African Business School (Pty) Ltd (‘ABS’) is a registered training organisation that operates from three training sites in Irene (close to Pretoria), Magaliesburg and Randburg. ABS focuses on providing one to three day courses on managerial development topics to middle and senior management personnel. Courses are held during weekdays and facilities are closed over weekends. ABS leases the three training sites.

The Irene and Randburg training sites can accommodate a maximum of 30 people per day and the Magaliesburg site 40 people per day. Standard course rates are charged per person per day and there is no difference in the daily prices for one, two and three day courses.

The Magaliesburg training site is situated on the outskirts of the town of Magaliesburg within a small game reserve. The facility includes a lodge that can accommodate training course attendees overnight. Attendees on two and three day courses stay over at the lodge and all meals are included in the course rates. This site currently charges such attendees an extra R400 per night for meals and accommodation. The land on which the lodge and training site are situated is leased from the owners of the game reserve. The lease has recently been renewed for a further ten years.

The head office of ABS is responsible for scheduling of courses, marketing, finance and administration. The head office is situated on the Randburg site and the allocation of rent and related fixed overheads is based on the relative floor space occupied by the head office and the Randburg training facility.

Salient information regarding the operational and financial performance of the three training sites and the lodge for the year ended 28 February 2006 is summarised below:

<table>
<thead>
<tr>
<th>African Business School (Pty) Ltd</th>
<th>Financial information for the year ended 28 February 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Notes</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td></td>
</tr>
<tr>
<td>Course fees</td>
<td>1</td>
</tr>
<tr>
<td>Accommodation and meals</td>
<td>2</td>
</tr>
<tr>
<td>Bar revenue</td>
<td></td>
</tr>
<tr>
<td>Operating costs</td>
<td></td>
</tr>
<tr>
<td>Variable expenses</td>
<td>3</td>
</tr>
<tr>
<td>Fixed costs</td>
<td>4</td>
</tr>
<tr>
<td>Head office costs</td>
<td>5</td>
</tr>
<tr>
<td>Operating profit/(loss)</td>
<td></td>
</tr>
</tbody>
</table>
Notes

1. The course fee per person per day during the 2006 financial year was R600 at all ABS training venues. The number of people who attended courses during 2006 and site capacities are set out below:

<table>
<thead>
<tr>
<th></th>
<th>Irene training site</th>
<th>Randburg training site</th>
<th>Magaliesburg training site</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum number of days available for training in the 2006 financial year</td>
<td>225</td>
<td>225</td>
<td>225</td>
</tr>
<tr>
<td>Maximum number of people who could have attended courses in 2006</td>
<td>6 750</td>
<td>6 750</td>
<td>9 000</td>
</tr>
<tr>
<td>Actual number of people attending training courses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>One day courses</td>
<td>1 425</td>
<td>1 695</td>
<td>240</td>
</tr>
<tr>
<td>Two day courses</td>
<td>150</td>
<td>420</td>
<td>720</td>
</tr>
<tr>
<td>Three day courses</td>
<td>100</td>
<td>280</td>
<td>640</td>
</tr>
</tbody>
</table>

2. The lodge marks up alcohol and beverages sold in its bar by 60%.

3. Variable costs at the training sites include costs of hiring external presenters, course materials and refreshments served during courses. ABS employs a limited number of presenters at each training site on a permanent basis and contracts with external presenters for specific courses as required. Variable costs at the lodge comprise the costs of alcohol and beverages, and catering costs.

4. Fixed costs in the 2006 financial year were made up as follows:

<table>
<thead>
<tr>
<th>Fixed costs for the year ended 28 February 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Irene training site</td>
</tr>
<tr>
<td>---------------------</td>
</tr>
<tr>
<td>R</td>
</tr>
<tr>
<td>Administration and finance costs</td>
</tr>
<tr>
<td>Cleaning costs</td>
</tr>
<tr>
<td>Kitchen staff salaries and overheads</td>
</tr>
<tr>
<td>Bar staff salaries</td>
</tr>
<tr>
<td>Marketing expenses</td>
</tr>
<tr>
<td>Rental of premises</td>
</tr>
<tr>
<td>Presenter salaries</td>
</tr>
<tr>
<td>Scheduling costs</td>
</tr>
<tr>
<td>Other fixed costs</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

15
5. Head office costs were fully allocated to each training site and the lodge in 2006 based on each site's revenue (excluding bar revenue) as a percentage of total ABS revenue.

ABS has been under pressure from the shareholders because of the performance of the company over the last three years. At the last shareholders' meeting, management was requested to identify and explore strategies to improve the financial performance of the company.

Management has subsequently identified the following three strategies for improving profitability:

- Closing the Irene training venue,
- Outsourcing the catering at the Magaliesburg training facility, and
- Using the Magaliesburg site as a wedding venue over weekends.

Option 1  Closing the Irene training venue

As the Irene site seems to be the least profitable, management is investigating the implications of closing this training facility, based on two possibilities: The first is to close the facility completely, and the second is that the University of Pretoria (UP) operate the facility on behalf of ABS.

Courses currently offered at Irene could be offered at the Randburg site, and initial feedback indicates that 75% of ABS clients would attend courses at Randburg if the Irene site were closed.

Other relevant information relating to the potential closure of the Irene training facility:

- The presenters currently employed in Irene could be offered positions at Randburg;
- The rental agreement for the Irene premises expires on 28 February 2007;
- The estimated costs of retrenching employees at Irene, excluding presenters, would be R200 000; and
- Other site closure costs would amount to R75 000.

The UP has offered to operate the Irene training site on behalf of ABS. UP will assume full operational responsibility for the site including marketing, course scheduling, finance and administration. In addition, UP will pay all operational expenses associated with the site, except for head office charges, and will collect course fees directly from attendees. Apart from course presenters the current Irene employees will be employed by UP. ABS will retrench the presenters at Irene at a total cost of R350 000.

Essentially ABS will provide course material to UP and allow them to operate the training site as an ABS facility. In return, UP will pay ABS a fee amounting to 5% of course revenue. UP has undertaken to charge the same course fee per person per day as is charged at other ABS sites.
Option 2 Outsourcing of the catering at Magaliesburg lodge

Management also investigated the possibility of outsourcing the catering at the lodge. Though the catering is of a very high standard and receives mostly positive comments on course evaluations, management is of the opinion that the costs of providing this service are too high.

Brilliant Catering has made the following proposal for taking over the catering and bar functions on an exclusive basis at the lodge:

- Existing kitchen and bar staff will be offered employment by Brilliant Catering. Employees who refuse the offer will be retrenched by ABS. If no employee accepts the Brilliant Catering offer, the estimated retrenchment cost will amount to R230 000.
- Accommodation functions at the lodge will remain the responsibility of ABS.
- If Brilliant Catering takes over the catering and the bar, and kitchen and bar staff elect to join Brilliant Catering, the fixed costs at the lodge payable by ABS will decrease by an estimated R325 000 per annum.
- ABS will continue to pay rental for the premises as well as the fixed overheads associated with provision of accommodation facilities.
- Brilliant Catering will charge ABS a fixed fee of R125 per person per day for meals provided. Brilliant Catering will operate the bar for profit and amounts spent by attendees on alcohol and beverages will be recovered from ABS, who in turn will recover it from attendees.

Option 3 Using the Magaliesburg lodge as a wedding venue

As ABS does not use the Magaliesburg training site and lodge over weekends, management is keen to investigate the possibility of using the facilities as a wedding venue. However, the facilities will need to be upgraded and expanded to make them suitable for this purpose. An initial estimate from a reputable building contractor put the alteration cost at R1 250 000. These alterations would enable the lodge to cater for wedding parties of up to 200 guests.

The management of ABS has consulted with various wedding planners and the consensus is that the upgraded Magaliesburg facility could be hired out for 30 weddings in a normal calendar year.

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**REQUIRED**

| (a) | Critically analyse and discuss the financial performance of the training sites and the lodge during the 2006 financial year. | 15 |
| (b) | Advise the management of ABS, with reasons, on the most appropriate strategy with regard to the Irene training site namely –  
- to continue operating the Irene training site on the current basis,  
- to close the site, or  
- to outsource the operations to the University of Pretoria.  
Your answer should include the financial considerations involved in each alternative as well as any other factors to be considered before making a final decision. | 15 |

Continued
<table>
<thead>
<tr>
<th></th>
<th>Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>(c) Evaluate and provide an initial recommendation as to whether outsourcing the catering at the lodge to Brilliant Catering will improve the profitability of ABS. List any additional aspects that should be considered before a final decision is taken.</td>
<td>8</td>
</tr>
<tr>
<td>(d) Outline how the management of ABS should approach the evaluation of the financial feasibility of upgrading the Magaliesburg facility to make it suitable as a venue for weddings, and list the additional financial information they would require in order to make an informed decision.</td>
<td>7</td>
</tr>
<tr>
<td><strong>TOTAL MARKS</strong></td>
<td><strong>45</strong></td>
</tr>
</tbody>
</table>