EXAMINER’S GENERAL COMMENTS
The standard of the examination paper was good and a good number of the candidates prepared well for the examination.

STANDARD OF THE PAPER
The standard of the paper was good. It compares favourably with those of previous years. There were no ambiguities, typographical or other errors in the paper. The marks allocation was fair and marks were allocated to each sub-question. All the questions were within the scope of the syllabus.

PERFORMANCE OF THE CANDIDATES
The performance was slightly above average. It was however an improvement over that of November 2016. A good number of the candidates performed creditably. However, there were some of the candidate who performed poorly because they did not prepare very well for the examination.

NOTABLE STRENGTHS AND WEAKNESS OF CANDIDATES
The main strength was that almost all the candidates attempted the required number of questions. A few of them demonstrated good understanding of the subject matter. Most of the candidates were now familiar with the difference between factors in the external environment and forces of competition.

The weakness of the candidate was that some of them provided incorrect responses to questions. Another weakness is a problem of transfer of learning. Some of the candidate could not compute return on investment and residual income which is a subject in Cost and Management Accounting.
QUESTION ONE - CASE STUDY

GUSSIE PERRY LTD

Introduction
Gussie Perry Ltd (GPL) is a long-established divisionalised company with its origins in shipping. The company has been in existence for nearly 120 years and has developed a reputation for reliability and quality service.

The shipping activities in which Gussie Perry Ltd (GPL) is engaged comprise four divisions - cruise, ferry, container and bulk shipping. The cruise division is engaged entirely in the carriage of passengers and the ferry division carries passengers and vehicles. The vehicles carried by the ferries range from motor cars to articulated trucks and buses. The container and bulk shipping divisions are engaged in the carriage of freight only.

Organisational goals
The company has stated over recent years that it aims to:
1. Increase its international business to achieve long-term profitability.
2. Provide the necessary capital investment to support its international operations.
3. Train and develop the company's employees.

Environmental and Safety policy
Environmental protection is now a key aspect of corporate social responsibility. Pressure on Gussie Perry Ltd (GPL) for better environmental performance is coming from many quarters. The company recently implemented an environmental and safety policy, which is monitored through an audit system, in an effort to ensure that its policies are being executed. It is the aim of the company to have operational standards which match with the best industry’s standard. Training of management, staff and specialist auditors is seen as a priority within the organisation's environmental and safety policy. This has become a major concern for the company, because of customer anxiety about the safety of the ferries.

Financial results
In the last financial year, earnings per share was GH¢2.12 producing a dividend cover of 1.15 times. The dividend per share paid by Gussie Perry Ltd (GPL) has remained at the same level for five years. Comparative values for divisional revenue and operating profit are shown in table 1.

Table 1: Divisional Financial Data

<table>
<thead>
<tr>
<th></th>
<th>Cruise</th>
<th>Ferry</th>
<th>Container</th>
<th>Bulk Shipping</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GH¢000</td>
<td>GH¢000</td>
<td>GH¢000</td>
<td>GH¢000</td>
</tr>
<tr>
<td>Current year’s revenue</td>
<td>5,136</td>
<td>4,002</td>
<td>7,572</td>
<td>750</td>
</tr>
<tr>
<td>Previous year’s revenue</td>
<td>4,410</td>
<td>3,756</td>
<td>6,306</td>
<td>672</td>
</tr>
<tr>
<td>Current year’s operating Profit</td>
<td>780</td>
<td>650</td>
<td>252</td>
<td>(30)</td>
</tr>
<tr>
<td>Previous year’s operating profit</td>
<td>528</td>
<td>480</td>
<td>240</td>
<td>(18)</td>
</tr>
<tr>
<td>Assets/Capital Employed</td>
<td>2,800</td>
<td>2,500</td>
<td>3,200</td>
<td>3,800</td>
</tr>
</tbody>
</table>
During the year, general inflationary levels in the shipping industry was 14% per annum. The company’s cost of capital is 25%.

**Extract from the Chairman's statement for the financial year**

In his statement, Mr. Aaron Yeboah, the Chairman of Gussie Perry Ltd (GPL), commenting on revenue and profit before the inflation adjustment, said the company achieved encouraging results, particularly in the cruise division. The company had taken delivery of a new cruise liner, at a cost of GH¢1,200,000 and has two more on order. Aaron believed that this was an expanding market and considered the company to be in a good position to take advantage of the opportunity. With regard to the ferry division, Aaron expected continued growth, although there was an expectation of potential new entrants due to increased cargo volumes. This contrasted with his view of the declining performance of the container and bulk shipping divisions as shown in table 1.

**Market information**

Gussie Perry Ltd (GPL) commissioned a marketing research into its cruise and ferry operations. The results of this research indicated that, in recent years, within the cruise liner industry, there has been a change in customer appeal. Traditionally, the main customer base had comprised of traders. In the last five years, the cruise division has experienced an increase in its clientele especially holiday makers. This stemmed from the promotion of domestic tourism.

Furthermore, the research showed a 15% increase in marine transport but Gussie Perry Ltd's market share actually reduced by 4%. The report indicates that the probability of the cruise market continuing to grow was bright. However, there were uncertainties about the future potential of the container and bulk shipping divisions.

**Required:**

a) Identify FOUR ways in which GPL’s concern for environmental and safety policy can impact on its performance. (4 marks)

b) The Chairman of the company has recently attended a short course on strategic planning. He was particularly interested in the relevance of mission statements to the strategic management process. Explain in FOUR ways how a mission statement is relevant in strategic management. (8 marks)

c) i) Calculate the current return on investment (ROI) and residual income (RI) for each division for the current year. (4 marks)

   ii) Assess the performance of each division and advise the management of Gussie Perry Ltd (GPL). (8 marks)

d) With reference to Porter's five competitive forces model, assess the nature of the cruise and ferry shipping market in which Gussie Perry Ltd (GPL) is engaged. (16 marks)

(Total: 40 marks)
QUESTION TWO

Susie Kabe completed first degree in pharmacy programme abroad and returned to her native country Ghana with the hope of starting a pharmaceutical company. Ghana has been experiencing high graduate unemployment and Susie was very determined not to join the teeming unemployed youth in the country. Susie put together an excellent business plan and approached four other childhood friends who have also completed university to start the company for manufacturing of basic and essential drugs locally. After many months of hard work the company finally commenced operations two years ago.

Susie Kabe plays a dual role of the chief executive officer (CEO) and chairman of the Board of Directors and the four other friends are all executive directors of the company. The board of the company is currently composed of five executive directors and two non-executive directors. The two non-executive directors are close friends of the executive directors without relevant work experience since they remained unemployed 3 years after completing university. There have been several board meetings held without the non-executive directors. This situation is largely due to believe by the executive directors that non-executive directors are really not needed since they do not play any important role on the board. Susie and other executive directors participated in a seminar on corporate governance where the facilitator made the following statements on best practices of corporate governance:

- “The roles of board chairman and chief executive officer should be held by two different individuals”
- “The board chairman performs critical functions to ensure that the board functions effectively”
- “The board should be composed of at least one-third of non-executive directors”

After the seminar the executive directors disagreed with some of the facilitator’s assertions. They claimed the statements are idealistic and not pragmatic. Susie Kabe has approached you as corporate governance expert to help provide clarity to the statements by the facilitator.

Required:

a) Discuss THREE justifications why the roles of the board chairman and chief executive officer should not be held by Susie Kabe.  

   (9 marks)

b) Explain THREE roles of non-executive directors on the board.  

   (6 marks)

c) Identify FOUR roles expected of Susie Kabe as the board chairman.  

   (5 marks)

(Total: 20 marks)
QUESTION THREE

a) Corporate Social Responsibility represents a company’s voluntary commitment to address the ethical, social and environmental factors associated with its operations. Despite its potential for furthering social needs, there are cogent arguments against Corporate Social Responsibility and may come under severe pressure in terms of its financing.

**Required:**
Discuss **FOUR** limits of Corporate Social Responsibility.  
(10 marks)

b) Professional accountants face many threats in the performance of their duties that may negatively affect accountants’ objectivity and independence. One of such threats is **intimidation threat** which may arise from close business relationships, family and personal relationships, and assurance staff members moving to employment with client as well as actual and threatened litigation.

**Required:**
Explain **FOUR** safeguards you will consider to deal with **actual and threatened litigation** as a professional accountant.  
(6 marks)

c) Human Resource Management play an essential role in employee development activities. Employee development activities refer to initiatives taken by organization and employees to enhance their skills with time and keep themselves acquainted with the latest developments.

**Required:**
Explain **TWO** strategic importance of Human Resource Management and employee development.  
(4 marks)

(Total: 20 marks)

QUESTION FOUR

a) Persiba IT Limited (PIL) started operations 10 years ago in Ghana providing a wide range of information technology solutions to diverse clientele. Mr. Quainoo, the chief executive officer (CEO) of the company, recently has been contemplating venturing into other West African markets to take advantage of untapped opportunities. This is also to strengthen competitive position of PIL since Ghanaian market growth is beginning to slow down and competition is getting keener.

At the 2016 second quarter Board meeting, the CEO tabled his proposal for consideration and board’s input before the document was finalized. During the Board discussions Prof. Amartey, who lectures Corporate Strategy, suggested to the CEO to use **Porter’s Diamond of national advantage** to assess competitive advantage of the other West African countries the company intends to enter. Prof. Amartey also mentioned to the CEO that companies that compete in the global market place typically face two types of competitive pressures: **pressures for cost reductions or global integration** and **pressures to be locally responsive**.
The cost reduction-local responsiveness dilemma shapes and results in four basic international strategies - international, global, multidomestic, and transnational – which the CEO should consider in making the choice.

**Required:**
Discuss how the **FOUR** factors in the Porter’s Diamond of national advantage determine competitiveness of the other West African countries on the global stage.  

**b)** Explain the following internationalisation strategies and identify **TWO** risks associated with each of the strategies:
1. International strategy
2. Global strategy
3. Multidomestic/Multinational strategy; and
4. Transnational strategy

(Total: 20 marks)

**QUESTION FIVE**

Covenant Mission (CM) is a non-governmental organisation that provides charitable support to disadvantaged families.

It is currently involved in a number of community projects to assist in the provision of clean water supply to families in Liberia, Nigeria and the Gambia. In its home country, Ghana it focuses more on assisting clients in accessing state granted financial support as well as providing counselling and psychological support to less privileged people.

The NGO has grown very rapidly in recent years as demand for its services have increased. In line with this rising demand, it has begun to slowly evolve from an enterprise primarily run by volunteers to an institution employing professional managers from the private sector. These changes are considered essential in supporting the sustainability of the charity.

The board of trustees at the NGO recognise the need to adopt a relevant code of ethics as part of necessary governance support structures. They are however concerned about recent criticism of such codes and wish to ensure that any code developed is effective throughout the organisation.

**Required:**

a) Advise CM on **FOUR** fundamental principles to be included in its code of ethics.  

(8 marks)

b) Explain **FOUR** benefits of good corporate governance to CM.  

(12 marks)

(Total: 20 marks)
QUESTION SIX

a) The chairman of Adama Group, which is large and diversified, has expressed concern about the inadequacies of the present voluminous monthly reports submitted to the Board. He acknowledges that it compares budget and actual results for all operations, and that it contains extensive reporting of non-financial indicators such as customer satisfaction and factory performance towards Total Quality Management (TQM). However, he regards much of this as operational detail, and considers that the report should place more emphasis on strategic issues.

A strategy consultant is currently assisting the Group to implement a Balanced Score card to effectively monitor the performance of managers.

Required:

i) Explain THREE strategic issues that should engage the attention of the Board of Directors of Adama Group.  

(6 marks)

ii) Explain how Balanced Score card can be used to monitor and measure performance in Adama Group.  

(10 marks)

b) Agency problems are inherent in static corporate structures. This conflict arises when separate parties in a business relationship, such as a corporation's managers and shareholders, have disparate interests. Corporations employ several dynamic techniques to circumvent static issues resulting from agency problems.

Required:

Identify FOUR measures which shareholders may seek to resolve any agency problems that arise.  

(4 marks)

(Total: 20 marks)
MARKING SCHEME

QUESTION ONE

a) Ways in which GPL’s concern for environmental and safety policy can impact on its performance.

- Understanding and managing environmental costs. Environmental costs are often hidden in overheads and environmental and energy costs are often not allocated to the relevant budgets.
- Minimise accidents and long-term environmental effects. Accidents and long-term environmental effects can result in large financial liabilities.
- Companies with poor environmental performance may face increased cost of capital because investors and lenders demand a higher risk premium.
- Environmental protection and ethical labour practices is now a key aspect of corporate social responsibility. Any steps they can take to protect the environment and its employee’s safety are considered both good for the company’s reputation and society as a whole.
- Pressures on businesses for environmental and safety of employees are increasing.
- Short term savings through waste minimization and energy efficiency schemes can be substantial.

(Any 4 points for 4 marks)

b) The Relevance of Mission Statements to Strategic Management

- Aaron Yeboah’s recent exposure to mission statements as part of the strategic management process provides a useful opportunity to evaluate their relevance and value to a small company such as GUSSIE PERRY. In some ways, Aaron is a ‘walking mission statement’. He epitomises the values, behaviour, strategy and purpose of why GUSSIE PERRY exists. Mission statements in defining the reasons why the firm exists, what it aims to achieve, how it aims to achieve its purpose and who it is in business for, can act as a powerful motivating force for the company. In strategic terms it may clarify the markets that the firm intends to serve, the products and services provided for those markets and the way they will be reached. In so doing it may define the boundaries of the organisation chosen by the top management.

- It may also specify the technologies to be used (perhaps important for GUSSIE PERRY and the competencies it will use to compete in its chosen markets. It is therefore a combination of ‘hard’ tangible drivers of the business and the ‘softer’ values and behaviours, which will enable the mission of the business to be achieved.

- Ideally, it should have relevance and resonance with all types and levels of employees. It expresses values and beliefs and in so doing will shape and influence the policies and standards adopted by the firm. They can profoundly

Page 8 of 30
influence the attitudes and behaviour of key stakeholder groups both inside and outside the firm and achieve a consistency of purpose for the stakeholders.

- By their very nature mission statements typically come at the beginning of the rational planning process and thereby facilitate consistent strategic decisions. However some commentators have argued that you discover rather than invent your mission.

- Aaron may now be in a position to develop a much more meaningful mission statement reflecting the origins of the company, his preferences, and the environmental conditions influencing the company together with its resources and associated competencies and capabilities.

- As the organisation grows and develops so its need for a formal mission statement may increase, enabling the direction of the company to be understood and for more detailed goal setting and planning to be done against a consistent framework.

- Its ability to communicate what the firm stands for both to stakeholders inside and outside the firm should not be underestimated. As such, development of an effective mission statement will take time and reflect changing conditions faced by the firm.

- Mission statements by their very nature are broad in their scope and intended to positively influence the many stakeholders linked to the company. Effective statements should be brief, adaptable to changing circumstances and clearly show the distinctiveness of the firm and its mission. Ineffective statements will convince nobody, have little or no impact on, or relevance to, what the firm does. They may be merely statements of good aspirations and intentions, and used for public relations purposes to justify actions already taken. Once created, good statements should be re-visited at regular intervals to ensure they are relevant to the environment the firm is operating in.

(Any 4 points for 8 marks)

c) i) Computation of ROI and RI for the current year of all Divisions

**Return on Investment**
The return on investment of a specific department within a company can be calculated by dividing the departmental operating profits by the capital employed by that department.

<table>
<thead>
<tr>
<th>Cruise</th>
<th>Ferry</th>
<th>Container</th>
<th>Bulk Shipping</th>
</tr>
</thead>
<tbody>
<tr>
<td>780/2,800*100</td>
<td>650/2,500*100</td>
<td>252/3,200*100</td>
<td>(30)/3,800*100</td>
</tr>
<tr>
<td>27.86%</td>
<td>26%</td>
<td>7.88%</td>
<td>-0.79%</td>
</tr>
</tbody>
</table>
Residual Income
Residual income can be calculated by taking the difference between the company's net income and its equity charge, where equity charge is the product of equity capital and the cost of capital.

<table>
<thead>
<tr>
<th>Division</th>
<th>Net Income</th>
<th>Equity Charge</th>
<th>Residual Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cruise</td>
<td>GH₵000</td>
<td>GH₵000</td>
<td>GH₵000</td>
</tr>
<tr>
<td>Ferries</td>
<td>GH₵000</td>
<td>GH₵000</td>
<td>GH₵000</td>
</tr>
<tr>
<td>Container</td>
<td>GH₵000</td>
<td>GH₵000</td>
<td>GH₵000</td>
</tr>
<tr>
<td>Bulk Shipping</td>
<td>GH₵000</td>
<td>GH₵000</td>
<td>GH₵000</td>
</tr>
</tbody>
</table>

(App 18 ticks @ 0.33 = 6 marks)

ii) Assessment of the Various Divisions

APPENDIX: SUMMARY OF KEY RATIOS FOR THE ASSESSMENT OF THE DIVISIONS OF GUISE PERRY LIMITED

<table>
<thead>
<tr>
<th>Division</th>
<th>ROI (%)</th>
<th>RI (GH₵)</th>
<th>Turnover Growth (%)</th>
<th>Growth in Asset Turnover (%)</th>
<th>Growth in Profit (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cruise</td>
<td>27.86</td>
<td>80,000</td>
<td>16.46</td>
<td>15.80</td>
<td>47.73</td>
</tr>
<tr>
<td>Ferries</td>
<td>26.00</td>
<td>25,000</td>
<td>06.55</td>
<td>06.67</td>
<td>35.42</td>
</tr>
<tr>
<td>Container</td>
<td>07.88</td>
<td>-548,000</td>
<td>20.10</td>
<td>20.30</td>
<td>05.00</td>
</tr>
<tr>
<td>Bulk Shipping</td>
<td>-0.79</td>
<td>-980,000</td>
<td>11.60</td>
<td>11.11</td>
<td>-66.70</td>
</tr>
</tbody>
</table>

Workings

*Growth in Turnover
\[
\left( \frac{\text{Current Year Turnover} - \text{Prior Year Turnover}}{\text{Prior Year Turnover}} \right) \times 100
\]

*Growth in Asset Turnover

Step 1: Asset Turnover Ratio
\[
\frac{\text{Turnover/Revenue}}{\text{Capital Employed}}
\]

Step 2: Growth in Asset Turnover
\[
\left( \frac{\text{Current Year Turnover}}{\text{Prior Year Turnover}} \right) - 1 \times 100
\]

^Growth in Profit
\[
\left( \frac{\text{Current Year Operating Profit}}{\text{Prior Year Operating Profit}} \right) - 1 \times 100
\]

Overall Company’s performance
Total turnover of GUSSIE PERRY Ltd increased from GH¢ 15,144,000 to GH¢ 17,460,000 - an increase of 15.3%. Profit increased from GH¢ 1,230,000 to GH¢ 1,652,000 - an increase of 34.30%.

For the company as a whole, the return on sales may be calculated as follows:
Last year – GH¢ 1,230,000 ÷ GH¢ 15,144,000 = 8.1%.
This year – GH¢ 1,652,000 ÷ GH¢ 17,460,000 = 9.46%.

Returning to the individual divisions, the following table expresses the various key financial measures.

**Divisional assessment**

**Cruise**
As regards the Return on Investment and Residual Income, one could really say that the cruise division had ‘encouraging results’. The returns from its investment is able to cover its cost of capital thus a positive Residual income. Turnover growth in Cruise division is 16.45% more than the Turnover growth rate of the company as a whole thus additional investment in this area might be productive. Although, without knowing the precise market conditions and the needs of this division as regards new shipping or other facilities, the financial performance of this division is very bright to make any firm judgements on investments and capital decisions.

**Advise for Cruise Division**
It will be advisable to approve and fund decisions for projects and programs of different types (for example marketing programs, recruiting programs, and training programs) for this division as a higher ROI means that investment gains compare favorably to investment costs.

**Ferries**
Ferries division shows an improvement of 6.55% in sales but 35.42% increase in profits, this is encouraging. It has a ROI of 26%, thus is covering its cost of investment. Capital and additional investments should be approved and encouraged at this division.

**Advise for Ferries**
Although there was low increment in sales, it translated into a high operating profits. The company should make efforts to increase turnover through company’s pricing policies, inventory management and investment in capital assets.

**Bulk Shipping and Containers**
In both containers and bulk shipping, the Chairman’s statement is fairly accurate in his pointing to disappointing results in this area. Both are not able to cover its cost of investment. Both Divisions has negative residual incomes.

**Advise for Bulk Shipping and Containers**
A negative residual income means that the division could have done better by another, risk-free approach. Some analysts refer to residual value as Economic Value Added. If your residual value is negative, you are not truly adding value to what you are
doing. There will be no value added if more funds and investments are approved at this division.

(2 marks each for every Division = 8 marks)
1 mark for any correct computation for each division
1 mark for correct advice for each division

d) Porter’s model identifies five competitive forces that affect performance and these are considered below with particular reference to the cruise and ferries divisions.

(i) The threat of new entrants
In both cruises and ferries, the threat of new entrants is restricted by the cost of entry, namely the acquisition of the shipping and facilities required to operate these very substantial vessels. If one considers outright purchase then this will be a significant deterrent. However, one must also consider that such vessels might be rented which makes access to the capital required more available. One might also consider that such vessels do exist all over the world and there is a possibility that competing companies might divert vessels that are not currently competing on GUSSIE PERRY Ltd routes to directly compete on GUSSIE PERRY Ltd routes. However, this threat should be related to the likely response that might come from incumbent firms within the industry.

One must also consider in this heading the extent to which a new entrant would gain access to the market. Unless such a new entrant has an existing name and reputation that is associated with this sort of marketplace then it is more difficult for them to attract customers to their services.

(ii) Competitive rivalry
Cruise liners and ferries are a high fixed cost operation. As such, one can only make profits if a company exceeds the breakeven volumes. All competitors in this marketplace will therefore be seeking to maximise their capacity, obviously without reducing prices to an extent that makes break-even capacity more and more difficult to achieve.

We have no details in the question as to how the marketplace operates, but one would expect a certain amount of price competition and, more importantly, significant non-price competition as well. Such non-price competition would include newer and higher quality vessels; improved port facilities to speed passenger and car throughput; customer loyalty schemes which may include links with other types of supplier (of which air miles would be a good example) but any such similar scheme.

(iii) The bargaining power of buyers
The buyers in this case are the passengers that use the ferries or cruise liners. Given that this is a very competitive market, then buyers do have significant power given that they can transfer to other suppliers if they do not like the price or the quality of
the facilities offered by a particular company. Such power is effectively limited by the differences that exist between the companies and to the extent that companies cannot differentiate themselves by price or non-price competition then buyers are put in a weaker position. This market is probably better described as an oligopoly rather than a perfectly competitive market as for any particular route there will be a limit on the number of suppliers. To the extent that these companies do have unofficial albeit illegal agreements regarding price and facilities offered then the power of the buyers will be diminished.

(iv) The bargaining power of suppliers

Many suppliers will have little bargaining strength as they are themselves subject to very competitive markets. Thus suppliers of food, fuel, various fixtures or fittings on the vessels themselves, will be in highly competitive markets and GUSSIE PERRY Ltd will be able to take advantage of its own fairly strong position.

However, its labour force must also be considered a supplier in this context and it depends on the industrial relations within this particular industry as to whether the company is in a strong or weak position in this respect. Port facilities and landing fees may also be an area where the company is in a weak position vis-a-vis a fairly small number of suppliers. However, as with all suppliers there will be limitations implied by legislation which limits, albeit not very effectively, the ability of the near monopoly suppliers to abuse their position.

(v) Threats of substitute products or services

Substitute products for the cruise division will be alternative types of leisure holidays. Thus a fortnight’s holiday visiting several cities by coach or air may be a perfectly reasonable substitute to a fortnight’s holiday cruising on a liner. Similarly, the numerous fly/drive holidays that are available would also be substitutes. The company would have to do market research to establish what sort of customers chose their cruises, whether it was customers who just liked cruising and would not really consider the alternatives available or whether it was customers who considered all the possible alternatives and then made a decision in favour of one or the other. Such market research would be vital for the company to produce the correct marketing strategy.

In the case of ferries, there are possibly more obvious alternatives such as the Channel Tunnel for the West African and also the airlines. Different considerations will apply to passengers and freight. As regards freight, the decision will be based almost exclusively on cost and time. Thus to compete, ferries would have to demonstrate that they can offer a cheaper service which does not significantly increase the time of the journey. As regards passengers, non-price factors such as the facilities and general amenity of the ferry service may also be important.

(3 marks each for every Force=15 marks)
(1 mark for presentation)
(Total: 40 marks)
EXAMINER’S COMMENTS
Case Study
This was a compulsory question. Some of the areas examined included significance of mission statement, assessment of the performance of divisions of a company using return on investment and residual income, competitive forces and the impact of environmental and safety policy on the performance of a company. The performance was above average. However, some of the candidates could not compute the return on investment and residual income.

QUESTION TWO

a) The justification for the separation of CEO and Board chairman roles:

- **Demands of roles.** It reflects the reality that both jobs are demanding roles and ultimately the idea that no one person would be able to do both jobs well. The CEO can then run the company. The chairman can run the board and take the lead in liaising with shareholders.

- **Authority/Dominance by an individual.** There is an important difference between the authority of the chairman and the authority of the chief executive, which having the roles taken by different people will clarify. The chairman carries the authority of the board whereas the chief executive has the authority that is delegated by the board. Separating the roles emphasizes that the chairman is acting on behalf of the board, whereas the chief executive has the authority given in his terms of appointment. Having the same person in both roles means that unfettered power is concentrated into one pair of hands. The board may be ineffective in controlling the chief executive if it is led by the chief executive.

- **Conflicts of interest.** The separation of roles avoids the risk of conflicts of interest. The Chairman can concentrate on representing the interests of shareholders.

- **Accountability.** The board cannot make the CEO truly accountable for management if it is led by the CEO.

- **Board opinion.** Separation of the roles means that the board is more able to express its concerns effectively by providing a point of reporting (the chairman) for the non-executive directors.

- **Control over information.** The chairman is responsible for obtaining the information that other directors require to exercise proper oversight and monitor the organisation effectively. If the chairman is also chief executive, then directors may not be sure that the information they are getting is sufficient and objective enough to support their work. The chairman should ensure that the board is receiving sufficient information to make informed decisions, and should put pressure on the chief executive if the chairman believes that the chief executive is not providing adequate information.
• **Compliance.** Separation enables compliance with governance best practice and hence reassures shareholders.  

(3 marks each for any 3 points=9 marks)

b) **Three functions of non-executive directors:**

- **Strategy**
  Non-executive directors should contribute to, and challenge the direction of, strategy. They should use their own business experience to reinforce their contribution. The most critical need is for an environment in which effective challenge of the executive is expected and achieved in the boardroom before decisions are taken on major risk and strategic issues.

- **Scrutiny**
  Non-executive directors should scrutinise the performance of executive management in meeting goals and objectives and monitor the reporting of performance. They should represent the shareholders' interests to ensure agency issues don't arise to reduce shareholder value.

- **Risk**
  Non-executive directors should satisfy themselves that financial information is accurate and that financial controls and systems of risk management are robust.

- **People**
  Non-executive directors are responsible for determining appropriate levels of remuneration for executives, and are key figures in the appointment and removal of senior managers and in succession planning.

(2 marks each for any 3 points=6 marks)

c) **The role of the Board chairman**

- **Running the board and setting its agenda**
  The chairman should ensure the board focuses on strategic matters and takes account of the key issues and the concerns of all board members. He should ensure the contributions of executives and non-executives are co-ordinated and good relationships are maintained.

- **Ensuring the board receives accurate and timely information**
  Good information will enable the board to take sound decisions and monitor the company effectively.

- **Ensuring effective communication with shareholders**
  The chairman should take the lead in ensuring that the board develops an understanding of the views of major investors. The chairman is often the public face of the company as far as investors are concerned.
• **Ensuring that sufficient time is allowed for discussion of controversial issues**
  All members should have enough time to consider critical issues and not be faced with unrealistic deadlines or decision-making.

• **Taking the lead in board development**
  The chairman is responsible for addressing the development needs of the board as a whole and enhancing the effectiveness of the whole team, also meeting the development needs of individual directors. The chairman should ensure that the induction programme for new directors is comprehensive, formal and tailored.

• **Facilitating board appraisal**
  The chairman should ensure the performance of the whole board, board committees and individuals is evaluated at least once a year.

• **Encouraging active engagement by all the members of the board**
  The chairman should promote a culture of openness and debate, by, in particular, ensuring that non-executive directors make an effective contribution to discussions.

• **Reporting in and signing off accounts**
  Financial statements in many jurisdictions include a chairman's statement that must be compatible with other information in the financial statements. The statement provides an opportunity for the chairman to demonstrate that he or she is acting in the shareholders’ best interests, and to provide an independent view of the company’s affairs. The statement can also explain how the chairman is exercising his or her role and highlight other aspects of corporate governance that might be of concern to the shareholders.

  (1 mark each for any 4 points + 1 mark for Presentation =5 marks)

  (Total: 20 marks)

**EXAMINER’S COMMENTS**
The focus of the question was on justification for the separation of the roles of Board Chairman and Chief Executive Officer, roles non-executive Directors and the functions of Board Chairman.

This was a popular question with the candidates and the performance was good.
QUESTION THREE

a) The limits of Corporate Social Responsibility can be argued along the following lines

- If managers do this, they are generally speaking, spending the owners’ money for purposes other than those they have authorized; sometimes it is the money of customers or suppliers that is spent and on occasion, the money of employees. By doing this, the manager is in effect, both raising taxes and deciding how they should be spent, which are functions of government, not of business. There are two objections to this:
  - Managers have not been democratically elected (or selected in any way) to exercise government power
  - Managers are not experts in government policy and cannot foresee the detailed effect of such social responsibility spending.

- Businesses do not have responsibilities, only people have responsibilities. Managers in charge of corporations are responsible to the owners of the business, by whom they are employed.

- These employers may have charity as their aim, but generally their aim will be to make as much money as possible while conforming to the basic rules of the society, both of those embodied in ethical custom.

- Maximizing wealth has the effect of increasing the tax revenues available to the state to disburse on socially desirable objectives.

- If the statement that a manager has social responsibilities is to have any meaning, it must mean that he is to act in some way that is not in the interest of his employers.

- Many company shares are owned by pension funds, whose ultimate beneficiaries may not be wealthy anyway.

(Any 4 points @ 2 ½ marks = 10 marks)

b) The following safeguards could be considered:

- Disclosure to audit committee – disclosing to the audit committee the nature and extent of the litigation

- Exclusion from audit team - removing specific affected individuals from the engagement team

- Additional reviewer - involving an additional professional accountant on the team to review work
- **Resignation from engagement** - if the litigation is at all serious, it may be necessary to resign from the engagement, as the threat to independence is so great.

(1.5 mark each for 4 points=6 marks)

c) **Strategic Importance of HRM and employee development**

Effective human resource management and employee development are strategically necessary for the following reasons:

- **To increase productivity**: Developing employee skills might make employees more productive, hence the recent emphasis on public debate on the value of training.

- **To enhance group learning**: Employees work more and more in multi-skilled teams. Each employee has to be competent at several tasks. Some employees have to be trained to work together (i.e. team working skills).

- **To reduce staff turnover**: Reducing staff turnover, apart from cutting recruitment costs, can also increase the effectiveness of operations. In service businesses, such as hotels, or retail outlets, reductions in staff turnover can be linked with repeat visits by customers. As it is cheaper to keep existing customers than to find new ones, this can have a significant effect on profitability.

- **To encourage initiative**: Organisations can gain significant advantage from encouraging and exploiting the present and potential abilities of the people within them.

**Alternative answers**

- **Recruitment and Training**

This is one of the major responsibilities of the human resource team. The HR managers come up with plans and strategies for hiring the right kind of people. They design the criteria which is best suited for a specific job description. Their other tasks related to recruitment include formulating the obligations of an employee and the scope of tasks assigned to him or her. Based on these two factors, the contract of an employee with the company is prepared. When needed, they also provide training to the employees according to the requirements of the organisation. Thus, the staff members get the opportunity to sharpen their existing skills or develop specialised skills which in turn, will help them to take up some new roles.

- **Performance Appraisals**

HRM encourages the people working in an organisation, to work according to their potential and gives them suggestions that can help them to bring about improvement in it. The team communicates with the staff individually from time to time and provides all the necessary information regarding their performances and also defines their respective roles. This is beneficial as it enables them to form
an outline of their anticipated goals in much clearer terms and thereby, helps them execute the goals with best possible efforts. Performance appraisals, when taken on a regular basis, motivate the employees.

- **Maintaining Work Atmosphere**
  This is a vital aspect of HRM because the performance of an individual in an organisation is largely driven by the work atmosphere or work culture that prevails at the workplace. A good working condition is one of the benefits that the employees can expect from an efficient human resource team. A safe, clean and healthy environment can bring out the best in an employee. A friendly atmosphere gives the staff members’ job satisfaction as well.

- **Managing Disputes**
  In an organisation, there are several issues on which disputes may arise between the employees and the employers. You can say conflicts are almost inevitable. In such a scenario, it is the human resource department which acts as a consultant and mediator to sort out those issues in an effective manner. They first hear the grievances of the employees. Then they come up with suitable solutions to sort them out. In other words, they take timely action and prevent things from going out of hands.

- **Developing Public Relations**
  The responsibility of establishing good public relations lies with the HRM to a great extent. They organise business meetings, seminars and various official gatherings on behalf of the company in order to build up relationships with other business sectors. Sometimes, the HR department plays an active role in preparing the business and marketing plans for the organisation too.

Any organisation, without a proper setup for HRM is bound to suffer from serious problems while managing its regular activities. For this reason, today, companies must put a lot of effort and energy into setting up a strong and effective HRM.

(Any 2 points for 4 marks)
(Total: 20 marks)

**EXAMINER’S COMMENTS**
This question was in three parts.
Part (a) was on the limits of corporate social responsibility. (b) was on safeguards to deal with actual and threatened litigation of a professional accountant. (c) was on strategic importance of human resource management and employee development. The candidates did well in all the three parts, although most of the candidates did very well in Part (b) of the question.
QUESTION FOUR

a) Porter identified four factors that determine competitiveness of countries and for that matter West African countries.

- **Factor Conditions/Endowments** - The first dimension in Porter’s model is the factors of production. This dimension refers to the inputs necessary to compete in any industry - labour, land, natural resources, capital, and infrastructure (such as transportation, postal, and communication systems). There are **basic factors** (for example, natural and labour resources) and **advanced factors** (such as digital communication systems, technological and scientific know-how and a highly educated workforce). Other production factors are generalized (highway systems and the supply of debt capital) and specialized (skilled personnel in a specific industry, such as the workers in a port that specialize in handling bulk chemicals).

Advanced factors tend to give countries more competitive advantage than the basic factors of production. If a country has both advanced and specialized production factors, it is likely to serve an industry well by spawning strong home-country competitors that also can be successful global competitors. Since West African countries are more endowed in basic factors of productions and less endowed in advanced factors they are likely to be less competitive when compared to other advanced economies such as Japan, United States, France, etc.

- **Demand conditions** - refer to the demands that consumers place on an industry for goods and services. Consumers who demand highly specific, sophisticated products and services force firms to create innovative, advanced products and services to meet the demand. This consumer pressure presents challenges to a country’s industries. But in response to these challenges, improvements to existing goods and services often result, creating conditions necessary for competitive advantage over firms in other countries.

Countries with demanding consumers drive firms in that country to meet high standards, upgrade existing products and services, and create innovative products and services. The conditions of consumer demand influence how firms view a market. This, in turn, helps a nation’s industries to better anticipate future global demand conditions and proactively respond to product and service requirements.

- **Related and supporting industries** - enable firms to manage inputs more effectively. For example, countries with a strong supplier base benefit by adding efficiency to downstream activities. A competitive supplier base helps a firm obtain inputs using cost-effective, timely methods, thus reducing manufacturing costs. Also, close working relationships with suppliers provide the potential to develop competitive advantages through joint research and development and the ongoing exchange of knowledge.
Related industries offer similar opportunities through joint efforts among firms. In addition, related industries create the probability that new companies will enter the market, increasing competition and forcing existing firms to become more competitive through efforts such as cost control, product innovation, and novel approaches to distribution. Combined, these give the home country’s industries a source of competitive advantage.

- **Firm Strategy, Structure, and Rivalry** - Rivalry is particularly intense in nations with conditions of strong consumer demand, strong supplier bases, and high new entrant potential from related industries. This competitive rivalry in turn increases the efficiency with which firms develop, market, and distribute products and services within the home country. Domestic rivalry thus provides a strong impetus for firms to innovate and find new sources of competitive advantage.

This intense rivalry forces firms to look outside their national boundaries for new markets, setting up the conditions necessary for global competitiveness. Among all the points on Porter’s diamond of national advantage, domestic rivalry is perhaps the strongest indicator of global competitive success. Firms that have experienced intense domestic competition are more likely to have designed strategies and structures that allow them to successfully compete in world markets.

*(2 marks each for 4 points=8 marks)*
International strategy
Explanation
Multinational companies that are confronted with low cost pressures and low pressures for local responsiveness pursue “International Strategy”. An international strategy is based on diffusion and adaptation of the parent company’s knowledge and expertise to foreign markets. Country units are allowed to make some minor adaptations to products and ideas coming from the head office, but they have far less independence and autonomy compared to multidomestic companies. The primary goal of the strategy is worldwide exploitation of the parent firm’s knowledge and capabilities. All sources of core competencies are centralized. This strategy type is ethnocentric since the foreign activities only secure the home-country company. A strong dependence of the foreign subsidiary on the resources of the home country is a consequence.  

Risks associated with international strategy
i. Different activities in the value chain typically have different optimal locations. The international strategy, with its tendency to concentrate most of its activities in one location, fails to take advantage of the benefits of an optimally distributed value chain.
ii. The lack of local responsiveness may result in the alienation of local customers.
iii. The firm’s inability to be receptive to new ideas and innovation from its foreign subsidiaries may lead to missed opportunities.

Global strategy
Explanation
The multinational companies facing low pressure for local adaptation and responsiveness but high pressure to lower cost pursue “Global Strategy”. Companies that pursue a global strategy focus on increasing profitability by reaping the cost reductions that come from economies of scale and location economies; that is, their business model is based on pursuing a low-cost strategy on a global scale. A global strategy emphasizes economies of scale due to the standardization of products and services, and the centralization of operations in a few locations. These companies try not to customize their product offerings and marketing strategy to local conditions because customization, which involves shorter production runs and the duplication of functions, can raise costs. Instead, they prefer to market a standardized product worldwide so that they can reap the maximum benefits from economies of scale.

Risks associated with Global strategy
i. A firm can enjoy scale economies only by concentrating scale-sensitive resources and activities in one or few locations. Such concentration, however, becomes a “double-edged sword.” Thus, decisions about locating facilities must weigh the potential benefits from concentrating operations in a single location against the higher transportation and tariff costs that result from such concentration.
ii. The geographic concentration of any activity may also tend to isolate that activity from the targeted markets. Such isolation may be risky since it may
hamper the facility’s ability to quickly respond to changes in market conditions and needs.

iii. Concentrating an activity in a single location also makes the rest of the firm dependent on that location. Such dependency implies that, unless the location has world-class competencies, the firm’s competitive position can be eroded if problems arise.

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

Multidomestic/Multinational strategy
Explanation
Multidomestic strategy is the reverse of global strategy since the company faces high pressure for local responsiveness and adaptation but with low pressure to lower costs. A firm whose emphasis is on differentiating its product and service offerings to adapt to local markets follows a multidomestic strategy. Decisions evolving from a multidomestic strategy tend to be decentralized to permit the firm to tailor its products and respond rapidly to changes in demand. This enables a firm to expand its market and to charge different prices in different markets.

(1 mark for explanation)

Risks associated with Global strategy
i. Decreased ability to realize cost savings through scale economies.
ii. Greater difficulty in transferring knowledge across countries as a result of localization of core competences.
iii. May lead to “over adaptation” as conditions change. In many industry segments, a variety of factors, such as the influence of global media, greater international travel, and declining income disparities across countries, may lead to increasing global standardization.

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

Transnational strategy
Explanation
Transnational strategy is adopted by company that simultaneously faces both strong cost pressures and strong pressures for local responsiveness. In essence, companies that pursue a transnational strategy are trying to develop a business model that simultaneously achieves low costs, differentiates the product offering across geographic markets, and fosters a flow of skills between different subsidiaries in the company’s global network of operations. As attractive as this may sound, the strategy is not an easy one to pursue because it places conflicting demands on the company.

(1 mark for explanation)

Risks associated with Transnational strategy
i. The choice of a seemingly optimal location cannot guarantee that the quality and cost of factor inputs (i.e., labor, materials) will be optimal. Managers must ensure that the relative advantage of a location is actually realized, not squandered because of weaknesses in productivity and the quality of internal operations.
ii. Although knowledge transfer can be a key source of competitive advantage, it does not take place “automatically.” For knowledge transfer to take place from one subsidiary to another, it is important for the source of the knowledge, the target units, and the corporate headquarters to recognize the potential value of such unique know-how.

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

(Total: 20 marks)

EXAMINER’S COMMENTS
This question was in two parts. Part (a) of this question required candidates to discuss how the factors in porter’s diamond can be used to determine the competitiveness of West African countries. In part (b), the candidates were required to explain four internationalization strategies (international strategy, global strategy, multinational strategy and transnational strategy) and two risks associated with each.

A good number of the candidates attempted this question and the performance was poor in both parts of the question.

QUESTION FIVE

a) Code of ethics may usefully draw upon the underlying principles of good governance or existing codes such as the IFAC code for accountants. Blending the most appropriate elements from a variety of sources is a difficult skill to apply in practice but necessary for the creation of a worthy document.

Below are the fundamental principles that should be included in code of ethics
A professional accountant is required to comply with the following fundamental principles:

• Integrity
A professional accountant should be straightforward and honest in all professional and business relationships.

• Objectivity
A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

• Professional Competence and Due Care
A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act
diligently and in accordance with applicable technical and professional standards when providing professional services.

- **Confidentiality**
  A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the professional accountant or third parties.

- **Professional Behavior**
  A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

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

b) Good corporate governance is important for any organisation. The benefits that derive for private sector structures easily transpose to those in the NGO sector.

- In as much as good governance leads to increased returns of profits for private organisations, the existence of controls, risk management and appropriate supervision ensure financial stability within the NGO. This finance related goal can be considered through the ability to continue to provide value for money, achieving entity goals and ensuring economic and efficient operations so as to meet needs both today and into the future.

- Risk reduction through governance regulation has a particular resonance when considering the risks inherent in operating in poorer regions around the world. These risks may be political or physical and may manifest themselves in negative publicity or unexpected costs.

- Good governance assists private organisations in attracting investment. This is equally true for NGOs. Those that wish to support such worthy causes such as governments or private individuals will feel more assured that their money is being put to good use if the organisation is well governed through appropriate structures for board operations and internal control.

- The scenario identifies the increased commercialisation of the venture. This would include the use of professional management teams who understand and support governance apparatus used in the private sector. This alignment to their management style provides a positive working environment for management, a known structure within which to operate effectively. It is also true that the use of such management will make the implementation or imposition of such a regime easier to deal with for an NGO going through such a transition.
The existence of governance regimes includes the inherent need to adhere to the underlying governance concepts of integrity, justice, even handedness and probity amongst others. Since these will be fundamental ethical belief with the NGO, the implementation of additional levels of governance regulation is smoothed or made easier.

Overall, the benefits of good governance are within the word itself. To govern is to command and implicit in this is the ability to command in a beneficial way. The requirement is to attempt to balance the level to which commercial governance regulation is necessary or sought. It is of benefit to the extent to which it does not compromise the ability to offer the service in the most effective way. Clearly to embrace the concept without regard to this qualification would be inappropriate.

**Alternative solution**

- To ensure adherence to and satisfaction of the strategic objectives of the organization, thus aiding effective management.

- To minimize risk, especially financial, legal and reputational risks, by ensuring appropriate systems of financial control are in place, systems for monitoring risk, financial control and compliance with the law.

- To promote integrity, that is straightforward dealing and completeness.

- To fulfill responsibilities to all stakeholders and to minimize potential conflicts of interest between the owners, managers and wider stakeholder community.

- To establish clear accountability at senior levels within an organisation. However, one danger may be that boards become too closely involved with day-to-day issues and do not delegate responsibility to management.

- To maintain the independence of those who scrutinize the behaviour of the organisation and its senior executive managers. Independence is particularly important for non-executive directors, and internal and external auditors.

- To provide accurate and timely reporting of trustworthy/independent financial and operational data to both the management and owners/members of the organisation to see them a true and balanced picture of what is happening in the organisation.

- To encourage more proactive involvement of owners/members in the effective management of the organisation through recognising their responsibilities of oversight and input to decision making processes via voting or other mechanisms.

(3 marks each for any 4 points =12 marks)

(Total: 20 marks)
EXAMINER’S COMMENTS
This was a scenario type question which tested fundamental principles to be included in code of ethics and benefits of good corporate governance to a non-governmental organization. This was a popular questions with the candidates and the performance was good.

QUESTION SIX

a) i. Strategic issues that should engage the attention of the Board of Directors of Adama Group.

The strategy elements can be analysed into three broad categories

- **Strategic management** - How the entity intends to generate and preserve Value in terms of the following: strategy and objectives; business model

- **Business Environment** - The internal and external environments in which the entity operates – i.e. Trends and factors; Principals risks and uncertainties; Environmental, employees, social, community and human right matters.

- **Business performance and position** - How the entity has developed and performed and its position at the year end - Analysis of performance and position; Key performance indicators (KPIs); Employee gender diversity

- **Corporate social responsibility issues**

  (Any 3 points for 6 marks)

  a) ii. How Balanced score card can be used to measure performance in Adama Group

  The balanced score card approach is an approach to the provision of information to management to assist strategic policy formulation and achievement. The information provided may include both financial and non-financial elements, and cover areas such as profitability, customer satisfaction, internal efficiency and innovation.

  The scorecard offers four perspectives on performance

  - Financial
  - Customer
  - Innovation and learning
  - Internal business processes

  - **Using Financial Perspective to Monitor and Measure Performance**

    *How do should Adama Group look to shareholders.* Financial performance measures indicate whether the company’s strategy, implementation, and execution are contributing to bottom-line improvement. Typical financial goals have to do with profitability, growth, and shareholder value. Adama group’s financial goals could simply be: to survive, to succeed, and to prosper. **Survival**
can be measured and monitored by cash flow, success by quarterly sales growth and operating income by division, and prosperity by increased market share by segment and return on equity.

- **Customer Perspective:** *How Do Customers See Adama Group*
  Customers’ concerns tend to fall into four categories: *time, quality, performance and service, and cost*. To put the balanced scorecard to work, Adama Group should articulate goals for time, quality, and performance and service and then translate these goals into specific measures. Senior managers at Adama Group should therefore be assessed and monitored by percentage of *sales from new products, on time delivery to customer (defined by customers)*, improvement on the company’s Total Quality Management, become customers’ supplier of choice through partnerships with them, and development innovative products tailored to customer needs.

- **Internal Business Perspective:** *What Must Adama Group Excel at?*
  Customer-based measures are important, but they must be translated into measures of what the company must do internally to meet its customers’ expectations. The internal measures for the balanced scorecard should stem from the business processes that have the greatest impact on customer satisfaction—factors that affect cycle time, quality, employee skills, and productivity.

  Managers of Adama Group should attempt to identify and measure their *company’s core competencies, the critical technologies* needed to ensure continued market leadership, decide what *processes and competencies* they must excel at and specify measures for each.

- **Innovation and Learning Perspective:** *Can Adama Group Continue to Improve and Create Value?*
  The customer-based and internal business process measures on the balanced scorecard identify the parameters that the company considers most important for competitive success.

  Adama Group innovation measures should focus on the group’s ability to *develop and introduce standard products rapidly*, products that the company expects will form the bulk of its future sales. Its manufacturing improvement measure should focus on new products; the goal is to achieve *stability in the manufacturing of new products* rather than to improve manufacturing of existing products. Adama Group should use the *percent of sales from new products* as one of its innovation and improvement measures. If sales from new products are trending downward, managers can explore whether problems have arisen in new product design or new product introduction.

  In addition to measures on product and process innovation, Adama Group should overlay specific improvement goals for their existing processes.

  *(2.5 marks for each perspective=10 marks)*
b) Measures which Shareholders may seek to resolve any agency problems

- One of the measures that can be taken to overcome this problem is the way of **financial rewarding of the managers**. The best way is to calculate their bonuses as a percentage of the realized profit of the company.

- To resolve any agency problem and the development of the company, **the external and internal audit** is of the great importance to be made. It helps to evaluate the efficiency of the company, to detect and stop the eventually inefficient operations as well as to protect the assets and the capital. The most effective way in this situation is to engage **external audits** who would periodically value the reality and objectivity of the company’s financial reports. Precise financial reporting is critical to ascertaining that the results are stated fairly and the management has not manipulated results for personal gain.

- **Share options.** This gives directors and possibly other managers and staff the right to purchase shares at a specified exercise price after a specified time period in the future. The options will normally have an exercise price that is equal to, or slightly higher than, the market price on the date that the options are granted. Options can be used to encourage cautious directors to take positive action to increase the value of the company – for the benefit of shareholders.

- **Performance-related bonuses.** The performance-related elements of executive directors’ remuneration need to be carefully designed in order to ensure that the behaviours and actions that are promoted as a result of the targets are aligned with the long term success of the company and the interests of shareholders and at the same time are stretching. Remuneration incentives should be compatible with risk policies and systems and criteria for paying bonuses should be risk-adjusted. However, non-executive directors should not be remunerated by shares or other performance-related elements, since this will compromise their independence.

- **The threat of take over.** Another market force is the threat of takeover by another firm that believes it can enhance the target firm’s value to restructuring its controlling, processes, and funding. The constant threat of takeover tends to motivate management to act in the best interest of the firm’s owner.

- **Annual General Meetings.** AGMs are a means to engage shareholders and allow them to participate actively in the running of their companies. This way, agency problems would be reduced since shareholders are involved in the decision making regarding their companies.

(4 points at 1 mark = 4 marks)
(Total: 20 marks)
EXAMINER’S COMMENTS
The first part of this question tested the application of balanced score card as a merger of performance. The second part required candidates to explain mergers which shareholder may use to resolve agency problem. A good number of the candidates attempted this question and the performance of the first part was generally good while the second part was not answered adequately.