LEARNING UNIT 4: PERFORMANCE MANAGEMENT SYSTEMS

Activities	**Notional study hours**
Prescribed reading	Chapters: 1 (6 minutes)
Learning unit content	10 minutes
Activities	Activities: 10 (7 hours and 25 minutes) Videos: 1 (2 hours)
Total	**9 hours and 41 minutes**

This learning unit deals with the following topics: **performance based on key performance indicators; performance evaluation; and reward structures, including the offering of incentives**. Since these topics are linked to several integrated concepts, they are treated as one holistic learning unit.

INTEGRATION AND INTEGRATIVE THINKING

Financial analysis outline consists of the following areas: (I) Profitability; (II) Capital structure; (III) Liquidity; (IV) Return on invested capital; (V) Financial market/ Investor; (VI) Cash-flow related and (VII) Other Performance areas (see Skae, et al section 8.3.1).

When determining the area of analysis it is important that you take cognisance of who the **key stakeholder** is as this will guide you to identify and analyse the appropriate analysis area.

Performance management is regularly integrated with **strategy** and **working capital management** which falls under the (III) Liquidity analysis area.

There are various areas where financial performance can be integrated between subject areas. For example, in **auditing** there will be various substantive audit procedures performed on the different balances such as inventory, debtors, etc. Correct financial accounting treatment is a prerequisite of performing sound financial performance analysis. The **Taxation** impact on each item of the financial statement will have to be considered for VAT, Income tax and Capital Gains Tax (CGT), etc. **Integrated reporting** is also linked with **King IV** which links to auditing subject area.

LEARNING OUTCOMES AND ASSESSMENT CRITERIA

Owing to the integrated nature of this learning unit the learning, outcomes and assessment criteria refer to activities and measures for tracking and monitoring performance, which include organisational, management and divisional

(a) **performance based on key performance indicators (KPIs),**
(b) **performance evaluation, and**
(c) **reward structures, including the offering of incentives.**

<table>
<tr><th>Learning outcomes</th><th>Assessment criteria</th></tr>
<tr><td rowspan="2">Evaluate an enterprise’s strategic development plan in terms of its overall objective.</td><td>Judge an organisation’s ability to manage its performance in accordance with its strategies.
a) Evaluate the efficiency of an integrated performance management system based on the six capitals to create value for stakeholders.
b) Assess the ability of an organisation’s performance management system to:
• drive value creation for stakeholders, and
• inform decision-making
c) Critique the appropriateness and coherence of the KPIs used for the different capitals.</td></tr>
<tr><td>Assess the alignment of management decisions with an entity’s vision, mission, values and mandates.
a) Interpret management information taking cognisance of the organisation’s business objectives and external and internal environments (e.g., competitive, economic, social, political and internal factors [culture, incentives]).
b) Assess the effectiveness and appropriateness of the organisation’s performance methodology with reference to reward structures and measures for offering incentives to inform decision-making in this regard.</td></tr>
<tr><td rowspan="2">Evaluate financial planning and control techniques.</td><td>Assess the appropriateness of performance measures within an organisation.
a) Analyse the appropriateness of the organisation’s performance management framework, performance methodology and measures used for offering incentives.
b) i) Assess the appropriateness of financial and non-financial KPIs in business performance management.
ii) Evaluate the efficiency of financial and non-financial KPIs in respect of reaching business objectives and creating value for key stakeholders.
c) Assess the appropriateness of non-financial KPIs to evaluate the entity’s effectiveness and efficiency.</td></tr>
<tr><td>Interpret the managerial and economic performance measures within an organisation.
a) (i) Perform a financial analysis using appropriate techniques (e.g. data analytics) and assumptions.
(ii) Interpret the results you have benchmarked.
(iii) Conclude on the organisation’s present and projected financial situations.
b) (i) Use data analytics to analyse and interpret management, financial and non-financial information (this analysis will inform risk evaluation and opportunities, key causes of business variance, and areas of strength or concern in performance).
(ii) Advise on potential improvement based on your data analysis.
c) Evaluate how the above interpretations, the analyses on costs, the delivery of products/services and the KPIs, inform decision-making on performance management and appraisal.</td></tr>
</table>

4.1 ASSUMED PRIOR LEARNING

If you wish to refresh your knowledge, please refer to your undergraduate material and prescribed textbook (*Managerial finance*, 10th edition). For your convenience, we provide textbook references. It is important to ensure that you are familiar with all the concepts covered in your prior learning in this learning unit, otherwise you will need to first revisit your prior learning.

Learning outcomes assumed to have been attained during prior learning Before you study this topic, you should be able to:	***Managerial finance* (10th edition)**
1. Describe and explain the purpose of the various **financial and non-financial reports.**	**Chapter 8: Reporting and performance analysis** 8.1 Financial and non-financial reports 8.1.1 Integrated reporting 8.1.2 Supplementary reports 8.1.3 Annual financial statements 8.1.4 Integrated reporting
2. Identify and describe the **six capitals** critical to an entity's success.	8.2 Integrated reporting principles 8.2.1 The six capitals (financial, manufactured, intellectual, human, social and relationship, and natural)
3. Demonstrate the application of **integrated thinking** to evaluate value creation in the short, medium and long terms by taking cognisance of an organisation's strategy, governance, performance and prospects in the context of its external environment.	8.2 Integrated reporting principles 8.2.1 The six capitals (integrated thinking principles) 8.2.2 Seven guiding principles 2. Connectivity of information
4. Assess the interrelatedness of the six capitals and how they are transformed to create sustainable value for key stakeholders.	8.2.1 The six capitals (capital inputs of the capitals yield outputs that create value for an entity and its key stakeholders)
5. Identify and describe the **seven guiding principles**.	8.2.2 The seven guiding principles 1. Strategic focus and future orientation 2. Connectivity of information 3. Stakeholder relationships 4. Materiality 5. Conciseness 6. Reliability and completeness 7. Consistency and comparability
6. Identify and describe the **eight content elements**.	8.2.3 The eight content elements 1. Organisational overview and external environment 2. Governance 3. Business model 4. Risks and opportunities 5. Strategy and resource allocation 6. Performance 7. Outlook 8. Basis of presentation
7. Identify the key stakeholders and other users of financial and non-financial statements and analysis.	8.2.2 The seven guiding principles 3. Stakeholder relationships (employees, customers, shareholders/investors, regulators, society and financiers)

8. Identify and describe key performance indicators (KPIs) and evaluate their appropriateness in relation to achieving an entity's objectives and creating value for its key stakeholders.	8.2.3 The eight content elements 6. Performance (KPIs in relation to an organisation's objectives)
9. Assess the appropriateness of financial and non-financial KPIs in relation to evaluating an entity's effectiveness and efficiency.	8.2.3 The eight content elements 6. Performance (KPIs in relation to outcomes achieved over the period)
10. Advise on an entity's management or divisional performance appraisal methodology and measures for offering incentives.	8.2.3 The eight content elements 6. Performance (KPIs in relation to an organisation's management or divisional performance assessment framework)
11. Determine whether management performance appraisal is aimed at meeting the needs, interests and expectations of key stakeholders.	8.2.3 The eight content elements 6. Performance (KPIs in relation to management or divisional performance assessment linked to key stakeholders)
12. Identify the objectives of financial and non-financial analysis.	8.3.1 Financial analysis 8.3.2 Non-financial analysis
13. Describe the different analysis techniques used.	8.3 Techniques used for financial and non-financial analysis 8.3.1 Financial analysis 8.3.2 Non-financial analysis 8.3.3 Data analytics
14. Perform financial analysis calculations for each financial analysis area based on the needs of key stakeholders and other users.	8.3.1 Financial analysis 8.3.1.3 Financial analysis calculations 8.3.1.4 Financial analysis example (fundamental and intermediate levels)
15. Perform non-financial analysis calculations for social, environmental and other entity-specific analysis areas.	8.3.2.1 Non-financial analysis basic example 8.2.2.2 Non-financial analysis integrated example
16. Provide insightful comments based on financial and non-financial analysis comparisons between historical, actual, budgeted, industry, competitor and divisional data. 17. Analyse relevant financial and non-financial information to identify relevant analytical comparisons (e.g., corporate social responsibility contribution compared to profits).	8.3.1.4 Financial analysis example (fundamental and intermediate levels) 8.3.2.1 Non-financial analysis basic example 8.2.2.2 Non-financial analysis integrated example
18. Describe the purpose of a balanced scorecard and tabulate a balanced scorecard worksheet.	8.3.3 The balanced scorecard
19. Describe the limitations of accounting data and ratio analysis.	8.4 Limitations of accounting data 8.5 Limitations of ratio analysis
Learning unit 1	**Chapter 1: The meaning of financial management** 1.4 Stakeholders of an entity
Learning unit 1	**Chapter 2: Strategy and business models** 2.1 The purpose of an organisation 2.2.2 Strategy defined 2.2.3.7 Key performance indicators

4.2 PRESCRIBED READING FOR THIS UNIT

After you have refreshed the knowledge attained during your prior learning, read the following material in the outlined order in your prescribed textbook, (Managerial Finance, 10th edition):

Chapter	Sections	Estimated time
Chapter 8	8.3 Techniques used for financial and non-financial analysis (prior learning) 8.3.3 Data analytics	6 minutes

4.3 INTRODUCTION

The concept of integrated thinking was introduced in learning unit 1 as part of an organisation's strategy. The concept is expanded in this learning unit. Integrated thinking forms an integral part of an organisation's six capitals and drives integrated reporting. Integrated reporting is aimed at meeting the needs of an organisation's key stakeholders.

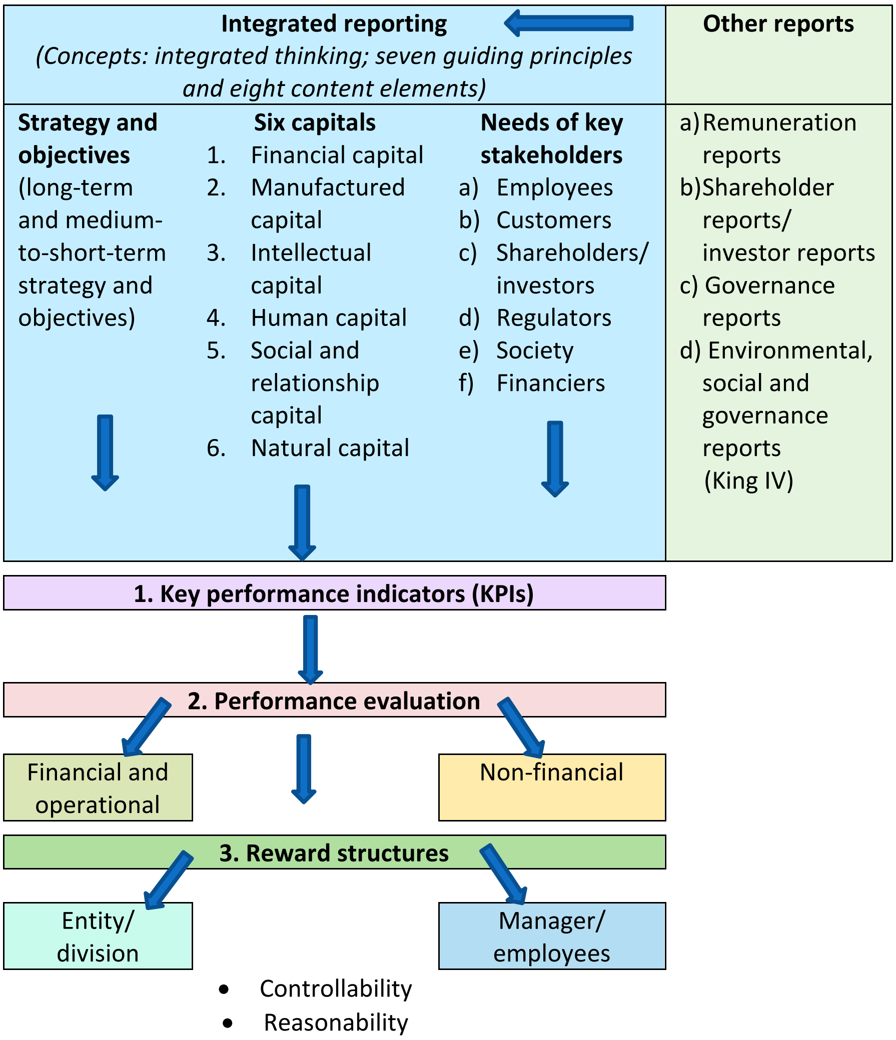


Figure 4.1 Overview of integrated reporting and performance analyses

(Source: Skae et al (2024); used with permission)

It is important to ensure that you are familiar with all the concepts illustrated in figure 4.1 as these concepts were addressed in your prior learning, otherwise you will need to first revisit your prior learning. Performance management and analysis can be approached from based on stakeholder needs, benchmarking with market, prior periods or budgets, or problem-based per info given in the scenario. To familiarise yourself with the needs of key stakeholders and typical ratios they are interested refer to Chapter 8; 7 Guiding principles; 3. Key stakeholders (Skae et al, 2024)

PERFORMANCE ANALYSIS

Note that this content can be linked to enabling competencies, particularly those involving **business** acumen and **decision-making** acumen.

Taking cognisance of the diverse needs of the organisation's key stakeholders an integrated report contains key **financial and non-financial** information obtained from several supplementary reports, such as annual financial statements, remuneration reports, shareholders reports/investors reports, environmental, social and governance reports, since this information is used by the key stakeholders.

An organisations performance management system is based on its **Key Performance Indicators (KPIs)** which are determined by incorporating of the six capitals, key stakeholders needs and strategic goals. It is vital that an organisations' KPIs are linked with **reward structures** on which the **performance evaluation** of management and divisions is based. This will ensure that the divisions and the managers align their performance objectives with the strategic objectives of the entity and that their efforts lead to value creation for the organisation. In learning unit 7 (Internal cost allocation methods), performance management is analysed from the perspective of management and other internal users of an organisation. Within the framework of decision-making based on internal cost allocation (e.g., standard costing) and transfer pricing options, learning unit 7 incorporates the *reasonability and controllability* concepts of management performance assessment.

4.4 VIDEO (2 hours)

Watch the videos about financial and non-financial analysis that are available on myUnisa. You can access the videos at the link below.

[Financial and non-financial performance analysis]

4.5 ACTIVITIES

After you have read the above-mentioned sections and watched the videos, complete the following activities:

Financial analysis

Activity 4.1: Precious Royalty Ltd Group
Chapter 8, section 8.3.1.4 (financial analysis example)
Note: Provide **advanced** ratios and comments (the basic and fundamental levels were covered in your prior learning).

Activity 4.1: Precious Royalty Ltd Group		**Estimated time**
	Reading	**Total**
Perform advanced ratios and comments	12 pages	1 hour and 12 minutes

Non-financial analysis

Activity 4.2: Netcare 2021
Chapter 8, section 8.3.2.3 (non-financial analysis integrated report example)

Activity 4.2: Netcare 2021		**Estimated time**
	Reading	**Total**
Perform the non-financial analysis integrated report example	2 pages	12 minutes

KPIs and financial and analysis

Activity 4.3: OfferTop Group (extract)

Activity 4.3: Offer Top Group		**Estimated time**		
	Reading	**Writing**	**Marking and review**	**Total**
28 marks	6 minutes	42 minutes	12 minutes	60 minutes

PART A: BACKGROUND INFORMATION

The OfferTop Group ('OfferTop') is a service, trading and distribution company that was founded in 1985 by Mr Ben Graff. The group is structured into four divisions, namely, Commercial Products, Financial Services, Construction and Logistics. Mr Graff is the chief executive officer (CEO) and he built OfferTop into a strong and diversified business.

OfferTop's strategy is to purchase South African companies and to apply a decentralised operating model. For more than 30 years, OfferTop has assisted in developing businesses that provide goods and services in line with a focused business-to-business (B2B) philosophy. The group's strategy encompasses the following four key performance areas:

- **Diversifying the group portfolio**
  OfferTop's diversity has provided it with a competitive edge. The company therefore needs to continuously expand its product and service basket.
- **Ensuring the adequate management of divisions**
  Since OfferTop has a decentralised business model, it must provide adequate supervision to new and current businesses.

- **Maintaining healthy liquidity**
  OfferTop needs to remain liquid to ensure the sustainability of the business.
- **Optimally allocating capital for growth**
  OfferTop's business model is based on the acquisition of businesses. The company therefore needs to continuously retain capital for future acquisitions to ensure growth and profitability.

PART B: SOLAR POWER (PTY) LTD

Solar Power (Pty) Ltd ('SPL') was incorporated in South Africa in 2010 by Mr Vince Wilson. SPL's mission is to supply affordable solar power to South Africans. Mr Graff is interested in acquiring SPL and has requested Mr Wilson to provide him with information, as reflected below.

1. The balances as at 31 December 2023 are as follows:

	R'000
Trade and other receivables	R12 663
Inventory	R16 332
Cash and cash equivalents	R15 623
Trade and other payables	R18 628

2. Mr Wilson provided the following ratios relating to SPL and a similar unlisted competitor:

	SPL		**Competitor**	
	2023	**2022**	**2023**	**2022**
Change in revenue (from prior year)	33,6%	26,1%	23,0%	29,8%
Gross profit margin	51,2%	45,0%	50,2%	49,8%
Current ratio	3,4	1,3	3,5	3,3
Inventory turnover	4,6	6,5	5,3	5,1

REQUIRED		**MARKS**	
		Sub-total	**Total**
(a)	With reference to OfferTop's business model, provide two key performance indicators for each of the performance areas outlined in Part A of the scenario. No discussion of the performance indicators is required. *Y1: Integrative thinking*	8 *1*	 9
(b)	Discuss SPL's performance based on the ratios provided by Mr Wilson in Part B of the scenario. **You are not required to perform any calculations.** *Z2: Business external environment*	18 *1*	 19
	Total		**28**

Solution

(a)	With reference to OfferTop's business model, provide two key performance indicators for each of the performance areas outlined in Part A of the scenario. No discussion of the performance indicators is required.	9

NOTE: A KPI should always be measurable.
A **SMART** KPI is: Specific, Measurable, Attainable, Relevant, and Time-bound

***Y1:* Integrative thinking** Demonstrating synthesis of the information provided to provide two key performance indicators that is relevant to OfferTop's business model problem	*1*

Diversifying the group portfolio

1) Number of industries invested in **OR** number of new industries invested in/markets entered (1)
2) Actual number of new products launched **OR** target number of new products/services (1)
3) Growth in capital expenditure (CAPEX) spend on new product development (1)
4) Relative percentage of sales from new products and services (1)
5) Sales growth by product or service line (1)
6) Profitability by product or service line (1)
7) Relative market share and market position of product lines and services in invested industries (1)

Maximum: 2

Ensuring the adequate management of divisions

1) Percentage of employees participating in development programmes (1)
2) Percentage of time spent on staff (management) development (1)
3) Manager-to-staff ratio (1)
4) Brand image/reputation index (1)
5) Customer satisfaction index (1)
6) Divisional financial performance (1)

Maximum: 2

Maintaining healthy liquidity

1) Acid-test ratio (1)
2) Cash conversion days (1)
3) Current ratio (1)
4) Cash ratio (1)
5) Ratio of operating cash flow to current liabilities (1)
6) Net working capital or operating cycle or cash conversion cycle (1)

Maximum: 2

Optimally allocating capital for growth

1) Debt-to-equity/gearing ratio (1)
2) Number of acquisitions during a financial year (1)
3) Growth in share price/growth in market capitalisation (1)
4) Efficiency measure: planned CAPEX versus actual investment in CAPEX (1)
5) Effectiveness measure: available CAPEX budget versus actual investment in CAPEX (1)
6) Return on investment (ROI, ROCE, ROIC) (1)
7) Cash-to-debt ratio (1)
8) Dividend payout ratio or percentage change in payout ratio/earnings retention (1)
9) Borrowing capacity based on target structure (1)
10) Cash retention percentage (1)

Maximum: 2
Communication skills: 1
Maximum: 9

	**DISCUSSION** It is important for Offertop's KPIs to align with its strategy. Strategic alignment is necessary to ensure that an appropriate performance management framework is implemented and used for performance assessment and management, which will ultimately assist in achieving the strategic objectives of the company.

(b)	Discuss SPL's performance based on the ratios provided by Mr Wilson in Part B of the scenario. **You are not required to perform any calculations.**	19

Z2: Business external environment *Consideration of SPL's* ***position in the market*** *must be applied in the discussion*	*1*

Change in revenue

1) SPL experienced very **strong growth** in revenue compared to the competitor. (½)
2) This shows that SPL has **managed to carry out its mission of supplying affordable solar power very well**. (1)
3) The growth can be attributed to the fact that **solar power has become increasingly popular**: (1)
   - because it is an **environmentally friendly source of power**, and (1)
   - **Eskom** is experiencing **financial and operational difficulties** and **load-shedding**. (1)
4) The **competitor** also **experienced strong growth in revenue**, (½)
5) but its **growth slowed down in 2023** (½)
6) and SPL seemed to **gain more market share**. (1)

Gross profit margin

1) SPL's **gross profit margin improved** from the prior year. (½)
2) Its **gross profit increased** because of the lower cost of providing solar energy (1)
3) as a result of achieving **economies of scale** due to greater demand. (1)
4) SPL's gross profit margin seems to be **in line with that of its competitor** in 2023, (½)
5) but **compared to the competitor**, its gross profit margin **improved more**. (½)

Current ratio

1) The current ratio **improved** significantly from 2023. (½)
2) This improvement can be attributed to the **strong growth in profits** and **effective working capital management**. (1)
3) With the **improved ratio in 2023**, SPL's ratio is **in line with that of the competitor**, (½)
4) but SPL's **improvement from the prior year is greater than the competitor's improvement**. (½)

Inventory turnover

1) As **sales increase**, an **increase in inventory holding is expected**. (1)
2) This is to ensure that SPL does not incur **inventory shortages**,
   which is a great risk in the current solar market since demand exceeds supply due to the availability of solar inventory (equipment). (1)
3) SPL's **inventory turnover worsened** from 2023 (½)
4) whereas the **competitor's inventory turnover improved**. (½)
5) SPL's ratio is **inferior compared to that of the competitor**. (½)
6) SPL runs the risk of **holding too much stock, thereby increasing stock holding costs**. (1)

7) SPL also runs the risk of **holding obsolete inventory**. (1)

Overall

1) SPL's performance **has improved significantly** in the last year. (½)
2) SPL is in a **growing market with a promising future**. (1)
3) There was an improvement in SPL's liquidity (current ratio), but the **inventory turnover requires further investigation** because of the anomaly that the **inventory turnover decreased even though there was a significant increase in revenue**. (1)

Maximum: 18
Z2: 1
Maximum: 19

DISCUSSION

Discussing performance based on given ratios requires you to know the formula and the purpose of each ratio.

You may review the formulas by referring to 8.3.1.3 (financial ratio analysis calculation) and 8.3.1.4 (financial analysis example for interpretation of ratios).

Six capitals and financial analysis

Activity 4.4: CCP (extract)

		Estimated time		
Activity 4.4	**Reading**	**Writing**	**Marking and review**	**Total**
34 marks	12 minutes	51 minutes	21 minutes	1 hour and 24 minutes

Background and strategy

The Cement Company & Productions ('CCP') was established in Pretoria in 1945 by the Van Wyk family and was South Africa's first cement plant. CCP is a resilient organisation that has adapted and flourished through changing economic, technological and political circumstances, becoming a leading provider of quality cement. CCP has expanded internationally and operates in various countries, specifically in Africa.

Cement manufacturing is a complex process that begins with grinding the required raw materials, which primarily include limestone and clay, to a fine powder. This powder is fed into mills for mixing and is then heated in large furnaces. The nodules formed during the heating process are called clinker. The clinker is cooled by a rotary cooler and is mixed with water and other minerals, in very specific proportions, to produce cement.

CCP's strategy is aimed at prioritising the financial capital of the group. The board's main concern is to maximise shareholder wealth.

Financial results

Mr Van Wyk performed a preliminary overview of the 2023 results. He was slightly concerned because the results were not as expected. He mentioned the poor results to the largest shareholder, Mr Anton Mtsepe.

An extract of the statement of financial position as at 30 September 2023

EQUITY AND LIABILITIES		R'000 2023	R'000 2022
Capital and reserves			
Share capital and premium	1	20 000	20 000
Other reserves	2	12 304	0
Retained earnings	3	45 260	38 960
Total equity		**77 564**	**58 960**
Non-current liabilities			
Long-term loan	4	152 370	147 959
Deferred tax		4 309	1 262
Total non-current liabilities		**156 679**	**149 221**
Current liabilities			
Trade and other payables		8 737	8 276
Short-term portion of long-term loan	4	9 523	7 776
Bank overdraft		3 299	1 449
Total current liabilities		**21 559**	**17 501**
Total liabilities		**178 238**	**166 722**
Total equity and liabilities		**255 802**	**225 682**

An extract of the statement of profit or loss for the year ended 30 September 2023

Profit before tax	5	14 583	20 183
Income tax		(4 083)	(5 683)
Net profit for the year		10 500	14 500

Notes:

1. CCP has 10 million ordinary issued shares trading at 840 cents in 2023 and 1 450 cents in 2022.
2. Owing to the Covid-19 lockdown, CCP was able to upgrade some of its facilities, which resulted in CCP recording a revaluation surplus in the 2023 financial year.
3. The movement in retained earnings relates to profit for the year after the payment of dividends of R4 200 000 in 2023 and R10 150 000 in 2022.
4. This relates to an eight-year South African flexible bank loan. The bank requires that a significant portion of CCP's assets be given as security for the loan. The loan is included in the financial statements at market value.
5. The profit before tax includes interest of R13 728 000 in 2023 and R15 838 000 in 2022 on the above-mentioned loan.

Competitor

The following financial indicators relate to one of CCP's competitors, ESAR Ltd ('ESAR'):

	2022
Price-to-earnings (P/E) ratio	9
Return on invested capital (ROIC)	10%
Dividend yield	4%
Earnings per share (EPS)	82 cents
Ordinary shares in issue	30 000 000

Additional information

- CCP's weighted average of cost of capital (WACC) in 2023 is 12%.
- The South African tax rate of 27% applies.
- CCP and ESAR are listed on the Johannesburg Stock Exchange.
- The directors of CCP have no ordinary shares in CCP.
- The board of CCP is considering insourcing the bagging of cement.
- Deferred tax is not considered an equity equivalent for CCP.

REQUIRED			**MARKS**	
			Sub-total	**Total**
(a)	(i)	Comment on CCP's strategy as outlined in Part A of the scenario.	2	
	(ii)	Discuss the six capitals (i.e., financial, manufactured, human, intellectual, natural, and social and relationship capital) in terms of the International Integrated Reporting Council (IIRC) framework, which CCP would require to create value for its stakeholders. Use the **information in the scenario** and your **knowledge of the industry** in your discussion.	9	
	X1: Communication skills – clarity of expression		*1*	12
(b)	Analyse (7 marks) and comment on (14 marks) the following ratios for CCP in respect of the period 2022–2023: • P/E ratio • ROIC at market value • Dividend yield **You are not required to provide definitions for the ratios.**		20	
	Y1: Critical thinking		*1*	
	Y3: Problem solving		*1*	22
TOTAL				**34**

Solution

(a)	(i)	Comment on CCP's strategy as outlined in Part A of the scenario.	2

X1: Communication skills *Clarity of expression (use of correct technical and sub-technical vocabulary)*	*1*

1. CCP's strategy is **only focused** on one capital, that is, **financial capital**, (½)
2. as well as maximising **shareholder wealth**. (½)
3. In the past, profit maximisation was the objective of many companies. However, there has been a shift, and the focus should be on **all key stakeholders** (employees, customers suppliers, government, etc) and **value creation/long-term sustainability**. (1)

Maximum: 2

(a)	(ii)	Discuss the six capitals (i.e., financial, manufactured, human, intellectual, natural, and social and relationship capital) in terms of the International Integrated Reporting Council (IIRC) framework, which CCP would require to create value for its stakeholders. Use the **information in the scenario** and your **knowledge of the industry** in your discussion.	10

The six capitals assist in creating value, as follows:

1) **Financial capital**

- Financial capital is a **medium of exchange** that **releases its value through conversion** into **other forms of capital**. (1)
- Financial capital relates to the **pool of funds available to CCP to use in the production of goods and the provision of services**. (1)
- This financial capital is sourced through **debt, equity and cash generated from operations and investments**. (1)
- Based on the **nature of CCP's business**, as well its **planned initiatives regarding the bagging plant and the acquisition of new machinery**, the company would require access to a substantial amount of funding to ensure the business remains profitable and sustainable. (1)

2) **Manufactured capital**

- Manufactured capital relates to the **physical objects** (distinct from natural physical objects) available to CCP **for use in the production of goods/provision of services**. (1)
- Manufactured capital includes the **buildings, equipment, infrastructure, plant and machinery** that CCP requires to manufacture and sell cement. (1)
- The equipment includes **mixing mills, furnaces, rotary coolers and so on**. (1)

3) **Human capital**

- Human capital relates to the **skills, capabilities and experience** of the staff and management of CCP. (1)
- CCP's operations include **complex processes** (grinding, mixing, heating, cooling, etc), which require a diverse range of **skills and expertise**. (1)
- **Managing** such a **large, specialised business** requires **strong management and leadership skills**. (1)

4) **Intellectual capital**

- Intellectual capital relates to the **knowledge-based intangibles** that CCP would require to gain a competitive advantage. (1)
- This capital includes **intellectual property** (patents, copyrights, software, organisational systems, procedures and protocols). (1)
- It also includes **CCP's processes and procedures**, that is to say, the type and proportion of raw materials (limestone, clay, water, etc) used in making **good-quality cemen**t (1)
- and the associated **brand and reputation** that CCP has developed. (1)

5) **Natural capital**

- Natural capital relates to the **renewable and non-renewable environmental resources** that CCP requires to produce cement. (1)
- These resources include **limestone, clay, water and so on**. (1)
- Natural capital also relates to the **effects of the extraction** of limestone, clay, water and so forth **on biodiversity and ecosystem health**. (1)

6) **Social and relationship capital**

- Relationship capital relates to the **trust, loyalty, common values and behaviours that are developed, built and protected** within and between **CCP and its various stakeholders**, such as employees, customers and the community. (1)
- CCP needs to **engage with its various stakeholders** on a continuous basis to ensure it is **aware of their needs and that these needs are appropriately addressed**. (1)

Communication skills: 1
Maximum: 10

DISCUSSION

There are six capital **inputs** that will yield **outputs** and create value for CCP and its key stakeholders.

(b)	Analyse (7 marks) and comment on (14 marks) the following ratios for CCP in respect of the period 2022–2023: • P/E ratio • ROIC at market value • Dividend yield **You are not required to provide definitions for the ratios.**	22

Y1(c): Critical thinking and Y3(a) Problem solving *Critical thinking applied to be able to identify the respective performance outcomes of each ratio. Mark is awarded if a candidate demonstrates an understanding of the outcome of* ***each*** *ratio.*	*1*
Y3(a): Problem solving *Candidates will have to use a questioning mind-set during problem identification and analysis to be able to determine which* ***key stakeholders*** *were affected by each ratio.*	*1*

	2023	**2022**		**Comparison**		**ESAR**	**Movement**	
P/E ratio (calc 1)	8	10	(1)	(20%)	(½)	9	(11,11%)	(½)
ROIC (calc 2)	8,3%	8,7%	(1)	(0,4 percentage points)	(½)	10%	(1,7 percentage points)	(½)
Dividend yield (calc 3)	5%	7%	(1)	(2 percentage points)	(½)	4%	(1 percentage point)	(½)

Maximum: 6

Calculations

1. **P/E ratio:**
   2023: (84 000 / 10 500) = 8
   2022: (145 000 / 14 500) = 10

2. **ROIC:**
   Net operating profit less adjusted taxes (NOPLAT) (2023) = 10 500 + (13 728 x 0,73) = 20 521 (½)
   NOPLAT (2022) = 14 500 + (15 838 x 0,73) = 26 062 (½)

   Invested capital 2023
   a) Market cap (2023) = 10 000 x R8,40 = R84 000 (½)
   b) Debt (2023) = (152 370 + 9 523) = R161 893 (½)

   Invested capital 2022
   a) Market cap (2022) = 10 000 x R14,50 = R145 000 (½)
   b) Debt (2022) = (147 959 + 7 776) = R155 735 (½)

   ROIC = NOPLAT / Invested Capital
   a) ROIC (2023) = (20 521 / 245 893) = 8,3%
   b) ROIC (2022) = (26 062 / 300 735) = 8,7%

3. **Dividend yield**
   2023: (4 200 / 84 000) = 5%
   2022: (10 150 / 145 000) = 7%

P/E ratio

- CCP's P/E ratio deteriorated **(20%)** in 2023. (½)
- Furthermore, in 2023, CCP's P/E ratio is **lower** (inferior) **than that of its competitor**. (½)
- The decline is primarily attributed to the **large decline in the share price** (42%), (1) **which is offset by a lower decline in earnings**. (1)
- This decrease is indicative of **lower potential growth** and/or **higher investment risk (deteriorated)**. (1)
- This decrease can lead to **shares** being **more affordable**, as well as **possible higher returns** for new investors (improved). (1)

ROIC

- CCP's ROIC **deteriorated** in 2023 (0,4 percentage points). (½)
- Furthermore, in 2023, CCP's ratio was **worse than that of its competitor**. (½)
- While the **decline** in the ratio appears **relatively small**, it is important to note the **significant decline in the market capitalisation** (42%) (1)
  compared to the **decline in the NOPLAT** (21%), (1)
  which resulted in the **ratio for 2023 being overstated**. (1)
- This indicates that **invested capital** was used **less effectively** in 2023. (1)
- The **WACC (12%) of CCP** was **higher than the ROIC (8,3%)**. (1)
- The above is concerning since it indicates that **value is being depleted**. Consequently, **investors may seek other investment opportunities**. (1)

Dividend yield

- The yield **decreased by** two percentage points in 2023. (½)
- The yield is, however, **higher than that of the competitor** (1 percentage point), (½) but that might be due to a difference in **dividend policy**. (1)
- There was a big decline in the market value of equity, resulting in a higher dividend payout ratio than that of the competitor. (1)
- The decrease can be attributed to the **large decrease in dividends** (59%), (1) but this may be **necessary for CCP given the decreased profitability and liquidity, as well the required capital investments for the planned initiatives**. (1)
- It is, however, important to consider the **impact** that the **decreased dividend (signalling)** will have on **shareholders** and their **perception of the company** (1) since this factor may cause the **share price** to **drop** even further. (1)

Overall

The ratios are indicative of **CCP's poor performance in 2023**. (1)
Reasons for the poor performance could be the following:

- Decrease in demand (½)
- Poor economic conditions (½)
- Lower production output (½)
- Increased competition (½)

Maximum: 15
Y1 and Y3: 2
Maximum: 22

DISCUSSION

When calculating the different financial analysis ratios for CCP, it is important to know not only the formulas but also the information (content) that can be derived from comparing the company's ratios with those of prior periods and a competitor.

- The P/E ratio should be **higher** to indicate increased desirability for investors.
- The ROIC percentage should **increase** to indicate the organisation's improved efficiency with respect to investing capital.
- The dividend yield showed a reduced return received by CCP investors on their investment. It is unlikely that the shareholders' preference changed from dividend to capital growth. Fortunately, CCP's dividend yield is still higher than that of its competitor, which reduces the risk of investors opting for ESAR instead.

Understanding the purpose of financial ratios

Activity 4.5: BSP (extract)

Activity 4.5	Estimated time			
	Reading	**Writing**	**Marking and review**	**Total**
6 marks	3 minutes	9 minutes	3 minutes	15 minutes

BACKGROUND

Broad Site Properties Ltd ('BSP') is a property investment company with assets in South Africa and Australia. BSP was established in 2001 by Mr Johnson. BSP's portfolio currently comprises high-quality retail, office and industrial properties located in South Africa and Australia.

INTEREST FROM WAUGH PROPERTIES AUSTRALIA

Waugh Properties Australia (WPA) is an Australian property holding company with several subsidiaries listed on the Australian Stock Exchange. WPA is considering acquiring BSP and has requested, among other things, the following information from BSP:

- Vacancy levels
- Capital gearing ratio
- Return on invested capital (ROIC)
- Interest cover

REQUIRED		**MARKS**	
		Sub-total	**Total**
(a)	Explain the potential reasons why WPA requested each of BSP's specific ratios (vacancy levels, capital gearing ratio, ROIC and interest cover).	5	
	X1: Communication skills – clarity of expression	*1*	6

Solution

X1(e): Relational acumen: Communication skills – clarity of expression *Well laid out response (easy to follow and to identify the various reasons for ratios identified by the candidate). The candidate's response is well formulated.*	*1*

Vacancy levels

- Vacancy levels will indicate if the properties owned by BSP are **occupied**. 1
- High vacancy levels would indicate that BSP's assets are not earning rental income or not being sold and are therefore **underutilised**. 1
- High vacancy levels could also indicate **potential for new customers** as WPA would have "stock". 1
- Vacancy levels could be used to **estimate the vacancy level break-even point**/safety net (margin of safety)/**revenue/expected cash flows/profitability**. 1

Capital gearing ratio

- The capital gearing ratio refers to the debt-to-equity ratio (based on market values), which WPA can use to **measure BSP's level of financial risk**. 1
- WPA would probably compare the ratio with BSP's **target capital structure** to assess the financial flexibility (capacity to borrow) or optimality of the current structure. 1

Return on invested capital

- The return on invested capital will provide an indication of how **efficiently BSP has invested** the capital under its control. 1
- The return on invested capital can be **compared with the weighted average cost of capital (WACC)** to determine the **profitability/financial viability** of the company. 1
- Owing to the **high asset/inventory values** of a property investment company, it is imperative that BSP yield a good return since the company would not be able **sell its assets as quickly** as companies in a different industry. 1

Interest cover

- The interest cover indicates the **likelihood that BSP will default on loan interest payments**. 1
- It can also be used to **measure profitability**. 1
- A low interest cover would **indicate an increased risk**, which would/could **lead to higher interest rates**. 1

Maximum: 6

	**DISCUSSION** WPA is trying to determine how acquiring BSP could be to its **strategic advantage** by aligning with BSP's growth and diversification objectives. WPA also needs to know the potential **risk exposure**. WPA would be able to derive a lot of information from analysing and interpreting these ratios.

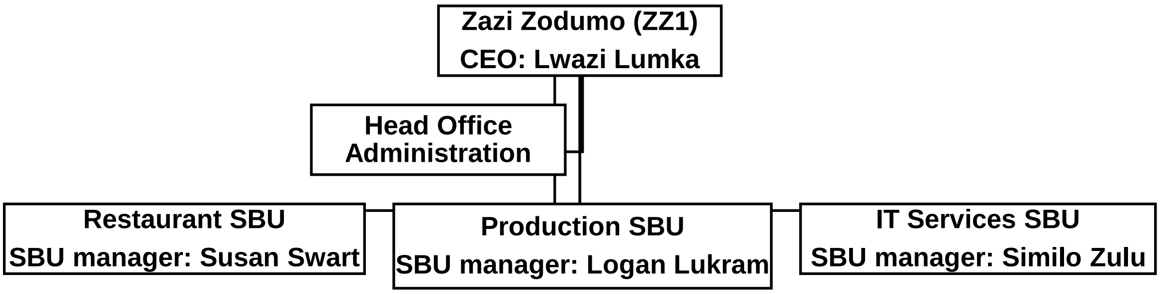
Activity 4.6: ZZ1 (extract)

Activity 4.6	Reading	Estimated time Writing	Marking and review	Total
32 marks	12 minutes	48 minutes	18 minutes	1 hour and 18 minutes

1. Background

Zazi Zodumo Group Ltd ('ZZ1') is a holding company that is listed on the Johannesburg Stock Exchange (JSE). The company has interests in the hospitality, production and information technology service sectors in Gauteng, South Africa. ZZ1 was formed 11 years ago when the current chief executive officer (CEO), Lwazi Lumka, resigned as CEO at a listed company to pursue entrepreneurial ventures. Lumka used his pension fund and personal savings to form ZZ1. He then went on to acquire potential high-growth companies in the first year of starting ZZ1. The company was listed on the JSE seven years after inception. The company structure, strategic business units (SBUs) and SBU managers are presented in the organogram below.

1.1 Company structure



Each SBU comprises one company that was acquired by ZZ1. The previous owners of each of these companies were given shares in ZZ1 in exchange for their shares in their respective companies. The owners were also employed by ZZ1 as SBU managers of the companies they sold. The fourth division (Head Office Administration) was created by Lwazi Lumka to help relieve the administrative burden of the strategic business units, by performing the following corporate administrative functions for the group: strategy, risk management and governance, human resource administration, accounting and finance, and sales and marketing.

1.2 Strategic objectives

The following strategic objectives have been developed for ZZ1 and its SBUs:

1) Through acquisitions, expand into a well-diversified conglomerate that operates in multiple industries and economies.
2) Achieve an annual return on total assets of at least 3% above the weighted average cost of capital (WACC).

1.3 Performance and performance reward system

Financials

Extracts of ZZ1's financial statements for the year ended 30 September 2022 are presented below.

2022 financial statements excerpts	Restaurant SBU	Production SBU	IT Services SBU	ZZ1
	R'000	**R'000**	**R'000**	**R'000**
Revenue	76 485	428 965	99 215	604 665
Cost of revenue	(29 263)	(225 207)	(15 418)	(269 888)
Gross profit	**47 222**	**203 758**	**83 797**	**334 777**
Other operating expenses	(26 020)	(126 545)	(41 898)	(194 463)
Head Office Administration expenses[a]	(16 217)	(16 217)	(16 217)	(48 652)
EBIT: operating profit before bonus	**4 985**	**60 996**	**25 682**	**91 662**
Current assets	7 649	42 897	1 562	52 107
Non-current assets	55 695	458 065	33 502	547 262
Intangible assets	*28*	*9 161*	*30 152*	*39 341*
Tangible assets	*55 667*	*448 904*	*3 350*	*507 921*
TOTAL ASSETS	**63 344**	**500 962**	**35 064**	**599 369**
EBIT margin before bonus	6,52%	14,22%	25,88%	15,16%
Number of employees	*289*	*1 986*	*32*	*2 359*[b]
Revenue per employee (rand)	*264 654*	*215 994*	*3 100 469*	*256 323*
Operating profit per employee (rand)	*17 249*	*30 713*	*802 563*	*38 856*

[a] The total costs incurred by the Head Office Administration division are allocated equally among the SBUs.

[b] Total ZZ1 employees include 52 employees of the Head Office Administration division.

New performance reward system (bonus)

To reward the SBU managers and employees, a new performance reward system has been set up by ZZ1 management and will be applied for the first time to calculate annual performance bonuses for the year ended 30 September 2022. The bonus pool (i.e., the total amount to be paid as a bonus) is determined at 15% of ZZ1's total operating profit before the bonus. Each of the three SBUs gets an equal share of this bonus pool. This bonus has not been allocated to the Head Office Administration division. The bonus allocated to an SBU is first distributed to the SBU manager (10% of the amount allocated to the SBU), and then the remaining part of the bonus pool is distributed equally among the employees in the SBU. This system ensures that all employees within an SBU are treated equally and paid the same amount. The bonus payments are not taken into account in the financial information provided above.

Additional information

- The normal income tax rate is currently 27%.
- All SBUs were acquired many years ago and are situated in Gauteng, close to Lwazi Lumka's home, making it easier for him to commute and manage.
- ZZ1's levels of current assets and profits generated are lower than they were in prior years.
- ZZ1's current debt ratio, based on market values, is 15,00% and it comprises a bank loan with a market-related variable pre-tax interest rate of 13,70% per annum.

REQUIRED			**MARKS** Sub-total	**MARKS** Total
(a)	(i)	Calculate the bonus to be paid, based on the new performance reward system, to each of the three SBU managers and each employee in the respective SBUs.	4	
	(ii)	Critique the new performance reward system and conclude on its effectiveness in encouraging and motivating employees to contribute to the positive performance of ZZ1.	10	
	Y4: Judgement and decision making		*1*	15
(b)	(i)	Assess whether ZZ1 has achieved its strategic objectives in the 2022 financial year. Comment on your assessment results and recommend key initiatives that can be employed to assist the company in achieving its strategic objectives. • Assume the WACC is **16,99%**.	16	
	Y2: Integrative thinking		*1*	17
TOTAL				**32**

Solution

(a)	(i)	Calculate the bonus to be paid, based on the new performance reward system, to each of the three SBU managers and each employee in the respective SBUs.	4

Bonus per SBU manager and SBU employee

Bonus pool **R13 749** (15% x 91 662) **(1)**

		Restaurant SBU	**Production SBU**	**IT Services SBU**	
Bonus per SBU (13 749 / 3)	**R'000**	4 583	4 583	4 583	**1**
Less: bonus per SBU manager (4 583 X 10%)	**R'000**	458	458	458	**1**
Equals: SBU employee bonus pool	**R'000**	**4 125**	**4 125**	**4 125**	
Number of SBU employees	#	289	1 986	32	
Bonus per SBU employee 4 125 / #	**Rand**	**14 273**	**2 077**	**128 906**	**1**

(a)	(ii) Critique the new performance reward system and conclude on its effectiveness in encouraging and motivating employees to contribute to the positive performance of ZZ1. *Y4: Judgement and decision making*	10 1	 11

Y4: Judgement and decision making *Apply the facts from the case study and results from the calculation to enable critical discussion of the new performance reward system.*	*1*

1. The bonus is **purely based on a financial measure**, ignoring important non-financial measures that can be incorporated to help the company achieve its objectives and be a good corporate citizen.	1
2. The bonus is **automatically granted as a percentage of EBIT, regardless of** the **performance of the SBUs** or the **overall performance of the company**.	1
3. **Allocations to the SBUs are the same despite differences** in the SBUs' profitability, contribution to ZZ1's profits and size. Therefore, the reward system is not performance driven.	1
4. **The managers' bonus payments do not reflect their performance or the SBUs' performance**, which could lead to the managers not making decisions in the best interest of the company since an equal bonus is paid regardless of performance.	1
5. **Individual employee performance is not considered** in the determination of the bonus reward. Paying high-performing employees the same bonus as low-performing employees in the same SBU could discourage the high-performing employees.	1
6. The **amount of bonus received by an employee largely depends on how many employees** are in the specific SBU rather than the performance of the SBU or its employees, which results in a higher allocation of the bonus per employee in an SBU with a low employee headcount (e.g., IT Services gets R128 000 per employee whereas Production gets R2 077 per employee).	1
7. **Employees' pay grades/annual packages/basic salaries are not considered** in the determination of the reward. Therefore, employees who earn a higher pay will receive an insignificant amount in relation to their normal pay.	1
8. **Comparison of Restaurant and Production SBUs:** It does not make sense that the **Production SBU** receives the lowest bonus per employee (R2 077), while the **Restaurant SBU receives almost seven times** the lowest bonus per employee (R14 273),	1
9. even though the **profit per employee in the Production SBU** is almost **twice as much as** what was achieved by the **Restaurant SBU**.	1
10. It is likely that the **large pay gap** between managers and other employees, as well as the gap between employees in the different SBUs, will create a **hostile working environment** and lead to very low staff morale.	1
11. **No clear performance criteria are given** to employees to enable them to work towards reaching their targets and maintaining good performance to obtain the performance bonus.	1
12. The bonus pool of **15% is quite high, considering that the business needs to expand through acquisitions**. Therefore, the bonus could limit the company's expansion capacity/equity capital reinvestment.	1
13. The **bonus pool and the performance reward structure are not benchmarked against similar businesses/competitors** to ensure that the bonus paid is market related in order to attract and retain high-performing employees.	1
14. The employees of the **administrative division do not receive a bonus**, which is unfair and may **cause low employee morale/poor performance**.	1
15. **Conclusion:** Owing to the inherent design flaws of the performance reward system, especially the unfair allocation of rewards (not directly linked to the performance of employees), it is **unlikely that the system will encourage good performance**.	1
Y4: Judgement and decision making **Maximum**	*1* **11**

(b)	(ii)	Assess whether ZZ1 has achieved its strategic objectives in the 2022 financial year. Comment on your assessment results and recommend key initiatives that can be employed to assist the company in achieving its strategic objectives. • Assume the WACC is **16,99%**.	16	
	Y2: Integrative thinking		1	17

Y2(a): Decision-making acumen: Integrative thinking *Candidates are able to synthesise and integrate the information provided to correctly assess whether strategic objectives were achieved*	*1*

Strategic objective 1 Through acquisitions, expand into a well-diversified conglomerate that operates in multiple industries and economies.	
• **No acquisitions have been made** in the current year; the SBUs acquired at inception are still the same today.	**1**
• ZZ1 still only **operates in Gauteng, South Africa** (one economy). Therefore, this **objective is not being achieved in the current year**.	**1**
• A **lack of funds**, as shown by the low levels of current assets and profits generated, could explain why acquisitions have not been made.	**1**

Recommendations: strategic objective 1	
• Consider raising funds by **issuing shares or issuing share options** to fund acquisitions. • **Increase debt leverage** (debt ratio of 15% is low) by **issuing debentures and corporate bonds or acquiring business loans** (i.e., source debt capital funds) to make investments/acquisitions in the different industries/economies.	**1** **1**
• Seek small firms **(identify business opportunities) in different industries and economies** that could be acquired using the same financing strategy **(acquisition via share exchange)** that was used previously to acquire the existing SBUs.	**1**
• **Consider developing a KPI** (such as number or value of acquisitions, or new sectors/economies in which ZZ1 has acquired businesses) **for this strategic objective** in order to have a clear target to pursue and to be able to measure performance objectively.	**1**

Strategic objective 2 Achieve an annual return on total assets of at least 3% above the WACC.

2022 financial statements excerpts	**Restaurant SBU**	**Production SBU**	**IT Services SBU**	**ZZ1**
	R'000	**R'000**	**R'000**	**R'000**
EBIT: operating profit before bonus	4 985	60 996	25 682	91 662
Total assets	63 344	500 962	35 064	599 369
Return on total assets	**7,87%**	**12,18%**	**73,24%**	**15,29%**

• This **strategic objective has not been achieved**; the **return on assets (ROA) of 15,29% is lower than the WACC of 16,99%**.	**1**
• The ROA is lower due to the **low ROA in the Production and Restaurant SBUs**.	**1**
• The **EBIT** achieved by these SBUs is **low** for the **large asset base that they hold**.	**1**
• Only the **IT Services SBU managed to achieve the ROA** rate that is above the WACC due to its **low asset base and higher EBIT margin**.	**1**

Recommendations: strategic objective 2	
• **Amend the performance reward system to include this strategic objective as a key performance indicator (metric)** in determining the bonus in order to encourage the SBUs to improve their performance and to align with the company's strategy.	**1**
• Devise a cost transformation programme that involves **monitoring and managing operating costs and reducing inefficiencies** to increase the EBIT margin.	**1**
• Devise **sales and marketing strategies** and tactics to **increase sales/revenues**.	**1**
• **Identify and sell non-core assets** and **invest the proceeds in profitable projects** in order to reduce the low-performing asset base and increase EBIT.	**1** **1**
• Consider providing for **accelerated depreciation on the Production SBU's machinery to reduce the asset base** (the assets do not generate enough returns, which is a sign of possible impairment).	**1**
• Consider **leasing assets** in the future, when it is cheaper to do so, rather than purchasing them.	**1**
• Consider **revising this strategic objective KPI to a measure or measures that are easier to target and measure** (e.g., EVA, ROI, ROE).	**1**
Total maximum	**18**

FEEDBACK

Remuneration measurement and incentives (bonuses) should always be **controllable** and **reasonable**. ZZ1 should align its KPIs and strategy to ultimately ensure that management and employees are encouraged to create value for its key stakeholders.

Non-financial performance

Activity 4.7: African Sun Limited (extract)

		Estimated time		
Activity 4.7	**Reading**	**Writing**	**Marking and review**	**Total**
12 marks	6 minutes	18 minutes	6 minutes	30 minutes

Background

African Sun Limited ('ASL') is a company that is listed in the Travel and Leisure sector of the Johannesburg Stock Exchange (JSE). ASL operates two key divisions, namely, gaming (casinos) and hotels.

Additional information relating to ASL

- ASL has rolled out a series of print and digital campaigns to highlight the importance of sustainable behaviour for both its staff and guests.

- ASL is highly reliant on its personnel due to the nature of its business. Most aspects of the customer experience are dependent on interactions with the entity's staff. ASL therefore pays careful attention to its recruitment process and ensures that staff have the required skills and expertise. In addition, ASL strives to maintain positive employee morale by ensuring that employees are well compensated and satisfied with their working conditions.

- Periodical capital expenditure is required to maintain and improve the entity's facilities. Capital expenditure undertaken during the current year include, among other things:

  ✓ the implementation of energy-efficient lighting, which entailed replacing light bulbs with LED and energy-efficient globes,
  ✓ the refurbishment of a large number of hotel rooms to replace baths with showers, and
  ✓ the acquisition of a new e-learning platform to facilitate the further training and development of staff.

- The following financial and non-financial information applies to ASL for the year ended 30 September/as at 30 September:

	2023	**2022**
Training spend	R53 million	R49 million
Electricity consumption (kWh)	245 million	270 million
Share price (cents per share)	2 170	1 990
Staff resignations	7,5%	9%
Water consumption (kilolitres)	2 million	2,2 million
Number of shares in issue	100 000 000	100 000 000
Greenhouse gas emissions (tonnes)	50 000 tonnes	45 000 tonnes

Required:

(a)	Analyse (3 marks) and interpret (9 marks) the social and environmental performance of ASL for the 2023 financial year. *Y4: Judgement and decision making*	11 *1*

Solution

Y4: Judgement and decision making *Using conclusions in part as well as information across the scenario and technical competencies to make insightful decisions*	*1*

Training 53 000 000 - 49 000 000
49 000 000
8,16% **½ r**

- Training spend has **increased** during the current year, which is an indication of **positive social behaviour**. (1)
- One of the reasons for this increase could be the **acquisition of the new e-learning platform to facilitate the further training and development of ASL's staff**. (1)

Resignations 7,5–9%

1,5% percentage points
½ r

- Resignations have **decreased** during the current year, which is an indication of **improved performance**. (1)
- One of the reasons for this decrease could be that **ASL strives to ensure that positive employee morale is maintained** by ensuring that employees are well compensated and satisfied with their working conditions.
(1)

Electricity usage 245 000 000 - 270 000 000
270 000 000
(**9,26%)**
½ r

- Electricity usage has **declined** during the current year, which is an indication of **improved performance**. (1)
- One of the reasons for this decline could be the **implementation of energy-efficient lighting** during the current year, which involved **replacing light bulbs with LED and energy-efficient globes**.
(1)

Water consumption 2 000 000 - 2 200 000
2 200 000
(9,09%) **½ r**

- Water consumption has **declined** during the current year, which is an indication of **improved performance**. (1)
- One of the reasons for this decline could be the **replacement of baths with showers** in a large number of hotel rooms. (1)

Greenhouse gas emissions 50 000 - 45 000
45 000
11,11% **½ r**

- Greenhouse gas emissions have **increased** during the current year, which is indicative of **negative environmental performance**. (1)
- ASL should **investigate reasons** for this increase and **strive to improve**. (1)

Overall, ASL's **environmental performance** is **favourable**, (1)
which could be attributable to the **print and digital campaigns** that were rolled out during the current year to **highlight the importance of sustainable behaviour** for both staff and guests. (1)

Maximum: 12 marks

Financial performance

Activity 4.8: Khuselo (extract)

		Estimated time		
Activity 4.8	**Reading**	**Writing**	**Marking and review**	**Total**
8 marks	4 minutes	12 minutes	4 minutes	20 minutes

Khuselo (Pty) Ltd ('Khuselo') is a company that manufactures and instals vehicle-tracking devices and performs tracking services for various clients in South Africa. Customers who purchase devices from Khuselo can choose to subscribe for tracking services with Khuselo or any other service providers. Khuselo has been in operation for the past 10 years and has chosen to remain an unlisted entity.

The following financial information of Khuselo has been correctly prepared by the company's management accountant:

Extract of statement of profit or loss of Khuselo (Pty) Ltd for the periods ended 30 March

	Note	2023	2022	Change
		R'000	R'000	%
Revenue		**1 300 562**	**1 125 600**	**15,54%**
Device sales revenue		*585 253*	*450 240*	*29,99%*
Subscription revenue	1	*715 309*	*675 360*	*5,92%*
Cost of sales		**(702 303)**	**(675 360)**	**3,99%**
Gross profit		**598 259**	**450 240**	**32,88%**

Common size analysis

	2023	2022
Revenue	**100,00%**	**100,00%**
Device sales revenue	*45,00%*	*40,00%*
Subscription revenue	*55,00%*	*60,00%*
Cost of sales	**54,00%**	**60,00%**
Gross profit	**46,00%**	**40,00%**

1. **Subscription revenue**

	2023	2022	Change
Number of subscribers	425 779	375 200	13,48%
Average annual revenue per subscriber	R1 680,00	R1 800,00	-6,67%

Required:

(a)	Comment on the financial performance of Khuselo (in respect of revenue and gross profit) for the 2022 and 2023 periods. Y2: Integrative thinking	7 1

Solution

Y2(a): Decision-making acumen: Integrative thinking *The candidate is able to use the information provided to calculate, decide and comment on the financial performance*	*1*

Revenue performance	
Revenue has **improved**. The total company revenue has increased **above the inflation rate**. Therefore, **revenue has grown in real terms**.	1 1 1
This improvement in revenue is largely driven by the **increase in revenue from device sales (29,9%)**. The **selling price per device has increased**. This is supported by the **increase in the number of subscribers** (13,48%).	1 1 1
The subscription revenue increase (5,92% vs 29,99%) **was lower due to reduced subscription fees charged to customers** compared to 2022 (R1 680 vs R1 800). This could be an **attempt** by Khuselo to **increase the number of subscribers**.	1 1
The **composition of revenue between subscriptions and device sales changed** as a result of a higher increase in device sales revenue compared to subscription revenue.	1

Gross profit performance	
Gross profit has **improved**. The improvement in gross profit (32,88%) is due to a significantly **lower increase in the cost of sales** (3,99%) **compared to the increase in revenue** (15,54%).	**1** **1**
The **increase in the cost of sales is lower than the increase in inflation**. Therefore, the **cost of sales is decreasing in real terms** and enhancing gross profit growth.	**1** **1**
The minimal nominal increase in the cost of sales **could be due to scale economies** in producing and selling more devices and servicing more subscribers.	**1**
Khuselo is therefore **managing its costs effectively**.	**1**
This is further evidenced by the decrease in the cost of sales to revenue from 60,00% to 54,00%, which **resulted in the gross profit percentage improving** from 40,00% to 46,00%.	**1**
Maximum	**8**

FEEDBACK

Between gross profit and net profit there is a great deal of expenditure/income that is not related to operations. Therefore, gross profit is a better performance measure to use.

Financial performance analysis and interpretation

Activity 4.9: BBL (extract)

Activity 4.9		Estimated time		
	Reading	**Writing**	**Marking and review**	**Total**
25 marks	6½ minutes	37½ minutes	12 minutes	56 minutes

BACKGROUND AND INDUSTRY INFORMATION

Best Brands Limited ('BBL') is a manufacturer of fast-moving consumer goods (FMCG). The business was established in 1925 and was family owned and managed until 1949 when the company listed on the Johannesburg Stock Exchange (JSE). BBL's business model encompasses the entire value chain, from the procurement of raw materials through to manufacturing processes and the marketing and distribution of its products to customers.

BBL's operations comprise the following segments, which are independently managed and assessed:

- **Consumer Brands.** This segment houses many of BBL's brands relating to groceries, snacks, treats (including sweets and chocolates) and beverages.
- **Home and Personal Care.** This segment comprises household cleaning, and personal hygiene and body care brands.
- **International (Exports).** This segment exports many of BBL's products across Africa.

While the size, the changing demographic profile and the growing income levels of the population in sub-Saharan Africa provide opportunities for growth, many African countries have also experienced difficulties during the current year, some of which relate to the devaluation of currencies, labour stoppages, and fuel and power shortages.

BBL FINANCIAL INFORMATION

Extract of the segment report for the year ended 30 June 2023

	Sales		Operating income	
	2023 R'm	**2022 R'm**	**2023 R'm**	**2022 R'm**
Consumer Brands	4 920,05	4 635,15	516,15	491,66
Home and Personal Care	873,67	788,45	149,11	122,40
International	1 217,06	1 200,23	236,86	275,34

BBL STRATEGIES

BBL undertakes various initiatives in the interest of continuous improvement and growth.

- **Current strategic initiatives**

Some of the key initiatives undertaken by BBL during the current year are as follows:

✓ The manufacturing facilities of the Home and Personal Care segment were enhanced to enable improved production and to achieve greater supply chain efficiencies.

✓ The Consumer Brands segment has undertaken various product innovation exercises with the aim of improving its offerings. The segment also invested in a vibrant advertising and marketing campaign to enhance public awareness of the product innovations.

- **Future strategic initiatives**

One of the growth opportunities that BBL is considering pursuing is the acquisition of a 75% interest in a Zambian-based private company, Sweet-O, that manufactures cordials, powdered drinks and sweeteners, all with a high sugar content. The sugar is sourced from local refineries. Sweet-O performed well up until last year when performance began declining and gearing increased substantially as a result of a change in management and subsequent poor management decisions. Many customers voiced their dissatisfaction with the recent service relating to product quality and are considering purchasing from alternate suppliers.

Required:

(a)	Analyse (10 marks) and interpret (15 marks) the profitability of BBL based on the available information. Round answers to two decimal places. *Y1: Integrative thinking*	24 *1*

Solution

Y1: Integrative thinking *Synthesise and analyse information across BBL's scenario that is relevant*	*1*

CONSUMER BRANDS ANALYSIS

	2023	**2022**	
Movement in sales ((4,920.05 - 4,635.15) / 4,635.15)	6,15%		½
Movement in operating income ((516.15 - 491.66) / 491.66)	4,98%		½
Operating profit margin	516.15 / 4,920.05 = 10,49%	491.66 / 4,635.15 = 10,61%	**1**
Change in operating profit margin	10,49% – 10,61% = - 0,12 percentage points		½

Interpretation

- The **consumer goods** operating segment has experienced an **improvement in sales** (½) **and operating income**. (½)
  This could be attributable to the **product innovation undertaken**. (1)
- Both the **smaller improvement in operating income compared to sales** (½)
  and the **deterioration in the operating margin** (½)
  could be attributable to the **increase in marketing costs to raise public awareness of the product innovation**. (1)
- However, should the **product innovation** be **successful**, it is likely that these **marketing costs** will be **recovered in forthcoming years** (1)
  and that the **operating income and margin will improve**. (1)

Analysis

	2023	**2022**	
Movement in sales ((873.67 - 788.45) / 788.45)	10,81%		½
Movement in operating income ((149.11 - 122.40) / 122.40)	21,82%		½
Operating profit margin	149.11 / 873.67 = 17,07%	122.40 / 788.45 = 15,52%	**1**
Change in operating profit margin	17,07% – 15,52% = 1,55 percentage points		½

Interpretation

- The **Home and Personal Care** operating segment has experienced an **improvement** in **sales** (½)
and operating income. (½)
- Both the **larger improvement in operating income compared to sales** (½)
and the improvement in the **operating margin** (½)
could be attributable to the **improvements** made to the **manufacturing facilities** that enable **improved production and supply chain efficiencies**. **(1)**

INTERNATIONAL (EXPORTS) ANALYSIS

	2023	**2022**	
Movement in sales ((1,217.06 - 1,200.23) / 1,200.23)	1,40%		**½**
Movement in operating income ((236.86 - 275.34) / 275.34)	(13,98%)		**½**
Operating profit margin	236.86 / 1,217.06 = 19,46%	275.34 / 1,200.23 = 22,94%	**1**
Change in operating profit margin	19,46% – 22,94% = - 3,48% percentage points		**½**

Interpretation

- This segment **performed poorly** as the **sales increased** very **slightly** and (½)
the **operating profit decreased** significantly. (½)
- The **operating margin** has **deteriorated** from the prior year. (1)
- The above could be attributable to the **difficulties experienced** by many of the **African countries** during the current year in respect of, for example, the **devaluation of currencies, labour stoppages and fuel shortages**. (1)

OVERALL

	2023	**2022**	
Consumer Brands % of total sales	4,920.05 / 7,010.78 = 70,18%	4,635.15 / 6,623.83 = 69,98%	**1**
Consumer Brands % of total operating income	516.15 / 902.12 = 57,22%	491.66 / 889.40 = 55,28%	**1**
Home and Personal Care % of total sales	873.67 / 7,010.78 = 12,46%	788.45 / 6,623.83 = 11,90%	**1**
Home and Personal Care % of total operating income	149.11 / 902.12 = 16,53%	122.40 / 889.40 = 13,76%	**1**
Exports % of total sales	1,217.06 / 7,010.78 = 17,36%	1,200.23 / 6,623.83 = 18,12%	**1**
Exports % of total operating income	236.86 / 902.12 = 26,26%	275.34 / 889.40 = 30,96%	**1**

- While the Consumer Brands segment is the **largest contributor** to both **total sales and total operating income**, it has the **smallest operating margin**. (1)
This **makes sense**, given that the **products sold** within this segment have **low profit margins**. (1)
- While the Home and Personal Care segment **contributed** the **least** to both **total sales and total operating income**, it experienced the **highest growth in sales, operating income and operating margin**. (1)
- Although this segment performed the **worst** in terms of **growth in sales and operating income**, it has the **largest operating margin**. (1)

Analysis – **maximum: 10**
Interpretation – **maximum: 15**

	FEEDBACK When comparing two percentages with each other, the movement is expressed as **percentage points**. You cannot determine a percentage movement from percentages (%).

Divisional manager performance

Activity 4.10: Rise Up Ltd (extract)

		Estimated time		
Activity 4.10	**Reading**	**Writing**	**Marking and review**	**Total**
6 marks	3 minutes	9 minutes	6 minutes	18 minutes

Background and introduction

Rise Up Ltd ('RU') is a leading producer of a wide range of dough types for a diverse customer base in a very competitive market. RU has five autonomous divisions. Each divisional manager is responsible for his/her division's planning, management and control. The five divisions are Pizzeria, Bread, Cookie, Muffin and Sponge. Each division is responsible for its own material ordering, machine set-ups, machine maintenance, production runs and quality inspections.

RU's dough products are cost-effective, time efficient and easy to use, allowing users to be creative in their preparation of the final product. RU regularly invests in the latest research and development (R&D) in the food industry, which gives it a competitive edge in the market in respect of new product development and ensures that it is at the forefront of customer food trends and quality management. RU's board of directors annually decides which R&D projects should be implemented for all divisions.

Divisional performance

RU assesses the performance of its management using return on investment (ROI). Divisional managers receive bonuses if their respective divisions achieve an ROI of 22%. Several divisional managers have expressed their dissatisfaction in this regard and have requested their bonuses to be assessed based on economic value added (EVA®) instead. RU's board of directors has indicated that each divisional manager who is in charge of a division that creates shareholder wealth (value) above R5 million will become eligible for a bonus if EVA® is used as a performance measure.

Required:	**Marks**
(a) Evaluate the appropriateness of EVA® as a performance measure for the divisional managers of RU, as proposed by the company's board of directors. *Y3: Problem solving*	5 *1*

Solution

Y3(c): Problem solving *The candidate demonstrates a clear understanding of RU's scenario's context and principles of EVA® to determine its appropriateness.*	*1*

1.	*EVA® is a **superior method of measuring performance** compared to ROI because it determines if shareholder wealth was created or depleted.*	*Theory*
2.	*It will also achieve **goal congruence** for RU as a whole since it is not focused on divisional performance alone.*	*Theory*
3.	RU invests extensively in research and development. EVA® will eliminate accounting distortions such as R&D **expenses** (add back) and **capitalise R&D** as an asset. The capitalised R&D will be amortised over a longer period. This will make RU as a company keener on investing in R&D.	(1)d (1)d (1)d
4.	*By capitalising R&D (and advertising costs), EVA® is more focused on the **long term** than ROI.*	*Theory*
5.	*The EVA® adjustments made to the accounting figures are designed to minimise any benefits that managers get from manipulating the accounting figures when using ROI.*	*Theory*
6.	EVA® is **complex/difficult** to perform since it entails making several adjustments and assumptions. Does RU have the in-house skill to perform EVA®?	(1)d
7.	R&D investments are decided by RU's board of directors and are **not controlled by the divisional managers**. Since the managers' performance should only be assessed based on assets/liabilities/income/costs under their control, R&D should be excluded.	(1)d
8.	Therefore, they will lose the advantage of capitalising R&D – "correction of accounting distortion" of EVA®.	(1)d
9.	*The EVA® of the divisions will be difficult to compare since the divisions are **different sizes** based on their absolute **(monetary) rand value**.*	*Theory*
10.	RU's divisions, Pizzeria, Bread, Cookie, Muffin and Sponge, are different sizes when one looks at, for example, their sales, which makes comparability difficult.	(1)d
11.	Achieving R5 million to become eligible for a bonus may be easier for a large established division than for a small new division; it is **not reasonable** for all divisions.	(1)d or
12.	***Smaller divisions may become demotivated** if the same wealth creation target of R5 million is used to determine their performance.*	*Alternative*
13.	If **Sponge** is treated as a **cost centre**, EVA® will not be appropriate.	(1)d
14.	EVA® uses net operating profit after tax (NOPAT) (therefore, after tax). The **controllability of taxation** for management performance purposes should be considered. Alternative 1: It is often argued that taxation forms part of the operational performance of an entity and that an entity/a division/management should seek to minimise the tax liability. **Operating profit*** is therefore determined **after deducting taxation**. *Alternative 2: On the other hand, entities may argue that taxation should be excluded from operating profit, especially for entities from different countries under different taxation legislation.*	(1)d (1)d *Alternative*
15.	**Conclusion:** EVA® is not appropriate for determining the performance of RU's divisional managers.	(1)d

Available: 10/maximum: 6

DISCUSSION

Marks will only be awarded for the application of theory to the scenario. You need to be familiar with theory to answer the question *(theory in grey provided for learning purposes)*.

The concepts of reasonability and controllability in respect of management performance assessment are dealt with in detail in learning unit 7.

4.6 REFERENCES

Skae, FO. 2024. *Managerial Finance*. 10th edition. Johannesburg: LexisNexis.