Part (a) **Evaluate, with reference to sections 3 and 4, the financial risk of S4N by –** **(i) calculating five relevant financial risk ratios for both years.** • **Round all final amounts to one decimal; and**			**Marks**
Description	**2023**	**2022**	
Ratios			
Debt ratio (%) (Total debt)	34,8%	30,9%	2
Debt to equity (%)	34,7%	24,1%	2
Interest bearing debt as a % of total debt (%)	65,0%	53,9%	2
Gearing ratio	25,7%	19,4%	2
Short term debt as a % of total debt (%)	46,0%	55,0%	2
Debt to EBITDA (x)	2,6	2,1	2
EBIT interest cover (x)	1,9	3,0	2
EBITDA interest cover (x)	2,7	4,4	2
Degree of financial leverage (x)	2,1	1,5	2
Change in interest bearing debt	35,4%		1
Change in interest	80%		1
Or: Effective interest rate	14,2%	10,7%	
Available (limited to five risks)			**20**
Maximum			**10**
Total for part (a)(i)			**10**

Part (a) **Evaluate, with reference to sections 3 and 4, the financial risk of S4N by –** **(ii) analysing the capital structure based on the ratios calculated and concluding on the level of financial risk to which S4N is exposed.**	**Marks**
• Interest-bearing borrowings have increased from 2022 to 2023, causing an increase in the debt ratio which therefore increases the financial risk of S4N.	1
• Additionally, about 57% of S4N's total debt is interest bearing. This increases the financial risk that the company is exposed to, since the company will have to honour its interest commitments even when it makes a loss.	1
• S4N's debt to EBITDA rose from 2022 to 2023, increasing the likelihood that the company could possibly default on its debt commitments.	1
• Performance of the company has deteriorated over the past years, and this has probably increased the threat of default on debt commitments.	1
• There is a significant deterioration in the EBIT interest cover from 2022 until 2023, indicating that the company may not be able to cover its interest payments in the future. This is further supported by the EBITDA interest cover.	1
• The ratios have also deteriorated due to a decrease in equity and not only because of an increase in debt.	1
• Although there is a profit for the year, there is a decrease in retained earnings which could possibly be due to dividends being paid. If so then this would reflect negatively on the shareholders, taking a dividend at a difficult time for the company and on management who declared a dividend in this time. It could also be as a result of an accounting restatement (in which case the FY2022 figures may not be comparable).	1
• The company relies on bank overdraft as a long-term source of finance. This increases the interest expense and might indicate that lenders are not	1

willing to extend additional loans to the company, indicating an increase in financial risk.	
• The interest charge has increased with 80%, whereas the interest-bearing debt only increased with 35%. This seems to indicate that the suppliers of debt and credit consider S4N to be more financially risky than in the past, as the cost of debt has risen steeply.	1
• S4N has a high financial risk which increased from 2022, as shown by the DFL, and the shareholders should be worried that the increased debt of the company may not necessarily be creating value for their investment.	1
Available	**10**
Maximum	**4**
Total for part (a)(ii)	**4**
Total for part (a)	**14**

Part (b)	**Critically evaluate the acquisition and subsequent rebranding of Stay-Fresh to S4N.**	**Marks**
1	**Alignment with strategy**	
1.1	The new market offered opportunities for Shop-4-iT to grow its presence on the continent in accordance with its objectives.	1
1.2	Stay-Fresh's product offering did not align with those of Shop-4-iT, as Stay-Fresh focuses on local produce whilst Shop-4-iT prefers imported products. This would have impacted on the Shop-4-iTs ability to understand the business model of the newly acquired company and could be seen as a poor strategic fit.	1
1.3	Furthermore, Stay-Fresh's strategy of targeting middle- to low-income households did not align the Shop-4-iTs niche market philosophy. This would have negatively impacted the company's ability to reshape the Stay-Fresh's strategy to align with its own.	1
1.4	The Stay-Fresh brand and product offering did not align with the ethos of Shop-4-iT as Stay-Fresh focused on the resale of locally produced goods, whereas Shop-4-iT believed in imported products (product-market fit). This ultimately could have caused confusion for loyal customers of Stay-Fresh who probably stopped shopping at the company (brand-customer fit).	1
1.5	Shop-4-iT lacks expertise and experience in the West African market which could explain why it was difficult to penetrate this new market. Shop-4-iT would have been better served investing in a Southern African company where it had more expertise and already some measure of success.	1
1.6	The company's unwillingness to adapt to changes in its operating environment affected the performance of the company.	1
1.7	Stay-Fresh's retail store locations are vastly different from Shop-4-iT's traditional retail store locations – this meant that the company needed to increase its borrowings to help fund its move to locations more in line with its brand. This ultimately led to an erosion of shareholder returns.	1
1.8	Shop-4-iT focused more of its time on the newly acquired entity which resulted in Shop-4-iT losing valuable market share in South Africa. This shows that the company may not yet have the required resources to pursue external growth opportunities outside Southern Africa.	1
1.9	The company's shareholders are also unlikely to have been pleased with the company investing in counties where there is a systematic increase in financial crimes and political instability as this may further erode S4N's profitability, and increase its riskiness, thus reducing the value of the investment.	1
1.10	The relocation of the stores, market positioning and targeting of more affluent customers would have led to the loss of the exiting loyal customer base.	1
1.11	The cancelling of the contracts with local farming suppliers would have negatively reflected on their CSR policies and negatively impacted their reputation. This would have contributed to the loss of the existing customer base.	1
1.12	The risk of the acquisition appears not to have been evaluated in full as there was very little indication of an assessment having been performed evaluating the impact of possible retaliation for the violent attacks on Nigerian businesses in South Africa. Furthermore, by changing the name of the company to the same name of the South African operations, the company was more easily identified as being South African and hence	1

	was more likely to be targeted for looting than if it had retained its original name.	
2	**Product demand, pricing and distribution**	
2.1	Shop-4-iT does not appear to have performed any form of research on the demand for its products in the country. Most consumers would probably be price conscious given the increased unemployment rate and competition. Undertaking such research would have protected the company's shareholder value.	1
2.2	Shop-4-iTs products would probably have been priced higher than its competitors given that most of its retail products would have been imported. Given the state of the economy, this was unlikely to have attracted customers from the onset. Given the devaluation of the Naira against the US dollar, product prices were always going to be unlikely to attract many consumers in the country.	1
2.3	Given the decision to change to imports, the slowness of the ports to clear goods, would affect the ability to have goods available on time in order to generate sales. Furthermore the cost of clearing goods is high which could affect profitability.	1
3	**Management**	
3.1	The CEO of Stay-Fresh had no experience in the West African region and no experience outside South Africa. This negatively affected the company's ability to understand the Nigerian market.	1
3.2	The CEO also lacked experience in management at a senior leadership level. His previous experience was in HR and the new role required him to head portfolios for which he may not have had sufficient experience.	1
4	**General**	
4.1	Given the perception of South African business in Nigeria (i.e., the 2019 attacks) it would have been wise for the company to seek alternative countries for investment.	1
4.2	The current strategy was also not a good fit for the country, as it was beginning to focus more on ecommerce, whereas Shop-4-iT focuses on traditional retail stores.	1
4.3	Shop-4-iT should have considered that the low initial asking price was an indication of financial and operational challenges within the company and country. Thus Shop-4-iT should have been better prepared for these challenges.	1
4.4	Not including a local partner as part of the investment strategy in Nigeria ultimately affected Shop-4-iT's ability to understand and make an impact in the country.	1
5	**Conclusion**	
5.1	The strategy was ultimately flawed and did not create value for shareholders of the company.	1
	Available	**22**
	Maximum	**9**
	Communication skill s– appropriate style	*1*
	Total for part (b)	**10**

Part (c) Discuss the merits and pitfalls of the two potential plans of action suggested by S4N by the board of directors for Shop-4-iT.	Marks
Option 1 – Disinvesting completely	
Merits	
• Disinvesting seems feasible as profit for the company has dropped from the prior year and the situation may continue to worsen considering the declining economic growth of the country.	1
• Disinvesting completely would align with the request of shareholders.	1
• Exiting the Nigerian market would afford the company more time to focus on its core operations in South Africa, which may positively affect its market share there.	1
• Disinvesting would allow Shop-4-iT to pursue other areas for growth and the company may use the funds to invest in other more profitable countries in Southern Africa.	1
• Nigeria's declining middle class and increasing unemployment rate are indicators that the country may not be ready for a niche product offering. Thus Shop-4-iT would be making the correct decision in leaving the country.	1
• High inflation decreases the possible purchasing power of consumers, also reducing the opportunity for growth of the company as consumers would be less likely to purchase niche products at such a time.	1
• The Naira has devalued considerably over the past year, which increases the likelihood that profits from the country would continue to represent a small portion of total group company profit. Thus, disinvesting in the country would not cost the company a considerable sum.	1
• The continued declining value of the Naira would likely drive up the cost of imported products in the country. As Shop-4-iT depends heavily on its imported goods, this may erode its ability to generate sufficient profits from its operations given the increasing costs.	1
• The increase in government spending on debt would further decrease the ability of government to spend on key areas of the economy needed for Shop-4-iT to operate efficiently e.g., road infrastructure, for deliveries of goods from ports.	1
• Moreover, poor infrastructure in the country would likely increase company spending on auxiliary costs such as transport, which would cause a decline in shareholder value. This would continue increase if government spending on services dwindle due to its increased debt servicing costs.	1
• GDP growth only marginally exceeds population growth; this is a further indicator that government may not have the necessary finances to support infrastructure – it will be too busy servicing debt and a growing consumer population.	1
• The company tax rate in Nigeria, which is higher than the rate in South Africa is not particularly beneficial to Shop-4-iT. Given Nigeria's structural problems, this is a further indicator that the country is not open to investment.	1
• Opportunities for growth in large retail stores seems limited as the consumers appear to favour smaller retail outlets. However, selling in smaller stores does not fit in with the Shop-4-iT brand.	1
• Rentals in Nigeria are all USD denominated, which means that exiting the country would help to reduce the company's foreign exchange risk.	1
Pitfalls	
• The sale of S4N would not align with the company's strategy for achieving growth on the African continent, as the company only has a presence in Southern Africa.	1

• Nigeria is Africa's largest economy. Therefore, disinvesting in the country may hamper further growth opportunities for the company in the region and on the continent.	1
• Shop-4-iT currently employs 1 500 people in Nigeria, therefore exiting could increase the already high unemployment rate in the country, as there is no guarantee that the new owners would retain the existing employees.	1
• The proposed offer of NGN80 billion is lower than the current net asset value of the company based on book values. This may be a further indication of the deterioration of its investment in Nigeria. Thus, it would seem as though it is the correct decision to sell shares in the company.	1
• Although disinvesting would enable the company to reduce its foreign exchange risk, Shop-4-iT may incur costs such as penalties for early termination of rental agreements with shopping centre landlords. These costs may be significant given that the company would likely have signed long-term agreements.	1
• Completely disinvesting may prove difficult given that S4N's loans were recently refinanced, and creditors may have included additional conditions which prevent the resale of assets.	1
• There is a significant delay in the repatriation of funds from Nigeria and therefore there is a risk that S4N will not be able to repatriate any funds generated by the closure to South Africa. Or, disinvestment could provide immediate cash for the company.	1
Option 2 – Develop the online system	
Merits	
• Remaining partially invested would allow the company to benefit from access to a wider marketplace for its products given Nigeria's large population.	1
• Given the growth of the ecommerce industry in the country, investing in this type of operation would enable Shop-4-iT to diversify its operations, which would in turn increase shareholder value.	1
• Staying invested would allow the company to take advantage of any further opportunities that may become available over the years without the need to invest too heavily.	1
• Developing an online system could bring about cost savings (in terms of the physical infrastructure), ultimately increasing company profitability	1
Pitfalls	
• High financial crimes in the country may point to risk that the company may fall prey to cyber attacks on its infrastructure in the country.	1
• The lack of USD in the country increases the risk that Shop-4-iT would struggle to repatriate funds to South Africa.	1
• A further devaluation of the Naira could further translate to lower profits to Shop-4-iT in South Africa.	1
• S4N might not have the necessary skills to establish and manage an e-commerce platform. There is a risk that the lack of expertise in this field will lead to failure and losses.	1
• Operating online as an ecommerce platform would also require an established delivery network. It is unclear given the issues in the country whether this is viable.	1
• **Capital investment** would be needed in technology in order to facilitate the on-line sales. There is a risk that this investment will not yield the required return and will be another failure, just as the acquisition and rebranding of Stay-Fresh	1
• Even if S4N does sell online, the type of products they sell might still not be in demand (luxury products). Therefore, the primary issue is still not addressed.	1

Unless they foresee that they will gain access to the higher income market through their online offering.	
• The media news release may create negative customer sentiment towards Shop-4-iT which may impact negatively on future operations in Nigeria, in which case pursuing the online strategy may not be advisable.	1
Other pitfalls	
Operational risk	
• Increasing cost of clearing products at the ports increases the risk that the company would struggle to generate appropriate returns for its products given that high product costs are likely to be high.	1
• Political instability in the country provided the legal cases around the election of the president may create a difficult macro environment to operate it.	1
• Shop-4-iT may have a limited ability to pass on increased costs (imports, inflation) to customers through price increases given the weak macro backdrop and consumer demand.	1
Interest rate risk	
• Fluctuations in the interest rates due to inflation may cause debt servicing costs to increase significantly, which would increase the risk of default.	1
Political risk	
• Given the political instability in the country, there is a risk that the Nigerian government may revise repatriation rules for funds to South Africa	1
• The risk of damage to property due to the threat of the attacks on South African owned business in the country	1
Available	**39**
Maximum	**18**
Communication skills – logical argument	*1*
Total for part (c)	**19**

Part d) Discuss, with regard to the board's responsibility for good governance, the decision by the board of directors of Shop-4-iT to not respond to the news article.	Marks
• Part of King IV requires the board to proactively engage with stakeholders, thus the board **should communicate with shareholders** about the matter.	1
• Given that Shop-4-iT is committed to good corporate governance in accordance with King IV, the accusations in the article may cause **stakeholders** not to view the company as such given that the article accuses the company of focusing solely on profits and not considering the environment in its decision making.	1
• The news article negatively affects Shop-4-iT's **public reputation.** Not responding to the article may negatively affect the company's reputation. It does not seem to be in the best interest of the company to ignore the disclosures.	1
• Moreover, the duty to demonstrate ethical leadership would require the board to inform its **employees** of the matter under consideration as this could impact the staff morale.	1
• Given the high **unemployment rate of 30%,** the **public** would also need to be informed of the board's view on the situation.	1
• The board should **consider developing an effective ESG strategy** (including a monitoring system like assurance) which drives better governance and innovation and helps the organisation to navigate through this tough economic climate. Such a strategy would assist in appropriately responding to the concerns raised about the company in the article (Lack of national building/lack of national investment i.e. in the Nigerian nation).	1
• The article places the blame for the lack of investment on the CEO, but as part of ethical leadership, the board would need to act with integrity. Thus, the board should acknowledge its shortcomings regarding the lack of investment in the country.	1
• The board should inform the public that the decisions taken by the company are done with the approval of the board.	1
• Should the board not respond to the article, the negative publicity may cause the company share price to fall, given that the company would no longer be seen as a good corporate citizen. This would impact shareholder value and therefore the company may need to prioritise managing the impact on its reputation.	1
• Potential investors may begin to question their investment in the company as a result of a loss of trust.	1
• The company may need to consider obtaining legal and public relation advice about the statements made in the article.	1
• P1 of KING IV states that the governing body should lead ethically & effectively which includes being **transparent** in the manner they exercise their responsibilities. By not responding to the newspaper article, it appears that the board of directors are not transparent and have something to hide.	1
• P11 of KING IV states that the governing body should govern risk. It appears that the directors are unsure of the way forward and do not have appropriate **risk management policies** and procedures in place.	1
• **Good and right for self and others -** the directors may be criticized for choosing action (ignoring the article) because it is good for them and not for employees' public/Nigeria/stakeholders.	1
Available	**14**
Maximum	**7**
Total for part (d)	**7**
TOTAL FOR QUESTION 1	**50**