Jomo Kenyatta University of Agriculture and Technology

EFFORT SCHOOL OR MORE EFFORT?

Author: Fred Mugambi Mwirigi

Introduction

In October 2005, John K. J. Mwai, the proprietor of Effort School in Kerugoya, Kenya, was conducting a research assignment for his degree course in Entrepreneurship. The assignment triggered a thought process that culminated in a decision dilemma for him. Since the inception of the school he had consistently ploughed back 100% of the profits to finance growth and expansion. However, he now found himself wondering whether time was not ripe to diversify to petroleum and microfinance; businesses he had always hoped to venture in one day.

The Entrepreneur

Mwai had witnessed and also experienced the rise and fall of business during his active business life spanning over 20 years. Indeed he had experienced the fall of businesses, not once but thrice. Immediately after completing high school he had tried selling eggs but the business could simply not yield enough money to sustain itself and at the same time finance his youthful pleasures then. In his words, ‘I got too expensive for the business’. Then followed a small shop dealing in fast moving consumer goods, which collapsed within five months. After this Mwai started buying rice from the rice plains of Mwea, which he then sold to traders in Nairobi at a good profit. Although this business was very profitable it got too demanding for him and his then young family. As much as he felt he was a born entrepreneur he had to seek a less demanding and less paying option. His reprieve came in the way of a government job as a procurement officer.

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However, being the entrepreneur he was, four years later he ventured back into business, this time starting Effort School on the sidelines of his government job. Mwai and his wife agreed that she resigns from the government where she had been working as a teacher in a government school to help run the school. Three years later Mwai also resigned to join his wife full time at Effort School. “We have come very far together,” he thoughtfully said during the interview, “but perhaps my biggest motivation has been the need to get as far away as possible from the dehumanizing poverty I grew within. I have not managed to perfect some of the values we are told characterize a good entrepreneur, but where I fall short my wife takes over. For instance, I simply don’t give up until I have achieved my goal but I can get very edgy under extreme conditions. On the other hand my wife is very composed and a very good team leader, but she lacks in patience. We are simply a team that somehow works”.

His need to improve his entrepreneurial skills saw him enroll for a part-time degree course in entrepreneurship and he says he is already successfully applying some of the concepts learnt in class in his business.

The Effort School

Effort School, a medium sized school complex located in Kerugoya town, Kirinyaga district some 120 km east of Nairobi was started in 1990 with an initial capital of ksh 300,000 (US$ 4,100)[1]. The school started with four pupils, two teachers and two support staff. It grew rapidly in the next few years and by the last quarter of 2005 its net worth had risen to about Ksh 50 million (US$ 700,000), with over 500 students and 67 staff.

By 2005, Effort School was already one of the best performing schools in the region. For instance, in 2004 it achieved the top position in its district and also attained an impressive 17th position nationally in the Kenya Certificate of Primary Education (KCPE). It contributed more than 10% of the district‘s quota of positions guaranteed for primary school graduates in national secondary schools that year.

By October 2005 the school was structured in three sections: the junior school which offers primary education, the senior school which offers secondary education and TES College, a relatively new component in the school set up to offer middle level college education in various business and technology disciplines.

For fifteen years up to October 2005 the school’s growth was phenomenal. Its rapid growth within this relatively short period was fueled by a sustained offering of quality education and very good care for the children, and a deliberate and sustained effort to plough back 100% profits into the business throughout the entire period of the schools existence. This, though, does not mean it had been smooth sailing for the school all along. The school had faced many financial and non financial challenges especially during its formative years but Mwai had persisted and persevered in times of intense challenge always making use of professional advice and help.

1 In 2006 1 US$ was approximately Ksh 72

Perhaps the school's most daunting challenges, which according to Mwai had potential to slow growth, were threefold: one, 'staff poaching' by better paying and better performing schools in Nairobi, which made his school more of a training ground for other schools, two, emerging competition from new and existing private schools in the region some of which were backed with fairly deep budgets, and, three, the new government initiative to offer free and compulsory primary education.

Growth Path

For fifteen years Effort School grew by leaps and bounds, primarily because of a combination of a number of factors including favorable management policy and lack of strong competition within the industry. By ploughing back 100% profit for fifteen years the proprietor was easily able to create necessary capacity upon which quality could be offered. Mwai had by now started realizing that times had changed and that he needed to become a little more innovative to stay afloat in the crowded market that the education sector in Kenya had become.

During his Entrepreneurship studies Mwai had also realized that when faced with stiff competition businesses tended to have a higher capital demand and this demand needed to be satisfied to keep business competitive. Mwai had all along obeyed this rule by constantly ploughing back huge profits over the years. However, the Kenyan market had now become increasingly uncertain and he knew that sooner than later he would need to find new and innovative ways to keep afloat as an entrepreneur. He was by now not too sure of his earlier theory that continuous profit plough back would work for him and the school even into the future.

Having been an active entrepreneurship degree student for the previous three years at Kenya Methodist University Mwai had been exposed to various enterprise growth alternatives which he thought he could apply to further grow his business. "My dilemma is double edged," he had quipped, "if I continue growing Effort the way I am doing I might end up putting all my eggs in the same basket. You know the basket could fall. If I go into different other businesses, they might eat into Effort. Moreover, there is some risk in spreading too thin". One thing remained certain to Mwai though, that he needed to make a move that would change the status quo of his business before change caught up with him.

Investment Alternatives

Mwai's decision dilemma was compounded by the fact that the various investment alternatives he was thinking about all had huge profit potential. However, they all seemed to present unique bottlenecks.

Petrol Stations

Mwai's first alternative was to venture into the petroleum industry. The economy had been liberalized and petroleum dealers were making good profits since they now had wider and varied sources of petroleum products. Moreover, Mwai already had a piece of land in a prime location next to a main highway not far from Kerugoya town. This, he thought, would be a very ideal location for a petrol station. "If I chose to go this route I can use some of the school's profits and a bank loan to finance the project. I could also borrow a few of the schools equipment to start me off." After all Mwai had a good credit rating with a number of banks in his town so securing a bank loan was not really a big concern for him. However, the problem with this idea was that he lacked networks in the industry. A visiting researcher in the petroleum industry had told his university class that success in the industry highly depended on what networks one could build, particularly with good suppliers to ascertain steady and cheap supply of quality petroleum.

According to Mwai, this option presented a set of internal management challenges. For instance this business would have required very close attention. This meant that Mwai needed to devote a lot of time on it. He simply did not have this amount of time considering his other commitments. Also, the business would have required a well trained, experienced and thus fairly expensive manager.

Mwai had already gone out of his way to gather as much industry statistics as possible. These figures had given him conflicting projections for the future of the industry though. For instance, although statistics had shown continued rise in petroleum demand, they also showed that in the previous two to three years retail net profit from diesel had fallen from about ksh 5 to around ksh 2.50 per litre.[2] The reduction in profitability had been occasioned by the continuous ballooning of operating costs mainly as a result of higher taxes and insurance costs.

Other statistics, however, showed that in spite of the fact that profitability per litre had fallen, generally most industry players had continued to post growing total profits. However, most people that Mwai had talked to were of the opinion that the performance of this industry was highly dependent on factors out of the control of individual businesses or even players of the industry in the country collectively. "However much you invest in a petrol station the business can go either way", James, a close friend of Mwai and an established petrol station owner had said to him during one of their discussions. "What, for instance can an individual business do about the ever recurring conflicts in the middle east?" In spite of the implied uncertainty in the industry, statistics nevertheless showed that very few business collapses had been reported in the industry in Kenya in the previous two years. In general, Mwai's survey of the industry showed that he could earn a net profit of up to Ksh 150,000 per quarter assuming an initial investment of Ksh 4.5 to Ksh 5million. This was significantly more than what his school was able to give him for a similar level of investment within a similar period. He was however just not sure he had what it would take to succeed in this cartel-controlled industry.

2 At the time one litre of diesel was selling for about Ksh 75

“In petroleum, you see, the major suppliers control everything. You price your products and generally manage your business the way the ‘big boys’ suggest”, he had said.

Microfinance

Ken, a banker friend of Mwai, had also approached Mwai with the idea of starting a joint microfinance company. He had actually already coined a name for the business: Effort Finance Services (EFS). The idea here was that each of them would contribute Ksh 700,000 and jointly take a loan of Ksh 3.6 million to finance the business. Ken had offered to arrange a cheap finance package from his bank (at a competitive rate of between 6% and 8% payable over a period of about five years). A market survey done by Ken had showed that the demand for micro-credit was huge. For instance the survey showed that only a partly 5% of all potential loanees were served by commercial banks and other conventional and non conventional financial providers such as shylocks. This translated to less than 50,000 borrowers in total. Upon digging deeper for facts, statistics from the Central Bureau of Statistics (CBS), the Kenya government’s statistics office, showed that whereas default rates among commercial bank loanees were fairly high (sometimes reaching 25%) this was not the case with microfinance lending. Microfinance institutions had posted as low as 2% default rates in the past with the industry average standing at about 3.5%. This, according to Mwai, was enough indication that this business would be fairly secure with regard to loss of investment. Of course their main target was going to be micro and small enterprises (MSEs) in Kerugoya town and its environs. These in Mwai’s opinion were plenty.

Also, Profits in this industry were quite handsome. For instance, Mwai and Ken would lend at between 17% and 21% which would upon deduction of all overheads and taxes give them up to 10% in profits on each loan. Ken had actually found that loans lent out over periods exceeding two years could yield a net of up to 20%. This was not withstanding the fact that there existed more than sixty banking and non-banking institutions in the country at the time and lot more informal money lenders such as shylocks.

This alternative also, presented unique internal and external challenges. Just like in the previous alternative, this business would require well trained and experienced personnel. It would be difficult for Mwai and Ken to compete with established financiers in as far as attracting and maintaining good staff was concerned. The risks of financial loss associated with a micro finance company would also be much higher than those of the other alternatives.

Externally though, first, competition was steadily rising; especially with the influx of non-conventional informal lenders like shylocks. Secondly, to register this kind of business Mwai and Ken would need to acquire clearance with several government agencies including the ministries of finance and trade and the Central Bank of Kenya. Indeed Ken had voiced concern over this challenge. “Our biggest challenge will be to get EFS registered.” He had said. According to Ken, getting this kind of business registered and cleared to operate could easily have taken up to eighteen months. Given government red tape and strict registration requirements for such an undertaking by the Central Bank of Kenya, this would have been a daunting task. Mwai actually knew several wealthy people who had tried to start microfinance companies but had failed. Thirdly, managing a microfinance company was a complex affair that would require highly skilled and experienced personnel. These would be very expensive to acquire and maintain. At least Ken was willing to give up his job at the bank to manage EFS if Mwai agreed to go along with the idea. But perhaps the main challenge would be the long period within which EFS would not return on investment. Ken's paperwork showed that they would wait for between one year and one and half years to break even. This was unlike the petrol station which, he thought, could break even within a period as short as one year.

Expanding the School

Perhaps an easier growth path would be to continue reinvesting profits in the Effort school. After all the school was still a reliable cash cow. Besides, Mwai already had very long and rich experience in school management. He already knew what to do and when to do it to keep his school on top.

Effort school had managed to rise to the top among primary schools in Kirinyaga district and in deed the entire Central province. This obviously had brought with it very good financial returns. Although the school had continuously raised school fees in the previous five years this had not deterred parents from enrolling their children in The Effort School. Actually this had raised the worth of the school in many a parent's mind. During the previous year the school had managed to collect Ksh 27,500,000 in school fees out of which slightly above Ksh 3.5 million was retained as profit. However, Mwai strongly felt that the school had now peaked in its lifecycle. The thought of Effort school could drift into decline bothered him quite a bit. "Effort is now part of my life. It would kill me to see it go down". Mwai said to me during my interview with him.

According to Mwai, the main problem with the option of continued l00% plough-back to the school was the uncertainty that had permeated the industry. For instance, the government had just made public primary education free for all pupils and Effort School just like many other private schools had started feeling the heat. For instance Effort school had already lost more than twenty pupils to neighboring public schools already. Enrollment had also gone down, albeit marginally, within the previous two years. This was notwithstanding the fact that even among private schools competition had stiffened in the previous few years. Many competitors were fast building capacity to provide equally good education. This did not seem to worry Mwai though. He had bounced back from much worse situations in the past.

Effort school was still one of the best and although it could survive competition for some time Mwai knew that the market had potential to shrink fast in the next few years. He did not want to 'fight fires' when this finally happened. This was just not his way of doing business. Over the years he had leant the importance of meticulous long term planning. Of course he had a plan for the future of his which included expanding the college component. However, he had changed his plans many times in the past, and it had worked. He was ready to change again if need arose.

Conclusion

Mwai got thinking hard. He needed to make up his mind in time to make a decision about that year's profits. He also needed to refocus his mind, effort and resources as quickly as possible. To do this a thorough analysis of the three alternatives was necessary. For so many years he had operated business as a lay entrepreneur. He had now successfully finished his degree course in Entrepreneurship and he needed to engage this knowledge to unravel business dilemmas and grow his business. He had a big challenge ahead; a challenge he believed he could overcome.

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TEACHING NOTE: EFFORT SCHOOL OR MORE EFFORT?

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Abstract

John K. J. Mwai, the proprietor of Effort school, a successful medium sized school complex in the heart of rural Kenya is faced with a dilemma about the future of his business. Times are fast changing and so are the prospects of the school. Should he expand the school further or should he diversify into petroleum and microfinance, his preferred alternatives? Does he have any other option? Each alternative has its challenges, costs and benefits and the student needs to conduct a critical analysis of each and identify a clear and ideal growth path for Mwai.

Immediate case issues:

- Should Mwai continue growing his school or should he diversify to other businesses?
- Are his preferred diversification alternatives (microfinance and petroleum) the best alternatives for him given the information in the case?
- If he decides to take either or all the options, how should he conduct the alternatives' implementation? E.g. what pitfalls should he anticipate and how should he prepare himself for them?

Target audience

This case is intended to teach third and fourth year undergraduate entrepreneurship classes various concepts and theories in the process of starting and managing the growth of a small or medium business.

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Teaching objectives and Key Learning Points

The case is designed to help students to learn and comprehend the following:

1. Various modes of business growth: Lateral and Vertical business growth
   - Description of each mode
   - Practical application of each mode
   - Pitfalls to watch for when implementing each mode
   - Advantages and disadvantages of each mode
   - Combination mode of business growth
2. Analyzing investment alternatives- key considerations
3. Characteristics of successful entrepreneurs
4. Theories of entrepreneurship-economic, sociological and psychological theories

Key learning points:

1. There are at least three modes of enterprise growth
   - Lateral
   - Vertical
   - Combination
2. Each of these is ideal in different situations for specific business types
3. Each has its advantages and disadvantages (highlight them)
4. The key considerations when selecting investment alternatives are
   - Cost-benefit position of the alternative
   - Opportunity cost of the alternative
   - Sustainability of the alternative
   - The capacity of the entrepreneur to successfully manage and grow the alternative
5. An entrepreneur may be driven by any of the following motivations (theories) to start and grow business
   - Economic motivation
   - Sociological motivation
   - Psychological motivation
   - Any combination of the above

Teaching Strategy

The case is designed to give the instructor large flexibility in how to design the class session. The teaching plan discussed (Approach A) here assumes that the case is used as an "overview case" of how to manage growth and diversification. As such, it will probably be taught fairly early in a course. An alternative approach (Approach B) would be to go much deeper into the issues raised. This may be the preferred approach if the case is used later in the course. Both approaches assume a class session of 120 minutes.

A typical design consists of a pre-assignment, small group discussions and plenary discussions or student presentations:

Approach A (overview session):

Pre-assignment:

The students are asked to read the case in advance and are typically given an open-ended assignment such as:

1. Please evaluate the three options discussed in the case (pros and cons). Be prepared to make a specific recommendation and defend it based on your analysis

Introduction (20 minutes):

Introducing the case and the topic of the day (**Managing Business Growth**). Summarize the case and clarify unclear facts about the case.

Before moving on to the case discussion, the instructor may ask how many students support option 1, 2 and 3 and write down the number on the blackboard.

Small group discussions (30 minutes):

The students are assigned to small groups of 3-6 students to share and discuss their analysis of the preassignment. The groups can either be assigned randomly or assigned to maximize the diversity in opinions (at this stage you should avoid putting students who agree in the same group). The groups are expected to make a group recommendation, although it is quite possibly that they cannot agree on the best action.

Plenary discussion (50 minutes):

The instructor has two options:

1) ask three of the small groups (who have been able to agree on a group recommendation) to present for 5-10 minutes. The first group presents option 1, the second group option 2, and so on. After the presentation the students are asked to vote again, followed by a more general discussion.

2) a general plenary discussion structured around the following issues:
- Analyze the alternatives open to Mwai and highlight the strengths and weaknesses of each and the pitfalls open to each.
- Analyze the cost-benefit potential of each alternative

- Analyze the entrepreneurial strengths and weaknesses of Mwai as depicted in the case
- Analyze possible motivations for starting and growing business and identify key motivation(s) for Mwai

Wrap-up (15 minutes):
- Summarize key learning points
- Close class session

Approach B (in-depth session):

Pre-assignment:

The students are asked to read the case in advance. The students are either assigned to of self form three groups. Each group is given the assignment to present one specific option, and each group is expected to do additional research.

Introduction (20 minutes):

Introducing the case and the topic of the day (**Managing Business Growth**). Summarize the case and clarify unclear facts about the case.

Presentations (45 minutes):

Each group presents a thorough analysis of their assigned option. After the presentations, the students are asked to vote for their preferred option.

Plenary discussion (30 minutes):

The general plenary discussion structured around the same issues as under Approach A

Wrap-up (15 minutes):
- Summarize key learning points
- Close class session

Potential Discussion Questions in Class

1. Do you think Mwai has conducted his business well so far? Why or why not?

There is no doubt from the case that Mr. Mwai has been highly successful. However, competition in education was almost non-existent during his schools growth period. This is evidenced by the rapid growth the school underwent over the years.

2. What do you think are the main challenges facing Mwai as far as his current business (Effort School) is concerned? How can he overcome them?

Challenges include:

- *High and progressively rising competition from other private operator*
- *The free primary education government program*
- *Uncertainty within the industry*

The challenges can be overcome by:

- *diversifying within the school by, for instance, offering other programs or diversifying geographically*
- *diversifying out of the school business by starting other businesses of a different nature*
- *entering into strategic partnerships with established schools*
- *taking over some components of his forward or backward linkages to reduce operating costs hence maintaining good profits at low price (school fees)*

3. Should Mwai continue growing his school by ploughing back 100% profits every year or should he diversify? Are microfinance and petroleum the best diversification alternatives for him in your opinion? Why or why not?

Effort school:

The school is a proven success, both in terms of growth, reputation and the financials. It has a 13 % net profit margin (case fact), but the problem is that all profits are reinvested in the school. Other problems are increased competition (low barriers to entry in a highly profitable industry) and substitutes (free public education). Hence, Mr. Mwai may want to consider diversification options.

Instructors who want to consider the issues of managing a private school in more detail may consider assigning JKUAT case 2006-J-04-A Competition in the Education Sector: Grace Ngumi and Mugumi-ini Academy in their course.

Petrol stations:

This is a very low profit margin (3 % net profit, case fact), capital intensive high volume business, with no margin for error - even a small mistake could prove to be disastrous. A low margin business requires great attention to detail. There is no direct indication in the case of Mr. Mwai's attention to detail, except for a quote "I can get very edgy under extreme conditions." But the fact that Mr. Mwai has been successful in the education sector probably indicates that his real skills are very different from what would be critical in the petrol station business.

Instructors who want to consider the issues of managing a petrol station in more detail may consider assigning JKUAT case Thika Garissa Road Service Station.

Micro financing:

Micro financing is very different from petrol stations and schools. It is very capital intensive, but it can be a very profitable business if it is managed correctly, but the case gives plenty of indications that it can be a very complex business with plenty of opportunities for making mistakes.

Synergies between the businesses:

Some students may want to explore the potential benefits (other than diversification) of managing multiple businesses. For example, micro financing could be used to finance school fees, and parents of the students may be more likely to buy petrol from Effort. There is no indication in the case that Mr. Mwai has even considered the possibility of synergies (he seems to be purely driven by diversification) other than by using the same brand name (Effort Finance Services). There are probably some synergies in the business, but these should not be overestimated.
In conclusion, his choices of diversification options are rather complex to operate. He may need to study other types of business which he has competence to run. He could go into petroleum or microfinance businesses but he needs a lot more expertise and capital to venture into these. He should keep running and growing the school however.

4. What are Mwai's strengths and weaknesses as an entrepreneur?

Strengths:

- *experience in entrepreneurship*
- *good capital base*
- *resilience*
- *good educational background*

Weaknesses:

- *possibly overly ambitious which makes him want to start multiple businesses at a go even when his capacity is limited*

5. What do you think might be Mwai's main driving force in wanting to grow his business?

- *profits*
- *financial security*
- *prestige*
- *need to build capacity hence reduce competition based shocks*

6. Would you say Mwai is a successful entrepreneur? Why or why not?

Yes. He has successfully run his school for more than ten years. However, his entrepreneurial capacity is now grossly reduced

Suggested Readings

Compulsory Readings:

1. The Effort School case
2. Holt, H.D. (1992). *Entrepreneurship: New Venture Creation*; Prentice Hall-India (chapters one, two and fourteen)

Other Readings:

3. Stokes, D. (1995). *Small Business Management: An Active Learning Approach (2nd Ed.)*; London, DP Publishing Ltd. (chapter One)
4. Baumback, C.M. (1988). *How to Organize and Operate a Small Business (8th Ed)*; Prentice Hall, London (chapters two and six)