CONTOH SOAL

CASE STUDY: BALANCE LTD

The date is September 20X8.

Ambrosia is a small country with a strong economy and a thriving financial services sector. Its currency is the Ambrosian dollar ($). Ambrosia attracts many foreign nationals (expatriates) who are employed in technology roles and are temporarily resident in Ambrosia on 5–10 year working visas.

Education in Ambrosia

The Ambrosian Government offers state-funded education for children born and resident in Ambrosia. Children must be in full-time education until they are at least 16. The state funds education leading to two qualifications:

- Certificate of Ambrosian Education (CAE) - taken by all state-funded children at age 16
- Final Award of Ambrosian Education (FAE) – taken at age 18 by state-funded children who choose to continue in post-16 education

80% of children up to age 16 who are eligible for state funding attend state-run schools. 60% of eligible children continue in education to age 18.

In addition to state-run schools, there are several privately-run schools in Ambrosia. These offer two internationally-recognised qualifications:

- International GCSE (IGCSE) – taken at age 16
- International Baccalaureate (IBAC) – taken at age 18

Privately-run schools are commercial organisations which charge fees to parents. They are primarily attended by the children of expatriates and the remainder are children of Ambrosian residents whose parents opt to pay for education.

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BALANCE SCHOOL – BACKGROUND INFORMATION

BALANCE LTD (BALANCE) is a company owned by the Balance family which operates Balance School, a privately-run school in Ambrosia. Balance School has a reputation for providing high-quality education for children aged 11–18. All children take IGCSE at age 16 then at age 18 they can take the IBAC. 30% of children attending Balance School were born in Ambrosia. Children must pass an exam to gain entry to Balance School. Demand for places on Balance School's IGCSE programme (aged 11–16) is very high and there is always a waiting list. However, Balance

School has spare capacity on its IBAC programme post-16, as many expatriate children return to their country of origin to continue post-16 education.

BALANCE's board consists of members of the extended Balance family, all of whom were born in Ambrosia. The board's primary objective is profit maximisation.

Government Plans For Education

The Ambrosian Government wants to maintain its strong economy and achieve year-on-year growth. An extract from the Government's latest strategic plan for education states that its priorities are to:

- Increase the number of Ambrosian-born children who continue in post-16 education; and
- Develop technological expertise to provide Ambrosia with resident IT specialists in the future.

The Government has approached BALANCE with a proposal to create a new College of Technology (College) for children post-16. All children passing the exam to attend the College would study for both the IBAC and an International Diploma in Technology (IDT). The course would last for two years.

The Government would pay fees to the College for children born in Ambrosia. This would cost the Government an extra $1,500 per year per child than if the child attended a state-run FAE programme. Children of expatriate families would be encouraged to attend the College, but their parents would be required to pay the fees in full.

Joint Venture

If the College goes ahead, it will be operated as a joint venture company (JV), with the Government and BALANCE each owning 50% of the shares and sharing profits and losses equally. The JV will run for five years initially. The Government and BALANCE will each be able to appoint two members of the College's senior management team.

The Government will close an existing state-run school, for children post-16, that has considerable spare capacity and the College will operate from these buildings. The Government will pay a one-off sum of $250,000 to refurbish the buildings to an appropriate standard. The Government will retain ownership of the buildings and make them available to the JV in return for rental payments of $225,000 each year.

To equip the College, BALANCE will provide the JV with $250,000 initial capital for learning resources, including IT equipment. BALANCE will manage the College's day-to-day educational operations and will be paid $375,000 each year by the JV for doing this.

If the JV goes ahead, BALANCE will continue to operate Balance School as a separate independent company, but will offer only the IGCSE programme for children aged 11–16. Balance School will close its IBAC programme and encourage children completing IGCSE at 16 to move to the College. Balance School's specialist IBAC teachers will move to the College.

Closing the IBAC programme will increase Balance School's capacity so it can offer more places on its IGCSE programme for children aged 11–16. Closing the IBAC programme will result in an estimated net reduction in profits for Balance School of $400,000 each year.

The following estimates have been made for the College:

- Variable costs such as tuition materials will be 15% of tuition fees.
- Fixed costs of operating the College, including teacher salaries, will be $794,000 each year. This excludes any payments to the JV parties.
- Course fees will be $8,000 each year per child. These will be paid by the Government for children born in Ambrosia.
- The first intake will be 120 children and the intake is expected to grow by 20% each year.

REQUIREMENTS:

1. Discuss the extent to which the government's objectives for the College of Technology may conflict with BALANCE's objectives.
2. Calculate the number of children that need to attend the College each year for it to break even, stating any assumptions. Comment briefly on the implication of your result for the financial success of the College.
3. Evaluate the benefits and risks of the joint venture for both Balance and the Government.

____________________*END OF TEST*____________________

ANSWER

1. **Conflict of objectives**

Balance and the Government will have different objectives, which will themselves be linked to their different stakeholders. As a profit making company, key stakeholders for Balance will be its shareholders (the Balance family). Their main aim may be to generate as much profit as possible. As the public sector body responsible for the running of Ambrosia, key stakeholders for the Government will be residents, businesses, the wider community and any partners in other public services such as health, infrastructure. The Government as a not for profit (NFP) organisation has a wider range of stakeholders and is likely to have to balance the use of limited resources to ensure it provides the best possible services and maximises benefits for the country.

For the College to be a success, the two members of the JV need to have complementary and aligned objectives and in certain cases their aims and objectives may coincide. If the college is successful, this will generate profits for Balance but will also facilitate the achievement of the Government's strategic priorities for education to:

- Increase the number of Ambrosian-born residents, aged 17–18, who undertake statefunded further education; and
- Develop technological expertise to provide Ambrosia with future resident IT specialists and reduce the need for expatriate resources.

However, there is also scope for conflict of interest about the strategy and activities of the College between Balance as a private entity and the Ambrosian Government as a public body, and the two parties may have different planning horizons. A balance will need to be struck between financial return annually and delivering a public educational service in the longer term.

Also conflicts may arise between the interests of the JV and the separate interests of the two participating members. Balance's aims for the College are likely to involve growth and profits. Its primary objectives are more likely to be financial rather than nonfinancial, with a probable focus on cost control and margins. Balance's desire to increase profitability may conflict with the Government's obligations to society. This may give rise to conflict for example over admissions policies and who decides on the balance between expats and residents. The Government may be less keen on selection criteria like those applied within Balance School if this reduces the number of resident children who qualify for attendance.

The Government will need to insist on controls to ensure that decisions/actions by the JV do not undermine its objectives in relation to national education.

However, Balance brings commercial experience to the venture, which may help increase profits from the college. If the JV generates additional income for the Government then it may indirectly allow the Government to better achieve its other objectives by providing more financial resources. As a public body, the Government needs to act in the public interest and is likely to have to uphold certain principles including integrity, accountability, transparency and honesty. These are very similar to the core corporate governance principles of a company and so the values of Balance and the Government should be aligned in this respect.

Conclusion

Although Balance and the Government have different stakeholders, they both have a vested interest in the success of the College and their objectives are sufficiently aligned for the joint venture to succeed. Since each party is entitled to appoint two representatives to the JV's senior management team, neither would appear able to dictate decisions. However, there is some scope for conflict and they will need to agree on the methods for resolving any disputes.

2. **Break-even attendance and financial implications**

Fee per pupil = $8,000

Contribution per pupil = $8,000 × 0.85 = $6,800

Fixed costs = $794k + Rental $225k + Management fee $375k = $1,394k

Break-even attendance = $1,394,000/$6,800 = 205 pupils p.a.

The IBAC programme and technology diploma is a two year course. In year 1 the College will only have one year-group, starting their two year programme. In year 2 and subsequent years there will be two year-groups. The 205 pupils would represent the total number of pupils in attendance required to break-even over a year, so once the College is up and running this would equate to two intakes/year-groups. For example if, as expected, the College attracted 120 pupils in the first year and 144 in the second (20% increase), then it would be loss making in year 1 (120 pupils in attendance) and profitable in year 2 (264 pupils in attendance compared to 205 break-even, a margin of safety of 22%). The calculation therefore suggests that the College will be a financial success. The fact that the College will break-even if it has an attendance of 205 pupils does not necessarily mean that this is the point at which the individual JV parties will break-even on their investment, since each has different income and costs arising from the JV. However it is clear that the College will start to generate a profit share for both Balance and the Government from year 2 onwards.

It would be useful to have some further information to substantiate the forecasts of the likely attendance of the College – the numbers of children currently attending Balance's 17–18 programmes and the FAE programme that the Government is proposing to close would give some more idea of the level of demand. The break-even calculation depends on the assumptions that have been made about the average fee, contribution and fixed costs. In reality these may vary over the five-year period.

Some sensitivity analysis would be useful to identify the assumptions that are most critical. As with most colleges the model is one of high operating gearing. The attendance of the College may depend on its exam success. Thus the financial success of the venture will partly depend on the College's ability to retain the academic standards and quality that Balance's reputation relies on. It would also be important to understand if there are any other schools/colleges operating in competition. Expats may prefer to send their children to an IBAC-only school rather than one offering a mix and the fees charged by competitors may influence demand.

3. **Benefits and risks**

Government

Benefits

- The venture is consistent with the Government's strategic priorities for education and the economy.
- It provides access to the resources and expertise of Balance that the state schools may lack to train students in international qualifications and technology. If successful this will provide home-grown IT skills and reduce the country's need for expats. There is a guaranteed return on the College building in the form of the $225k annual rental from the JV. Also the Government retains ownership of the building in the event that the JV is not a success.
- Balance's experience may help improve exam results and hence the quality of education received. The Government and Balance are sharing the cost of the initial investment. Thecontribution from Balance reduces the financial risk for the Government compared to funding the College set up alone.
- The Government's 50% profit share can be used to fund other public sector projects and hence benefit wider stakeholders.

Risks/downsides

Risk identification will be particularly important for the Government. Risks include the following:

- The Government will need to finance the $250k up-front investment for refurbishment which may take funds from other projects.
- The Government may attract adverse publicity as a result of closing the state school for 17–18 year olds and may be criticised for becoming involved with a commercial organisation and prioritising profit over education.
- Although profits are shared 50/50, the Government receives less in fixed annual payments from the JV than Balance does (£225k compared to £375k).
- The College costs the Government an extra $1,500 per pupil if they switch from an existing FAE programme and $8,000 if they were previously not in education aged 17–18. Some residents whose parents previously paid for education may now take up their offer of state funding (the data suggests that approximately 20% of Ambrosian parents currently pay privately between the age of 11–16) and if the College is successful in attracting some of the 40% of students who are not currently in 17–18 education, this will significantly increase costs for the Government.
- There may be conflicts of interest with Balance – the fact that Balance has 50% control and profit share may mean public interest arguments are not always the priority and the Government may have to compromise on certain objectives.
- It may take a while for the venture to become profitable and it is unclear what evidence there is for demand for the new technology qualification (what research has been done?).
- If the JV is loss making then the Government has to take a 50% share of losses, although it will still own the building that the College is using.
- The new College may reduce demand for FAE at other state schools, which could appear a second rate option in comparison.

Balance

Benefits

- The JV frees up space for Balance School to use for education of 11–16 year olds. Since there is a waiting list this should increase Balance school's profits from these courses.
- It widens the audience for 17–18 year old courses which are currently undersubscribed and extends the market beyond the expat community
- Balance is guaranteed an income stream in the form of the $375k management fee.
- Balance are likely to be able to staff the College by transferring existing staff from the IBAC programme which may increase their utilisation rate and will be faster.
- There may be corporate social responsibility (CSR) benefits of being associated with an innovative state education programme. The additional publicity may increase Balance's reputation and attract other pupils to Balance School.
- If the venture is successful Balance could extend this model to other countries.

Risks/downsides

- Balance will need to finance the $250k up-front investment in equipment and resources.
- Balance loses $400k net income from closing existing 17–18 programme, although the guaranteed $375k management fee means most of this is recovered and Balance will break even provided the College makes at least $50k profit.
- Balance is responsible for the day-to-day control of the College. Balance has no apparent experience of technology and the existing tutors may lack the necessary skills so Balance may initially have difficulties managing the College operations. Management time on the College may distract managers from running Balance School's operations effectively.

- Balance will not be free to set prices/decide on strategy as it will need to take the Government views into account. The Government may be reluctant to accept fee increases in future if it is funding some of the pupils.
- A JV with the Government may damage Balance's reputation, particularly if the College has to accept resident children using lower selection criteria than Balance would normally apply. This may have a knock-on impact on the success of the Balance School.
- If the College is too successful it will provide home-grown IT skills and reduce Ambrosia's need for expats, potentially reducing the market for Balance school.
- If the College is not successful and the venture ends, Balance may find it hard to re-open its own courses for 17–18 year olds.

Conclusion

Overall the College looks likely to be a financial success and is probably beneficial for both parties. Balance will generate a financial return from the JV and have the capacity to earn more profit from Balance School. It will also strengthen its ties with the Ambrosian Government. Partnering with Balance will reduce the costs and risks for the Government of setting up the College and help the Government achieve some of its strategic priorities for education.

More work could be done in the form of market research to assess the demand for the new College and the Government could engage in stakeholder consultation. The JV will need to be set up carefully to ensure that the risks identified for each party are properly addressed and that exit arrangements are clear should either party want to terminate the venture.