NOVEMBER 2023 PROFESSIONAL EXAMINATIONS
STRATEGIC CASE STUDY (PAPER 3.4)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

GENERAL COMMENTS AND STANDARD OF THE PAPER

The standard of the paper was good and the questions were clear. The case study was about a Niikai Shito Limited (NSL) a wholly-owned Ghanaian company.
The case and the questions were within the scope of the syllabus. The marks were fairly allocated to each question.

PERFORMANCE OF CANDIDATES

The overall performance was a slight improvement over that of the previous examination. Most of the candidates performed well in Questions 1(b), 2 and 4(b). Most of the candidates performed poorly in Question 3 and Question 5. One observation was that a few of the candidates scored below 10% which indicate the lack of preparation for the examination.

NOTABLE STRENGTHS & WEAKNESSES OF CANDIDATES

Strengths

Most of the candidates attempted all the six questions. A few of the candidates presented their answers in a well organised manner.

Weaknesses

The candidates did not demonstrate good understanding of contemporary concepts like the share management teams. They could also not explain fundamentals of international finance such as interest rate parity, forward rates/future spot rates.

Niikai Shito Limited (NSL)

Introduction

Niikai Shito Limited (NSL) represents a classic example of the Ghanaian spirit of resilience and entrepreneurship. The company's business and commercial journey can best be described as a roller coaster ride or a topsy-turvy adventure. It was registered originally to commercialise the production and sale of a hot pepper sauce, popularly called "shito" in Ghana, although NSL, over the years, has diversified its line of business beyond what was conceived at its inception. The driving motivation of NSL's two shareholders was to elevate the Ghanaian shito brand to global recognition, positioning it as a condiment akin to well-known western brands like mayonnaise and tomato ketchup. Shito has gained popularity in Ghana and is mostly patronised by restaurants, hotels, students, schools with boarding facilities, food vendors and households. It is served alongside a variety of foods including kenkey, waakye, rice, banku, among others.

Early History of NSL

NSL is a 100% wholly owned Ghanaian company founded by Mr. and Mrs. Martinson. The company started operations in 2001 as a sole proprietorship under the trade name, Niikai Shito Ventures (NSV), registered under the Registration of Business Names Act, 1962 (Act 151). As the business grew, sole proprietorship could no longer serve the needs and aspirations of the owners, hence they decided to change the legal character of the business. In July 2016, NSL was incorporated as a private company limited by shares, under the Companies Act, and took over the business of NSV. The couple have equal shareholdings in the company. They intend to run the company as a family business into the foreseeable future. Mr. Martinson asserts that "*when my wife and I are old, we expect our three children to step into our shoes and continue the family business*". This philosophy is underpinned by the couple's experience in business dealings that went awry with non-family members. They, therefore, do not have trust in others. This phenomenon may not be peculiar to the Martinsons. It appears to be a sub-culture in Ghana and seems to account for small size family-based businesses in the country with limited potential for growth.

At the inception of the business, the proprietors operated it on a part-time basis with the assistance of 2 workers engaged on a full-time basis. The recipe and formula used in the preparation of shito were developed by Mrs. Martinson. The formulation and recipe are a result of years of experience in shito preparation on a very small scale and selling to close friends who provided high positive feedback and some recommendations for improvement. This was one of the motivations for the commencement of commercialisation of shito production by NSL. The network of friends proved critical for the company's success in its formative years and even now; as the company does no formal promotion of its products. Being gainfully employed, the shareholders did not want to abandon their secure jobs until they were convinced that the business would work. The respective jobs of the Martinsons were quite engaging, sometimes requiring travelling for days, and this negatively affected the smooth running of the business. Given the nature of shito preparation, getting correct measurement of the recipe as well as the actual process of cooking determines the consistent taste and quality. However, because their jobs were highly demanding, there were occasions when Mrs. Martinson was absent and could not directly supervise the production resulting in control lapses and quality issues.

One of the initial challenges the Martinsons faced was determining a suitable location for the production facility. After considerable deliberations and with limited financial resources, they decided to convert one of the three rooms in their rented apartment into a production facility.

With the consent of the landlord, the room was retrofitted for that purpose. Due to the increasing demand for shito, that single room was no longer able to support adequate production. This challenge imposed a limitation on production capacity, resulting in complaints and dissatisfaction among loyal customers who were sometimes unable to access shito when they needed it. Eventually, in early 2014, the owners decided with the approval of their family head to move production to the family house located at East Legon, Accra. They were assigned three rooms which were remodeled for the purpose. This came as a huge relief to the proprietors because the new place was rent free and allowed the company to ramp-up production to largely meet increasing demand from consumers.

The company's main source of finance has been equity. This came from the shareholders who made contributions from their savings and their monthly earnings. As the business expanded and became profitable, the profits were retained to finance the business. There were occasions where family members supported the business with soft loans that were subsequently repaid. Sometimes when the company received orders which it could not rely solely on its limited funds to deliver, the shareholders did approach friends for loans at interest. While the company sought bank loans, stringent conditions, including a six-month account relationship, collateral requirements, and high interest rates, rendered this option unattainable. Friends have suggested to the couple the need to invite new shareholders into the business as a means to raise new equity finance to support the company. However, the shareholders have rejected that suggestion. They are simply not comfortable having new shareholders who they do not know and cannot trust how they will behave in future.

To sell shito through major supermarkets and convenience stores, the company needed to register with Food and Drugs Authority (FDA), the national regulatory body responsible for the regulation of food, drugs, food supplements, herbal and homeopathic medicines, veterinary medicines, cosmetics, medical devices, household chemical substances, tobacco and tobacco products, blood and blood products as well as the conduct of clinical trials protocols. The company also needed to register with the Ghana Standards Authority (GSA), the national statutory body responsible for the management of the nation's quality infrastructure embracing the three (3) pillars of Metrology, Standardisation and Conformity Assessment (i.e. Testing, Inspection and Certification). This proved extremely difficult over a long period due to the company's inability to meet the required standards by the regulators. NSL made several unsuccessful attempts to obtain FDA and GSA registration. This meant that the company was forced to sell largely to individuals, traditional shops, corner stores and a few convenience shops that did not insist on FDA and GSA registration. The need to obtain registration from the regulators was another reason the company needed to relocate its operations. Following the company's relocation to the family house in 2014, it successfully had its shito approved and registered by FDA and GSA in the same year. This achievement marked a significant milestone as major supermarkets and some convenience shops began to accept NSL shito, expanding the company's reach and market presence.

Developments in the company post-early years - the challenges and prospects

From its humble beginnings, where the company delivered its first 24 bottles of shito to a grocery store in Madina in 2001, NSL has experienced notable growth, albeit not yet realising its full potential. The company in 2022 sold approximately 14,400 bottles and cans of shito in Ghana and in various international markets including the United States of America, the United Kingdom, Germany, South Africa, and others. The company's brand of shito, **Niikai Shito**, has become the preferred choice for Ghanaians living in the Diaspora. It is the high demand by the Ghanaian Diaspora that led the company to start production of canned shito as a way of preventing spillage of oil associated with the bottled shito in course of transportation. The company does not export through formal channels. It depends on family members and friends travelling abroad to transport the products. The company receives orders from the Diaspora, but until somebody is traveling, it is unable to satisfy the orders.

Over the years, the company has worked hard to produce quality shito and its brand has gained popularity in Ghana, especially in the Greater Accra Region where it currently operates. The general view of customers is that Niikai Shito has maintained consistent taste and quality. This did not happen fortuitously, but it has taken deliberate strategy of maintaining quality throughout the value chain process. Quality is strictly adhered to, right from the sourcing of the ingredients, through to the processing, the measurement of the composition of the ingredients as well as the cooking method used in getting the desired finished product. The company depends on farmers and to some extent retailers in markets such as Agbogbloshie and Malam Atta Market for the ingredients. However, sometimes the quality of the ingredients purchased from suppliers (i.e., retailers and farmers) is not of the desired standard resulting in the company having to apply extra measures to get the expected quality and taste. In this regard, the company decided in 2020 to incorporate a wholly owned subsidiary, Nhyira Farms Ltd, to venture into farming some of its ingredients to partially meet its needs while ensuring the quality of the ingredients. This has gone a long way in assisting NSL to maintain high standards. The strategy of the company is to deliver quality shito at a reasonable price. It does this by buying directly from small holder farmers within the Greater Accra region. These are the ingredients the company does not cultivate. Buying directly from farmers is relatively cheaper than buying from the retailers in the traditional markets, convenience stores and supermarkets.

The company, in 2019, acquired three (3) plots of land at Senya Beraku in the Central Region on the Cape Coast - Winneba Road and began the construction of a new factory on one plot with potential for future expansion. This decision was prompted by the recognition that the family house was no longer adequate and suitable to cope with the growing demand, which the company was unable to meet. After completing the construction of the factory in 2022, the company decided to relocate its operations. Although the new factory is bigger than the old one, it is still not big enough to adequately cater for the present demand and expected future growth; but that is what the company could afford within its financial constraints. At least the new factory will serve the needs of the company better than the old one. The shareholders are determined to grow relying on internally generated resources and competences. The machines in the new factory primarily consist of the older ones relocated from the previous facility, supplemented by the acquisition of a single new machine to enhance production capacity of the company. Therefore, NSL will continue to rely on some automation and manual production processes which has had a negative impact on its speed of production. In fact, one of the manual processes is the use of mortar and pestle for pounding, crushing and grinding some ingredients into powdered form for use. At present, the company lacks the resources to acquire state-of-the-art machinery, which represents a substantial advancement compared to the existing ones. The new location has allowed the company to have access to cheaper casual workers due to particularly high unemployment in the community. The predominant occupation of the people is fishing with very few involved in farming. This has improved access to cheaper fish and shrimps, a very essential ingredient in the Shito making business.

One important machine which remains a dream for the company is the acquisition of a fully automatic canning machine which could cost, on the average, USD50,000 to USD200,000. The company presently cannot afford to acquire it because of limited financial resources. Therefore, to complete the production process, the company depends on Nkulenu Industries Ltd (NIL) at Madina, a factory built by the famous Ghanaian industrialist, Mrs. Esther Ocloo of blessed memory. The company, after producing the shito, transports it in large containers to Madina for canning to be done. The new location of the company presents some challenges, especially in terms of cost, stress, and time. Furthermore, this arrangement makes the company vulnerable because sometimes NIL is not able to deliver on time. Unfortunately, when it comes to canning, NSL has very limited options.

Regarding the creation of awareness about its products, the company has been largely inconspicuous. The only form of promotion of the company's products is the limited presence on some social media platforms. The company does not pay any social media platform to boost/advertise its products. It is family and friends who have put the products on their social media accounts. In fact, the shareholders who are also the key management staff can be described as "*not in tune with the technology craze*". The company does not have a website since the shareholders consider it as unnecessary cost for now. Again, Mrs. Martinson has stated that "*we are afraid to even do aggressive promotion for the fear that the company cannot meet the expected boom in demand because even without promotion, the company is unable to meet the current high demand. We do not want to disappoint our cherished customers. We will only start serious adverts in future when the company has the capacity to meet expected increase in demand that will follow aggressive promotion since our shito is such that once tasted, it becomes addictive*". The company has essentially grown its sales through a network of friends and referrals from happy customers. The company is happy to keep to this free mode of promotion until it is ready to meet the potential surge in demand if it pursues deliberate promotional activities.

The Corporate Purpose – vision, mission and critical success factors

In December 2022, Mr. Martinson attended a business management training workshop organised by Ghana Enterprises Agency (GEA), formerly known as the National Board for Small Scale Industries (NBSSI). In that workshop, the facilitator encouraged participants to consider developing vision and mission statements for their respective businesses. Mr. Seth Appiah, a management consultant and a friend of the Martinsons, paid a new year visit to the family in January 2023 and in the course of business discussion, it emerged that NSL did not have a formally written vision and mission statements. However, Mr. Martinson mentioned that after the GEA training, he had some ideas about the company's purpose and wrote them down in his diary as follows:

- *"Our vision is to become a producer of shito that would be recognised as the best in the world".*
- *"Our mission is to produce high quality and delicious shito that can be used by a wide range of home and foreign consumers such as restaurants, hotels, individuals, and households. That is exactly what our mission is, and we intend to achieve same in the coming years."*

The shareholders believe that it is about time they formally wrote out their vision and mission and display them prominently in their new factory. They are not sure whether the statements in the diary are proper for use as vision and mission for the company.

According to Mr. Martinson, the above statements of purpose are anchored on some critical success factors (CSFs). He highlighted the company's CSFs to include lasting customer satisfaction, consistent taste, unrivaled quality, operational efficiency, and compliance with regulatory requirements. Mr. Seth Appiah intimated his happiness about the CSFs that underpinned the purpose statements. However, he indicated to Mr. Martinson that to complete the purpose exercise, the company must equally identify key performance indicators (KPIs) that would be used to assess the company's performance in its CSFs. Mr. Martinson responded that "*he was not too sure how to develop the KPIs*".

Management Team, Staffing, Organisational Structure and External Relationships

Mr. Martinson is the founding Chief Executive Officer (CEO). He is currently 51 years old, and he continues to hold the position. He held the role on a part-time basis until 2018 when he assumed the position on a full-time basis. He obtained first degree in computer science in 1998 from Kwame Nkrumah University of Science and Technology. After school, he joined one of the local banks and worked in the Information Technology (IT) Department, rising through the ranks to become a senior IT Officer. However, in December 2017, he decided to take advantage of a voluntary redundancy package and focus on the business. The CEO also doubles as Head of Marketing as well as Head of Credit. He leads a team of four (4) permanent workers in Marketing and Credit whose functions are to ensure that shito is distributed efficiently and effectively to all customers, cash is collected, and to see to it that those who are granted short term credit do not default. Unlike in the past when Mrs. Martinson handled credit and collections issues with very high bad debts, debt issues have minimized to almost zero bad debt since the CEO took over the role in 2018. Mr. Martinson is known for his aggressive collection of receivables compared to his wife.

Mrs. Martinson, now 47 years old, has been holding the position of Deputy CEO since the company's formation. She is the main brain behind the business, and also serves as Production Manager. She holds the key to the secret formula used in preparing Niikai Shito. The name of the shito is derived from her husband's first name. The quality and taste that has consistently been maintained over the years is largely attributed to her diligence and insistence on quality input, process, production and finishing. She can best be described as "*a stickler for high standards*". With a science background and a professional nurse working at Korle-Bu Teaching Hospital since 2000, she continues to play her roles on a part-time basis. Her background and experience have been useful in shaping the secret formula used by the company in preparing Niikai Shito. Combining her professional work and the business has taken a heavy toll on her but she is committed to seeing the company become a successful multinational one day.

The other key management staff member appointed in 2021 is David Martinson, 25 years of age and first born of the Martinsons. He is the Finance and Administration Manager and takes care of general administrative tasks and finance matters. He graduated from the prestigious University of Ghana Business School with first class in Human Resource Management in 2019. As of July 2023, the company has a total staff strength of 25, comprising three (3) management staff, ten (10) permanent workers and twelve (12) casual workers. The company has not been able to maintain permanent workers for longer than two (2) years, although two (2) of the current permanent workers have been with the company for at least 5 years. This situation means that the workers leave the job at a time they are really getting to know it. Most of the workers, six (6) permanent workers and the casual workers are involved in production. The employment contracts of the workers, just like many policies and procedures, are not documented.

Apart from on the job training that workers receive from the management staff; the company benefits from free trainings that are organised by GEA. GEA is the apex governmental body dedicated to the promotion and development of Micro, Small and Medium Enterprises (MSMEs) in Ghana. The management staff benefits from GEA training courses targeted at capacity building, financial management, accounting and record keeping and leadership training. The training courses have been helpful to the management in improving how the company is managed on a day-to-day basis.

The style adopted by management in managing the business is one that requires working closely as a team to get work done. A culture that can best be described as result-oriented. The workers are encouraged to communicate freely with each other and with management at any time if they are in doubt about any matter concerning their work. In this regard, management meets all workers once every week, usually Friday evenings, to discuss matters pertaining to the work and plan for the coming week. The company understands that it is operating in a dynamic and competitive environment, hence decisions must be made quickly. In the formative years of the company, the main driving force was Mrs. Martinson with the support of the CEO. She made most of the decision regarding operations and production of shito. For many years, the company was managed based on the directives and instructions issued by the CEO and the Deputy CEO. There was no procedure manual, policies nor standard operating manuals. Positions were not defined, yet the company thrived. However, the growth of the company has necessitated the creation of some departments such as Marketing, Credit, Production and Finance & Administration. This is to inject some semblance of formality, provide effective leadership and direction for workers and help them appreciate their core functions. David Martinson has advised his parents on the need to begin to put in place some key policies and procedures to streamline the operations of the company. According to him, the policies and procedures are not intended to kill teamwork, flexibility, agility and quick decision making, but to introduce controls in how things are done in the company. He said controls are necessary as the company expands, for its effective and efficient management.

Finally, the company has decided to outsource some aspects of the finance function to a professional accounting firm. Functions outsourced include maintenance of general ledger, preparation of monthly management accounts, filing of various tax returns and preparation of year-end financial statements. There have been disagreements between the accounting firm and the management team over some financial reporting issues. The management team attempted to interfere with the work of the accounting firm but the firm firmly resisted this move, claiming it is inconsistent with generally accepted accounting principles and standards.

Corporate Governance

The company has a board of directors comprising four (4) members. The membership of the board are the Martinsons and Daniel Aidoo ESQ, FCA. Daniel Aidoo is a senior lawyer and a fellow of the Institute of Chartered Accountants, Ghana. He is the family friend of the Martinsons and was brought on board to bring to bear his rich experience in finance and law. He runs his own private law chambers where he focuses on the practice of tax law, representing clients before Ghana Revenue Authority and litigating in the law courts. Previously he was a partner in an auditing firm. The board is chaired by the CEO. Board meetings are held twice in a year to fulfil the requirements in the law. The current board composition took effect in 2021. Prior to that, the board was made up of only the two shareholders who hardly held board meetings. The two shareholders have not hidden their abhorrence for this whole concept of corporate governance, stating that "*it is all about cost, but our company is very small and does not need the board of directors*".

The shito sector and the economy of Ghana

The shito sector represents a prime example of a fragmented and highly competitive industry in Ghana. The commercialisation of shito production is fast growing as more Ghanaians develop preference for it. Shito is a preferred local condiment for a variety of food. One other reason accounting for this growth is the increasing demand in boarding schools by secondary school students who are increasingly skipping dining and feeding themselves from their chop boxes. Demand for shito has been largely concentrated in the major urban areas. The recent 2021 Population and Housing Census Report by Ghana Statistical Services indicates a trend of growing urbanisation. Presently, there are many micro, small and medium businesses engaged in the production of shito for home and foreign markets. The approximate number of these businesses is currently unknown. However, some shito producers are part of Glass Jar Users Association of Ghana (GJUAG), a union of businesses that make use of containers for packaging a variety of processed food products. The current membership of GJUAG is about 300 of which 60% are shito producers. It ought to be stated that most of the members of GJUAG are businesses in and around the Greater Accra Region. The top 10 brands in terms of popularity are said to control less than 10% of the shito market. Although some shito producers try to differentiate their sauce, including NSL, it is generally considered a low-price product. The average retail price ranges between GH¢25 to GH¢180, depending on the size and the retailer.

Those who buy shito from producers directly include individuals, households, hospitality businesses (such as restaurants, hotels, etc.), food vendors and supermarkets. Of these buyers, the demand by supermarkets and hospitality businesses is substantial while demand by others is insignificant. Most of the food vendors prepare their own shito. Households and individuals just buy one or two bottles for their daily consumption. This group of buyers tend to buy from retailers. Supermarkets and hospitality businesses buy shito from only FDA and GSA registered producers. The ingredients required for shito production, which include shrimps, fish, salt, natural spices (cloves, cayenne pepper, onions, ginger and garlic) and soya oil, are readily available and can be sourced from many suppliers in the various traditional markets (Agbogbloshie, Malam Atta, and Okaishie), supermarkets, mini shops and directly from farmers. The prices of the ingredients are largely competitive, and most sellers are willing to reduce their prices to attract buyers. However, the bottles and cans for packaging of finished shito can only be obtained from a few major suppliers and due to high demand for jars/containers by various users, shortages do occur from time to time. This continues to push prices of the containers up. For shito producers who use cans and do not have their own canning machines, they depend on a few large companies for that service. The margins on shito are generally considered to be low and the only way to make reasonable profit is through sale of large volumes. There are many households that prepare their own shito for their domestic consumption. Indeed, there are many brands of shito on the market produced by households for convenient stores dotted across the major cities. The production of shito on a small scale can be done with very minimal investment.

The general consensus among business owners is that 2022 and 2023 have been very difficult years. The cost of doing business has skyrocketed with high inflation hovering around 40% in 2023, high depreciation of the Cedi, especially in 2022, making imported inputs very expensive and unabated increases in utility tariffs. The attempt by Bank of Ghana to control inflation by raising Monetary Policy Rate to 30% as at September 2023, is causing a hike in all interest rates in the economy, including lending rates which are averaging 40% per annum. The other bitter pill that businesses had to swallow is the hair cut they suffered on their investments in

Government of Ghana bonds and notes as part of Domestic Debt Exchange Programme (DDEP). NSL signed up to DDEP on the small investment the company made in a 5-year Government bond. This truncated the expected coupons which are used to support business occasionally. The economic crisis has led to a general reduction in the consumption of goods and services by households, businesses and Government. Again, there has been a general decline in personal disposable income caused by economic challenges. However, the demand for food related products has remained generally unaffected. A significant trend emerging as a result of the economic crisis is a positive shift of consumers towards consumption of food with shito as a sauce. The silver lining in the dark cloud of economic crisis is that Ghana remains a stable, peaceful, and democratic country that continues to attract foreign direct investment. This is significant in the context of recent military takeovers in the West Africa sub region.

Sustainability and Corporate Social Responsibility

The company's management is aware of the devastating impact of climate change and its consequences for the sustainability of its operations and other businesses. Human and business environmental footprints are responsible for climate change leading to extreme weather conditions such as wildfires, heatwaves, marine heatwaves, cold waves, floods, droughts, storm surges, and rising sea levels. The effects of these extreme weather events are economic costs, loss of human lives, increasing cost of doing business, failure of businesses, deterioration of crops and decreased agricultural production and deterioration of the ecosystem. In fact, with the recent disastrous flooding in Libya which caused the loss of over 10,000 lives and destruction of businesses, the CEO observed that "*it is a grim reminder of the devastating consequences of climate change and an urgent need to take environmental protection very seriously*". The company is also conscious of its role and responsibility as a corporate citizen in society. In this regard, the company depends exclusively on liquefied petroleum gas (LPG) in its operations. Even though LPG is increasingly becoming more expensive than firewood used previously, the company has resolved to use only LPG as part of its contribution to reducing environmental footprint and to protecting the environment against degradation. The company is also determined to play its role in reducing food miles carbon dioxide emission by sourcing most of its inputs from farmers and retailers close to its operations. This is to reduce the miles that the ingredients used for the shito travel. Although the inputs sourced directly from the farmers in remote areas are relatively cheaper, research has shown that food transportation accounts for 19% of total food system emissions. Again, when the entire food supply chain was considered by researchers, it was found that global food miles equate to about 3.0 gigatonnes of carbon dioxide equivalent ($GtCO_2e$) – higher than previously thought. According to management, the use of LPG and input sourcing are the company's noble contribution to environmental sustainability.

There is a growing number of middle-income consumers who are concerned about carbon dioxide emissions and are only interested in buying shito that is produced sustainably. Furthermore, the company has implemented a recycling program for its bottle containers. It offers a small fee to customers who return their empty bottles for reuse instead of disposing of them. This has also mitigated, to some extent, the shortages that occur with suppliers. Recycled containers/empties are cheaper than buying new ones. The company has a future plan to move its packaging to biodegradable containers in line with Government of Ghana long term policy to ban the use of non-biodegradable plastic containers.

The company as part of its corporate social responsibility donates 80 bottles of shito to public schools within the community in which its business is located. This is done on a quarterly basis in support of the free school feeding programme where school pupils are provided one hot square meal a day. On some occasions, when the production fails to meet the strict quality standards and taste, shito so produced is also donated to the schools. Again, the company has identified senior high schools boarding students coming from very poor homes within its area of operation and gives them free shito when they are going to school. Between 2022 and 2023 the company donated a total of 200 bottles of Shito to such students. The Martinsons assert that this is a cost to the company, but they believe that in the long run it will inure to shareholders' benefit since the business of the company stands to gain in terms of increased demand, hence maximisation of the shareholders' wealth. Donations will also enhance the company's positive image in the long run.

Company's products and product development

Quality and consistent taste are the main driving considerations in the development and production of Niikai Shito. This is to give customers a unique experience, attracting new customers and retaining them. The company, on the average, has a very high customer retention rate since the company specifically monitors first-time customers. It was observed that first-time customers tend to make repeat purchases. Unlike other shito producers who use food preservatives, NSL uses none, yet its shito has a 9-month standard expiration duration.

The process of producing high quality and tasty Niikai Shito begins with the purchase of quality ingredients. For Niikai Shito, the typical ingredients used include fish (smoked dry sardines or herrings), shrimps, fresh and canned tomatoes, oil, natural spices (cloves, cayenne pepper, onions, ginger, Aidan fruit - *prekese,* Anise seeds - *nkitinkiti*, and garlic). At the factory, the ingredients are carefully sorted out. Rotten, foreign and substandard ingredients are removed, as these can affect the quality and taste of shito. The ingredients are then grounded or pounded into powdered or paste forms depending on the type. Then comes a critical stage in the production process, the measurement of each ingredient for production. And this is the stage that determines how taste is obtained. At this stage, the production of shito begins through a combination of frying and cooking. The cookware for the preparation of shito is placed on a gas cooker, then gradually different ingredients are added with a calculated time interval. First, fresh ingredients (such as onion, tomatoes, ginger, garlic, etc.) are poured into the cookware and allowed to boil for a specified time. Second, oil is added to the boiling fresh ingredients and together, they are allowed to cook for another specified duration. Finally, powdered ingredients (such as pepper, fish, shrimps, etc.) are added and allowed to cook until the taste required is achieved. This carefully timed production process is to ensure that the ingredients are not overcooked to destroy their nutritional value, achieve required taste and maintain quality. Completed shito is then bottled after careful sterilisation. The bottles and cans are correctly branded and packed into cartons for distribution to customers.

Over the years the company has developed a total of five (5) different types of shito to meet diversified customer tastes and preferences. At inception, the company focused on producing ***Regular Shito***, the normal shito without the addition of meat. The first addition to ***Regular Shito*** was ***Beef Shito***, shito mixed with cutlets of beef. Subsequently, there was demand for ***Chicken shito***, then ***Pork Shito*** and finally ***Chevon Shito***. Each of these product types contain cutlets of the meat after which the product is named. The various products developed have generally proven successful and the company stands ready to add more products as and when there is evidence of customer demand.

Production and product pricing data

The company does, on the average, three (3) productions per week for which, about 120 bottles and cans in total are produced per production based on the available data for the first half of year 2023. The total number of units produced and sold in 2022 was 14,400. Based on 52 weeks per year, the following production figures are projected for 2023. The projected average unit price for each of the products is also made available below.

Table 1 – Summary of 2023 forecast annual production in units.

Product Type	Bottled Shito	Canned Shito	Total Production
Regular Shito	1,825	983	2,808
Beef Shito	3,370	2,246	5,616
Chicken Shito	5,897	655	6,552
Pork Shito	955	168	1,123
Chevon Shito	2,097	524	2,621
Total	**14,144**	**4,576**	**18,720**

Table 2 – Break down of production per each product type and bottle/can sizes.

Sizes	Regular Shito	Beef Shito	Chicken Shito	Pork Shito	Chevon Shito	Total Production
Bottle Containers						
320g	639	1,180	2,064	334	734	4,951
500g	548	1,011	1,769	287	629	4,244
750g	456	843	1,474	239	524	3,536
1000g	182	335	590	96	210	1,413
Total	**1,825**	**3,369**	**5,897**	**956**	**2,097**	**14,144**
Can Containers						
400g	393	898	262	67	210	1,830
800g	590	1,348	393	101	314	2,746
Total	**983**	**2,246**	**655**	**168**	**524**	**4,576**

Table 3 – Unit price for each product

Bottle/Can Size	Regular Shito	All other shito
	GH¢	**GH¢**
320g	55	75
500g	75	95
750g	95	115
1000g	140	170
400g	100	120
800g	140	170

Although the company obtains various types of meat at different prices, the company applies the same pricing to different products containing meat. According to the Deputy CEO who does costing and pricing of the products, this is to avoid complexity of keeping detailed costing for each product. Hence, the overall average price is used to price all meat related shito. Prices are usually revised as and when it becomes necessary based on the prevailing cost of ingredients and other input costs such as cost of utilities. From historical data, prices have not been reviewed more than five times in a year. The prices of Niikai Shito are generally above the average prices one can obtain on the market for shito. The customers of the company are always willing to pay more because customers perceive Niikai Shito to be of high quality with consistent taste compared to most of the shito on the market.

The future plans of the company – the big dream

The shareholders have big plans for the future in terms of expanding the business both domestically and internationally. The company believes that the time has come for it to extend its reach within the Ghanaian market by going beyond Greater Accra Region. The plan is that within the next two years, that is by 2025, the company should begin retailing its products in Kumasi. The proposal is for the company to enter an arrangement with large supermarkets in Kumasi where the company will rent a gondola and retail Niikai Shito directly to customers. The preliminary discussions held between NSL and management of some of the large supermarkets look promising. The Kumasi market holds a high potential for the company's shito, and this opportunity should not be missed. If the Kumasi model is successful, then it would be replicated across other regional capitals in the future. The company also plans to sell more of the product on the foreign market. The company has been making limited sales to non-Ghanaians in the United States, the United Kingdom, and South Africa. The feedback received from such consumers is that even though Niikai Shito is very tasty, a lot more needs to be done to meet their exact preference. In this regard the company intends to commission a research in those markets in the future to better understand and appreciate their requirements to satisfy them accordingly.

Again, the company intends to expand its new factory within six (6) years, largely from its internally generated funds and if possible, some debt/loan. This expansion would include the acquisition of a grinding machine and a canning machine. These acquisitions would contribute to reducing operating costs by 4% annually and by 15% in the long term. Furthermore, the company intends, in the long term (between 8 -10 years), to open another factory in Kumasi to serve the northern part of the country, and perhaps another in the United Kingdom to serve the teeming Ghanaian population there. This would also help reduce food miles by not transporting shito from Accra to Kumasi and other cities in the northern part of the country. The company will also expand the new factory in the medium term to take advantage of the expected growth in demand for shito. Finally, the company is ultimately considering venturing into jars and containers production domestically to meet the its needs and to satisfy the high demand by jar users. Daniel Aidoo, the non-executive director, has told Mr. Martinson in confidence that the company's expansion plans are ambitious, and this calls for substantial financial resources. In light of this, he has suggested that the shareholders contemplate transitioning from a family-owned business model. His proposal includes raising equity through new shareholder investments or securing long-term debt. Mr. Martinson, in response, has expressed his willingness to consider these suggestions for the company's future.

ADDITIONAL INFORMATION

Mr. Daniel Aidoo, the sole non-executive director, has been persuading the shareholders about the need for fresh capital injection to finance the company's expansion plans and growth prospects. The shareholders were not willing to dilute their shareholdings in the short to medium term. As a result, the non-executive director then suggested convertible bond financing to the shareholders as a compromised financing option. This will allow the shareholders to maintain their shareholdings in the short to medium term by having a debt which could be converted to equity in the long term. This financing option will delay dilution of the Martinsons' shareholdings in NSL until the potential bondholders decide to exercise the call option embedded in the convertible bond by converting their bonds into shares. After Mr. Daniel Aidoo had explained the benefits and disadvantages of the convertible bond, the shareholders finally agreed to issue a ten (10) year convertible bond valued at GH¢6 million. The other terms of the bond are to be finalised to pave way for the bond issuance in November 2023.

The company had no immediate plans to enter the United Kingdom (UK) market due to limited financial resources, but the shareholders are now considering the possibility of investing in the UK in 2024. This investment would be funded by the convertible bond issuance. This decision depends on the results of the investment appraisal that the shareholders have requested.

The details of the UK investment are as follows:

The project would need an initial investment of £200,000 and generate cash inflows of £65,000 per year for the next four (4) years. The initial investment is expected to be made at the start of 2024. The projected average spot exchange rate between Ghanaian cedi and the British pound sterling on 1 January 2024 is GH¢15.2500/£1. The discount rate for the project in Ghana is 15%. The discount rate for similar projects in the UK is 8%. However, the UK government has banned foreign investors from transferring money out of the country for a period. This ban is likely to last for three years. This means that all cash inflows will be transferred to Ghana at the end of year 4.

The shareholders require an **international investment appraisal** to be carried out on the proposed project to determine its viability. This will help them decide whether to go ahead with the project or not.

Note:

Interest Rate Parity => $F_1 = {S_0}^{d/f} \times \left(\frac{1+i_d}{1+i_f}\right)$

QUESTION ONE

a) NSL outsourced some aspects of the finance function to a professional accounting firm. A misunderstanding about the relationship that does or should exist between a professional accountant and a client led to disagreements between the accounting firm and the management team over some financial reporting issues. An attempt by management to interfere with the work of the accounting firm was firmly resisted.

Required:
State and explain **THREE (3)** out of the FOUR models that describe ***a professional accountant-client relationship***, clearly indicating whether NSL or the professional accounting firm has ***most authority and responsibility for final decision-making***.
(10 marks)

b) Mr. Martinson highlights the company's CSFs to include lasting customer satisfaction, consistent taste, unrivaled quality, operational efficiency, and compliance with regulatory requirements. These are very essential considering the highly competitive environment within which NSL operates.

Required:
Using ***Johnson and Scholes' six-step approach to using CSFs***, explain the six steps approach NSL could employ to effectively achieve competitive advantage in the Shito Industry. **(10 marks)**

QUESTION TWO

Although the company's core business is the production of shito, it has diversified into farming/cultivating some of its inputs and it is also contemplating idea of retailing shito to customers by renting gondola in supermarkets in Kumasi by 2025.

Required:

a) Clearly identify and explain the ***integration strategy*** the company is adopting by going into cultivating some inputs and the proposal to go into retailing in Kumasi. **(2 marks)**

b) Explain to the Martinsons **FOUR (4)** potential ***weaknesses or disadvantages*** the company may or is likely to suffer with the integration strategy identified in (a) above. **(8 marks)**

QUESTION THREE

The approach to leadership and management that NSL has adopted in managing the business is one of working closely as a team to get work done. This is often referred to as ***shared management teams***. In shared management teams, management responsibility is distributed between individuals in a team, or organisation in such a way that the members of the team manage each other.

Required:
Research into shared management teams has identified several factors that contribute to the effectiveness of such a team and its ability to improve performance. Identify and explain **FIVE (5)** of those factors in relation to NSL. **(10 marks)**

QUESTION FOUR

a) Risk management is critical for the success of every organisation, including NSL. Responsibilities for effective risk oversight and management within NSL do not depend on only one stakeholder group.

Required:
Identify and explain the role of **THREE (3)** ***stakeholders*** as identified by the ***International Corporate Governance Network (ICGN) guidelines on responsibilities for the oversight and management of corporate risk (2010)***. **(6 marks)**

b) With the company's audacious expansion plans, it must also plan for its human resource needs to effectively respond to the expected growth. David Martinson, the Finance and Administration Manager, needs advice on how to plan for the company's human resource needs.

Required:
Outline and explain **FOUR** main stages in the human resource planning process. **(8 marks)**

c) It is evident that NSL has capacity challenges and this has impacted on the decision to expand to other markets. To succeed, NSL must plan to obtain the resources that it will need each year to meet the required capacity levels.

Required:
Identify and explain **FOUR (4)** ***production resource planning needs*** that NSL should focus on to effectively manage its production capacity challenges. **(6 marks)**

QUESTION FIVE

a) In connection with the proposed investment in the United Kingdom by NSL for shito production in that country, the shareholders require information to make final investment decision.

Required:

i) Using the ***interest rate parity formula/equation*** determine the ***forward rates/future spot rates*** at the end of 2024, 2025, 2026 and 2027. **(4 marks)**

ii) Calculate the ***net present value(s)*** for the project at the beginning of 2024 that will determine whether the project should be accepted by the shareholders. **Advise** the shareholders whether they should accept and proceed with the project or reject it. **(7 marks)**

b) To defer dilution of the Martinsons shareholding of NSL, they have agreed to issue a 10-year convertible bond to new investors/bondholders.

Required:

Explain **THREE (3)** advantages of issuing convertible bond to NSL and to investors/bondholders respectively. **(9 marks)**

QUESTION SIX

a) NSL current corporate governance structure consists of three executive directors and one non-executive director with the CEO serving as the chairman of the board. The board, as presently constituted, may have its strengths and weaknesses.

Required:

i) State and explain **TWO (2)** agency costs that the company would avoid as postulated by ***Agency Theory of corporate governance*** that "agency costs do not exist when the owners and the managers are exactly the same individuals". **(5 marks)**

ii) Explain **TWO (2)** roles that the non-executive director, Daniel Aidoo, ought to play on the board as identified by the document, ***Higgs Guidance (2003)***, to strengthen NSL board. **(5 marks)**

b) Risk management and internal controls are largely the responsibility of Management of NSL. However, the Board of Directors has a role to play.

Required:

Identify and explain **TWO (2)** key roles the Board of Directors of NSL should play in relation to risk management and internal controls in accordance with the UK Corporate Governance Code and the Ghana Code of Best Practices for Corporate Governance. **(5 marks)**

c) The OECD Principles of Corporate Governance as an international statements of principle about corporate governance, establishes minimum acceptable standards of corporate governance. However, like any such document on corporate governance, has several limitations.

Required:
Identify and explain **TWO (2)** limitations of the OECD Principles of Corporate Governance. **(5 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) Professional accountant-client relationship – this question focuses on whether a professional accountant or a client has authority and responsibility to make final decision when a professional accountant-client relationship exists.

There are several models for examining a professional accountant-client relationship. These differ in the extent to which the client or the professional has most authority and responsibility for decision-making. Essentially, there are four models:

- Agency relationship
- Contractual relationship
- Paternalism
- Fiduciary relationship.

Each of the models outlined above is examined within the context of NSL outsourcing some of its accounting functions to a professional accounting firm. Each model is likely to be most appropriate in different circumstances.

Agency relationship

In an agency relationship, the client has most of the authority and responsibility for decision-making. Thus, the client is in charge of the decision making and not the professional accountant. The professional is an expert acting on behalf of a client, but under instructions from the client. The client knows what is wanted and instructs the professional to do it. A good example of an agency relationship is the relationship between a client and the client's lawyer: the lawyer acts under the client's instructions.

A similar situation would apply in an agency relationship between a professional accountant and a client. For this sort of relationship to exist, the client must have a reasonable amount of technical knowledge and must understand what the accountant is being asked to do. **The accountant carries out the client's instructions, and provides information and possibly advice, but the client makes the decisions**.

An agency relationship can exist when the accountant is not independent but is acting on the client's instructions and on behalf of the client. For example, an accountant who is asked to prepare a tax return for a client should try to minimise the tax bill within the law.

NSL has outsourced some finance functions including maintenance of general ledger, preparation of monthly management accounts, filing of various tax returns and preparation of year-end financial statements. In the context of NSL, the professional accounting firm is acting on the instructions of NSL regarding specific functions it is to perform on its behalf. In this regard, the professional accounting firm is deemed as an agent acting on behalf of NSL and for that matter NSL has the authority and responsibility for final decision-making regarding the content of the various reports that have been outsourced. For example, when it comes to the general ledger management, NSL has the authority and responsibility to decide the number of line items to create for revenue, expenses, assets, liabilities and equity. Therefore, to the extent that the professional accounting firm is an agent acting on behalf of NSL, the management team has the authority and responsibility for final decision making regarding the outsourced services.

Contractual relationship

In a contractual relationship, the client and professional accountant are 'equals' in terms of authority and responsibility for decisions. There is a contract between them, in which the client arranges for the accountant to carry out some work, and the accountant undertakes to do the work.

This kind of relationship will exist when the accountant has some expertise or technical knowledge that the client does not have, and the client hires the accountant to provide it. For example, a firm of accountants may be asked to provide advice to a company on the implementation of a new law or set of regulations. The accountant provides the technical advice, and the client acts on the advice given.

NSL outsourcing some finance and accounting functions that were previously managed in-house to a professional accounting firm, may be viewed under the contractual relationship model. This is because a professional accounting firm has authority in deciding how it performs the services under the outsourced contract using its accounting expertise. On the other hand, NSL has authority to decide how it acts on any advice that is offered by the professional accounting firm regarding the outsourced services. For instance, NSL and the professional accounting firm are having some disagreement over some financial reporting issues where the firm is claiming that NSL unspecified demand is inconsistent with the generally accepted accounting principles and standards. The professional accounting firm can only advise and NSL's management has authority to decide whether to act on that advice or not. Therefore, the company and the professional accounting firm are equals in terms of their authority and responsibility for decision making under the contractual relationship model.

Paternalism

In a paternalistic relationship, the accountant has most of the decision-making authority and responsibility and can make decisions without the client's knowledge or consent. The accountant exercises his or her judgement in what he considers to be in the client's best interests.

To understand paternalism, it helps to think of the relationship between parents and their children. Parents have much more knowledge and experience than their

children, and they act and make decisions on behalf of their children that are in the children's best interests.
A comparable situation may exist between a professional accountant and a client. For this situation to exist, the professional accountant must have experience and knowledge, and the client should be inexperienced and without much knowledge of the matters that the accountant deals with. Paternalistic relationships between a professional and a client can be the relationship model that causes greatest concern, because the professional will be virtually taking over the client's affairs.

The professional accountant-client relationship created by NSL outsourcing some accounting functions does not constitute a paternalistic relationship for the professional accounting firm to have most of the decision-making authority and responsibility to make decisions without the NSL's knowledge or consent. Certainly, a paternalistic relationship is inapplicable to the relationship between the professional accounting firm and NSL.

Fiduciary relationship
Finally, in a fiduciary relationship between a professional and a client, the professional (as a 'fiduciary') has an obligation to act in the best interests of the client. The professional has superior technical knowledge and greater expertise than the client. **However, unlike a paternalistic relationship, in a fiduciary relationship the client retains significant authority and responsibility for making decisions.**

Both parties in the relationship have responsibilities and the judgements both of which carry weight. The client depends on the accountant for much information and advice, but the client's consent is needed for any decision, and in many instances the client is involved in reaching decisions and also makes the final decision.

For some issues, the client may recognise the technical knowledge of the accountant and allow the accountant to make the decisions. However, this is not the norm.

Within the context of NSL, the relationship between the company and the professional accounting firm may be deemed a fiduciary to the extent that it has to act in the best interest of the company. After all, agents have a duty to act in the best interest of the principal who appointed them in performing their duties. Although the relationship created between the professional accounting firm and NSL may exhibit some characteristics of a fiduciary relationship to the extent that the accounting firm must act in the best interest of the company, the relationship cannot perfectly be fitted or situated as one of a fiduciary relationship because NSL retains the authority and responsibility for decision making.

Marks allocation:
Identification of 3 theories @ 0.83 marks each = 2.5 marks
Good explanation of 3 theories @ 2.5 marks each = <u>7.5 marks</u>
10 marks

A good explanation would involve a student clearly determining whether the final authority and responsibility for decision-making lies with NSL or the Accounting Firm or whether both parties share equal responsibility for decision-making.

b) **Johnson and Scholes' six-step approach to using CSFs**

Johnson and Scholes have suggested a six-step approach to achieving competitive advantage through the use of CSFs. NSL can use this approach to effectively apply the identified CSFs to gain competitive advantage in the shito sector. The following detail discussion examines how best NSL can deploy CSFs to its advantage.

Step 1

Identify the success factors that are critical for profitability (long-term as well as short-term). These might include 'low selling price', and also aspects of service and quality such as 'prompt delivery after receipt of orders' or 'low level of sales returns'. It is useful to think about customer needs and the 4Ps of the marketing mix when trying to identify the CSFs for products or services.

Mr. Martinson has taken the first step of identifying the company's critical success factors critical for its long-term success. He highlighted the company's CSFs to include lasting customer satisfaction, consistent taste, unrivaled quality, operational efficiency, and compliance with regulatory requirements.

Step 2

Identify what is necessary (the 'critical competencies') in order to achieve a superior performance in the critical success factors. This means identifying what the entity must do to achieve success. For example:

- If a critical success factor is 'low sales price', a critical competence might be 'strict control over costs'.
- If a critical success factor is 'prompt delivery after receipt of orders', a critical competence might be either 'fast production cycle' or 'maintaining adequate inventories'.
- If a critical success factor is 'low level of sales returns', a critical competence might be either 'zero defects in production' or 'identifying 100% of defects on inspection'.

NSL management has not specified critical competences required to achieve superior performance in each identified critical success factor. It is important that as the company is expanding, the management clearly identifies the critical competences that would be required to deliver superior performance in all the CSFs. This is critical in supporting the company's CSFs to gain competitive advantage.

Step 3

The entity should develop the level of critical competence so that it acquires the ability to gain a competitive advantage in the CSF. Identifying critical competences for delivering superior performance in the CSFs is necessary, but far more important is the development of those critical competences to ensure that the company performs at the highest level.

In this regard, the workers of NSL receive regular on the job training as well as external training organised by Ghana Enterprises Agency (GEA). The management staff benefit from GEA training courses targeted at capacity building, financial management, accounting and record keeping and leadership training. The training courses have been helpful to the management in improving how the company is managed on a day-to-day basis.

Step 4
Identify appropriate key performance indicators for each critical competence. The target KPIs, if achieved, should ensure that the level of critical competence that creates a competitive advantage is obtained in the CSF.

KPIs serve as performance measurement indicators used to assess how well the company is performing in the identified CSF. Without KPIs a company cannot determine how far it has come and how far it is from realising its objectives and CSFs. From the facts of the case, Mr. Martinson did not think of the appropriate KPIs that would be used to assess the performance of NSL with respect to its CSFs.

The friend of the Martinsons, Seth Appiah, drew the attention of Mr. Martinson to the need to identify key performance indicators (KPIs) that would be used to assess the company's performance in its CSFs. To which Mr. Martinson responded that "*he was not too sure how to develop the KPIs*". It is therefore very important that the company identifies KPIs for each of the identified CSFs.

Step 5
Give emphasis to developing critical competencies for each aspect of performance, so that competitors will find it difficult to achieve a matching level of competence. This essentially involves the ability of a company to keep evolving its critical competences to make it difficult for its competitors to copy or imitate it.

NSL must keep recreating and renewing its critical competences to prevent the company's competitors from catching up with it. This calls for deliberate continuous development of the competences which the company considers to be critical to its future success.

Step 6
Monitor the firm's achievement of its target KPIs, and also monitor the comparative performance of competitors.
NSL must constantly monitor how well the company is performing in its CSFs against the set targets using the KPIs. This may be done on a monthly, quarterly, half-yearly or yearly basis and where the company identifies undesirable outcomes, corrective measures are taken to remedy the situation. It is also

important for the company to benchmark its performance against key competitors to determine how well it is performing.

(6 steps well explained @ 1.67 marks each = 10 marks)

(Total = 20 marks)

EXAMINER'S COMMENTS

This question was in two parts. The first part required the candidates to explain three (3) out of the four models that describes a professional accountant-client relationship.

The second part required the candidates to use Johnson and Scholes' six-step approach to explain how NSL could effectively achieve competitive advantage in the Shito Industry.

The candidates did not do well in the first part. Some of the expected answers which the candidates missed were:

- Agency relationship
- Contractual relationship
- Paternalism
- Fiduciary relationship.

QUESTION TWO

a) **The integration strategy is Vertical integration, which combines backward and forward integrations.**
Vertical integration is the integration strategy being adopted by NSL. With vertical integration, an entity extends its business by acquiring (or merging with or organically setting up) another entity at a different stage in the supply chain. A strategy of vertical integration is usually a form of concentric diversification. **Vertical integration might be forward vertical integration, or backward vertical integration**.

With **forward vertical integration**, also called '**downstream' integration**, an entity enters the product markets of its customers. Therefore, NSL proposal to rent a gondola and retail Nhyira Shito directly to customers is forward vertical integration.
With **backward vertical integration**, also called **'upstream' integration,** an entity enters the product markets of its suppliers. NSL organically sets up Nhyira Farms Ltd to farm some ingredients for preparation of shito amounts to backward vertical integration.

Correctly identifying vertical integration @ 0.5 marks = 0.5 marks
Explanation highlighting backward and forward integrations = 1.5 marks
2 marks

b) **Disadvantages of vertical integration &Arguments against vertical integration**
Although there are several arguments in favour of vertical integration, equally there are arguments against vertical integration. The potential weaknesses of vertical integration likely to be faced by NSL are discussed below:

- **Avoiding the discipline of the market**. A cosy, relaxed relationship is likely to grow between, say, an in-house component/input manufacturer and producer of the finished product. The component manufacturer knows that the sister company will almost certainly buy its components, and so there is little pressure for cost efficiency and innovation.

  There is a risk that Nhyira Farms Ltd, knowing that its farm produce (i.e., ingredients) will automatically be purchased by NSL, the farming business may not be cost efficient. The farming business is likely to pass on its cost inefficiencies to NSL since the owners of both businesses are the same. However, if NSL is buying from an unrelated party, the company negotiates for the best price for the ingredients. Therefore, vertical integration may result in higher cost of producing shito.

- **Other companies might turn out to be more successful than the ones bought or set up by the group**. For example, a rival component manufacturer makes a technical breakthrough so that their components are better and cheaper. It might be better on each purchasing occasion to have the pick of all manufacturers so that the best and most suitable cost-effective components can be bought.

On this point, the NSL faces the risk that Nhyira Farms Ltd may not be cost effective and efficient, thereby making the ingredients produced more expensive to NSL compared to similar ingredients that could be obtained from outside sources. Indeed, it is stated in the case that the prices of the ingredients are largely competitive, and most sellers are willing to reduce their prices to attract buyers. Thus, NSL could potentially negotiate with sellers of the ingredients and obtain far cheaper prices than it could obtain from its subsidiary, Nhyira Farms Ltd.

- **Different management skills**. If a manufacturer takes over a distribution chain, the skills needed to manage that will be quite different, and the company could easily mess things up. Again, skills required to produce raw materials or inputs may be different from those possessed by the manufacturer of finished products.

  NSL's main skills and core competences are in the preparation of quality shito, but these skills may not be that relevant in the upstream (i.e., the business of farming its own ingredients) and downstream (i.e., retailing of its products directly to customers) businesses. All things being equal, the management skills of NSL, a producer of shito, required to manage its upstream and downstream businesses may not be the same. This may then result in the company not managing these businesses well to exploit the maximum potential value therein.

- **Core business**. The company should examine its value chain and distinctive competences. These must be protected, and buying or setting up another company can mean that management pays less attention to the areas of its business that really matter.

  NSL engaging in vertical integration by diversifying into farming and seeking to venture into retailing may divert the focus of the company from its core business of producing high quality shito. This may subsequently affect the brand and reputation which the company has built over the years. The company may be distracted by challenges that may arise from managing the other businesses for which the management attention may shift from producing quality shito for which the company has become well known.

- **Use of capital**. Is buying, or setting up, a supplier or distributor really the best way for a company to use its capital?
  NSL has very limited financial capital, for which reason it is struggling to expand its existing business and to buy the state-of-the-art machines required to automate its production process and to expand its production capacity to meet the growing demand. Against this background, expansion into upstream business and downstream activities may not be the best use of the available limited capital. Further, if an investment appraisal has not been conducted on those investments, they may turn out to produce a negative return and not maximise the value for shareholders.

(Any 4 points @ 2 marks each = 8 marks)
(Total: 10 marks)

EXAMINER'S COMMENTS

The candidates were asked to identify and explain the integration strategy the company adopted by cultivating some inputs and the proposal to go into retailing by 2025. In the second part, they were to explain four potential weaknesses or disadvantages the company could suffer with the vertical integration strategy.

Most of the candidates did well in this question. They were able to explain the integration strategy as vertical integration, which combines backward and forward integrations. Vertical integration is the integration strategy being adopted by NSL. With vertical integration, an entity extends its business by acquiring (or merging with or organically setting up) another entity at a different stage in the supply chain. A strategy of vertical integration is usually a form of concentric diversification. Vertical integration might be forward vertical integration, or backward vertical integration.

With forward vertical integration, also called 'downstream' integration, an entity enters the product markets of its customers. Therefore, NSL proposal to rent a gondola and retail Nhyira Shito directly to customers is forward vertical integration.

With backward vertical integration, also called 'upstream' integration, an entity enters the product markets of its suppliers. NSL organically sets up Nhyira Farms Ltd to farm some ingredients for preparation of shito amounts to backward vertical integration.

QUESTION THREE

Factors that contribute to the success of shared management teams

Research into shared management teams has identified several factors that contribute to the effectiveness of such a team and its ability to improve performance. NSL must therefore be mindful of these factors as it seeks to work in shared management teams. The factors contributing to the success of shared management teams are considered below:

- **Shared purpose**. A shared purpose and shared beliefs motivate and empower team members. This increases their commitment to the team and the work they carry out and makes them more willing to share the leadership and responsibilities of the team.

  NSL management must endeavour to ensure that all the workers in the team clearly understand the purpose the team as a whole is working towards. This is where it becomes very important for the company to finalise its purpose statements, vision and mission, and communicate same to the workers. The understanding of the common purpose for which NSL exists will motivate every team member to work hard and play his/her part in making the team efficient and effective.

- **Task interdependence**. This relates to the extent to which the various team members are dependent upon each other in order for them to complete their tasks and achieve their goals. The greater the interdependence, the greater the need for co-ordination and the more likely a shared management team is to succeed.

  NSL management should design the value chain activities to create interdependences making every team member completely indispensable to the success of the team. Each team member must come to the realisation that he/she depends on others to complete their work whilst other team members also depend on him/her to complete their work. This situation creates a sense of interconnectedness and interdependence among the team members which fosters team spirit and belongingness. This will also force every team member to contribute his part to making the value chain complete. Task interdependence is a sine qua non for successful teamwork.

- **Age homogeneity**. Findings indicate that the most successful shared management teams are the ones that consist of members of a similar age. Where the diversity of ages is much wider, the ability of the group to effectively share leadership diminishes.

  Although the ages of the management team of NSL were provided as 25 (Finance and Administration Manager), 47 (the deputy CEO) and 51 (the CEO), the ages of other workers are unknown. It is important that the management of the company bear in mind that the more similar the ages of team members are, the more likely it is that that team will be more effective. While the contrary is also true that the more disparity there is in the ages of the team members, the effectiveness of shared management team declines. Therefore, NSL should consider age similarity in recruiting workers in the future.

- **Team tenure**. The ability to control the balance of power within a team becomes more difficult over time. Therefore, long established teams are less effective at shared management than newer teams.

  The implication of the team tenure regarding effectiveness of shared management team for NSL is that it must be ensured that occasionally the various team members are recomposed since the longer the teams exist, the less effective they become. NSL management should endeavour to renew and recreate teams in the company to maintain their effectiveness.

- **Work complexity**. If the work carried out by a team is very simple, or routine, the establishment of shared management in the team has negligible impact. As the complexity of the work increases, so do the benefits the team will receive by implementing shared leadership.
  In the case of NSL it can be stated that the process of shito production is not too complex a process and over time the process may even become simpler or routine, in which case shared management team may not be ideal. The more complex the work process is, the more it must be broken down into interdependent tasks and more allocation of management responsibilities to each team member with respect to the work one does or performs and the more the benefit of shared management teams. Therefore, NSL stands to benefit more from shared management teams should its work get more complex in the future.

(5 points @ 2 marks each = 10 marks)

(Total: 10 marks)

EXAMINER'S COMMENTS
This question required the candidates to explain five (5) factors that contribute to the effectiveness of shared management teams.
This question was poorly answered by most of the candidates. Most of them displayed ignorance of the concept.

QUESTION FOUR

a) **International Corporate Governance Network (ICGN) guidelines**
The International Corporate Governance Network (ICGN) has issued guidelines on responsibilities for the oversight and management of corporate risk (2010). The ICGN guidelines identified three key stakeholder groups or actors with responsibility for effective risk oversight and management of corporate risk which are board of directors, management and shareholders. They are discussed below:

- **The board of directors is one of the stakeholder groups that have responsibilities for the oversight and management of corporate risk**. The risk oversight process begins with the board. The board is responsible for deciding the company's risk strategy and business model, and it should understand and agree to the level of risk that goes with this. It should then have oversight of the implementation by management of a strategic and operational risk management system.

  Corporate risk management begins with the board of directors of NSL who must set the tone from the top and are responsible for designing risk management strategy and defining the company's risk appetite. NSL board, under the leadership of the CEO, must take the lead in defining risk strategy which must be cascaded down to the management for implementation under the board's oversight and leadership. The potential challenge that may face NSL in this process is the fact that majority of the board members are also the management team members and there could be conflict in the board providing effective oversight over itself in the management position.

- **The second stakeholder group that has risk management responsibility is the management of the company**. Management has the responsibility for developing and implementing the company's strategic and routine operational risk management system, within the strategy set by the board and subject to board oversight.

  NSL management responsibilities regarding corporate risk management is to develop and implement the company's strategic and routine operational risk management system within the context of the broad risk management strategy set by the board under board supervision. Management is therefore accountable to the board regarding how it has designed and implemented the risk management system. The board must take remedial action where it considers that management has not performed satisfactorily, or management has underperformed.

- **The third and final stakeholder group with risk management responsibilities is shareholders.** Shareholders have responsibility for assessing the effectiveness of the board in overseeing risk. Investors are not themselves responsible for the oversight of risk in the company.

  NSL shareholders retain the residual powers to remove directors if they fail to discharge their duties, including risk management oversight responsibilities.

However, since NSL shareholders are also directors it is almost certain that shareholders may not fire themselves in their capacity as directors. Perhaps, the only director NSL shareholders may remove is the non-executive director.

The ICGN Guidelines provide guidance on processes for the oversight of corporate risk by the board and within the company, for investor responsibility and for disclosures by a company on its risk management oversight processes.
(Identification and explanation of three stakeholders @ 2 marks each = 6 marks)

b) **Human resource planning process**
Human resource planning
A human resource plan consists of a forecast of the human resources that will be required at a given time in the future and plans for ensuring that the required numbers and skills will be available. A plan will typically look forward to about three to five years. Beyond five years, it might be difficult to forecast requirements with any accuracy or reliability.

There are four main stages in the planning process:

1. **Studying the corporate objectives of the entity and the strategic objectives of each division and department.** This analysis should then be used to estimate the likely total size and organisation structure of the entity. Total human resource numbers should be consistent with the corporate and divisional strategies.

   It is important that NSL in planning for its human resource needs for the future, it considers the various corporate growth objectives. The company has plans to expand its business locally as well as internationally. All the plans would require a significant increase in the head count of the company. It is therefore very critical that David Martinson, the Finance and Administration Manager, first analyses and determines the potential size of NSL and project the human resource numbers consistent with the future size of the company.

2. **Demand forecasting.** The required numbers and skills of human resources should be estimated. Estimates of requirements should allow for any expected changes in technology, including the introduction of labour saving equipment.

   After NSL has determined the potential size and structure of the company going into the future, the second step is for the company to forecast the number of employees, both permanent and temporary, required to deliver on the corporate objectives as well as the set of relevant skills that would be required by the company. This forecast should take into account whether the company will be technology or labour intensive. Technology intensive means that the company will rely on a fewer number of workers as compared to labour intensive.

3. **Assessing current resources.** An assessment should be made of the current human resources, and what might happen to these existing resources each year over the forecast period. The assessment should allow for expected 'wastage rates' or

labour turnover rates. For some employees, such as trainee accountants, the estimate might allow for the expected numbers who will pass their professional examinations and obtain a professional qualification during the period.
The third stage of human resource planning requires that David Martinson, the Finance and Administration Manager, assesses the existing human resources of the company and the possible future changes that might occur, for example labour turnover, experience, improvement in staff skills and among other factors. This will determine how many new workers to be recruited in the future.

4. **Preparing policies and plans.** The final stage in the planning cycle is to develop policies and plans to fill the gap between the required numbers and current forecasts of future human resources.

   NSL must develop comprehensive human resource policies and plans which may include the following:
   - recruitment of new staff.
   - training and development to improve skills.
   - performance appraisal to monitor and control the development of skills.
   - Promotion.
   - redundancies where some employees will be surplus to requirements or re-training.

   The plans to be prepared by NSL should be realistic, and should therefore take into consideration NSL environmental factors such as:
   - changes in population trends and the total size of the workforce in each country where the entity has its operations.
   - changes in government policy, such as changes in the retirement age of workers.
   - changes in the educational system and the numbers of students going from school into further education.
   - the availability of individuals who are trained in a particular skill or vocation.
   - changing patterns of employment, possibly with increasing numbers of part-time workers or home workers.
   - competition for human resources from competitors and other businesses.
   - trends in sub-contracting and outsourcing.
   - trends in IT and other technological changes that might affect labour requirements.

(4 main stages @ 2 marks each = 8 marks)

c) **The four production resource planning needs that NSL should consider.**
A manufacturing company must plan to obtain the resources that it will need each year to meet the required capacity levels. If the company plans to grow, the required resources will increase each year.

Resource planning involves NSL having to make decisions about:

1. **Production technology to be used.** What production technology will be used: with developments in robotics, a company may need to plan for the introduction of new technology into its operations at some time in the future. NSL needs to plan for the introduction of new and the state-of-the-art technology into the company's production process. The company currently depends on semi-automated production processes (i.e., a blend of manual and some automated technology) which has had negative impact on the speed of production. NSL has a dream to acquire fully automatic canning machine in the near future.

2. **Plan for capital equipment needs of the company**. How much capital equipment will be needed to provide the required capacity. The company must plan towards how much capital equipment it needs to acquire to match its expected production capacity considering the market demand for the company's shito. This point is important for NSL because it currently has limited capacity issue as it is unable to meet the market demand.

3. **Capital expenditure requirement.** How much capital expenditure will be needed to acquire new production equipment. NSL needs to forecast capital expenditure it will incur to acquire the capital equipment it needs to meet its production capacity.

4. **Number of production employees and skills they should possess.** How many production employees will be required and what skills they should have: the production function will need to liaise with the Human Resources department to plan recruitment and training requirements over the strategic planning period.

5. **Materials and components requirements as well as where they would be obtained.** What materials and components will be required and where they should be obtained: the production function will need to liaise with the procurement department to plan material supplies.

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

(Total = 20 marks)

EXAMINER'S COMMENTS

This was a three-part question. The first part required candidates to explain the role of three (3) stakeholders identified by the International Corporate Governance Network (ICGN) guidelines.

A good number of the candidates were able to identify stakeholders as Board of Directors, Management and Shareholders.

Some of the candidates produced wrong responses including consumers, competitors, suppliers and employees.

The second part required candidates to outline and explain four (4) main stages in the human resource planning process.

In the final part, the candidates were to identify and explain four (4) production resource planning needs that NSL should focus on to effectively manage its production capacity challenges. The candidates performed poorly. They seemed not to be abreast with other functional areas of business.

QUESTION FIVE

a)

i) Calculation of the future spot rates/forward spot rates using interest rate parity. The interest rate parity formula for predicting future exchange rates is also used to predict forward exchange rates. With this theory it is assumed that the forward rate does predict what the future spot rate will be. Future spot rates might be found using interest rate parity, purchasing power parity.

The formula for the forward rate or future spot rate (i.e., interest rate parity) is as follows:

$$F_1 = S_0^{d/f} \times \left(\frac{1+i_d}{1+i_f}\right)$$

Where:
F = the forward rate/future spot rate
$So^{d/f}$ = the current spot rate
Id = domestic interest rate (in this case, Ghana interest rate)
If = foreign interest rate (in this case, the UK interest rate)

Forward spot rates

Year	**Formula**	**Forward Spot Rate**
End of 2024	15.2500*((1.15)/(1.08))^1	16.2384
End of 2025	15.2500*((1.15)/(1.08))^2	17.2909
End of 2026	15.2500*((1.15)/(1.08))^3	18.4116
End of 2027	15.2500*((1.15)/(1.08))^4	19.6050

Forward spot rates (alternative solution)

Year	**Formula**	**Forward Spot Rate**
End of 2024	15.2500*((1.15)/(1.08))	16.2384
End of 2025	16.2384*((1.15)/(1.08))	17.2909
End of 2026	17.2909*((1.15)/(1.08))	18.4116
End of 2027	18.4116*((1.15)/(1.08))	19.6050

(Each year's forward spot rate @ 1 mark each = 4 marks)

ii) Calculation of NPVs to make investment decision.
International DCF appraisal: Market imperfection (Where exchange controls exist)
If there are imperfections DCF analysis should be carried out in two stages, and two net present values should be calculated.

- **Stage 1:** Calculate an NPV for the project on the basis of cash flows for the subsidiary in the foreign country. This should be an NPV based on foreign currency cash flows. If the NPV is positive and the risk seems acceptable, you should proceed to Stage 2.

- **Stage 2:** Consider the project from the viewpoint of the parent company (i.e., NSL), and estimate the cash payments and receipts for the parent company in its own currency. These might include costs incurred in the parent company's own country to set up the project. They will also include the dividend or interest payments received from the foreign subsidiary, in the currency of the parent company. These cash flows should be discounted at an appropriate cost of capital, which might be different from the cost of capital used in Stage 1.

Stage 1: NPV in the United Kingdom

Year	**Year**	**Cash flows (£)**	**DF @ 8%**	**PV (£)**
Start of 2024	0	(200,000.00)	1	(200,000.00)
End of 2024	1	65,000.00	0.9259	60,183.50
End of 2025	2	65,000.00	0.8573	55,724.50
End of 2026	3	65,000.00	0.7938	51,597.00
End of 2027	4	65,000.00	0.7350	47,775.00
Net Present Value (in pounds)				**£15,280.00**

Marks should be awarded for discount factors, Present Value and NPV as follows:
10 ticks for discount factors and PVs @ 0.2 marks each = 2 marks
NPV @ 1 mark = <u>1 mark</u>
3 marks

Alternative Solution using annuity formula

PV = PMT x [(1 - (1 + r)^(-n)) / r]

Where:

- PV = Present Value of the annuity
- PMT = Payment amount (the regular, equal cash flow received or paid at each period)
- r = Interest rate per period (expressed as a decimal)
- n = Number of periods

PMT = £65,000, n= 4, r = 8%
PV = £65,000 * [(1- (1.08) ^ (-4))/0.08]
PV = £65,000 * 3.3121
PV= £215,286.50

Net Present Value = Initial Cost of the project – PV of cash flows
Net Present Value = - £200,000 + £215,286.50
Net Present Value = £15,286.50 (difference is due to approximation)

Stage 2: NPV in Ghana

Year	Year	Foreign Cash Flow (£)	Exchange rate	Local Cash Flow (GHS)	DF @ 15%	PV (GHS)
Start of 2024	0	(200,000.00)	**15.2500**	(3,050,000)	1	(3,050,000.00)
End of 2027	4	260,000.00	**19.6050**	5,097,300.00	0.5718	2,914,636.14
Net Present Value (in Ghana cedi)						**(135,363.86)**

Marks should be awarded for foreign cash flows, local cash flows, discount factors, present values and NPV as follows:

8 ticks @ 0.25 mark each = 2 marks
NPV @ 1 mark = 1 marks
= 3 marks

Decision
NSL should reject the project because it does not produce positive NPV in Ghana based on the timing of the receipt of the cash flow from the United Kingdom. For a foreign investment project to be acceptable, it must first yield positive foreign NPV and secondly, positive NPV in the parent's local currency. The foreign NPV for the proposed UK project is a positive figure of **£15,280.00.** However, NPV of the proposed project in Ghana is a negative amount of -GHS**135,363.86,** hence based on this negative NPV, the proposed project should be rejected by NSL.

1 mark for the right decision = 1 mark

b) **Advantages and disadvantages of convertible bonds to NSL, the bond issuer, and the bondholders/investors.**

Advantages of convertibles to NSL
The advantages of convertibles for companies are as follows:

- **Tax savings on deductible interest/the interest is tax deductible.** The company can issue bonds now, and receive tax relief on the interest charges, but hopes to convert the debt capital into equity in the future. By NSL issuing a convertible bond, the interest payment on the bond is an allowable deduction for tax purposes. This will reduce the amount of taxes the company pays to tax authorities and consequently increase the value of the company since one of the methods used to value a business is free cash flow to firm (FCFF) or equity (FCFE) depending on the capital structure of a firm. The tax savings in terms of reduced cash outflow for tax purposes adds to the value of the firm. That is why Millier and Modigliani posited that the value of a geared firm is greater than the value of an ungeared firm (i.e., all equity financed firm).

- **Lower interest than on a comparable straight bond.** The interest rate on convertibles is lower than the interest rate on similar straight bonds. This is because investors in the convertibles are expected to accept a lower interest rate in return for the option to convert the bonds into equities in the future. Thus, NSL by issuing convertible bonds will enjoy lower interest rate compared to a similar straight bond without the option of the bondholder to convert the bond into equity at a future date.

- **Occasional strong demand from investors for convertibles.** Occasionally, there is strong demand from investors for convertibles, and companies can respond to investors' demand by issuing convertibles in order to raise new capital. Usually when there is a strong demand which is not matched with supply of the bonds, this can further drive down the yields demanded by the bondholders. Hence, NSL may issue the convertible bond to take advantage of any possible strong demand by the investors for convertible bonds.

- **Convertible bonds are self-liquidating**. When the share price reaches a level at which conversion is worthwhile the bonds will (normally) be exchanged for shares so the company does not have to find cash to pay off the loan principal – it simply issues more shares. This has obvious cash flow benefits. NSL does not have to look for cash to pay off the principal amount of the bond once the bondholders exercise their right of conversion. The only thing required to be done by the company is to pass an accounting entry of debiting the convertible bond and crediting stated capital to liquidate the bond.

- **Fewer restrictive covenants on convertible bonds compared to straight bond**. The directors have greater operating and financial flexibility than they would with a secured debenture. Investors accept that a convertible is a hybrid between debt and equity finance and do not tend to ask for high-level security, impose strong operating restrictions on managerial action or insist on strict financial ratio boundaries. The directors and management of NSL would be subject to fewer and less stringent covenants by issuing convertible bonds. This will allow them a free hand to manage the company more effectively without the invisible hands of the bondholders controlling them from afar.

- **Cheap way to issue shares**. Graham and Harvey (2001) found that managers favoured convertibles as an inexpensive way to issue 'delayed' equity. Equity is raised at a later date without the high costs of rights issues, initial public offering, seasoned, etc. The issue of equity shares through convertible bonds into equity shares is known as conversion issue. Conversion issue is a cheaper way to raise equity capital compared to right issue or public issue (either initial public offering or seasoned issue). This is because unlike right issue and public issue, conversion issue does not involve hiring professionals such as accountants, lawyers and investments bankers to put together a prospectus required for public invitation.

(3 points @ 1.5 marks each = 4.5 marks)

The advantages of convertibles for investors/bondholders are as follows:

- Investors receive a minimum annual income up to the conversion date, in the form of fixed interest. Thus, in the near term there is greater security for their principal compared with equity investment, and the annual coupon is usually higher than the dividend yield.

- In addition, investors in convertibles will be able to benefit from a rise in the company's share price and hope to make an immediate capital gain on conversion.

- Convertibles therefore combine some fixed annual income and the opportunity to benefit from a rising share price.

- Again, bondholders are able to wait and see how the share price moves before investing in equity; they may take advantage of the upside. Since convertible bonds give the holders a call option that is exercisable at the discretion of the bondholder, the investor is able to wait until the right time considering the prevailing market price before deciding to convert the bond.

- For companies that do not pay dividends the investor can gain a regular income stream through a convertible and then (possibly) make a capital gain through conversion.

(3 points @ 1.5 marks each = 4.5 marks)

(Total = 20 marks)

EXAMINER'S COMMENTS

This question was in two parts. The first part was on interest rate parity equation. The candidates were required to use interest rate parity/equation to determine the forward rates/future spot rates at the end of 2024, 2025, 2026 and 2027.
The candidates appeared not familiar with the concepts.

In the second part, the candidates were asked to explain three (3) advantages of issuing convertible bond to NSL and to investors/bondholders respectively.
A good number of the candidates were able to provide good answers

QUESTION SIX

a)

i) **Agency costs that NSL would avoid by having the two shareholders in the management as well as being on the board.**

It is the view of agency theory of corporate governance that when there is no separation of the management and shareholders of a company, for instance as it pertains in NSL, there will not arise agency conflict and hence there will be low to zero agency costs. **Agency costs are the costs that the shareholders incur when professional managers run their company.**

The following are the propositions advanced on agency cost by Agency Theory:

- **Agency costs do not exist when the owners and the managers are exactly the same individuals.** This is the situation with NSL because the owners/shareholders and managers are the same, that is, the Martinsons are the shareholders and managers at the same time.
- Agency costs start to arise as soon as some of the shareholders are not also directors of the company.
- Agency costs are potentially very high in large companies, where there are many different shareholders and a large professional management.

Following from the preceding discussion the three potential agency costs NSL will avoid are:

1. **Monitoring costs.** Under this subheading of agency cost, a company establishes systems for monitoring the actions and performance of management, to try to ensure that management are acting in their best interests. An important example of monitoring is the requirement for the directors to present an annual report and audited accounts to the shareholders, setting out the financial performance and financial position of the company. Preparing accounts and having them audited has a cost. NSL does not have to incur monitoring costs, except for those that are statutorily mandated like audited accounts, because the shareholders and managers are the same. It would be an absurdity to say that shareholders who are managers have to monitor themselves, unless a particular monitoring mechanism is a requirement of law.

2. **Bonding costs.** The second aspect of agency costs is costs that might be incurred to provide incentives to managers to act in the best interests of the shareholders. The main example of bonding costs are the costs of remuneration packages for senior executives. These costs are intended to reduce the size of the agency problem. Directors and other senior managers might be given incentives in the form of free shares in the company or share options. In addition, directors and senior managers might be paid cash bonuses if the company achieves certain specified financial targets.

   These costs do not arise at all as far as NSL is concerned because the shareholders are the managers and they do not have to be offered shares to align their interests since the managers are already shareholders.

3. **Residual loss**. Agency costs also include the costs to the shareholder that arise when the managers take decisions that are not in the best interests of the shareholders (but are in the interests of the managers themselves). Losses occur for the owners, such as the losses arising from a lower share price, because the managers take decisions and actions that are not in the best interests of the shareholders. Monitoring costs and bonding costs will not prevent some residual loss from occurring. For example, agency costs arise when a company's directors decide to acquire a new subsidiary and pay more for the acquisition than it is worth. The managers would gain personally from the enhanced status of managing a larger group of companies. The cost to the shareholders comes from the fall in the share price that would result from paying too much for the acquisition.

   This residual loss will not arise in the context of NSL because the managers who are shareholders will not be involved in any reckless acquisitions or investments without demanding that such investments maximise their value. This explains why Mr. Martinson has requested an investment appraisal of the proposed investment in the United Kingdom.

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

ii) **The role that Daniel Aidoo, ESQ, FCA can play on NSL board as a non-executive director as recommended by Higgs Guidance.**
A document published in the UK in 2003, known as the Higgs Guidance, identified four broad roles for non-executive directors (NEDs).

- **Strategy**: NEDs should challenge constructively and help to develop proposals on strategy. NEDs were encouraged to provide constructive challenge to the executive directors and contribute to the development of effective strategies. They should bring their diverse skills, experience, and expertise to board discussions, ensuring a balanced decision-making process.

  Daniel Aidoo needs to scrutinise strategies that the executive directors present to the board to ensure that the strategies will achieve the set corporate goals and objectives. The company has many expansion plans, and it is the duty of the non-executive director to challenge those plans constructively to make them better, especially because of his finance and legal background as well as rich experience at his disposal.

- **Performance**: NEDs should monitor the performance of executive management in meeting their agreed targets and goals.

  Since the executive directors who form management are responsible for the day-to-day actual execution of the approved corporate strategies, their performance must be evaluated by non-executive directors. Since Daniel Aidoo is the sole NED, he must assume this duty and critically assess the performance of the Martinsons as executive directors. This must be done objectively and independently to draw the attention of the executive directors to where their performance is below the financial and operational targets set by the board.

- **Risk:** Non-executive directors are responsible for overseeing the risk management processes within the company. They should ensure that risks are identified, assessed, and managed effectively. NEDs should satisfy themselves about the integrity of the financial information produced by the company and should also satisfy themselves that the company's systems of risk management and internal control are robust.

  Daniel Aidoo has the onerous responsibility to ensure that the executive directors are executing strategies within the approved risk management framework and internal control systems. Naturally, management directors have a propensity to assume higher risk which must be effectively countered by non-executive directors' vigilance and checks. One common area where risk may be high has to do with financial information produced by the company which may lack integrity, or which may not be a faithful representation of the economic transactions of the company. The NED would have to ensure that the financial statements are fairly presented.

- **People:** NEDs should be responsible for deciding the remuneration of executive directors and other senior managers and should have a major role in the appointment of new directors. The Higgs Report recommended that NEDs should be involved in the development of executive remuneration policies, helping to ensure that executive pay is aligned with the company's performance and objectives.

  Finally, Daniel Aidoo should ensure that the remuneration of the executive directors is based on market rates as there is a potential risk that the Martinsons may overpay themselves as related parties. Again, since there is only one NED on the NSL board, Daniel Aidoo should recommend appointment of more NEDs to strengthen the company's board.

  These roles suggest that NEDs on a unitary board have the complex task of acting partly as a colleague of the executive directors, and partly as 'policemen'. They act as colleagues in discussing strategy and helping to develop strategy. However, they act as a 'policeman' in monitoring the performance of executive management, checking the integrity of financial reporting, evaluating the effectiveness of the risk management system and internal control system, and deciding the remuneration of their executive colleagues.

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

b) **Board's responsibility for risk management and systems of internal control.**
Risk management is largely a responsibility for management. However, the board of directors has overall responsibility for risk management, just as it has overall responsibility for the system of internal control. The requirements of the Ghana

Code of Best Practices for Corporate Governance for the board of directors are very similar to those of the UK. The evaluation of risk management systems, and the board's responsibilities for reporting to shareholders, are the same as the board's responsibilities for internal controls.

The Ghana Code of Best Practices for Corporate Governance and the UK Corporate Governance Code state the following key responsibilities of directors of NSL for risk management and system of internal control:

- **Board has responsibility for setting company's risk policy and risk appetite.** The board should set the company's policy for risk and give clear guidance about the company's risk appetite. The Board is generally responsible for defining the company's risk policy, risk appetite and risk limits as well as ensuring that these are integrated into the day-to-day operations of the company's business.

  A company's risk policy, also known as a risk management policy, is a document or set of guidelines that outlines how the organization identifies, assesses, and manages risks to achieve its objectives while minimizing potential negative impacts.

  Risk appetite varies from one company to another. Some companies are willing to take fairly large risks whereas others are 'risk averse'. In general, companies expect higher returns by taking larger risks. Risk appetite should be established by the board of directors, which should formulate a policy for strategic risk/business risk.

  NSL board of directors, therefore, have overall responsibility for defining risk policy of the company by identifying, assessing, and managing risks to achieve its objectives while minimizing potential negative impacts of the risks. The board of NSL also has responsibilities for setting the company's risk appetite to place restrictions on the extent of risk the company can take.

- **Regular review of the effectiveness of internal controls**. The board should conduct a review at least once a year of the effectiveness of internal controls, and this includes the effectiveness of risk management systems. The board therefore has overall responsibility for ensuring the effectiveness of internal controls, but much of the task of monitoring this is delegated to the audit committee, which reports to the board. Thus, the audit committee, on behalf of the board, should perform an annual review of the company's internal control over financial, operational and compliance matters, and report on this to shareholders in the company's annual report.

  NSL board of directors must endeavor to conduct a review, at least once a year, of the effectiveness of the company's internal controls. This is to ensure that the potential risks that may arise in the absence of internal controls are mitigated or minimised.

- **Annual reporting to shareholders on the annual review of the effectiveness of internal controls**. The Ghana and UK Corporate Governance Codes also require the board to report to shareholders on its review of internal control. NSL board of directors are required to report to shareholders the results of the internal control effectiveness review in the annual report.

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

c) **Limitations of international codes/OECD or statements of principles**
International statements of principle about corporate governance establish minimum acceptable standards of corporate governance, but they have several limitations.

- **OECD principles of corporate governance are too general**. Because they apply to all countries, they can only state general principles. They cannot give detailed guidelines, and so are not specific. Since they are not specific, they are possibly of limited practical value. Although the world has become a global village, there remains country differences in terms of practices, infrastructure and financial markets which call for customised corporate governance principles for each country. The more country specific a corporate governance code is, the more applicable, relevant and effective it is.

- **OECD corporate governance code is less relevant for countries with high standards of governance.** Their main objective is to raise standards of corporate governance in the countries which have not so far made much progress with establishing a good system of corporate governance. They have less relevance for countries where corporate governance standards are above the minimum standard.

- **OECD corporate governance code lacks legal/regulatory authority and backing.** Unlike national laws and codes of corporate governance, there is no regulatory authority for international statements of principle. The principles therefore lack any 'force'. In specific countries, by contrast, there may be a supervisory body or regulatory body with specific responsibility for encouraging or enforcing corporate governance practices. For instance, in Ghana the Central Bank in 2018, following the banking sector failures, issued **Corporate Governance Directive for Banks, Savings and Loans Companies, Finance Houses and Financial Holding Companies** pursuant to Sections 56 and 92(1) of the Banks & Specialised Deposit Taking Institutions Act, 2016 (Act 930). This makes the directive mandatory and compulsory making any breach by the covered entity punishable under the law. This does not apply in the case of OECD code because it does not have the backing of any law or regulatory authority.

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

(Total = 20 marks)

EXAMINER'S COMMENTS

This question were in three parts. In the first part candidates were required to explain two (2) agency costs that the company would avoid.

The second part required candidates to explain two (2) key roles that the Board of Directors of NSL play in relation to risk management and internal controls in accordance with the UK Corporate Governance Code and the Ghana Code of best Practices for Corporate Governance.

The final part required candidates to state and explain two (2) limitations of the OECD Principles of Corporate Governance.

The performance was generally good as candidates demonstrated familiarity and understanding on the areas examined. They performed well in this question.

CONCLUSION

Overall, there was a little improvement in the candidates' performance over that of the July, 2023 examination.