LEARNING UNIT 4: PERFORMANCE MANAGEMENT SYSTEMS

Activities	Notional study hours
Prescribed reading	Chapters: 1 (6 minutes)
Learning unit content	10 minutes
Activities	Activities: 12 (11 hours and 19 minutes) Videos: 1 (2 hours)
Total	**13 hours and 19 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.**

LEARNING OUTCOMES	ASSESSMENT CRITERIA	COMPETENCY AREA / LEVEL:
Evaluate the enterprise's strategic development plan in terms of its overall objective.	**Judge an entity's ability to manage its performance in accordance with its strategies:**	**C6.2 Performance Evaluation**
	Perform financial analysis using appropriate techniques, evaluate assumptions, interpret the results, benchmark and draw conclusions as to the organisation's present and forecast financial situation (C6.2b)	**3**
	Use an integrated performance management system based on the six capitals to evaluate their contribution to creating value for stakeholders (C6.2c)	**2**
	Assess the alignment of management decisions with an entity's vision, mission, values and mandates:	**C6.3 Reward Structures and Offering Incentives**
	Assess the effectiveness and appropriateness of the organisation's appraisal methodology with reference to reward structures and measures used to offer incentives, to inform decision-making thereon (C6.3a)	**2**
	Identify whether the organisation's performance management drives value creation for stakeholders, to inform decision-making (C6.3b)	**2**
Evaluate financial planning and control techniques.	**Interpret the managerial and economic performance measures within an organisation:**	**C6.2 Performance Evaluation (continued)**
	Use data analytics to analyse and interpret management, financial and non-financial information (evaluate risk and opportunities, key causes of business variance, and areas of strength or concern in performance) to advise on potential improvement (C6.2d)	**2**
	Evaluate the impact of the above interpretations and analyses on costs, delivery of products/services and KPIs, to inform decision-making on performance management and appraisal (C6.2e)	**3**
	Interpret and analyse management information taking cognisance of the organisation's business objectives and external and internal environment (e.g., competitive, economic, social, political and internal factors (culture, incentives)) (C6.2a)	**3**
	Assess the appropriateness of performance measures within an organisation:	**C6.1 Performance based on Key Performance Indicators (KPI)**
	Analyse the organisation's performance management framework, appraisal methodology and measures used to offer incentives (C6.1a)	**2**
	Assess financial and non-financial key performance indicators (KPI) in business appraisal and evaluate the appropriateness thereof in reaching business objectives and creating value for stakeholders (C6.1b)	**2**

	Assess the appropriateness of non-financial KPIs to evaluate the entity's effectiveness and efficiency (C6.1c)	**2**
	Critique the appropriateness and coherence of KPIs used for the different capitals (C6.1d)	**2**

Performance management forms part of SAICA's technical competency framework: C6.1 Performance based on Key Performance Indicators (KPI); C6.2 Performance Evaluation and C6.3 Reward Structures and Offering Incentives which are on the following competency levels:

- SAICA technical competency **level 1** refers to Foundational level of competence. At this level you will be expected to i) Identify and explain the significance and relevance of the subject matter and recognise the linkages with other subject matter(s) and ii) Recognise issues when encountered and seek further depth / guidance.
- SAICA technical competency **level 2** refers to Intermediate level of competence. At this level you will be expected to: (i) Apply the knowledge to non-complex routine situations; (ii) Identify and utilise the relevant knowledge within and across competency area(s) in a limited manner and (iii) Prepare or analyse solutions for specified problems and applying limited judgement.
- SAICA technical competency **level 3** refers to Advanced level of competence. At this level you will be expected to: (i) Apply the knowledge to complex routine situations; (ii) Evaluate and synthesise the knowledge within and across competency areas (Integrative thinking is required); and (iii) Evaluate or formulate solutions for specified and implicit problems – applying a high degree of rigour, and/or exercise sound judgement in making recommendations.
- The above are based on SAICA's latest competency framework

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
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 ratio 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.	8.3.2.2 Non-financial analysis basic example 8.3.2.3 Non-financial analysis Integrated Report 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) 8.3.2.2 Non-financial analysis basic example 8.2.2.3 Non-financial analysis integrated example
18. Describe the purpose of a balanced scorecard and tabulate a balanced scorecard worksheet.	8.3.4 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 (KPIs)

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	8.3.2.1 ESG and Quality reports 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.

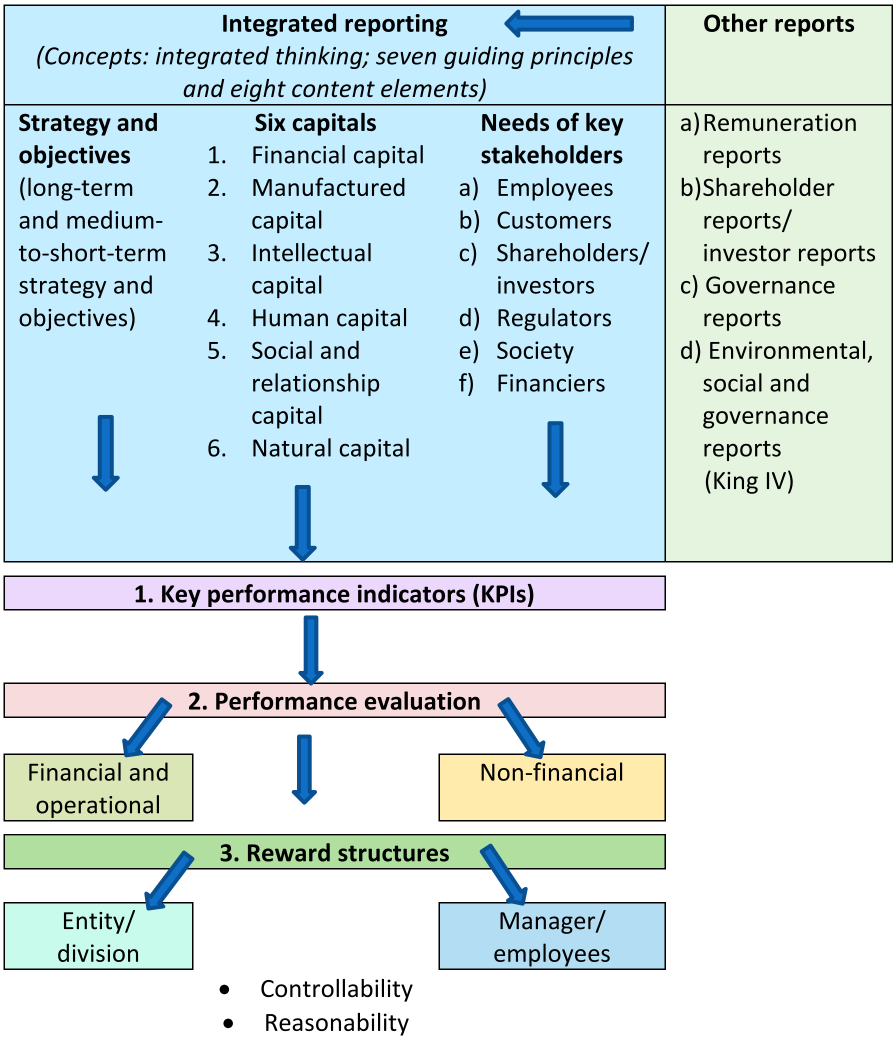

Figure 4.1 Overview of integrated reporting and performance analyses

(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 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 in, 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 the six capitals, key stakeholders' needs and strategic goals. It is vital that an organisation's 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

Strategy and financial and non-financial analysis

Activity 4.3: CWT (Test 1 of 2025)

Activity 4.3		Estimated time		
	Reading	Writing	Marking and review	Total
40 marks	24 minutes	60 minutes	36 minutes	120 minutes

All amounts should be rounded to two decimals. Ignore Value-Added Tax (VAT), Dividends Tax and any possible impact of Section 8 of the Income Tax Act.

BACKGROUND

Clear Water Technologies Ltd (CWT) is a leading South African water filtration company that has been operating since 1997 and has been listed on the Johannesburg Stock Exchange (JSE) since 2002. Its key strengths lie in its adaptability to market developments through innovation, competitive pricing and superior-quality products. CWT prepares its annual financial statements in accordance with International Financial Reporting Standards (IFRS) and has a 31 March financial year (FY) end.

CWT sells high-quality water treatment components and filtration systems, providing water that is suitable for human consumption. Most components and filtration systems are manufactured in-house at its factory located in Kwa-Zulu Natal. Its diverse product range starts from small 'Do It Yourself' (DIY) household water filtration systems to other extensive water filtration systems suitable for industrial use. The DIY product range includes free online tutorials, whereas the larger filtration systems require professional installation and are designed to run in harsher conditions, at higher flow rates and prioritise water quality while maintaining good value.

To ensure customer satisfaction, products and components regularly undergo quality testing. CWT's support staff further provide their customers with free after-sales advice. Its products are efficiently distributed through a well-established distribution network to give customers quick turn-around times. CWT's excellent customer care has strengthened its market position as a leading water filtration producer, and production volumes have steadily increased since listing on the JSE.

CWT envisions growing organically, sustainably and ethically in the medium to long term. Mr Berber, the financial manager, has identified two potential product ranges for FY2026: Eco filtration systems **(ECOs)** and Aquatic filtration systems **(AQUATICs)**. Unlike the current product ranges, which use resin beads that should be replaced regularly, ECOs and AQUATICs only require regular cleaning and are completely environmentally safe and sustainable.

OPTION 1: Eco filtration systems (ECOs)

Mr Berber's research identified the growth potential that the introduction of eco-filtration systems (ECOs) could have on CWT's market share. In addition to its numerous health benefits, ECOs reduce scale build-up, which reduces electricity usage and expands the lifespan of water pipes and heating elements. To gain market entrance, the sales team has agreed to sell the entry-level ECOs at R7 050 each in FY2026, which is 10% lower than competitors are expected to sell at. Their data analysis found a 70% probability that they will sell 7 000 ECOs and a 30% probability of selling 7 500 ECOs in the next 12 months.

Entry-level ECOs cater mainly for households or small businesses. Provided this entry-level product line successfully gains market entrance, CWT will expand its eco product range to incorporate larger industrial eco filtration systems in its medium-term future. Mr Berber and his sales team are confident that the worldwide focus on environmental sustainability will rapidly increase demand for ECOs.

OPTION 2: Aquatic filtration systems (AQUATICs)

Aquatic filtration systems (AQUATICs) vastly differ from their current product range as these filters maintain water quality for marine organisms within a tank by removing waste while maintaining beneficial bacteria. Therefore, they provide water that is not safe for human consumption.

Mr Berber's daughter is a marine enthusiast and social media influencer. Her connections with South African aquatic conservancies (non-profit organisations) has created an opportunity for CWT to be the sole producer of AQUATICs required for the revamp of all their marine tanks. This revamp comes as the conservancies realised that their tanks are not aligned with the United Nations sustainability goals (sustainable life below water), and they have committed to purchase 6 500 AQUATICs at R2 095,00 each, for the next 12 months, but will require minimal AQUATICs thereafter.

Mr Berber's was tasked to determine the viability of ECOs and AQUATICs production, including determining the adequacy and availability of resources.

FY2026 RESOURCES

i) Mr Berber confirmed that CWT does not have the financial resources to invest in plant expansion and modification without obtaining a loan from ZAR Bank. The modification to the production line would have to be completed before the commencement of either production option. The modification cost for the production line will amount to R5 050 000 for ECOs (suitable for all future Eco-product ranges) and R1 025 000 for AQUATICs.

ii) The production manager, Ms Mongwe, hesitantly agreed that the production plant could adapt to incorporate either production options. She cautioned that both proposed product ranges fall outside her field of expertise, as she and most of the production team have been working on the current filtration systems for 15 years or more and are unfamiliar with the science of ECOs or AQUATICs.

CWT further has **in**sufficient labour production capacity to pursue both opportunities simultaneously. Ms Mongwe estimated that there will only be 17 600 direct labour hours available for the production of additional products for the FY2026. ECOs require 2,6 labour hours per unit, and AQUATICs require 2,4 labour hours per unit. The standard direct labour cost for either filtration system is budgeted at R125 per labour hour (FY2026). Employees directly involved in manufacturing have indicated that they are prepared to work overtime, if necessary, provided they are paid 1,5 times their standard hourly rate.

iii) Annual fixed manufacturing overheads will be allocated to all the products that will be manufactured in FY2026 based on available machine hours. There are 120 000 machine hours available for the manufacture of products in FY2026. Planned machine hours, excluding the new opportunities, are 75 300 hours for the FY2026. There is ample spare machine hours available for either production option.

iv) CWT's accounting manager is currently busy with the preparation of the FY2026 budget. Mr

Berber needs to urgently decide if CWT will start production of ECOs or AQUATICs as manufacturing staff will have to undergo training immediately. Mr Berber would prefer creating and backdating a training provision accounting entry that will allow CWT to charge the R450 000 or R75 000 training costs (relating to ECOs or AQUATICs, respectively) as part of the FY2025 as there is still sufficient training budget available.

ECOs and AQUATICs PROJECTIONS

The finance team **accurately** calculated the "relevant profit" projection below for the next 12 months based on the available research and data analysis.

	ECOs		**AQAUTICs**	
Sales quantity	7 150 units (70%x7 000)+(30%x7 500)		6 500 units	
	R Per unit	**Total R**	**R Per unit**	**Total R**
Selling Price	7 050,00	50 407 500	2 095,00	13 617 500
Raw materials cost (given)	(3 240,00)	(23 166 000)	(915,00)	(5 947 500)
Variable manufacturing overheads (given)	(1 823,00)	(13 034 450)	(485,00)	(3 152 500)
Direct labour	(325,00)	(2 323 750)	(300,00)	(1 950 000)
Overtime premium *(Calculation 1)*	(8,65)	(61 875)	0,00	0
Training	(62,94)	(450 000)	(11,54)	(75 000)
Plant expansion	(706,29)	(5 050 000)	(157,69)	(1 025 000)
Total relevant profit for FY2026	**884.12**[A]	**6 321 425**	**225,77**[A]	**1 467 500**

Note [A]: limited rounding difference.

Overtime calculation 1:	***ECO***	***AQAUTIC***
Estimated labour hours to be used	*18 590 (2,6 hours per unit x 7 150)*	*15 600 (2,4 hours per unit x 6 500)*
Available labour hours	*17 600*	*17 600*
Shortage	*990 hours*	*Sufficient hours*
Overtime premium	***R61 875*** *(990 hours x 0,5 x R125)*	

Conclusion:

With a total "relevant profit" of R6 321 425, the ECOs product range is optimal. CWT's board is expected to approve the production proposal of ECOs, provided the loan application at ZAR Bank is approved.

ZAR BANK LOAN APPLICATION

Mr Berber contacted CWT's private banker at ZAR Bank to determine if they could raise funding to inject into CWT for growth or expansion purposes in the medium term. The banker requested him to complete the application form and cautioned that ZAR Bank would look at CWT's capital gearing ratio (X:1) and interest cover ratio (X:1 times) for FY2025 and FY2024.

Mr Berber provided you with extracts from CWT's statement of financial position as at 31 March 2025:

EQUITY AND LIABILITIES		2025 R'000	2024 R'000
Capital and reserves			
Share capital	1	20 000	20 000
Retained earnings	2	35 260	28 960
Total equity		**55 260**	**48 960**
Non-current liabilities			
Long-term loan	3	156 679	149 221
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	3	9 523	7 776
Bank overdraft	4	3 299	1 449
Total current liabilities		**21 559**	**17 501**
Total liabilities		**178 238**	**166 722**
Total equity and liabilities		**233 498**	**215 682**

An extract of CWT's statement of profit or loss for the year ended 31 March 2025 is noted below:

Profit before tax	2,5	15 342	13 013
Income tax		(4 142)	(3 513)
Net profit for the year		11 200	9 500

Notes

1. CWT has 20 million issued ordinary shares, with a market price per share of 1 040 cents in 2025 and 850 cents in 2024.
2. The movement in retained earnings relates to profit for the year after the payment of dividends of R4 900 000 in 2025. The profit before tax includes all interest from ZAR bank amounting to R15 442 000 in 2025 and R14 613 000 in 2024.
3. The loan relates to a current medium-term South African flexible ZAR bank loan. ZAR bank requires that a significant portion of CWT's assets be given as security for the loan. The loan value included in the financial statements approximates market value.
4. The ZAR Bank overdraft is assumed to be a permanent source of financing and, therefore, included in CWT's target capital gearing ratio of 0,46:1.

5. The following information also applies to CWT for the year ended 31 March 2025:

	2025	2024
Training expense	R12 million	R12,5 million
Staff resignations	12,5%	10%
Greenhouse gas emissions (tonnes)	33 000 tonnes	35 000 tonnes

REQUIRED		**MARKS** Sub-total	**MARKS** Total
(a)	Discuss strategic factors CWT should consider when determining the optimal expansion opportunity to pursue in FY2026. i) ECOs ii) AQUATICs • Do **not** perform any further calculations • Do **not** discuss ZAR bank loan application or CWT's finance risk. *Y1: Integrative thinking*	 11 5 *1*	17
(b)	Analyse and comment on CWT's ratios as required by ZAR Bank for FY2025 and FY2024. Your analysis and comments should be based on: i) capital gearing ratio (X:1) ii) interest cover ratio (X:1 times) • *Ignore taxation* *Y3: Problem solving*	 9 6 *1*	16
(c)	Analyse and interpret CWT's social and environmental performance for FY2025. *Y3: Problem solving*	6 *1*	7
TOTAL			**40**

Solution

(a)	Discuss strategic factors CWT should consider when determining the optimal investment opportunity to pursue in FY2026. iii) ECOs iv) AQUATICs • Do **not** perform any further calculations • Do **not** discuss ZAR bank loan application or CWT's finance risk. *Y1: Integrative thinking*	 11 5 *1*	17

	ECOs	
1.	ECOs fall within an **emerging sector of the market** as demand is **expected to grow rapidly as technology evolves** given the global **sustainability drive** and **UN** goals and thus gives CWT the opportunity to incorporate ECOs as an **innovate product range**	emerging market 1d UN sustainability goals 1d ECOs innovative 1d
2.	Some of the current customers **might prefer the ECO-product as an alternative to the current product range i.e. DIY** thus **cannibalising** its current product range.	Alternative product 1d

3.	CWT could gain market entrance /market share by reducing their initial selling price to 10% lower than competitors which is know as **penetration pricing.** CWT need to consider how the market will react (and how projected demand will change) if competitors lower their prices. If CWT needs to further differentiate the ECOs from similar products or introduce an extensive marketing strategy it will increase cost.	1d penetration pricing
4.	They should be cautious of not setting it too low initially and creating an **unachievable expectation** of **customers** to keep such a low price for future periods	Future price expectations 1d
5.	**Long-term growth potential** of expanding its product range as the ECOs product ranges can be further expanded.	1d Long-term growth potential
6.	**Working overtime is only a short-term solution** and either additional staff should be hired in the long term or **staff morale** and productivity may decline due to overworked employees/ Ongoing overtime is not sustainable, particularly if the existing business grows	Long-term overtime unsustainable 1d Employee morale 1d
7.	CWT will have the opportunity to mitigate their risk of being disrupted by being a **disruptive business** themselves (get a foothold in an emerging market before you are too late and the market evolved without CWT).	Disruptive business 1d
8.	**Research/ Data analysis** should be conducted to determine the **long-term growth potential** or future demand probabilities for ECOs product that is in an emerging market.	Data analysis 1d
9.	CWT should prepare a capital budget spanning 3–5 years to estimate NPV and IRR. This will take into account for differences in investments, lifespans, risks, future and time-value of money etc of options.	Consider future and time value of money 1d
10.	The large **initial investment** of R5 050 000 caters for all ECOs product ranges and **further organic growth opportunities in future.**	1d

ECOs Available 13/ MAX 11

	AQUATICs	
11.	Consider going concern, reputation and credibility of SA **conservancies**.	Association with SA conservancies 1d
12.	Limited repeat options from conservancies after the revamp that will thus **not lead to product diversification in the long term**. However, the fixed contract reduces sales uncertainty associated with other products.	Not a long term product diversification 1d Contract reduces uncertainty 1d
13.	Potentially only a once off (12 month) option with South African conservancies and perhaps **not worth the effort** in the long-term (time and cost of investment R1 025 000; training and modification to the production line).	Extensive once off effort 1d
14.	Consider **other potential AQUATIC filtration customers** than South African conservancies post FY2026 to supplement the market demand.	Potential demand after 2026 1d
15.	The current customer base require water filtration for human consumption and they will **unlikely be interested in the AQUATIC which is for aqua marine tanks.**	Not an alternative 1d
16.	AQUATIC **utilises** CWT's employees **spare capacity** without the need for overtime which **improves efficiency.**	Utilise capacity 1d

AQUATICs Available 7/ MAX 5

Both options/ Other/ General		
17.	Producing **sustainable** products such as ECOs and AQUITICs could enhance CWT's **reputation and sustainability credentials.**	Reputation 1d Sustainability credentials 1d
18.	ECOs and AQUITICs aligns with **its strategy** as it provides CWT with an **organic growth** opportunity by diversifying their product range.	organic growth 1d
19.	ECOs and AQUITICs have the ability to **diversify CWT's product range.**	diversify the product range 1d
20.	ECOs and AQUITICs production may **divert their focus from their core business** and may ultimately have an impact on its existing operations and relations with customers.	focus away from their core business 1d
21.	**Quality testing** needs to ensure that the filtration is still effective and achieves the required level of filtration (per the requirements of the United Nations to avoid legal/reputational risks).	1d quality testing
22.	Are there any **other profitable opportunities** which combined with the spare capacity are better than the two options being considered alone.	1d
23.	Data analysis /Forecast costs (RM, lab., var. OH's) & volumes may not be accurate, this could have serious implications on the decision	1d
24.	Determine if there sufficient physical space in the factory to accommodate additional production or storing inventory	1d space
25.	CWT staff will have to be **retrained** as they are not familiar with ECOs and AQUATICs fall outside their current expertise. Determine if training will be sufficient in upskilling the staff and also if the estimated **training cost** is reasonable/ alternatively CWT can **hire experts**/ skilled staff.	1d lack expertise 1d training or hire skilled staff
26.	Neither ECOs or AQAUTICs require resin replacement and are completely **environmentally safe and sustainable.**	1d environmentally safe and sustainable
27.	Both options will utilise additional **machine hours** that will in the long-term require additional repairs and maintenance.	1d
28.	In the long-term the fixed overhead rate should incorporate the options.	1d
29.	Mr Berber's **daughter's connections** with South African aquatic conservancies may pose a ethical/reputational risk **if it includes a bribe,** but increases opportunities for expansion in this segment in the future.	1d daughter's connections
30.	**Reputational risk** applied for example the quality of the new products may be compromised as they lack the necessary expertise.	1d Reputation
31.	CWT needs to consider **regulations/legal requirements (legal risk)**/ **compliance** with JSE listing requirements/ IFRS implications relating to selling these new filtration systems and how the testing of the products will take these requirements into account.	1d compliance
32.	Any other valid point	1d

Both Available 18

33.	**Conclusion:** In the short-term AQUATICS offers a cheaper entry into the market, however ECOs have potentially more long-term benefits and growth potential hence ECOs may be better assuming finance is readily available.	1d

Y1: Integrative thinking *Discussion based on the synthesis and analysis of information across CWT's scenario that is relevant to AQUATICS and ECOs*	*Y1*

Available 40
Y1: 1
Max 17

(b)	Analyse and comment on CWT's ratios as required by ZAR bank for FY2025 and FY2024. Your analysis and comments should be based on: iii) capital gearing ratio (X:1); iv) interest cover ratio (X:1 times); • *Ignore taxation* *Y3: Problem solving*	 9 6 *1*	 16

Y3(a) Problem solving *Critical thinking applied to be able to identify the respective performance outcomes of each ratio.* *Mark is awarded if a student demonstrates an understanding of the outcome of **both ratios***	*1*

i) Capital gearing ratio (X:1)

= Total interest bearing debt (ST and LT)[A] / Shareholders Equity + Total interest bearing debt (ST and LT)[B]

		2025 **R'000**	**2024** **R'000**
Correct formula*	=	169 501[A] 208 000[B] + 169 501[A] = 169 501 377 501 **= 0,45 :1** **½ c***	158 446[A] 170 000[B] + 158 446[A] = 158 446 328 446 **= 0,48:1** **½ c***
Calc A:		156 679 + 9 523 + 3 299 = 169 501[A] **1r**	149 221 + 7 776+ 1 449 =158 446[A] **1r**
Calc B:		(20 million x R10,40) =208 000[B] **½ r**	(20 million x R8,50) =170 000[B] **½ r**

Sub-total for calc 4

Capital gearing ratio (X:1)		
1.	CWT's capital gearing ratio has **improved** as it reduced from **0.48:1 (2024) to 0.45:1 in 2025**	1d improved
2.	This indicates a **reduced finance risk** form ZAR Bank's perspective/still capacity for CWT to obtain more finance *or* *The reduction of debt dependence signalled by the ratio would definitely improve CWT's **credit ratings** and improve the bank's confidence in the company.*	1d reduced finance risk/ improved credit ratings
3.	**Despite** an increase in the interest bearing debt of **6,98%** (7%) from 2024 to 2025 [(158 446-169 501)/ 158 446] the capital gearing ratio only improved as the share price improved with **R1,90 indicating a good market perception** of CWT.	1r 7% 1d Share price/ good market perception
4.	CWT has less debt at **0.45:1** (FY2025) than their target set at **0.46:1.** and as there is **still capacity to obtain finance** in terms of its target gearing ratio which indicates that it is a **good time for CWT to invest in opportunities** to **grow/ expand.**	1d debt capacity ito target 1d invest
5.	Utilising **bank overdraft** which is generally more expensive and short term as part of CWT's permanent source of finance is an indication of an **inappropriate financing policy.**	1d permanent overdraft = inappropriate financing policy.

Available for discussion 7/ Max 5

ii) Interest cover ratio (X:1) = EBIT Total finance cost			
		2025 **R'000**	**2024** **R'000**
		½r both 15 342+ 15 442 15 442 ½r	½r both 13 013+ 14 613 14 613 ½r
		= 1.99 times	**= 1.89 times**

Sub-total for calc 2

Interest cover		
1.	There is a **slight improvement** in the interest cover from 1.89 (2024) to 1.99 (2025) indicating that CWT is **slightly less likely to default** on **loan interest payments** to ZAR Bank. *The improved ability to cover interest expenses could be a reassurance to the funders about CWT's debt management and sustainability.*	1d improved *Alt*
2.	This improvement in FY2025 largely stems from **CWTs higher profit** (EBIT) increased with 11.43% which is **commendable (good).**	1d ↑EBIT good
3.	This is despite CWT utilising more of its **bank overdraft** facility which is a **more expensive** form of finance as seen from its **increasing finance cost** of **5.67%** from FY2024 (15 442 -14 613)/ 14 613.	1d expensive overdraft 1r 5.67%
4.	Resignations increasing could reduce salary expense and thus contributed to higher EBIT in FY2025.	1d ↑Resignations ↑EBIT
5.	This is an indication that CWT's financial risk has decreased, which will likely lead to an **approved loan application** and perhaps even a **lower interest rate (favourable lending terms).**	1d loan approved at good rate

Available for discussion 6/ Max 4


Using terms such as "increase" without interpreting the movement would not earn a mark

(c)	Analyse and interpret CWT's social and environmental performance for the FY2025. Y3: Problem solving	6 1	 7

Y3(a): Problem solving *Candidates will have to use a questioning mind-set during problem identification and analysis to be able to determine which **non-financial ratios relate to social and environmental performance**.*	*1*

Employee Training 12 500 000 - 12 000 000 / 12 500 000

- 4% **1 r**

• Training spend has **reduced** during the current year, which is an indication of **negative social behaviour**.	1d reduced training cost has a negative social impact
• Especially as the FY2025 training budget was **underutilised**.	1d underutilised training budget

Employee Resignations 12,5–10%

2,5% percentage points **1 r**

• Resignations have increased during the current year, which is an indication of **deteriorating** employee and social welfare.	1d deteriorating
• One of the reasons for this increase could be due to reduced **staff morale**, same work environment within CWT for 15 years or more and employees becoming dissatisfied with their working conditions or not receiving training or opportunities within CWT.	1d staff morale
• **Other reasons** for resignations should be obtained through an exit interview, perhaps there were other reasons than poor staff morale. Perhaps staff was **poached by competitors** or **includes retirement** (staff working for 15 years or more).	1d Other reasons
• Increasing resignations could lead to increasing the **unemployment** which is already extremely high in South Africa	1d increased unemployment has a negative social impact

Greenhouse gas emissions $\frac{33\ 000 - 35\ 000}{35\ 000}$

\- 5,71% **1 r**

• Greenhouse gas emissions have **decreased** during the current FY2025, which is indicative of **improved environmental performance**.	1d improved
• This is especially commendable as the **production volume** by CWT has increased (since listing on the JSE in 2002), indicating that CWT utilised more efficient or renewable energy sources in FY2025.	1d production volume

Available 11
Y3: 1
MAX 7

	**DISCUSSION** In the CWT question you will learn to apply integrative thinking by evaluating strategic expansion options in light of broader economic, social, and environmental considerations rather than focusing only on financial outcomes. You will further strengthen your problem-solving skills by analysing financial ratios and sustainability performance to interpret risk, financial stability, and overall organisational impact.

KPIs, strategy and financial analysis

Activity 4.4: SUPER ST@R (Test 1 of 2024)

		Estimated time		
Activity 4.4	**Reading**	**Writing**	**Marking and review**	**Total**
40 marks	18 minutes	60 minutes	36 minutes	114 minutes

The SUPER ST@R (ST@R) Ltd group is a public company listed on the Johannesburg Stock Exchange. It was established in 1979 within the fashion-value retail market sector of South Africa. It has grown from one store in Gauteng into 1 800 stores nationwide, largely due to its competitive pricing. In the last couple of years, the group has established a strong online market presence through its Sales application (App) and has great aspirations to achieve its long-term strategic goals.

ST@R's strategy is continuously informed by extensive market research and data analysis of the South African retail sector, enabling the identification of clear opportunities for both organic and acquisitive growth. The strategy is based on the following six pillars:

The ST@R group has a unique and special culture. People and their intellectual capital input are vital to the successful operation of ST@R and they pride themselves on retaining a highly skilled local talent pool within the fashion-value retail industry. This is aided by ST@R's rigorous appointment process which includes psychometric testing. Over the years ST@R has developed a loyal customer base ascribed to its strong brand based on high quality and great value for money.

ST@R strives to empower local businesses and contribute to economic growth through its extensive supply chain, strategic partnerships with international and local brands, and a comprehensive understanding of the South African fashion-value industry.

The strategic **growth goals** set for ST@R's 2025 financial year includes:

a) Sales growth of 9% - to be achieved by an increasing online presence and reduced credit sales.
b) Stable or improving Return on Capital Employed (ROCE) percentage.
c) Strong cash conversion cycle (operating cycle) of 70 days maximum.
d) Local expansion.

ST@R's strategy is aimed at long-term sustainable value creation for all its **key stakeholders** which have been identified as the following:

1. Shareholders (including investors);
2. Financiers (including banks, creditors and landlords);
3. Customers;
4. Suppliers; and
5. Regulators (including auditors and South African Revenue Services (SARS)

Background of Flashy Stores Group (Flashy)

ST@R's research team identified the Flashy Stores Group (Flashy) with potential as an attractive investment. One of the main reasons is the diverse range of brands offered by Flashy, which were found to compete with ST@R's existing customer and product positioning and, combined, could deliver on the ST@R group's strategic growth goals.

Flashy is a large South African independent retailer of clothing brands from leisure, lifestyle and sporting apparel to footwear. It is a founder-led business that has operated in South Africa since 1999. Flashy operates through more than 300 stores, predominantly based in central business districts, regional malls and rural communities. They further source their products from wholesalers and manufacturers located mainly in rural communities. Flashy has a broad customer base as it caters to a wide range of age profiles and affordability levels. With a limited budget, the marketing manager has developed an online shopping application (App) for Flashy, but it is not fully functional yet and customers have been complaining. Flashy prides itself on sourcing products containing recyclable material as far as possible.

Mrs Ashly Nguni, the founder of Flashy, has decided that she will go on early retirement after the completion of this acquisition deal. She has never been interested in technology and is looking forward to an internet-free retirement. As Mrs Nguni is a foreign national herself, she has promised all staff members job security (regardless of their employment history with Flashy or their level of qualifications) as one of the acquisition's non-negotiable requirements.

Financial information of Flashy

The financial manager, Mr John Mtungi (a qualified CA(SA)) prepared the extracted financial information of Flashy. He also prepared the FY2025 forecast keeping the successful acquisition by ST@R in-mind.

Statement of Comprehensive Income extract for the year ended 29 February 2024

	Notes	Actual 2023 R'million	Actual 2024 R'million	Forecast 2025 R'million
Revenue	1	**2 180**	**2 200**	**2 450**
Cost of Sales		(1 635)	(1 687)	(1 688)
Gross Profit		**545**	**513**	**762**
Operating Costs		(169)	(157)	(189)
EBITDA		**376**	**356**	**573**
Depreciation		(12)	(11)	(11)
EBIT		**364**	**345**	**562**
Interest Income		11	12	13
Finance Charges		(35)	(34)	(33)
Profit before tax		**340**	**323**	**542**
Tax	2	(90)	(103)	(164)
Profit for the year		**250**	**220**	**378**

Statement of Financial Position extract as at 29 February 2024

	Notes	Actual 2023 R'million	Actual 2024 R'million	Forecast 2025 R'million
Non-current assets				
Plant and equipment		883	878	802
Current Assets				
Inventory		205	282	289
Trade receivables	1	204	270	355
Cash and cash equivalents		480	533	920
TOTAL ASSETS		**1 772**	**1 963**	**2 366**
Equity				
Share capital		100	100	100
Retained earnings		969	1 189	1 567
Non-current liabilities				
Long-term loan	3	341	301	261
Current Liabilities				
Trade payables	4	323	333	398
Current portion of long-term loan	3	39	40	40
TOTAL EQUITY AND LIABILITIES		**1 772**	**1 963**	**2 366**

Additional information

1. The credit sales were 30% (FY2023) and 34% (FY2024) of total sales. Cash sales are encouraged and debtors exceeding 60 days are charged 8% interest per month.
2. Taxation was calculated correctly and where applicable already submitted and paid to SARS.
3. The long-term loan is linked to the prime rate and is at two basis points lower than prime. These favourable terms were agreed with the bank three years ago and it is unlikely that Flashy will be able to obtain the same rate if they applied now.
4. Flashy's creditors have agreed to 90-day interest free term, where after 12% interest will be charged per month. All purchases are on credit.

REQUIRED		Marks	
		Sub-Total	**Total**
(a)	Identify two additional key stakeholders for ST@R and provide a reason for each.	4	4
(b)	Discuss Key Performance Indicators (KPIs) that ST@R could incorporate to ensure strategic goal alignment of its: i) Technology and innovation (two examples); and ii) Environmental sustainability goals (two examples).	 2 2	 4
(c)	Evaluate whether the acquisition of Flashy will align with ST@R's strategic goals in terms of: i) People; ii) Brand; iii) Technology and innovation; and iv) Environmental sustainability. *Communication skills – logical argument*	 2 1 2 1 *1*	 7
(d)	Analyse and discuss whether ST@R will be able to place reasonable reliance on Flashy's **FY2025 forecast** Statement of Comprehensive Income. • *You may ignore tax and non-operating income and expenditure* *Communication mark – logical argument*	8 *1*	 9
(e)	Based on the **actual** financial results (FY2024 and FY2023), analyse and discuss Flashy's performance in terms of: i) ROCE; and ii) Cash conversion cycle. • *Your discussion should include underlying **reasons.*** • *Calculations should be based on closing balances.*	 8 8	 16
	TOTAL		**40**

Solution

(a)	Identify two additional key stakeholders for ST@R and provide a reason for each.	4	4

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Key stakeholders have the ability to assist or hinder in achieving the entities objectives.
Refer to 1.4.1 and Figure 1.4 for the key stakeholders of a private sector entity.

		ID	Reason
Employees should be identified as key stakeholders and their needs incorporated within the organisations Strategy and KPIs		1 d*	
1.	**a)** **Human capital** is one of the capital inputs required to create value for ST@R through its business activities within its **business models.** b) Employees will want to work in a safe and healthy environment, experience empowerment and career development. Without this, employees may have a low **morale** and **reduced efficiency**.		1d 1d
2.	a) **People** was also incorporated as one of the six strategic pillars which ST@R should incorporate within their KPIs to ensure long term sustainable growth. b) Employees should be treated as Key stakeholders otherwise their **intellectual capital and local talent pool** within the fashion-value retail industry will diminish and ST@R will be unable to operate successfully.		1d 1d
Society including the community and environment:			
3.	**Community** **Employment** within the local community, utilising the local supply chain and local brands will ensure that ST@R contributes to the community as one of its key stakeholders.	1 d	1d
4.	**Environmental sustainability** was also incorporated as one of the six strategic pillars and as a retailer ST@R should ensure that they do not contribute towards **environmental pollution** through plastic bag waste or non-recyclable material used for their clothes.	1 d	1d
Other such as Competition commission/Lobbyist group/Unions/Political parties		1 d max	
5.	**Competition commission** may object to the acquisition of Flashy by ST@R as they compete in terms of customers and product ranges. *Discussion should link to other Identified key stakeholder with an applied reason.*		1d max
		MAX 2	**MAX 2**

Only the first three stakeholders discussed should be marked. Students should not provide an extensive list of answers hoping that something will be right. This will also help with time management.

(b)	Discuss Key Performance Indicators (KPIs) that ST@R could incorporate to ensure strategic goal alignment of its: iii) Technology and innovation (two examples); and iv) Environmental sustainability goals (two examples).	 2 2	 4

A **SMART** KPI is: Specific, Measurable, Attainable, Relevant, and Time-bound

i) Technology and innovation	MAX 2
1. Increased customer satisfaction with the App and service delivery measured through e.g., an improved **customer satisfaction score** by getting feedback from users/ by not allowing advertisements**.**	1
2. Increased customer satisfaction with the app and **increased online sales percentage (%)/** number of new **app downloads.**	1
3. Improved and enhanced App features, leading to **less complaints** (lower % of complaints in comparison with the number of customers).	1
4. **Data analysis** indicating success of **App adverts leading to sales** (e.g percentage (%) of adds that lead to sales).	1
5. Customer data tracked and used for **data analysis to determine emerging fashion trends**, etc.	1
6. St@r can improve the app by adding **more features** (number of new or improved features).	1

ii) Sustainability goals	MAX 2
1. ST@R should provide alternative options to reduce plastic shopping bags. KPIs should be informed by reduced **(number or %) plastic bags** used and ultimately reaching 0% plastic bags used or using an increased % percentage of recycled bags.	1
2. Suppliers should be sourced that use **more/ higher percentage or composition of sustainable materials, or**	1
3. **consume less water** (litres), or	1
4. emit less **environmental waste** (such as, the amount (kiloton) of Carbon emission/ CO^2 emitted.	1

(c)	Evaluate whether the acquisition of Flashy will align with ST@R's strategic goals in terms of:		
	v) People;	2	
	vi) Brand;	1	
	vii) Technology and innovation; and	2	
	viii) Environmental sustainability.	1	
	Communication skills – logical argument	*1*	7

Communication skills – logical argument	1

People;		
1.	ST@R strives to employ locally and reduce local unemployment, however Ms Nguni has promised all staff members employment as one of the acquisition requirements. ST@R may not be able to employ their rigorous appointment process and may be forced to take on board all of Flashy's current employees **irrespective of their employment history or level of qualification.**	1d
2.	The **talent pool** of Flashy integrating with ST@R may be weakened if the founder goes on early retirement and **her intellectual capital is lost.**	1d

3.	The retirement of Ms Nguni is also likely to impact the **corporate culture** and **morale of staff** transferred to the new team, staff such as the marketing manager may even be open to using the successful App used by ST@R.	1d
		MAX 2

Brand;		
4.	Flashy has a **diverse range of brands** that could complement and expand ST@R's current brands as they are currently competing in terms of customers and product ranges.	1d
5.	*The brands competing currently could still be driving down current sales or influence pricing strategy on current brands*	1d
		MAX 1
Technology and innovation;		
6.	Flashy's app is not fully functional, and customers are complaining. This App will likely become redundant anyway if taken over by ST@R as ST@R's App will be utilised and **customers satisfaction will improve.**	1d
7.	*Current App's intellectual capital might not be included in the private equity or there could be other factors at play with regards to security or exposure to legal claims.*	1d
8.	The tone from the top of Flashy, Mrs Nguni, is **not pro internet** and may thus have a **negative impact** on the corporate culture if incorporated into ST@R which want to drive online sales. However, some staff such as the marketing manager may even be **open to using** the successful App used by ST@R.	1d
		MAX 2
Environmental sustainability;		
9.	Flashy prides itself in **using recyclable material** in their products as far as possible which aligns with ST@R's strategic environmental sustainability goals.	1d
		MAX 1
Conclusion:		
	In most aspects discussed above the acquisition of Flashy will align with ST@R's strategic goals.	1d
		Bonus 1

Available 8/ Max 6
Com 1
Total MAX 7

(d)	Analyse and discuss whether ST@R will be able to place reasonable reliance on Flashy's **FY2025 forecast** Statement of Comprehensive Income. • *You may ignore tax and non-operating income and expenditure* *Communication mark – logical argument*	8 *1*	9

Communication mark – logical argument	1

<u>Analysis of the forecast</u>		**Actual**		**Forecast**
		2023	**2024**	**2025**
Revenue increase	#1		1% ½ r	11% ½ r
COS increase	#2		3% ½ r	0% ½ r
COS as a % of revenue	#2	75%* ½ r	77%* ½ r	69%* ½ r
GP% **GP margin** is better than Year on Year GP growth comparison	#3	*25%** ½ r	*23%** ½ r	*31%** ½ r
Operating cost to sales %	#4	*7,8%* ½ r *(169/ 2 180)*	*7,1%* ½ r *(157/ 2 200)*	*7,7%* ½ r *(189/ 2450)*
EBITDA as a % of revenue	#5	17% ½ r	16% ½ r	23% ½ r
EBITDA increase/ (decrease) *(discussed with #1 and #2)*	#5		*(5%)* ½ r	*61%* ½ r

**Alt*

9 Calcs/ MAX 4

Revenue growth:

#1.1	**Revenue** is showing a slightly increasing trend of **1%** from FY2023 to FY2024, but the FY2025 forecasts shows an **11% increase.**	1d sales growth **1% to 11%** unrealistic
#1.2	Revenue growth of **11%** increase which is above **inflation** (6%), thus **not reasonable** unless there is a specific contract that has been entered into.	1d 11%>**inflation** is not realistic
#1.3	The 11% sales growth per the FY2025 forecast exceeds the required sales **growth rate of 9%** set by ST@R and could thus be **manipulated** by Mr John Mtungi to meet acquisition requirements.	1d **Minimum growth > 9%** thus manipulation

COS:

#2.1	The actual cost of sales margin shows an increasing cost ratio (75% vs 77% → 2 percentage points), however the forecast shows a decreasing cost ratio (77% vs 69% → 8 percentage points) which is **not realistic.** *<u>Alternative</u>* *COS increased with 3% FY2024 and is expected to increase with 0% FY2025 which is **unrealistic**.*	1d comparison declining COS trend not realistic
#2.2.	COS 0% unrealistic especially given the increasing inflation rate of 6%.	1d COS 0% increase <inflation
#2.3	In FY2025 a **0% cost of sales** increase is forecast despite the **11%** increase in sales which is **not realistic.**	1d COS increase of only 0% vs sales increase is unrealistic

Gross profit

#3.1	Actual gross profit margin decreased (25% FY2023 to 23% FY2024 → 2 percentage points) but the FY2025 GP margin increases to 31% (8 percentage points) and is **not realistic**	1d Declining trend 25% to 23% comparison thus 31% GP not reasonable.

Operating costs

#4.1	Operating costs to revenue has increased slightly/ remained relatively stable and reasonable (around 7%)	1d Operating cost relatively stable
#4.2	A diminishing balance method depreciation policy seems to be in place as asset values and depreciation is on a declining trend. Depreciation was Rm12 in FY2023 and Rm11 in FY2024 and thus depreciation is expected to be lower than Rm11 for FY2025.	1d decreasing trend expected for depreciation

EBITDA

#5.1	There was a slight decrease in the EBITDA to sales ratio from FY2023 (17%) to FY2024 (16%), however the FY2025 forecast (23%) indicates an increase which appears **over optimistic (not reasonable).** *Alternative a forecast EBITDA increase of 61% FY2025 is not realistic if actual EBITDA declined with 5%.*	1d Declining trend 17% to 16% comparison thus 23% not reasonable.

General

#6.1	Given that the financial manager prepared the budget for the **purpose** of the acquisition to go through he has **motive** to overstate the profits (understate costs) of Flashy.	1d Motive to manipulate

Conclusion:

#7.1	**Conclusion:** In general the forecast appears **unrealistic** and should not be relied on.	1d Concl

10 available / Max 4
Com 1
TOTAL 9

(e)	Based on the **actual** financial results (FY2024 and FY2023), analyse and discuss Flashy's performance in terms of: iii) ROCE; and iv) Cash conversion cycle. • *Your discussion should include underlying **reasons.*** • *Calculations should be based on closing balances.*	 8 8	16

Return on capital employed (ROCE) (%) = EBIT/ Capital employed*
*: Capital employed = shareholders' funds + interest-bearing debt (or = Total assets – current liabilities)

ROCE = <u>EBIT</u> Capital employed	FY2023	FY2024
EBIT (given)	364,00 ½ r	345,00 ½ r
Capital employed (Share capital + retained earnings + Lt loan + St portion of Lt loan) (100 + 969 + 341 + 39) or (1 772 – 323) (100 + 1 189 + 301 + 40) or (1 963 -333)	1 449 ½ r	1 630 ½ r
	25%	**21%**

Subtotal 2/ MAX 2Discussion

1.	Flashy's Return on Capital Employed **worsened (21% FY2024 vs 25% FY2023)** indicating that **capital or assets were used less efficiently** in FY2024.	1d
2.	There was a **5% decline in EBIT which is concerning,** However Flashy still managed to **repay the short-term portion** of their long-term debt.	1d 1d
3.	<u>**EBIT**</u> i. The FY2024 EBIT has worsened possibly due to Flashy utilising an **ineffective sales App** as **sales increased with only 1%.** ii. **COS margin worsened** (77% FY2024 vs 75% FY2023) and therefore COS is consuming a greater portion of the revenue. <u>**Capital employed:**</u> a. The **favourable loan rate (prime less 2 basis points)** may not be granted again and **surplus cash** was therefore not utilised to reduce the long-term loan as cash could be used for new investments or to improve the cash conversion cycle instead. b. Flashy's **PPE assets are ageing** as the balance is decreasing year on year and there appears no planned capital investment in Plant and equipment in FY2025 either. *c.* Inventory has **increased by 37,5%** possibly indicating that inventory is **aging.** */Alternative debtors days **worsened** with 15 days.* i. This is especially concerning given the high reliance on brands in the fashion industry. *d. Debtors days have **worsened** with 18 days.*	1d 1d 1d 1d 1d 1d 1d
4.	**Not appealing to investors** such as ST@R due to Flashy's declining **ROCE ratio**.	1d

Subtotal 10/ MAX 6

ii) **Cash conversion cycle:**

Cash conversion cycle	**FY2023**	**FY2024**
Creditors days (Trade payables/ Credit purchases x 366#) (323/ 1 635 x 365) (333/ 1 687 x 366)	(72) ½ r	(72) ½ r
Debtor days (Trade receivables/ Credit sales x 366#) (204/ (2 180 x 30%)) x 365 (270/ (2 200 x 34%)) x 366	114 ½ r	132 ½ r

Inventory days (Inventory/ Cost of sales x 366#) (205/ 1 635 x 365) (282/ 1 687 x 366)	46 ½ r	61 ½ r
Cash conversion cycle Days	**= 88** ½ c	**= 121** ½ c

Note: # FY2023 has 365 days and FY2024 has 366 days
Allow reasonable differences due to rounding

Subtotal 4/ MAX 4

Discussion

	<u>**Cash conversion cycle:**</u>	
1.	The cash conversion cycle has **worsened** from **88 days to 121 days** and is worse than expected in the retail industry and ST@R's expectation. The 121 days also far exceeds the maximum set by ST@R of **70 days.**	1 d 1d
2.	**FY2023** Inventory is sold after 46 days, then debtors only pay after another 114 days, but creditors were already paid 72 days after delivery. **FY2024** Inventory is sold after 61 days, then debtors only pay after another 132 days, but creditors were already paid 72 days after delivery	1 d 1d
3.	<u>**Creditors**</u> Flashy's creditors days remained unchanged at 72 days, which is less than the 90 interest free days offered, and thus cheaper than other sources of finance and thus Flashy is utilising the **interest free financing option** *and could possibly be extended to 90 days (before interest will be charged) to improve the cash conversion cycle.*	1 d 1d #
4.	<u>**Debtors days**</u> have **worsened** with 18 days (114 vs 132) as debtors are utilising the 8% favourable/ **cheap credit** terms as it is less than the prime rate, and 60 days is interest free. The actual debtors days (114 FY2023 and 132 FY2024) far exceeds the 60 days interest free. *Flashy should charge a higher interest rate and offer cash discounts to reduce debtor days.*	1 d 1d 1d #
5.	The <u>**inventory days**</u> has **worsened** with 15 days (61 vs 46) which is **concerning** especially in the retail fashion industry as trends change rapidly and may be an indication of **obsolete inventory.**	1d 1d

Subtotal 7/ MAX 4

Note #: Not required → for learning purposes only.

	**Discussion** The ST@R question teaches you to think holistically about strategy by linking stakeholders, KPIs, acquisitions, and financial performance to overall strategic alignment and value creation. You will also develop analytical and communication skills by interpreting financial metrics, evaluating forecasts, and constructing logically structured, evidence-based arguments.

Activity 4.5: OfferTop Group (extract)

Activity 4.5: 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.	8	
	Y1: Integrative thinking	*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.**	18	
	Z2: Business external environment	*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).

Activity 4.6: CCP (extract)

Activity 4.6	Reading	Estimated time		
		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

		R’000 2023	R’000 2022
EQUITY AND LIABILITIES			
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.** *Y1: Critical thinking* *Y3: Problem solving*	20 *1* *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)

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)

3) **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 cement** (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 4.7: BSP (extract)

		Estimated time		
Activity 4.7	**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.

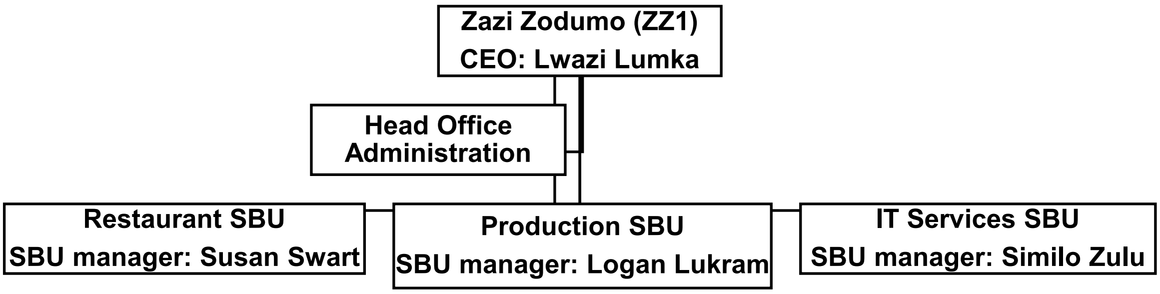
Activity 4.8: ZZ1 (extract)

Activity 4.8		Estimated time		
	Reading	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.	10	
	Y4: Judgement and decision making	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	*1*
Maximum	**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**

Discussion

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 4.9: African Sun Limited (extract)

Activity 4.9		Estimated time		
	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

$$\frac{53\ 000\ 000 - 49\ 000\ 000}{49\ 000\ 000}$$

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

$$\frac{245\ 000\ 000 - 270\ 000\ 000}{270\ 000\ 000}$$

(**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

$$\frac{2\ 000\ 000 - 2\ 200\ 000}{2\ 200\ 000}$$

(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

$$\frac{50\ 000 - 45\ 000}{45\ 000}$$

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 4.10: Khuselo (extract)

Activity 4.10	Estimated time			
	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**

DISCUSSION

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 4.11: BBL (extract)

		Estimated time		
Activity 4.11	**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**

DISCUSSION

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 4.12: Rise Up Ltd (extract)

		Estimated time		
Activity 4.12	**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.