Rise and fall of abc learning

Business, Company

Rise and fall of ABC Learning

History of ABC Learning and its business strategy

ABC Learning led its foundation in the year 1988 in Ashgrove, Brisbane, Queensland in Australia. The rapid expansion of ABC resulted in 43 childcare centers around the year 2001 to a whooping 697 centers in 2005 all over Australia and New Zealand. ABC Learning is subjected to child care and qualityeducationhence; its performance can be gazed from its rapid expansion in the country. The child care company acquired similar groups in the United States and United Kingdom for its further global expansion and is aiming to provide child care services on a global scale. The business strategy of ABC is to achieve its objectives through global expansion but for that they had enormous dependency on debt which eventually led to its fall out due to the recent subprime mortgage crisis.

ABC Learning acquired United States Learning Care Group Inc, Peppercorn Management Group, La Petite Academy of Chicago, UK based Busy Bees Group Ltd, etc, which resulted in its striking the chord with the major global child care operators and creating a global brand image for itself. The first and foremost reason for mergers and acquisitions is the firms' desire to increase market power. In order to expand the size of the firm, firms go in for horizontal, vertical and conglomerate mergers. If two firms operating and competing in the same business activity merge, it is known as horizontal merger. When firms in the same industry but in different stages at value chain merge, it is known as vertical merger. When two firms from unrelated types of business activities merge, it is known as conglomerate merger. The

ABC Learning had enforced vertical mergers for their business expansion in the global scenario.

The company ABC Learning is following a very aggressive strategy of acquisition and expansion in its business, which is very risky owing to the scenario of the maturing child care industry. ABC is quite open with the fact that they are going to continue their expansion procedure in the same way. This strategy is too risky as it will increase their debt ratio and they might not be able to integrate their business in an effective way. The share price is at the 24 times of the historical earnings per share and is considered as one of the biggest problems of ABC in the near future. (Kruger, 2009).

Intangible asset problem of ABC Learning

Intangible assets are those assets which have no physical being but nevertheless are of economic value, sometimes more than all tangible assets taken together, to the business entity. Intangible assets include items such as patents, copyrights, trademarks, franchises and goodwill. Despite their lack of physical substance, these assets are extremely valuable resources for a company. An intangible asset should be measured initially at cost. Therefore, an intangible asset should be recognized if, and only if the cost of the asset can be measured reliably. An intangible asset can be generated from separate acquisition, acquisition as part of amalgamation, acquisition by way of a governmental grant or exchange of assets. Hence, the measurement and valuation of an intangible asset is dependent to its process of acquisition.

ABC according to its recentfinancial statementholds intangible assets worth $ 3. 05 billion, which is a huge percentage of its net holding of assets. According to the accounting standards, if any intangible has the probability to generate future economic benefits to the business entity then only is can be recognized but this is not the case for ABC. ABC's claim of childcare licenses worth $ 3 bilion is questionable as the company had never made any profit from childcare. This sort of business strategy and valuation of assets is creating major problems for ABC and putting its image in lots of trouble. The share price hike of the company is also due to its net worth of assets but the major worth of the intangible assets does not seem to be very supportive to that hike. The main problem that the company and its shareholders might face is that if there is any fall in share price then that would not get the necessary back up support from the company's assets. The rapid expansion strategy of ABC Learning had created enormous business risk but that is not clearly visualized in the financial statements of ABC. Hence, the shareholders did not have a transparent view of the business performance and procedures of ABC, which subjected them to large risk of losses in the near future. (Schwab, 2008).

Accounting Standards of ABC Learning

In this age ofglobalization, companies are operating in different countries. They are not restricted to the country of their origin. With their different area of operations, it has become imperative to the companies to follow similar practices in terms of accounting. This would mean higher transparency and it would be more useful to the users. In the last century, different frauds unearthed which underlined the value of accounting standards. There are several factors for the creation of accounting standards like political, legal, tax factors, cultural, economic, educational, and capital market but the main four drivers are state of economic development, business complexity, political persuasion, and some reliance on a particular system of law.

ABC Learning follows some specific standards in their accounting practices, which are quite rigid in their prediction and interpretations. They use bright line rules, which are very narrow in terms of interpretation and composed of some specific objective factors. The purpose of this type of standard rules in terms of their application is to produce consistent results which are also predictable beforehand. This type of accounting standard made the financial statements of the company quite narrow in terms of its interpretation and thus they fail to cover every contingency of the business entity. They use bright line rule of accounting standards and not the other one because weighing various factors might result in inconsistent application of rules and would reduce objectivity of the business entity. However, principles based accounting standards would lead to the reduction of objectivity of ABC but would also ensure more practical view point of the future prospects and would make the business procedure more transparent to the stake holders.

As it has been said earlier that the use of bright line rules type accounting standard helps ABC to produce predictable consistent results but there are also some dangers of changing it. The foremost danger of changing such type of accounting standard is to get diverge from the ongoing business strategy. The business strategies are planned according to the objectivity factors of the business entity and if the principles based accounting standards are followed then they would reduce the objectivity factors which would led to thefailureof the ongoing business strategies. The change of bright line rules would also lead to the inconsistency in the results of application of rules, which would hamper the business procedure and the interpretations. (McRobert, 2009; A. B. C. Learning Centres Limited, 2008).

Mechanism of agency cost minimization

The agency costs are those costs which are borne by the stakeholders for the encouragement of the managers to uplift the wealth of the shareholders rather than working on their self-interest. The most important types of agency costs are: (1) the expenditure on monitoring the activities of the manager like, the audit cost; (2) expenditures of hiring outside members for the structuring of the business organization and putting limitations on the undesired managerial behavior; and (3) opportunity costs that are incurred in case of shareholder-imposed restrictions. The agency costs can be minimized by shareholders by controlling the above discussed points.

ABC Learning had already indulged itself into a huge debt and the financial position of the business entity is not very sounding in the present scenario but still some of the shareholders are hoping the company to recover from the increased debt. For this they are opting to minimize the agency cost of the company to help it in its recovery. The audit cost of ABC is quite high as they had appointed the top auditors of the country and the audits were done on half yearly basis. The auditors of ABC were Pitcher Partners and Ernst and Young, who are the topmost auditors of Australia. Hence, the cost of the audits of ABC is very high and can be controlled by the lenders or the shareholders of the business entity. They had also used KPMG as a neutral party for a fair judgment on the audits of the other two audit firms, which also incurred a fair amount of expenditure from the lenders. (Kruger, 2009). The lenders of ABC should also look into putting limitations on the managerial behavior so that the business strategies and the financial statements reflect the transparent and fair picture of the company's present scenario. The business strategy of the company involving aggressive acquisitions resulted in the huge possession of intangible assets, which boasted the share price of the company but does not provide a great future prospect for its lenders. Hence, the managerial abilities came under scrutiny and the lenders have the opportunity to limit the managerial behavior and also the agency cost for the same. (McRobert, 2009; A. B. C. Learning Centres Limited, 2008).

Auditor's opinion on ABC Learning

The audit of ABC was previously done by Pitcher Partners on and before 2006 and thereafter by Ernst and Young. These auditors are the top ranked auditors of Australia but their reports were quite different to each other. The previous auditors of the company that is, the Pitcher Partners' audit reports lacked transparency and provided the financial scenario according to the will of the company. The audit report of Ernst and Young provided a fairer picture of the financial position of the company. This divergence of opinions of the two auditors of the company is due to the conflict of interest among the lenders and the business entity. The previous auditors acted according to the will of the company whereas, the current auditor acted according to the will of the lenders of the company. The previous audit reports were misleading the potential investors of ABC by artificially creating apparent shareholder value. Hence, the need of changing the auditors had aroused and the current auditors, Ernst and Young was appointed to depict a fairer picture of the present financial position of ABC. However, a third neutral party KPMG was also appointed to judge the audit reports of the two auditors and they concluded that the report of Ernst and Young are fairer among the two. (Kruger, 2009).

There were significant reforms introduced in the framework of auditor independence by CLERP 9. The reforms stated in the Division 3 Part 2M. 4 of the Act were enforced from 1 July, 2004 and are subjected to the fundamental importance of independence of auditors and the credibility of their reports. These reforms were made to promote and protect the auditor importance and make their reports more reliable to the mass. The Act provides independence requirements for auditors in various forms of organizations. The organizational forms include, individual auditors along with audit firms comprising of many auditors and the Act provides a framework for auditor independence. If any auditor breaches any independence requirement under the Act, then he is subjected to criminal liability. Generally, the independence requirements revolve around a central concept of conflict of interests between an auditor and his client. Although the auditor might be aware of this conflict but still he does not take any initiative to resolve it. Hence, a conflict of interest arises in such situation and CLERP 9 advocates the issue of auditor independence and opts to follow the framework of the Act in such circumstances. (Mirzabegian, 2005).

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