

**NOVEMBER 2019 PROFESSIONAL EXAMINATION
STRATEGIC CASE STUDY (PAPER 3.4)
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME**

EXAMINER'S GENERAL COMMENTS

The November 2019 Strategic Case Study (Paper 3.4) examination was the first of the examinations marking the beginning of the new syllabus, which has been adopted by the Institute of Chartered Accountants (Ghana). The paper, being the final paper of the professional examinations for one to fully qualify, was meant to be very challenging. The paper aimed at testing candidates' ability to integrate and synthesize the various knowledge acquired in the other courses to solve business problems. Key highlights of the Paper 3.4 which departed significantly from earlier regimes included a pre-seen information that preceded the day of the examination by two weeks as well as an emphasis on financial or quantitative analysis for organisational decision making. In my estimation, there was a general disappointment from candidates since the general performance fell woefully below what was expected. The paper was not overly challenging, as was expected, to warrant the poor performance that candidates exhibited.

The abysmal performance of candidates is largely attributable to candidates' woeful performance on the financial analysis questions. This weakness on the part of the candidates is highly unacceptable and inexcusable. Undoubtedly, majority of the candidates who sat for the paper were ill prepared for the examination or failed to appreciate the demands of such a high-level paper. Their performance suggest that their preparation level was woefully inadequate and not up to the level expected of would be chartered accountants. Generally, answers of candidates were very shallow and did not reflect the standard expected of such high level paper. In fact, it is expected of candidates at this level to exhibit a top notch understanding and high-level application of knowledge acquired from other courses/papers. For instance, it was quite pathetic that majority of candidates who sat for this paper could not perform relatively simple financial analysis per the data given and not to even talk about writing accompanying narratives. Sadly, it seems students still do not appreciate the essence of strategic case study - i.e. applying (synthesizing and integrating) knowledge acquired from other functional areas of business to solve business problems that will achieve business success.

Indeed, candidates who do not fully grasp the contents in the other subject areas, in addition to failure on their part to adequately prepare, would find it extremely difficult in securing a pass in Strategic Case Study (Paper 3.4) going forward.

STANDARD OF THE PAPER

Overall, the standard of the paper was fairly high, and more especially being the first of the new syllabus. The examination reflected the exact contents of the syllabus, without any significant lapses. Even though, the paper was expected to be more challenging, considering that it is no longer a level two paper, the questions did not

depart significantly from the line of questioning under the erstwhile Corporate Strategy, Ethics and Governance (Paper 2.6) of the old syllabus. The only reservation I had with the paper was the fact that there were lots of repetition of information within the case. Largely, the additional unseen information were repetitions of information from the pre-seen information, which was administered two weeks prior to the examination day. It is, however, laudable that the case was very rich in content. It was well researched and represented real issues within the tourism industry of Ghana.

Notwithstanding the above, there were some few challenges which was observed. First was with the numbering of the questions. There were only two major questions with each major question having sub (e.g. 'a') and other sub (e.g. 'i' and 'ii') questions. The numbering of the questions made marking somewhat clumsy and difficult. Some candidates easily missed up the numbering making it difficult to identify to which question they were answering.

The mark allocations reflected the weightings proposed within the syllabus. Also, the questions were fairly distributed across the issues contained within the syllabus. Thus, there were issues on corporate strategy covering formulation, implementation and evaluation issues. Additionally, corporate governance and ethics also featured significantly. Meanwhile, the financial analysis aspect, which is a key component of the Strategic Case Study paper, also featured prominently and reflected a significant portion (20%) of the entire examination. The only notable weakness was with the mark allocation for question 2a, which had three (3) sub questions. The total marks of twenty (20) was not specifically allocated among the three (3) sub questions to help candidates to determine the extent of their answers.

In my candid opinion, none of the questions could be considered as too loaded for candidates to handle. There were no repetitions of questions, which is a notable improvement from the previous examination. There were no ambiguities/errors/typing problems that adversely affected performance in the examinations. Overall, all the eighteen (18) questions administered were of a very high standard at the level of the examination.

PERFORMANCE OF CANDIDATES

The poor performance could be attributed generally to the candidates' shallow answers and poor performance on the financial analysis question. Interestingly, many candidates who failed did so with marks slightly below the pass mark of 50 percent. Clearly, candidates' poor performance cannot be attributed to any weaknesses in the examination itself but poor preparation on the part of the candidates.

I would like to reiterate a recommendation I made in the immediate past (i.e. May 2019) report, which I believe if taken seriously by both instructors and candidates will ensure better performance going forward. It is crucial for both instructors and candidates to intensify teaching and learning in order to perform better in the Strategic Case Study

(Paper 3.4). Specifically, they should endeavor to delve deeper into the concepts contained in the syllabus by reading further from other references as provided in the list of references, and not solely depend on the manual provided by the Institute. I also recommend that both instructors and candidates familiarize themselves with various issues bothering on the business environment by reading relevant newspapers and magazines (such as Business and Financial Times, Forbes magazine, The Economist, Harvard Business Review, corporate annual reports, etc.), listening and watching general news and business news in particular from the broadcast media. Doing these should enlighten both instructors and candidates about different industries and the general business environment. Both instructors and candidates are also to endeavor to bring their expertise and learning from other courses to bear on the Strategic Case Study paper.

As I have indicated in previous reports, the new Strategic Case Study paper is a capstone course, which integrates all the subject areas in the professional programme. Candidates especially ought to go into the Strategic Case Study (Paper 3.4) examination against the backdrop that every prior learning from other subject areas is in preparation towards the Paper 3.4. If candidates fail to appreciate this, I am afraid they would struggle for a long time to pass and ultimately qualify as chartered accountants.

NOTABLE WEAKNESS OF CANDIDATES

Simply put, candidates should understand that every other paper they are studying is a preparation towards the Strategic Case Study paper.

Other Weaknesses Include;

- Some candidates still do not write answered question numbers at the appropriate columns provided for that purpose.
- Most candidates do not number the pages in the answer packets even though spaces for that have been provided in the answer packets.
- Some candidates still refused to write the answered questions in the spaces provided in the answer packets.
- Some candidates also mix up question numbers with respect to the questions answered.
- The grammatical expression of some candidates is still very worrying.
- Some candidates have very poor handwriting that makes marking extremely difficult.
- Some candidates write their student identity numbers at the back of the answer booklet. This makes for easy identification of such student by an examiner.
- Some candidates' approach to answering questions was done without giving consideration to the mark allocation. For instance, some students could write a whole page for a question which has 2 marks allocated to it.
- Weak control over the issuing of additional papers. The current system makes it possible for either candidates and/or invigilators to abuse by assisting examination candidates in the examination hall.

QUESTION PAPER

Introduction

Adofo Boateng (Adofo) and Coffie Oduro (Coffie) met in 2010 when they were both students at a university in the United States. They both had ambitions to succeed in business back in their home country, Ghana. They shared common interest in Ghanaian history and culture, and saw commercial opportunities in setting up a business in the tourism industry. At that time, tourism was a growing but under-developed industry. Adofo and Coffie agreed that if they could establish a small and successful tourism business, there would be opportunities for rapid growth within just a few years.

On returning to Ghana in late 2011, they established a private company, Ghanalux Ltd, with money from family backers and some private means. The company's business was to organise small tour groups of tourists from the United States, mainly the north-eastern states of the US. They had dedicated tour guides taking the groups on planned itineraries lasting about four weeks. Initially, Adofo and Coffie acted as tour guides themselves, although they gradually did less of this work as the company expanded.

The tours are priced at a high rate, but the aim is to deliver high-quality 'luxury' holidays for all customers. Ghanalux uses the services of a travel booking company in the US to advertise its tours and attract customers. The booking company charges a commission for its services, as a percentage of the tour prices paid by customers.

Early growth

The tourism industry in Ghana suffered from a skills shortage, and Ghanalux proved a success initially because Adofo and Coffie were both talented individuals, with a strong motivation to succeed, extensive knowledge of Ghana and its tourist attractions, and an ability to communicate easily with their US customers. The company gained a strong reputation in parts of the US for efficient tour organisation, but also exhilarating and life-enhancing tours.

The company operated from a small office in Accra, from which tours were organised and coordinated. In the first year of operations, ending December 2012, they generated revenue of just under GH¢2 million, and although they made losses in the early years, they were pleased with the revenue growth they achieved. As the company grew, it recruited a small number of full-time tour guides, using contacts in US universities to identify and attract Ghanaians who were studying there and were attracted by the prospects of working in the tourist industry in Ghana, and for a company where the prospects of career development seemed strong. In recruiting new guides, the company looked for individuals with strong motivation, an interest in Ghana and its history, culture and resources, and an ability to communicate well with both foreigners and the local folks.

By 2018, the company was operating several tours each year for tour groups of about 16 people who were willing to pay premium prices for a top quality holiday experience, combining elements of Ghanaian culture, heritage, recreation and adventure. They also started to organise special themed tours each year to the PANAFEST festival in Elmina and Cape Coast. The company's annual revenue in 2018 amounted to just short of GH¢16 million, and the net profit margin after tax was about 4% of revenue or GH¢639,000.

The tourism industry in Ghana

Tourism is now a major industry in Ghana. In 2018, the industry earned about US\$3 billion for the national economy, attracting about 1.5 million international tourists from around the world and employing almost 700,000 people. However the industry is fragmented, with many small companies operating hotels, travel services, tours, catering for tourists, and so on. Visitors range from tourists looking for low-price holidays or short breaks to wealthier tourists taking longer holidays and visitors to business conferences.

The government is helping to support growth in tourism by funding infrastructure projects and other initiatives. However, Ghana's tourist industry is still under-developed compared to other countries in Africa. Factors that appear to be holding back growth are a shortage of individuals with suitable skills, and insufficient branding and marketing of Ghana as an attractive tourist location to other countries. Tourists also often complain about the lack of comfort on tour buses that take them between their hotels and sightseeing locations.

Adofo and Coffie have discussed what Ghana needs to do to be a more attractive destination for foreign tourists.

Growth strategies

Adofo and Coffie believe that they need to think ahead and develop a strategy for taking the company forward and growing the business. There seem to be a number of different options for growth, and they want Ghanalux to be at the forefront of developments in the tourism industry. The strategic options they have discussed are set out briefly below:

Increase the number of tours each year. In 2018 the company ran twelve tours. It might be able to increase this number in future, although there is probably a limit to the number of tours that can be sold to customers in the north-east of the USA. There would be a need to recruit more tour guides.

Develop new bespoke high-end luxury tours, tailored to the specific requirements of individuals, couples or small families, where customers are accommodated in top quality hotels and have their own tour guides and private cars. These bespoke tours should sell for at least twice the price per person that the company charges for its existing tours.

Develop a range of themed tours. Currently, the company's tours have an itinerary that combines different types of activity, such as visits to local festivals and events, visits to UNESCO heritage sites linked to the country's history, adventure tours to rain forests and game parks, and recreational days at beach resorts. The company could develop tours that deal exclusively with just one type of activity.

Seek strategic tie-ups with other businesses in the tourism industry in Ghana, such as hotels and festival event organisers, so that they actively market each other's services and products to their customers.

Merger. The company might consider a merger with one or more other tour companies. The directors of Ghanalux think that they would be unable to raise enough finance for an acquisition of suitable size, so any growth by way of business combination would have to be in the form of a merger, involving a share-for-share exchange.

A restriction on the company's growth potential is that currently all its customers come from the north-eastern part of the USA. Ghanalux would be able to sell more tours if it could market its services successfully in other countries.

Company performance

The directors are pleased with the progress that the company has made since it was established. Annual revenues have grown, although profit has only been a relatively recent outcome, and there are encouraging future prospects. However, the company's business is still at an early stage of development, and the directors understand that the company needs to sustain or improve the quality and efficiency of its operations and the skills of its employees. It cannot stand still and so needs to innovate, and it must find new ways of attracting customers so that its business continues to grow.

Until now, the directors have not made formal plans or budgets for the business, but they think that the company is reaching a stage where greater formality is required in the process of setting business targets and monitoring performance.

Shortage of talent

The company has so far been very careful in its selection of guides to lead its tour groups. Guides are well-educated, communicate well with other people and enjoy the tourism industry. However, many of them are also ambitious. If they think that Ghanalux is unable to offer them an attractive career, they are likely to move elsewhere in time, and possibly set up their own businesses. Already two experienced tour guides have left the company to seek a career elsewhere.

Adofo and Coffie think that if they are to retain as well as attract the top talent available, they will need to offer long-term incentives to their best guides. Incentives should encourage them not only to stay with the company, but also to contribute innovative ideas about how the company should develop.

At the moment guides are paid annual salaries of around GH¢60,000, plus a small annual bonus, but other forms of incentive might be needed.

Adofo thinks that if the company is unable to retain talent, it should 'accept the inevitable' and recruit guides locally on lower salaries, but give them intensive training before using them as tour leaders.

Ownership and organisation structure

Adofo and Coffie each own 40% of the shares in their company, and are the only directors of the company. The remaining 20% of shares are owned by members of their families. There are 50,000 equity shares in issue.

They recognise that unless and until the Ghana Stock Exchange grows substantially, there are no prospects for the company to obtain a stock market listing.

Now that the company has grown, neither Adofo nor Coffie act as tour guides themselves, and together they handle all the administrative and financial affairs of the company, with the help of an assistant, from their office in Accra.

Although there is no requirement for the company to appoint non-executive directors, Adofo thinks that more diversity of membership would benefit the board and the company's leadership. He thinks that it might be a good idea to appoint a non-executive director to assist them with strategy formulation. Coffie disagrees, and thinks that if there is any benefit to be gained by increasing the size of the board, the new appointment should be an executive director, chosen from among the company's tour guides. In this way, the owners would be demonstrating their commitment to promoting the careers of the individuals they recruit for their business.

Decision-making

The directors are reluctant to delegate authority to their employees. Each tour has a strict budget, and most spending is controlled from head office, for example spending on hotels, transport, entry to tourist sites and insurance. Tour guides are given a small budget for each tour for discretionary spending. Problems and concerns of customers during their tour are dealt with initially by the tour guide, but are referred to head office if they cannot be resolved easily.

Even so, the directors are keen to encourage their participation in decision-making, and to this end they hold six-monthly meetings with staff. These meetings are used to discuss issues that have arisen in the business, matters that concern staff, and ideas that the directors have for the future of the business. Adofo and Coffie think that these meetings are constructive and useful. The meetings help them to monitor feelings and concerns among employees, and give employees an opportunity to contribute their ideas about how the company should be run and what it should be doing.

Sustainability

During their period of study in the USA, Adofo and Coffie met and shared ideas with many individuals who were concerned about climate change, pollution of the earth and its atmosphere, and protection for wildlife. As a result of these influences, both directors have a strong sense of business ethics and sustainability. They believe that their company should demonstrate the attractions of Ghana to foreign visitors, but should operate their business without causing unnecessary environmental damage. They strongly support efforts by the government to protect rain forests and game parks, and for the protection of wildlife in game parks.

In spite of these views, they want to increase the numbers of international tourists visiting Ghana, even though they recognise that an expanding tourism industry might have adverse consequences for the country's environment.

Personal security and customer protection

International visitors to Ghana sometimes express their concerns about personal security and the risk of being attacked and robbed. Tourists are often the target for criminals operating around tourist locations, with crimes such as muggings, bag snatching, petty theft and pickpocketing, particularly in markets and tourist sites, and on beaches.

Tour guides are instructed to warn the tourists in their group about the dangers, and to remain vigilant for possible problems. Customers are also advised to take out suitable insurance before starting their holiday.

It is generally recognised that Ghana is a safer country for tourists than some other countries in Africa, but there is also a view that tourist concerns about personal security might be holding back tourist numbers visiting Ghana.

Standards of customer service

The company has produced a code of conduct for its employees. As well as addressing the matter of personal security and crime, the code also deals with standards of service to the company's customers. There have been occasional incidents in the past when standards of service have been poor; in particular, tour guides have sometimes left their group on their own, waiting for the local guide to turn up. There have also been complaints about tour guides ignoring customer requests for assistance, or forgetting to do something that they were supposed to do for their group.

There have been some indications recently that this problem is getting worse.

Financial issues

When the company was established, it was financed entirely by equity capital. As the business grew and made profits in some years, a proportion of the profits were retained in the business to finance further growth. However, there have been some years of loss, although the director's still recommended and paid a dividend even in those loss-making years. As at 31 December 2016, there were retained losses, although this has since improved. The company rents its offices in Accra, and does not have many non-current assets. Some thought was given a few years ago to buying two tour buses for the company, but the buses would not be used sufficiently to justify their cost, and the cost of employing the drivers. Even so, it has not been possible for the company to rely entirely on equity finance to support the business operations.

The company needs a relatively large amount of working capital. This is because when a tour is organised, Ghanalux is required to make down-payments to airlines, hotels and other suppliers a long time in advance of the tour. Customers who book tours are required to pay a deposit, but the deposit money is insufficient to cover the company's payments to other businesses. The company therefore borrows from its bank to finance working capital.

The company prices its tours in US dollars. Its expenses are mainly in US dollars (e.g. payments to airlines) and partly in cedis (for example, payments to hotels). Its short-term borrowings are in cedis.

Occasionally, tour groups visit parts of Ghana where most businesses do not accept credit card payments. Customers also sometimes want to buy cedis for personal expenditure, but have difficulty in finding a reliable foreign currency bureau or bank which can arrange currency transactions. The Ghanalux directors would like to make it more convenient for customers to make payments in cedis or buy cedis, but they are not sure what can be done.

Summary financial statements for the years ending December 2017 and December 2018 are shown in Appendix 1.

Appendix 1. Summary financial statements

Summary statement of profit and loss for the year ended December

	2018	2017
	GH¢'000	GH¢'000
Revenue (net of Tourist Development Fund tax)	15,840	11,730
Operating costs		
Tour expenses (flights, hotels etc)	12,947	9,389
Sales commissions	800	577
Salaries/wages (including directors' salaries)	390	316
Sundry operating costs	817	510
Total operating costs	<u>(14,954)</u>	<u>(10,792)</u>
Operating profit	886	938
Interest charges	<u>(34)</u>	<u>(98)</u>
Profit before taxation	852	840
Taxation at 25%	<u>(213)</u>	<u>(210)</u>
Profit after taxation	639	630
Retained profit brought forward	<u>311</u>	<u>(119)</u>
	950	511
Dividend	<u>(150)</u>	<u>(200)</u>
Retained profit carried forward	<u>800</u>	<u>311</u>

Summary statement of financial position as at the end of the year

	2018	2017
	GH¢'000	GH¢'000
Non-current assets (Note 1)	75	82
Prepayments	673	489
Trade receivables	958	739
Sundry assets (Note 2)	<u>8</u>	<u>11</u>
Total assets	<u>1,714</u>	<u>1,321</u>
Share capital	150	150
Accumulated retained profits	<u>800</u>	<u>311</u>
Total equity	950	461
Bank loan	262	445
Customer advance deposits	223	161
Trade creditors	46	34
Taxation payable	<u>233</u>	<u>220</u>
	<u>1,714</u>	<u>1,321</u>

Note 1: There were no non-current asset additions or disposals in the year.

Note 2: Sundry assets comprise an inventory of brochures, and some small currency notes in a tin.

QUESTION ONE

Prospects for the tourism industry in Ghana

Adofo wonders whether official estimates of future growth in the Ghana tourism industry over the next few years might be too optimistic. He is not convinced that West Africa, and Ghana in particular, is necessarily in a strong position to compete for tourists with other regions of the world, both in other parts of Africa and also in South America and parts of Asia. He thinks that prospects for growth in the tourism industry in Ghana, although reasonably good, are limited.

He has therefore suggested that it might make strategic sense for the company to look for ways to expand its business in other parts of the African continent. He has also suggested that since Ghanalux has positioned itself in the high price high quality segment of the tourist market, the company should consider moving into the conferencing business, for example by managing international business conferences in Accra.

Coffie has responded to these suggestions by saying that any strategic initiative by the company needs to be suitable, feasible and acceptable. He has an ethnocentric view of tourism in Africa and believes that Ghanalux must focus its growth strategies on tourism in Ghana.

Competitive advantage and performance management

The directors have discussed ways of making the company more competitive in the Ghana tourism industry. They recognise that Ghanalux charges high prices for its tours and to justify these it must be able to provide customers with a top quality experience during their holiday. Adofo and Coffie agree that they must focus on protecting and promoting their company's competitive advantage, and they have been discussing ways of doing this.

The directors would like to increase the net profit margin from its current level of 4%, but they recognise that before they can think about raising prices, they must also consider a range of other aspects of performance, including control over costs. Adofo has suggested that a balanced scorecard approach to setting key performance indicators (KPIs) is needed, in order to strengthen the reputation of Ghanalux in the Ghanaian tourist industry.

Marketing and sales

The directors are not sure what to do about a further problem facing the company. At the moment, Ghanalux obtains customers through a travel booking company in the north east of the USA. The booking company charges a commission for the customers they obtain for Ghanalux. Commission costs are quite high, and the booking company does not operate outside its geographical region. Adofo and Coffie would like to reduce commission costs and extend their marketing coverage to a much wider area.

Strategic opportunities

Two strategic opportunities have arisen recently, which might enable the company to achieve more rapid growth.

Sunlit Hotels

Kwame Achebe, the managing director of Sunlit Hotels, a hotel chain company, has proposed that his hotel chain and Ghanalux should enter into a strategic alliance, and offer luxury package holidays in Ghana based on the tours currently operated by Ghanalux, with tour guests staying in hotels owned and operated by the hotel chain. In addition, each company would market the other's services to their broader customer base. Sunlit Hotels operates five hotels in Ghana, each with between 100 – 200 guest rooms, with an average price of GH¢800 per room per night. Last year it made a profit after tax of GH¢3 million on sales turnover of GH¢110 million.

Kumasi sale

The directors have been informed privately that Jojo Okoye, the owner of a tour company based in Kumasi, is planning to retire soon, and would like to sell his company. The company operates luxury tours similar to those of Ghanalux, but from a different customer base; most of its customers come from France and Germany. The company has been operating for about the same length of time as Ghanalux, and in its previous financial year, it made a profit after tax of GH¢300,000 on sales revenue of GH¢8 million. Adofu and Coffie are not sure whether Ghanalux would be able to raise sufficient finance to buy this company, but they think there could be a strategic benefit from a merger of the two companies, subject to appropriate due diligence.

Required:

- a)
- i) Discuss the view that the tourism industry in Ghana might currently be at a disadvantage and under-developed compared to other countries.
Note: Use Porter's Diamond to structure your answer. (8 marks)
 - ii) Assess the **TWO (2)** suggestions about expanding the business of Ghanalux outside Ghana and into conferencing, from the perspective that strategy should be suitable, feasible and acceptable. (6 marks)
- b)
- i) Discuss what you consider to be the main competitive advantage of Ghanalux in its industry. (5 marks)
 - ii) Discuss how a balanced scorecard approach to performance measurement might help Ghanalux to improve its profitability. (3 marks)
 - iii) Recommend performance measures that might be used by Ghanalux if it adopts a balanced scorecard system. (8 marks)
- c) Discuss the issues that should be considered when responding to proposals for each of the following:
- i) A strategic alliance between Ghanalux and Sunlit Hotels. (7 marks)
 - ii) A business combination with the tour company in Kumasi (7 marks)
- d) Recommend measures that Ghanalux might take to extend its marketing and sales operations to regions or countries outside the north east region of the USA. (6 marks)

(Total: 50 marks)

QUESTION TWO

Financial issues

Ghanalux makes large payments to hotels, airlines and travel companies in Ghana to secure places for its tour customers. It also makes payments of commission to its agent (a travel booking company) in the USA, with 50% payable to the agent when a customer pays a deposit for a holiday and the remaining 50% when the customer pays the balance of the money owed for the holiday. All these advance payments to the agent are short-term assets of the company. Taken together, these prepayments are much greater than the amounts received as deposits from customers when they book their holiday. (Deposits from customers average 10% of the total holiday price.) As a result the company, although profitable, operates with a bank overdraft and the bank overdraft, although expensive, has become a permanent feature of the company's financial structure.

The directors have discussed ways of reducing the bank overdraft, although this year has seen a reduction primarily from a sound positive net cash flow from operations, and the owners taking a reduced dividend. One approach to reducing the overdraft would be to look for ways of reducing the investment in working capital; and another would be to arrange with their bank to convert the bank overdraft into a medium-term bank loan.

There are other financial issues that the directors think they might not yet have arranged to their company's best advantage. Customers pay for their holidays in US dollars. Airlines and most hotels used by Ghanalux for its customers also ask for payment in US dollars. Other payments are in cedis, and if the company has a short-term dollar cash surplus at any time, it converts the dollars into cedis at the available spot rate. If it arranged a loan with its bank, this would be denominated in cedis. The cash flow statement for the year ended 31 December 2018 is given below:

Summary statement of cash flows for the year

	2018	2017
	GH¢'000	GH¢'000
Profit before tax	852	
Add: depreciation	7	Cash flow
Add: interest expense	<u>34</u>	information
	<u>893</u>	for 2017
Changes in working capital		is not
Increase in prepayments	(184)	available
Increase in trade receivables	(219)	
Decrease in sundry assets	3	
Increase in customer advance deposits	62	
Increase in trade creditors	<u>12</u>	
	<u>(326)</u>	
Cash flow from operations	567	
Interest paid	(34)	
Taxation paid	<u>(200)</u>	
Net cash flow from operations	<u>333</u>	
Investing cash flows		
Dividend paid	<u>(150)</u>	
Change in cash and cash equivalents	183	
Cash and cash equivalents brought forward	<u>(445)</u>	
Cash and cash equivalents carried forward	<u>(262)</u>	

Organisation and governance

The directors also agree that in order to prepare for growth, the company needs to establish a more formal governance and organisation structure. At the moment, the company is managed by the two directors, although they try to keep their employees informed about their plans and what the company is doing. As the amount of administrative work has built up, they agree that they need to recruit an additional person to help them with management and administration.

Coffie has already expressed the view that they should appoint one of the company's tour guides to a position on the board of directors. Adofu disagrees. He would like to appoint a non-executive director, and promote a tour guide to the role of senior manager in the company, with responsibility for developing new tour services. Part of the background that is of relevance in determining whether to promote from within, or appoint from outside, is that the company's current remuneration packages are rapidly looking out-of-date, and, frankly, not offering an attractive proposition. Coffie and Adofu have both read that start-ups and early stage companies in their sector are either paying more, or introducing additional elements to the remuneration package, such as share options.

When asked by Coffie about the identity of a possible non-executive director, Adofu made two suggestions. One was to appoint a retired retail banker who is known to both himself and Coffie. The other is the managing director of a transport company in Ghana that operates a fleet of buses and other transport vehicles, and who has extensive knowledge of the tourism industry in the country. This individual is also well known to both directors.

Security and control

The company has just received a report at its Accra office from a tour guide who is currently leading a tour with a tour group of 18 people. Two of these individuals have been robbed in the street, and the police have so far been unable to catch the thief. This incident has led to a number of other complaints from members of the tour group, about the tour leader sometimes being unavailable when expected, or late for the start of daily excursions; problems with the handling of luggage and suitcases; and on one occasion missing a short sea cruise because the tour group arrived too late at the embarkation point.

Adofu and Coffie are alarmed by these reports, and think that some tour guides might be ignoring the company's code of conduct, which puts customer care and ethical business practice at the forefront of employee concerns. The company's marketing and promotional material boasts that customers receive five-star service and complete protection during their holiday. Coffie questions whether the company is being entirely ethical in its approach to business, and he is doubtful whether the company's tour guides are sufficiently competent in the work they do.

Required:

- a)
- i) Analyse the *financial performance* of Ghanalux in 2018 in order to determine the extent to which the continuing large bank overdraft is attributable to profitability issues, cash flow management issues, or a combination of both.
 - ii) Prepare a *forecasted cashflow statement* for Ghanalux in 2019 to determine the likely bank balance or bank overdraft balance as at the end of 2019. Assume the financial relationships and ratios are largely maintained from 2018 to 2019.
 - iii) Recommend measures to *improve the cash flow* of the company. **(20 marks)**
- b) Discuss the *potential benefits and problems* with proposals to:
- i) Convert the company's short-term borrowings into a longer-term loan.
 - ii) Pay bigger cash salaries, or add a share option element to the remuneration packages.
 - iii) Maintain the dividend for 2019 at the 2018 level, or even reduce it further.
 - iv) Convert any surplus dollar cash into cedis. **(10 marks)**
- c) In response to the views of the company directors, and giving your reasons, recommend any changes to the governance and organisation of Ghanalux that would benefit the performance of the company. **(8 marks)**
- d)
- i) Discuss whether the company is operating in an ethical manner. **(5 marks)**
 - ii) Recommend internal controls that might be implemented by the company to improve customer safety and security, and to deal with the problems of poor service to customers. **(7 marks)**
- (Total: 50 marks)**

SOLUTION TO QUESTIONS

QUESTION ONE

(a)

(i) Porter's Diamond can be used to analyse the competitive advantage of nations. At the moment the tourism industry in Ghana is relatively under-developed, compared with tourism in other countries, although it is growing and has government support.

Porter argued that four factors can give one country's industry a competitive advantage over similar industries in other countries.

- One factor is **the existence of strong and competitive supporting industries**. A tourism and tourist hotels industry benefits from a strong and competitive transport industry and a good and reliable food and restaurants industry, for example. Arguably, these supporting industries well-developed in other countries, putting tourism in Ghana at a relative disadvantage.

- A second factor is **the strength of local demand for tourism within a country**, particularly when this demand is sophisticated and discerning. Strong local demand can help firms in the country to develop products and services that can attract demand from other countries, and make the country's tourism industry more attractive than foreign competition. Arguably, the demand for tourism within Ghana is not as strong as local demand in other countries.

- A third factor is the **structure and strategy of firms in the industry, and the rivalry between them**. The tourism industry will benefit from the existence of companies with a large amount of resources and efficient management organisation, and strong competition between firms. In Ghana, there is probably an insufficient number of large, competing firms in the tourist industry, and further development is needed to make tourism in Ghana compete more effectively with other countries.

- The fourth factor is **favourable factor conditions**, i.e. advantages in terms of natural resources, climate, labour skills, technological development, and infrastructure such as transport and telecommunications networks. Countries with more favourable factors will compete more successfully with countries that have less of them. Tourism in Ghana will benefit from more labour skills and better infrastructure, and building these will take time. However, Ghana has natural resources – historical sites, game parks, beaches, rainforests and so on – that give its tourism industry great strength, and these have already contributed to its development and growth, and will continue to do so in the future.

(4 points well explained @ 2 marks each= 8 marks)

(ii)

- A strategy of expanding into other countries in Africa might be successful, provided that the *company has sufficient resources* to do so. Many aspects of tourism are similar in most countries, and there are large companies specialising in tourism and travel that have global reach. However, Coffie Aduro has an ethnocentric view of the tourism business, and thinks that Ghanalux should focus exclusively on Ghana because the tourism business in Ghana is different from other countries. This view is not necessarily correct.
- A strategy of expanding into other countries might therefore be suitable, because *opportunities for growth might be greater in other countries than in Ghana*. However, Ghanalux does not have experience in other countries, and because it is still a fairly small company with limited resources, this strategy is probably unrealistic and not feasible. It would also be unacceptable to Coffie Oduro, one of the directors and an important stakeholder in the company.
- A strategy of developing the business into conferencing might also seem suitable for a company in the *'high quality' end of the tourism industry, especially if there are prospects for strong growth in the conferencing business* in Ghana. However, the strategy is almost certainly not feasible, because of the company's lack of experience, marketing structure and resources.

(2 points well explained @ 3 marks each = 6 marks)

(b)

(i) [Tutorial note: Answers to this question might vary. However, answers should be well argued and suggestions and conclusions justified.]

Competitive advantage is something that enables a business to compete successfully in its markets and against rivals. It comes from being either the least cost producer in the industry, or by having product differentiation that appeals to customers and enables it to sell its products or services successfully. **(1 mark)**

Ghanalux is not a low-cost producer, and its competitive advantage must therefore come from the way in which it differentiates its product. (1 mark)

From the information provided, it would seem that the competitive strength of Ghanalux comes from one or more of the following factors:

- its sales operations in the north east of the USA, which are successful in attracting customers;
- the unique skills and abilities of its two founders and directors;
- the quality of its tours.

It is not clear that the directors of Ghanalux have unique skills or talents that add to the company's competitiveness. The tours, although positioned in the 'luxury' sector of the market, have experienced operational failings. It might therefore seem that its selling operations are likely to be its most competitive feature.

However, the company does not appear to have unique resources or features, and it will be exposed to the threat from rival companies offering more successful product differentiation in the 'high end' segment of the tourism market.

(Any 3 points @ 3 marks)

(ii)

- A balanced scorecard approach to setting business targets and performance management seeks to achieve a balance between the short-term requirement for financial success with the longer-term requirements for a sustainable, successful business.
- Companies commonly measure their performance in financial terms and on the basis of (backward-looking) historical results. With a balanced scorecard approach, performance targets are set and monitored by forward-looking perspectives (a customer perspective, internal perspective and innovation and learning perspective) as well as financial measures.
- Over the long-term, achieving performance targets for the three forward-looking perspectives will result in the continuing achievement of financial targets.
- In the case of Ghanalux, setting targets from a customer perspective, internal perspective and innovation and learning perspective should therefore help the company to achieve its long-term objectives of financial success and growth.

(Any 3 points for 3 marks)

(iii)

Customer perspective

- From a customer perspective, key aspects of performance are likely to be customer satisfaction, sales numbers and customer profitability. Performance targets can be set for each of these.
- Customer satisfaction measures are likely to be subjective, but the company can obtain feedback from customers at the end of a tour, giving scores or ratings for various aspects of the tour they have been on. For example, customers might give ratings for the quality of hotels they have stayed at, transportation they have used, the tour activities, the helpfulness of the tour guide, and so on. Customer satisfaction ratings can then be used to derive a total score for satisfaction. The company's aim should be to set higher targets for satisfaction scores over time, and to achieve or beat those targets on every tour.

- Customer satisfaction is likely to be linked to sales numbers. Other measures of customer satisfaction might be the number of bookings on tours over a given period of time, and the percentage of bookings that are 'repeat sales'. If Ghanalux hopes to achieve rapid growth in its business, targets for sales numbers will be a key element in performance management from a customer perspective.
- Customers must also be profitable for the company. The company might take the view that from a customer perspective, there should be a target or minimum profit per customer.

(Any 2 points for 2 marks)

Internal perspective

- From a customer perspective, a key aspect of performance is likely to be effectiveness in selling/marketing and in providing successful tours for customers.
- Currently, the company has only one sales agent (the travel booking company in the USA) but to make its selling operations more effective, the company might consider setting targets for growth in the number of agents that it uses.
- Other performance targets for the effectiveness of operations might be the number of brochures (advertising tours) that are distributed in a given period or (if the company uses a website for marketing) the number of clicks on its website.
- The effectiveness and efficiency of tour operations might be measured by the number of 'incidents' reported that indicate mistakes or shortcomings during tours. Success over time may be linked to reducing the number of incidents to an acceptable minimum. In a balanced scorecard, a target might therefore be set for the maximum acceptable number of reported incidents and complaints.

(Any 2 points for 2 marks)

Innovation and learning perspective

- From an innovation and learning perspective, it might be argued that a tourism company needs to refresh and change its offerings to customers regularly. However, in view of the shortage of employee skills in the tourism industry, the 'learning' perspective is probably more important. By developing their skills, employees become more knowledgeable and efficient, and should be able to contribute towards the success of the company's tours, and customer satisfaction.
- The company should seek not only to develop employee skills, but also to retain experienced and well-trained employees. Although the company is fairly small, performance targets might be set for the amount of spending on employee training, and/or the number of training days per employee.

- Success in retaining employees might be measured by employee turnover rates, but it might also be possible to establish a system for obtaining feedback about employee satisfaction, and then using this feedback to derive an employee satisfaction score.
- Improvements in employee development might also be measured by profitability per employee.

(Any 2 points for 2 marks)

Financial perspective

Targets for financial performance can set monetary values for sales and profits, but if the long-term ambition of the company is to achieve sustainable growth, suitable financial targets would be sales revenue growth, growth in profits and possibly also targets for cost reduction.

(2 marks)

(c)

(i) Strategic alliance

It is questionable whether the proposed agreement between Ghanalux and Sunlit Hotels is a strategic alliance, or whether it is simply a trading arrangement between the two companies.

Measured by sales revenue and profits, Sunlit Hotels is a much bigger company than Ghanalux. Unlike Ghanalux, it also has extensive capital assets (its hotels). It is therefore possible that Sunlit Hotels would be the 'dominant partner' in any trading arrangement between them.

(1 mark)

We do not have figures for room occupancy in Sunlit's hotels, but its proposal for an alliance is probably motivated by a wish to increase room occupancy in order to boost profits and return on capital, by arranging to accommodate Ghanalux customers during their tours. Assuming that the average number of rooms per hotel is 150, and that there are 360 trading days a year, the average revenue per hotel room in the Sunlit chain over the year is about GHC407 per night (GHC110 million/(5 hotels × 360 × 150)).

This is a low figure for a luxury standard hotel where the average room price is GHC800 per night, suggesting that occupancy rates are very low at 51% (407/800 = 51%).

(2 marks)

From the viewpoint of Ghanalux, it is not clear how much extra business it might win from its alliance with Sunlit Hotels. Ghanalux might be able to sell short oneday excursions to Sunlit's customers, but the company does not currently operate one-day excursions. It is also unlikely that visitors to Sunlit Hotels would be persuaded to book lengthy tours with Ghanalux.

Since the average length of a tour is four weeks and presumably covers much of the country, it is also unlikely that Sunlit's five hotels could offer all the accommodation that Ghanalux requires.

There may be a cost benefit for Ghanalux, if Sunlit Hotels offer a price per room that is lower than the price Ghanalux is currently paying for hotels for its customers. However, cost savings would need to be substantial to justify any trading agreement in which Ghanalux ties itself to using the hotels of a trading partner. **(2 marks)**

In summary, a strategic alliance between the companies seems an unrealistic proposition. However a trading agreement might be beneficial, in which Ghanalux undertakes to use Sunlit's Hotels where possible, in return for attractive room rates. This would help Ghanalux to control its costs, but is unlikely to help it to grow its business to any great extent. **(1 mark)**

Alternate solution

A strategic alliance is an agreement between two or more parties to pursue a set of agreed upon objectives needed while remaining independent organisations. This main objective of such partnership is to enable each of the parties to leverage on the strength of each partner to foster a long-term win-win situation for all the parties involved.

Below are some of the qualitative issues that directors of Ghanalux should consider in responding to proposals for a possible strategic alliance.

- **Shared risk:** It is important for Ghanalux to determine the extent to which the partnership with Sunlit Hotels would enable it to offset its market exposure. Strategic alliances probably work best if the companies' portfolio complement each other, but do not directly compete. In this instance, the business of Ghanalux is complementary to the business of Sunlit so it is expected that the proposed alliance would enable Ghanalux to offset its market exposure. Thus, they stand to be able to obtain new business by arranging tours for customers of Sunlit Hotels who may demand tour services. This would be in addition to those who visit the country for tourism purposes through its US marketing agency.
- **Shared knowledge:** Sharing skills (distribution, marketing, management), brands, market knowledge, technical know-how and assets leads to synergistic effects, which results in pool of resources which is more valuable than the separated single resources in the particular company. It is important for directors of Ghanalux to assess the skills set that Sunlit Hotels would bring into the alliance and determine whether they could leverage on these skills to achieve more competitiveness within its markets. Additionally, it is important for them to also ensure that Ghanalux do have the skill set which can be of beneficial to Sunlit Hotels, otherwise a win-win situation cannot be fostered.

Notwithstanding, it is crucial for the directors of Ghanalux to assure themselves that there will not be the divulgement of business secrets through the sharing of knowledge, which will be detrimental to Ghanalux, should the alliance be brought to an end someday. Even though agreements can protect these secrets, the directors of Ghanalux cannot guarantee that Sunlit Hotels would stick to such agreements. If the directors of Ghanalux decide to go ahead with the strategic alliance with Sunlit Hotels, they would have to put in place measures that will significantly reduce the risk of losing control over proprietary information, especially regarding complex transactions which require extensive coordination and intensive information sharing.

- **Creating a competitor:** The strategic partner, in this case Sunlit Hotels, might become a competitor one day, if it profits enough from the alliance and grow enough to end the partnership and then is able to operate on its own in the same market segment. This should especially be of great concern for the directors of Ghanalux considering the fact that Sunlit Hotels is already well positioned within the industry and have the financial resources or could easily obtain the financial resources to enter into the tour business successfully. This would be injurious to Ghanalux business.

- **Uneven alliances:** Ghanalux stand the risk of becoming a weak partner in a strategic alliance with Sunlit Hotels. As it stands now, Sunlit Hotels seems to have much more resources compared with Ghanalux. It is important for the directors of Ghanalux to critically assess their relative position in terms of the alliance so as to avoid a situation where it becomes a weaker partner in the alliance and thus be forced to act according to the will of Sunlit Hotels, which could be a more powerful partner, especially when it is not actually willing to do so.

Other risks which should also be critically considered and discussed by the directors of Ghanalux with regards to a possible alliance with Sunlit hotels include:

- Failures which might be attributable to **unrealistic expectations of the partner**. It is important for the directors to exercise prudence and be measured in their expectation of the benefits and opportunities that would crystallise should they enter into a strategic partnership with Sunlit Hotels. They may have to engage the services of a strategic consultant to be able to have an objective view about the possible benefits of the strategic partnership.

- They should also gauge the **commitment level of the partner vis-à-vis their own commitment** towards the strategic alliance. A lack of commitment from either both sides or even one side can seriously and negatively affect the expected outcome of the alliance. The directors should satisfy themselves with their own commitment level and that of Sunlit Hotel management before accepting any proposal for a strategic alliance. If they cannot commit to a high degree or their potential partner cannot commit to a high degree, they should not go ahead with the agreement. Otherwise, they would waste time which comes with some opportunity cost.

- The directors of Ghanalux should also consider the **cultural differences, strategic goal divergence and matters bothering on sufficient trust** before accepting a proposal of Strategic Alliance with Sunlit Hotel. If there are significant differences with the culture of the partners, coupled with extreme strategic goal differences and insufficient trust, then the directors of Ghanalux should refrain from entering into the alliance since this will be detrimental to the success of the company.

2 marks each for any 3 points

- (ii) If there is to be a business combination between the two companies, it would need to be an all-equity transaction, or a transaction financed mostly by equity. Ghanalux is unlikely to raise sufficient finance to pay for an acquisition in cash. It is not clear whether the owner of the Kumasi-based tour company would be willing to accept Ghanalux shares as consideration for selling his company.

(1 mark)

Assuming that the owner would be willing to discuss an all-equity merger or acquisition, there will be a problem in agreeing the valuation of each company, since both are private companies. The two companies began operations at about the same time, which means that Ghanalux has grown faster in terms of revenues (about GHC16 million compared to GHC8 million) and profits (GHC639,000 compared to GHC300,000), so that Ghanalux is twice the size of the Kumasi-based company, and growing at a much faster rate. The profit/sales margins of the two companies are roughly the same, but slightly higher for Ghanalux. The Kumasi-based company, since it operates a similar business to Ghanalux, is likely to own relatively few long-term assets.

(2 marks)

Since Ghanalux might be seen as being twice the size of the other company, it seems possible that in order to obtain the agreement of Jojo Okoye to a merger or takeover, Ghanalux might need to increase its shares in issue by up to 50%, so that Jojo Okoye would own up to about one-third of the combined business. The current shareholders of Ghanalux would need to consider whether they are willing to accept a dilution in their equity share of the company in order to grow the company.

The directors of Ghanalux also need to consider whether a combination with the Kumasi-based company makes strategic sense.

Ghanalux would gain access to the customer base of the Kumasi company, but this is mostly in France and Germany. A business combination would therefore almost certainly lead to management and administrative difficulties due to language differences and probably also big differences in corporate culture. Some restructuring of the management organisation of the combined entity would also be necessary.

A business combination might result in some savings in labour costs (since Jojo Okoye is retiring and might not need replacing as executive head of his business), but it is not clear whether any other synergies are achievable. Since they operate

from different locations (Accra and Kumasi) and deal with different customer languages, it might be difficult to reduce other operating costs. **(3 marks)**

In summary, Ghanalux might reasonably consider a strategy of growth through merger or acquisition, but given its current size and position in the market, dealing with US customers, it would be advisable for the directors to look for business combinations where the potential benefits are greater. **(1 mark)**

(d)

- Ghanalux uses just one sales agent in the USA, and has none in other countries of the world. It is therefore exposed to a serious risk of losing its main or only sales channel. We have no information about the extent to which the company might use a website to advertise and sell its tours. If it does not do so already, it should consider *creating a website for this purpose and advertising on the internet* to attract potential customers from all over the world. However as the company's tours use English as their language, internet marketing should be in the English language and so directed at English-speaking customers.

- The company's main sales channel, through its agent in north east USA, appears to have been successful. The company might therefore consider searching for similar agents in other regions of the USA. If it does so, it should discuss its intentions with its existing agent, to make sure that any such initiative would not damage their business relationship in any way. The company's existing agent might, for example, be considering an expansion of its business into other parts of the USA, and so might expect to act as agent for Ghanalux in those regions. If the existing agent is not planning to expand its business geographically, it might nevertheless be able to recommend agents in other parts of the USA, and possibly arrange an introduction to them for Ghanalux.

- Finding agents in other English-speaking countries might be difficult, but should not be an impossible task. The company should consider which country or countries it should target initially, and *locate a consultant who can help it to search for a potential agent*. (Most of the major consultancy firms have consultants specialising in tourism.) However, this process could be costly, and the company should allocate a budget to the project.

- In planning an expansion of its market coverage, the company should also ensure that its *marketing material (e.g. brochures and website) are of a sufficiently high quality* to attract the attention of potential customers.

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

(Total: 50 marks)

EXAMINER'S COMMENTS

Generally, candidates performed better on Question one (1) and poorly on Question two (2). Most candidates who failed to make the pass mark performed fairly well (25 or above) on Question one (1) but poorly on Question two (2) (with marks less than 25). Majority of candidates performed well on the question requiring the use of the Porter's Diamond (Question 1ai) with some disappointments - some candidates confused the Porter's Five Forces model with the Porter's Diamond. Candidates' performance on Question one (1aii) could be described as only fair. While some candidates had no idea what was being asked, others who were able to answer correctly provided shallow answers.

Performance on Question one (1b) could also be described as only fair. Most candidates understood generally what competitive advantage meant but overly relied on just one aspect of competitive advantage in their discussion, even though there were many issues they could have discussed - which gave Ghanalux a competitive edge over rival firms. The case was replete with so much information on competitive strengths.

Furthermore, candidates generally performed creditably well on the question that bothered on balanced scorecard. The weakness, however, had to do with the failure of many candidates to relate their discussion to the case itself, thus, losing significant marks.

With respect to Question one (1c), candidates performed poorly. Almost all candidates failed to discuss strategic alliance and business combination from a financial perspective, which is usually the threshold analysis to make before any consideration to the qualitative factors. A very large majority of candidates discussed the issues only from a qualitative perspective, albeit in a very shallow manner. Generally, Question one (1d) was well answered and could pass as the most well answered question.

QUESTION TWO

(a)

(Tutorial Note: Answers to this question should make use of the financial information provided)

(i) Financial analysis

Ghanalux	2018	2017	Change	
	GHC '000	GHC '000	GHC '000	%
Revenue	15,840	11,730	4,110	35%
Operating costs				
Tour expenses (flights, hotels etc)	12,947	9,389	3,558	38%
Sales commissions	800	577	223	39%
Salaries/ wages (including directors' salaries)	390	316	74	23%
Sundry operating costs	817	510	307	60%
Total operating costs	(14,954)	(10,792)	(4,162)	39%
Operating profit	886	938	(52)	-6%
Interest charges	(34)	(98)	64	-65%
Profit before taxation	852	840	12	1%
Taxation at 25%	(213)	(210)	(3)	1%
Profit after taxation	639	630	9	1%
Retained profit brought forward	311	(119)	430	-361%
	950	511	439	86%
Dividend	(150)	(200)	50	-25%
Retained profit carried forward	800	311	489	157%

Ratios				
<i>Gross profit margin</i>	5.6%	8.0%		
<i>Net profit margin</i>	4.0%	5.4%		
Interest cover	26.1	9.6		
Dividend cover	4.3	3.2		

• **Expenses**

The major factor in the reduction in operating profit margin arises from an increase in sundry operating costs, which have increased from 4.7% (510 / 10,792) of the total operating costs in 2017, to 5.5% (817 / 14,954) of the total for 2018.

Looked at another way, the revenue has increased by 35%, and the tour expenses, commissions and wages and salaries have broadly matched this. But the sundry operating costs have increased by 60%. A reference to the two directors' realisation that cost control and budgeting needed to be improved points to the underlying cause of the reduced operating margin. **(1 mark)**

• **Interest**

The interest expense is covered 26 times in 2018 (886/34), compared to only 10 times in 2017 (938/98). This is both a healthy and improved position, and evidence that the amount of debt has been significantly reduced. Calculating the apparent interest rate suggests that the interest rate in 2018 has also reduced. **(1 mark)**

• **Cash flow analysis**

There are indications that the directors understand the impact on cash flow of the timings of the large payments made to hotels and airlines, versus the receipts from customers.

In 2017, the prepayments amounted to 19 days of tour expenses ($489/9,389 \times 365 = 19$ days). In contrast, the customer advance deposits amounted to 5 days of revenue ($161/11,730 \times 365 = 5$ days). The cash flow implications are serious, reflecting that nearly four times more cash is committed to prepaying the airlines and hotels, than is covered by customer deposit cash flow. How does 2018 compare?

In 2018, the prepayments amounted to again 19 days (same basis of calculation as above), and the customer advance deposits were also 5 days.

The conclusion from this is that although there is a structural imbalance between these two cash flows, resulting in nearly 14 days of hotel and airport booking to be financed by working capital, the situation has not worsened during 2018.

What about the collection of the balance of holiday money from customers? A similar calculation to the above reveals that in 2017, customer balance payments were being received on average 23 days after invoicing ($739/11,730 \times 365 = 23$ days). In 2018 the payment time was 22 days – a small but worthwhile improvement.

Is there any scope for offsetting the total time for customer payment of $5 + 22 = 27$ days, with a period of trade credit? Unfortunately it seems not, given that the majority of the cash flow detriment arises from the payments to the main suppliers – hotels and airlines. Other trade creditors are such a small amount that calculating creditor days would not add to our analysis.

We do not know whether the end-of-year statement of financial position of the company is typical or representative of its financial position at other times of the year. However, assuming that it is reasonably representative, the company made a profit of GH¢639,000 last year but had bank borrowings of GH¢262,000 at the year end. Its non-current assets amounted to just GH¢75,000, indicating that the cash flow problems of the company are attributable partly to a continued dividend distribution policy, and much more so to its investment in working capital.

(3 marks)

Conclusion

Although there is scope to improve some cost control, which would help profitability and cash flow, it appears as if the structural imbalance between payments out and payments in is largely to blame for the continuing high bank borrowings.

(1 mark)

Forecasted cashflow statement 2019

Revenue growth rate can be estimated in a number of ways.

- The growth rate g since formation of the company is $2m \times (1+g)^6 = 16m$. Solving this for g gives $g = 41\%$
- Utilizing the two P&L accounts given suggests a revenue growth rate of 35% ($11,730(1+g) = 15,840$)

(1 mark)

It would be sensible to use this most recent growth rate as the estimate, given the likelihood that 41% pa over 6 years is unlikely to be sustainable (for example concerns over holiday-maker safety). This forecast will use 35% as the next period growth rate in revenue, suggesting a revenue for 2019 of around 21.4m, and with an operating profit margin of (say) 6%, an operating profit of about 1.3m. The major operating cost for modelling purposes will be an estimated 87% of the total operating costs, representing “Tour expenses”. Total operating costs are estimated as $21.4 - 1.3 = 20.1m$, of which $17.5m$ ($87\% \times 20.1$) are “Tour expenses”.

Other figures needed for modelling are:

- Prepayments for tour expenses at Dec 2019: $19/365 \times 17,500 = 911$
- Trade receivables at Dec 2019: $22/365 \times 21,400 = 1,290$
- Customer advance deposits at Dec 2019: $5/365 \times 21,400 = 293$
- Taxation expense and cash flow: $25\% \times 1,300 = 325$

(2 marks evenly spread using ticks)

ii) The cash flow statement for the year ended December 2019 can now be forecast:
Forecasted statement of cash flows for the year

Forecasted statement of cash flows for the year

	2019 GHC '000	2018 GHC '000
Profit before tax	1,300	852
Add: depreciation (ignored – not material enough to model)	-	7
Add: interest expense (assumed zero)	-	34
	1,300	893
Changes in working capital		
Increase in prepayments (911-673)	(238)	(184)
Increase in trade receivables (1,290 – 958)	(332)	(219)
Decrease in sundry assets (ignored)	-	3
Increase in customer advance deposits (293-223)	70	62
Increase in trade creditors (ignored)	-	12
	(500)	(326)
Cash flow from operations	800	567
Interest paid	-	(34)
Taxation paid	(325)	(200)
Net cash flow from operations	475	333
Investing cash flows		
Dividend paid (set to zero for modelling)	-	(150)
Change in cash and cash equivalents	475	183
Cash and cash equivalents brought forward	(262)	(445)
Cash and cash equivalents carried forward	213	(262)

(7 marks evenly spread using ticks)

Comment on forecast

It is apparent that without any capital expenditure during the 2019 year (probably can't be delayed forever), and with no dividend distribution, then the bank overdraft

will be eliminated by the year end. If the cash flows are broadly constant over the year, then the bank borrowings could be expected to be eliminated by $(262/475 \times 12 = 7 \text{ months})$ just after the middle of the year. Given this projection, it would then be possible to estimate the amount of interest that would be payable for borrowings declining to zero over 7 months, and the forecast above reworked. This has not been done because the impact would be insignificant to the scale of numbers involved. (Approximate interest rate for 2018 was $34 / (445+262) / 2 = 10\% \text{ pa}$, so for half a year on 262 = 13).

Clearly the payment of a dividend, and/or any significant capital expenditure, can be accommodated within these forecasts, in a total of as much as 213, and still leave the company with zero net borrowings at the end of the year.

(1 mark)

(iii) The cash flow position might be improved in several ways.

- It would appear that the company has made an effort to address its high level of borrowings by reducing the dividend in the most recent year. Whilst effective at bringing down the bank borrowings, it is likely that such a decision will have been unattractive to Adofo and Coffie from a personal tax perspective, and may have been relatively more unattractive to the family members who helped back the formation of the company.

- The company should also look at ways of reducing costs. There is no detailed information about salaries and wages, although these are the smallest cost in the income statement. Some sundry operating costs might be reduced, and these should be analysed with a view to preparing lower-cost budgets in future years. Commission costs are about 5% of sales (800/15,840). It might be possible to negotiate a lower commission rate with the company's agent in the USA, but as (most) sales appear to come through this agent, the company cannot seek to impose a drop in the commission rate. A reduction in commission rate by about one percentage point to 4% would reduce costs (and improve cash flow) by about GHC158,000 per year – or more, since sales revenue continues to grow; however, as stated previously, such a big cut in the commission rate is unlikely to be achievable.

- Growth in sales will improve the cash flow position, but the benefit is much reduced, since adding to sales appears to increase working capital requirements too, reducing net cash inflows.

- Customers are required to pay a deposit of 10% when they book a holiday. This might be a low amount, although the company should investigate deposit rates charged by other tour companies operating in north east USA. If Ghanalux could increase deposits from 10% to 20%, say, without any reduction in tour bookings, working capital requirements would fall by about GHC223,000 because advance bookings would double in amount (equal to the level of advance deposits in the

statement of financial position). This on its own would be almost sufficient to eliminate the bank borrowings.

- The company might also seek to reduce the prepayments that it makes to airlines and hotels. It might seek to negotiate either lower advance payment rates, or later payments. Either of these would reduce the prepayments that the company has to make. These are GH¢673,000 in the statement of financial position, so a negotiated reduction of, say, 10% would reduce working capital requirements and improve the cash position by about GH¢67,000.

If the company is able to adopt the measures suggested above, it might be able to eliminate its bank borrowings even sooner in 2019, but it would then need to ensure that any future increases in working capital each year are less than the company's retained profits for the year.

(Any 3 points well explained for 3 marks)

(b) Proposals (i) Convert the company's short-term borrowings into a longer-term

Medium-term borrowings should ideally be used to finance medium-term requirements. Converting short-term borrowings into a medium-term loan would indicate a need for the finance on a longer-term basis. The company would need to estimate its financing requirements over a future period of several years in order to decide how much to borrow.

A problem with borrowing a fixed amount to finance varying amounts of working capital is that there will be times when the finance is not required, and the company will therefore be paying interest for finance that it does not currently need. On the other hand, if the company borrows less than it might need at times, it will need to arrange short-term borrowing in addition to its medium-term loan. This is likely to be more expensive.

There are other issues to consider in switching from short-term borrowings to a medium-term loan. These include:

The willingness of the company's bank to make a medium-term loan. In view of the company's profit and loss statement for the previous year, when net profit after tax was GH¢639,000 and interest costs just GH¢34,000, it is likely that the bank will agree to provide the loan.

The comparable interest costs. From a financial perspective, the company should seek the lower cost financing method.

(2.5 marks)

(ii) **Paying bigger cash salaries** may well simply add to the costs, without achieving any marked increase in either motivation, or the tendency to stay as a loyal employee. Many studies have shown that increased salaries don't make a

marked improvement in attraction or retention of staff. On the other hand, it is a quick and quite immediate response to the threat of losing staff.

However, the *introduction of a share option award scheme* may well achieve both the offer of a more attractive package, and help retention (for at least the service vesting period). Studies seem to indicate that such schemes are well received by employees in a fast growing, even if cash poor, company. However, any shares resulting from such a plan would (at least currently given the private status of Ghanalux), be largely unmarketable, and this will reduce the attractiveness of any such plan. Additionally, the calculations involved for accounting for such a plan under the requirements of *IFRS 2 Share-based Payments* are demanding in all cases, but especially so for private companies. There may be considerable fees to be paid to remuneration consultants or accountants for developing the amounts and disclosures required under IFRS.

(2.5 marks)

(iii) Maintain the dividend for 2019 at the 2018 level, or even reduce it further
The cash flow forecast has indicated that a dividend could be paid in 2019, and in the absence of any capital expenditure requirements, could be at the 2018 level, or see a return to the 2017 level. Even with payment of a dividend of 200, to match the 2017 level of dividend, the company could still expect to finish the year approximately cash positive.

But, the cash flow forecast has not made any allowance for needed capital expenditure, or a contingency, or perhaps at least offering a part cash/part shares deal to the shareholders of Sunlit Hotels. In general, exit shareholders in an acquisition will want some cash, even if to just utilise any capital gains tax allowance, but the main advantage of offering at least some cash is certainty for the exit shareholders. Withholding a dividend in 2019 to be able to complete at least a part cash offer should be seen as an acceptable move by all investors – after all, their shares should be worth more after the event.

On the other hand, although there seems little prospect at the moment of a move to take Ghanalux to quoted company status, the evidence of a broadly constant, or growing, recent dividend history would be essential to the achievement of that long-term aim.

(2.5 marks)

(iv) Convert any surplus dollar cash into cedis

The company does not have any surplus cash in its end-of-year statement of financial position, so any holdings of US dollars are temporary. The surplus cash should be held in the currency where the money will be needed to cover expenditures. If the company expects to make payments in US dollars in the near future, it should retain the cash in dollars.

Most of the company's revenues are in US dollars, and much of its expenditures (flights, commissions) are also in US dollars. It would therefore seem that dollar income should be retained in US dollars to cover these expenses, and only dollars that are not required for these expenditures should be exchanged into cedis.

Another possibility is that, subject to foreign exchange regulations, the directors of Ghanalux might prefer to retain profits in US dollars too, and operate with a minimum amount of cedis. This might depend on expectations about the future depreciation or appreciation of the cedi against the US dollar. If the cedi is expected to depreciate over time against the dollar, holding cash in dollars rather than cedis would probably be financially more beneficial.

(2.5 marks)

(c) Governance

- The two directors appear to disagree about the need to appoint a non-executive director to the board, even though they agree that governance in the company should be made more formal and both have ideas about appointing a new director. Adof's reasons for wanting to appoint a non-executive director appear to be that a non-executive director would bring more diversity and experience to deliberations and decision-making by the board. He appears to hold the view that the company might benefit from an injection of external experience to assist the company to succeed and grow.
- If the company were to appoint a non-executive director, the person appointed should be able to bring knowledge and experience that the existing two directors lack. It is questionable whether a retired retail banker would be able to contribute much to the deliberations of a tourism company. Ghanalux can consult its bank about financing matters.
- It is also not clear how the addition of a director of a transport company would benefit the company, especially since Ghanalux might use rival transport companies for its tours, and the appointee would be faced with conflicts of interest.
- In view of the relatively small size of Ghanalux, it is also questionable whether the company needs to appoint a non-executive director at all. Unless and until the need for external experience and skills is clearly required, the most appropriate recommendation is to reject the idea of appointing a non-executive director.
- Coffie Oduro has suggested appointing an executive director from among the company's existing tour guides. At the moment, the company has no management structure, other than the two directors. Making an appointment of an individual as an executive director, when there is still no management structure other than the board of directors, seems premature.

- However, there will be a need at some time to establish a more formal organisation structure as the company grows. Initial measures might be taken now. A first step should be to identify areas of authority and responsibility within the management structure. If the management tasks are becoming too much for the existing directors, they should decide which management tasks might be given to an employee. When the division of responsibilities has been decided, the directors can consider the appointment of an individual to fill the new management role that has been created.

- Another element of a necessary change in governance and organisation might be a change in management style. At the moment the two directors are authoritarian, making all decisions for the company except relatively minor operational decisions. They may think that they are being democratic by meeting with employees occasionally and describing aspects of the company and its affairs. However by making a management appointment, the directors should reconsider their approach. The appointment of one employee to the role of manager should open up the prospect of further management appointments in the future. The directors should therefore consider a governance or organisation and management policy of delegating more decision-making to front-line employees.

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

(d) i)

Ethics

The directors of Ghanalux would like their company to act ethically, and they promote this view through its code of conduct and marketing materials.

- Important aspects of ethical behaviour include acting with honesty and integrity, and in a professional way that shows concerns for customers. If there are concerns that some of the company's tour guides are not complying with the code of conduct and are providing poor customer care, the directors should have taken measures already to deal with the problems. They have not done so, which suggests a lack of honesty (false marketing) and integrity on their part.
- It might also be argued that corporate social responsibility or sustainability policies are also ethical. Here again, the company pays lip service to environmental concerns, but it does not appear to do anything that is obviously beneficial for the environment. Since its flies its customers from the USA to Ghana, it can be argued that Ghanalux is a contributor to environmental pollution.

(2 points discussed @ 2.5 marks each = 5 marks)

ii)

Internal controls

Various controls can be applied to reduce the threat to the safety and security of customers and the risk of poor customer service. All of these should have been implemented already, but the directors should review existing controls and their

effectiveness as a matter of urgency. **Internal controls to improve customer safety and security should include the following measures:**

- Tour guides should be responsible for customer safety at all times that they are in direct contact with their tour group. The company's code of conduct should also set out procedures to be followed in the event that a customer's safety or security is at risk.
- Customers should also be given clear warnings about possible risks, particularly when they are on their own and not with the group. . To reinforce this message about security, customers should be given warnings and guidance in writing and also verbally from the tour guides.
- They should be advised about measures they should take to reduce the risks to their security, or how to act in the event that a threat occurs

(3 points for 3 marks)

Internal controls to reduce the risk of poor customer service should include the following measures.

- Staff training. Tour guides should be given training to develop their understanding of their role and the measures needed to provide good customer service, such as promptness and adhering to timetables. Guides should also be given occasional 'refresher' courses to reinforce their awareness.
- The process of recruiting new personnel, particularly new tour guides, should be thorough and demanding, so that only very able individuals are offered jobs in the company.
- Customer care issues should be discussed at the regular meetings between the directors and employees, so that the importance of customer care remains at the forefront of employee thinking.
- Measures to supervise employees, particularly tour guides, should be introduced. A number of guides might be appointed as 'senior tour guides' with responsibilities that include supervising and mentoring a small number of other guides. Senior tour guides should have procedures for monitoring the activities and performance of the individuals for which they are responsible, for example by means of regular contact by mobile phone.
- There should be reporting and management controls. Procedures should be implemented for reporting incidents of poor customer care, from both customers and tour guides themselves. Management or supervisors should be responsible for acting on reports immediately.

- There should be a system for recording reported incidents of poor customer service, the reasons why they occurred and the measures that were taken to deal with each incident. Management should review reports regularly and consider whether any further policy measures need to be taken, or new procedures introduced.

(Any 4 points @ 1 marks each = 4 marks)

(Total: 50 marks)

EXAMINER'S COMMENTS

Candidates performed extremely poorly on Question two (2), which required conducting some financial analysis. This was a bit shocking and totally unexpected especially considering the caliber of candidates who sat for the paper (individuals who have passed all papers requiring financial analysis). Indeed, candidates' performance on this question was woefully disappointing. Notwithstanding, almost all candidates performed very well on the Question two (2a-iii), which required them to recommend measures to improve the cashflow of the company. Generally, performance on Question 2b, which required candidates to discuss the potential benefits and problems associated with various financial strategies, could be described as fairly good. Obviously, this was very much expected from candidates who have sat and passed papers relating to financial management and strategy.

Questions 2 c and d were also well answered by candidates to some extent. The only weakness identified bothered on some candidates' failure to situate their recommendations of appropriate corporate governance within the right context. Thus, many candidates made suggestions which were impracticable for the company – they failed to relate their recommendations to the case. For instance, some candidates suggested the inclusion of non-executive directors to the board of Ghanalux without giving consideration to their independence as well as the financial circumstance of Ghanalux (a small company which lacked the financial resources to be able to engage a high caliber independent non-executive directors).

Going forward, my advice to candidates is to intensify their learning of issues bothering on quantitative tools for making strategic decisions. Instructors should be advised to intensify teaching bothering on the environment of business and engage students more in solving lots of case study/scenario-based questions. Candidates should also be encouraged to read, listen to, and watch general news and more specifically business news in order to appreciate the environment of business and be able to effectively answer case study questions.

The reason for the weaknesses in the Strategic Case Study paper are not far-fetched. I have indicated these in earlier reports (see, for instance May 2019 report). The Strategic Case Study paper is currently a capstone paper, which requires very technical and professional individuals as instructors. Additionally, instructors are advised to engage candidates in more case study discussions and not just teaching the concepts

and theories. Candidates are advised to read and practice solving case study and scenario-based questions on their own as a way of assessing their own understanding of the concepts and theories they have learnt. Furthermore, it would be crucial and extremely beneficial for candidates to form discussion groups to discuss case studies and scenario based questions. Lastly, candidates must remember that whatever course they are studying as part of the professional examinations must be done having this paper in view.