A conference edition of these Guidelines was distributed at a workshop held on 25 October 2017 in Harare for SEP board chairs and chief executive officers of SEPs, and senior officials from line ministries, including over a dozen Permanent Secretaries. The Minister of Finance and Economic Development, Hon Dr. I.M. Chombo, delivered the opening remarks and the Chief Secretary to the President and Cabinet, Dr. M.J.M. Sibanda, gave a keynote address, both outlining the importance of modern performance management. Some 300 participants shared their views during a question and answer segment.
# Acronyms & Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>AGM</td>
<td>Annual General Meeting</td>
</tr>
<tr>
<td>CCSEP</td>
<td>Cabinet Committee on State Enterprises and Parastatals</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CIPFA</td>
<td>Chartered Institute of Public Finance and Accountancy</td>
</tr>
<tr>
<td>EBITDA</td>
<td>Earnings Before Interest, Tax, Depreciation and Amortization</td>
</tr>
<tr>
<td>ESG</td>
<td>Economic, Social and Governance</td>
</tr>
<tr>
<td>GCU</td>
<td>Government Committee Unit</td>
</tr>
<tr>
<td>GLC</td>
<td>Government Linked Company</td>
</tr>
<tr>
<td>&lt;IR&gt;</td>
<td>Integrated Reporting</td>
</tr>
<tr>
<td>KPI</td>
<td>Key Performance Indicator</td>
</tr>
<tr>
<td>MoFED</td>
<td>Ministry of Finance and Economic Development</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and development</td>
</tr>
<tr>
<td>OPC</td>
<td>Office of the President and Cabinet</td>
</tr>
<tr>
<td>PPP</td>
<td>Public Private Partnership</td>
</tr>
<tr>
<td>SEP</td>
<td>State Enterprise and Parastatal</td>
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<tr>
<td>SERA</td>
<td>State Enterprises Restructuring Agency</td>
</tr>
<tr>
<td>SOE</td>
<td>State-Owned Enterprise</td>
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<tr>
<td>SPV</td>
<td>Special Purpose Vehicle</td>
</tr>
<tr>
<td>ZIMREF</td>
<td>Zimbabwe Reconstruction Fund</td>
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### Annex

Annex 62
Introduction
In common with many other countries, in Zimbabwe, State Enterprises and Parastatals (SEPs) play a major role in the provision of infrastructure and services like water, electricity, telecommunications, transportation, health, education, etc. In some cases SEPs are involved in advancing state policy. Ensuring that SEPs are accountable, transparent, efficient, effective, and viable is important for the country’s efficient allocation of resources, competitiveness, economic development, and poverty alleviation.

SEPs are assets owned by the state on behalf of the public. In terms of the Constitution of Zimbabwe, state controlled commercial entities are expected to maintain commercial viability and adopt generally accepted standards of good corporate governance in their operations.

Ensuring they create value for society through effective professional and transparent management and oversight is critical to good public accountability and a precondition for creating public trust in the state. Additionally, it is generally acknowledged that adoption of sound corporate governance practices contributes to SEPs enhancing their performance and viability. Sound SEP Performance Management systems are one of the ways to improve corporate governance practices of SEPs and they contribute to improved SEP performance. By the same token, there is increasing recognition that poor corporate governance practices in SEPs significantly contribute to their underperformance.

Evidence from many countries demonstrates that effective SEP performance management can lead to improved financial and non-financial performance. A strong SEP performance management system sets objectives and targets that provide clarity to SEP boards and management on the expectations of government as owner. Clear goals, accompanied by accountability, transparency and high quality reporting and disclosure requirements, establish a framework in which the SEP board can set and execute strategy while providing government with sufficient assurance that the SEP will be held accountable for its performance.

**Objectives of the Guidelines**

A 2016 Survey of SEPs to assess the level of awareness of, and compliance with, existing corporate governance requirements revealed that most SEPs did not have any effective performance management systems in place, and where such systems did exist, they were found to be weak and largely ineffectual in terms of enabling effective monitoring of target-based performance of SEP Boards and Management by Line Ministries.

These findings led to a decision to develop basic Guidelines on effective performance management of SEPs. The Guidelines are a product of the Government of Zimbabwe, with technical support provided by the World Bank under the ZIMREF facility.

The principal objective of these Guidelines is to assist SEPs in developing and implementing effective performance monitoring systems as part of sound corporate governance aimed at enhancing SEP performance and overall service delivery. As Guidelines, they are meant to give guidance in formulating entity specific performance management systems.
SEP Performance Management System

A SEP performance management system refers to the institutions, processes, and documents (including laws and regulations) that government uses to monitor the financial and non-financial performance of SEPs. SEP performance management involves three key elements:

- Setting clear mandates, strategies, and objectives
- Establishing performance indicators and setting targets
- Structuring performance agreements between government & each SEP

SEP Performance objectives and targets are often contained in formal documents agreed to by the Government and the SEP. They can include both high-level statements of the SEP’s objectives and more detailed agreements specifying annual or multi-year performance measures. High-level objectives are often referred to as SEP mandates. The Organization for Economic Co-operation and Development (OECD) defines SEP mandates as “simple and brief descriptions of the high-level objectives and missions of a SEP in the long run” (OECD 2010, 19). Mandates are generally defined by the state as owner, not by the SEP and are contained in the law establishing the SEP.

Performance indicators are measures used to communicate performance expectations and to evaluate performance against expected results. Using these indicators, a SEP can track its results against its targets, and quickly identify potential problems and take remedial action.

Specific performance agreements established by the government and the SEP go by different names in different countries, often reflecting their different form or legal status. Examples include statements of corporate intent (as in Seychelles), performance contracts, memorandums of understanding (MoUs), business plans etc.
Institutional context for SEP performance management in Zimbabwe

Currently there are a number of institutions which monitor the performance of SEPs. These institutions include: Line Ministries, Ministry of Finance and Economic Development (MoFED), Office of the President and Cabinet (OPC), State Enterprises and Parastatals Restructuring Agency (SERA), Parliament, Auditor General, Performance Management Committee and Auditors/ Performance Review Consultancy and Cabinet Committee on State Enterprises and Parastatals Development (CCSEP). This situation is understandable given the complexity of the SEP sector in Zimbabwe, in terms of the number of SEPs, spread of their legal framework, mandates, objectives (commercial and non-commercial), sizes, operational complexity, sector, geography, etc. Monitoring of SEPs by such a large number of institutions requires enhanced coordination and consolidation to guard against the risks of possible over-monitoring/regulation, duplication of roles, and any monitoring gaps, while contributing to overall enhanced SEPs performance. The monitoring roles provided by these institutions include checking compliance,¹ establishment of performance indicators, setting targets, development of performance agreements and performance contracts, as well as tracking the performance management systems. It is against this background, that roles and responsibilities of the different monitoring institutions are clarified as follows;

Shareholders/Ownership and Oversight Functions - defined

The State delegates ownership functions to OPC and Line Ministries, and consequently OPC and Line Ministries exercise ownership functions for SEPs that fall under their purview.

In addition to Line Ministries as direct shareholders, ownership/ shareholders’ functions are also exercised by MoFED and OPC. In some instances, Line Ministries further delegate their ownership/ shareholder functions to Special Purpose Vehicle (SPVs).

¹ With applicable laws, standards, codes etc.
Roles and Responsibilities of Line Ministries

As delegated owners, Line Ministries are expected to carry out the following functions.

A To approve and monitor the development of strategic plans for SEPs under them.

B Setting annual targets for the Boards of their SEPs. (This should be done in the last quarter of the year for the following year).

C Developing together with the Boards, the Performance Agreements/ Performance Contracts between the Shareholders, SEPs Boards and management, by December of every year for the following year.

D Ensuring that the Performance Agreements are signed by all parties (shareholders, the Boards and management) by December of every year for the following year.

E Monitoring the implementation of the Performance Agreements on a quarterly/half yearly basis and taking corrective action where necessary. Produce monitoring reports by end of the following month of the last quarter/year.

F Carry out Board Evaluation on an annual basis to determine the suitability of the Board and take appropriate action where necessary and produce Boards Evaluation Reports by January, the following year.

G Monitoring submission of mandatory financial reports

H To ensure the Board produces annual reports on the SEPs’ performance and table them before Parliament, including audited financial statements.

Role and Responsibilities of the Office of the President and Cabinet

3.1 To capture and store comprehensive corporate governance related data which should be submitted by SEPs including:

(i) Strategic Plans and subsequent annual assessment/evaluation/progress reports

(ii) Signed performance Agreements/contracts between (a) Shareholders/Line Ministries and SEPs’ Boards (b) Boards and Chief Executive Officers (CEOs), and (c) Boards/CEOs and Senior Management

(iii) Annual Board Evaluation reports and CEOs/Senior Management Evaluation Reports

(iv) SEPs Board Resolutions
SEPs Annual Reports and Reports of Annual General Meeting (AGM)

Disclosure of Assets Declarations by the Board members and all Senior Management

Annual Audited Financial Statements

OPC should advise Line Ministries of SEPs that are not adhering to mandatory deadlines, as well as non-submission of the required documents.

To provide a centralized support mechanism for Line Ministries, with capacity to alert Line Ministries to any serious deviation from the requirements of good corporate governance, so as to allow for intervention and corrective action to be taken by the Line Ministry timeously.

To establish and maintain a data-base of potential Board members willing to serve on State Entity Boards, and to assist Line Ministries in identifying competent and qualified individuals to serve on SEP Boards.

To coordinate the provision of comprehensive Board induction programs, and corporate governance training for Boards and Executive Management of State Entities.

To produce an Annual Report on SEPs and table it before Parliament.

Roles and Responsibilities of SEP Boards (Part of SEPs’ Internal Governance)

Together with senior management, develop Strategic Plans.

Together with management, establishing performance indicators.

Setting targets for CEOs and Senior Management.

Developing Performance Agreements/ Contracts between Boards and CEOs.

Monitoring performance of CEOs on a quarterly and annual basis.

Producing, monitoring and evaluating reports, and submitting to shareholders a month after monitoring and evaluation.

Set up board responsibility to oversee the implementation of the performance management system. This can be a standalone Board committee or an added responsibility to an appropriate, existing Board committee.
Roles and Responsibilities of MoFED

The Accountant General's Department is responsible for the management of, custody and safety of public resources as enunciated in the Public Finance Management Act (PFMA) through:

1. Monitoring the financial performance of Public Entities through financial performance reviews.
2. Analyzing Public Entities' quarterly and annual financial statements for senior management.
3. Monitoring and reviewing the financial affairs and budgets of Public Entities: through the analysis of annual budgets that require Treasury concurrence and approval, and make recommendations to the Minister in line with the provisions of Section 47 of the PFM Act and other enabling Statutes.
4. Identifying problems of public enterprises in producing their financial statements and budgets, and where necessary, provide advice.
6. Analyzing borrowing powers for Public Entities and Local Authorities.
7. Providing technical assistance to all Ministries, SEPs and Local Authorities.
9. Participating in Public Entities restructuring reforms in line with the Cabinet committee on Parastatal Development.

Roles and Responsibilities of SERA

SERA is a semi-autonomous agency that was initially established as the Privatization Agency of Zimbabwe (PAZ) in 2000, under the Office of the President and Cabinet. It was later transformed to the current SERA in 2005, when its mandate was broadened from mere privatization to also look into other SEP reform strategies. It falls under the purview of the MoFED. Its functions are to:

1. Assist in coordinating and managing the commercialization, privatization and restructuring process of SEPs;
2. Advise Line Ministries on all matters relating to the reform process and to assist in the financial restructuring of SEPs earmarked for commercialization, privatization and restructuring;
(iii) Provide legal advice on legislative changes to be effected in order to speed up the reform process;

(iv) Assist SEPs in the preparation of Business Plans, Strategic Plans and Turnaround Strategic documents;

(v) Assist SEPs in the development of Performance Monitoring Framework;

(vi) Provide corporate finance advice to SEPs;

(vii) Prepare in consultation with Line Ministries, a Memorandum, including detailed work plans and timetables for the commercialization, privatization and restructuring of SEPs;

(viii) Assist Line Ministries and the relevant SEPs in the identification of local and/or external consultants (accountants, valuers, management and marketing specialists, etc.) to be engaged to undertake technical aspects of the commercialization, privatization and other restructuring strategies of SEPs;

(ix) Assist SEPs with technical advice in preparation and approval process of Public-Private-Partnerships (PPPs) projects;

(x) Undertake the preparation and implementation of a public information campaign relating to the benefits of commercialization, privatization and other restructuring strategies including the anticipated empowerment benefits for indigenous Zimbabweans;

(xi) Undertake due diligence on prospective joint ventures or strategic partners;

(xii) Undertake post commercialization, privatization and restructuring evaluation exercise of SEPs.

Roles and Responsibilities of Cabinet Committee on State Enterprises and Parastatals Development

To review all aspects of the operations of SEPs in the economy with a view to recommending measures that enhance viability and the attainment of turnaround objectives.

Roles and Responsibilities of Auditor General’s Office

In terms of the Audit Office Act, the Auditor General;

(a) Shall, on behalf of the House of Assembly, audit the accounts of any public entity, or designated corporate body;

(b) May carry out examinations into the economy, efficiency and effectiveness with which any Ministry, public entity, local authority, designated corporate body, statutory fund or other body has used public resources in discharging its functions.
Roles and Responsibilities of Parliament

Parliament, through the Public Accounts Committee (a post-audit committee) examines audited reports of various state institutions including SEPs.

Reporting Structures and Lines

To further clarify the roles played by the various performance monitoring agencies in setting targets, it is also important to clarify reporting lines among the various players in the process of monitoring State Enterprises and Parastatals’ performance.

The reporting structure/lines for the various players should be as follows:

1. (a) The Shareholder/ Line Minister reports to His Excellency, the President of the Republic of Zimbabwe.

   (b) Administratively, the Line Minister relates/ reports to the Minister responsible for the Public Entities Corporate Governance (PECG) – Office of the President and Cabinet.

   (c) The Line Minister tables a Report on State Enterprises and Parastatals’ performance to Parliament, once every year.

   (d) The Line Minister reports on State Enterprises and Parastatals’ performance to Cabinet, on a regular basis.

2. The Board reports to the Shareholder/ Line Minister through the Board Chairman.

2.1 Board Committees report to the full Board.

2.2 (a) Chief Executive Officer reports to the Board through the Board Chairman.

   (b) Administratively, the Chief Executive Officer reports to the Line Ministry through the Permanent Secretary and Senior Management who reports to the Chief Executive Officer.

3. Head of Internal Audit reports functionally, to the Board through the Audit Committee, and, administratively, to the Chief Executive Officer.

4. The Head of Corporate Governance Unit in the Office of the President and Cabinet liaises with the Permanent Secretaries of Line Ministries, as and when necessary.
SERA reports to the Ministry of Finance and Economic Development, through the Permanent Secretary, and shall be engaged by State Enterprises and Parastatals for restructuring technical advice, through the Line Ministries.

The Auditor General reports to Line Ministers, Office of the President and Cabinet, and Ministry of Finance and Economic Development. The Auditor General tables to Parliament the reports on State Enterprises and Parastatals’ performance.

**Audience for the Guidelines**

These Guidelines are part of the SEPs reform program aimed at enhancing SEPs performance in Zimbabwe. They are aimed at assisting SEPs in complying with the Public Entities Corporate Governance Act. The Guidelines are also intended for use by the OPC, Line Ministries, MoFED and SERA in the execution of their monitoring and oversight functions over SEPs. Other users of the Guidelines include SEPs stakeholders.

**Sources**

It is with great appreciation that these Guidelines borrow from various sources including:

- **Malaysia GLC Blue Book; Guide to Intensifying Performance Management**
- **Corporate Governance of State-Owned Enterprises: A Toolkit; World Bank Group**
- **Corporate Governance of State-Owned Enterprises in Latin America - World Bank**
- **The Zimbabwe Constitution: 2013**
- **Zimbabwe Corporate Governance Framework for State Enterprises and Parastatals 2010**
- **Corporate Governance Principles Approved by Cabinet on March 4, 2014**
These Guidelines were drafted as part of the Capital Budget project under ZIMREF implemented by the World Bank. The Guidelines benefited from inputs from OPC, MoFED, and SERA. The World Bank team comprised of Henri Fortin (Global Lead, Corporate Governance and Financial Reporting), Gael Raballand (Lead Public Sector Specialist), MacDonald Nyazvigo (Senior Finance Assistant), Peter Rundell (consultant), Nikeisha Russell (consultant), Sonny Mabheju (consultant and main author), and received technical advice from Pascal Frerejacque (Senior Operations Officer).

The document was developed from November 2016 to July 2017.
Rationale for Establishing A Performance Management System for SEPs
International Context

The paragraphs below demonstrate examples of the impacts of good governance practices (including performance management systems) on SOEs in various jurisdictions.

There is evidence of improved SEP performance in many countries globally in the recent past. This has been attributed to factors such as; budgetary and fiscal reforms, restructuring measures, improved governance practices (including performance management), exposure to greater competition and capital market discipline.

Box 1: Improved SEP Performance management systems and Impacts

- In China, SEPs profitability has increased since the expansion of competition, corporatization, and the creation in 2003 of the State-Owned Assets Supervision and Administration Commission to exercise authority over state enterprises. (World Bank and Development Research Center 2013).

- In India, the 24 largest non-financial SEPs generated a 17% return on equity in 2010, and profits almost doubled in the five years to 2014.

- In Indonesia, following restructuring and governance improvements, SOE profits grew at a compound annual rate of 18.9% between 2004 and 2009, while contributions to the state budget through dividends and tax payments amounted to 12% of budget revenue (Abubakar 2010).

- In Malaysia, a program aimed at transforming government-linked companies (GLCs), helped improve performance. The return on equity of 20 larger companies rose from 7.7% in 2009 to 10.5% in 2010, while total shareholder return grew by 16.4% from 2004 to 2011. Indicators such as operating cash flow and debt-to-equity ratios also improved (Putrajaya Committee 2011).

- In the Middle East and North Africa, many countries in the Persian Gulf have created profitable and well-run SEPs in strategic industries. These include the Saudi Basic Industries Corporation, Emirates Airlines, Dubai, and Etisalat, all of which have made their mark at home and abroad (Hertog 2010; OECD 2012).

Source: Developed from Corporate Governance of State-Owned Enterprises: A Toolkit-World Bank
SEP performance has however generally lagged behind the private sector and has not been uniformly positive. Even those SEPs that are performing well often lag behind their private sector comparators in integrated performance. High performance is not evenly distributed over the SEPs. High performance is usually limited to a few SEPs that have advantages in; competition, access to cheaper capital and other input resources. Compared to the private sector, many state-owned banks suffer from a number of vulnerabilities, including weak balance sheets and low capitalization, relatively low profitability, and high non-performing loans.

Box 2: SEPs performing well tend to lag behind private sector comparators

☐ In China, non-state firms had an average return on equity 9.9% higher than that of SEPs in 2009 (World Bank and Development Research Center 2013).

☐ In Vietnam, although SEPs registered healthy returns on equity (17%), their returns were well below the returns of foreign firms (27%). Rapid growth in the capital and fixed-asset base of SEPs has not been accompanied by higher productivity: in 2009, the average ratio of turnover to capital was 1.1 for SEPs but 21.0 for all enterprises; the ratio of turnover to employees was 1.7 for SEPs and 16.3 for all enterprises; and the ratio of turnover to fixed assets fell for SEPs between 2000 and 2008, while remaining unchanged for all enterprises (World Bank 2011).

☐ In Malaysia, a 2008 study showed that government-linked companies tend to score lower than private sector companies on metrics of economic performance or economic value added (measured as the difference between cash flow returns on investment and the weighted average cost of capital) (Issham et al. 2008).

☐ A study of nine Middle Eastern countries found that state-owned banks have much lower profitability than private banks due to their large holdings of government securities, larger ratios of overhead costs to assets (because of much larger ratios of employment to assets), and higher ratios of loan-loss provisions to outstanding loans (reflecting much larger shares of nonperforming loans in their portfolios) (Rocha 2011).

☐ Although there are exceptions, SEPs tend to perform particularly poorly in low-income countries. A study in Burkina Faso, Mali, and Mauritania found that of the 12 SEPs that provided information, 8 reported losses while 3 were operating at close to breakeven. Only one reported significant profits: Mauritania’s Société Nationale Industrielle et Minière, a mining company (Bouri, Nankobogo, and Frederick 2010).

Source: Developed from Corporate Governance of State-Owned Enterprises; A Toolkit-World Bank
Underperforming SEPs can be a burden to governments. They can be a source of high financial and economic costs, remain a fiscal burden and a source of fiscal risk. In Indonesia, for example, subsidy payments to three SEPs alone, in the fuel, electricity, and fertilizer industries averaged at 4% of GDP between 2003 and 2006; yet the subsidy still fell short of what was needed to cover all quasi-fiscal obligations and arrears with other SEPs (Verhoeven et al. 2008). The financial and fiscal risks from SEPs can spill over into the broader economy, especially if SEPs have strong links with state-owned banks.

The shortage of key infrastructure capacities is ranked as 1 of the TOP 3 constraints on country competitiveness and growth.

Poor performance by SEPs can negatively impact national competitiveness and growth. In many countries, SEPs continue to crowd out or stifle the private sector, while lack of competitive markets or a level playing field creates inefficiencies and limits the expansion of the private sector. Numerous surveys and studies show that the shortage of key infrastructure capacities, due in part to SEP inefficiencies and underinvestment is ranked as one of the top three constraints on country competitiveness and growth. This is particularly so in Zimbabwe with regards to electricity, water and transportation infrastructure. Achieving higher levels of economic activity will therefore require substantial improvements in the performance of existing infrastructure SEPs, along with private sector investments and public-private partnerships.

Loss-making and ineffective financial services SEPs weaken the financial system in a country. By lending to unprofitable SEPs, financial services SEPs can create contingent liabilities that become a source of fiscal risk. By underpricing and engaging in business practices that displace commercial financial services of the private sector, financial SEPs hinder new private entry and undermine competition, which in turn retard financial market development, diminish access to financial services, and weaken the stability of the financial system (Scott 2007). Financial SEPs, particularly in some emerging markets provide significant amount of financing to unviable SEPs and weak institutions. This can harm economic growth, competitiveness and erode public trust.

There is increasing realization of the impact of poor corporate governance on the performance of SEPs. Although underperformance of SEPs is a symptom of a number of underlying problems including external factors, such as shifts in commodity prices and sector-specific factors, such as public service obligations and regulated prices, there is increasing recognition that poor corporate governance of SEPs is at the heart of the underperformance problem.
Zimbabwe Context

The paragraphs below demonstrate the importance of good SEPs performance to the Government of Zimbabwe and some of the challenges SEPs in Zimbabwe face.

Performance of SEPs is at the core of Government reforms in Zimbabwe. This is evidenced by the following quote from the 2017 Budget Speech by the Minister of Finance and Economic Development, Hon. Patrick Chinamasa:

10. Consequently, this Budget, therefore, proposes corrective measures on fiscal and external imbalances to restore fiscal and debt sustainability, which provides a conducive environment for productive activities.

11. Specifically, while as alluded to above, fiscal imbalances will require containment of expenditures, implementation of strong structural reforms will entail:

- shedding off those State Enterprises that would benefit from joint venture partnerships with identified strategic investors;
- improving performance of those State Enterprises that remain;
- reducing policy uncertainty;
- fighting corruption in an effective way;
- enhancing competitiveness;
- enforcing guidelines on good corporate governance in public enterprises and local authorities; and
- building strong systems for ensuring transparency and accountability.”

SEP viability is a Constitutional requirement in Zimbabwe. The Zimbabwe Constitution (Section 195) requires state controlled commercial entities (companies and other entities owned or wholly controlled by the state) to conduct their operations so as to maintain commercial viability and abide by generally accepted standards of good corporate governance.

Zimbabwe SEPs face many performance challenges. The SEPs face challenges in improving performance including those tabled below.
<table>
<thead>
<tr>
<th><strong>Challenge</strong></th>
<th><strong>Description</strong></th>
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<tr>
<td>Inadequate capitalization</td>
<td>SEPs largely rely on depressed revenue (due to the state of the economy), debt and other sources of finance including government transfers to fund basic operations. When the country adopted a multicurrency regime in 2009 with the US$ as the main functional currency, most SEPs started with very low capital bases and few have been able to raise capital from the markets. The government had no resources to capitalize these SEPs. This left SEPs with inadequate funding to fund capital projects especially rehabilitation and upgrading of infrastructure in the capital intensive sectors like utilities and network. Examples are SEPs in the electricity, water, telecommunications, transport sectors, etc.</td>
</tr>
<tr>
<td>Below-cost pricing/failure to recover costs</td>
<td>Some tariff structures are kept artificially low and prevent full cost-recovery by SEPs. Compensation from treasury may be required for non-commercial services and this has not been forth coming in some cases because of limited cash resources. The fact that many SEPs in Zimbabwe are established and operated with both commercial and non-commercial objectives compounds this problem.</td>
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<tr>
<td>Current activities are no longer supportive of the original mandates of the SEPs because of changed/additional mandates or Government directives</td>
<td>Activities in some commercial SEPs are remnants of initial investment decisions which have been overtaken by events over the years, a result of lack of ability to adjust to changing situations and circumstances. Mandates have changed over time in for example; urban transport, grain management and business models have not responded appropriately to the changes in mandates.</td>
</tr>
<tr>
<td>Failure to collect money for services rendered</td>
<td>Failure to collect on services provided has led to under-funding in some SEPs.</td>
</tr>
<tr>
<td>Inadequate reporting and monitoring systems</td>
<td>Inadequate reporting and monitoring is common and does not allow for the transparency, accountability and governance requirements for SEPs. It further does not help early exposure of situations where SEPs may be over or under financed, and it ultimately shields SEPs from misuse of public funds, corruption, and from disclosing inefficiencies where they exist.</td>
</tr>
<tr>
<td>Ineffective boards</td>
<td>Most SEP boards require enhanced professionalization, improved composition and structure, and shielding from any unwarranted external interference in order to enhance their effectiveness. This is dealt with in more detail, in the manual on Enhancing Board Effectiveness.</td>
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Source: Developed from the findings of the assessment of corporate governance practices in 39 SEPs selected by the Government.

These guidelines address the elements necessary to enhance SEP performance through sound performance management systems.
CHAPTER 2

Establishing SEP Performance Indicators and Setting Targets Linked to Strategy
Sound SEP performance monitoring systems acknowledge that some commercial SEPs have both commercial and non-commercial objectives. Consequently, the performance monitoring processes need to be explicit in identifying core financial and social, economic and governance (non-financial) objectives of the SEP as well as state priorities from each SEP’s diverse objectives, which change over time in line with shifting situations and circumstances. Clearly defined mandates for each SEP are necessary to set targets specific to the SEP. Based on the mandates, each public enterprise develops its own strategies which provide a basis for performance management. Strategies are expected to include objectives and targets. The objectives must be clear and realistic, measured by performance indicators.

SEP performance indicators and targets provide feedback that allows SEPs to improve themselves continuously. They are derived from the strategy and address all relevant aspects of value creation within the entity, both at the entity level and at the lower levels of the organization, such as divisions or business units. Performance indicators must be effective, thus carefully selected to ensure each directly drives a strategic objective. SEP performance indicators should include both financial and economic, social and governance (non-financial) indicators.

Performance Indicators and KPIs Cascade from SEP Strategy

**Performance indicators;** are the complete set of measures reflecting the SEP’s underlying value drivers. They are derived from the SEP’s strategy. They assist in diagnosing areas requiring improvement. The performance indicators are set by the Line Ministry board and management, preferably following a "bottom-up" and a “top-down” approach. They are reported on by the board to the Line Ministry.

**Entity Key Performance Indicators/CEO KPIs-(KPIs):** these are a subset of performance indicators described above. They focus on key performance of the entity. They demonstrate how effectively the entity and the CEO are performing in achieving key organizational objectives. They are ideal for benchmarking and can be used to show how the organization is performing against goals, previous performance and competition. They are also used to determine reward and consequences. Entity KPIs and CEO KPIs are the same to ensure the required goal congruence between the CEO and the SEP. They are set by the board and the CEO, who reports on them to the board.

Business/Division Unit KPIs equate to relevant business/division management KPIs and cascade from Entity/CEO KPIs. These are set by the Board and CEO, with inputs from business/division management and reported on by the CEO to the Board.
The following requirements and guidelines assist in designing high quality effective performance indicators and setting targets for SEPs:

**Guideline 1**

*Design a set of relevant performance indicators directly derived from the entity’s mandate, strategy and objectives (i.e. linked to the entity’s value drivers).* Dimensions for performance indicators should include financial, customer related, operational, and organizational measures.
Description

- Performance indicators must be linked to the entity’s strategy and objectives. They must:
  - Measure both direct shareholder and stakeholder value creation and any other concrete social/developmental objectives of the entity as reflected in its mandate.
  - Be high quality and therefore; balanced, complete and comprehensive addressing both financial and non-financial performance of the entity.
  - In aggregate, all the indicators must reflect the overall priorities of the entity as reflected in its objectives.

- Characteristics of good, effective, high quality SEP performance indicators are that they should involve legal issues, strategy, objectives, incentives, benchmarking, management performance, tracking and audit: They should therefore:²
  - Not violate Zimbabwe laws, standards and codes influencing the SEP, and should encourage and reflect international good practice;
  - Be well defined and clear, avoiding or reducing subjectivity. For example, indices and surveys might be used to quantify subjective measures;
  - Ideally, measure outcomes rather than inputs. Clear links to value creation should be defined when an input indicator is selected;
  - Avoid damaging side-effects (e.g. should not discourage reporting of failures);
  - Be linked to SEP strategy and objectives. The combination of all the indicators should reflect the overall priorities in the objectives;
  - Be Challenging, Specific (to the entity), Measurable (the indicator can be quantified in a meaningful and realistic way), Achievable (given the prevailing environment and available resources), Results –oriented, and Time based;
  - Be based on objectives that SEP management can actually control and be held accountable for;
  - Aim for goal congruence between senior management and the SEP objectives;
  - Be capable of appropriate benchmarking with international and local comparators in similar industries and of similar size, complexity, and risk profiles, helps identify performance gaps;

² Adapted from Corporate Governance of State Owned Enterprises: A Toolkit- World Bank Group.
- Be based on assumptions that are clear and allow for revision of targets if the assumptions change because of factors beyond management control;

- Be capable of tracking by appropriate information systems

- Be linked to management performance indicators. The same indicators used to evaluate the SEP must also be used to evaluate management, and management compensation must be linked in part to performance;

- Be audited/auditable (external or internal) to enhance credibility.

Indicators must initially be simple and enhanced over time as experience and capacity increase.

- Performance indicators should be cascaded down to lower levels of the organization (e.g. to each business unit or department). Conversely the lower level performance indicators should aggregate to the performance indicators at the entity-level.

Guideline 2

Apply careful judgment to set targets that are stretch and achievable.

Description

- Upfront in the budgeting cycle, the Board should clearly state its expectations on the targets for the entity. This should be informed by advice that is independent of management.

- Targets must be stretch and informed by benchmarking against industry peers (both domestic and international). Peer entities are entities in the same industry, of similar size and subject to similar complexity and risk. The Board should approve the selection of the appropriate benchmarks. Because SEPs often operate as monopolies or in non-traded sectors, they may not have domestic comparators. Any comparisons should be interpreted with care.

- Ensure targets are challenging but achievable, based on; bottom-up estimates from senior management, extrapolating historical performance, and an assessment of internal capabilities. Unachievable targets may lead to reporting fraud, management gaming results, and other unintended consequences.

- Targets should be agreed upon between the Board and the CEO before the beginning of the financial year.
Guideline 3

Allow revision of targets for cases where the external environment has fundamentally changed.

Description

- Targets should be explicit about critical assumptions made in setting them. This allows for appropriate revision when the assumptions change significantly because of factors beyond the control of the entity’s management. At the same time, the indicators must be robust enough to allow for normal dynamics in the business environment and permit realistic flexibility.

- Indicators should be capable of tracking by appropriate information systems. To the extent possible, indicator measurements must be obtained directly from the entity’s information systems with no additional adjustments needed, and minimum human interface.

- Performance of management should be evaluated against indicators. The same indicators used to evaluate the entity must be used to evaluate management, and management compensation should be partly linked to performance.

- The quality of any indicator depends on its accuracy and reliability. Performance indicators must therefore be subjected to external audit or assurance.

- Indicators should be enhanced overtime, starting simple with basic financial and economic, social and governance (non-financial) indicators which are improved over time as experience and capacity increase. The Line Ministry should regularly review the relevance of the performance indicators to ensure they remain relevant.

- In all cases, Board approval is required to revise targets during the year should the need arise.
Financial Performance Indicators

Financial indicators are the traditional measures of entity performance. They are based on standard information contained in the financial statements or readily available. They fall into the following broad categories:

- **Activity indicators**, revenue/sales in volumes, number of outputs, hours worked, etc

- **Profitability indicators**, including profits, sales/revenue, and whether profits are returned to owners through dividends or value creation. The choice of indicators is unique to every industry, sector, and SEP, but typically include:
  - **Revenues**, a measure of how much the entity has generated through sales in a period, taken directly from the income statement. Revenue growth is a good sign for the entity.
  - **Profits**, taken from the income statement.
  - **Return on equity**, net income divided by shareholders’ equity. Comparing an entity’s return on equity with that of similar entities in its sector is a good way to measure its competitiveness.
  - **Return on assets**, net income divided by total assets. Return on assets is a measure of the entity’s effectiveness in using its assets. This ratio is best benchmarked against other entities in the same sector adjusted for different levels of debt.
  - **Return on invested capital**, net income minus dividends, divided by total capital. Return on invested capital is a measure of the entity’s ability to allocate its capital into profitable investments that produce returns.
  - **Economic value added**, a measure of profit that takes into account the costs of capital. This ratio is not commonly used.

- **Efficiency indicators** measure the efficiency of the entity and how well it uses the resources at its disposal. These indicators might include the return on assets or equity (described above) along with direct efficiency measures such as the ratio of the costs of production to sales.

- **Liquidity ratios**; measure the entity’s ability to pay off its short-term obligations. This is done by comparing liquid assets or those that can easily be converted to cash with its short term liabilities. The ratios include; current ratio, quick ratio, cash ratio, and cash conversion cycle.

---

Solvency indicators measure the entity’s borrowing, its indebtedness, and its ability to service its debt. These indicators include:

- Debt-equity ratio;
- Liquidity ratio;
- Asset-liability ratio;
- Changes in net borrowing;
- Investments (equity, loans);
- Non-performing loans;
- Capital adequacy ratio; is relevant only for financial institutions (prudential concept);
- Interest covered by earnings.

Budgetary appropriations indicators cover transactions that relate to government transfers to the entity to cover the entity’s losses or subsidize its operations.

A detailed list of Financial KPIs explaining each KPI and giving guidance on how each is calculated is available in Annex 1.

Economic, Social and Governance (ESG) or Non-Financial Indicators

SEPs KPIs can be structured along the 3 Pillar dimension of ESG or non-financial indicators (simply referred to ESG KPIs hereafter). Many countries are adding corporate governance indicators to their broader non-financial performance indicators for SEPs,⁴ hence the term economic, social and governance indicators. In practice, a 4th Pillar; “long term viability” is added to capture those KPIs that depict sustainability. It is therefore common for SEP performance management to go beyond financial indicators and look at specific ESG aspects of the SEP operations. ESG KPIs provide a broader perspective on an entity’s performance. They offer the following potential advantages over measurement systems based on financial data alone:⁵

- They tend to be forward looking. ESG performance measures tend to act as leading indicators. By contrast, financial indicators are generally lagging indicators of enterprise performance, reporting the historical performance of an enterprise but offering much less value as predictors of future performance.

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⁴ The Zimbabwe Constitution requires SEPs to comply with generally accepted corporate governance practices. The National Code on Corporate Governance Zimbabwe was adopted for all entities in Zimbabwe and the Public Entities Corporate Governance Bill is in the final stages of enactment into law.

⁵ Adapted from Ittner and Larcker 2000.
They tend to be more closely linked to enterprise strategy. Financial reporting focuses on periodic performance against accounting benchmarks. It does not assess progress toward strategic goals relating to such issues as economic competitiveness, quality and spread of services, environment, etc.

They tend to capture intangible success factors. Critics of traditional measures argue that it is the “intangible assets” such as customer loyalty and service, not the balance sheet that drive success in many industries. Ignoring intangible assets can lead managers to make bad decisions.

They tend to offer better management incentives. Many aspects of an enterprise’s financial performance are outside the control of management. ESG indicators allow the board to target specific behaviors by management of that which it wants to encourage.

ESG performance indicators should generally reflect all important objectives in an entity’s strategy. The objectives (and thus the indicators) should be specific to the sector in which the entity operates. Industry groups and development organizations have identified a range of indicators that measure operational performance in key sectors. One example is the water sector, for which the International Benchmarking Network for Water and Sanitation Utilities, has developed indicators covering service coverage, consumption and production, metering practices, efficiency (non-revenue water), staffing, and quality. (Refer Table4)

While there are advantages to having ESG performance indicators, there are potential challenges as well. Ittner and Larcker (2000) identify five limitations:

- significant time and cost involved in developing and evaluating a large number of indicators;
- lack of a common denominator in measuring ESG data, which leads to subjective assessments and makes evaluating performance difficult;
- adoption of incorrect ESG measures with no clear bearing on financial performance, which can focus attention on the wrong objectives;
- lack of statistical reliability/credibility - some information may not be audited/auditable; and
- dilution or “disintegration” of the measurement process when too many measures are chosen.

Ittner and Larcker (2000) highlight three steps that can be taken to select and implement appropriate measures:

- understand and identify the entity’s value drivers based on its strategy and objectives;
- document, review, and choose measures ensuring consistency and alignment with the entity’s objectives and strategies, value drivers, and competitive environment; and
- incorporate the measures as an integral part of the entity’s reporting and performance evaluation to create employee incentives and influence performance.
It is important to ensure that ESG indicators do not lead to unintended consequences whereby achieving the objectives of the ESG indicators creates another problem working against the overall strategic objectives of the SEP. Care should also be taken to ensure ESG indicators do not give rise to or encourage a silo performance culture which does not take into account enterprise wide and cross-cutting issues necessary to achieve the SEP’s strategic objectives.

**Environmental management indicators**

Environmental management is particularly relevant for SEPs that use a lot of natural resources as input to their processes; particularly those in the extractive industries. Sound environmental management such as managing water, waste and energy can contain costs, and enable SEPs to maintain margins despite slumps in revenue. For example, innovative lean production methods, can contribute to better than expected results and stable margins despite relatively flat top line growth. Key indicators include:

- The existence of an environmental management program;
- Certification against standards such as ISO Standards;
- Publishing environmental consumption figures and trends (e.g. green-house-gases, waste, energy and water).

**Social Indicators**

*Human rights indicators:* Human rights are particularly relevant in companies with large supply chains using a lot of human capital such as retailers and consumer product producers, as well as in SEPs with significant footprint on the local community such as agriculture and extractive SEPs.

Child labor (particularly in agriculture), unfair living wages and inappropriate regard to the community in which the SEPs operate, tend to be major issues. Key indicators include:

- Audit of supply chain activities - both internal and external;
- Gender equality and diversity programs;
- The extent of community involvement in the context of the business environment.

*Labour relations:* labor relations are particularly relevant in extractive industries, SEPs with history of governmental influence such as telecommunications, transport, and for boards that have a focus on innovation, Research & Development and need highly skilled labour.

Good health and safety practices and strong employee training programs improve productivity and employee retention. For example, targeted training programs can contribute to growth in sales per employee workforce hour. Poor health and safety practices can result in fines and production disruption. Similarly, industrial action can lead to prolonged disruption to operations. Key indicators include:
Lost time injury rate and fatalities;
Training hours per employee;
Staff turnover;
Relationship with unions;
Absenteeism.

**Governance**

Good governance is relevant across sectors in which SEPs operate, and it is a constitutional and legal requirement for public entities in Zimbabwe. Key indicators include:

- The existence of appropriate internal controls through an audit system, with board level oversight;
- Level of board independence, quality, diversity;
- Remuneration incentives and its implication for risk taking/appropriate inclusion of ESG elements;
- Litigation actions against the SEP;
- Taxation and other legal compliance;
- Data and IT security and systems;
- Quality of accounting, financial & non-financial reporting and disclosure.

**Innovation (Long term viability)**

Innovation in SEPs should be a core area of focus especially those in sectors affected by technology changes, and those that need to adapt to climate change, devise methods of greater food production, devise new methods of transportation, manufacturing etc. Innovation in all these areas is relevant in a world of increasing resource scarcity, global & local competition and changing operating environments. Key indicators include:

- Percentage of sales devoted to research & development;
- Method by which ESG factors are included in capital budget allocations;
- Where appropriate, revenue derived from sustainable new products.
### Table 2: Economical, social and long term viability indicators most commonly used by large entities in Canada and USA

<table>
<thead>
<tr>
<th>Customer service</th>
<th>Innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Customer satisfaction</td>
<td>1. New product development</td>
</tr>
<tr>
<td>2. Delivery performance</td>
<td>2. Manufacturing flexibility</td>
</tr>
<tr>
<td>3. Product and/or process quality</td>
<td>3. Technological capability</td>
</tr>
<tr>
<td>4. Service quality</td>
<td>4. Research and development productivity</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market performance</th>
<th>Employee involvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Marketing effectiveness</td>
<td>1. Employee satisfaction</td>
</tr>
<tr>
<td>2. Market growth</td>
<td>2. Employee turnover</td>
</tr>
<tr>
<td>3. Market share</td>
<td>3. Education, training</td>
</tr>
<tr>
<td></td>
<td>4. Core competencies</td>
</tr>
<tr>
<td></td>
<td>5. Internal recognition</td>
</tr>
<tr>
<td></td>
<td>6. Morale</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Goal Achievement</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Productivity</td>
<td></td>
</tr>
<tr>
<td>2. Environmental compliance</td>
<td></td>
</tr>
<tr>
<td>3. Strategic achievement</td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Stivers et al
### Table 3: Examples of Key Performance Indicators for the Water Sector

<table>
<thead>
<tr>
<th>Key Performance Area</th>
<th>Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economic and Social</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Service coverage</strong> - Coverage is a key development indicator. All coverage indicators are affected by whether the data on population and household size are up to date and accurate.</td>
<td><strong>Water coverage</strong> - Population with access to water services (with a direct service connection or within reach of a public water point) as % of total population under utility’s nominal responsibility.</td>
</tr>
<tr>
<td><strong>Consumption and production</strong> -</td>
<td></td>
</tr>
<tr>
<td><strong>Non-revenue water</strong> - Water that has been produced and is “lost” before it reaches the customer (through leaks, theft, or legal use for which no payment is made). Part of this “lost” water can be retrieved.</td>
<td><strong>Water production</strong> - Cubic meters (m3) per connection per month. <strong>Total water consumption</strong> - Liters per person per day or m3 per connection per month.</td>
</tr>
<tr>
<td><strong>Metering practices</strong> - Metering of customers is considered good practice. It allows customers to influence their water bills and provides utility providers with tools and information to better manage their systems.</td>
<td><strong>Non-revenue water</strong> - Difference between water supplied and water sold (volume of water “lost”) as % of net water supplied. <strong>Non-revenue water</strong> - Volume of water “lost” per km of water distribution network per day (m3/km/day).</td>
</tr>
<tr>
<td><strong>Network performance</strong> - The number of pipe breaks, relative to the scale of the system, is a measure of the ability of the pipe network to provide a service to customers. The rate of pipe breaks can also be seen as a reflection of the general state of the network, and it also reflects operation and maintenance practices.</td>
<td><strong>Metering level</strong> - Number of connections with operating meter as % of total number of connections. <strong>Metered water sold</strong> - Volume of water sold that is metered as % of total volume of water sold.</td>
</tr>
<tr>
<td></td>
<td><strong>Pipe breaks</strong> - Total number of pipe breaks per year per km of water distribution network.</td>
</tr>
</tbody>
</table>
### Key Performance Area

<table>
<thead>
<tr>
<th>Economic and Social</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost and staffing</strong> - Unit operational costs provide a “bottom line” assessment of the mix of resources used to achieve the outputs required. The preferred denominator for operational costs is the amount of water sold. This ratio reflects the cost of providing water at the customer off-take point.</td>
</tr>
<tr>
<td><strong>Indicators</strong></td>
</tr>
<tr>
<td><strong>Unit operational costs</strong> - Annual water service operational expenses/total annual volume sold ($/m³ sold).</td>
</tr>
<tr>
<td><strong>Staff costs</strong> - Number of staff per thousand water connections.</td>
</tr>
<tr>
<td><strong>Staff costs</strong> - Number of staff per thousand people served.</td>
</tr>
<tr>
<td><strong>Labor costs</strong> - relative to operational costs. Total annual labor costs (including benefits) as % of total annual operational costs.</td>
</tr>
<tr>
<td><strong>Electrical energy costs</strong> - as % of operational costs.</td>
</tr>
<tr>
<td><strong>Contracted-out service costs</strong> as % of operational costs.</td>
</tr>
</tbody>
</table>

| Quality - Complaints, while relatively easy to track, give only a glimpse of actual entity performance; consumers may have become accustomed to poor service and may not complain. In other cases, it may be difficult for customers to report complaints. Capturing at least some customer-derived data is important. |
| **Continuity of service** - Average hours of service per day for water supply. |
| **Quality of water supplied** - Number of tests for residual chlorine. |
| **Quality of water supplied** - Samples passing on residual chlorine (%). |
| **Complaints** - Total number of complaints per year as % of total number of water and wastewater connections. |

<table>
<thead>
<tr>
<th>Financial</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong> - Billing customers and getting paid are two different things. The effectiveness of the collections process is measured by the outstanding revenue at year-end compared with the total billed revenue for the year, in day equivalents, and by the total amount collected as a percentage of the billed amount.</td>
</tr>
<tr>
<td><strong>Total annual operating revenue</strong> - per volume of water sold ($/m³ water sold) or per connection.</td>
</tr>
<tr>
<td><strong>Collection period</strong> - Year-end accounts receivable/total annual operating revenues.</td>
</tr>
<tr>
<td><strong>Collection ratio</strong> - Cash income as % of billed revenue.</td>
</tr>
</tbody>
</table>

| Assets - The capital intensity of the utility is indicated by the gross fixed-asset value per capita served. |
| **Gross fixed assets** - Total gross fixed assets per population served ($/population served). |

Source: Adapted from the International Benchmarking Network for Water and Sanitation Utilities indicators
Integrated reporting is a concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long-term. Its purpose is to explain to the providers of the 6 <IR> framework capitals how the organization creates and sustains value over time. It therefore contains financial and other information.

All organizations depend on various forms of capital for their success. The 6 <IR> framework capitals are; (1) financial, (2) manufactured, (3) intellectual, (4) human, (5) social & relationship, and (6) natural. The capitals are stocks of value that increase, decrease, or transform through the activities of the organization. For example, the organization’s financial capital increases when it makes a profit. Human capital increases when employees are trained but the training costs decrease financial capital i.e. financial capital is transformed into human capital. This demonstrates in a simple way, the interactions and transformation between the organization’s capitals.

Many activities cause increases, decreases or transformations that are far more complex than the above example and involve a broader mix of capitals or of components within a capita (e.g. the use of water to grow crops that are fed to farm animals, all of which are components of natural capital).

<IR> and Performance

An integrated report should tell to what extent the organization achieved its strategic objectives and the outcomes in terms of each of the organization’s capitals.
An Integrated report contains quantitative and qualitative information about the organization’s performance, for example;

- Qualitative indicators with respect to targets, risks and opportunities explaining their significance and implications;

- The organization’s effects (both positive and negative on its capitals throughout the value chain;

- State of relationships with key stakeholders and how the organization has responded to shareholders’ legitimate needs and expectations;

- The linkages between past and current performance and between current performance and the outlook.

KPIs that combine financial measures with other components (e.g. the ratio of land degradation to sales) or narrative that explains the financial implications of significant effects on other capitals and other causal relationships (e.g. expected revenue growth resulting from efforts to enhance human capital) may be used to demonstrate the connectivity of financial performance, with performance regarding other capitals. In some cases, this may involve monetizing certain effects on the capitals e.g. impact of land degradation, water use etc. on natural capital).

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6 The International Integrated Reporting Council.
It is also relevant to include in the performance discussion, the impact of regulation on performance, e.g. regulation of tariffs on the provision of services like water, electricity, urban routes bus fares etc. and quantify their impact on revenues and reported performance indicators.

<table>
<thead>
<tr>
<th>&lt;IR&gt; Framework Capitals</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial</strong></td>
<td>The pool of funds available to an organization for use in the production of goods or the provision of services, which are obtained through financing, such as debt, tax or grants, or generated through own operations or investments.</td>
</tr>
<tr>
<td><strong>Manufacturing</strong></td>
<td>Physical objects (as distinct from natural physical objects) that are available to an organization for use in the production of goods or the provision of services, including buildings (such as schools, hospitals and offices), equipment and infrastructure (such as roads, ports, bridges, and waste and water treatment plants).</td>
</tr>
<tr>
<td><strong>Intellectual</strong></td>
<td>Organizational, knowledge-based intangibles, including intellectual property, such as patents, copyrights, software, rights and licenses, and ‘organizational capital’ such as tacit knowledge, systems, procedures and protocols.</td>
</tr>
<tr>
<td><strong>Human</strong></td>
<td>People’s competencies, capabilities and experience, and their motivations to innovate, including their alignment with and support for an organization’s governance framework, risk management approach, and ethical values along with the ability to understand, develop and implement an organization’s strategy and loyalties, and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate.</td>
</tr>
</tbody>
</table>
### Examples of Capitals in the public sector context

<table>
<thead>
<tr>
<th>Framework Capitals</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image" alt="Social &amp; relationship" /> Social &amp; relationship</td>
<td>The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective wellbeing. Social and relationship capital includes shared norms, common values and behaviors, key stakeholder relationships, and the trust and willingness to engage, that an organization has developed and strives to build and protect with external stakeholders. Also, intangibles associated with the brand and reputation that an organization has developed. An organization’s social or regulatory license to operate.</td>
</tr>
<tr>
<td><img src="image" alt="Natural" /> Natural</td>
<td>All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of an organization. It includes air, water, land, minerals and forests, along with biodiversity and eco-system health.</td>
</tr>
</tbody>
</table>

Source: Integrated Thinking and Reporting- Focusing on Value Creation in the Public Sector; CIPFA and World Bank

### Use of <IR> KPIs

<IR> is an evolving reporting framework and the National Code on Corporate Governance of Zimbabwe requires boards to “formally adopt a suitable reporting framework for use by management in integrated and sustainability reporting”. However, it is worth taking note that; "<IR> is a journey and it will take more than one reporting cycle to get there.” Appropriate <IR> KPIs should be used from reported <IR> information as entities progressively implement <IR> over time.
**Performance Indicators and Targets Linked to Strategy**

Identifying performance indicators which are linked to strategy is an effective way to align top management and drive overall performance.

**Best practice in designing performance indicators**

1. Designing the right performance indicators for a SEP is a demanding process that requires a good understanding of the business of the SEP. It can however be simplified by splitting it into 3 steps:
   (i) Define a clear strategy for the SEP;
   (ii) Derive performance indicators from the strategy - (these are the value drivers for the SEP);
   (iii) Translate and measure the performance indicators at all levels of the SEP;

2. Monitoring and tracking performance indicators at all levels of the SEP to identify any deviations and taking early action is vital;

3. Indicators should comprise both backward looking indicators (to take stock of the SEP’s performance to date and forward looking to assess mid to long-term sustainability. The table below demonstrates this for an industrial SEP.

<table>
<thead>
<tr>
<th>SEP Operating Level/Department/Dimension</th>
<th>Performance Indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Backward looking/historic</td>
</tr>
<tr>
<td>Finance</td>
<td>• Return on Assets</td>
</tr>
<tr>
<td></td>
<td>• Production/unit cost</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations</td>
<td>• Productivity</td>
</tr>
<tr>
<td></td>
<td>• Safety e.g. frequency of incidents</td>
</tr>
<tr>
<td>Organizational</td>
<td>• Employee satisfaction</td>
</tr>
<tr>
<td></td>
<td>• Continuous attraction of high quality employees</td>
</tr>
</tbody>
</table>
## Designing performance indicators: Example 1 - A Financial Institution

### Issues:
Profit erosion signs are visible as a result of increased sector competition and more stringent regulatory regime. Shareholder returns are declining.

### Analysis:
This identified a number of sustainability problems including: the banks’ customer satisfaction which was falling against competition; bank’s brand rating was amongst the worst 5; cost-to-income ratio was higher than for competitors; and productivity was low and declining. The analysis identified crucial strategic/performance issues to be addressed in order to achieve the strategic objectives.

### SEP Operating Level/Department/Dimension | Performance Indicator
--- | ---
**Backward looking/historic** | **Forward looking/sustainability**
Market | • Share of business of key customers | • Quality of key customer relationships (e.g. is it based on people relationships or on integration of supply chains)
Stakeholder | • Record of union action (e.g. strikes) | • Quality of union relationships
 |  | • Quality of relationships with bankers
 |  | • Quality of relationships with regulator

Source: Adapted from; The Blue Book; Intensifying Performance Management in Government Linked Companies-Malaysia
Table 5: Designing Performance Indicators; Financial Institution

<table>
<thead>
<tr>
<th>SEP Operating Level/Department/Dimension</th>
<th>Strategic Objective</th>
<th>Performance Indicator</th>
</tr>
</thead>
</table>
| **Financial**                          | • Increase sustainable earnings growth 10% per annum  
• Contain cost of distribution channels | • Earnings growth  
• Return on equity  
• Cost/income ratio  
• Non-performing loans ratios | • NPV of identified cost saving initiatives  
• Quality of book (measured as % of interest income derived from low-risk loans) |
| **Operational**                        | • Deliver consistently good customer service  
• Improve customer relations management capabilities | • Number of complaints  
• Cost per bill payment transaction  
• Time taken to complete transaction | • Errors identified by bank as percentage of all errors  
• Quality of customer data |
| **Organizational**                     | • Compete for talent in market | • Number of high performers leaving  
• Leadership strength | • Employer of choice score  
• Level of voluntary attrition  
• Strengths of succession plans |
| **Market**                             | • Improve cross selling and product bundling  
• Improve customer segmentation  
• Develop products for aging and high profile customer base | • Number of products per customer  
• Proportion of customers expressing satisfaction  
• Market share in significant segments | • Perception of brand  
• Market share in fastest growing market segments  
• Number of new customers |
| **Stakeholder**                        | • Develop and maintain good relations with regulators  
• Maintain public trust | • Fines levied by regulators  
• Number of surprise moves by regulators | • Perception of regulator  
• Number of negative stories in press |

Source: Adapted from; The Blue Book; Intensifying Performance Management in Government Linked Companies-Malaysia
**Designing performance indicators: Example 2 - A Mining Company**

**Issues:** Drop in global commodity prices, regulatory changes, and decline in demand, left the SEP without a viable long term strategy

**Analysis:** A situation analysis of the company revealed; higher product costs than competition, decreasing mineral quality, decreasing global prices, aged assets with high maintenance costs, and increasing problems with unions on remuneration issues.

The strategic objectives of the company required the introduction of certain performance indicators to achieve them.

**Table 6: Designing Performance Indicators; Mining Company**

<table>
<thead>
<tr>
<th>SEP Operating Level/Department/Dimension</th>
<th>Strategic Objective</th>
<th>Performance Indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial</strong></td>
<td>• Improve ROCE &amp; EBIT</td>
<td>• Return on assets/capital employed</td>
</tr>
<tr>
<td></td>
<td>• Reduce production costs to level of major competitors</td>
<td>• EBIT</td>
</tr>
<tr>
<td></td>
<td>• Improve productivity</td>
<td>• Production costs per unit</td>
</tr>
<tr>
<td></td>
<td>• Reduce work accidents</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Improve production reliability</td>
<td></td>
</tr>
<tr>
<td><strong>Operational</strong></td>
<td></td>
<td>• Quality of preventive maintenance program</td>
</tr>
<tr>
<td></td>
<td>• Improve productivity</td>
<td>• Safety awareness culture</td>
</tr>
<tr>
<td></td>
<td>• Reduce work accidents</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Improve production reliability</td>
<td></td>
</tr>
<tr>
<td><strong>Organizational</strong></td>
<td>• Retain best employees</td>
<td>• Number of high performers leaving</td>
</tr>
<tr>
<td></td>
<td>• Reduce absenteeism</td>
<td>• Employee satisfaction</td>
</tr>
<tr>
<td><strong>Market</strong></td>
<td>• Improve customer service</td>
<td>• Number of customer complaints</td>
</tr>
<tr>
<td></td>
<td>• Improve relationship with regulators</td>
<td>• Number of fines from regulators</td>
</tr>
<tr>
<td><strong>Stakeholder</strong></td>
<td>• Improve relationships between management and unions</td>
<td>• Processing time for customer requests</td>
</tr>
<tr>
<td></td>
<td>• Improve brand quality</td>
<td>• Number of new customers</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from; The Blue Book; Intensifying Performance Management in Government Linked Companies-Malaysia
Best practice in setting targets for performance indicators

Best practice in setting targets for performance indicators is based first on an initial “bottom-up” approach for collection of relevant information, where all business units provide inputs on the targets at the start of the process some months before the beginning of the year. The information gathering is followed by a “top down” process of setting targets.

The advantage of this approach is that all stakeholders have an opportunity to provide inputs and to sign off on the final targets. This embeds in the system the needed consensus on the targets. It ensures that realistic targets are set, and all staff is well informed on the targets.

**Establishing performance indicators and setting targets that work**

To ensure minimum adjustments of performance indicators and targets during the benchmarking and evaluation processes, it is important to ensure that all variables are right and the operating environment for the entity is both conducive and appropriate before implementing performance management systems. Otherwise the effectiveness of the performance management systems will be compromised by possible gaming and/or requests for adjustments of targets from management during the benchmarking and evaluation processes to take into account factors claimed to be beyond management control.
CHAPTER 3

Establishing and Review of KPIs
Establishing KPIs and Setting Targets for Senior Management

The rationale for designing KPIs is to ensure alignment of effort of people in the SEP to the overall goals of the SEP. This is achieved by:

- Ensuring each employee is clear on what is expected of them;
- Instilling a culture of accountability for results and outcomes in all employees; and
- Providing a basis for rewards and consequences.

Individual performance monitoring and assessment for the CEO and senior management in an entity is done by benchmarking actual performance against entity KPIs. Properly designed KPIs align desired management behaviors and performance with the entity’s strategy and objectives.

Implementation of a performance management system will be guided by each SEP’s strategic plan which indicates key results areas to be achieved within a given period. These specific targets will then be agreed upon between the SEP and responsible oversight institution for that SEP to form the basis upon which performance will be monitored through KPIs. The strategic plan will indicate areas of responsibilities and the performance management system through the board will provide indicators which will guide the performance contract of the CEO and senior management. The Board reports the CEO’s performance results to the oversight institution for the SEP while, the CEO reports the performance results of key management to the Board.

Entity KPIs (which are the same as the CEO’s KPIs), and KPIs for managers are derived from/are a subset of the individual SEPs’ performance indicators that are ultimately linked to the SEP strategy (the value drivers of the entity). They contribute to the overall KPIs of the SEP but translated to specific activities within the individual’s domain. For KPIs to be valid and relevant, they must meet certain characteristics and these are set out in Table 7 below.
Table 7: Characteristics of valid and relevant KPIs

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Qualities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Linked to SEP strategy</td>
<td>The measure can be aligned with a strategic objective or specific customer value.</td>
</tr>
<tr>
<td>Controllable</td>
<td>The results are controllable or influenced under a specific span of control.</td>
</tr>
<tr>
<td>Can be acted upon</td>
<td>Action can be taken to improve performance on the measured dimension.</td>
</tr>
<tr>
<td>Measurable</td>
<td>The desired performance can be quantified in a meaningful and realistic way.</td>
</tr>
<tr>
<td>Simple</td>
<td>The measure(s) can be explained easily and clearly by management.</td>
</tr>
<tr>
<td>Few in number</td>
<td>The measures focus management attention on key areas.</td>
</tr>
<tr>
<td>Credible</td>
<td>The measures are resistant to manipulation/gaming. They must be auditable.</td>
</tr>
<tr>
<td>Integrated</td>
<td>The measures are holistic and compatible with related processes.</td>
</tr>
</tbody>
</table>

Source: The Blue Book; Intensifying Performance Management in Government Linked Companies-Malaysia

The following are some of the guidelines for designing KPIs and setting targets for senior management:

Guideline 1

*Design a balanced and holistic set of KPIs linked to strategy.*

**Description**

- Entity KPIs and KPIs for the CEO are very relevant performance indicators for the entity. KPIs for other senior management are subset performance indicators for their respective divisions, business units or departments.

- Best practices suggest that for clarity and focus, each senior manager should have a manageable number of KPIs - (no more than five to eight KPIs).

- Entity KPIs and KPIs for other senior management may also include major milestones with measurable outcomes (e.g. cost, time and impact of successful implementation, etc.).

- KPIs for senior management other than the CEO, may also include overall entity performance. KPIs must be appropriately weighted based on their importance to the business objectives.
Guideline 2

Ensure senior management formally agree to KPIs and targets.

Description

- The CEO should agree formally with the Board on entity KPIs and targets and the Chairman should sign-off this agreement with the CEO.

- For other senior management, apply a similar process which includes a "bottom up" process where both the CEO and individual managers sign off.

- KPIs and targets should be agreed on and signed-off at the latest, by the first month of the financial year.

Guideline 3

Demonstrate clear link up-front between targets and performance ratings.

Description

- Choose a performance rating scheme in line with the SEP’s culture and strategy.

- The methodology to link KPIs to individual performance ratings should be clear and announced at the beginning of the year e.g.

  - Performance against entity KPIs determines ratings, rewards and consequences (commonly known as “Absolute Rating”). The employee’s actual performance is compared with his/her KPIs, irrespective of the performance of other people in the SEP.

  - Performance against peers determines rating, rewards and consequences (commonly known as “Relative Rating”). This rating scheme is based on the relative performance of the employee compared to that of his/her peers. Under this method, regardless of how well all business unit managers perform, there will always be a certain number of them rated as low performers.
Guideline 4

*Report headline performance indicators.*

**Description**

- SEPs’ CEOs should report to stakeholders their objectives, headline performance indicators and priorities, without revealing strategic actions to competition. They must also not conflict with Zimbabwe laws, regulations, standards and codes.

- The headline performance indicators are a subset of the broader performance indicators. Headline performance indicators should, where possible, include economic profit and, at least, the main drivers of value creation (e.g. revenue growth, EBITDA, etc.)

- Headline performance indicators are a powerful tool to rally all levels of employees, by providing a common reference point to chart progress. This is especially important where staff rewards across all levels are linked to the headline performance indicators.

- Headline performance indicators should be announced at least annually with the year-end results, and progress against them should be included in the quarterly reports of results.

**Setting performance targets and dealing with uncontrollable factors**

- Many SEPs struggle to set the right targets because external factors on which the employees have no influence, affect their ability to reach their targets. An example is that airlines might find it difficult to set financial targets and hold the managers responsible, because fuel prices and other events outside the managers’ control significantly impact the financial results, and hence the KPIs.

- SEPs should use appropriate mechanisms to correct the targets where uncontrollable factors come to play e.g.:

  - Pre-agree on some key assumptions (e.g. fuel price for airlines) and a “deviation band”. If the parameter deviates outside the “deviation band”, the overall SEP’s financial targets would be revised and the financial KPI targets recalculated;

  - An alternative solution is to use a set of complementary indicators, sensitive to different external factors. For example, when an airline is affected by rising fuel costs, its market share would not be affected as much as its financial targets.
Inherent ethical and compliance pressures associated with performance targets

There are inherent ethical and compliance pressures associated with performance targets, which need to be mitigated. If not mitigated they can lead to various types of fraud, including reporting fraud, reporting results that “meet” the targets through gaming. There has to be controls to mitigate these risks including a clear and consistent message from management demonstrating their commitment to ethics and compliance in the face of performance targets.

Reviewing Individual Performance of Senior Management

The performance of the CEO and other senior management must be reviewed regularly against the KPIs (at least annually). It is important to set the objectives of monitoring performance of CEOs, this would include;

- Monitor the SEP’s performance. This is part of the Board’s broader role;
- Assess how well the SEP is managed;
- Determine the CEO’s variable/performance compensation (“bonus”);
- Identify poor performers;
- Identify remedial actions (e.g., coaching, training, appointing a deputy).

The CEO’s evaluation is to be done by the Board at regular intervals (every year), and communicated to the ownership entity.

The general approach, principles, criteria and activities carried out to evaluate performance must be clearly described.

- The principles should include: transparent framework, fairness and confidentiality of deliberations.
- Criteria should capture a broad sense of performance, not just net profits but include all the 6 capitals of<IR> as described in Chapter 3.
Safeguards should be built in for the most “extreme” cases - e.g. possible dismissal of the CEO when circumstances warrant. The Board should document the evaluation in reasonable detail.

It is important to clarify that total compensation includes: i) salary/emoluments, ii) benefits (medical, school, vacation pay, sick leave etc.) and iii) performance pay (bonus, profit sharing, stock option – if applicable). Reimbursements of out-of-pocket do not represent compensation strictly speaking (even if paid through the payroll system).

SEPs in Zimbabwe are required to comply with the following requirements of the Government of Zimbabwe as stated in the “Corporate Governance Principles as Approved by Cabinet on 4 March 2014”;

- **CEOs and other senior management staff at Public Enterprises to be placed on performance-related contracts;**
- **Performance-related contracts to clearly spell out the minimum requirements which, if not met, shall constitute grounds for termination of service;**
- **Performance related contracts to clearly spell out what a CEO is entitled to as a severance package under the different scenarios of termination of service;**
- **Boards to evaluate the performance of CEO’s on a quarterly basis and brief Line Ministers on the results thereof.**

The following are the requirements and guidelines for reviewing individual performance:

**Guideline 1**

**Put in place a rigorous process for reviewing individual performance.**

**Description**

- Even though there should be a clear link between the performance of a business area and the review of the individual leading that business area, business performance reviews should be followed by a separate review of individual performance.
- The Board should regularly review the performance of the CEO as well as identify any issues and recommend remedial action if required.
- The CEO should review senior management periodically (ideally once every 6 months, but at least annually).
Guideline 2

Ensure evaluations show real differentiation in terms of overall rating.

Description

- The individual’s performance rating should clearly link to their performance against KPIs.
- The evaluation process should rate people on a sufficiently broad scale so that a wide distribution of ratings can be achieved.
- It is important that the performance rating shows true dispersion across each level in the organization.

Guideline 3

Follow up performance with meaningful rewards and consequences.

Description

- There should be a strong link between a person’s performance rating and any subsequent monetary and/or non-monetary incentives/consequences, and the Board should monitor the process.
- Low performers should be initially coached to improve or moved to a new position where their capabilities are better matched. Consistently low performers should be considered for termination.
Reviewing Individual SEP Performance

The performance of the entity and each division, business unit or department, must be reviewed on a regular basis to ensure early identification of issues and opportunities, as well as to keep focus on business priorities in order to drive overall performance improvement for the entity.

The following are the requirements and guidelines for reviewing business performance for the entity:

**Guideline 1**

*Board should review entity performance.*

**Description**

- The full Board should conduct periodical (probably quarterly) detailed reviews of entity performance against entity KPIs.

- The output of the review should be an action plan that addresses major variances. This action plan should form the basis for measuring progress at the next review.

**Guideline 2**

*Conduct regular performance reviews for all divisions, business units and departments.*

**Description**

- The CEO should review the entity KPIs with the Chairman. The CEO should then review each Division’s performance indicators with the relevant senior manager(s) periodically (probably quarterly).
Performance review meetings should be held at least once every quarter. Frequency and duration should be adjusted according to importance and complexity of the business area reviewed.

The output of the meeting should be an action plan that addresses specific gaps and opportunities. This action plan should form the basis for measuring progress at the next review.

**Table 8: Board Performance Review as Part of Board’s Role in Performance Management**

<table>
<thead>
<tr>
<th>Steps in Board Review</th>
<th>Key Activities</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Board helps establish the right measures to monitor</td>
<td>- Review KPI results each quarter</td>
<td>- Review variances to ensure corrective action taken</td>
</tr>
<tr>
<td>2 Board helps establish the appropriate performance targets</td>
<td>- Focus on variances and ensure corrective action taken</td>
<td>- Board monitoring will ensure management attention</td>
</tr>
<tr>
<td>3 Board reviews results and approves corrective action</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Where necessary communicate with stakeholders</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
CHAPTER 4

Structuring and Monitoring Performance Agreements
Performance agreements between Government and SEP Boards

SEP monitoring is one of the key ownership functions of Government as owner of SEPs and performance agreements facilitate the effective discharge of this function.

The assessment of corporate governance practices in 39 SEPs selected by the Government, conducted by OPC, MoFED and SERA, with assistance from the World Bank in 2016, revealed that the majority of SEPs in Zimbabwe do not have written performance agreements with the Line Ministry as the owner.

Structuring performance agreements between Government and SEP boards

Once the entity’s mandate is agreed, Government as owner through the Line Ministry should develop a framework for communicating the Government’s expectations of the entity’s performance to the entity and the public. A performance agreement is used for this purpose. It describes the expectations and specific objectives agreed between the Government and the entity’s Board. The performance agreement typically includes the following elements:

### Table 9: Main Elements of SEP Performance Agreements

<table>
<thead>
<tr>
<th>Element</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The SEP mandate and the scope of activities that the entity will undertake.</strong></td>
<td>The mandate defines the core and non-core activities of the business that the Board is accountable for delivering. The mandate has two benefits: it prohibits the entity from undertaking activities that may not be in the best interests of the shareholders and stakeholders, and also protects the Board and management from being asked to undertake activities that are inconsistent with the core business of the entity.</td>
</tr>
<tr>
<td><strong>A short description of the entity’s vision and strategy.</strong></td>
<td>To understand and manage performance, each SEP needs to develop and adopt its own strategy. The performance agreement should be based on and incorporate the entity’s strategy.</td>
</tr>
<tr>
<td>Element</td>
<td>Description</td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>A clear description and explicit financial cost estimate of the entity’s non-commercial objectives.</td>
<td>This includes access, coverage, and affordability for low-income consumers, providing the state and the public with an overall understanding of the cost of meeting social objectives. When an entity has significant policy objectives, the Board needs to consult with the Line Ministry or the MoFED to balance commercial and non-commercial objectives.</td>
</tr>
<tr>
<td>Financial and non-financial performance indicators, as well as targets for the indicators, to measure the performance of the entity against its strategy.</td>
<td>Performance measures can grow over time as capacity and experience increase.</td>
</tr>
<tr>
<td>Frequency and procedures for reporting.</td>
<td>In addition to legal and regulatory requirements, the performance agreement should specify the reporting requirements and deadlines for the SEP.</td>
</tr>
<tr>
<td>A statement describing the dividend policy.</td>
<td>Dividends are driven by a SEP’s capital structure, profitability, cash resources, and estimate of future capital expenditure, among other factors. In addition to the dividend policy set by the Government for SEPs, each SEP performance agreement should specify that policy. The Government of Zimbabwe issued a statement of Dividend policy applicable to all entities expected to pay dividends.</td>
</tr>
</tbody>
</table>

Sources: Adapted from World Bank 2014 - Corporate Governance of State Owned Enterprises ... A Toolkit

**Negotiating performance agreements between Government and SEP Boards**

Before the performance agreement is finalized, the Government as owner through the Line Ministry and the entity’s Board must discuss it and agree on its contents. In countries where this process is fully developed, such as India, Malaysia, and South Africa, agreements and targets are produced annually. In many countries, the performance agreement is made public and presented to Parliament to establish accountability links. It is crucial that the Government’s expectations of the entity be formally, clearly, and publicly communicated. These international good practices will become mandatory in Zimbabwe, when the Public Entities Corporate Governance Bill becomes Law.

A good performance agreement requires the Line Ministry, representing the Government as owner, to have good knowledge of the entity’s industry based on research, experience, and discussion with the entity. The Line Ministry should seek help from consultants or other experts as needed.
Monitoring performance agreements between Government and SEP boards

Monitoring entity performance against the agreed entity objectives and performance targets as set out in the performance agreement is generally done on an annual basis. However, for more important portfolio entities, more regular monitoring (bi-annual or quarterly) should be required. The key to implementing a periodic monitoring framework is establishing suitable performance indicators and targets.

The monitoring process can be streamlined by requiring SEPs to provide standard-form financial and non-financial baseline data along the lines, as collected by SERA initially with assistance from the World Bank. This data will be in varying degrees of complexity as time progresses - from the current simple spreadsheet-based templates to dedicated online data entry portals in future.

The data required should conform to the existing data requirements imposed on the entity, for example, requirements should preferably align with the financial reporting framework that the entity must adopt for its financial statements, i.e. IFRS for commercial entities.

Periodic monitoring by the Government through the Line Ministry instills a culture of accountability with the following requirements:

- The Government as the owner should ensure that the SEP is complying with all periodic and annual financial reporting requirements and external audits and delivering them on time.
- All variances between the actual financial and non-financial results and the agreed performance as set out in the performance agreement should be documented and reasons explained.
- Large or unjustified variances from planned results should be reported to the Line Minister.
- Large adverse variances that are not appropriately explained should give rise to consequences administered by the Line Ministry under the performance agreement.
- Periodic public disclosure and to the Line Ministry should be made of SEP performance, against the agreed objectives or relevant benchmarks and should act as a strong incentive for Managers and Boards to improve performance of the SEP.

Performance agreements/contracts for senior management

While target setting is a “top-down” process, senior management should review and agree on individual targets with their superiors or the board and formalize such agreement in a performance contract. Any negotiation(s) must not affect the established KPIs and set targets, which are derived from the SEP’s strategy.
Structuring performance agreements for senior management

Performance contracts should include short-term targets, i.e. for the next 12 months and also lay out longer-term expectations. The longer term targets should be revisited every year to ensure their continued validity.

Monitoring performance agreements/contracts for senior management

It is recommended that individuals and their superiors or the board sign the performance contract before the beginning of the year of performance to facilitate monitoring during the year.

Box 3: Example of Extract from a Performance Contract

Specific goals/objectives

- Maintain presence throughout the country;
- Design and implement a risk assessment and monitoring system by end of 2017;
- Develop a human resource plan by Q3 2016 to promote commercial skills development through training and recruitment.

Personal KPIs

<table>
<thead>
<tr>
<th>Measure</th>
<th>Unit</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Gross margin</td>
<td>%</td>
<td>50</td>
<td>50</td>
<td>55</td>
</tr>
<tr>
<td>Operational</td>
<td>$/Unit</td>
<td>1.05</td>
<td>0.95</td>
<td>0.90</td>
</tr>
<tr>
<td>• Operational cost</td>
<td>$/Unit</td>
<td>0.30</td>
<td>0.26</td>
<td>0.24</td>
</tr>
<tr>
<td>• Transport cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial</td>
<td>%</td>
<td>20</td>
<td>23</td>
<td>25</td>
</tr>
<tr>
<td>• Market share</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Organizational</td>
<td>% of employees</td>
<td>80</td>
<td>85</td>
<td>90</td>
</tr>
<tr>
<td>• Annual training</td>
<td>Number</td>
<td>30</td>
<td>35</td>
<td>40</td>
</tr>
<tr>
<td>• Personnel hiring</td>
<td>% above 3</td>
<td>60</td>
<td>70</td>
<td>75</td>
</tr>
<tr>
<td>• Employee satisfaction survey</td>
<td>(1-5 scale: 5= very good)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Common Problems with performance contracts

Problems encountered in performance agreements include;

a. **Contracts that are not binding;** Although agreements may be of a contractual nature in form and appearance and entered in good faith by parties involved, it is common that reciprocal commitments are not met. For example, if an entity is to fund investments from increases in charges, government may later give policy directives not to increase charges and the entity fails to meet the investment targets for reasons beyond management control. It will therefore not be proper to sanction management for failing to perform on the contract.

In many cases contracts may also not explicitly show the state’s non-commercial objectives like social employment, charges for services, grants, subsidies, access to finance and inputs issues. The impact of these on the entity’s financial statements may not be quantified and disclosed. If contracts ignore such specific issues and assume a standard format which lacks detail and mutual commitment, there may be challenges in enforcing such contracts.

b. **Poor quality of contracts and information;** Contracts may be of poor quality to enforce and often not made public. Information on which to enforce the contract may be outdated or not available because of failure to meet reporting deadlines. This leads to challenges in enforcing the contracts.

c. **Contracts may not be flexible.** Contracts may be rigid and not adapt to changing situations and circumstances, resulting in challenges in enforcing them.

d. **KPIs on which the contract is based may not be realistic;** there may be structural defects in the process of establishing KPIs resulting in unrealistic KPIs. For example, there may not have been adequate “bottom-up” processes resulting in inadequate or absence of line management inputs into the KPIs.

Guide to creating a performance agreement

The steps are designed for performance agreements between Government and SEP boards. They are applicable to other performance agreements with minor amendments.

---

**Step 1**

Within reasonable time before the beginning of the performance agreement period, the whole board should set aside some time (preferably a whole board meeting) to seriously consider the present state of the SEP. Matters to be considered during the meeting include the following:

1. Have the previous year’s strategic and annual operating plans been achieved?
2. Were there any issues arising from the previous performance agreement that needed attention?
3. Have any professional development needs arisen in the process?
4. Are there any new internal matters that must be addressed, e.g. new or out-dated mandates, objectives, directives, etc.?
5. Are there any new external matters that must be addressed e.g. requirements of new laws, standards, codes, etc. Or any such that are no longer applicable?
6. What specific objectives need to be addressed in the performance agreement?
7. Has the Line Ministry or other entity exercising ownership rights or stakeholders raised any concerns?
8. Are there specific concerns about the performance of the SEP, Board or CEO?

Responses to the questions should provide a basis for the current draft performance agreement outline.

**Step 2**

Draft a ‘board outline’ document and delegate, in writing, the performance review responsibility to a committee of the board to develop further in consultation with the CEO.

**Step 3**

Create a draft performance agreement in consultation with the CEO. The Performance Agreement should include the elements in Table 12.
Step 4

Determine 'good performance'.
A statement of what is considered to be good performance of the CEO should be included. This is important if there is disagreement as to whether objectives or standards have been met. Good performance can be determined by the delegated committee who may want to consider what constitutes good performance according to the needs of the SEP.

Step 5

The delegated committee should confirm the policy and process by which the review will be undertaken.

Step 6

The board has the final say on all the processes and final form and content of the performance agreement.

Step 7

Finally, the performance agreement is ratified by the board and is used as the basis of the next performance review.

Board and Senior Management Remuneration Guidelines

The Government is currently in the process of developing board and senior management remuneration guidelines. Once finalized they will be included in a stand-alone volume of guidelines and monitored in a manner that is consistent with Government policy on the matter.
### Financial KPIs Entities May Find Useful

<table>
<thead>
<tr>
<th>Cash flow KPIs</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working Capital</td>
<td>Measures an organization's financial health by analyzing readily available resources that could be used to meet any short-term obligations.</td>
</tr>
<tr>
<td>Operating Cash Flow</td>
<td>The amount of cash generated by regular business operations/activities.</td>
</tr>
<tr>
<td>Cash Rotation (365/cash cycle)</td>
<td>The number of times the cash comes back to the organization for a period of one year.</td>
</tr>
<tr>
<td>Cash Flow from Investing Activities</td>
<td>Shows the change in an organization's cash position caused by investments gains or losses.</td>
</tr>
<tr>
<td>Cash Flow from Financing Activities</td>
<td>Demonstrates an organization's financial strength. Formula: (Cash Received from Issuing Stock or Debt) - (Cash Paid as Dividends and Reacquisition of Debt/Stock) = (Cash Flow from Financing Activities)</td>
</tr>
<tr>
<td>Cash Flow</td>
<td>The total amount of money being transferred into and out of an organization.</td>
</tr>
<tr>
<td>Cash Conversion Cycle</td>
<td>Demonstrates the amount of time it takes for money invested to come back to the organization in the form of increased cash.</td>
</tr>
<tr>
<td>Accounts Receivable Turnover</td>
<td>The rate at which an organization collects on outstanding accounts. Formula: (Net Credit Sales) / (Average Accounts Receivable) = (Accounts Receivable Turnover)</td>
</tr>
</tbody>
</table>
### Financial KPIs Entities May Find Useful

<table>
<thead>
<tr>
<th>Cash flow KPIs</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>The amount of money an organization is owed by its customers.</td>
</tr>
<tr>
<td>Accounts Payable Turnover</td>
<td>The rate at which an organization pays off suppliers and other expenses. Formula: (Total Supplier Purchases)/(Average Accounts Payable) = (Accounts Payable Turnover)</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>Shows the amount of money an organization owes its suppliers.</td>
</tr>
<tr>
<td>#/% Invoices Past Due</td>
<td>Invoices that remain unpaid after their due date.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost KPIs</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Expenses</td>
<td>Consists of the total costs an organization incurs during a reporting period (including marketing, sales, and operations costs).</td>
</tr>
<tr>
<td>Selling, General &amp; Administrative expenses</td>
<td>The costs of operating an organization - including selling, general and administrative expenses</td>
</tr>
<tr>
<td>Sales Expenses</td>
<td>Costs incurred by the sales department - including salaries and commissions.</td>
</tr>
<tr>
<td>Marketing Expense</td>
<td>Encompasses the total costs incurred by the marketing department, including advertising, salaries, research, and surveys.</td>
</tr>
<tr>
<td>Inventory Turnover</td>
<td>The number of times an organization is able to sell off its in-stock inventory in a given period. Formula: (Sales) / (Inventory) = (Inventory Turnover)</td>
</tr>
<tr>
<td>Cost Per Unit</td>
<td>The price to produce, store, and sell one unit of a particular product including fixed and variable costs of production. Formula: ([Variable Cost] + [Fixed Cost]) / (Number of Units Produced) = (Cost Per Unit)</td>
</tr>
<tr>
<td>Cost Per Hire</td>
<td>The average cost of hiring a new employee, including advertising fees, employee referrals, travel expenses, relocation expenses, and recruiter costs. Formula: (New Hire Expenses) / (Number of New Hires) = (Cost Per Hire)</td>
</tr>
<tr>
<td>Cost KPIs</td>
<td>Description</td>
</tr>
<tr>
<td>----------------------------------------------</td>
<td>------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>COGS (Cost of Goods Sold)</td>
<td>Represents the cost of materials and direct labor used to produce a good.</td>
</tr>
<tr>
<td>Average Annual Expenses to Serve One Customer</td>
<td>This is the average amount needed to serve one customer. Formula: (Total Expenses) / (Total Customers) = (Average Annual Expenses to Serve One Customer)</td>
</tr>
<tr>
<td>Customer Acquisition Cost</td>
<td>The cost to acquire one new customer</td>
</tr>
<tr>
<td>Percentage Cost of Workforce</td>
<td>The cost of the workforce as compared to all costs can be measured by summing all salaries and dividing by the total company costs within a given time period. Formula: (Salary Costs) / (Total Company Costs) = (Percentage of Cost of Workforce)</td>
</tr>
<tr>
<td>Healthcare Expense per Current Employee</td>
<td>The total price of health care costs divided out among all employees provides an understanding of the comprehensiveness of a company’s health care plan.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debt KPIs</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Quick Ratio/Acid Test</td>
<td>Shows the ability of an organization to meet any short-term financial liabilities, such as upcoming bills. Formula: ([Current Assets] - [Inventories]) / (Current Liabilities) = (Quick Ratio)</td>
</tr>
<tr>
<td>Price-Earnings Ratio (P/E)</td>
<td>An equity valuation multiple that compares an organization’s share price to its per-share earnings. Formula: (Market Value Per Share) / (Earnings Per Share) = (Price-Earnings Ratio)</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>Measures how an organization is funding its growth and using shareholder investments. Formula: (Total Liabilities) / (Shareholders’ Equity) = (Debt to Equity Ratio)</td>
</tr>
<tr>
<td>Debt Level</td>
<td>The amount of debt that an organization currently has.</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>Measures the ability of an organization to pay all of its debts over a given time period. Formula: (Current Assets) / (Current Liabilities) = (Current Ratio)</td>
</tr>
<tr>
<td>Bad Debt</td>
<td>Debt that is not collectible, and is often written off as an expense.</td>
</tr>
</tbody>
</table>
### Investment KPIs

<table>
<thead>
<tr>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>Saving Levels Due to Improvement Efforts</td>
<td>Many organizations look at investing in improvements, or merging operations (or even companies). This KPI looks at the dollar value of the savings achieved as a result of these investments.</td>
</tr>
<tr>
<td>Return on Innovation Investment</td>
<td>Can be calculated by looking at the revenue from new products, or the number of new products meeting a revenue threshold. This is typically only reviewed by organizations that have created an innovation department or budget.</td>
</tr>
<tr>
<td>Inventory Assets</td>
<td>The cost of merchandise purchased or manufactured, but not yet sold, may be a good leading indicator of preparedness for growth or even slowing growth.</td>
</tr>
<tr>
<td>Innovation Spending</td>
<td>The amount of money that an organization spends on innovation. Some organizations have this budgeted as research and development, and others have different accounting terms. Ultimately, if you use this measure, you are valuing innovation as a key strategic thrust.</td>
</tr>
<tr>
<td>Break Even Time</td>
<td>The time it takes an organization to break even from its investment in a new product or process. If the costs are big up front, this measure can help you understand how long it will take to recoup these expenses.</td>
</tr>
<tr>
<td>% Investment in...</td>
<td>Used for measuring investments in different lines of business. You might measure the percentage of your investment in organic products vs. total investment in products overall. Formula: (Amount of Investment) / (Total Capital Spent) = (Percentage of Investment)</td>
</tr>
<tr>
<td># of Key Capital Investments that Meet or Exceed ROI Expectations</td>
<td>Can be based on the plan for investments, or on the results of past investments. Useful for organizations that invest in many capital projects.</td>
</tr>
</tbody>
</table>

### Profitability KPIs

<table>
<thead>
<tr>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>Sales Growth</td>
<td>The change in an organization’s profits from one reporting period to another. Formula: ((Current Profit) - [Past Profit]) / (Past Profits) = (Profit Growth)</td>
</tr>
<tr>
<td>ROI (Return on Investment)</td>
<td>Shows the efficiency of an investment. Formula: ([Gain from Investment] - [Cost of Investment]) / (Cost of Investment) = (ROI)</td>
</tr>
<tr>
<td>Profitability KPIs</td>
<td>Description</td>
</tr>
<tr>
<td>-------------------------------------------</td>
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</tr>
<tr>
<td>ROE (Return on Equity)</td>
<td>The amount of net income an organization generates compared to the amount of shareholders’ equity. Formula: (Net Income) / (Shareholders’ Equity) = (ROE)</td>
</tr>
<tr>
<td>ROA (Return on Assets)</td>
<td>Indicates how profitable an organization is relative to its total assets. Formula: (Net Income) / (Total Assets) = (ROA)</td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>Measures an organization's profitability and the efficiency with which its capital is employed.</td>
</tr>
<tr>
<td>Program Profitability</td>
<td>Tracks the profitability of an individual program.</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>Measures income after variable costs of production are considered. Formula: (Operating Income) / (Net Sales) = (Operating Profit Margin)</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>The percentage of an organization’s revenue that is net profit. Formula: (Net Profit) / (Revenue) = (Net Profit Margin)</td>
</tr>
<tr>
<td>Net Profit</td>
<td>The amount of money an organization makes after taking out all expenses and other costs. Formula: (Income) - (Expenses) = (Net Profit)</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>The percentage of revenue that is profit after the cost of production and sales is considered. Formula: (Gross Margin) / (Revenue) = (Gross Profit Margin)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>An organization's profit after the cost of production and sales is considered. Formula: (Revenue) - (COGS) = (Gross Profit)</td>
</tr>
<tr>
<td>Economic Value Added (EVA)</td>
<td>An estimate of an organization's economic profit.</td>
</tr>
<tr>
<td>Average Capital Employed</td>
<td>Shows profitability compared to investments made in new capital.</td>
</tr>
<tr>
<td>Customer Lifetime Value</td>
<td>The net profit an organization anticipates gaining from a customer over the entire length of a relationship helps to determine the costs/benefits of acquisition efforts.</td>
</tr>
<tr>
<td>Customer Lifetime Value / Customer</td>
<td>The ratio of customer lifetime value to customer acquisition cost should ideally be greater than one, as a customer is not profitable if the cost to acquire is greater than the profit they will bring to a company. Formula: (Net Expected Lifetime Profit from Customer) / (Cost to Acquire Customer)</td>
</tr>
<tr>
<td>Acquisition Cost</td>
<td></td>
</tr>
<tr>
<td><strong>Profitability KPIs</strong></td>
<td><strong>Description</strong></td>
</tr>
<tr>
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</tr>
<tr>
<td>Human Capital Value Added (HCVA)</td>
<td>By taking all non-employee related costs away from the revenue and dividing the result by the number of full-time employees, one can deduce how profitable the average worker in an organization is. Formula: [\frac{\text{Revenue} - \text{Non-Employee-Related Costs}}{\text{Number of Full-Time Employees}} = \text{(HCVA)}]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Revenue KPIs</strong></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Sales Volume</td>
<td>The amount of sales in a reporting period, expressed in the number of units sold.</td>
</tr>
<tr>
<td>Sales Forecast Accuracy</td>
<td>The proximity of the forecasted quantity of sales to the actual quantity of sales.</td>
</tr>
<tr>
<td>ROI of R&amp;D</td>
<td>The revenue generated by investing money into research and development. Formula: [\frac{\text{Gain from Investment} - \text{Cost of Investment}}{\text{Cost of Investment}} = \text{(ROI of Research &amp; Development)}]</td>
</tr>
<tr>
<td>Revenue per FTE (Full time employee)</td>
<td>Demonstrates how expensive an organization is to run. Formula: (\frac{\text{Revenue}}{\text{Number of FTE}} = \text{Revenue per FTE})</td>
</tr>
<tr>
<td>Revenue Growth Rate</td>
<td>The rate at which an organization's income is increasing. Formula: [\frac{\text{Current Revenue} - \text{Past Revenue}}{\text{Past Revenue}} = \text{Revenue Growth Rate}]</td>
</tr>
<tr>
<td>Revenue</td>
<td>The total income an organization receives. Formula: (\text{Price of Goods} \times \text{Number of Goods Sold} = \text{Revenue})</td>
</tr>
<tr>
<td>Operating Income</td>
<td>The profit from operations after removing operating expenses. Formula: (\text{Gross Income} - \text{Operating Expenses} - \text{Depreciation &amp; Amortization} = \text{Operating Income})</td>
</tr>
<tr>
<td>Net Income</td>
<td>The amount of sales after subtracting discounts, returns, and damaged goods. Formula: (\text{Revenue} - \text{Expenses} = \text{Net Income})</td>
</tr>
<tr>
<td>EBT (Earnings Before Taxes)</td>
<td>Shows how much an organization has made after considering COGS, interest, and SG&amp;A expenses, before taxes are subtracted. Formula: (\text{Revenue} - \text{COGS} - \text{Interest} - \text{SG&amp;A} = \text{EBT})</td>
</tr>
<tr>
<td>Revenue KPIs</td>
<td>Description</td>
</tr>
<tr>
<td>-----------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>EBITDA</td>
<td>Measures revenue after expenses are considered and interest, taxes, depreciation and amortization are excluded. Formula: (Revenue) - (Expenses Excluding Interest, Tax, Depreciation &amp; Amortization) = (EBITDA)</td>
</tr>
<tr>
<td>Average Annual Sales Volume Per Customer</td>
<td>This is the average amount of sales per customer, expressed in currency. Formula: (Total Sales) / (Total Customers) = (Average Annual Sales Volume per Customer)</td>
</tr>
<tr>
<td>Asset Utilization</td>
<td>Total revenue earned for every dollar of assets an organization owns. Formula: (Total Revenue) / (Total Assets) = (Asset Utilization)</td>
</tr>
<tr>
<td>Share of Wallet</td>
<td>Measures the portion of a customer’s total spending that goes toward the company’s products and services.</td>
</tr>
<tr>
<td>EBIT</td>
<td>An indicator of a company’s profitability with expenses removed and interest and tax excluded. Formula: (Revenue) - (COGS) - (Operating Expenses) = (EBIT)</td>
</tr>
</tbody>
</table>

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