TOPIC: STRATEGY

Owing to the integrated nature of the topics and the concepts dealt with in learning units 1, 2 and 3, the learning outcomes and related assessment criteria, as well as the assumed prior learning, are incorporated holistically in learning unit 1.

Learning unit 1, “Strategic analysis and the strategy development process”, deals with the following topics:

- The strategy development process
- External and internal influences on an organisation’s strategy

Learning unit 2, “Business strategy and business models 1”, deals with the following topics:

- Implementing strategy
- The building blocks of a business model

Learning unit 3, “Business strategy and business models 2”, deals with the following topics:

- IT and data strategy
- Disruptive business models

LEARNING OUTCOME AND ASSESSMENT CRITERIA

The content of this topic is based on the following learning outcome and assessment criteria:

Learning outcome	Assessment criteria
Evaluate an enterprise’s strategic development plan in terms of its overall objective.	Critique the appropriateness of an entity’s mission, vision and strategic plan.
	Reflect upon internal and external influences on an entity’s strategy development.
	Assess the alignment of management decisions with an entity’s vision, mission, values and mandates.
	Comment on the suitability of the business model of an entity in terms of the model’s alignment with the entity’s vision, mission, values, mandate and overall objective and the financial function.
	Assess the feasibility of business strategies that have been formulated by using relevant analytical tools.
	Debate the capitals within an organisation (financial, manufactured, intellectual, human, social and relationship, and natural capital) as referred to in the Integrated Reporting Framework.
	*Determine the relevant structural and governance issues within a company, including sustainability issues and integrated reporting matters, and provide recommendations.
	**Review the applicable legal system and legal framework within the public sector.

Note:

* Determining the relevant structural and governance issues within a company forms part of auditing. For the purpose of this module, it is important that you see the link between auditing and management accounting, particularly King IV in respect of governance and integrated reporting. The learning units that deal with strategy (1, 2 and 3) provide insight into several of the strategic and other concepts that are incorporated into an integrated report. In learning unit 4 you will learn more about integrated reporting. In this learning unit your assumed prior learning (indicated below) incorporates governance principles and recommended practices in respect of stakeholder relations. You are encouraged to revise theory on sustainability.

** It is recognised that the public sector is a context in which many entry-level CAs(SA) work. This aspect is, however, only included as a basic level of competency for this academic programme.

Legislation applicable to the public sector is very comprehensive. Therefore, the following summary of public sector-enabling legislation should not be regarded as a complete list:

- The Constitution of the Republic of South Africa
- Public Finance Management Act (PFMA)
- Local Government: Municipal Finance Management Act (MFMA)
- Treasury Regulations
- Division of Revenue Act
- Public Audit Act (PAA)
- Procurement legislation

You may advance your knowledge level as part of your lifelong learning, values and attitudes or self-development. For this purpose, you may refer to the additional reading section at the end of this learning unit.

ASSUMED PRIOR LEARNING

If you wish to refresh your knowledge for this topic, please refer to your undergraduate material and prescribed textbook (Managerial Finance, 10th edition). For your convenience, we provide textbook references.

The first part of the assumed prior learning for this topic is found in chapter 1, "The meaning of financial management", which introduces financial management and contains several key concepts.

Learning outcomes assumed to have been attained during prior learning Before you study this topic, you should be able to	**Managerial Finance (10th edition), chapter 1**
1. explain financial management and describe the goal of an entity and the role of an entity's financial manager	1.1 Financial management 1.1.1 The finance function 1.1.2 The finance decision 1.1.3 The investment decision 1.1.4 The role of the financial manager
2. define 'sustainable development', including 'capitalism' (six capitals) and 'good corporate citizenship'	1.2 Goal of an entity 1.2.1 Sustainable value creation 1.2.2 Shareholder wealth maximisation 1.2.3 Sustainable development, inclusive capitalism and good corporate citizenship 1.2.4 Other emerging perspectives on the goal of an entity
3. identify key stakeholders of an entity and describe their roles, both in the private sector and the public sector 4. explain the governance principles pertaining to stakeholder relations 5. describe the concepts related to stakeholder engagement and the benefits of stakeholder engagement	1.4 Stakeholders of an entity 1.4.1 Definition of a stakeholder 1.4.2 Key stakeholder groups 1.4.3 Sustainable theory 1.4.4 Governance principles and recommended practices in respect of stakeholder relations 1.4.5 Stakeholder engagement 1.4.6 Reporting to stakeholders

Learning outcomes assumed to have been attained during prior learning Before you study this topic, you should be able to	**Managerial Finance (10th edition), chapter 1**
6. describe the relationship between investment risk and return	1.5 Risk and return of investors 1.5.1 Business risks 1.5.2 Financial risks
7. explain the overall function of the capital markets	1.6 Capital markets 1.6.1 Capital markets defined 1.6.2 Raising equity finance on the JSE 1.6.3 Sustainability and responsible investment in the capital markets

The second part of the assumed prior learning for this topic is found in chapter 2, which deals with strategy and business models.

Learning outcomes assumed to have been attained during prior learning Before you study this topic, you should be able to	**Managerial Finance (10th edition), chapter 2**
1. explain the strategy development process of an organisation	1.2 The purpose of an organisation 1.3 Defining strategy
2. describe, appraise and assess the influence and the impact of the external and internal environments on an organisation's strategy	2.3 Key criteria for a successful strategy 2.3.1 The considerations 2.3.2 External environment 2.3.3 Internal environment
3. explain the influence that stakeholders have on an organisation's strategy and justify how this relationship should be governed	2.4 Stakeholders and governance 2.4.1 Stakeholders 2.4.2 Governance
4. recognise the effect that strategy and corporate culture have on each other and illustrate how this aspect should be managed	2.5 Corporate culture
5. define, describe and apply relevant analytical tools to evaluate and assess key issues and priorities that a strategy needs to address	2.6 Changing the strategy 2.6.1 Strategy summary 2.6.2 SWOT analysis 2.6.3 Gap analysis 2.6.4 Scenario planning
6. assess and apply strategy assessment tools and techniques for determining available strategy options, especially growth	2.7 Available strategies 2.7.1 Choosing the right strategic option 2.7.2 Product-market strategies 2.7.3 Competitive strategies 2.7.4 Growth strategies
7. apply appropriate methods for making the right strategic choice and ensuring that a strategy is properly implemented	2.8 Choosing and assessing a strategy 2.8.1 The strategy dilemma 2.8.2 How to choose as strategy 2.8.5 Assessing strategy implementation 2.8.6 Performance measures for non-profit organisations (NPOs) 2.8.7 Performance management tools 2.8.8 Problems with performance management

Learning outcomes assumed to have been attained during prior learning Before you study this topic, you should be able to	***Managerial finance* (10th edition), chapter 2**
8. assess the business model of an organisation and ensure it is aligned with the organisation's strategy	2.8.3 Aligning the business model with the strategy
9. describe and evaluate leadership and management approaches for effective change and performance management	2.9 Change management 2.9.1 Change is a constant 2.9.2 Management roles 2.9.3 Key concepts in management
10. analyse the need for and recommend an appropriate IT and data strategy	2.10 Information technology (IT) strategy 2.10.1 Technology integration 2.10.2 New technologies are rapidly influencing the 'new way of doing things' 2.10.3 Considerations for a change in IT strategy

LEARNING UNIT 1: STRATEGIC ANALYSIS AND THE STRATEGY DEVELOPMENT PROCESS

Activities	Notional study hours
Prescribed reading	Chapter: 1 (3 minutes)
Activities	Activities: 3 (114 minutes) Videos: 1 (6 minutes)
Total	**2 hours and 3 minutes**

This learning unit deals with the following topics: the strategy development process, and external and internal influences on an organisation's strategy. Since these topics are linked to several integrated concepts, they are treated as one holistic learning unit.

1.1 PRESCRIBED READING FOR THIS LEARNING UNIT

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

Chapter	Section	Estimated time
Chapter 2	2.4.4 Sustainability	3 minutes

Note that all sections of chapter 1 and most sections of chapter 2 are included in the assumed prior learning indicated above. The remainder of the sections will be included in learning units 2 and 3.

1.2 INTRODUCTION

In order to develop an appropriate strategy for an organisation, management needs to consider more than the financial impact that the business will make. Although an organisation may consider the equity holders to be its primary stakeholders, it also needs to appreciate both the social and environmental impact it will have on various other stakeholders.

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

1.2.1 Strategy development process

An organisation will develop a strategy to achieve its goals and to meet its key stakeholders' needs, interests and expectations by using its resources and capitals. Strategic planning is an ongoing process and includes specific plans, actions and policies to ensure that an entity meets its goals such as creating long-term sustainable value. The deliberate or rationale approach (see section 2.2.3.2 of *Managerial Finance*, 10th edition) takes place in four steps: strategic analysis; the selection of appropriate strategies; the implementation of the strategies; and the measurement of performance against strategic objectives and key performance indictors (KPIs). In the next sub-section, the internal and external environments of an organisation are analysed in relation to the strategic analysis step.

1.2.2 External influences on an organisation's strategy

An organisation's strategy has to be suitable, feasible within its internal and external environments and acceptable for its stakeholders. An analysis of the external business environment will incorporate an analysis of the **macro-economic environment, the relevant industry or sector, competitors and the market**.

A **political, economic, social, technological, environmental and legal (PESTEL) analysis** is used to identify risks and opportunities emanating form the **macro-economic environment**. An environmental analysis is concerned with ensuring sustainable business practices and goals. The Sustainable Development Goals put forth by the United Nations (refer to figure 1.1) are global challenges that companies have to meet to achieve a more sustainable future.

Figure 1.1: Sustainable Development Goals (Prometeon 2022)

Porter's five forces model is used to evaluate a business's ability to be successful within an **industry or a sector** by looking at new entrants, competitive rivalry, substitutes, the power of buyers (customers) and the power of suppliers (see section 2.3.2.3 of *Managerial Finance*, 10th edition).

Figure 1.2: Porter's five forces (Wikimedia Commons 2017)

A further market analysis will be done to analyse the **customer market** by analysing demand, brand, product life cycle and more. When analysing **competitors**, it is important to understand their strengths and weaknesses. In this regard, the 4Cs approach, which consists of collecting data, converting information to intelligence, communicating the intelligence (using analysis methods such as SWOT) and, finally, countering competitors' actions, is followed (see section 2.3.2.4 of *Managerial finance*, 10th edition).

1.2.3 Internal influences on an organisation's strategy

The internal environment includes the resources and competencies that will enable an organisation to create value and remain competitive in the long term. Some of the analysis tools used for this purpose are: VRIO (valuable, rare, inimitable, organised), value chain analysis, product life cycle, BCG (Boston Consulting Group) matrix and resource audit (see section 2.3.3 of *Managerial Finance*, 10th edition).

1.3 VIDEO

Access the link below to watch a video that gives a brief introduction to strategy.

[Strategic introduction video]()

1.4 ACTIVITIES

After you have read the introduction and the prescribed reading material and watching the video, complete the following activities:

Strategic development

Activity 1.1: MSL (adapted)

Activity 1.1: MSL	Estimated time			
	Reading	Writing	Marking and review	Total
14 marks	15 minutes	21 minutes	9 minutes	45 minutes

Millennials Schools Limited ('MSL') is the holding company of a group of schools that specialises in both primary and secondary school education. MSL is also listed on the Johannesburg Stock Exchange (JSE) under the Consumer Services sector. Over the years the group has expanded its number of schools in South Africa, fitting into a key growth sector, and has been strategically positioned to satisfy the education needs of the middle class, which is growing every year. The group listed on AltX in 2012 and its shares are currently trading at 625 cents per share. The group's mission is to increase the number of schools and to continuously enhance the quality of education provided, thereby becoming an education provider of choice. The target debt-to-equity ratio for the group is 1:4.

MSL's product offering includes education from Grade 000 to Grade 12, aftercare services and bridging courses for adults who want to achieve a matric exemption. There has been strong growth in all segments, which is promising, especially in the light of the tough economic climate faced by South African consumers.

The group's major lines of income include school fees, donations (from alumni, ex-students and corporates), levies (government and international), aftercare fees and other income (investment income and sales from tuck shops). The student fees are mainly allocated to funding the operational expenditure and the capital expenditure required for the group's sustainability. MSL's school fee increases have approximated 12% per annum, which is above the inflation rate of 6,3%. These fee increases were accepted by the parents of students, based on the company's strong brand and a convincing presentation done by the school governing body (SGB) and MSL's chief executive officer (CEO).

The chairman of MSL made the following comments at a recent board meeting:

> We are all aware of the protest action in the 2022 academic year with the burning of schools. This has created a demand for quality education and has also left a gap in an already strained sector. We therefore need to fill this gap and provide South African students with quality education at a reasonable price. This can only be achieved by having world-class teachers in MSL classrooms and having state-of-the-art computer and science laboratories and teaching aids. We are aware of the strain that the South African economy is under, with large-scale retrenchments coupled with limited growth in South Africa, and we have a duty to ensure efficiency and effectiveness in all that we do. We need to continuously change and enhance in order to be relevant … .

The group therefore needs to find alternative sources of income, curtail costs and increase its student numbers in order to compete effectively. The group must do all this with limited resources, relying on capital from shareholders and debt markets.

Potential cost-saving initiative by MSL

A proposal has been made to purchase a printing machine and to complete all printing of study material, brochures and application forms in-house. This proposal involves purchasing a machine in December 2022, with printing commencing on 1 January 2023.

The following information applies to the new proposal:

- The initial purchase price of the machine will be $0,2 million, and the machine will be purchased at the end of 2022 (paid to supplier on 31 December 2022). The machine will have a useful life of three years and a disposal value of R0,5 million.
- The projected printing costs will be R1,1 million per annum in 2023, increasing by 1% above the projected inflationary increase. Costs include material, labour, ink and maintenance.
- A suitable location has been identified for the printing machine and the related consumables. The lease will require a deposit of R1 million in the first year and an annual rental of R1,5 million, which will increase by 10% above the annual inflationary increase. The deposit is non-interest bearing and is refundable at the end of the lease. It is likely that 25% of the deposit will be deducted by the landlord since painting will have to be done at the end of the lease term. In order to secure this deal, a R100 000 finder's fee has been paid to the agent. The lease may be cancelled by MSL at short notice.
- Staff cost will comprise R0,75 million in the first year, increasing by inflation thereafter.
- The South African Revenue Service (SARS) will allow an allowance on the machine to be claimed equally over three years.
- MSL uses a weighted average cost of capital (WACC) of 18,6% for all project evaluations.

The net present cost (NPC) in relation to the **current** printing costs for a representative **three-year** period is R9,5 million.

The following two proposals have been made regarding the financing of the printing machine:

- **A euro-denominated loan to fund the $0,2 million purchase.** Interest will be charged at 1,25% above the prime lending rate at December 2022, which will be payable annually in arrears. The full capital will be repaid at the end of a three-year period.
- **A loan with a fixed interest rate of 12,5% from a local bank.** Interest will be paid during the term of the loan annually in arrears and the capital will be repaid at the end of a three-year period. An initiation fee of R0,1 million will be charged at the inception of the loan.

Other information

The creation of a training academy has been proposed by MLS's head of training and development in response to resignations by academic staff. This academy will train current and new staff members, providing them with the necessary tools to increase the pass rates within MSL. The project will involve a two-year training programme that is the equivalent of a postgraduate qualification. Substitute teachers will be appointed to fill in for the teachers who attend the training programme. After teachers have completed the two-year training programme, they will be required to commit to staying with MSL for a further two-year period. If a teacher leaves earlier, he or she will be expected to pay back the full cost of the training, prorated for the period of the early exit.

The group currently pays R12,4 million per annum to fund debtors since the average outstanding debtors equal 75 days. An alternate option is to enter into a joint venture with a bank, where the bank provides loans to parents who cannot pay school fees upfront at the beginning of the schooling year. The debtors will be managed and collected by the bank, with a fee being paid to MSL for the value of lending. The bank will bear the cost of bad debts, and MSL will not incur further costs. The structure will be subject to requisite regulatory approval before it is implemented.

Other group and market information

- A renowned academic who participated in a talk show recently expressed concern over the future of physical schools due to the significant amount spent on capital expenditure ('brick and mortar') and continued maintenance. The resultant costs are eventually borne by students in the form of school fees. There was a panel discussion on the use of online tools like tablets and the provision of online courses for teaching, which will save on school fees paid by students and, consequently, make schooling more affordable.
- The group corporate tax rate is 28% per annum, with a one-year lag for tax cash flows.
- The inflation and exchange rates are projected to be as follows:

	Dec 2022	Dec 2023	Dec 2024	Dec 2025
Inflation rate			7%	7,3%
Exchange rate (ZAR:US $1)	15,60	16,54	17,53	16,83
Prime lending rate	10,5%			

REQUIRED		**MARKS**	
		Sub-total	**Total**
(a)	Provide feedback to the analyst as to why online teaching using tablets may not work.		7
(b)	Evaluate the viability of the training academy, as proposed, incorporating the potential risks and benefits.		7
Total			**14**

Solution

(a)	Provide feedback to the analyst as to why online teaching using tablets may not work.	7

An online approach may **not necessarily result in a decrease in school fees** for the following reasons: (1)

- **Expenditure** will have to be incurred to **set up** the online teaching model (external consultants, software, etc). (1)
- **Tablets** are still relatively **expensive**. (1)
- **Data costs are high.** (1)
- The **cost savings relating to the capital expenditure and the maintenance** of the schools are more **long term in nature** and **may not result in an immediate significant decrease in school fees**. (1)
- Several **benefits are linked to traditional teaching methods**, **which will be lost** if an online approach is followed. (1)
  This could result in:
  - a **loss of students to competitors** who use traditional methods of teaching, and (1)
  - a **decrease in pass rates**. (1)
- MSL may **not have the necessary technological know-how** to manage online teaching. (1)
- MSL would be **susceptible to the unauthorised use of its learning material** by competitors and its systems could be hacked. (1)
- There is a **risk that tablets could be stolen**, which would have an **impact on students' studies**. (1)
- Students may not have **internet access**. (1)

Maximum: 7

(b)	Evaluate the viability of the training academy, as proposed, incorporating the potential risks and benefits.	7

The following risks and benefits are associated with the proposed training academy:

Risks

- Upon completion of the training programme, **teachers may become sought after** and may be **poached by competitors**. (1)
- Teachers may then **leave MSL to work at competitor schools**. Although MSL will recoup the costs of the training, it will **not reap the benefits of the training provided**. (1)
- The project will run over a relatively long period and there is **no guarantee that it will provide a return**, or the **pass rate/benefits may not be as expected**. (1)
- **Unions could be reluctant to accept/could disagree with the retainer of two years** and may advise members not to attend the programme. (1)
- Upon completion of the programme, **teachers might demand an increase in pay** on account of the new skills they acquired, **resulting in unplanned costs** for MSL. (1)
- When teachers want to attend the programme but are **not nominated/do not qualify for the training, they might develop low morale**. (1)
- This could lead to poor performance by such teachers. (1)
- MSL may encounter **difficulty in recovering training costs** from teachers who leave before the two-year retainer period lapses. (1)

Benefits

- Teachers may be **better equipped to deal with the challenges of teaching**, which could lead to an **increase in pass rates**. (1)
- The MSL **brand and reputation may be enhanced** if teachers have better qualifications. (1)
- Teachers who undergo the training could **experience higher levels of job satisfaction**. (1)
- This could result in enhanced:
- **work performance**, and (½)
- **loyalty towards MSL**. (½)

Conclusion: Based on the above discussion, MSL **should not proceed** with the training academy. (1)

Maximum: 7

Feedback

When making any decisions, it is important to consider an entity's **strategy and objectives in the long, medium and short terms**. The organisation will, to a large extent, be concerned with financial aspects such as the **cost-versus-benefit** impact of a decision, but it is also important to consider the **non-financial** factors (needs) that have an impact on other key stakeholders, such as employees and society.

SWOT analysis

Activity 1.2: African Sun Limited ('ASL') (extract)

Activity 1.2: ASL	Estimated time			
	Reading	Writing	Marking and review	Total
14 marks	12 minutes	21 minutes	5 minutes	38 minutes

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.

Gaming division

ASL owns 10 gaming and entertainment facilities in four provinces of South Africa. The following key product offerings are provided within this division:

- Gaming
- Cinemas
- Restaurants and bars
- Theatres
- Conferencing and banqueting

Hotel division

ASL operates 70 hotels across all sectors of the market, from luxury to budget, in South Africa and parts of Africa. The following key product offerings are provided within this division:

- Accommodation
- Restaurants and bars
- Conferencing and banqueting

Given the multifaceted structure of its operations, ASL has a large number of policies and procedures in place. This results in a very complex and lengthy decision-making process.

Industry background

The current gaming regulatory framework, which was established during the late 1990s, led to the formalisation of the industry. Rapid growth was experienced within the gaming industry until 2008, when the impact of the global recession resulted in growth slowing down to be more or less in line with local inflation.

The demand within the hotel industry experienced rapid growth after the 1994 election, which resulted in an increase in hotel construction. This construction cycle continued despite the decrease in demand resulting from the recession experienced in 2008. The reasons for this were twofold: the construction cycle often lags the economic cycle, and construction was boosted by the anticipated increase in demand as a result of the 2010 FIFA World Cup. A significant decline in the hotel market was, however, experienced in 2011, the primary cause of which was decreased demand and oversupply.

Theme park

ASL owns a boutique hotel and a conference centre near Hartbeespoort, a small town that consists of holiday homes around the Hartbeespoort Dam. Many visitors from around Gauteng visit the area for short holidays and weekend getaways. Tourist attractions in and around the town include the Hartbeespoort Dam wall and tunnel, the Hartbeespoort Dam Snake Park, the Hartbeespoort Dam Aquarium and the Hartbeespoort Aerial Cableway.

There is vacant land next to ASL's boutique hotel in Hartbeespoort. The chairperson of ASL's board feels that this piece of land presents an ideal opportunity to open a theme park with rides for kids, families and thrill seekers. Other attractions would include jungle gyms, costume parades and restaurants. ASL has had discussions with the owners of the land, who have indicated a willingness to sell. The chief financial officer (CFO) of ASL has indicated that the purchase of the land will most likely deplete the company's cash reserves. The chief executive officer (CEO) of ASL, who is strongly opposed to the project, tendered his resignation due to several differences of opinion with the chairperson and the board. The chairperson will now act as CEO until a replacement can be found.

The development of the land for a theme park would be an immense project that would require the skills of construction workers and other professionals. ASL has therefore requested a consulting firm to perform a feasibility study regarding the development and opening of a theme park in Hartbeespoort.

Additional information relating to ASL

- ASL has rolled out a series of print and digital campaigns that highlight the importance of sustainable behaviour in relation to 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.

REQUIRED		**MARKS**	
		Sub-total	**Total**
(a)	Analyse the weaknesses (4 marks) and the threats (9 marks) relating to ASL's business, based on the principles of a SWOT analysis. *Ignore the effects of any potential investments/acquisitions but incorporate general knowledge of the relevant industry in your answer.*	13	
	Communication skills – presentation	1	14

Solution

Weaknesses (internal environment)

1. ASL has a **varied product range**, including gaming, entertainment, accommodation and so on, which **may distract management's focus from key business operations.** (1)
2. The **decision-making process** within ASL is **complex and lengthy**, making it **difficult to implement changes**. (1)
3. **Differences of opinion** between board members (i.e., the **CEO's** views versus the **board chairman's** views) could be **detrimental to the company** due to a potentially dysfunctional board of directors. (1)
4. ASL has **lost key management** as a result of the **resignation of the CEO**. (1)
   This could lead to a **loss of investor confidence** in the **certainty of ASL's future**. (1)
5. ASL is in **contravention of the principles of King IV** because the **chairman of the board cannot act as the CEO**. (1)
6. ASL is **highly reliant** on its **well-trained personnel**; (1)
   these personnel can be **poached by competitors**. (1)

Threats (external environment)

1. ASL operates in an industry that is highly regulated; **gaming operations require licences**. (1)
2. Failure to comply with regulations could result in **fines/penalties, reputational damage or loss of licences**. (1)
3. The preparation and serving of food is subject to various **health regulations**, which exposes ASL to **compliance risk**. (1)
4. Given the **nature of the gaming industry** (i.e., gambling can be **addictive**), entities operating in this industry are often susceptible to **negative publicity**. (1)
5. The **slow growth** in the industry**/the downturn in the economy** could negatively impact **ASL's profitability**. (1)
6. ASL's operations are also **dependent on tourism**, which is likely to be **negatively affected** by the recent **negative publicity South Africa** has been receiving in the media (e.g., electricity crisis, xenophobia, crime). (1)
7. The operations of ASL are **highly reliant on water and electricity**, which are becoming increasingly **scarce**. This reliance on water and electricity **threatens business continuity** and (1)
8. can be **costly**. (1)
9. The entity's operations are relatively **capital intensive**. Capital expenditure is required to **maintain and improve the entity's facilities**, thereby ensuring revenue growth. (1)
   This requires **large cash outflows** and could **potentially increase gearing** in the future. (1)
10. There is an **oversupply of hotels** in the wake of the 2010 FIFA World Cup, resulting in ASL operating within a **highly competitive environment**. (1)
11. ASL has operations within **Africa**, which exposes it to **country risks**, such as political instability, inadequate infrastructure and foreign exchange risk. (1)

Maximum: 13

Communication skills – presentation: **1**

Maximum: 14

Feedback

A SWOT analysis entails evaluating the strengths, weaknesses, opportunities and threats of an entity. This question specifically required you to analyse **weaknesses** (which relate to ASL's internal environment) and **threats** (which relate to ASL's external environment).

Alignment of strategy and the six capitals

Activity 1.3: The Cement Company & Productions ('CCP') (extract)

Activity 1.3: CCP	Estimated time			
	Reading	Writing	Marking and review	Total
12 marks	5 minutes	18 minutes	8 minutes	31 minutes

A: BACKGROUND AND STRATEGY (A2.2 b)

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.

Additional information relating to financial results

1. CCP has 10 million ordinary issued shares trading at 840 cents in 2020 and 1 450 cents in 2019.
2. CCP was able to upgrade some of its facilities during the Covid-19 lockdown, which resulted in the company recording a revaluation surplus in the 2020 financial year.
3. The movement in retained earnings relates to profit for the year after the payment of dividends of R4 200 000 in 2020 and R10 150 000 in 2019.
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 board of CCP is considering insourcing the bagging of cement. Currently the bagging of cement into 500kg bags are outsourced to Bags for Africa (Pty) Ltd (BFA). BFA has a contract with CCP to bag 20 million bags per year at a fixed rate of R3 per bag for the duration of the contract. Any bagging performed by BFA above the contractual volume (20 million bags), is charged at a rate of R3.75 per bag. The Chief Financial Officer, Mrs Gobodi, was tasked to investigate this insourcing initiative. Should CCP decide to insource the bagging of cement, five new bagging machines will be required, each costing R13 000 000.

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 the discussion.	9	
	Communication skills – logical argument	1	12

Solution

(i) CCP's **strategy is only focused** on:

- **financial capital**, as well as (½)
- maximising **shareholder wealth**. (½)

In the past, profit maximisation was the objective of many companies. However, there has been a shift away from profit maximisation, and the focus should be on:

- **all key stakeholders** (employees, customers, suppliers, government, etc), and
- **value creation/long-term sustainability**. (1)

Maximium: 2

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

3. Human capital

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

4. Intellectual capital

- Intellectual capital relates to the **knowledge-based intangibles** that CCP would require to gain a competitive advantage. (1)
- This capital includes **intellectual property** (patents, copyrights, software, organisational systems, procedures and protocols). (1)
- It also includes **CCP's processes and procedures**, that is, 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)

Maximum: 9

Communication skills – logical argument: 1

Maximum: 10

	**Feedback** CCP needs to create value through the inputs derived from its six capitals. Learning unit 2 focuses on the six capitals within a business model.

1.5 BIBLIOGRAPHY AND ADDITIONAL READING

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