasco Banking Group recently reported that it was offshoring (moving) its back-office operations from Ghana to South Africa where it already has some significant operations. Centralising most back-office operations in South Africa is part of the Group's plan to grow its international banking business. South Africa is one of the fast emerging economies.

According to an Agyasco Banking Group spokesperson, the move would involve cutting about 500 jobs from its operations in Ghana, but generating a similar number of new jobs in South Africa where it already employs 3,000 people.

Required:

i) Critically assess the ***advantages*** and ***associated problems*** for Agyasco Banking Group of offshoring its back-office operations to an emerging country. **(12 marks)**

ii) Identify **FOUR** roles that the Group's Human Resources Division can play when dealing with employees who cannot be redeployed following the offshoring of its back-office operations. **(4 marks)**

b) Marketing activities within an organization can be grouped broadly into four roles.

Required:
Explain **TWO** broad roles of marketing activities within an organization. **(4 marks)**
(Total: 20 marks)

QUESTION SIX

a) Transformational leaders have been posited to impact an organization's culture, structure, and strategy. These types of leaders manifest themselves as change catalysts, who manipulate organizational factors with the aim of improving knowledge cycles.

Required:
Explain **FOUR** expectations of leaders in strategic management. **(8 marks)**

b) One of the criticisms levelled against the five competitive forces model is that it is static – i.e. it does not focus on the dynamic nature of the business environment. Thus, two other concepts that are proposed to deal with competition dynamics are the concepts of strategic group analysis and the cycle of competition.

Required:
Explain the concept of ***strategic group analysis*** and identify **THREE** examples of common strategic characteristics that define a strategic space. **(6 marks)**

c) Demand conditions in the home market is one of the four factors in the Porter's Diamond Model used for analysing the international environment before formulating an international strategy. The home market determines how firms perceive, interpret and respond to buyer needs.

Required:
Explain **THREE** home conditions that may put pressure on firms to innovate and provide a launch pad for global ambitions. **(6 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) Assessing the social, legal and economic environment of the Ghanaian banking industry

The environment of an organisation is a set of factors/influences both inside and outside of an organisation which determine its competitive advantage. Social, legal and economic factors are those outside of the organisation for which management has no control over. These factors set constraints on what the organisation can do.

Social Environment

- Social factors influence demand indirectly. The number of banks operating in Ghana had increased from 25 in 2010 to 34 as at the close of 2017. The general level of prosperity influences the number of people in the population who can save at banks, rising incomes and wealth means more can be saved at the banks after spending.
- Changes in pattern of demand of customers resulting in a wide array of products and services being offered by the banks to attract customers. Thus, customers new preferences for diverse banking products is exerting pressure on the banks in the industry to respond accordingly by fashioning out new products to meet consumer needs.
- There are some perception problems associated with saving at banks, with the collapse of these two banks, it will affect the savings culture of the population.

(Any 2 points for 3 marks)

Legal Environment

- The banking industry is a regulated environment which is regulated by the Bank of Ghana. Some recent measures by the Bank of Ghana include: increase of minimum capital from GH¢120 million to GH¢400 million effective December 31, 2018 and temporary freeze on issuance of new licenses.
- In July 2016, the Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930) was passed by Parliament to tighten regulation of the banks. The Act imposes heavier sanctions for regulatory breaches.
- To improve the quality of risk management, corporate governance and internal control practices in the banks, Bank of Ghana has issued directive to the banks to implement Basel II/III Capital Framework effective June 30, 2018. This imposes stringent requirements for capital measurement.

(Any 2 points for 3 marks)

Economic Environment

The economic environment affects firms at national and international level, both in the general level of economic activity and in particular variables.

- Government securities and money market offer a favourable returns in the banking industry than loans and advances. This is seen from the fact that, in response to worsening NPL ratio, banks are tightening credit risk stance by cutting back on loans and advances portfolio and redirecting the funds to money market and government securities.

- The High Non-Performing Loans represents a decline in growth in economic activity. Businesses and individuals are not able to repay their loans as they fall due.
- Access to credit – given that the non-performing loans are on the increase banks have responded by cutting back on the loans/credit to private sector. This action in medium to long term will affect the overall economic growth since private sector, considered as engine of growth, will not have access to credit to expand and grow.
- Unemployment and purchasing power – the affected staff of the two banks who have become unemployed would be affected in terms of their purchasing power until such time that they are able to secure new jobs.

(Any 2 points for 3 marks)

b) Good Corporate Governance practices that the defunct banks failed to adhere to

- **Adequate Supervision**
  Employees who are not properly supervised by the board can create large losses for the organisation through their own incompetence, negligence or fraudulent activity. Interference by Non-Executive Directors in the day-to-day administration of the banks weakened the management oversight function of executive directors. Some non-Executive Directors were also acting as consultants to the same banks with no clear mandate, which gave rise to conflict of interest situations. Non-Executive Directors of the banks compromised their independence and fiduciary duties to serve as checks on Executive Directors. This was because rewards such as business class air tickets were being granted to them annually.

- **Non-Dominant role of shareholders**
  A feature of many corporate governance scandals has been boards dominated by a single senior executive with other board members merely acting as a rubber stamp. In the case of these two defunct banks, there was the dominant role of majority shareholders who exerted undue influence on management of the banks, leading to poor lending practices.

- **High Involvement of board**
  Boards that do not meet regularly or that fail to systematically consider the activities and risks of an organisation are clearly weak. For instance, one bank was paying royalties for the brand name, even at a time that the bank's financial performance was abysmal and could not pay dividends. Interestingly, the royalties were approved by four (4) out of seven (7) members of the Board **without the consent of the other significant minority shareholders including an International Financial Institution**. As a result, the international institution placed a notice on its website abrogating all relationships with the Bank and this led to most of the foreign lenders cutting off their credit lines to the Bank and recalling their credits thereby creating serious liquidity squeeze to the bank.

- **Good oversight of accounts and audit**
  A lot of governance guidance has been concerned with defining effective internal control. At the time of the collapse in 2017, the two defunct banks had for the previous year not published their financial statements. Also, very high executive compensation schemes were being operated by the affected banks which were not commensurate with their operations.

- **Adequate control function**
  An obvious weakness is a lack of internal audit. Non-adherence to credit management principles and procedures as the banks were heavily exposed to insiders and related parties. There was also no evidence of interest payments on these investments. The investments were therefore impaired, but some members of the Board at the time accepted the responsibility to pay off the said amount through a board resolution. Diversion of funds to holding companies and their related parties was widespread. In the case of one Bank, placements could not be traced to the bank's records though some customers showed proof of their investments with the Bank

(4 points well explained at 2.5 marks each=10 marks)

c)
Appendix of ratios of selected Financial Soundness Indicators

	Formula	**Industry**	**2014**	**2013**
Net interest income growth	Percentage change in net interest income (Current year-Previous year)/ Previous year * 100	12.7%	(72,324-71,657)/71,657*100 0.93%	
Cost to income ratio	Operating expenses/ operating income *100	56%	99,962/143,551 * 100 = 69.64%	87,045/124,573 *100 = 69.87%
Asset utilisation ratio	Interest income/ total assets * 100	8.8%	226,346/1,628,412 * 100 = 13.89%	187,888/1,336,336 *100 = 14.05%
Return on Equity	Profit for the year/ Shareholders equity * 100	30.8%	10,955/138,421 * 100 = 7.91%	9,757/126,670 * 100 = 7.7%
Profit after tax growth	Percentage Change in profit for the year ((Current year-Previous year /Previous year)) * 100	66.5%	(10,955-9757)/9757 * 100 = 12.28%	

(5 marks evenly spread using ticks)

Operating Efficiency
Operating efficiency ratios are typically used to analyse how well a company uses its assets and liabilities internally. An efficiency ratio can calculate the turnover of

receivables, the repayment of liabilities, the quantity and usage of equity, and the general use of inventory and machinery. This ratio can also be used to track and analyse the performance of commercial and investment banks.

An efficiency ratio measures a company's ability to use its assets to generate income. Ratios in the Financial Soundness Indicators that can be used to assess the Operational efficiency are cost to income ratio and asset utilisation ratio.

(1 mark)

- **Cost to income ratio**

The cost-to-income ratio is a key financial measure, particularly important in valuing banks. It shows a company's costs in relation to its income. The ratio gives investors a clear view of how efficiently the firm is being run – the lower it is, the more profitable the bank will be.

There was an insignificant improvement in the cost to income ratio from 69.87% in 2013 to 69.64% in 2014 but still compares unfavourably to the industry average 56%. This suggests that the defunct banks were operating less profitably than the banking industry as costs are rising at a higher rate than income which could suggest that the banks were less efficient in driving down their operating cost to match the falling operating income.

This could have been improved by reducing labour costs, implementing more efficient operations by adopting technology-driven solutions, and increase sales and income.

(2 marks)

- **Asset utilisation ratio**

The asset utilization ratio calculates the total revenue earned for every cedi of investment in assets. This ratio is frequently used to compare a company's efficiency over time. Asset utilisation ratio is an analytical tool that identifies whether company is effectively putting assets to work in terms of income generation of or not.

In 2013, the asset utilisation was 14.05% and it reduced to 13.89%. This means that the defunct banks earned GH¢0.14 for every cedi invested in assets and it earned GH¢0.1389 for every cedi invested in 2014. This suggests that the defunct banks were more efficient in using assets compared to the industry average ratio of 8.8% of GH¢0.088 per cedi invested. Banks in the industry are earning as low as GH¢0.08 for every cedi invested.

(2 marks)

Profitability

Profitability ratios are financial metrics used by businesses to measure and evaluate their ability to generate income (profit) relative to revenue, balance sheet assets, operating costs, and shareholders' equity during a specific period of time. They show how well a company utilizes its assets to produce profit and value to shareholders.

A higher ratio or value is sought-after by most companies, as this would mean the business is performing well by generating revenues, profits, and cash flow. Ratios in the Financial Soundness Indicators that can be used to assess the Profitability of the defunct bank are Return on Equity, profit after tax growth and net income growth.

(1 mark)

Return on Equity (ROE)

Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. A rising ROE suggests that a company is increasing its ability to generate profit without needing as much capital. It also indicates how well a company's management is deploying the shareholders' capital.

There was an insignificant increment in ROE from 7.7% in 2013 to 7.9% in 2014. This signifies how bad the banks were in generating returns on the investment it received from its shareholders as compared to the industry average of 30.8%. The defunct banks could not have attracted investors compared to the other banks in the industry hence the ultimate failure.

(2 marks)

Profit after tax growth

The net amount earned by a business after all taxation related expenses have been deducted. The profit after tax is often a better assessment of what a business is really earning and hence can use in its operations than its total revenues.

A company's profit after tax is significant because it shows how well a company controls its costs. A high profit after tax growth generally indicates that a company runs efficiently, providing more value, in the form of profits, to shareholders. The defunct banks performed poorly (12.28%) in terms of their ability to grow profit in subsequent year compared to the industry average of 66.5%. This suggests the defunct banks were not run efficiently in terms of controlling its costs, providing more value for shareholders and making profits.

(1 marks)

Net interest income growth

Net interest income is the difference between the revenue that is generated from a bank's assets and the expenses associated with paying out its liabilities. A typical bank's assets consist of all forms of personal and commercial loans, mortgages and securities. The liabilities are the customer deposits. The excess revenue that is generated from the interest earned on assets over the interest paid out on deposits is the net interest income.

Net Interest Margin measures the effectiveness of a bank's investment decisions, particularly for financial institutions. The net income growth for the defunct banks is 0.93% which compares unfavourably to the industry average of 12.7%. This indicates that the defunct banks have been achieving increasingly lower returns/margins on their assets resulting from non-performing loans, while failing to attract cheaper deposits in form of demand and savings account. The reduced net interest margins ultimately impacted negatively on the defunct banks resulting in their failure.

(1 marks)

d) Roles the Board Audit Committee could have played to avert the collapse of the banks

- Determining that the company internal controls are effective and formally reporting on the status of those controls on an annual basis with quarterly updates.
- Taking action, where appropriate, on significant control weaknesses reported by internal audit, the external auditors, and others.
- Reviewing and distributing the audited financial statements submitted by the outside auditor. This includes initiating appropriate actions based on any recommendations by the outside auditor or the Director of Internal Audit.
- Circulating a Code of Ethics to senior officers and obtaining their assent on a quarterly basis.
- More clearly demonstrate the effectiveness and value of its oversight of the selection, independence, performance and quality of the audit and the auditor to shareholders and other stakeholders.

(Any 2 roles for 6 marks)

(Total: 40 marks)

EXAMINER'S COMMENTS

Case Study

- Most of the candidates did well in part (a) of the question on the assessment of the social, legal and economic environment of the Ghanaian banking industry. Most of the candidates were also able to discuss corporate governance practices that the two defunct banks failed to adhere to.
- The worse performance was in the part (c) of the question where the candidates were required to assess the operational efficiency and profitability of the two banks. It was shocking that majority of the candidate did not answer this part of the question and the few who attempted it produce poor answers.
- There was a good attempt at part (d) of the question which dealt with the role the Board Audit Committee could have played to avert the collapse of the two banks.

QUESTION TWO

a)

- Conflict of interest
- Deception
- Unprofessional behaviour

(3 marks)

- First, you have a **conflict of interest** as the finance director wants you to keep the takeover a secret, but you probably feel that you should tell a friend what is happening as it may affect their job.
- Secondly, the finance director is asking you to **deceive** your friend. Deception is **unprofessional behaviour** and will break your ethical guidelines. Therefore, the situation is presenting you with two conflicting demands. It is worth remembering that no employer can ask you to break your ethical rules.
- Finally, the request to break your own ethical guidelines constitutes **unprofessional behaviour** by the finance director. You should consider reporting him to their relevant body.

(3 points @ 3 marks each = 9 marks)

b) Strategies for Managing CSR

- **Proactive strategy**- strategy which a business follows where it is prepared to take full responsibility for its actions. A company which discovers a fault in a product and recalls the product without being forced to, before any injury or damage is caused, acts in a proactive way.

- **Reactive strategy** - This involves allowing a situation to continue unresolved until the public, government or consumer groups find out about it. The reactive strategy refuses all kind of CSR and then does not implement what the stakeholders expect.

- **Defence strategy** - This involves minimising or attempting to avoid additional obligations arising from a particular problem. The defensive strategy accepts the idea of some CSR but defines and implements only the minimum of what stakeholders expect.

- **Accommodation strategy** - This approach involves 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. The accommodating strategy integrates CSR and tries to implement what the stakeholders expect. The proactive strategy anticipates the requirements and expectations of the stakeholders, it defines objectives and implements actions going beyond what stakeholders require (this is the case of the linked and integrated CSR).

(Four 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 three fundamental ethical principles that could be breached using the scenario given in the question. This part was poorly answered by the candidates. The part (b) which asked the candidates to explain four strategies for managing Corporate Social Responsibility in organisations was well answered by the candidates.

QUESTION THREE

a) The following critical success factors should help management achieve the above objectives:

(i) **To ensure the loyalty of its customers** – i.e. to generate lifetime loyalty the following CSFs should be addressed:

- Stocking the goods that customers most want to buy
- Making the shopping experience as pleasant as possible/differentiating the shopping experience from that of other supermarkets to lock in customers.
- Making the supermarket more accessible to customers by establishing out-of-town outlets
- Etc.

To ensure its prices are at least 2 percent cheaper than the average of rival supermarkets – i.e. to create value for customers the following CSFs should be addressed:

- Refining internal processes to operate the business on a cost-effective basis – e.g. building close partnerships with suppliers to implement a JIT system (in order to eliminate or reduce warehousing costs)
- Using economies of scale to source appropriate goods as cheaply as possible.
- Etc.

(Any 2 points each for each objective @ 1 mark each = 4 marks)

(ii) In order to measure how well Addie management is performing against the above CSFs, the supermarket needs to set the following KPIs: The first three KPIs are in respect of the first two CSFs above and the last three are in respect of the remaining CSFs.

- The proportion of goods taking more than a week to sell
- Results of customers feedback surveys
- Percentage of customers who are repeat customers
- Market share
- Cost measures and progress against savings targets
- Cost savings in procurement

- results of benchmarking prices or costs against that of rivals

(1 point each for each CSF @ 1 mark each = 6 marks)

b) The factors that should be considered before choosing an approach to communicate corporate strategy in an organisation are stated and explained below:

i. **Proprietary nature of the strategy:** The wider the dissemination of information concerning strategic decisions, competitive moves, or shifting emphasis, the greater the likelihood that it will reach a competitor, who could subvert the move, decision, or shift. A strategy which will provide or exploit an unpublicized advantage may be best kept undisclosed. The advantages of organisational commitment would be offset by the loss of surprise. If the strategy will divulge proprietary information, it should be shard only on need-to-know basis.

ii. **Political impact of strategy***:* It is not always possible to achieve consensus concerning the appropriate strategic directions for an organisation. If a number of top level managers participate in the formulation process, it is not unlikely that there will be differences of opinion about the final choice. In an organisation in which relationships are strained, factions may form around strong individuals, and the strategy may be judged and supported according to who is backing it rather than upon its own merits. In such a situation, it may be more efficient to communicate the strategy piecemeal rather than as a whole. Strategy communication that sparks infighting will hinder implementation more than it will help.

iii. **Expectation aroused by strategy:** The announcement of a strategy gives all organisational stakeholders a means of evaluating operations and performance. It also raises and defines expectation about the future of the organisations which may prove embarrassing to management if unforeseen circumstances arise and diminish performance. For this reason, many public announcements of strategy are retrospective, indicating what has been attempted and how well the objectives have been met. An organisation which announces strategy prospectively is subject to criticism from security analysts, to fluctuation in share prices, to government scrutiny, and to buyer and supplier moves, as well as union responses that may be generated by stakeholders.

iv. **Motivational impact of strategy:** A clear statement of strategy may either inspire or demoralize. The effect of a given communication must be considered in light of the personal implications for the individuals required to implement it. Growth strategies have enjoyed popularity because, among other things, the rewards – both financial and career – are perceived as greater for all concerned. Retrenchment strategies are full of financial and personal unpleasantness even though they may be necessary to maintain long-term viability. Unfortunately, good managers may be tempted to leave at the time they are most needed.

At the corporate levels, considerable differences may exist among the strategies of various business units. These differences may make some units much more attractive than others. The use of the term "dog" with the attendant divestiture strategy is likely to have negative effects on unit morale. If communicating strategy is more likely to reduce morale or drive away good managers than to inspire action, a comprehensive strategy announcement is usually undesirable.

v. **Decisional impact of strategy**: Strategy is often an evolving understanding of where the organization is going and of how to get there. An announced strategy brings closure to the formulation question and focuses on implementation. This closure is not always desirable, because lower levels of management can make significant contributions to the strategy as they work through the implementation process. Therefore, before top management announces a strategy, it should be certain that closure of formulation is desired.

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

c) The importance of physical environment conditions

i. Integrating the environment into capital expenditure decisions (by considering environmental opposition to projects which could affect cash flows, for example).
ii. Understanding and managing environmental costs. Environmental costs are often 'hidden' in overheads and environmental and energy costs are often not allocated to the relevant budgets.
iii. Introducing waste minimisation schemes
iv. Understanding and managing life cycle costs. For many products, the greatest environmental impact occurs upstream (such as mining raw materials) or downstream from production (such as energy to operate equipment). This has led to producers being made responsible for dealing with the disposal of products such as cars, and government and third party measures to influence raw material choices. Organisations therefore need to identify, control and make provision for environmental life cycle costs and work with suppliers and customers to identify environmental cost reduction opportunities.
v. Measuring environmental performance. Business is under increasing pressure to measure all aspects of environmental performance, both for statutory disclosure reasons and due to demands for more environmental data from customers.
vi. Involving management accountants in a strategic approach to environment-related management accounting and performance evaluation.

(Any 2 points @ 2 marks = 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

- The part (a) of the question had two sub questions. The first sub- question required identification of two Critical Success Factors and the second sub-question was identifying two Key Performance Indicators to aid in tracking the delivery of the Critical Success Factors. The candidates did well on the first sub-question but did not do well in the second sub-question.
- The part (b) required the candidates to identify and explain four factors that should be considered before choosing an approach to communicate corporate strategy in an organization and part (c) asked the students to explain two ways in which business and environmental benefits can be achieved. The part (b) and (c) of the question was also poorly answered by the candidates.

QUESTION FOUR

a) Differences between unitary and two-tier board structures

- Under a unitary board structure there is a single board of directors, comprising executive and non-executive directors (NEDs). There are two separate boards under the two-tier structure: the management (operating) board which is responsible for the day-today running of the business, consisting of executives only and led by the chief executive. The supervisory (corporate) board with a wider membership, responsible for the strategic oversight of the organisation and led by the chairman.
- Concentrating the role of CEO and chairman in the hands of one person (so called CEO duality) is admitted in a one-tier board in the one-tier board. In the two-tier board, the CEO cannot chair the supervisory board under any circumstances.

- One-tier boards are organized in a unitary way; control and supervision of management are integrated and exercised by one group of directors while the two-tier board adopts a binary approach; the supervisory board exercises the control role, while the formally separated management board exercises the strategy role.

- The two-tier model allows for more stakeholder inclusivity than the one-tier model.

- The non-executive directors (NEDs) on a unitary board will be, largely, classified as independent NEDs, stressing the fact that they will act in the best interests of the wider shareholder population. The supervisory board under a two-tier structure will include representatives of major shareholders, environmental groups, employees (possibly from trade unions) and providers of finance. These individuals, although not holding executive positions within the business, are definitely not considered to be 'independent' and will be acting in the interest of their own group.

- Under a two-tier board structure the two boards meet separately, so executive discussion around running the business will not be heard by the higher board members, and vice versa. This is unlike the single board meeting that will be held for a unitary board.

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

b)

Factors determining the intensity of competition among rival firms

- **Market growth**. Rivalry is intensified when firms are competing for a greater market share in a total market where growth is slow or stagnant. In a matured or declining market rivals would have to battle for the customers of one another if they want to increase market share. Thus, rivals firms resort to a lot of competitive actions such as advertising battles, sales promotion campaigns, price competition, etc. The telecommunication industry in Ghana, for instance, is currently experiencing intensified competition among rival firms due to the slow growth in the market coupled with the increase in participating firms in the industry.

- **Cost structure.** In an industry which is characterised by high fixed costs, firms will have to sell more of their products in order to breakeven and start making profits. Such high fixed costs are a temptation to rival firms to compete on price, since in the short run any contribution from sales is better than none at all. This seems to be true in the Ghanaian telecommunication industry. Rivals firms have invested heavily in terms of the telecommunication infrastructure such as masts, fibre cable networking, and office spaces across the regions, etc. These are very huge fixed costs that must be catered for. The result is the fierce promotional campaigns and advertising battles in the industry.

- **Switching costs.** Switching costs come in three different ways – money costs, time costs and inconvenience costs – that customers of a product face when they switch their preference from one product to that of a rival. Higher switching costs tend to lock-in customers to particular products. In an industry which is characterised by lower switching costs of customers – i.e. they can switch easily without incurring significant costs – suppliers will compete intensely in order to win over the customers of rival firms. For instance, the porting system that was introduced into the telecommunication industry by the NCA has significantly reduced the switching costs of customers. This further intensified competitive rivalry among rival firms in the industry.

- **Capacity.** A supplier might need to achieve a substantial increase in output capacity, in order to obtain reductions in unit costs or enjoy economies of scale.

In an industry where achieving economies of scale is a strategic objective, competitive rivalry is intensified since each firm focuses on increasing its capacity and to sell more.

- **Degree of uncertainty.** In an industry where rival firms are unsure what one another is up to, there is a tendency for firms to respond to the uncertainty by formulating a more competitive strategy. Competitive rivalry is intensified if the degree of uncertainty is high as is the case in the telecommunication industry in Ghana. There is high degree of innovation in the industry and thus rival firms are always on the look out to see what competing firms are bringing on board next. This uncertainty spurs firms on to innovate at shorter intervals to appeal more to customers.

- **Exit barriers.** Exist barriers make it difficult for an existing supplier to leave the industry. Exit barriers come in many forms such as low break-up values of non-current assets, cost of redundancy payments to employees, effect of withdrawal on the other operations within the group, reluctance of managers to admit defeat, their loyalty to employees and their fear for their own jobs and government pressures on major employers not to shut down operations. In an industry where exit barriers are high, competitive rivalry is intensified since competing firms will do everything possible to stay in operation and avoid the difficulties associated with exiting the industry.

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

(Total: 20 marks)

EXAMINER'S COMMENTS

- This question was in two parts. Part (a) of the question required candidates to compare and contrast unitary board structure and dual board structure. The candidates did well in comparing and contrasting unitary board structure and dual board structure.
- In part (b), the candidates were required to explain the factors that could be responsible for the intensity of competition among rival firms within the telecommunication industry in Ghana. Most of the candidates could not answer this part of the question.

QUESTION FIVE

a) Offshoring

Offshoring is the relocation of some part of an organisation's activities to another country.

Developments in technology have made offshoring feasible in many situations, such as back office support for banking operations. Offshoring has grown significantly in recent years. South Africa is one popular offshoring country, many banks and other companies now have service centres based in South Africa.

i) Offshoring offers a **number of advantages** to the AGYASCO Banking Group.

- **Lower overall cost**. Labour and other costs (eg premises) will be lower in South Africa than in
- Ghana.
- **Able to afford a more qualified workforce**. Call centre positions in South Africa are often filled by better qualified individuals than would be the case in Ghana.
- **Investment by host government**. Infrastructure (for example communication) in emerging economies has often been heavily invested in by the host governments, in order to attract inward investment.
- **Economies of scale / centralised operations**. The back office operations will now be able to concentrate its back office operation in South Africa, where it already employs 3,000 people.
- Economies of scale are likely to result. Long-term moves such as this also encourage strategic planning.
- **Allows specialisation**. Offshoring back office operations to South Africa will allow the AGYASCO Banking group to concentrate on the more complex side of its banking operations and grow its international business by allowing other staff to focus on specialised areas of operation. This is necessary in a global economy where competition is increasing.

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

On the other side of the discussion, managing operations based in another country will involve a **number of challenges for the AGYASCO Banking Group**:

- **Risks associated with currency exchange rates**. As an experienced banking group, this should be manageable. Exchange rates will always be liable to fluctuate and this may erode some of the cost savings.

- **Language barriers and cultural differences**. This may not be such a significant hurdle to overcome for AGYASCO Group as they already have a large presence in South Africa. There may be some resistance by customers based in Ghana, due to perceived problems dealing with call centres based overseas.
- **Technical challenges**. Staff in South Africa will need to be properly trained to ensure that service levels in the offshored function do not suffer. Some functions may be retained at the call centres in Ghana, so that customer service and satisfaction levels remain high.

- **Exercising control from a distance**. Offshoring can lead to a loss of control, particularly over quality.
- **Dealing with different time zones.** This is a challenge that a multinational company should be able to meet reasonably comfortably, although employees may find themselves inconvenienced occasionally (for example the timing of telephone conference calls).

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

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ii) Role of the Human Resources Division

The 500 employees of The AGYASCO Group that aren't redeployed following the offshoring will be dismissed through reason of **redundancy**. The Human Resources Division should have **policies governing redundancy** and ensure these are followed.

The HR Division's role should include **setting policies** that cover areas such as:

- **Selection for redundancy** – the criteria for selection must be clear and must be communicated as clearly as possible
- **Pre-redundancy consultation** and clear communication of where and when redundancies are to occur to enable staff to plan their futures
- Help with **developing a CV** and clear guidelines covering time off to attend interviews
- Clear guidelines on **redundancy payments**, with clear communication of packages and negotiation where appropriate
- Assistance with **re-development of skills**, re-training to learn new skills for a new career, or re-location of redundant employees
- **Careers advice**, counselling and post-redundancy support
- Redundancy is likely to be an unpleasant experience. The HR Division must ensure affected staff are handled with **care** and **sensitivity**.
- HR should also play a part ensuring **remaining employees** remain motivated, and morale is as high as can be expected in the circumstances.

(Any 4 points for 4 marks)

b) The following are the four (4) models of marketing within an organisation

- **Sales support:** The emphasis in this role is essentially reactive. Marketing supports the direct sales force. It may include activities such as telesales or telemarketing, responding to inquiries, co-ordinating diaries, customer database management, organising exhibitions or other sales promotions, and administering agents. These activities usually come under a sales and marketing director or manager.

- **Marketing communications:** The emphasis in this role is more proactive. Marketing promotes the organisation and its product or service at a tactical level. It typically includes activities such as providing brochures and catalogues to support the sales force.

- **Operational marketing:** The emphasis in this role is for marketing to support the organisation with a co-ordinated range of marketing activities including marketing research; brand management; product development and management; corporate and marketing communications; and customer relationship management. Given this breadth of activities, planning is also a function usually performed in this role but at an operational or functional level.

- **Strategic marketing:** The emphasis in this role is for marketing to contribute to the creation of competitive strategy. As such, it is practised in customer-focused and larger organisations. In a large or diversified organisation, it may also be responsible for the coordination of marketing departments or activities in separate business units.

(2 points @ 2 marks each = 4 marks)

EXAMINER'S COMMENTS

- This question was in two parts. Part (a) had two sub-questions which was based on a scenario. Section (i) required candidates to critically assess the advantages and associated problems for Agyasco Banking Group of off-shoring its back-office operations to an emerging country.
- Section (ii) asked students to identify roles that the Group's Human Resources Division can play when dealing with employees who cannot be redeployed following the off-shoring of its back-office operations. In part (b), the candidates were to explain broad roles of marketing activities within an organization. Most of the candidates could not answer this question.

QUESTION SIX

a) **Expectations of leaders in strategic management**

- To change organisations and systems from within.
- To drive forward adventurous, visionary strategies. Leaders need to have a clear vision for the future and what needs to be done to get there, so that they can inspire others to aim for the future as well.
- To provide clarity of purpose and direction.
- To be good communicators, both to communicate their vision and purpose, but also to listen to others' point of view and gain their trust.
- To motivate others. Visionary leaders motivate others to work harder by making work seen as natural as play, and by making their teams see the value and purpose in what they do.

(Any 4 points for 8 marks)

b) **Strategic group analysis** is a competitive analytical tool used in strategic management to group firms within an industry into various sub-groups that exhibit similar strategic characteristics and compete on similar bases. Strategic group analysis enables a firm to identify its competitive arena and, thus, assist managers to identify the firm's closest and most influencing competitive rivals. The analytical tool enables organisations to overcome the limitation

associated with the five forces analysis, which deals with the competitive environment in broad industry-wide terms.
(3 marks)

The strategic space pertaining to a strategic group is defined by two or three common strategic characteristics. Examples of strategic characteristics that define a strategic group are:

- Product diversity
- Geographical coverage
- Extent of branding
- Pricing policy
- Product quality
- Distribution method
- Target market segment **(Any3 point @ 1 mark = 3 marks)**

c)

- There are **no cultural impediments** to communication.
- The **segmentation** of the home market shapes a firm's priorities: companies will be successful globally in segments which are similar to the home market.
- **Sophisticated and demanding buyers** set standards. If the home market sets high standards, achieving these high standards will put a firm in a strong position to be competitive on the international market.
- **Anticipation of buyer needs**: If consumers needs are expressed in the home market earlier than in the world market, the firm benefits from experience.
- **The rate of growth**. Slow growing home markets do not encourage the adoption of state of the art technology.
- **Early saturation** of the home market will encourage a firm to export.

(Any 3 points for 6 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

- This question was in three parts. Part (a) of this question required candidates to explain the expectations of leaders in strategic management.
- In part (b), the candidates were asked to explain the concept of strategic group analysis and identify three examples of common strategic characteristics that define a strategic space.
- The final part (c) required the candidates to explain home conditions that may put pressure on firms to innovate and provide a launch pad for global ambitions. A good number of the candidates attempted this question and the performance of the first part was generally good while the second and last part were not answered adequately.