INSTITUTE OF CHARTERED ACCOUNTANTS GHANA
CORPORATE STRATEGY AND GOVERNANCE
SOLUTIONS- MAY 2012

**Question 1**

A. Financial performance of Aduropa Ltd

| | 2009 | 2008 |
|---|---|---|
| Net Sales | 17,460 = 100% | 13,900 = 100% |
| Cost of Sales | 10,724 X 100 = 61•4%<br>17,460 | 8,491 X 100 = 61%<br>13,900 |
| Distribution | 4,917 X 100 = 28%<br>17,460 | 3,9375 X 100 = 28•3%<br>13,900 |
| Admin. Cost | 1,907 X 100 = 10•9%<br>17,460 | 1,484•5 X 100 = 10•7%<br>13,900 |
| Financial Costs | 110•5 X 100 = 0•6%<br>17,460 | 152•5 X 100 = 1%<br>13,900 |
| Income | 126•5 X 100 = 0•7%<br>17,460 | 123•5 X 100 = 0•9%<br>13,900 |

A look at the performance in term of various costs shows that cost of sales and administrative costs were higher in 2009 than in 2008 while distribution costs were lower. This means that Aduropa must work at reducing cost of sales and administrative costs and push distribution and finance costs further down if possible.

B. Non –financial Performance

i. From the point of view of customer satisfaction, one can say that, it is low because of the high prices of the drugs, irregular supply and lack of advertising. This has resulted in the low level of sales and demand for the products.

ii. Staff Motivation/Training: this has also remained very low as a result of the withdrawal of incentives and irregular payment of salaries. The evidence is the poor work culture. Staff empowerment has also suffered.

iii. Innovation and Learning: in this area, the company has also not done well. Very little has been budgeted for research and development and no new product has been developed neither has the existing ones improved.

iv. Internal Business Process: is poor because of bad inventory management.

C. Corporate Governance Issues

i. Board incompetence / frequent changes / Appointment of a new board

ii. Fraud- : overstatement of income; change of accountant and internal auditors

iii. Poor monitoring: - internal and external auditing / appointment of new external auditors.

D. Qualities of Directors

A good Board must have the following qualities:

i. Board Members must have the expertise and relevant experience
ii. Members must come in with different backgrounds
iii. The Board must have a higher fraction of independent (external) members
iv. The size must not be too large.
v. Board must meet regularly
vi. Board must evaluate their own performance regularly.
vii. Board must demonstrate leadership skills.

E. Solution to the puzzle – Internal Operations

The company must reduce the prices of the drugs and release them unto the market. Because of their high quality, they will sell quickly and the company will raise some money for investment and payment of debts.

Inventory cost will reduce and this will also affect manufacturing costs. With this improved position, the company can approach a bank to negotiate for a facility to invest in its operations.

**Question 2**

a. The agency theory of corporate governance holds that a company's ownership and control are separated between two parties – shareholders and management. Shareholders own the business and management control the firm.

   A common problem associated with this separation of ownership and control is that managers often put personal interest first. If shareholders cannot effectively monitor managers' behaviour, the latter may be tempted to use the firm's assets to enhance their own lifestyles.

b. Approaches to align management interest with those of shareholders include:

   i) Monetary Incentives: CEOs are paid specific annual salaries often through benchmarking with other organizations. In addition, the CEOs often receive cash bonuses. The size of the payment is based on the performance of the firm over the past year. It is typically based on accounting profit measurements on earnings per share (EPS) and earnings before interest and taxes (EBIT). Higher levels of performance merit higher bonus up to a specific maximum or cap

   ii) Share Options: - share options are contracts that allow executives to buy shares at a fixed price. Therefore if the price rises above the initial price, the executives will capture the difference as profits.

   Share options give executives of the firm, the incentive to manage the firm in such a way that as to increase the share price as shareholders want.

   iii) Retirement / resignation Compensation:- another popular arrangement used to motivate CEOs is the retirement compensation. Under this arrangement, the executive is paid a specific amount when he retires. In addition, he may also be allowed the use of company facilities even after retirement.

   iv) Company Loan: - another benefit is obtaining a loan. Executives commonly borrow large amounts of money at extremely low interest rates or interest free.

   v) Crime and Punishment:- punishment is another way of aligning the interest of managers with those of shareholders. Under this arrangement, executives who intentionally and knowingly mislead or behave in ways that are not beneficial to shareholders may be penalized. One way to extract appropriate behaviour from executives is to get them to sign financial statements.

**Question 3**

A. The role of Accountants on corporate governance

   i. Accountants supervise accounting transactions and keep an up-to-date recording of all those transactions.

   ii. They ensure the preparation of financial information contained in appropriate form for presentation to stakeholders.

   iii. They make budgets or projections of income and expenditure by identifying the sources.

   iv. Cash and Inventory Management:- they ensure that the company has enough cash to pay debts

B. Problems that may occur in accounting

   i. Errors due to miscalculations

   ii. Wrong judgments for example counting receivables when they know customers may never pay.

   iii. Perpetuation of fraud: - including overstatement of income, understatement of liabilities, or overstatement of assets such as receivables or inventory. This may be done by accountants themselves or may be tricked into it.

C. Role of Auditors

   i. Financial Operations – auditors have the responsibility to oversee the entire financial operations of the firm.

   ii. They are also to check the accuracy of the financial record keeping

   iii. To implement improvements with internal control

   iv. To ensure compliance with accounting regulations.

   v. To check fraud

**Question 4**

This question requires the candidate to take one of two positions on the shareholder's views of corporate social responsibility.

i. Explain Corporate Social Responsibility.

- A concept whereby organizations consider the interest of society by taking responsibility for the impact of their activities on customers, communities, employees, shareholders and the environment in all aspect of its operations.
- The overall relationship of an organization with its stakeholders.
- An organizations awareness of the social problems which arise out of its relationship with stakeholders and its willingness to commit resources to solve these problems.

Areas of Corporate Social Responsibility

- Investment in community development

ii. Reasons for Corporate Social Responsibility

- Organizations take inputs from the society. They must support its developments.
- They charter from the society and must show appreciation
- Organizations' activities affect the society and the environment. They must help to protect and solve its problems

In addition to the above benefits of Corporate Social Responsibility,

- The company's image is boosted
- Companies get publicity of their activities
- Organizations attract qualified and experience employees
- They receive tax concessions.

**Question 5**

a. The resource-based view considers valuable resources to be the source of sustained competitive advantage. What makes a particular resource valuable becomes the issue.

   Valuable resources are believed to possess the following characteristics which enable an organization to perform better than its competitors.

   i. Competitive Superiority: - this is a feature that helps to fulfill a customer's need better. E.g. a good location

   ii. Resource Scarcity: - the resource must be in short supply in order to be scare. When competitors cannot easily get them, then the firm has an advantage because it can use that resource to outdo its rivals

   iii. Imitability: - when a resource can easily be copied or acquired, it may only generate temporary value. For sustained competitive advantage, the resource must not be easily imitated.

   iv. Substitutability: - when alternatives are available, the value of a resource is not very high. Non-substitutable resources therefor are more valuable.

   v. Durability: - when a resource depreciates slowly, it is more valuable. Depreciation is easily measured with tangible assets but difficult to measure with intangible ones.

b. Internal Analysis of an organization has some implications for the formulation of its strategies. Internal Analysis of an organization reveals its strengths and weaknesses. That is the resources and capabilities it has and those that it does not have in sufficient quantities as compared to its competitors.

   i. Setting Objectives:- the strengths and weaknesses are important in determining which objectives are achievable and realistic. Objectives must be set within the limits of the resources – assets, skills and capabilities – available to the organization. Knowing the resources also enables the firm to plan leverage the deficient resources.

   ii. Selecting appropriate strategies:- knowledge of strength and weaknesses also enables a firm select appropriate strategies. Management must select those strategies for which it has superior and sufficient resources in order to achieve a strategic fit

**Question 6**

A. Making customers the focus of all business activities is to adopt a total quality management philosophy. This enables the business to meet quality expectations as defined by their customers. In doing this, the business has to deal with some cost.

1. To ensure that the business comes out with quality products, there are some costs to be incurred in the process of preventing poor quality products from being produced. For example, the cost of quality product design. This may call for the purchase of modern factory equipment. It also requires that employees are trained in quality management. These costs prevent defects from occurring.

2. During the course of production, it is important that appraisal activities are undertaken to uncover or detect faulty products. This will assist the business to reduce its costs. To achieve this aim, there should be frequent inspections, product testing and performing of audits to ensure that quality standards are being met. These are cost to the business as time is spent to perform these activities. Also, there may be the need to purchase some equipment to monitor the production activities.

3. The company would have to deal with issues of quality as the product gets to the customer. These issues have to be addressed as their presence may damage the reputation of the company. Issues that need to be addressed include customer complaints, warranty claims, recalls and repairs. To avoid these problems, a company may have to employ more staff to quickly handle customer complaints. Other machines may have to be purchased to track the process of correcting a defect.

4. Another issue a company may address is to correct a defect before it gets to the customer. This calls for a reproduction or re-work of the product. This is a cost as the resources of labour, materials and machine expenses are incurred in coming out with defective product. As the goal of the business is to be seen as being quality oriented, it will have to absorb these costs.

B. The usage of the concept of quality in manufacturing and service organizations is different as they produce different products. Whereas manufacturing produce tangible products, the services come out with intangible products.

In manufacturing, business quality is mostly seen in how the product conforms to standards or the degree to which the features of a product meets standards. Quality is also seen as the extent to which a product is reliable. That is the extent to which the product will perform or function without failure.

In a service business, the product is intangible as it cannot be seen in a product line or touched. This makes it difficult to define the concept of quality. However, the concept of quality can be defined in perceptual factors. For example, the promptness showed in resolving a customer compliant, the courtesy, friendliness and warmth showed to a customer may all be said to be providing a quality service.

**Question 7**

a. The portfolio analysis model that is required here is the BCG Matrix. This model allows one to analyze the product or business portfolio of the firm. The key elements required are the relative market share of the organization and the industry growth rate.

For Akon, the relative market share of various courses is:

| | Market Share | Market Growth |
|---|---|---|
| Marketing | 0•43 | 10% |
| Banking & Finance | 1•30 | 40% |
| Accounting | 0•67 | 20% |
| Human Resource | 1•20 | 30% |

Each of these courses is put in a particular quadrant according to its market share and market growth rate. Depending on its position, a course may be a ‘star’, a ‘cash cow’, a ‘question mark’ or a ‘dog’.

Diagram

**Relative Market Share**

| Market Growth Rate | High | Low |
|---|---|---|
| High | Banking & Finance | Accounting |
| Low | Human Resource | Marketing |

**Star: High market growth / High Share**

The Banking & Finance course in in the star quadrant and tends to be profitable because of its strong share position. It may be self-financing or may provide or require additional cash injections in order to keep up with market growth and support its competitive position. Provided it maintains its dominant position, it may move down into the cash cow position.

**Cash Cow: Low Market growth / High Share**

The Human Resource course is the cash cow of Akon University. It is very profitable and brings in cash in excess of its additional investment requirements if any. The excess cash may be used to support other courses like Accounting and Marketing. It is also the source of payment for most the university's financial needs.

**Question Mark: High Market growth / Low Share**

In this portfolio, the Accounting course is the question mark or problem child. It has a low market share which means that there is a relatively weak cash-flow from that source. It is difficult to maintain because of the rapid market growth increase in student numbers. It requires substantial cash injections to turn it into a star. However, if this not available, a quit may be considered since it may be too expensive to maintain.

**Dog: Low Market Growth / Low Share**

In this portfolio, the Marketing course is the dog. It is unlikely to ever generate cash and any investments made are likely to be wasted. It is advisable to drop it.

b.

i. Diversification – this involves moving away the investment in the product or service into a new venture.

ii. Harvesting – this is the gradual withdrawal of capital from the product or service. This is a sell off without necessarily replacing it with another.