CIMA

Final Level

Management Accounting – Case Study

15 FLCS

PRE-SEEN MATERIAL, PROVIDED IN ADVANCE, FOR PREPARATION AND STUDY FOR THE EXAMINATION TO BE HELD ON THE AFTERNOON OF THURSDAY, 21 NOVEMBER 2002

INSTRUCTIONS FOR POTENTIAL CANDIDATES

This booklet contains the ***pre-seen case material*** for the November 2002 examination. It will provide you with context information that will help you to prepare yourself for the examination on 21 November.
You may not take this copy of the pre-seen material into the examination hall. A fresh copy will be provided in the examination hall.
Unseen material will be provided for the examination: this will comprise further context information and the examination question.
The examination will last for three hours.
You will be required to answer one question which may contain more than one element.

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Constro (Pty) Ltd

Background to telecommunications in Africa

Africa is some way behind the rest of the world in terms of communications and even landlines are few and notoriously unreliable. Because of government bureaucracy in some countries, waiting lists for landlines are long, and high tariffs have contributed to the fact that all but wealthy individuals and multinational businesses have no access to basic communication services.

Africa has experienced many problems throughout the last century, including political instability in many countries and natural disasters. For these reasons alone, few companies have been enthusiastic to invest large amounts in infrastructure since the level of returns is so uncertain.

Some countries in Africa are now undergoing a period of change, and investment in the vital infrastructure is at last happening, although many African countries remain underdeveloped. Historically, most of the fixed (landline) telecommunications infrastructure has been dominated by government-run telephone networks, and in many countries the telephone systems in place are ageing and regularly have major maintenance problems, partly caused by climatic extremes.

The Africa Telecom 1998 Conference

The Africa Telecom 1998 conference was opened by the (then) South African President Nelson Mandela in May 1998. The event attracted nearly 20,000 telecommunications (telecoms) specialists. It was hailed as a triumph by many of Africa's leaders, who wanted to see the latest technology being exhibited. Over 400 companies had exhibitions of their products and services and the exhibition covered telecoms, information technology and audio-visual entertainment fields.

The conference was attended by over 500 VIPs including heads of state, ambassadors and government ministers of many of Africa's 55 countries. Attendees included industry leaders at the highest level, as well as many industry analysts and commentators.

Among the many important industrialists who attended this conference was a delegation from Constro (Pty) Limited, a leading construction company in the country of Afri. The Chairman and Chief Executive, Malan Beka, had always been frustrated that his home continent was so far behind the rest of the world in telecoms and was interested to hear what the leading telecoms companies from around the world would be saying and how they saw the future of telecoms in Africa.

Demographic data for the country of Afri for the year 2000

The key statistics for this country are as follows:

Area	0·9 million sq km
Political system	Democratic republic
Number of major towns	9 (including the capital city)
Number of ports	2
Population	42 million
Population growth rate	2·0% each year
Urban population (as a % of total population)	45%
GDP	US$ 50,400 million
GDP growth rate	1·2% per annum
Exports	Oil, textiles, fruit, leather, olive oil, clothing.

Constro

Constro (Pty) Ltd (Constro) is a large construction company that has been operating for over 40 years in the North African country of Afri. Constro's shares are not listed on a stock exchange but the majority of the shares are held by four of Afri's former industrialists. No market value is easily available for Constro.

The principal four shareholders of the company are all now retired, and no family members are actively involved with, or employed by, Constro. The families of the four main shareholders all have their own business interests. The owners required dividends of $20 million in 2001 in total, and the remaining cash generated from operations is held in the form of short- and medium-term investments, which have a variety of risk profiles. The founders have no family succession plan and the appointed Constro Board of Directors has full authority for the company's actions.

Constro's four shareholders have had a number of approaches from leading African companies and other multinational companies over the last ten years, all of which have been declined as the owners have stated that Constro is not for sale. The prices offered for Constro have varied between $250 million and $450 million, all of which have been refused.

Constro is one of the Afri government's preferred builders and has been involved in a number of large, high-risk construction projects including the construction of a large hydroelectric dam. Its main areas of construction have included road-building projects, building of airports and other construction projects involving public service buildings, such as administration offices and hospitals within Afri.

The company has two wholly-owned subsidiaries, one of which is involved in the construction of residential houses and apartments. The other is involved in the import and sale of domestic electrical appliances. The company has grown rapidly in the past by expansion in new areas, such as the import and sale of domestic electrical products, and is in need of a new opportunity to invest some of its available cash reserves.

The Board of Directors of Constro is made up mainly of Afri nationals, many of whom had worked outside of Africa in a variety of jobs before returning to their home country. Brief career histories of some of Constro's senior management follow.

Malan Beka –Chairman and Chief Executive

Malan Beka is 51 years old. He had been educated in Europe and had graduated from a leading university with a degree in electrical engineering. After working for several large construction companies in the UK and Europe for over 10 years, he returned to his native country of Afri in his early thirties.

He joined Constro as Director of Road-building, and worked in this division for almost 10 years. He was then transferred to Constro's Special Construction Projects team, where he managed a large contract, which was finished almost on time and to the satisfaction of the government. This project had brought him closer to many influential government ministers and he has maintained and built upon these links, which have assisted Constro in being awarded many more contracts over the years.

Five years ago, the founder of the company, Mani Freel, retired. He appointed Malan Beka as Chairman and Chief Executive, with a remit to expand the company and to take it into the 21st century. The company has built up large cash reserves from positive cash flows for the last quarter century, and has been awaiting a suitable investment opportunity. With the exception of dividends, the owners of Constro and their families have no desire at present to remove funds from the company.

Malan Beka does not see how the company can expand, or indeed maintain its current turnover and profitability, unless it generates business in new areas. The country of Afri has been transformed over a 50-year period and now has a good road infrastructure in place. While there are new building projects that Constro could bid for, the scope for expansion is becoming limited.

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In order for Constro to continue to grow, Malan Beka knows that Constro will have to embrace some of the many new business opportunities that are manifesting themselves in the fast-changing African continent. No longer could the company operate only within its own country or almost entirely within its current sphere of construction. Malan Beka, with his electrical engineering background, has always been interested in and knowledgeable about telecoms.

Andani Noon – Operations Director

Andani Noon, aged 48, has worked on large road and other building projects for Constro for over 20 years. He is an excellent manager and is well respected by the large workforce. He feels that Constro is good at building projects and should expand by bidding for construction contracts in neighbouring countries and elsewhere within Africa.

He is a little narrow-minded and, while happy to see changes introduced in working practice, he is not a very forward thinking director. Constro appointed him as Operations Director as he has the management skills to deliver the projects that he oversees, meeting quality and safety standards and deadlines.

Ben Knowle – Finance Director

Ben Knowle, aged 52, has been Finance Director of Constro for 18 years and has worked for the company for over 25 years, having started his career with one of the other large construction companies in Afri. He is IT-literate and is responsible for the IT requirements of the company and its subsidiaries.

He has seen the company grow and expand over the last ten years and he has introduced some very popular management tools, including sophisticated forecasting systems and an executive information system that all the senior managers actively use.

While he is forward thinking, he is very cautious by nature, and has always been reluctant to support Malan Beka's keenness to see the company expand into telecoms. He feels that the company is managing to grow, both in turnover and profitability, and does not see the need to put the company at risk by diversifying into telecoms.

Sol Endi – Marketing Director

Sol Endi joined Constro five years ago, having worked for a number of large companies in different African countries over the last 15 years. At the age of 40, he has acquired a wide range of marketing experience, though none in the telecoms industry. He feels confident that he can contribute to Constro's growth by continuing to increase the market awareness of its projects and available products. He has a small team of marketing managers, mainly dealing with the sales of residential accommodation and household appliances. His marketing team does very little work in regard to the large government-financed projects.

Sol Endi sees the growth of mobile telecoms in Africa as a huge opportunity for Constro. The company could also become involved in the import and sale of mobile handsets both within Afri and in other countries in Africa. He feels confident that Constro has the necessary purchasing and stock control systems in place to purchase in bulk from manufacturers and to sell to end users in Afri and in several neighbouring African countries.

AfriTel (Pty) Ltd (AfriTel)

The senior managers from Constro who attended the *Africa Telecom 1998 Conference* were encouraged by all that they had seen and heard at the conference. Many of the senior management team had been educated in Europe and had lived and worked abroad (outside of Africa) before returning to Africa. They were continually frustrated that Africa had failed to move with the rest of the world. Africa simply did not have access to the technology or the required infrastructure to improve and revolutionise companies' business practices and to improve the lifestyle of individuals.

In 1998, many African countries had either cellular mobile networks operating or were preparing to launch cellular networks, but the Afri government had been slow to react to the potential demand for mobile telephony.

Immediately following the conference, Malan Beka prepared a detailed paper for the next monthly Board meeting. In it he proposed that a subsidiary company should be set up to explore ways in which Constro could enter the fast-growing telecoms business in Afri.

Malan Beka felt strongly that Constro had the expertise and the necessary standing in the business community to finance the venture into telecoms and he badly wanted Constro to benefit from the large profits that telecoms companies elsewhere around the world were generating.

During the meeting, the Board agreed to set up a subsidiary company, wholly owned by Constro, called AfriTel, to explore this possible new market.

New staff recruited for AfriTel

Malan Beka appointed a global high-technology recruitment agency to identify some key individuals who had the necessary technical and managerial skills that Constro would need. Using this agency, Malan Beka recruited Tanda Lew in 1999 to be the Telecommunications Director for Constro, who would also hold the role of Chief Executive of AfriTel.

Tanda Lew's remit was to develop a strategy for how Constro could enter the growing telecoms market in Afri. This appointment was controversial at the time, and was opposed by many other senior managers in Constro who were concerned that Constro was entering an unfamiliar business sphere.

Tanda Lew is 43 years old and has had extensive experience in a variety of roles in cellular mobile telephony. He had worked for two different global telecoms companies. He had also been educated in Europe and had worked for over 12 years installing cellular networks in Europe for a leading telecoms company with global interests. He was then headhunted to design and implement a cellular network in an Eastern European country by a different global telecoms company, where he worked for four years prior to joining Constro.

He is an experienced telecoms engineer, who is well respected in the industry. He has a proven track record of managing the selection and implementation of mobile telecommunication technologies to meet the chosen objectives of the companies he has worked for.

When Malan Beka approached him for the role in Constro, he was initially a little reluctant. He was unsure whether the country of Afri would ever embrace the challenges of the technologies available, and did not want to find himself in a role in which it would take many years to bring a project to fruition. However, he accepted the challenge and was given a free rein to recruit a small team and to develop a business plan.

By the end of 2000, Tanda Lew had put together a small team of commercially-aware engineers and managers who investigated how the available mobile technology (known as GSM) could be introduced to Afri. He recruited an Operations Manager, Peter Bradley, who would be responsible for customer registration, customer service and billing.

Peter Bradley, aged 35, had previously worked as Customer Service Manager for a mobile telecoms network operator in another African country. He saw Constro's interest in running a network in Afri as a personal challenge. There would be an opportunity for him to be involved right from the beginning and to gain a senior management position in what he hoped could become a leading mobile telecoms operator within five years.

Peter Bradley had investigated the possible purchase of "off the shelf" mobile customer registration and billing packages with a number of leading international software companies. Ben Knowle, who is responsible for IT in Constro, was concerned that Peter Bradley was inexperienced and should not be responsible for the selection of such vital software without considerable input from him and his finance department.

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Furthermore, the hardware requirements for AfriTel were considerable. Ben Knowle was concerned that new expertise would need to be brought into Constro to ensure that the systems installed were future-proof. The systems would need to be capable of being added to or upgraded to cope with the necessary large volumes of data that would be handled in the future with a rapidly expanding customer base. If Constro were to be successful in running a mobile telecoms network in Afri, and its customer base were to grow to over several million subscribers within five years, one of the key issues would be the selection of hardware and software, and an understanding of the demands which would be placed on these. In Ben Knowle's view, neither Peter Bradley nor Tanda Lew had appropriate experience in these areas.

The International Telecommunication Union's Telecom Africa 2001 Conference

At the *International Telecommunication Union's Telecom Africa 2001 Conference*, a report was released stating that the mobile telecoms marketplace in the whole of Africa could reach 100 million subscribers by 2005. By the end of 2001, many African countries had introduced cellular technology, and these new mobile telephone networks have provided telecoms to many people. The cellular markets have experienced a boom in many countries and it was forecast that the number of mobile subscribers would exceed the number of fixed (landline) connections during 2002.

Tanda Lew and his team, together with some of Constro's Directors, attended this conference. All of the representatives from Constro were reassured to see the long-awaited change in communications coming to Africa at last. However, some Directors were apprehensive as to whether Constro should enter this new market and also concerned about when the Afri government would announce that cellular networks would be licensed in Afri.

Market opportunities

By the beginning of 2002, many countries in Africa had opened up their telecoms markets (or were in the process of liberating them), in anticipation of encouraging private investment in telecoms infrastructure.

The growth in telecoms in many African countries is expected to bring with it many economic benefits and will demonstrate to the world the growth potential locked up inside many African economies.

South Africa launched its cellular mobile networks with two licensed operators as early as 1994, and in 2001 a third cellular operator was approved. Since 1994, there have been more than 70 new mobile telecoms networks licensed within the whole of Africa, in countries such as Egypt, Morocco, Cameroon, Nigeria, Kenya and Uganda. These markets have seen growth rates on a year-on-year basis exceed 100%.

There are now independent regulatory authorities established in 33 of Africa's 55 nations and these have opened up the opportunities for companies all over the world to become involved. The equipment manufacturers, the telecoms system providers and the telecoms maintenance providers all have large opportunities to become involved in the African telecoms market and to reap the rewards from the potentially explosive growth.

Many of the global telecoms companies and manufacturers of mobile telecoms equipment are keen to be involved with the emerging market in Africa. Many of these companies are already multinational telecoms companies or are leading companies in their geographical part of the world. However, there are also large numbers of small, new companies establishing themselves in the newly liberalised markets. AfriTel is one of the many new companies in Africa that have been specifically established to investigate, and possibly become involved in, the mobile telecoms market in Afri.

The market analysis prepared by the Afri government shows that the market size in the country of Afri could be as high as 8 million subscribers within five years of launch of mobile telecoms networks in Afri. A summary of its market surveys is shown opposite:

Number of subscribers (end year) 000	Year 1 2004	Year 2 2005	Year 3 2006	Year 4 2007	Year 5 2008
Forecast total Afri urban mobile telecoms market:					
High growth	200	1,000	2,000	5,600	8,000
Mid growth	100	500	1,000	2,800	4,000
Low growth	20	100	200	560	800

In addition to the above subscriber numbers, which will be from the nine major towns and surrounding areas, it is also anticipated that there could be a small number of subscribers from the rural population. However, the rural subscriber numbers are estimated to be 250,000 subscribers by the end of Year 5, which represents approximately a 1% penetration level of the rural population. The forecast phased growth of rural subscribers is expected to be as follows:

Number of subscribers (end year) 000	Year 1 2004	Year 2 2005	Year 3 2006	Year 4 2007	Year 5 2008
Forecast total Afri rural subscribers	10	40	80	140	250

The Afri government has indicated that it will grant a number of licences for a 10-year period.

In a neighbouring country with a population and land area some 50% smaller, two licences were granted almost 2 years ago. The mobile subscribers for both networks currently total approximately 150,000 subscribers, growing at the rate of 20,000 subscribers per month. These statistics support the mid-growth scenario that was forecast by the Afri government's market surveys.

A wider market than just mobile telecoms

As well as providing voice links within Africa, the telecoms market is also under increasing demand to provide other telecoms-based services including Internet access, long-distance learning, and online medical and financial information.

There is surging demand for online connections for the business community and also a growing number of Internet cafes. In many countries around the world, the growth of Internet cafes has seen an explosion in the demand for communications links, and in some countries in the Far East, there are Internet cafes on most street corners.

Internet subscriber numbers across Africa doubled in 2001 to reach more than 5 million, and the demand for Internet connections should also help boost demand for mobile phones across all of Afri.

Telecoms fraud and lost revenues

A growing concern around the globe is the fast-growing area of telecoms fraud and lost revenues. Few industries could afford to lose the estimated US$ 90 billion (one billion is equal to one thousand million) in revenue that the world's telecoms operators fear is currently being lost to them each year, either by inadequate billing systems and procedures, or fraud. Furthermore, the problem is growing.

Accurate statistics on fraud are hard to establish, but most telecoms operators admit to losing between 3% and 5% of revenues, and some start-up telecoms operators can lose up to 15%. Some of the large global companies, which have taken positive steps to combat fraud, have been able to reduce losses down to 0·2% of turnover, but this still represents large revenue losses on their significant turnovers.

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All new network operators will have to ensure that their software systems are designed to protect consumers, to prevent fraud when goods and services are bought by subscribers via mobile phones. Furthermore, in order to prevent payment default, many network operators have decided to introduce pre-paid subscription. It is expected that every telecoms operator will have to become involved in combating fraud, by ensuring that systems within the company are monitored closely, to control revenue losses, protect the company's bottom line, and protect customers. As telecoms fraud has become so prevalent in the industry, many companies have been established specifically to fight telecoms fraud.

Broadband

Around the world, some telecoms service providers are starting to offer broadband access to their customers. Governments in many countries are promoting the introduction of broadband technology as they see this as a major advantage to the business community. Additionally, some governments are offering large tax advantages to companies to provide broadband connections to under-served and rural areas of their countries.

Some countries have been more successful than others in offering broadband services, and the concern among industry analysts is that countries that do not have an adequate broadband network will be largely excluded from the new electronic environment. As new network services are planned in many countries in Africa, it is important that the latest technology is introduced so that the African continent does not continue to fall behind the rest of the industrialised world. In Africa, one reason for the introduction of broadband services is that it could bring with it the potential for good distance-learning services. If broadband is not introduced in Africa, it will widen the "digital divide" between Africa and Europe, denying Africa new digital electronic services.

Equipment manufacturers

As soon as Tanda Lew was appointed to AfriTel, he was approached by all of the world's major equipment manufacturers, which all wanted to expand into the new market place in Afri. These global telecoms equipment manufacturers are working closely with all of the companies which are thought to be considering applying for a licence to run a mobile telecoms network in Afri. These global telecoms equipment manufacturers want to sell their cellular network equipment into Afri as well as having their handsets and other cellular products distributed in this new market.

The handset manufacturers also see the growing African market as the place to expand, as demand for handsets in many other areas of the world is now declining. There are over ten major worldwide handset manufacturers which are all eager to enter, or become involved with, the growing African market.

It is planned that the division of Constro that sells domestic electrical appliances will add the sale of mobile handsets and accessories to its growing portfolio of products. The Marketing Director, Sol Endi, is very keen for Constro to enter this market irrespective of whether or not AfriTel is successful in obtaining an operating licence to run a mobile network in Afri.

The third generation of mobile phones (3G)

While the African continent is still introducing mobile telecoms networks to the current European standard, GSM, the rest of the world is facing the next major step in mobile telephony, 3G.

3G is a new breed of network and handsets that offer many more features than GSM, including a mobile internet service with the ability to make bookings online, access to music and videos and even cameras, enabling mobile users to see who they are talking to.

It is envisaged that within the 10-year licence period, the GSM technology that will be installed in Afri will become outdated. Furthermore, it is expected that the network infrastructure that will be established by all network operators in Afri after licences are granted will have no commercial value within the 10-year licence period.

Additionally, as technology changes, it is even possible that the mobile network operators may need to update their network infrastructure within the 10-year licence period, which would necessitate further capital expenditure.

The Afri regulatory authorities

Unlike many of Afri's neighbours, whose governments acted swiftly to grant operating licences to telecoms companies to run mobile telecoms networks, the government of Afri has only now announced that it will grant operating licences in April 2003, following licence applications that are due to be submitted by February 2003.

There are many companies (some Afri national companies and some global companies) that are keen to become a mobile telecoms network operator in Afri, despite the large initial investments in the infrastructure. It is expected that the number of companies that will be applying for an operating licence will be greater than the number of licences that the Afri regulatory authority will issue.

Discussions with global telecoms companies

Malan Beka reported to his senior management team that he had been contacted by a number of global telecoms companies that were interested in the Afri market, and that he had invited representatives from four global companies to Constro's headquarters in Afri for discussions. Some other global companies declined to meet with Constro and clearly had only made contact to try to find out market data for their own purposes.

Malan Beka was keen to gather whatever information he could from the four global companies, and to understand their intentions, before Constro made the decision to commit itself to applying for a licence to run a mobile telecoms network in Afri. The four companies that Constro had agreed to meet with included the two telecoms companies that Tanda Lew had previously worked for.

At the preliminary meetings with the four global telecoms companies, Malan Beka and Tanda Lew represented Constro. The details of the four meetings are given below.

Meetings with global telecoms companies

1. Meeting with Global Company A

Global Company A had sent two representatives, its International Investment Director, James Brown, and its African Continent Telecoms Development Manager, Anthony Vine. The meeting was held at Constro's headquarters and there was a lively debate about the need to speed up the roll out of cellular telephone networks across Africa.

Malan Beka reported to the Constro Board that he and Tanda Lew were impressed with the way James Brown and Anthony Vine saw the market in Afri developing. Furthermore, James Brown was open about Global Company A's intention to bid for a licence in Afri and he discussed his concern that the Afri government may not grant a licence to Global Company A if it bids on its own.

James Brown invited Malan Beka to consider a joint venture arrangement, so that together the two companies could apply for an operating licence and, if successful, they could then construct and operate a mobile telecoms network together in Afri. James Brown stated that this offered both companies opportunities that may not materialise if they did not operate together. James Brown outlined the experience his company had in launching and operating mobile telecoms networks in other parts of the world, as well as two other African countries, and all the other expertise that Global Company A could bring to Afri.

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Malan Beka reported to the Constro Board that Global Company A considered Constro to be lacking experience in marketing and customer registration, and that James Brown had particularly pointed out Constro's complete lack of experience with billing large numbers of customers. Malan Beka also reported that he had informed James Brown that Constro did not feel it needed a joint venture partner, but was exploring a number of avenues. He had also discussed with James Brown the close government connections that Constro had from its experience of working on construction projects for the Afri government, and that he was fairly confident that Constro would be successful in obtaining a licence without a joint venture partner.

Malan Beka reported that James Brown had stated quite openly the reason why Global Company A would like to enter a joint venture. James Brown considered a joint venture would increase Global Company A's chance of becoming involved in the telecoms market in Afri. Malan Beka reported that he had been impressed with Global Company A's frankness and that he had found this refreshing.

It was established that Global Company A has two other joint ventures in Africa, in each of which it holds a 50% stake. In both countries the networks are growing rapidly. James Brown stated that in one of the African countries, where there are two competing networks, its joint venture currently has achieved a 60% share of that country's market. In the other African country in which it has a joint venture, all three network operators have almost equal market shares.

The last point that James Brown had made at the meeting was that if Constro did agree to a joint venture, Global Company A would be prepared to fund approximately half of the necessary financing.

Malan Beka reported to the Constro Board that both Tanda Lew and himself had established a good foundation for a future working relationship and that he had undertaken to consider Global Company A's joint venture offer.

2. Meeting with Global Company B

Malan Beka had originally agreed to meet with the Overseas Investment Director and another representative of Global Company B, but just the day before the planned meeting, they contacted Constro and rescheduled the meeting for a few weeks later. As Malan Beka wanted to meet with them as soon as possible, because of the February 2003 licence application deadline, he was not pleased.

Malan Beka was even more displeased when he finally met with Chris Harvey, who was sent to represent Global Company B. Chris Harvey was one of its Overseas Investment Managers and he was ill-prepared for this high-level strategic meeting with Constro. Additionally he was unable, or unwilling, to fully discuss what Global Company B wanted from the meeting. While some discussion of joint ventures was touched upon, Chris Harvey was simply unable to make any commitments to Constro. He stated that he would report back to his senior managers that Constro was possibly considering entering into a joint venture arrangement.

Malan Beka was insulted that this rescheduled meeting was so unproductive. He was, however, reminded by Tanda Lew that Global Company B had an excellent record of overseas investments and of working in joint venture arrangements with national companies in other areas of the world. Also, it is involved in mobile telecoms networks in five other African countries.

The only firm commitment that Chris Harvey was able to make to Constro was that if they were to enter a joint venture arrangement together, Global Company B would be in a position to provide much of the financing at competitive rates.

Although Tanda Lew did not know Chris Harvey, he knew Global Company B well, as he had worked for it for four years, prior to joining Constro. He still had many senior contacts there. Tanda Lew also knew that he was well respected by some of Global Company B's senior managers, and that if he wanted to work for it again, he was sure that it would make him a generous offer.

Tanda Lew was keen that Malan Beka should not be too annoyed at the lack of direction from the initial meeting and he found himself making excuses for Global Company B's poor representation at the initial meeting. Tanda Lew remarked to Malan Beka after the meeting that if Constro were to pursue a joint venture arrangement, then he and his team could work well with a company such as Global Company B, which he felt he knew well and could trust.

3. Meeting with Global Company C

Malan Beka and Tanda Lew met with Global Company C's Chairman, Robert Duvall, and also its International Division's Director, Victor Masters, at Constro's headquarters. Malan Beka was flattered that Global Company C's Chairman was able to attend and the tour of Constro's impressive HQ building had demonstrated to Global Company C's representatives that Constro was more than a backwater construction company.

Tanda Lew had met with (but had not worked for) its International Division's Director, Victor Masters, on a previous occasion, when he had been involved in the construction of a cellular network in Europe some years before. Victor Masters, now 58 years old, had been impressed by the young engineer and was pleased to meet with him again.

Victor Masters had negotiated a number of joint venture arrangements with companies in the Far East and Pacific Basin and industry gossip suggested that Global Company C wanted to be involved with as many mobile networks in African countries as possible. It already had joint ventures in four other African countries, all with fairly equal market shares.

At the start of the meeting, Malan Beka felt a little dismayed that Global Company C was more or less dictating its standard terms for a joint venture, without even considering what Constro had to offer, or even wanted, from a joint venture arrangement. It was clear that Global Company C felt that it was the dominant party.

When Malan Beka asked Global Company C how the financing of the project could be shared, Global Company C stated that it would not be prepared to invest more than $100 million in the network. However, Robert Duvall stated that his company would require a majority shareholding. He also stated that his company would provide marketing and operational expertise, but was not prepared to tie up vast sums of capital expenditure in Afri.

The rest of the meeting was cordial but Malan Beka was disappointed with Robert Duvall's attitude. After the meeting, Malan Beka explained how he felt to Tanda Lew, who agreed that he felt that Global Company C only wanted to use Constro for its influence in hopefully obtaining a licence and to share in the profits from the venture, while risking little of its own capital.

4. Meeting with Global Company D

This meeting had also been rescheduled (twice) and Malan Beka was beginning to doubt whether Global Company D wanted to hold preliminary joint venture discussions at all. Tanda Lew thought that maybe they had already agreed a joint venture with one of the other local Afri companies preparing a licence application. As he had worked in Europe over ten years earlier for Global Company D, he used his contacts in that company to try to find out; however, he could not establish any specific reasons for the meeting with Constro having been deferred.

Finally the meeting was fixed. The Overseas Director of Global Company D, Martyn Holland, together with his Overseas Investment Accountant, Joanna Sharp, arrived at Constro's headquarters. Martyn Holland made it clear that this meeting was only to establish initial contact and to see whether there were any common grounds for working together. He indicated that after the meeting, he would be flying to the Far East to review the company's business investments and handset manufacturing operations there. Global Company D was also a major manufacturer of mobile handsets.

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Martyn Holland, a 42-year old executive, clearly had a very challenging international schedule and Malan Beka formed the impression throughout the meeting that he would rather have been elsewhere. Martyn Holland outlined Global Company D's desire to be involved in a mobile telecoms network in Africa. He reported that it had formed a joint venture with a national company in a different African country two years before, but this consortium had not been successful in being granted a licence in that country. He stated that his company was keen to be involved in the country of Afri, which was the last country of significant size in Africa to be issuing licences for mobile telecoms networks. Martyn Holland saw this as possibly the last opportunity for Global Company D to be involved in the African continent.

Martyn Holland had not known or worked with Tanda Lew when the latter had worked for Global Company D, but he knew of his determination and of the good reputation he had gained at Global Company D. He stated that with Tanda Lew's technical expertise and Global Company D's marketing and customer service expertise, they could make a formidable team.

The Overseas Investment Accountant, Joanna Sharp, reported that her company had sufficient funds that could be made available for this investment if a suitable joint venture arrangement was agreed. She was not, however, prepared to state what the terms for this funding would be.

At the end of the meeting, Malan Beka and Tanda Lew agreed that they did not like Martyn Holland. However, they both felt that if Constro were to enter a joint venture arrangement with Global Company D, the skills of the two companies could complement each other, despite Malan Beka's lack of rapport with Martyn Holland.

Summary of the meetings with the global companies

After the four meetings, Malan Beka reported back to his fellow Directors. At the next Board meeting he presented the following table, which provides some key financial data in respect of the four global companies with which discussions had been held.

All financial data relates to the latest published financial year. All of the data has been converted at current exchange rates to US dollars for comparative purposes.

	Global Company A	*Global Company B*	*Global Company C*	*Global Company D*
Turnover	$19,000 million	$55,000 million	$42,000 million	$32,000 million
% increase in turnover over previous year	+15·2%	+1·3%	-0·1%	+9·1%
Operating profit	$2,200 million	$3,400 million	$4,700 million	$3,250 million
Gearing *	23%	44%	40%	57%
Capital expenditure (including joint ventures)	$3,100 million	$8,500 million	$1,100 million	$1,400 million
Number of African countries the global companies are involved in	2	5	4	0

*Gearing is defined as loans and borrowings as a percentage of total equity shareholders' funds plus loans and borrowings.

Constro's financial data

Ben Knowle reported that Constro's plans for a mobile telecoms network have forecast that the capital investment required will be of the magnitude of approximately $300 million over 3 years based on the mid-growth level of subscribers. However, no further funding will be required for working capital, as working capital requirements are forecast to be negligible due to a mix of prepaid network income and monthly mobile billings.

A consortium of local banks has agreed to a 10-year loan to Constro for up to $200 million at 13%. Furthermore, finance is also obtainable from an overseas bank (outside of Africa) at 14% for a maximum loan of $50 million, which is repayable after five years. All loan interest payable is eligible for tax relief at 30%.

Constro is currently all equity financed and has surplus cash invested in a variety of short-term instruments. Because of the mix of investments, some of which have been of a speculative nature, Constro has currently been able to achieve a return on its cash investments of 11% overall in the last year, although this is unlikely to continue. The interest receivable on these investments is subject to tax at 30%.

At present Constro evaluates all its capital investment projects using a discount rate based on its equity cost of capital, to which it sometimes adds a further risk premium for especially risky projects.

Ben Knowle has estimated that Constro's cost of equity is approximately 14·5% and the Afri market return is currently assessed to be 12%. The current risk-free rate in Afri is 6%. Constro's Beta, based on its current sphere of trading, and using a proxy company, is estimated to be 1·4.

Appendix A gives details of Constro's profit and loss account and balance sheet for the previous two financial years. All figures are presented in US dollars, although this is not the local currency for Afri. However, the Afri local currency does align itself to movements in the US dollar.

Appendix B shows extracts from Constro's current five-year plans, which analyse turnover, operating profit and capital expenditure by the main areas of current and possible future business categories. These exclude all financial data in respect of sales of mobile phones and mobile telecoms network financial data. Data for Constro's last financial year is also shown for the purpose of comparison.

Appendices A and B are overleaf

[continued]

Constro Balance Sheet for last two years:

	2001	***2000***
	$ million	*$ million*
Fixed assets	143	126
Depreciation	66	59
Net fixed assets	77	67
Current assets:		
Amounts due within 1 year:		
Stocks	26	22
Debtors	39	34
Cash and short-term investments	145	114
Sub-total current assets	210	170
Current liabilities:		
Amounts due within 1 year:		
Trade creditors	47	42
Corporation tax	15	13
Other tax creditors	2	2
Proposed dividends	20	16
Sub-total current liabilities	84	73
Net current assets	126	97
Debtors falling due after 1 year:		
Retained construction payments	30	50
Net assets	233	214
Financed by:		
Owners' share capital	20	20
Profit and loss account	213	194
Equity shareholder funds	233	214

Constro Profit and Loss Account for last two years:

	2001	***2000***
	$ million	*$ million*
Turnover	310	285
Operating costs (including depreciation)	268	244
Operating profit	42	41
Interest receivable	14	11
Tax	-17	-16
Net profit after tax	39	36
Dividends proposed	20	16
Retained profit for the financial year	19	20

Appendix B

Extracts from Constro's five-year plan

	***ACTUAL* 2001** *$ million*	***FORECAST* 2002** *$ million*	**2003** *$ million*	**2004** *$ million*	**2005** *$ million*	**2006** *$ million*	***TOTAL* 5 years** *$ million*
Turnover:							
Road-building – Afri	136·0	140·0	80·0	40·0	30·0	10·0	300·0
Road-building – other countries	2·0	10·0	20·0	50·0	70·0	100·0	250·0
Other major construction projects – Afri	100·0	80·0	50·0	40·0	30·0	30·0	230·0
Other major construction projects – other countries	0·0	0·0	0·0	10·0	20·0	50·0	80·0
Construction of residential property – Afri	51·0	60·0	80·0	100·0	125·0	150·0	515·0
Sale of electrical appliances (excluding mobiles)	21·0	30·0	40·0	50·0	55·0	65·0	240·0
Total turnover ***(excluding sales of mobiles and mobile network income)***	**310·0**	**320·0**	**270·0**	**290·0**	**330·0**	**405·0**	**1,615·0**
Operating profit:							
Road-building – Afri	19·7	19·6	10·4	4·8	3·6	1·2	39·6
Road-building – other countries	0·2	0·8	2·0	5·0	7·7	11·0	26·5
Other major construction projects – Afri	10·0	8·0	5·0	4·4	3·3	3·3	24·0
Other major construction projects – other countries	0·0	0·0	0·0	1·0	2·0	5·0	8·0
Construction of residential property – Afri	9·2	10·8	14·4	17·0	21·3	24·0	87·5
Sale of electrical appliances (excluding mobiles)	2·9	4·2	6·0	8·0	9·3	11·1	38·6
Total operating profit ***(excluding sales of mobiles and mobile network profitability)***	**42·0**	**43·4**	**37·8**	**40·2**	**47·2**	**55·6**	**224·2**
Capital expenditure plan:							
Road-building – Afri	2·0	3·0	2·0	0·0	0·0	0·0	5·0
Road-building – other countries	2·0	2·0	2·0	6·0	10·0	12·0	32·0
Other major construction projects – Afri	2·0	3·0	2·0	2·0	5·0	10·0	22·0
Other major construction projects – other countries	0·0	0·0	0·0	4·0	10·0	15·0	29·0
Construction of residential property – Afri	5·0	5·0	5·0	5·0	10·0	10·0	35·0
Sale of electrical appliances (excluding mobiles)	6·0	2·0	2·0	8·0	8·0	10·0	30·0
Total capital expenditure plan ***(excluding sales of mobiles and mobile network capital expenditure)***	**17·0**	**15·0**	**13·0**	**25·0**	**43·0**	**57·0**	**153·0**

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Management Accounting – Case Study

Pre-seen material