REPORT ON MCOM

UNIVERSITY OF GHANA

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1.0 EXECUTIVE SUMMARY

This is a report prepared to prioritize and evaluate the issues facing MCOM. The SNIPERS identified and prioritized five issues based on SWOT analysis, level of urgency and impact as follows:

1. Nakolia's crisis and legal wrangling
2. Nakolia's fine and capital structure implications
3. Political risk and strategic uncertainty in IIania
4. Mobile operator license in Chininsia
5. Shared Service Center in Sadimba

Recommendations are made along with appropriate actions. Ethical issues and their recommendations are also discussed.

2.0 INTRODUCTION

Mobile Communications **(MCOM)** Plc, is an African multinational mobile telecommunications giant. The company's overarching objective is to maximize shareholder value, It has 4 key operating segments; Sadimba, Nakolia, JV-Cellular and MCOM (others).

3.0 TERMS OF REFERENCE

The SNIPERS team of consultants are to prioritize, evaluate MCOM's issues and provide strategic advice to the Board. A breakdown of the S$6600m savings made on the SSC decision, an adjusted financials and a constructed case for relevant financial reporting rules applied need to be reported. Finally, an advice on principal audit considerations likely to guide auditors' risk assessments and a funding structure for the fine are requested

4.0 PRIORITIZATION OF THE ISSUES

4.1 Top priority – Security crisis and legal wrangling in Nakolia

This is topmost because of its high level of urgency, high level of impact and inherent threat (SWOT analysis). The S$3.9bn fine has a grave impact on MCOM and public attacks on MCOM need to be curtailed immediately.

4.2 Second priority – Nakolia fine and capital structure implication

This has a high level of urgency and impact. MCOM has 21 days to adjust its financials before auditors arrive. A suitable financial structure for the fine should be ready immediately.

4.3 Third priority - Political risk and strategic uncertainty in IIania

This presents a high level of urgency and impact, inherent threats and opportunities. Offers are open for a month and imminent indigenization laws threatens MCOM's stake in JV cellular.

4.4 Mobile operator license in Chininsia

This issue has a low level of urgency but a high level of impact with inherent opportunities. Bids are due in January 2017 and whichever option MCOM chooses has varying implications.

4.5 Shared Service Center in Sadimba

This has a low level of urgency and a high level of impact, with some cost-saving strength. The current uproar must be addressed immediately to restore stakeholders' confidence.

5.0 DISCUSSION OF THE ISSUES

5.1 Security and legal issues in Nakolia

Nakolia is in a state of security crisis and MCOM has been fined with US$3.9bn for noncompliance Terror attacks are a threat to MCOM (SWOT analysis, appendix 1) whiles new regulations form part of its political environment (PESTEL analysis, appendix 2). The fine is huge enough to affect financials and destroy its regulatory standing. MCOM has decided to seek court action. Two options are presented to MCOM:

Option 1: Pursuing the court case

Positive impact: If MCOM pursues the court case, it will have ample time to register more sim cards. Should they win the case, the fine could be reduced further.

Negative impact: MCOM risks incurring further expenses. If they lose the case, MCOM will suffer a great loss comprising the huge fine amount, legal expenses, bad reputation, and loss of subscribers.

Option 2: Comply and pay the fine

Positive impact: MCOM will avoid additional legal expenses and prevent a bad image.

Negative impact: MCOM's profitability will be affected, threatening their strategy of "*delivering sustainable growth and increasing stakeholder value*".

Although the NTRA does not make the payment of the fine a condition for MCOM's license renewal, Nakolia is MCOM's highest revenue stream thus it should not risk losing its license.

5.2 Nakolia fine and capital structure implication

MCOM's interim financials were prepared without factoring in the news of the hefty fine. Adjustments to the financials have been prepared in appendix 6, taking into account the matters to consider and relevant reporting rules:

1. The probable fine of S$58billion should be provided for, as an expense in the income statement and a liability in the statement of financial position (IAS 37).
2. The probable sale of MCOM's network towers at the fair value of S$20billion to Sidoms Limited should be provided for as a gain in the income statement and an asset (receivable) in the statement of financial position (IAS 37) since MCOM has accepted the offer.
3. The probable quote of S$5million from MCOM's legal advisers must be provided for as an expense and as a liability (IAS 37).
4. Payment of the lease instalments begins from March, 2016, hence it will not affect the adjusted financial statement. It must be disclosed as a sale and lease back transaction (IAS 17).
5. The impairment loss of S$4862million should be recognized as an expense in the income statement and reduce the goodwill value by the same amount in the statement of financial position (IAS 36).

6. The materiality level of S$2242.2million (1.4% of turnover) can be used as principal audit consideration.

It should be noted that IAS 10 (events after the reporting period) requires financial statements to reflect conditions that existed at the balance sheet date. Thus for:

a. Adjusting events: goodwill impairment, S$58bn fine and fair value of towers
b. Non adjusting events: sale of towers and lease of agreement

Advise on the principal audit consideration

1. Auditors should consider *the relative importance of an item* to appropriately classify and disclose transactions.
2. Auditors should draft *the necessary analytical procedures to assess possible risks* and help identify material misstatement.
3. Industry experts should be involved.
4. Perform further audit procedures at the assertion level for classes of transactions, account balances and disclosures that are responsive to risk of material misstatements.

Suitable Funding structure for the fine

Current gearing ratio (debt-to-equity) = 88%

Cost of debt: WACC = $(W_e*R_e) + (W_d*R_d)$

W_e = 88/188 = 0.47 W_d = 100/188 = 0.53

WACC (12) = (0.53*15)+(0.47 R_d)

$$R_d = \frac{12-7.79}{0.47}79 = 8.556\%$$

Cost of debt (8.556%) is cheaper than cost of equity (15%). Hence debt financing should be adopted.

5.3 Political risk and strategic uncertainty in Ilania

MCOM's future stake in JV Cellular is uncertain due to imminent indigenization laws, political unrest and international sanctions on Ilania. MCOM is faced with three strategic choices which are analyzed:

Option 1 Consolidate and expand

MCOM's stake will increase to 51% with the possibility of expanding to other Middle East countries. The cost-benefit analysis of this choice is shown below factoring in the probabilities of compliance, noncompliance and deviation of inflows.

a. Compliance and favourable outcome

Inflows – outflows
240,000 – (2,000+2,140)
0.56[235,860 +/- (0.25*240,000)]
NPV = S$(132,081 +/- 33600)m

b. Compliance and unfavourable outcome

24,000 – 4140
0.14[19,860 +/- (0.25*24000)]
NPV = S$(2780.4 +/- 840)m

c. Noncompliance

24,000 – 4,140
0.30[19,860 +/-- (0.25*24000)]
NPV = S$(5958+/- 1800)m

Total effects

(132,081 + 2,780 + 5958) +/- (33,600 +840 + 1800)
=S$(140,819 +/- 36,240)m

Option 2 Stay the course

MCOM can maintain its 49% stake and earn a perpetual growing dividend or sell its stake for S$28,000m.

If MCOM agrees to sell its stake, inflows = $\frac{5008 + 28,000}{1.12^2}$ = S$27329.43m

$$\text{Outflow} = \frac{5008(1.19)}{0.122} = \text{S\$49,662.7m}$$

$$\text{NPV} = \text{S\$27329.43m} - \text{S\$49662.7m} = -\text{S\$22333.27m}$$

If MCOM agrees to sell its stake, NPV will be negative. If it refuses, it will lose S$28000m but earn growing dividend. Also, keeping its 49% stake will shield it from the threat of indigenization laws.

Option 3 sell-off

Two offers have been made to MCOM

a. If MCOM sells its 49% stake to Bartini

Inflows = S$68,010m

Outflows = S$5800m + S$4210m + future dividends forgone (S$49,662.7m)

NPV = S$8,337.3m

Although this has a positive NPV, depositing the money in MCOM's account in IIania will be a breach of international law since majority of the stake held in JV Cellular is owned by IIanians. Inflows could be confiscated.

b. *If MCOM accepts the share for share exchange* worth S$85,000m from Turkish operator, MCOM will have a stake in their company. However inadequate information inhibits further evaluation.

5.4 Mobile operator license in Chininsia

MCOM has just qualified to bid for an operational license in Chininsia. This is an opportunity for MCOM to expand (SWOT analysis, appendix 1) and increase global market share as outlined in its strategic priorities. Although the environment is friendly, Michael Porter's five force analysis (appendix 4) shows an entry restriction, particularly by forcing firms to follow pre-emptive strategies. This is seen in the light of low prices charged by the big 4. Thus MCOM will be faced with stiff competition. The two strategic choices are examined below:

Option 1: Acquire 51% of CloudNet and bid as a local company:

	A win (S$m)	A lose (S$m)
Inflows	6262.00	1710.00
Less outflows:		
Acquisition cost	(2700.00)	(2700.00)
Tender price paid(0.51*2550)	(1300.50)	
Tender operation cost(0.51*5)	(2.55)	(2.55)
Net inflows	**2258.95**	**(992.55)**

Taking into account the probabilities given and assuming a 50-50 chance of change in the bidding rules,

$$\text{NPV} = 0.5[0.6(2258.95) + 0.4(-992.55)] + 0.5[0.4(2258.95) + 0.6(-992.65)]$$

$$\text{NPV} = \text{S\$633.2M}$$

Option 2: Bid directly and enter as a 100% foreign company:

	A win (S$m)	A lose (S$m)
Outflows		
Tender price paid(1.70*2550)	4335.00	
Tender operation cost(5*3)	15.00	15.00

MCOM will enjoy 100% profits, if it wins, and bear S$15m, if it loses. Taking into account the probabilities given and assuming a 50-50 chance that bidding rules will change or not, Below is a computation of total cost:

Total cost = 0.5[0.04(2250+15) + 0.96(15)] + 0.5[0.4(4335) + 0.6(15)] = S$960M

Testing if MCOM meets the gearing Critical Success Factor

$$\text{MCOM's debt-to-equity ratio} = \frac{53279 + 55952 + 11012}{133442} * 100\ \% = 88\%$$

Although MCOM does not meet the CSF target, it has an 88% gearing ratio which is almost equal to industry benchmark of 90% (V-Mobile). MCOM is therefore operating within industry standards and has a chance of qualifying for the license.

5.5 Shared Service Center in Sadimba

The breakdown of the S$6600m savings is as follows:

COST SAVINGS COMPUTATION				
	SADIMBA	NAKOLIA	MCOM(OTHERS)	TOTAL
Total operative hours (m)	45*1.6/60 =1.2	60*1.9/60 =1.9	90*1.8/60 =2.7	
Total operative cost (S$m)	(240*1.2) =288	(240*1.9) =456	(240*2.7) =648	1,392
Escalated transactions (m)	(0.2*1.6) =0.32	(0.3*1.9) =0.57	(0.6*1.8) =1.08	
Total manager hours	90*0.32/60 =0.48	120*0.57/60 =1.14	180*1.08/60 =3.24	
Total manager cost (S$m)	(480*0.48) =230.4	(480*1.14) =547.2	(480*3.24) =1,555.2	2,332.8
Total Overhead cost absorbed (S$)	1800*1.2 =2,160	1800*1.9 =3,420	1800*2.7 =4,860	10,440
full time operatives total salary (600*S$200,000) (m)				120
Total Cost without SSC				**14,284.8**
Total SSC cost recovery S$1450*(1.6+1.9+1.8)m				**7,685**
Total Cost Savings S$m (14,284.8-7,684)				**6599.8**

All transactions are handled by the operatives before a portion is escalated to managers.

Analyzing the SSC decision

Using the Johnson Scholes and Whittington SAF test:

Suitability: This decision fits into the company's strategy to 'remain lean, agile and competitive and to deliver stakeholder value.

Acceptability: Although shareholders are delighted about the outcome of cost savings, other stakeholders (local partners, employees and general public) are unhappy.

Feasibility: This decision has already been implemented by MCOM and is yielding positive economic returns. The location of the SSC at the headquarters is also very advantageous in terms of resources.

6.0 ETHICAL ISSUES AND RECOMMENDATIONS

Three ethical issues have been identified:

- SSC decision
- Failure to deactivate unregistered sim cards
- Releasing private information to the IIanian government

6.1 SSC Decision

The ethical dilemma in this case is: should MCOM continue with the 'cost reduction' at the detriment of workers' jobs? Although calls for boycott have not had any impact on their revenue and operations, constant uproar could affect profitability.

6.1.1 Recommendation

1. Hold a public forum to explain MCOM's cost efficiency agenda.
2. Explain the new strategy to workers and provide compensations for the laid off employees

6.1.2 Justification

1. The public are the subscribers of MCOM services which makes them key players (stakeholder analysis, appendix 3) If not satisfied, they could easily boycott MCOM. To prevent this, the media should be kept informed so they send the right messages across.
2. Employees are key stakeholders who help drive the company's objectives.

6.1.3 Action plan

1. Organize a forum immediately for the public and employees
2. Set up a team to provide compensation to the laid off workers

6.2 Failure to deactivate unregistered sim cards

This is an ethical issue because MCOM seems to be concerned about losing subscribers at the demise of the nation's security. The upheaval caused by the fine reduction should be enough to inform MCOM how grave the matter.

6.2.1 Recommendation

1. Comply and deactivate all unregistered sim cards immediately
2. Release a press report to apologize for noncompliance
3. Redirect CSR activities to help address the security crisis.

6.2.2 Justification

1. Complying with the law will help MCOM achieve its strategy of improving regulatory standings

2. This move will show that MCOM is sensitive to their needs and improve its image
3. MCOM should have a flexible CSR plan that addresses current issues. This will improve its community ratings as a responsible company.

6.2.3 Action Plan

1. Deactivate all unregistered sim cards
2. Release a public statement
3. Prepare a new CSR activity plan

6.3 Releasing private information to the ILanian government

This is an ethical issue because MCOM may be acting right by obeying the law. However, should this threaten human rights? Civil watchdogs have called on MCOM to withdraw from IIania to show their commitment to human rights.

6.3.1 Recommendation

1. MCOM should comply the country's laws but appeal to the government on the people's behalf.
2. MCOM should communicate to the watchdog group of its intention to convince the government to stop convicting the demonstrators.

6.3.2 Justification

As a corporate citizen, it is important that MCOM obeys the laws of the country. Appealing to the government to stop will show that MCOM's concern on human rights.

6.3.4 Action plan

Appeal to the government on the people's behalf.

7.0 RECOMMENDATIONS

7.1 Security crisis and legal wrangling in Nakolia

7.1.1 Recommendation

1. Halt the court case and deactivate unregistered sim cards.
2. Set up a contingent liability.
3. Review CSR policies to include activities that borders around national security such as providing CCTV cameras at vantage points in the country and in schools

7.1.2 Justification

1. There is a high possibility MCOM will lose the case on the grounds of fundamental breach of law. The stakeholder analysis (appendix 3) shows that the NTRA has high power and high interest and MCOM could be risking its license. If MCOM withdraws the case and deactivates the sim cards, it would show MCOM'S commitment in eradicating the crisis and help retain its license.

2. The fine meets the criteria in IAS 37 which says: To recognize a provision, there must be a present obligation from past event which have a probable outflow of economic benefits and can be measured reliably in terms of fine and cost.

3. Ensuring national security is the government's priority hence CSR should be tailored towards these areas to show some support and help boost MCOM's image. Notwithstanding, they should not neglect their earlier CSR strategy of creating jobs and supporting soccer.

7.1.3 Action plan:

1. Suspend the case and provide for contingent liability.
2. Deactivate unregistered sim cards immediately and apologize for breach of law.
3. Revise CSR activities and communicate them to the public.

7.2 Nakolia fine and capital structure implication

7.2.1 Recommendation

1. Apply the statements addressed in the matters considered
2. Sell off the towers
3. Acquire bank loans to offset fine
4. Issue bonds and debentures

7.2.2 Justification

1. The report produced are in line with IAS
2. These towers are passive investments and should be monetized. Weighing Lewin's force field analysis, the restraining factor supersedes the enabling factors and hence must be mitigated. The best way to achieve this is to comply with the law
3. Cost of debt is cheaper than cost of equity hence, it is better to seek more loans and enjoy tax shields.
4. These are long term debt obligations that MCOM can use to raise funds.

7.2.3 Action Plan

Issue bonds and debenture, acquire bank loans and Sell off towers

7.3 Political risk and strategic uncertainty in IIania

7.3.1 Recommendation

1. consolidate and expand
2. Pay the extra cost of S$200,000m for possible expansion.

7.3.2 Justification

Even though MCOM's current stake of 51% shares exposes it to outright nationalization, this is possible only when the government of IIania does not comply, which is only a 30% chance. This risk is acceptable with MCOM since it is in line with its risk tolerance range. Due to hyperinflation in IIania is it will be wise for MCOM to pay the said amount now

7.3.3 Action plan

1. Consolidate and expand.
2. Pay the extra cost of S$200,000m.
3. Monitor government's activities closely.

7.4 Mobile operator license in Chininsia

7.4.1 Recommendation:

1. Acquire 51% of CloudNet and bid as a local company with an attractive price
2. Upgrade to 4G network and aim for a 4.5G network.
3. Improve gearing ratio to be within the range of 90%-100% and carbon emission rate.
4. Practice cost leadership and low pricing.
5. Establish relationships with mobile phone manufacturers.

6. Adopt innovative services (such as proving town and city wireless internet services) and liaise with restaurants, companies and buses to provide internet services at their premises.

7.4.2 Justification

1. Although MCOM may earn 100% profit if it enters as a foreign company and wins, it is not suitable for new entrants due to entrants-deterrent measure and stiff competition in the Chininsia market. This move may cause MCOM to incur losses from heavy capital outlay, recruitment cost, advertising cost, forced low pricing *inter alia* as identified in Michael Porters 5 forces analysis (appendix 4). If MCOM acquires 51% of CloudNet, there is a positive NPV of S$633.20, a 51% share of CloudNet's profit, a probable increase in share prices, added synergies as shown in CharterQuest's competitor analysis as well as an achievement of a lean and competitive strategy.
2. There is a growing global demand for 4G network thus, it will be beneficial for MCOM to upgrade to remain competitive in the market. Necessary steps should be taken to move to a higher data speed network like 4.5G to have an urge over its competitors and attract more customers. Besides, the Chininsians are heavy data users.
3. Improving its gearing ratio and carbon emission rate closer to set targets will enable it to fully meet the CSF in future years when the time for renewing license approaches.
4. From Ansoff's matrix (appendix 5), in an environment that has an existing market and product, one must adopt the market penetration strategy of low pricing, buying rivals as well as cost leadership to remain competitive.
5. With an increasing demand for smart phones, MCOM should establish links with mobile phone manufacturers so that they will be the network provider of such phones.
6. With a high demand for data, MCOM should provide high-speed internet services at every corner of the country. This will attract people to adopt its services

In summary, on the basis of SAF test, this practice is suitable, acceptable and feasible because it meets strategic goals of increasing market share, acceptable by stakeholders and within MCOM's resources.

7.4.3 Action Plan

1. Set aside S$2700m to purchase 51% share of CloudNet
2. Appoint a qualified person to serve as a Board Member in CloudNet
3. Study rivals to monitor their bidding price in order to bid a price above them
4. Employ qualified personnel in Chininisia who can assist MCOM to upgrade to 4G or a higher network.

7.5 Shared Service Center in Sadimba

7.5.1 Recommendation

1. Review the SSC decision to ensure its acceptability and suitability
2. Hold a forum for all stakeholders to address the issue

7.5.2 Justification

1. For the decision to be implemented successfully, the three factors of the SAF test must be fully met. As such, the suitability and acceptability factors considered in the SSC decision should be addressed to ensure that it is acceptable by all stakeholders and it fits perfectly into the strategy.
2. Senior managers, local partners, employees, general public and co shareholders are key players (stakeholder analysis, appendix 3) who need to be involved. Participation is the key to dealing with them as such there must be communication to explain to them the reason for their actions.

The media who have low power but high interest should be kept informed by realizing a press statement.

7.5.3 Action plan

1. Release a press report for the general public
2. Hold a special forum for all key stakeholders

CONCLUSION

Undoubtedly, MCOM has a bright future in the telecommunications industry. If they manage these issues well and carefully consider the SNIPERS team's recommendations and advice, shareholders will soon be earning sky-rocketing value on their investments.

APPENDICES

APPENDIX 1 SWOT ANANLYSIS

STRENGTHS	**WEAKNESSES**
1. Strong technical standing **2.** Transforming internal operations **3.** Differentiation with broad appeal	**1.** Inability to migrate to 4G
OPPORTUNITIES	**THREATS**
1. Increasing demand for data **2.** Untapped market in Africa **3.** Invitation for "expression of interest" in Chininsia **4.** Consolidate and expand	**1.** Stiff competition from rivals **2.** Terrorist activities **3.** Increase competition of online service providers. **4.** Favors towards local companies **5.** Changing reforms by new political parties **6.** No exit compensation if one loses license in Chininsia for existing infrastructure **7.** Hefty fine from Nakolia **8.** Indigenization laws

APPENDIX 2 PESTEL ANALYSIS

Political

- Risk of terrorist attacks
- New laws on industry regulations
- Introduction of telecommunication regulatory authorities
- Change of political power

Economic

- Hyper inflation
- Developed Chininsia market

Social

- Increasing use of social medias
- Increasing concern of data privacy and protection
- Both educated and non-educated users

Technology

- Introduction of mobile virtual network operators and mobile number portability
- Advanced technology such as smart home and LTE networks
- New application softwares

Environment

- Good environment for erecting infrastructure in Chinisia

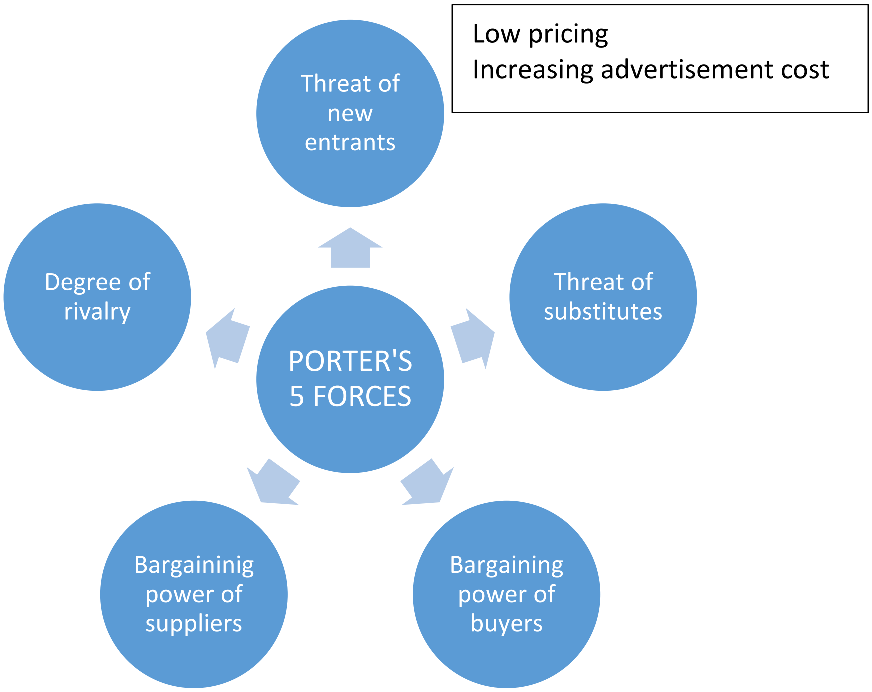
Legal

- New laws such as mobile number porting promulgation
- Restrictions in foreign nations

APPENDIX 3 MENDELOW'S STAKEHOLDER ANALYSIS MATRIX

	LOW INTEREST	**HIGH INTEREST**
HIGH POWER	KEEP SATISFIED • government	KEY PLAYERS, KEEP CLOSE • NTRA • Shareholders • The public including Subscribers • senior managers • local partners • employees • general public • co shareholders
LOW POWER	MONITOR • Non regular customers	KEEP INFORMED • The media • Civil liberty watchdogs

APPENDIX 4: MICHAEL PORTER'S FIVE FORCES



APPENDIX 5: ANSOFF'S MATRIX

	Existing Product and Service	**New Product and Service**
New Market	Market development	Diversification
Existing Market	Market penetration	Product development

APPENDIX 6: ADJUSTED FINANCIAL STATEMENTS

Figure 1 Abridged Income Statement

INCOME STATEMENT FOR THE YEAR ENDED 2015 (S$ Million)

	NOTES	2015
Revenue		160154
Other Income	1	28800
Operating Expense	2	145389
EBITDA		**43565**
Depreciation and amortization		23879
Impairment of goodwill	3	4862
Operating Profit		**14824**
Net Finance Cost		2568
Net Monetary gain		527
Share of results of associate and Joint Venture after tax		5008
Profit before tax		**17791**
Income tax expense		15871
Profit after tax		**1920**

Figure 2 Abridged Statement of Financial Position

STATEMENT OF FINANCIAL POSITION AS AT 2015 (S $ Million)

	NOTES	2015
Non-Current Assets		
Property, plant and equipment		89209
Goodwill and intangible assets	4	41687
Investment and loans		24978
Deferred taxes		13256
		169130
Current Assets		
Bank balances, deposits and cash		47495
Other current assets	5	64971
receivable from sale of towers		
Total assets		**281596**
Equity		
Equity attributable to equity holders of the company	6	98628
Non-controlling interests		5896
Total equity		**104524**
Non-Current Liabilities		
Interest-bearing liabilities		56059
Deferred tax liabilities		11984

		68043
Current Liabilities	7	109029
Total Liabilities		**177072**
Total equity and liabilities		**281596**

NOTES

1. This figure includes a provisional gain from the sale of MCOM's network towers to Sidom Limited at a fair value of S$20billion.
2. The value for operating expense includes a provisional expense of S$58billion being the probable fine that MCOM is liable to pay. This amount includes an expense - the quoted charge from MCOM's legal adviser (S$5million).
3. This figure represents MCOM's goodwill impairment of S$4862M, which has been expensed as per IAS 36.
4. This figure represents a reduction in goodwill by S$4862 due to an impairment in goodwill by the same amount.
5. The value of other current assets has increased by S$20billion representing a receivable from Sidom Limited in the sale of MCOM's network towers.
6. This figure represents a decline in MCOM's equity shareholders value due to a decrease in net income by S$42866M to the adjusted figure of S$1920M
7. The value for the current liability includes a provision of S$58billion being the probable fine that MCOM is liable to pay. The figure also includes a provisional liability of S$5million (the quoted charge from MCOM's legal adviser).