A Board Report on the Key Issues Facing MCOM

University of Pretoria
Mentor and Brand Ambassador: Elize Kirsten

Team number: 116

Team members:
Jenevieve Badenhorst
Caitlin O'Donoghue (Group Leader)
Kristin Williams

Table of Contents

Executive Summary

Introduction

The use of telecommunications is increasing globally with almost untouched markets throughout Africa. MCOM considers this an advantage and has invested in numerous developing African countries. This report discusses a number of issues including the legal proceedings regarding the Nakolian fine as well as the consideration with regards to a license tender in Chininsia. The breakdown of the savings due to the shared services centre in Sadimba and the broader assessment of the SSC decision are also focused on in this report.

The global telecommunications market still offers a wide range of opportunities for expansion in revenue and general services. Although there are many opportunities, there is also the political risk and strategic uncertainty in Ilania that needs consideration. Furthermore, even though MCOM is facing its currents issues, they are still optimistic that the issues can be resolved without a huge negative impact to the functioning of the company.

Terms of Reference

The purpose of this report is to identify and prioritise the key issues facing MCOM and to suggest appropriate solutions.

Identification and Prioritisation of Key Issues

The criteria used to determine the priority of each issue is based on the impact the issues have on MCOM and their ability to produce profits.

Political Risk & Strategic Uncertainty in Ilania

Due to the enriching uranium International law states that it is breaching the International law to deal financially in Ilania, this has a negative impact as MCOM required funding in the form of a loan which they cannot retrieve due to this law. However, MCOM are researching other options to retrieve this funding in order to continue their business operation in Ilania.

Security Crisis and Legal Wrangling in Nakolia

There is a negative impact emanating from the use of the mobile networks with unregistered SIM cards and the resulting enforcement by the Nakolian Telecommunications Regulatory Authority (NTRA) leading to fines granted for not complying with the regulations in time. The reduction in the fine amount has discouraged locals even further as they believe it is infringing on fundamental rights.

Nakolia Fine & Capital Structure Implications

Material matters regarding the fine should be brought the attention of management as the legal proceedings could significantly impact the current financial situation of MCOM. Amendments need to be made to the current financial statements in order to address this issue.

Shared Services Centre (SSC) in Sadimba

The potential loss of jobs resulting from withdrawing key operational support from other areas in Africa is negatively impacting the brand's name as a whole. MCOM is being portrayed as abandoning its corporate social responsibility due to removing the key operational support from other countries, and is experiencing pressure from locals to reverse this decision.

Mobile Operator License in Chininsia

This deals with the renewal of 4 mobile licenses in Chininsia, but only the top operators get accepted for this mobile license. MCOM is considering the decision whether they must tender for this mobile operator license in Chininsia or buy shares in CloudNet in order to obtain the license, however there is the choice of not tendering at all.

Key Recommendations

Political Risk & Strategic Uncertainty in Ilania

To determine whether there are feasible options to retrieve the funding required for the continuation of operations in Ilania, to establish the extent of political risk facing MCOM, and to decide on the best strategy approach to take with regards to the future of MCOM in Ilania.

Security Crisis and Legal Wrangling in Nakolia

The key recommendations would be to prioritise the compliance of registering SIM cards in the name of the owners and deactivate the required SIM cards that have not yet been registered to comply with the CIMA Code of Ethics. Furthermore, to allocate resources to acquire funding to pay for the fine incurred - the payment of the fine will be further discussed with problem three.

Nakolia Fine & Capital Structure Implications

Independent appraisal of the financial statements to verify the material matters that were discovered will in fact affect the face of the financial statements and state the adjustments that need to take place.

Mobile Operator License in Chininsia

The key recommendation with regards to this opportunity is to buy 51% shares in CloudNet and the market growth will be explained by referring to the Ansoff's product/market matrix (appendix 2).

Shared Services Centre (SSC) in Sadimba

The key recommendations would be monetising passive investments and moving key operational support to Sadimba to compensate for the Nakolian fine and increase savings. This is discussed using the Johnston and Scholes SAF analysis and with reference to the Ansoff's product market matrix (appendix 2).

Detailed Report

This part of the report will focus on the issues that require the board of directors' attention and why they have been prioritised in this particular order.

Detailed Findings and Recommendations

Political Risk & Strategic Uncertainty in Ilania

The issues facing MCOM is that of retrieving the dividends and loan owed to them by JV Cellular through legal means, the announced plan by the Ilanian government to surrender a certain portion of the company's equity to the citizens of the country, and the pressure from civil liberty watchdogs to withdraw from Ilania after demonstrators were convicted with information originating from MCOM and other mobile operators.

The three strategies suggested are discussed below.

Strategy 1:
MCOM is faced with the decision to either consolidate and expand or exit the country and realise the capital from the sale of the investment. The capital from the sale could aid MCOM financially as they need to pay off the fine issued to them in Nakolia. However, MCOM would lose a key position in the investment market if they left the country and would give competitors a chance to increase their own business profits. The consolidation and expansion would require MCOM to increase their shares in JV Cellular and spend more money in order to secure cash flows allowing MCOM to expand into Middle Eastern markets in 5 years' time.

Strategy 2:
This strategy allows MCOM to remain in their original position with the option to sell its entire holding at the end of 2017, making this strategy favourable to MCOM's risk appetite and tolerance.

Strategy 3:
For option one, MCOM would be required to renounce its claim to the loan and dividends owed to them by JV Cellular if they sold to the Indian cell phone group Bartini. As Bartini is also a major competitor, this would increase Bartini's stake in mobile operations and would negatively impact on MCOM's reputation. The second option would be more beneficial for MCOM as it would be a share-for-share exchange worth more than the amount offered in option one.

<u>Recommendation</u>:
As MCOM has a low risk appetite and smaller tolerance of risk, the second strategy would be the most favoured to implement as it does not require capital investment or losing out of the potential investment market. Calculations to further support this recommendation are found in Appendix 4.

Security Crisis and Legal Wrangling in Nakolia

Most Governments have set up Telecommunications Regulatory Authorities which allows them to have the legal authority to impose restrictions and enforce these restrictions when needed for the benefit of the citizens of the country. Therefore the Nakolian Telecommunications Regulatory Authority (NTRA) does have the authority to impose the fine upon MCOM and may determine to what extent it should be enforced. However, the actions of the NTRA are subject to legal review and thus MCOM can legally challenge the grounds of the fine.

While MCOM is in good standing with relation to the Corporate Social Responsibility (CSR)-related projects in Nakolia, residents of the country are concerned about the impact on their safety and security due to MCOM not meeting the extended deadline. The failure to register all SIM cards and deactivate unregistered SIM cards could be seen as trying to 'aid' Blokanda - as it is believed they use the unregistered SIM cards to organise terrorist attacks - and thus infringe on the fundamental rights of citizens as guaranteed by the Nakolian Constitution.

Allowing a reduction in the fine is shedding negative light on MCOM as people are concerned about the lack of enforced accountability towards large corporations and their disregard for the citizens' fundamental rights of security. The challenge of the fine from MCOM is furthering public distrust in the government to hold large corporations accountable

<u>Recommendations:</u>
Effective immediately, MCOM should broadcast a notice stating all unregistered will be deactivated within a stated period and formulate the statement and decided action as such that it is the subscriber's responsibility to ensure the SIM card is registered before it is deactivated. This would ensure compliance with stated regulations and gain the public's support in favour of protecting their personal security.

The issue of payment of the fine will be further discussed and recommendations given in issue three - Nakolian fine and capital structure implications.

Nakolia Fine & Capital Structure Implications

The fine charged to MCOM in Nakolia for non-compliance was not taken into account by management. This fine has caused a 25% loss of current market capitalisation and requires urgent attention as it has a significant impact on MCOM's reputation. Cash flow and equity have also been negatively impacted following the charge of the fine.

An independent appraiser should review the financial statements and report on any material matters that have not yet been addressed in the interim financials. A qualified audit report would also assist MCOM in determining all financial statements are correct and all material matters have been taken into account. MCOM could capitalise on more assets or look for potential investors in order to pay off the fine.

Recommendation:
MCOM should address the fine situation as swiftly as possible in order to retain a good reputation in the business community. The settling of the fine could possibly lead to a share price increase after the losses MCOM suffered due to the fine. The sale of the towers amounting to S$20 billion should be disclosed in the financial statements and a note stating that this capital is going towards the payment of the fine (refer to Appendix 5).

Shared Services Centre (SSC) in Sadimba

MCOM has decided to move all key operational support activities back into Sadimba to its SSC headquarters in order to increase the savings already attained. In 2014, the Shared Services Model delivered savings of almost S$6600m which is made up of the following:

	MCOM Sadimba	MCOM Nakolia	MCOM (All others)	TOTAL
Overhead costs absorbed per operative hour (S$)				1800
Standard operative costs per hour (S$)				240
Standard Manager costs per hour (S$)				480
Additional number of full time non-operative staff no longer required		400	200	600
Average salary of full time non-operatives staff no longer required				200 000
Average cost recovery per transaction by SSC for processing on behalf of MCOM businesses (S$) (75% is new personnel cost)				1450

However, moving all key operational support back into Sadimba is concerning for all employees currently employed in the other African countries. The Johnston and Scholes SAF analysis is used to assess the merits of moving all key operational support to the SSC in Sadimba.

Sustainability:
The move allows MCOM to save on the additional salaries and wages required for people working in other African countries. This would allow them to realise capital in order to contribute towards paying off the Nakolia fine as well as increase the investment within their own country. Expanding on the digital revenue options available to MCOM is also considered beneficial in the long run as MCOM will then have a base market in digital revenue.

Acceptability:
The move is not widely accepted by employees as there is fear of job-loss and a negative impact on the various economies. The main shareholders are encouraged to support the move as the company would be saving revenue on jobs that can be condensed into one service centre.

Feasibility:
MCOM needs to look at the size of the services required from various countries and determine whether all services could run just as efficiently out of one service centre. MCOM should also take into consideration the impact negative publicity will have on the brand name and the overall production of the company if the move continues to the SSC in Sadimba.

Recommendations:
Retain a few key positions in the currently occupied African countries as compensation for taking majority of the low level transaction processing jobs away from these countries. Negotiate how MCOM will give back to the communities it currently supports through Corporate Social Responsibility projects.

Mobile Operator License in Chininsia

The four mobile licenses in Chininsia require renewal in 2018 and MCOM is considering competing in the tender to become one of the main operating mobile telecommunications company in Chininsia.

The following three main options require consideration with regards to this issue:
1. Whether MCOM should acquire 51% of CloudNet and significantly increase their chance of being accepted for the tender
2. Whether MCOM must bid directly and enter as 100% MCOM Chininsia Limited
3. Whether MCOM should tender for the license at all

It can immediately be stated that not bidding at all would cause MCOM to lose the advantage of a large investing market and lose a chance to increase revenue.

From the table below, it is clear that there are numerous advantages in acquiring the 51% of CloudNet as opposed to bidding for the tender outright. CloudNet already has the necessary infrastructure and materials in place and also has a good understanding of the country - its laws and regulations - and the country's culture. Even if CloudNet do not win the tender, it is considered advantageous to own 51% of the company as they are internationally recognised and have global offices which will expand MCOM as a company.

The differences between option 1 and 2:

	Acquire 51% of CloudNet	**Bid directly as a 100% MCOM Chininsia Limited**
Licensing (If bidding rules are the same)	CloudNet is already an existing license holder and it states that all existing license holders have a 40% chance of winning which is already a bonus if MCOM acquires 51% of CloudNet.	MCOM is not an existing license holder and this will cause a negative effect since it will cost them 70% higher to secure a chance of winning, this is a very big expense to consider and it would not be good to MCOM considering the fact that they might not even get the tender.
Licensing (If bidding rules are changed)	This is to favour existing license holders, by keeping the tender price the same amount of S$2550m, which would lead to the effect that all license holders have a 60% chance of winning.	This is not good at all for a non-license holder like MCOM since there is only a 4% chance for foreign companies to win which is like a drop of water in the ocean.
Tender preparation costs	- S$5million	- 3 Times higher - Therefore S$15million

The Ansoff's product/market matrix assists in understanding where and in what market this issue places MCOM. The CloudNet acquisition would be considered market penetration a Dan is advantageous to MCOM as CloudNet is already familiar with this specific market. If MCOM had to bid outright, this action would place them in market development. Caution should be given toward this option as it can be an expensive and time-consuming exercise trying to adapt to the new market and could lead to MCOM falling behind other competitors (refer to appendix 2).

<u>Recommendation:</u>
The best choice for MCOM would be to purchase 51% of CloudNet as this increases their chance of winning the tender and expanding as a global company. MCOM should perform the necessary administration to ensure the acquisition is processed through correct channels. CloudNet can then inform MCOM of any future changes with regards to the tender and the overall functioning of the company.

Ethical Issues and Recommendations

The ethical considerations of the above issues have been analysed and recommendations to the above issues are as follows.

Political Risk & Strategic Uncertainty in Ilania

The ethical dilemmas MCOM are facing are the data protection of its customers and the portion of equity to be surrendered to the citizens of the country. MCOM should have specific data protection laws as part of their company policy in any country and only share information if required by government for crime prevention purposes. If the announced plans go through, MCOM should reach an agreement with the government stating that they will give back to the citizens in the form of Corporate Social Responsibility projects.

Security Crisis and Legal Wrangling in Nakolia

The ethical dilemma MCOM faces is the infringement of fundamental rights of the people of Nakolia as stated in the Nakolian Constitution. The lack of enforced accountability as felt by the reduction of the fine is considered as further cause for concern by citizens - the government and MCOM have disregarded their fundamental right of security and in doing so, MCOM has violated the professional behaviour principle as stated in the CIMA Code of Ethics (Appendix 3). This could be rectified by ensuring compliance with all relevant laws and regulations as imposed by the NTRA as well as discovering strategies to pay the fine.

Nakolia Fine & Capital Structure Implications

Non-compliance with the regulations set out by the government is in direct violation of the CIMA Code of Ethics and the prolonged wait for the outcome of the fine is further decreasing MCOM's ethical reputation. This could have a big impact of what the outcome of the financial statements might be after correcting the problem and including the fine in the financials which immediately affects the reputation of MCOM. MCOM also has a moral responsibility to pay the fine directly linking to the ethical issue with regards to this matter.

Mobile Operator License in Chininsia

Ethical consideration only needs to be given if CloudNet win the tender. MCOM and CloudNet should ensure that locals are employed at every opportunity before looking abroad to fill a position.

Shared Services Centre (SSC) in Sadimba

Moving all key operational support back to Sadimba is not considered ethical by the public due to the large job-loss that will occur in all the currently occupied African countries. News reports have stated that MCOM is neglecting its Corporate Social Responsibility towards these African countries as there will be no benefit to their economies even though they would be paying to use the services.
MCOM should consider drawing up an agreement with the current African countries stating that at least a small percentage of revenue earned will be given back to the communities in those countries and work it as part of MCOM's Social Corporate Responsibility program.

Conclusion

These five issues are considered as the most urgent matters that need to be addressed by the Board of Directors and Management and have recommendations pertaining to the issues.

Appendices

Appendix 1

<u>SWOT analysis</u>

Strengths
- 4 key operating segments situated in various countries
- Profits have increased over the years due to strategic decisions
- Decrease in risk tolerance and risk appetite

Weaknesses
- Non-compliance with the regulatory association in Nakolia
- Lack of financial resources to pay the Nakolian fine
- Material misstatement of financials

Opportunities
- Investments in new capital to ensure growth of the company
- Buy 51% shares in CloudNet and therefore tendering for the mobile operator license in Chininsia

Threats
- Legal action against them if the fine is not settled
- Various other competitors entering the market for mobile operator licenses
- The reputation of the company could decline if problems are not addressed correctly

Appendix 2

<u>Ansoff's product/market matrix</u>

		Products	
		Existing	New
Markets	Existing	**MARKET PENETRATION** MCOM buys 51% of	**PRODUCT DEVELOPMENT**
	New	**MARKET DEVELOPMENT** MCOM enters the bid for the tender as themselves	**DIVERSIFICATION** MCOM considers expanding digital revenue options

Appendix 3

CIMA Code of Ethics

Fundamental Principles

Integrity

- ◊ The financial manager should be straightforward, honest and truthful in all professional and business relationships.
- ◊ The business should not be associated with any information that is believed to contain a materially false or misleading statement or which is misleading by omission.

Objectivity

- ◊ Not allowing bias, conflict of interest or the influence of other people to override your professional judgment

Professional competence and due care

- ◊ An ongoing commitment to your level of professional knowledge and skill
- ◊ Base this on current developments in practical legislation and techniques
- ◊ Those working under your authority must also have the appropriate training and supervision

Confidentiality

- ◊ You should not disclose professional information unless you have specific permission or a legal or professional duty to do so

Professional behaviour

- ◊ Comply with relevant laws and regulations
- ◊ You must avoid any action that could negatively affect the reputation of the profession

Appendix 4

Calculations:

Strategy 2:
S$240 000 000 + (S$5 008 000 x 5 years) = S$265 040 000
MCOM's entire holding: S$28 000 000

Strategy 3:
Offer 1: S$68 010 000 – S$5 800 000 – S$4 210 000 000 = - S$4 147 790 000
Offer 2: S$85 000 000

Appendix 5

Financial statements:

MCOM PLC

ABRIDGED INCOME STATEMENT (S$ millions)	2014	2015
Revenue	***146,930***	***160, 154***
Other income	7,928	8,800
Operating expenses	(81,667)	(87,384)
Operating expenses	-	(5)
EBITDA	**73,191**	**81,565**
Depreciation and amortisation	(21, 513)	(23,879)
Impairment of goodwill	(2,033)	(4,862)
Operating profit	**49,645**	**52,824**
Net finance costs	(3,668)	(2,568)
Net monetary gain	878	527
Share of results of associates and join ventures after tax	4208	5,008
Profit before tax	**51,063**	**55,791**
Income tax expense	(13,702)	(15,871)
Profit after tax	**37,702**	**39,920**

ABRIDGED STATEMENT OF FINANCIAL POSITION (S$ millions) 2014	2014	2015
Non-current Assets		
Property, plant and equipment	87,546	69,209
Goodwill and intangible assets	36,618	41,687
Investment and loans	37,945	24,978
Deferred taxes	1,109	13,256
	163,218	**149,130**
Current Assets		
Bank balances, deposits and cash	48,736	47,495
Other current assets	41,731	44,971
	90,467	**92,466**
Total assets	**253,685**	**241,596**
Equity		
Equity attributable to equity holders of the company	128,517	141,494
Non-controlling interests	4,925	5,896
Total equity	**133,442**	**147,390**
Non-current Liabilities		
Interest-bearing liabilities	53,279	56,059
Deferred tax liabilities	55,952	11,984
	64,291	**68,043**
Current Liabilities	55,952	51,025
Total liabilities	**120,243**	**119,068**
Total equity and liabilities	**253,685**	**266,458**

ABRIDGED STATEMENT OF CASH FLOWS (S$ millions) 2014		**2015**
Net cash inflows from operating activities	27,132	37,132
Net cash used in investing activities	(25,991)	(35,991)
Net cash from/(used in) financing activities	2,639	3,640
Net increase/(decrease) in cash and cash equivalents	**3,780**	**4,781**
Cash and cash equivalents at start of the year	39,577	43,072
Exchange (losses)/gains and monetary loss on cash and cash equivalents	(285)	(385)
Cash and cash equivalents at end of the year	**43,072**	**47,495**
Statement of cash flows -extracts		
Cash generated from operations	64,628	76,628
Dividends paid to equity holders of the company	(20,527)	(31,809)
Acquisition of property, plant and equipment	(19,562)	(2100)

Note 1:
The sale of the tower has not yet taken place so the S$20billion will not be included in revenue in terms of IAS 16
Note 2:
The fine of S$58billion is outstanding and will be payable the following year