

Education Investment Guide

A Guide for Investors in Private Education
in Emerging Markets



About IFC

IFC, a member of the World Bank Group, is the largest global development institution focused on the private sector in developing countries. We create opportunity for people to escape poverty and improve their lives. We do so by providing financing to help businesses employ more people and supply essential services, by mobilizing capital from others, and by delivering advisory services to ensure sustainable development. In a time of global economic uncertainty, our new investments climbed to a record \$18 billion in fiscal 2010. For more information, visit www.ifc.org.

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Foreword



IFC is the largest multilateral investor supporting growth of private education in emerging economies. Our role is not only that of direct investment to support schools, colleges and universities; but also to help build the capacity of financial institutions to facilitate greater engagement with the sector and to increase access to funds at a local level.

This *Guide for Investors in Private Education in Emerging Markets* has been developed to share our experience of investing in the sector over the past decade. It consolidates the lessons IFC and its partners have learned about providing financing to the education sector and discusses success factors in entering the market. This guide can be used by investors and financial institutions that are considering entering this market for the first time or by those that want to formalize and expand their education sector investment strategy. I hope that it will stimulate higher levels of interest and investment in this important sector.

As of March 31, 2010, IFC provided \$481 million in financing to 63 private education projects in 31 developing countries. The projects had a total value of \$1.5 billion. Twenty-one IFC education projects (33 percent) were in IDA (International Development Association) countries, which are considered the world's poorest developing countries. We are proud of our leadership role in financing the growth of high quality private education in emerging economies.

A handwritten signature in black ink, appearing to read 'Guy Ellena'.

Guy Ellena
Director, Health and Education
IFC

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Acknowledgment

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Glossary of Educational Terms

Completion rate	The number of students successfully completing the last year of a school cycle
Educational assessment	The process of documenting, usually in measurable terms, knowledge, skills, attitudes and beliefs
Full time equivalent	A number of full time staff calculated by adding fractions of part time staff to the full time staff numbers (Thus, two staff working for 0.6 and 0.4 of their time become 1 fte)
ICT	Information and Communications Technologies (eg; networks and PCs).
Resits	The students who fail an examination and have to take it again
Retention rate	The proportion of pupils staying throughout the whole program and sitting an examination at the end of a term
Teacher-pupil ratio	The ratio between the numbers of teachers and pupils
TVET	Technical, Vocational Education and Training
Wastage rate	The percentage of pupils/students who do not stay the full course and leave before taking the examinations or reaching the end of the term

Introduction

This Guide has been prepared as a reference for IFC partner banks and other investors considering an investment in private education. The aim is to describe some of the special features of private education entities (primary and secondary schools, technical and vocational colleges as well as tertiary colleges and universities) and to indicate the key questions to ask and what to look for when such institutions are being appraised. While the Guide describes some of the traditional financial tools that are relevant to the education sector, it also aims to illuminate the educational issues. It is, in effect, an introduction to the 'educational due diligence' of a school or college investment opportunity.

The structure of the Guide is as follows:

- Section 1 sets the education market in a global context. The private sector is emerging as a major player in many countries (in some it is already larger than the state-funded sector) and this section explains why.
- Section 2 sets out the different approaches of private equity and banks as lenders. It then tackles some of the practical aspects of investing in private education, including the stages of a program that a bank might follow prior to investing in the sector. Topics covered include particular features of investing in education and the typical income and expenditure profiles of schools and colleges.
- Section 3 focuses on the national context and describes some of the national policies and regulations that might influence the operations and profitability of an education institution. The section discusses aspects of a regulatory framework including the state's role in approving new institutions and then monitoring or inspecting their quality. It also explores what financial incentives or penalties private providers might face as a result of the regulation.
- Section 4 illustrates the elements of a successful education investment from both the financial and educational points of view and some case studies are provided. It also highlights some of the risks and difficulties of working in the education sector.
- The Appendices contain checklists of questions to ask, an example of an education business plan and indicative measures of success.

The private education sector has certain inherent challenges. Investors unfamiliar with the sector often perceive it as having high levels of risk with low return. The result is that opportunities are lost for both investors and education institutions with the latter remaining underfinanced and therefore unable to achieve growth. This publication is meant to provide guidance to potential investors to create a greater understanding of education models and thus encourage further investment and growth in the sector.

Section 1. The Education Sector in Emerging Economies

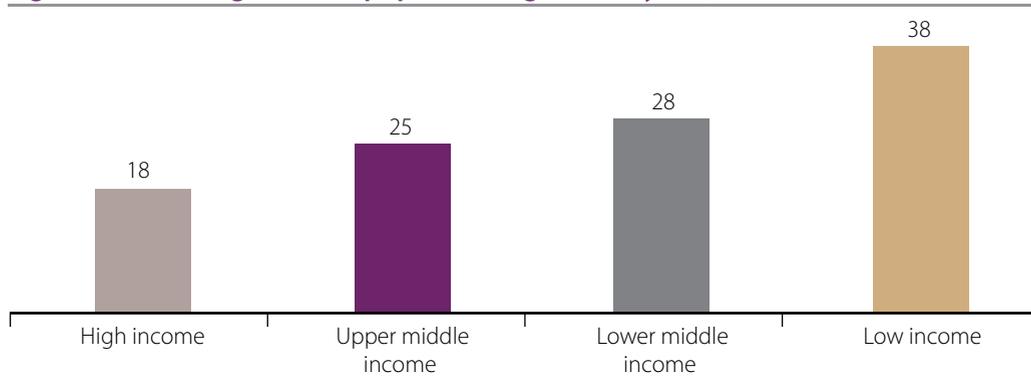
Governments want their citizens to acquire skills that will enable them to gain employment and add to the national human capacity. However, they often do not have enough money to fund the institutions that are required to meet a growing demand for education and, as a result, the private sector is responding. In global terms private education is a rapidly expanding market and it is occurring in all types of economies: developed, middle income, and the emerging economies.

The demand for education is growing as is the population of young people

Globally, demand for education is growing, especially due to the wish to develop an expanded educated workforce. This demand is driven not only by huge demographics but by new aspirations to use education as a vehicle for social mobility and to deliver widespread economic growth.

Many emerging economies are experiencing huge expansions in their population. Low income countries especially, have large populations under the age of 15. For example, India has 374 million and Nigeria 63 million children below the age of 15. Figure 1 shows that the percentage of the population under 15 in low income countries is more than double that of high income countries. In many developing countries this population expansion will plateau in the next few decades as fertility rates fall.

Figure 1: Percentage of total population aged 0–14 years, 2008



Source: World Development Indicators 2010

Good education is the key to national economic growth

The returns from an investment in education both socially to the State and privately to individuals can be significant (as Figure 2 shows).

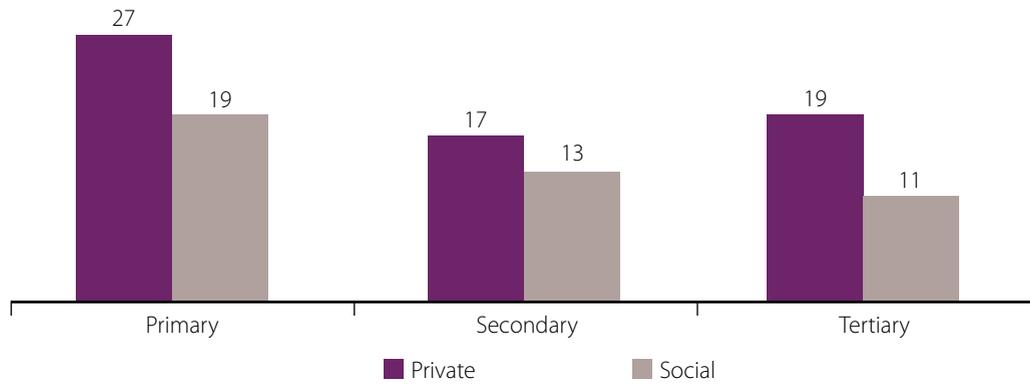
The OECD defines the social and private rates of return as the following:

“The social internal rate of return refers to the costs and benefits to society of investment in education, which includes the opportunity cost of having people not participating in the production of output and the full cost of the provision of education rather than only the cost borne by the individual. The social benefit includes the increased productivity associated with the investment in education and a host of possible non-economic benefits, such as lower crime, better health, more social cohesion and more informed and effective citizens. Meanwhile, the private rate of return is equal to the discount rate that equalizes the real costs of education during the period of study

to the real gains from education thereafter. In its most comprehensive form, the costs equal tuition fees, foregone earnings net of taxes adjusted for the probability of being in employment minus the resources made available to students in the form of grants and loans."

If a country is to achieve an increasingly skilled workforce, it needs to make consistent investments in all levels of its education system up to the tertiary level.

Figure 2: Rate of Return to completion of different levels of education



Source: G Psacharopoulos and H.Patrinós (2004)

Concern about the quality and relevance of education provision in many countries continues to grow. One way of comparing the way that countries' educational systems are performing is to look at their scores in the standard international tests for subjects such as mathematics and science. The emerging economies do not do well on these measures. This was confirmed by the UN Millennium Project report in 2005 illustrating that students in many developing countries are not acquiring basic skills, let alone the skills needed to actively participate in a 21st century economy.

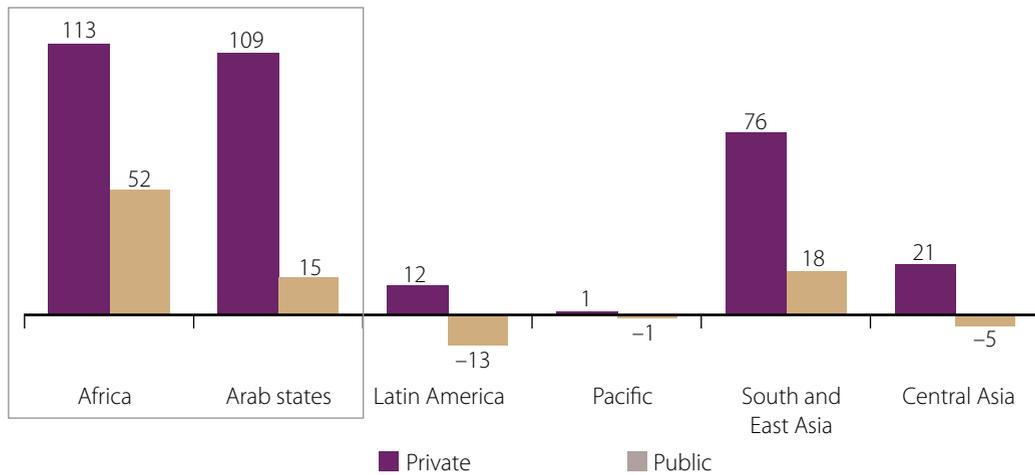
The low achievement in national tests is compounded by the fact that many of the skills tested are not those skills required by the business community. When employers were questioned, it was found that more than a fifth of all firms in developing countries as diverse as Algeria, Bangladesh, Brazil, China, Estonia, and Zambia rated inadequate skills and the low education of workers as a major or severe obstacle to their operations. (WDR.2006) These deficiencies translate directly into a country's poor ranking internationally in measures of innovation or competitiveness of their economies.

The private education sector presents a viable alternative to state provision and is growing

The poor quality of state education, in tandem with rising wealth and ability to pay, has led many parents to seek alternatives to the state sector. In many cases, the public sector lacks the capacity to respond to the increasing demand from the population, and adopts policies that look to the private sector's capacity to help, particularly in resource poor countries. As a result, across the globe private enrolment in education has increased and between 1991–2003 the growth in private enrolments outstripped that in public enrolments, particularly in the Arab States and Sub Saharan Africa. The IFC has estimated that globally the private education sector now has a market size of over \$400bn.

Enrollments in private education are particularly high in secondary and tertiary education. Figure 4 shows what proportion of education is provided by the private sector in the seven regions of the world; almost 35% of secondary education in South Asia is supplied by

Figure 3: Growth in primary and secondary educational enrollments between 1991–2003, in percent

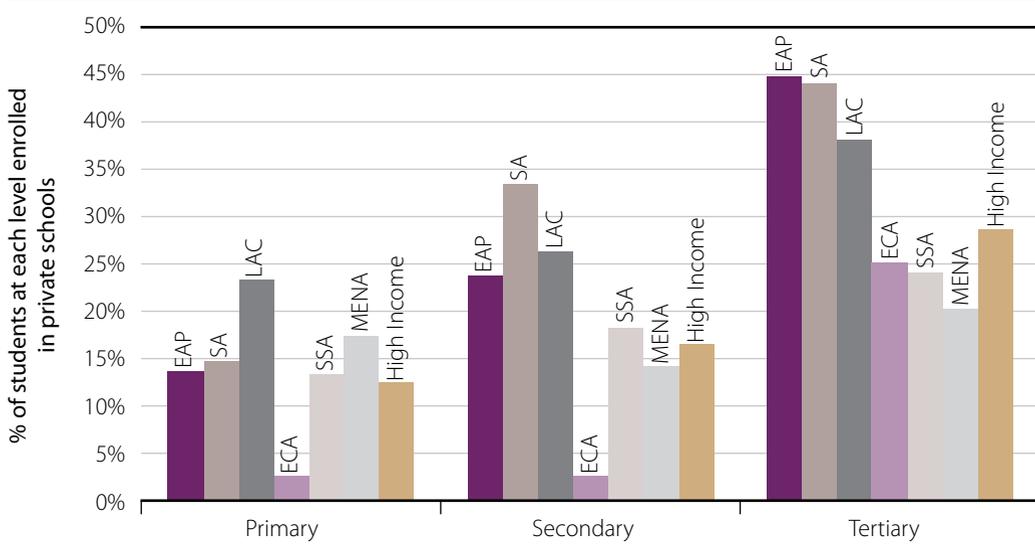


Source: UNESCO

the private education sector and 45% of tertiary education in East Asia and the Pacific and South/West Asia.

As regards the share of the private sector in tertiary education, Figure 4 shows that the global picture also varies between regions. In some Asian countries such as Indonesia and Korea the private sector provides the majority of higher education, while in others it is still small. In some countries the private sector has found disciplinary niches; thus in India private higher education provides the country with almost all its engineers and is also producing a growing percentage of medical students. Even in the United Kingdom private providers dominate the market in postgraduate education in law.

Figure 4: Percentage enrollment in the private sector by region and level of education



Source: UNESCO

A clear trend is emerging, which is that in several regions the private tertiary education sector is growing fast. The same reasons apply; the state cannot afford to educate all those who are qualified and wishing to be educated and consequently the market (with or without the state's support) is filling the gap. In many emerging economy countries parents with the ability to pay have a choice—either sending their children overseas to very expensive programs in the UK, USA or Australia or paying for them to attend private institutions at home, many of whom offer the degrees from foreign institutions.

More people can pay for private education

Despite the financial crisis, emerging economies continue to grow well above the world average, a trend set to continue up to at least 2015. The world average economic growth was negative in 2009 but emerging and developing economies performed much better, with a 2.4% growth rate. By 2015 the average growth rate for emerging and developing economies is forecast to be 6.7%.

Table 1: Average economic growth forecasts

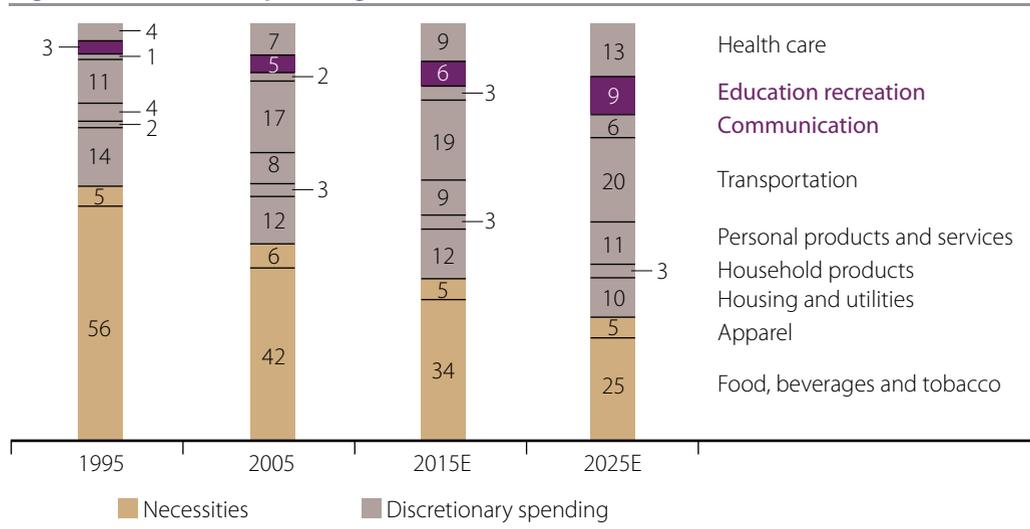
	2009	2015
World growth	-0.6	4.5
Growth in the emerging economies	2.4	6.7

Source: IMF World Economic Outlook 2010

The message is that much of the global growth after 2010 will be driven by the large emerging economies. In April 2010 The Economist wrote: "China's economy is now growing at double-digit rates. The IMF expects India's GDP to increase by almost 9% this year. Some forecasters believe that Brazil's growth rate could reach 7%, which would be its fastest pace in a quarter of a century".

As countries become richer the emergence of a middle class has led to increased spending on private education. This increase in income levels, even amongst the lower middle class, has led to a greater number of parents being able to spend some of this new income on private education. In India household spending on education has continued

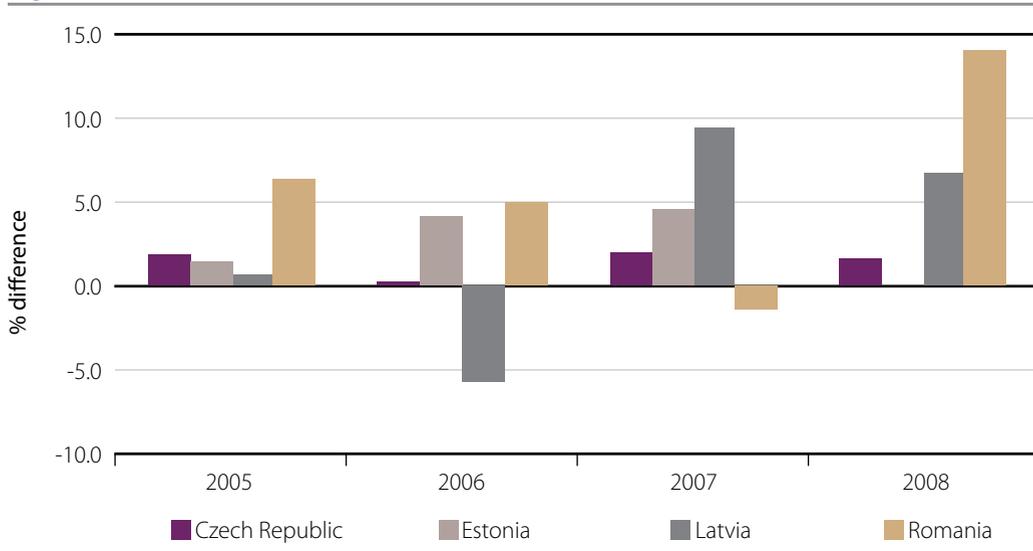
Figure 5: Growth in spending on education



to grow and McKinsey Global Institute estimates that by 2025 9% of household income in India will be spent on education almost double the 5% level in 2005.

There is some evidence that education costs tend to increase at a higher rate than other costs and this will affect the spending power of parents. The rate of education inflation in many countries is higher than the total inflation, as illustrated in Figure 6 below which shows education inflation minus the average inflation rate across industries in four East European countries.

Figure 6: Difference between education inflation and overall inflation



The implication of this difference in inflation rates is that it may be difficult for parents to pay for private education out of inflation-linked income and that some savings are essential.

Another risk is that the lower middle class is particularly vulnerable to unemployment and large increases could severely affect the parents' ability to pay. Unemployment is an important consideration for any sector, but even more so for education. Unemployment statistics in developing countries may only cover the formal sector rather than the informal sector, but can be useful predictors of both future demand and defaults.

Other sources of funding for private providers

Individual private income is not the only source of funding for private education providers, as multilateral agencies, bilateral agencies and governments are also subsidizing and contracting with private sector schools and colleges to provide education on their behalf. In the case of some governments this is done through Public Private Partnerships (PPPs).

Another major source of income for private providers is when government pays the tuition fees of their students. The classic example of this is in the United States where qualifying private providers can claim the tuition fees of the majority of their students from the federal government. Another variant is where governments give scholarships so that pupils from poor families can pay the fees of private schools.

"In some countries the private sector plays an important role in providing education but the government only subsidizes some of the students who attend private schools (for example, Chile). Several African countries have different types of non public schools, including government-subsidized independent schools (for example, the Gambia), partially subsidized mission or religious, schools (for example, Lesotho), and at least partially subsidized community-organized schools (for example, Kenya). Elsewhere, some countries have public schools that are supported financially by the private sector (for example, Pakistan). Overall, the private sector's participation at the primary school level has grown more than its participation at the secondary level, but there is significant variation across countries. While overall private participation is typically higher at the secondary level, private participation at all levels continues to grow".

Source: World Bank. Role and Impact of PPPs in Education 2009

Section 2. Investing in Education

Investment objectives and time horizons of investors

Private equity investors typically aim to deliver 20% to 30% risk-adjusted returns per annum. Banks, on the other hand, typically may target a few hundred basis points above the prevailing long-term rates in the country. For example, in an emerging country where the prevailing interest rates for medium to long-term loans may be between 8% and 10%, the banks might expect a return of 12% to 14% from their investments.

The typical time horizon for a private equity investor is 4 to 8 years while the horizon for a local bank is 3 to 5 (or extended to 7) years, depending on the use of the capital. In education, the time horizons have to be calibrated based on whether or not real estate forms a significant component of the investment.

Investments in schools, colleges and higher education institutions are usually made for two purposes: to acquire land and build infrastructure and to scale up operations on existing or regional locations. Often, short term working capital needs are also funded from external borrowings.

Most private equity investors do not require collateral to protect the investment and therefore, the cost of capital and risk expectation is higher, which implies that their expectation of returns is also higher. However, most private equity investors may include some financial controls, 'put options' and rights, which limit the downside risk and often enhance the upside potential. Such instruments and rights include liquidation preferences, buyback rights, piggyback rights, drag-along and tag-along rights, and various rights of first refusal. Oftentimes, educational companies offer a share of the equity but do not normally pay an interest rate to the investor unless the instrument is structured as convertible debt.

In contrast, a bank is more willing to forego any equity holding, but secure a loan on assets (which may be the main aim of the loan). The time horizon is often slightly longer than private equity. In the case of education loans, bank debt is used most often for funding construction and for short-term operating capital needs. Therefore, the collateral is land and buildings for construction projects and the school's free cash flows for funding operating capital requirements.

Other than the typical commercial objectives of returning capital and profits to investors, both private equity investors and banks aim to deliver on their secondary objective of providing and expanding access to good quality education.

Overall, education investments exhibit a higher level of principal protection than in some other sectors such as technology or some healthcare sub sectors. In most cases, education investments succeed if they are well located (i.e. there is high market demand and an acceptable level of competition) and the education quality is high. In the short term, an education investment may be able to achieve profitability based on a differentiated course offering, but in the long term the quality of education delivered plays a huge role in determining the profitability and overall viability of the institution.

The role of IFC's local partners and how to address the market

This Guide plans to serve those "local partner banks" that draw on the IFC for financial partnership and on-lend to local entrepreneurs and small-to-medium enterprise (SME) borrowers. These local partners have the key role in both selecting and monitoring the investments. The rest of this section describes some of the tools and processes in assessing and then monitoring loans to the private education sector.

Historically, local banks have been unable to meet SME demand for project and expansion finance; however, recently stronger demand for longer term (4–5 year) financing has developed alongside an increased understanding of education sector credit risks by bankers. As a result banks are now encouraged to revisit their product offerings for the education sector, as it becomes increasingly recognized as a strategic growth prospect in the long term.

Financing private education is a growing business. As an example of how the education market is developing Box 1 highlights recent activity in this sector for a local Bank in Africa.

Box 1: Recent growth in lending to education in Africa

An education SME department was established 2 years ago by an African bank and in 2007 a SME short-term loan product targeted at K-12 schools was introduced for bridge financing. An estimated \$3.3m has been lent since 2007 with \$2.1m of this disbursed between 2008 and 2009. The education portfolio is estimated to reach \$30 million by 2013, if longer-term expansion financing can be made available and \$20 million, if asset financing only is added, or a total of only \$10million with just the existing SME product.

The drivers for any private education market are very similar to those required in scaling up any 'retail' lending business, but they are complicated by the fact that the market is new and thus lenders have to create a new 'asset' class. Hence there are five main issues that need to be addressed:

- i. Identification of the target market;
- ii. Reduction and management of defaults;
- iii. Raising workforce productivity by instituting appropriate processes and adopting a standardized solutions approach;
- iv. Enhancing revenue generation possibilities to reduce the cost of delivery while maintaining customer service orientation; and
- v. Access to capital.

To address these issues, a prospective lender needs to adopt three requirements, discussed below, which are essentially good banking practice:

a) Creation of a private education institution database

When developing a strategy for entering the market, it will be important to understand the structure of the national education system. The following Table shows the kind of information that will be useful.

The next step is to map, identify and target the strongest private schools and colleges as potential clients. All types of private school can be considered—not-for-profit ones run by NGO's, faith organizations and charities as well as for-profit companies or businesses.

The SME education market has been growing for several decades, but has to date received little attention from commercial lenders; and many of the prospective borrowers lack experience in meeting the requirements of formal lenders (eg. the production of financial statements, audited accounts, a sense of creditworthiness and attention to the formalities of governance).

However, in other respects educational borrowers are no different from other SMEs. They have the same competitive features as other service industries. For example:

- They like to place a premium on product quality (in their case this means the results from tests and examinations).
- Good schools have a customer focus (which means being very alert and responsive to parental concerns).
- Efficient cash management is important (collection of fees on time is a key efficiency indicator).

Table 2: Typical structure of a national education system

Level	Types of school or college	Age range	Curriculum and examinations	Ownership
Pre-school	Nursery	0–5	—	Private State supported
Primary Basic education	Primary school Junior school	6–11	National curriculum International curricula (eg: American, British)	Private State owned
Lower Secondary	Secondary school	11–14	National curriculum International curricula (Eg: American, British)	Private State owned
Upper Secondary	Secondary school. Sixth form colleges Technical colleges	15–18	National examinations. International Baccalaureate. Junior Vocational Quali- fications.	State owned and run Private. Private with state support.
Technical and professional education	Technical and vo- cational colleges. Professional training institutes	16+	Technical and profes- sional qualifications (awarding certificates and diplomas)	Private. State owned and run. Private with state support
Tertiary education	Universities Professional training institutes	18+	University degrees Professional qualifications.	Private. Professional bodies. State owned and run. Private with state support.

- Cross-selling brings benefits (profitability can be increased if they promote multiple income streams and income from extras such as uniforms or texts).
- Brand development is important and is centered on publicizing student successes in examinations, particularly any international ones such as the International Baccalaureate.
- Market expansion is frequently an objective which can mean either increasing the number of streams in an existing school, splitting senior and junior schools or establishing new branches in other cities.

Successful investment in the education market requires a bank to be able to identify the characteristics of the best run schools in both academic and financial terms. This topic is pursued further in Section 4 which describes some of the features of a successful school or college.

b) Risk management framework that is relevant to education

Education loans are not immune from risk. They can go bad as easily as in any other sector. Therefore a robust risk framework is required in order to ensure that the quality of the portfolio is not compromised and sales targets are met without making dangerous loans. This framework needs to include at least the following three features:

- i. Effective credit filters and risk assessment, bearing in mind that sometimes—in the absence of audited financial statements—the lender will need to use qualitative filters as proxies for traditional credit quality measures.
- ii. Strong client training in credit management and collections with part of the bank's effort involving reminders to the borrowers of upcoming payments and specific attention to those with payment lapses. Bad debts in schools can range from 2–8% of income so that attention to debt collection can directly benefit the bottom line.
- iii. Regular reminders to both bank staff and clients of the importance placed on risk management.

c) Systems infrastructure and process disciplines

A lender's operating model must support efficient and effective execution of loans and an ability to add products efficiently; this will require an emphasis on the following three key features:

- i. A clear distinction between the roles of the branch offices which have the field staff trained to focus solely on deal origination and the central office (if it has been given a role in monitoring or overseeing the education sector).
- ii. On-line records for every private school or college visited with the results of all school calls recorded for both actual and potential borrowers; and
- iii. Focused regular visits to client schools and colleges in order to confirm that the portfolio is still sound as well as providing an opportunity to identify their needs and future requirements.

d) Potential scalability of revenue

A proactive lender will build on its relationship with its education customers. This means the lender differentiating itself from other lenders by viewing each school as its education partner. The aim is to stay ahead of the competition and work with the best clients to assess new sources of revenue actively. These might for example involve the bank delivering other education products and services over a larger geographical spread to other types of educational institutions.

Three issues to watch in designing the loan offer are: the provision of local currency financing (as fees are generally collected in local currency); phasing of the funding to ensure that the school is not over-capitalized in its early years; and using conservative projections for increases in enrollment, since building up the numbers and the fee income in a new school or college takes several years and cannot be achieved overnight.

Typical school and college finances

Investors embarking on the due diligence of an educational enterprise may be unfamiliar with the normal cost structures in both the Profit and Loss Account and the Balance Sheet of school and college businesses.

In order to describe the types of organization in the sector a distinction will be made between the Higher, Middle and Lower end of the range; these terms can all be applied to the teaching quality, the caliber of assets, the set-up costs, tuition fees and level of expenses. For example the average salaries at the Higher end can be three times that of the Lower end, and the fees can be up to twenty times.

Higher end institutions have a better offering in terms of resources and educational programs, allowing them to charge a higher fee per student, which results in a higher total revenue amount. This better quality offering is made available by having more teachers (who are often better trained), larger and better infrastructure and more resources per student. Although the absolute student numbers are sometimes less than in a Lower end institution, the much higher fee takes care of the higher expenses and investment, resulting in a higher return on income and on invested capital.

Loans to Higher end institutions are typically larger, as the total investment amount needs to take care of the more expensive and better located real estate, higher square footage per student, and more facilities like gymnasias, laboratories, auditoria, etc. Lower end institutions are able to offer a lower fee by having a larger student base with a higher student:teacher ratio. Some Lower end institutions also operate a second shift resulting in a very low average square footage per student.

When evaluating the financial viability of an institution, the cash reserves or endowments and also the actual cost of land and building (the older the institution the lower the value), need to be taken into account. These balance sheet items would reduce the borrowings and in turn the interest rates, and bring up net income and the return on investment.

Further points to consider with regard to each category are:

- *“Higher End”* Schools are the most expensive schools in the market and charge the highest fees and usually offer international qualifications such as the International Baccalaureate. They have a generous ratio of teachers to students (which might be as good as 1 staff member to 12 students). They may employ some international staff. Their salary levels are at the top end of the local pay range and the costs of any new building or facilities they use are also high. Since the parents will usually come from a high socio economic group, the percentage of bad debts is low.
- *“Middle Schools”* are far less expensive with a much less generous ratio of teachers to students at 1 to 30, larger numbers enrolled and cheaper buildings. The bad debt percentage is often twice that in the High End Schools.
- *“Lower End Schools”*: In many emerging economies there are groups of schools catering for the lowest socio economic group that can afford to pay fees. They may have a teacher student ratio of 40 to 1, which is still better than that found in many state schools. The buildings and equipment costs are low. In order to achieve profitability the

numbers of students tend to be large. The curricula would be based on national rather than international qualifications and would have a bias to vocational subjects.

- *“Higher End Colleges”* are those private universities and colleges which aim to fill the unmet demand for places in higher education that the State cannot afford to finance. They are often not-for-profit and many are faith-based. Very often these universities are reliant on foreign academic support and accreditation of their programs by a foreign university. It is rare for them to be as large as the public universities, but the quality of teaching is often higher, so a generous teacher-student ratio of 1 to 15 is common. However this depends on the disciplines they teach, since science, engineering and medicine require a larger number of teaching staff. Their capital costs are the same if not higher than Higher End Schools.
- *“Low End Colleges”* operate in a different part of the market similar to Middle Schools and charge about the same fees. They would usually award certificates or diplomas rather than degrees, although some would have affiliations with private Higher End institutions and might well feed students to them in the final year.
- *“Vocational Colleges”* are shown as operating at three levels: Higher, Middle and Lower. Their role is to offer technical and vocational qualifications at various levels within the national qualifications framework (where one exists). In some countries their fees are paid by employers directly, but in many cases National Training Funds are available to meet the fees they charge to students. The teacher student ratio ranges considerably and in the Lower End can be as high as 1 to 100, with very large lecture groups. Fees can also range widely. Teaching is often delivered in the evenings and weekends to part time students.

The profitability of an educational enterprise is influenced by several factors:

1. Whether the premises are owned or leased; a common situation is that most education enterprises have been given their premises by their founder and the reason they require loan finance is for expansion.
2. The fee level charged, which is usually set at market rates, but is heavily dependent on position in the market, reputation and image.
3. The teacher:student ratio, since teaching staff are the largest cost.

Some educational enterprises can be very profitable with EBITDA of between 20 and 30% (IFC portfolio average EBITDA margin for schools is 41% and 16% for tertiary education) and net profits after interest and depreciation in the range 10–20%.

From the perspective of a banking investor educational businesses have some distinctive features: they are essentially people-related and success is very dependent on the quality of the teaching and the leadership of the school or college; they are cash generating with fees paid up front at the start of each school term; they do not need to own their own buildings, as many institutions can operate quite effectively in leased accommodation. Another feature is that some established schools and universities do not need to spend great sums on marketing since, if they are well regarded, they operate on word of mouth recommendations and frequently have a waiting list. Private universities and colleges in countries where the State is failing to provide enough places in public institutions can also be assured of a regular flow of students if their offerings are well regarded and realistically priced.

Case study of a typical debt and equity investment

As an example Box 2 describes a project that is being started in an Asian country and which is being provided with 35% of its capital by a bank. Some of this is equity and some is a loan.

Box 2: The organization of funding for a planned large education project

The project will be the construction of four K-12 schools located in the three main cities of the country. Each school will have a capacity of 3,000 students at maturity. The schools will be opened one after another over four consecutive years, with a construction period for each school of two years. The schools will provide a combination of international and local curriculum, taught in English.

The project cost is US\$ 20 million with the bank taking an equity investment of US\$ 2 million equivalent and providing a loan of US\$ 5 million equivalent denominated in the local currency that will be disbursed in two tranches at a rate of return of 16.9%. The Bank's equity contribution will provide risk capital which is currently difficult to source locally, while the loan will offer maturities and a grace period in order to permit student build up.

The sponsor is the X Group that comprises a group of companies that provide a range of school services such as transportation, catering and supplies, construction and book production. X originally started as an English-language private school in 1977.

At full maturity, the project will provide additional spaces for more than 12,000 students, half of whom are girls. The project has three key strengths which are: the institutional owner's commitment, experience and reputation, the impressive academic and management systems and the overall market opportunity. However it also has risks that are common to the sector in the country, namely: governance of the entity, accounting and transparency, the untested business concept and the regulatory uncertainty in a politically unstable context.

Preparing to invest – three stages in developing a loan program

For any commercial bank wishing to enter the education market, there are three stages in establishing their loan program—the project design, implementation and monitoring and evaluation—and at each stage there are issues and challenges for which solutions have to be prepared. At the *project design* stage there are some key challenges:

- firstly, overcoming the lack of understanding in the local banking community regarding school financing,
- secondly, the need to provide the appropriate templates for monitoring school projects and developing business plans; and,
- finally, the question of whether or not to increase the local human resource capacity for managing loans in the private education sector.

A decision will need to be made whether or not to create a dedicated education support team (in regions or in Head Office) to advise branches on their education loans. Possible solutions to these challenges include involving consultants and beneficiaries in the design of the project concept; working on building a strong working relationship with any consultants needed for the market research; and, finally, setting up meetings with potential borrowers in a participative manner to discuss the education product and services. Where IFC funding is involved, the bank must check that the business plan falls within the risk spectrum suggested by the IFC.

Box 3 provides a summary of the challenges and possible solutions in the second *implementation* stage.

Finally, there is the third *Monitoring and Evaluation* stage in which a key challenge is to establish a reporting system across the bank network that is able to monitor the program in isolation from the bank's other programs that might be catering to a similar SME market or client base. A reporting system needs to be developed that can be used to monitor loan applications that are in different categories, such as those that are ready to take a loan, those

Box 3: Challenges and solutions in the implementation stage

Main challenges

- Ensuring an adequate number of bank staff are trained before an education loan program is rolled out
- Agreeing what specific criteria are necessary for the borrower, such as tenure, rate of interest, amount of borrowing and collateral arrangements
- Determining what the bank's position will be regarding borrowers needing to have accounts with the bank and for what period of time prior to receiving the loan (i.e., the bank needs to have the borrowers as members of its bank, yet many of the potential borrowers may have had long term arrangements with competitors, so there is a need to agree the policy)
- Making plans for mitigating any difficulties that are inherent when lending to private education institutions

Possible solutions

- Ensure that the borrower is advised and supported from the outset to produce accurate financial documentation in support of the application.
- Provide the borrower with a clear understanding of the 'value added' services that the bank brings, such as:
 - An understanding of the private education sector (or willingness to understand).
 - Speedy processing of the loan application.
 - Flexibility in repayments tied to termly not monthly payments.
 - Determining whether a policy will be established that there is no immediate requirement for an account in the local bank prior to accessing of the loan where this is offered

Source: IFC (2010). A Handbook for Stakeholders: Private Schools Support Programs.

that are in the immediate pipeline but require further processing and those that are in longer term status, but may require additional support.

The local bank will need to ensure that the quality of education being imparted is not compromised by the time demands of managing the project or the interest charges. This may be best conducted by periodically hiring a third party education quality inspection firm. It is important to ensure that all stated and targeted accreditations are received and maintained by the school and that it is fulfilling all legal and regulatory reporting obligations to the relevant authorities. Section 3 describes some of these obligations.

When the lending has been undertaken as part of an assault on a new market, senior management (in Head Office) will need to know how the venture has fared. Box 4 summarizes ways in which a bank can measure the performance of an educational lending program using a range of financial, efficiency and educational metrics.

Box 4: Performance Metrics for an education lending program

Financial

- Number of loans approved
- Average loan size
- Approved loan amount
- Total loan portfolio disbursed/outstanding

Efficiency

- Loan amount per loan manager
- Number of employees
- Number of bounced cheques
- Expense dollars per \$1,000 lent
- Number of school and college applications in the pipeline
- Average cost of each education project loan

Educational

- Number of schools and colleges assisted
- Total number of students involved
- Increased enrolment from the financing
- New school and college jobs created

Section 3. National Policies and Regulation

In this section we discuss the issues that a bank should consider relating to the national context, the government's policies and the way it regulates private education. Some of these policies could have a significant influence on the profitability and success of an educational provider; these range from the maturity of the financial market and its willingness to lend, to the tightness of the regulatory regime and to all the areas where the State might intervene in the affairs of an educational business.

Some relevant questions that might be useful as a checklist are listed at the start of each sub-section.

How mature are the financial markets?

Questions to ask

1. *Is the legal and financial framework in the country solid enough to make lending to an educational entrepreneur feasible?*
2. *Are there any structural or legal barriers that would make recovery of a debt or foreclosure of assets charged against an education loan difficult?*

The ability and willingness of education entrepreneurs to borrow for their business may depend to some extent on the general maturity of the financial markets. Strong financial markets come with a strong protection of the rights of the owners of assets and property. Economies which have a legal and financial framework which supports the ownership of property and assets have prospered more rapidly than others.

As described in Section 1, education is both a benefit to the State and to private individuals. Therefore, economies which have established and mature financial markets tend to be more suitable for investments. The maturity of a financial market is a qualitative indicator of the likelihood that money invested in a product will come back to the investor with a return commensurate with the risk associated with the product. Mature markets offer a wide variety of choices to the investor, including debt, equity, real estate, commodities and various structured products which are a combination of the above.

Generally, every country goes through a financial market maturity cycle. During the first phase of a country's development, the focus is on delivering the necessary conditions to sustain a financial market. A first step in this process is the establishment of laws to protect private ownership, including independent and effective courts to uphold the laws and enforce rulings. Generally, this is accompanied by basic infrastructure including a capital markets regulator, a liquid bond market followed by a cash equity market. The government often supports this model by issuing tradable treasury securities and privatizing through initial public offerings.

In the second step, stakeholders form interest groups and they build lobbying agencies as the markets show increased liquidity. Such bodies promote opinions to accelerate changes to make the markets more attractive to investors.

In the third step, usually, corporate governance and transparency are key areas of focus, which require that markets operate in an efficient and effective fashion without being overly affected by a single monitoring stakeholder or agency. Laws related to initial public offering, bond issues, debt collection, currency exchange rates, credit rating agencies, etc. all come into the picture to form the basis of a vibrant and transparent market. Such a market offers numerous products including trading options as indices, futures and options. If the markets

deliver steady and consistent returns, it generally leads to an increase in market coverage and a broad investor base. At the same time, larger volumes mean lower per unit costs, which can facilitate more aggressive pricing strategies.

A vibrant, healthy and transparent market is a prerequisite for any financial activity including lending to schools or other education entities. A well established financial market provides the right structure for completing the cycle of credit from start to finish: from consumption, to savings, to loan product creation, to borrowing, to healthy returns. This requires that each entity is a well organized business activity with a focus on generating returns while fulfilling other objectives such as social returns through quality education.

What are the government policies towards private education?

Questions to ask

1. *Does government policy generally support private providers of education and training? If not, what is the policy?*
2. *Is there any legislation on private providers? Does this have any special clauses or requirements concerning for-profit providers?*
3. *In the legislation does the Minister responsible for education have the right to intervene in the affairs of a private provider? If so, for what reason?*
4. *Is the government's procedure for registering a new school or college well defined and easy to understand?*

Government policies towards the private provision of education are a key factor in deciding whether to invest. Attitudes and policies can vary widely and range from outright opposition based on deep seated beliefs (which are suspicious of profit making in the delivery of education) to governments actively entering into large scale partnerships with the private sector in delivering education.

A recent survey of 81 countries by the IFC has found that in all but four it was legally possible to have private universities; in 74 of these countries the public policy on private universities was found to be good or very good. In some countries the policies are elaborated in a special law on private education, which in the case of higher education is often triggered by the arrival in the country of foreign universities or international education companies. In this context it is worth noting that public universities from one country are usually regarded as private entities by the government of another country in which they operate.

From the banker's perspective the key distinction in assessing a school is whether it is registered or not registered with the government. In the case of a college or university the question is whether it is accredited by the government to offer degree programs. The distinction between for profit and not for profit organizations is a more sensitive one for governments.

The legislation concerning registered private providers is rarely consolidated or clear. This does not mean that private providers cannot operate and in countries such as Bangladesh and Sri Lanka private institutions flourish despite the absence of a clear policy, since ad hoc ministerial decisions have taken the place of legislation.

In a well regulated environment any legislation on private education should set out guidelines in the following areas:

- Whether the private sector is generally free to operate.
- What the State expects from it as part of a national education strategy.
- What rights and entitlements the private sector has.

- What powers, if any, the Minister of Education will have over private providers.
- General principles of support.
- How new educational entities will be accredited/registered by the State.
- What the regulatory and control framework will be.

The principal objective behind any regulation is usually to protect pupils and their parents from poor quality providers, but any regulation must not be so tough as to deter potential investors. For example countries such as Cyprus, South Africa and the United Arab Emirates have very stringent provisions regarding private providers and South Africa has closed down many providers of MBAs on the grounds that their programs were not meeting national quality standards. However, some regulation is important for private providers as, if it is working well, it gives them some comfort that rogue traders and low quality institutions will be unable to operate. The good providers will not want to see their reputation damaged by the existence of disreputable competitors. This has sometimes led to private providers creating their own system of self-regulation where government has failed to act.

Although private providers can sometimes flourish without there being a clear policy in their favor, once a government declares that it wishes to encourage such provision, the reaction can be impressive, as the example in Box 5 from Chile shows.

Box 5: Private Education and Training in Chile: The impact of positive legislation

Chile has reformed the financing and regulatory mechanisms for its post-secondary education and training institutions since the early 1980s. Previously, post-secondary education had been provided by eight universities that were allocated a third of the total education budget. Private institutions could not offer post-secondary technical programs. A 1980 law established minimum requirements for setting up private post-secondary institutions, and proposals were dealt with on a case-by-case basis until 1988. In the nine years following the reforms, the number of universities grew from 8 to 34, the number of professional institutes from 0 to 41, and the number of technical training centers from 0 to 133. In the year following further relaxation of regulations to approve institutions, there was a further rapid expansion of numbers.

In the post secondary sector the stance of government on the provision of student loans is crucial. The issue is whether they allow students at private technical or tertiary institutions to have access to loans and grants on the same basis as students at publicly funded institutions. The most common scenario is that the private sector has grown in order to meet the demand that state institutions cannot fill and one would expect the government to support students in private colleges. However this will cost the State money. In many emerging economies it is common for tuition fees in the public sector to be very low compared with private institutions; this means that there is even greater need for government help for the poorer students and their parents.

In the vocational education and training sector it is usual for private providers to rely heavily on public funding or on funds derived from training levies raised from employers. In many countries such schemes have been unstable due to changes in government policy and private TVET colleges can only flourish if the following policies and conditions exist:

- Public funds are used to meet the demand for courses (eg: paid to students when they enrol) and not to fund the basic establishment costs of training organizations.

- The allocation of funds for technical and vocational education is stable and sustainable regardless of the economic situation.
- The basis for allocating funds to institutions or to systems is transparent and widely known and understood.
- Competition between training providers is encouraged.
- Funds for colleges raised from training levies are administered by industry-managed bodies and employers, through their associations and individually, are involved in making decisions about the allocation of funds at all levels.

Does government inspect the quality of private education?

Questions to ask

1. *What is the process for registering private schools or accrediting universities?*
2. *Is the vetting and accreditation process prompt and what delays are there before it can (a) enroll students (b) set examinations or award qualifications?*
3. *Does government have any system for external inspection or monitoring of the quality of the education and training delivered by private providers? Which organization does the monitoring and are the results published for parents to see?*
4. *Does the Ministry expect private education providers to submit any annual reports or statistical returns? Do providers have to publish their audited financial accounts?*

There are two possible government attitudes to the issue of the quality of private provision. One is to allow market forces to dominate on the assumption that parents and pupils will quickly desert a provider that is not delivering a good quality of education. The other is that government has a duty to intervene to protect consumers by establishing some mechanism for checking that a quality education is delivered in a satisfactory manner. However, the question of scale and location of the private provision could influence what steps a government takes. It will be harder for government to establish inspection mechanisms to monitor small scale rural providers of basic education than it will be for it to check larger providers of vocational and higher education in the capital city.

Well-designed inspection and quality assurance processes provide valuable information to consumers, providers and government officials on the outcomes of private education initiatives. Thus, if there is an effective national school inspection system that publishes its reports, a bank should be aware of its reports on any client schools. The impact of a bad report can be devastating in a city or market where there is local competition. Likewise, a very positive report can have a dramatic effect on pupil enrollments.

In private basic education there are two types of assessment of quality. For the high and middle tier private schools there are national or international quality standards, which use competency levels with expected common learning outcomes for each of the grades/subjects. In addition, as a second strand, there are teacher and head teacher standards that are set and monitored by the government through a national inspection system or by external accreditation agencies, such as the International Baccalaureate, IGCSE or CBSE. However, not all countries have effective systems of national or regional inspection that operate effectively for all levels of school—particularly the small private village schools.

Also in the emerging scenario of access and quality of basic education in many developing countries, Affordable Private Schools are increasingly playing a role within the official strategy for meeting the Millennium Development Goals and 'Education for All' targets. In Pakistan, for

example, there are approximately 90,000 plus such private schools that are growing through citizen-led efforts and even through public funding through the six Provincial Education Foundations. These schools currently lack any external quality assessment system and there is therefore a question as to whether they are receiving adequate quality assurance from either the public sector or non-state actors, or indeed, as to whether they meet minimum educational standards.

In higher education it is increasingly common for governments to establish national agencies or units to approve the creation of new institutions; these are usually housed in either the Ministry of Education or a buffer body or in an “independent” accreditation and quality assurance agency. In both cases the role of the organization is to approve and accredit the creation of new private institutions and then to review the quality of what is provided at intervals. In the tertiary level for example there are widely varying approaches to the vetting and initial approval processes, such as:

- To request detailed business plans and, if these are satisfactory, to issue Interim Licenses to Operate as a first step, which allows the investor to recruit students. (Tanzania)
- To review and then accredit all the courses and programs that are to be offered. (UAE)
- To expect all new providers to partner with an established public university for a limited period until it is mature enough to award its own qualifications. The role of the public institution is to develop the staff capacity of the private provider and apply its own procedures for checking the quality of what is delivered. (Ghana)
- To encourage private providers to partner with international universities and award their degrees initially. (Sri Lanka)

The criteria that are used to assess new providers are usually related to the existing norms within public institutions. This can be very frustrating to innovative providers who are aiming to operate more efficiently or more imaginatively than the State sector institutions. In Africa, for example, most of the accreditation bodies have developed checklists, pro-forma and questions relating to the space that is provided, the numbers and qualifications of teaching staff, volumes in the library or square meters of sports ground. Accreditation procedures are based partly on quantitative criteria such as this and partly on institutional visits by academic staff from public sector institutions.

Since the rationale for having external inspections or independent reviews of quality is to protect the public, there must be sanctions if the provider is found wanting. The University Grants Commission in Bangladesh revoked the licenses of some private institutions on quality grounds in 2005 and the quality agency in South Africa did the same after a review of provision of business education across the board.

If the public is to be able to select private schools, there need to be a requirement that schools should publish information about themselves (or that the findings of external inspections should be published). Banks should ask therefore about the collection and publication of information about private providers, as there is a wide range of practice. It is usually the role of the accrediting or overseeing body to require regular reports from those private providers that have been authorized to operate, but few governments do this reliably; consequently, there are not many examples in emerging economies of an annual publication containing comprehensive statistics on private providers. In particular, financial information about private providers is rarely found and very few countries require them to publish their audited accounts.

National policies on the financial aspects of private education

Questions to ask concerning primary and secondary schools

- *Is there any financial monitoring by government (at any level) of the private early years, primary and secondary education sub-sectors?*
- *Are there any government grants or incentives for those wanting to start a new school?*
- *Are private schools and institutions allowed to set their tuition fees without control by government?*
- *Can private and NGO/faith schools receive public subsidies?*

Questions to ask concerning colleges, universities and training providers

- *Does the government give private providers any financial incentives—grants for construction, support with infrastructure, access to land, exemption from VAT or other taxes etc?*
- *Does the government require any financial bond, deposit or guarantees from private investors starting a higher education institution?*
- *Can students get access to the same government loans and scholarships that are available to students in state funded institutions?*
- *Can private training colleges have access to any national training funds in the same way as public sector trainers?*

The financial policies of a government towards operators of private institutions can be crucial when reviewing a request for funds. Answers to the questions shown above will be needed in order to confirm that there will be no financial or fiscal surprises (or alternatively that no possible sources of public funding have been overlooked). One of the first checks in any due diligence process must be to explore the availability of any public funding support. In Indonesia, for example, where private higher education is almost universal (with over 2,900 institutions), the government offers a salary subsidy to encourage private institutions to hire teachers with masters or doctoral degrees. The purpose is to improve the general academic level of teaching staff.

Box 6: Positive financial support for private education

Pakistan is a good example of a country with a very positive set of financial policy incentives towards private higher education. Its Higher Education Commission actively wishes to encourage educational entrepreneurs and offers the following to both domestic and foreign providers; an allocation of land for the campus, capital grants for construction, support with accessing bandwidth for the internet, a tax holiday on profits and grants to support the hiring of foreign faculty (at salaries higher than domestic levels). In the last case the aim is to persuade academic staff in the Pakistan diaspora to return home.

A related issue is the extent to which private investors have access to the same financial benefits or facilities that are available to publicly funded bodies. In the higher education sector private universities often find that they are unable to compete for research funding from national research agencies; this inevitably limits their efforts to give their academic staff a broadly based career and ensure that they can develop their research interests. Other areas where parity may not be available are access to tax relief on philanthropic donations and the ability to make use of national electronic networks designed for public institutions.

The law of the land may contain some potential financial hurdles. A common regulatory burden is that some governments require compulsory levels of financial reserves or liquidity and in some cases expect a deposit with them of non-interest bearing bonds.

There are also examples of countries monitoring the level of tuition fees charged and in extreme cases setting a cap on the absolute level of fees or the scale of a fee increase in any year.

Since education is often posited as a 'public good' there is an argument that for-profit educational investors and companies should pay a low level of tax, but few governments accept this point. In South Africa, for example, the largest private company in the education and training sector regularly pays out tax at 30% of its operating surplus. The usual situation is for education companies to be treated in the same way as all other companies with no special tax privileges. However, in some countries there are demands for exemptions to be given in respect of the import of academic and scientific equipment and for the sector to be exempt from VAT.

In those countries with national schemes for student loans or grants for poor students, a key policy question is whether these are equally available to students in the private sector. In some developed countries like the United States and Australia students in private institutions are equally eligible and the large private for-profit companies benefit hugely from this. In emerging countries with a heavy reliance on the private sector such as Malaysia, there is also no difference in the way that students are treated, since those in private institutions can access both the National Higher Education Fund for a loan and those in selected private institutions are able to apply for scholarships to meet their fees.

The most tangible evidence of financial support is where government works jointly with the private sector. Box 7 below describes one such collaboration in technical training in Penang, which has been replicated in almost all the States of Malaysia.

Box 7: Industry-Government Cooperation: the Penang Skills Development Centre

The Penang Skills Development Centre (PSDC) is a joint company training centre established with government support. It has evolved to become a full private further education institution providing certificate and diploma level training. The Malaysian Government invests in the Centre and uses it to carry out public training programs. It demonstrates the potential of private educational institutions being used for public training purposes where these are not viable in themselves as private commercial undertakings, and without creating the facilities in the public sector. PSDC, with more than 100 member companies, runs both standardized and customized programs. It charges at cost and is basically self-financing. Companies can recoup the expenditure from the Human Resource Development Fund, a 'training fund' financed by a 1% levy on payrolls. The initiative for PSDC came from the Penang State Government. The State provided the land and buildings. The founder members included large multinational companies with training traditions of their own. Members donate equipment, laboratories, training modules and trainers. They have access to shared training facilities without having to duplicate with their own in-house capability. SMEs enjoy technology transfer from and can benchmark their standards against multinationals. Multinationals, in turn, receive better support services. Vendors donate equipment to familiarize the company workforce with their products and promote sales.

Source: Pillay (2005) Malaysia: The Vocational Education and Training System. Draft Working Paper, World Bank.

Government support for private providers of technical training is often channeled through Training Funds, as in the example above. Normally, this involves a transfer mechanism in which funds are diverted from public to private institutions or are used to support competition

between such providers. One of the most common methods is the use of vouchers, but this has not proved very successful in Africa due to a number of factors, including the lack of capacity within government to administer such schemes and an insufficient number of providers to offer real choice or competition.

Training funds like that in Malaysia are becoming an increasingly important mechanism for targeting resources at specific TVET programs, institutions and certain types of learners. Within such training funds a number of different funding windows are established and in the past these were linked to enterprise-based training—for the simple reason that funds were obtained from a levy on their payrolls. However, now that sources of funds have become more diversified, emphasis is being given to (a) pre-employment TVET, largely aimed at young people entering the formal sector, (b) support for enterprise training, either apprenticeship training or skill upgrading, (c) training for the unemployed and other groups who are disadvantaged in the labor market and (d) other areas where there is a severe labor market failure, including training for those in the informal sector.

Box 8: Example of a training levy in Kenya

Under the present Kenyan TVET system, organizations in the public and private sector are required by law to pay a training levy of 50 shillings per month for each employee. Subsequently, these organizations can claim a reimbursement if training occurs at a TVET institute approved by the Directorate for Industrial Training (the DIT is the body responsible for industrial TVET). All publicly funded TVET institutions are classified as approved, but private TVET institutions have to register with the DIT in order to be approved. Special guidelines have been developed to guide this process and an official visits the company to evaluate whether it complies with certain criteria relating to training equipment, conditions and the presence of professional trainers. Each year an approved company must register again and provide a further payment for each skill area. The DIT is supposed to provide regular monitoring of such provision, but does not have enough full-time members of staff to undertake this task.

Some barriers and controls to look out for

Questions to ask

- *Are there any government requirements on what has to be taught in schools and colleges (eg; the language of instruction, compulsory religious or political topics)?*
- *Can private institutions choose their own students freely or are there any government requirements (eg: an allocated percentage from certain ethnic groups or income levels)?*
- *Does government allocate students to private colleges or seek to put a cap on the number of students?*
- *Is a private investor able to choose the members of a School Board or Governing Body free from government influence? Does the appointment of a Vice Chancellor or college Principal require any Ministerial approval?*

As we saw earlier, there are many factors encouraging investment in private primary and secondary education including low levels of access to education, the poor quality and relevance of public sector service provision, a growing demand for private alternatives, low public sector education expenditure, population growth and a growing willingness and ability to pay for education.

However, private investors may face a number of constraints:

- Firstly, a lack of easy access to funding. Social areas such as education and health are not a traditional focus for lenders.
- Secondly, as in the public sector, one of the major constraints to expansion in many countries is the shortage of skilled and qualified professionals to teach.
- Thirdly, there is difficulty in accessing infrastructure and land which governments at all levels may be reluctant to allocate to ventures that are run for profit.
- Fourthly, the demand for education may be hard to assess as well as the ability of parents to pay the fees required.
- Finally, there are nearly always bureaucratic hurdles. Initial licensing and registration procedures are usually slow and arduous with the result that many potential providers see little alternative but to start operating on an unregistered basis or on provisional certificates.
- Government may introduce policies on what has to be taught, and in what language.
- In tertiary education governments may set quotas on the proportion of students from particular areas or tribes.

Another type of barrier that has no financial impact but can restrict operational flexibility is where government seeks to intervene in the way private institutions are managed. In some countries there is a requirement that one or more places on the governing bodies of private higher education institutions are made available for nominees of the Minister of Education. Also, in some countries the appointment of a President or Vice Chancellor requires government approval.

As we have seen above, the scale and duration of the bureaucratic process involved in starting a new private educational institution can be a major deterrent to investors. A typical process for registering a school is often long and complex. Key elements in such a process might be:

- An application for school registration is submitted through the District/Municipal/City Education Officer accompanied by several documents: (i) Inspection reports from the Public Health Officer and the inspector of schools, (ii) Minutes of the District Education Board in which the application is discussed, (iii) Certification of registration of business name, (iv) Names of school managers and their education certificates and (v) Proof of land ownership.
- Once the Registrar receives the application, it is presented to the Ministerial Committee on Registration of schools for evaluation.
- If approved, the application is forwarded to the Ministry of Education for authorization, then the Minister issues an authorization to operate and the Registrar issues a certificate after the final inspection.¹

In the university sector some of the accreditation processes in African countries are designed to take over three years before a private institution is fully authorized.

Some countries such as Japan and Azerbaijan control the student enrolments in private universities. The Japanese situation is driven by the overall demographic decline and has led

¹ Cited in Verspoor, Adriaan (2008) *The Power of Public-Private Partnership: Coming Together for Secondary Education in Africa*, World Bank, Washington DC.

to a system of enrolment quotas for both public and private universities. If a university does not enroll its allocated quota of students, it loses a subsidy allocation from government. The situation in Azerbaijan is driven by a simple objective of control. The State Students Admission Commission sets national university entrance examinations and allocates students to programs in both public and private institutions based on their results. The best students are allocated to state funded universities, while the next best go to the private sector where they are expected to pay higher fees.

What might go wrong at the national level

There are two levels at which things may go wrong; at the national level discussed here and at the school or institutional level which we consider in Section 4. The kind of risks arising at the national level are shown in Table 3.

Table 3: Risks at national level

<i>National policy on private education</i>	Government may change its policy and legislate against private education—particularly if it is for-profit—and either bans it, imposes heavy taxation or withdraws all concessions and benefits.
<i>Government regulations</i>	Operations can be impacted by a change in policies by the Government (e.g., the establishment of free primary or secondary education which removes the market).
<i>Inadequate judicial system and enforcement of contracts</i>	Investments can be affected by weak judicial systems which can be further exacerbated by corruption and lack of accountability in the legal system.
<i>National demographic trends</i>	The numbers of young people in the age groups targeted for a school or college might decline, affecting the chances of enrolling the planned numbers.
<i>Economic decline</i>	In a recession not enough parents are able to pay tuition fees and tough competition forces down fees, making profit targets unachievable. Governments may remove any incentives or financial concessions in their search for savings.
<i>Fears of poor quality</i>	Any scandals or public outcry about very poor quality providers could drive government to introduce a tighter regulatory framework on quality. The cost of meeting any new bureaucratic impositions would lower profit margins.
<i>International competition</i>	Large companies may open campuses offering ready-packaged courses with a US qualification at low fees. Planned student number targets are not achievable.

Many of these risks are almost impossible to mitigate since they originate at national level; however both borrowers and lenders should be alert to the national and global market realities. If policy changes are foreseen that threaten profitability or the ability to repay any loan, consultation with the borrowers is essential, as there may well be some strategic options (such as a merger or a change in market positioning of the school) that would reduce or minimize the policy impact.

Section 4. Good Practice, Pitfalls and Performance

This section sums up the features that make a good educational investment and looks at what the success factors are in schools and colleges. It also considers some of the educational and financial risks that are relevant to investing. Three Appendices are also relevant; Appendix I provides an example of a business plan that a school might submit to justify a request for funding, Appendix II describes the educational factors that make a successful school or college, while Appendix III is a checklist of educational questions to ask when appraising an investment in a school or college.

How to make a good educational investment

There are a number of steps to be followed to obtain a good investment in the education sector. The first is a *preliminary evaluation*, which is not a detailed assessment of a financing proposal, but a first-cut assessment to decide whether the project is worth taking up for detailed examination or whether it can be dropped at the outset as “project not worth pursuing”. If this preliminary scrutiny is positive, then a detailed appraisal of the various facets of the project is undertaken and any missing information/data gap is filled after discussions with the borrower. This process of preliminary evaluation, apart from hastening the decision making process, also helps borrowers considerably.

Schools and colleges usually seek finance for two reasons: (i) setting up a new school/college or expanding onto another site (ii) undertaking a “school improvement program” entailing provision of modern infrastructure, blending ICT (information, communication and technology) to planned increases in numbers. All the normal principles of technical appraisal and commercial viability appraisal, as applicable to any SME lending, will be as relevant in the evaluation of their proposals.

Box 9 highlights the types of commercial and academic review that can be included in the Preliminary Evaluation:

Box 9: Aspects of the Preliminary Evaluation

Commercial

- Regulatory Compliance
- Managerial Appraisal
- Infrastructure Appraisal
- Commercial Viability
- Financial Position

Academic

- Competitive strengths in the local market
- Purpose of a School Improvement Plan or College Strategic Plan
- Expected results of the School Improvement Plan and Strategy

Based on the assessment of the preliminary evaluation, the lender then proceeds to the loan evaluation. In any credit limit sanction, the loan origination process commences with the receipt of a formal loan application from the client. The loan request should clearly state the following seven components: i) the purpose of the loan, (ii) the amount of the loan sought, (iii) the extent of the promoter’s or founder’s own equity contribution, (iv) term of the loan, (v) the term of the repayment, (vi) the sources of repayment, and (vii) collaterals offered etc.

Box 10 provides a summary of the commercial and academic documents that will usually be required in an educational loan assessment: All the parameters listed in Box 10 should be reviewed with the promoter or Head of the college or school.

Box 10: Indicative documents required to support the loan

Academic

- Statement of school or college vision and mission
- Strategic plan or School Improvement Plan
- Organizational structure
- Members of the Governing Board, their standing and experience
- Key persons managing the school and their brief profile, particularly the Head of the school or college
- Teaching staff and non-teaching staff complements and their relevant experience
- Addition/attrition to teaching staff in the last three years
- School curriculum—brief outline
- Inspection or external quality review reports

Commercial

- Banking references
- Past three years' audited financial statements with details of student enrollments
- Details of the project to be financed, including:
 - Project cost, the underlying assumptions and documentary evidences
 - Means of financing
 - Proposed project implementation schedule
 - Market survey to test the ability to pay of the target group
 - Historical and projected enrollment levels
 - Profitability estimates and repayment program
 - Fund flow projections and assumptions
 - Projected financial statements
 - Security offered/credit enhancement

Financial and educational success factors

There are two ways of assessing whether an educational project is successful; from a financial perspective and from an educational perspective by reviewing what happens in the school or college. In Box 11 some of the financial parameters are shown with comments and interpretation.

If the funds have been spent by the promoters according to the plan submitted to the bank, there should have been an improvement in the educational position of the school or college. Either a new extension or site is operating effectively or the educational experience on the existing site has been strengthened with a consequent improvement in the school's reputation, enrollment and ability to increase the fees. It is therefore helpful to have a set of educational parameters against which to check the school or college's performance. Appendix II contains such a set covering five areas of activity: enrollments, teacher qualifications and rate of staff turnover, student attendance rates, academic performance in examinations and inspections and aspects of governance and school discipline. These questions can be used when reviewing the performance of the loan.

Pitfalls, problems and loan risks

Section 3 has described the things that might go wrong with an educational loan as a result of external and national events. One of these was that, since the private education sector is booming in many countries, the competitive position may not be stable and new market entrants could appear. These entrants may be challenging existing providers with new models of operation, the use of expatriate teachers and international curricula. One key issue therefore for banks to watch for is the current competitive position. Are new competitors emerging? Has the position of the school or college in its market niche remained unchanged?

Box 11: Financial parameters

(i) Profitability	<p><i>Gross profit margin or profit before interest, depreciation and tax (EBITDA)</i></p> <p><i>Occupancy cost ratio, defined as the expenses incurred in respect of the school premises as a proportion of gross revenues</i></p> <p><i>Operating cost ratio defined as the operating costs of salaries and instructional expenses as a proportion of gross revenues</i></p> <p><i>The average increase in school/college fees annually during the last two years compared with general inflation. This is an indication of the ability of the school to increase the fees in tune with rising costs. This has a direct implication on revenues and the ability to maintain the enrollment levels.</i></p> <p><i>The debt service coverage ratio (DSCR) indicates the capacity to service interest and loan repayment commitments.</i></p> <p><i>Bad debt ratio, which is the percentage of the annual provision for bad debts to total income.</i></p>
(ii) Liquidity	<p><i>The school/college's ability to meet the day-to-day running expenses and ensure smooth functioning is dependent on its liquidity. This is measured by the Current Ratio (Current Assets/Current Liabilities)</i></p>
(iii) Leverage	<p><i>This refers to the level of reliance on external sources to meet the funding requirements of the school/college and its impact on the overall solvency of the borrower. The relevant ratio is the debt equity ratio, being the ratio of total outside liabilities (TOL) to tangible net worth (TNW)</i></p>
(iv) Capitalization	<p><i>The extent to which the founder's or promoters' funds have been invested in the total assets of the school/college is a measure of their commitment.</i></p> <p><i>Fixed assets usually constitute a preponderant portion of total assets. Where there is a relatively low level of fixed assets in relation to its total assets, it may be either because it is operating in leased premises or it genuinely lacks the facilities essential for the effectiveness of a school. However, there may also be a case where too heavy an investment in fixed assets at the cost of liquidity may hamper the smooth functioning of the school.</i></p> <p><i>The financial ratios relating to capitalization therefore are: (a) Capital to Total Assets or Capitalization Ratio and (b) Fixed Assets Ratio, being the proportion of fixed assets in the total assets</i></p>

There is a similar challenge with respect to the curricula and the technical content of any training in tertiary and TVET colleges. Most private universities and colleges have a competitive edge over their public sector counterparts through their links with the community and with employers. If they are to continue to provide students with the employability skills that the market wants, they will need to be alert to what employers are thinking about the quality of the graduates they take from them. In the higher education sector this is particularly important and is achieved either through selecting employers as members of the Board or by creating advisory committees in each main discipline to monitor the curriculum content so that it is relevant and up to date.

Private for-profit education is a contentious issue in some countries and there will always be a political risk that governments will change and one will emerge that is hostile to the concept of profit being earned from delivering a public good. This may not be easily foreseeable, and it is clearly a very significant risk in some countries. However the general global trend, as has been shown in Section 1, is towards an expansion in the private sector and almost all the former Soviet countries and China have embraced it as a solution to their needs. Nonetheless, there are still countries where the political climate has not been persuaded of the merits of a free market for the private sector and a tightening of regulatory environment remains a possibility.

Less dramatic but still very serious, would be a negative report from a government inspection or audit service on the quality of the education delivered by the borrower. In those countries where such inspections exist and where their reports are published the public would have access to the findings and the report could have an impact on enrolments. In such circumstances the bank will need to know that the founder or the Head has put in place actions to remedy any failings that were identified.

In all other respects making a loan to an educational client is subject to the same type of risks as with other SMEs. One such standard risk relates to real estate; it is possible that the local real estate laws and lease laws do not support either private titles or long-term lease rents. In some cases, litigation related to land titles and leases takes a long time to resolve, thereby rendering the school or college subject to losing its premises. It may make sense for the bank to verify real estate title copies and to keep them as collateral unless they are hypothecated already. In such a situation where the real estate is already hypothecated, it would be prudent to hold real estate of similar value as collateral.

However, in the schools sector there are sometimes special factors relating to the culture of educational institutions that one must watch out for. As an example Box 12 below provides a summary of some of the difficulties faced by Investment Officers preparing to support loans in the basic education subsector in Kenya.

Box 12: Examples of difficulties faced doing due diligence by investment officers in Kenya

- Slow turnaround and response time lag
- Delays in submission of required documents such as audited financial statements, bills of quantities, etc
- Poor means of communication—non electronic in most instances
- The school calendar means that in vacation periods some staff may not be available
- School managers lack expertise in dealing with banks
- Centralized management controls
- School managers are often unwilling to do the financial analysis and administration required
- They want confidentiality and have a fear of sharing information
- Support staff may not have the professional capacity and necessary IT infrastructure
- It can be difficult getting an objective market assessment of competition, the borrower's niche, goals and competitive advantage
- Borrowers have unrealistic assumptions/expectations about the ease of the application process
- Reliability of the information that is provided.

Source: Help Desk for the Kenya Private Sector Support Project 2003

In the monitoring stage after a loan has been made it may be useful to identify some 'alarm' bells for loans that are showing signs of possible default. These signs are common to all SME loans, but identifying them in a timely manner can be complicated by the school or college timetable.

An important way of mitigating against risk is to establish a credit rating system. The objective of this rating is to obtain an indicator of the quality of financing and thus the relationship to the probability of default. The rating will provide a uniform frame of reference to further the understanding between the lenders and the borrowers. Credit rating would help speedier decision-making and also provide a rational basis for pricing the loan in relation to the perceived risk.

Box 13: Signs of a risk of default

- Project implementation and utilization of funds is slow
- Guarantor requests the lender to withdraw the guarantee
- Frequent check bounces give an indication that the client has financially overstretched itself
- There is suspected diversion of loan funds to other purposes than those agreed
- Borrower intentionally avoids taking follow-up telephone calls from the lender
- Client facing a cash crunch has requested increasing the term beyond that agreed.

In educational businesses there are some features that are good indicators of stable management and a potential strategic investment. A selection of these, based on practical experience in the sector, is summarized in Box 14.

Box 14: Features that indicate stable management

1. Schools/colleges with a regular growing enrolment and a waiting list for places. The larger the enrollment, the more likely that the school has survived some downturns and could operate in a range of economic conditions.
2. An improvement in the student-teacher ratio is a key indicator of quality. Clearly, a ratio of 1 staff member to 100 students implies a poor level of interaction and hints at poor quality results; in contrast a ratio of 1 to 20 would imply closer contact and a better chance of quality outcomes.
3. Schools that own rather than rent their premises present a much more satisfactory profile to a lender, with greater security and a better ratio of equity to loan.
4. Borrowers that offer secured loans rather than unsecured loans give more comfort.
5. Schools with more than 5 years of operation are usually more stable and enjoy more regular cash flows.

The five “C’s” summarize the key elements in a successful loan

There are five overarching fundamentals of success for the provision of credit to the education sector. These fundamentals are similar to loans and the provision of credit to other SMEs and businesses.

The first fundamental is *‘Character’* and the need to obtain evidence about the character of the people who manage the school or college. This evidence can be gathered through such means as (i) checking their past record of discharging loan obligations and a carrying out a discreet market check; (ii) background check on the business experience of members of the school or college governing board and the senior staff on their ability to manage the school; and (iii) checking the reputation of the board members and their reputation with the government and the local community.

The second fundamental is *‘Capacity’* and the repayment capabilities of the loan applicant. This capacity can be assessed through reviewing: (i) the expected cash flow surplus available for servicing the loan, after meeting the ongoing obligations; (ii) the school/university fee collection that is driven by projected enrollments and the fee structure; and (iii) cash outflow that is substantially taken up by staff salaries for both teaching and non-teaching staff as well as the ongoing expenditure by way of provision of teaching aids and maintenance of school infrastructure.

The third fundamental is *‘Capital’* and the financial worth of the client. Capital is measured by the net worth of the enterprise and it is required in addition to the assessment

of the cash flow since, even if this cash flow is deemed adequate to meet the repayment installments, the feasibility of securing suitable credit enhancements in the form of personal guarantees from the promoters, charges over their personal properties etc. should be explored.

The fourth fundamental is '*Collateral*' that is based on an assessment of the assets that are created out of the loan. Land, buildings, computers, equipment, vehicles etc. can be taken as security for the loan, but since the main security is the school buildings which are special purpose properties that usually have limited adaptability to other uses, it is advisable to set a conservative maximum loan-to-value ratio and consider taking equity investment or subordinated debt from the promoters for funding the project.

The final and most difficult fundamental to assess is '*Conditions*' or the probability of changes in the current market scenario. These have been referred to already when we discussed risks at the national and school levels and could range from new stiff competition in the market with new schools adversely impacting the planned student enrollment to the regulatory authority imposing a ceiling on the tuition fees that can be charged so that the economics of the project would be seriously affected.

When financing schools or colleges an assessment of their effectiveness involves an assessment of characteristics that are unique to education and that differ from business risk assessment in other lines of business. Studies on school effectiveness have shown that the characteristics of effective schools or colleges can be summarized in the following nine main parameters, namely:

- Professional leadership.
- Shared vision and goals between teachers, parents and students.
- A favorable learning environment.
- Concentration on learning and teaching.
- Purposeful and informed teaching.
- Mutual high expectations of staff and students.
- Regular internal monitoring of quality and external evaluation of progress against agreed goals and indicators.
- Agreed statements of rights and responsibilities for the pupils.
- Partnership between the school and the home environment.

Examples of successful educational investments

There is no doubt that schools and colleges can be very successful financially after borrowing and this can be achieved in a short space of time. Two examples from the school and university sectors show how this can happen. The first from India is where a school decided to take on debt to finance its expansion, while the second is an example of an offshore investment in a new university in Sri Lanka financed with equity funding.

One misconception is that private colleges focus solely on disciplines requiring little investment in buildings and equipment, such as business, law and accounting. This is not universally true and there are good profits to be made in some countries from expensive disciplines such as medicine and dentistry, where there is demand. The next example shows how a profitable university was achieved in Tanzania using a mix of debt and equity investment.

Box 15: Debt funding for schools

In 2005, a local entrepreneur established a school in Bangalore, India that integrated the preschool and K-12 education. The school was primarily targeted at the higher middle income families providing a mix of local ICSE and IGCSE curriculum. Starting off with a modest number of 30 students, the school today has expanded to two campuses within the same city. Currently it has 1250 students and a total capacity of 2000 students.

Although the original school was profitable, the founders realized that there were efficiencies in scaling up their enterprise within the same city and decided to take on debt funding for expansion. They borrowed an additional \$6 million of debt from banks to build the new school. This changed its debt to equity ratio from 0.49 to 2.66 which had a direct impact on the interest payable which increased 30 times in 2008 as compared to 2007, decreasing the profit margin from 31% to 7%. Although this took a toll on the profitability of the school in the short run, the venture remains profitable with an additional capacity of 750 further students. Once this has been filled over the next 3 years, the school will be back to previous levels of profitability.

Box 16: A successful equity investment in higher education

An undergraduate college was established in 2002 in Colombo, Sri Lanka, offering multi-discipline twinning programs of various US universities all under one roof. The college provides a US-based liberal arts education, a novel concept in the region, and offers students a choice of graduating with liberal arts, social sciences, engineering, information technology, management, pre-medicine, pharmacy, management and pre-dentistry degrees.

The founders chose the equity funding route to establish the college and injected US\$2.9m over the first 3 years after inception. This funding was used to acquire the lease of a property of 40,000 square feet, for faculty, training as well as marketing. The college had a trimester system with 50% international faculty, and started with 170 students in a building that was located in central Colombo, as it was originally planned to be a city college. However, the numbers grew rapidly due to a reputation for a quality offering and the college building was housing over 1000 students by the end of the 5th year.

The college incurred losses for the first three years, but maintained the fees at the same level for 5 years. The student numbers rose to 760 in year 4, by which time the college had a PAT of 33%. The payback period for the investment was 5 years after which the college generated US\$ 2.7m of net surplus cash per year i.e. doubling the investment every year. The success of the college encouraged the founders to lease a second building next door and to diversify by bringing in other universities from Australia and UK to carry out the same twinning concept. Today, the two college buildings house upward of 2300 students. This is a very successful business model for the founders, who are looking to expand into other parts of the region funded entirely from internal sources.

Box 17: Successful debt and equity investment in a medical university in Tanzania

In 1995, an Indian Educational Foundation joined hands with the Government of Tanzania in establishing the first ever private university in Dar es Salaam. Tanzania, which had very poor medical infrastructure and very few centers of higher education, was an ideal investment avenue suiting the Foundation's social and educational objectives. The University was therefore designed to cater for the increasing demand from a professional high quality work force in the emerging global economy.

This project was a classic example of a mix of debt and equity in the proportion of 2:1. The debt was raised from the government of Tanzania, whereas the Indian Educational Foundation committed its' equity capital. The total project size was USD 13 million spread out over a 10 year period, wherein the college of nursing, college of medicine, college of dental sciences, college of technology and college of management were set up over 5 phases.

Today, the debt has been serviced and repaid in full and the university in Dar e Salaam boasts over 10,000 students with a profitability of 25%.

Conclusion

The private sector is providing a growing proportion of education in almost all the countries of the world. Demand is high since most governments cannot afford to provide all levels of education from their own funds. Thus, the sector is a fruitful one for investors since an increasing number of parents are able and willing to pay private tuition fees to ensure a quality education for their children.

This Guide has shown that educational businesses can be a sound investment. Although their proprietors are not always fully versed in commercial and business disciplines, they can be helped to develop into very profitable and flourishing enterprises. The experience of banks and other investors is that schools and colleges have many advantages over other SME clients; they have a regular income that is usually paid in advance; their customers stay with them for many years and often become strong supporters of the school; and if a school's reputation is good, it will need limited investment in marketing and promotion, since word of mouth will suffice.

The IFC is keen to encourage banks to invest in this sector. Not only will such an investment provide a solid financial return, but it will also contribute to bringing social and economic benefits to their country. An investment in education strengthens the country's potential for economic development and greatly enhances the lives of individual students.

Appendix I

Indicative business plan

Acorn Academy

A Primary and Secondary School in Lima

Introduction

Acorn Academy (Acorn) is a Grade "A" Private School of academic excellence that has been in business for over thirty years. It prepares students for the International Baccalaureate. Mr Andy Garcia is the present Managing Director and 100% owner of the school. The key objective of this Business Plan is to source medium term funding assistance from a commercial bank at competitive rates to fund the School's Strategy 2020 Improvement & Expansion program.

Acorn is located at Stadium Area in the suburbs of Lima, Peru. It enjoys a high reputation for the standard of teaching and student discipline. The School at present runs a single stream from KG2 to Junior Secondary School and has on its rolls 589 pupils.

The Board consists of five Directors of standing, chaired by Mr. Roberto Gonzales, a professional investment and financial analyst, and this Board provides strategic direction and exercises effective oversight on the management of the affairs of the school. The management team comprises Mr Garcia and the Head Master Mr. David Bocco who looks after the academic affairs.

Competitive advantage

Acorn enjoys a number of competitive advantages over other private schools. The School has an impressive record of success in the examinations with many students going on to further study in prestigious senior secondary schools. The School's stress on English language speaking and writing gives it an edge. Another main advantage is its moderate fee structure compared to other private schools with comparable facilities and accomplishments. The School offers good infrastructure facilities. It has a Student Teacher Ratio of 37:1. It has 26 teaching and non-teaching staff and all the teaching staff are well qualified and trained in teaching.

School Improvement & Capacity Expansion program

Considering the potential and the market demand as also its own competitive advantages, the Board has decided to implement a School Improvement & Capacity Expansion program at an estimated cost of US\$ 3.5 million. The program envisages: (i) construction of new buildings to accommodate a second stream of classes (ii) equipping the library (iii) construction of a staff room (iv) construction of a science laboratory and acquisition of equipment (v) construction of technical workshop and (vi) procurement of additional computers and school management software.

The project is scheduled to commence in 2011 and be completed in 2013 to become operational from the academic year in July 2013 so that it can admit a new batch of students in the expanded capacity. In 2013, pupil enrollment will be only for KG1 to Class 3 and as the Class 3 gets promoted every year, additional classes will be started, achieving the increased capacity of 1200 in a phased manner.

Simultaneously, the School will be able to step up its fee structure too, both for the new and existing students. The latter will benefit from the improvement in school infrastructure like the science lab, computer facility, technical workshop, etc., and hence there will not be any price resistance from the parents. These two major contributors of revenue are factored

in the projected financial forecasts for the next five years, given in the table below, and the management is confident of servicing the Term Loan interest and the principal.

The school

School organization

- Mr. Garcia founded Acorn Academy in 1976 and owns 100% of the school.
- It was incorporated as a Limited Liability company and commenced operations on Sept 27, 1977.
- Current strength of 589 students.
- Classes from Kindergarten 2 to Junior Secondary School 3 level and runs a single stream.
- Mr Garcia, the Managing Director of the School for over 25 years, is in charge of finance and
- administration of the School assisted by a qualified and experienced Head Master who manages the academic activities of the school.

School services

- The present school policy precludes the school from operating a Pre-school department.
- Admission of pupils from other schools into the various classes in both Primary and JSS is very much discouraged. The School has 16 teaching and 10 non-teaching staff. The average number of pupils in each class is 37.
- Teaching staff turnover is low at less than 5%.
- The School has 10 standard classrooms equipped with standard furniture.
- Well-developed library, a Science Laboratory, Computer and Language Labs and Home Science Center.
- There is no Staff Common Room

Instructional focus and goals

- Good climate and relationships and a high sense of pride in the school has been observed.
- Staff morale and commitment is very good.
- Teacher-student relationship is quite
- Discipline is good and mainly enforced by the Head Master and teachers.
- The School has a Student Representative Council
- Staff are encouraged to promote inclusion and to support participation by all pupils
- The School has no special structure to support children with special needs or special programs for gifted children.

Governance and management structure

- The School has a Board of Directors. The Board formulates strategies and oversees the functioning of the Management Team.
- There are 5 Directors and the Chairman is a professional Investment and Financial Analyst.
- The Managing Director and his son have been the main drivers for steering the School and are ably supported by another director who is a management consultant.
- The Head Master is a well qualified and experienced teacher and generally looks after all the academic affairs and activities of the school.

School Improvement (Expansion) plan

The proposed capacity expansion program envisages an increase in the student intake from the present 589 to about 770 by starting a second stream and also a pre-school (KG1) section.

The key objectives of the expansion/improvement program are:

- To increase student strength by adding a second stream from KG1 to Class 3 initially and adding a class every year
- To equip the library with modern and relevant books
- To provide special attention to students who are slow at learning
- To improve the teacher: pupil ratio, by additional recruitment of qualified teachers
- To develop student data base and a billing system
- To implement proper systems for financial, administrative and human resource management
- To promote career development and morale of teaching staff
- To improve teaching methodology and enhance learning
- To increase use of ICT to upgrade the teaching and learning process

To achieve the above objectives, substantial additions/improvements to the infrastructure are proposed including: (i) construction of building to accommodate a second stream; (ii) equipping the library; construction of staff room; (iii) construction of science laboratory and acquisition of equipments for laboratory; (iv) construction of technical workshop; and (v) the procurement of additional computers and school management software.

The Business Opportunity – Marketing Plan

Market Analysis

The business opportunity is that of promoting/ improving/ running a commercially viable private school, which would give a reasonable return on the investment to the promoters while adding to the social infrastructure. There are a number of drivers including: (i) the business environment that supports entry of the private sector into the education market; (ii) the inability of the government to meet demands for access to a quality basic education; and (iii) market preference for a private educational system.

The business opportunity that is available can easily be gauged by the demand and enrollment figures in private schools in Peru and especially the capital region of Lima. Statistics on the number of private schools and growth of enrollment during the five-year period of 2005 to 2010 are given in Table 1.

Table 1: Number of private schools and growth of enrollment (2005–2010) (not provided here)

Competitive advantage of ACORN Academy

ACORN Academy enjoys the following competitive advantages over its competitors, including:

<i>Competitive fees</i>	<ul style="list-style-type: none"> • Fees are very competitive. • High quality education and has proven track record of academic performance • Fees moderate and extremely competitive relative to other competing schools targeting the same market segment.
<i>Academic performance</i>	<ul style="list-style-type: none"> • Good success rate of students of the School in the core subjects of Mathematics, English, Science and Social Studies • 100% for the past three years.
<i>Teacher quality</i>	<ul style="list-style-type: none"> • All teachers have appropriate qualifications and competence for teaching. • Of the selected 30 schools in the District, ACORN is among the five schools that have 100% qualified teaching staff.
<i>Average class room size</i>	<ul style="list-style-type: none"> • 20 feet by 30 feet. • Classrooms are airy, spacious and well lit
<i>Pupils per class</i>	<ul style="list-style-type: none"> • The average number of pupils in a class is 35
<i>School compound</i>	<ul style="list-style-type: none"> • fairly spacious and walled • large and convenient compound for recreational activities and physical training activities.
<i>Quality grooming</i>	<ul style="list-style-type: none"> • Code of conduct and a set of realistic rules and regulations in place • Clear aim to groom the pupils and develop their personality in the formative years.

Management plan

School constitution

The School is incorporated as a limited liability company and has a Board of Directors. The Managing Director and his son, who is on the Board, are the main drivers for steering the School. A third director, who is a management consultant, ably supports the two directors.

School organization

The School has 16 teaching and 10 non-teaching staff. One of the teachers also serves as librarian. With the expansion of the capacity, the organizational structure may need to undergo some minor changes. A Head Master for the primary and nursery sections may be required so that the management team is strengthened. The number of teaching and non-teaching staff will be increased in phases with the implementation of the capacity expansion.

Management initiatives in the human resources area

Even though human resource policies are not documented, management performs the following tasks for each of the activities:

Recruitment

- Vacancies are advertised
- Applications are invited and scrutinized by the management team
- Interviews are conducted by a panel
- Selections are made on the basis of qualifications, experience and interview performance
- Appointments are made and the Managing Director issues letters of appointment detailing the terms.

Motivation and reward

- Job satisfaction is high because of availability of teaching and learning materials
- Team work is encouraged among staff
- Regular staff meetings are held to promote management-staff communication flow
- Teaching staff conduct their own meetings to discuss their welfare
- Bonuses are paid by management and parents on the basis of performance of students in IGCSE
- Annual and special bonuses are paid
- Staff are provided with loans for purchase of computers

Training and development

- Teachers attend Foundation for Educational Research and Development Training Programs
- Distance education programmes aimed at enhancing the academic credentials of teaching staff are encouraged
- Off campus training reports are prepared and experiences shared with non-participants
- School management encourages staff to fund their own long term educational programs and refunds their training cost where it is deemed beneficial to the school's curriculum

Discipline

- Copy of the code of conduct is attached to the appointment offer letter.
- Staff punctuality is good
- There is low absenteeism among staff
- Teaching staff and students do daily cleaning on the compound to prepare students for boarding house life.
- Spot checks are conducted on cash held, unwholesome literature or materials, mobile phones, etc by students to discourage any unwanted practices during the school hours.

Operations plan

Physical infrastructure and facilities plan

- The existing land area, which is freehold, is sufficient for the proposed expansion.
- Reputed consultants/architects/engineers will be engaged to supervise the construction of additional building/infrastructure so that project implementation risk is addressed.

- In view of the existing facilities, which are adequate to meet the present and future requirements after the implementation of the proposed expansion and quality improvement plan, no separate Facilities Plan has been prepared.

School environment

- There is adequate natural light in the class rooms
- Standard furniture has been provided for all classrooms for both pupils and teachers.
- The School provides safe drinking water to the students
- The School runs “extended” class hours for its students
- The daily school hours begin at 8.00 a.m. and end at 4.00 p. m., with two break periods
- Students either come by themselves or are dropped by their parents
- The School does not run a transport service for pupils staying at a distance
- Teaching is mainly through chalk and black board method although other T/L materials are used
- Physical training /Games are also a part of the routine and there is adequate space in the walled compound for such activities which require open space
- The School has adequate security staff
- The School has first aid equipment but does not operate a sick bay.
- There are 14 washrooms, which are all in good and sanitary condition
- The School gets adequate and consistent power and water supply from the Utilities Board but there are no backup arrangements

School administration

- The educational process is supported by the Finance and Administration Unit (FAU) which is managed by the administrative assistant under the supervision of the M.D.
- The FAU performs the accounting and financial management functions as well as the human resource and administrative functions.
- The Administrative Assistant writes up the source documents of transactions and enters them in “provisional book of accounts”.
- The financial year of the School is from January to December
- The Managing Director approves all transactions.
- Sometimes expenses are paid from daily cash receipts and the Administrative Assistant keeps the petty cash
- No formal reconciliation of cash and bank statements is prepared periodically.
- The School is planning to introduce computerized accounting and once the package is installed and the staff is trained in the use of the software, periodical statements will be prepared for the purpose of management review.
- The School Accounts of the School are audited annually.

Conclusion

The strengths and weaknesses

	Strengths		Weaknesses
Location:	well located in a residential area populated by middle to top income groups who are the target segments. premises are spacious and the surroundings are good.	Leadership succession	one of the major weaknesses, which the Board has addressed is managing the transition
Teachers	disciplined, qualified and experienced teachers who are dedicated to pupils’ development use of quality teaching materials and techniques for maximum effectiveness.	EMIS	lacks an appropriate database on a billing system for students. lacks a defined and functional HR Management and Payroll system for staff management lacks Academic Management System is in place to process and facilitate academic work.

Facilities	adequate facilities for a single stream establishment in terms of furniture, class rooms, and library, etc	Policies	administrative policies and procedure manual to guide the staff in performance of their duties are yet to be finalized. staff conditions of service have not been formally documented.
Fees	in keeping with the mission of the school to provide quality education at affordable cost, the school fee is moderate and there is a very low default rate.		
Brand	enjoys a very positive image established over the last two decades and there is a strong brand pull in its favor.		
Community	active students' and parents' participation in all its activities emotional attachment to the school by students and parents. Students as alumni are proving to be ambassadors and support the ongoing developmental efforts of the school.		

Conclusion

For the following financial and academic reasons it is concluded that this proposed capacity expansion cum school improvement plan proposed by ACORN Academy is based on sound considerations.

- i. Competitive advantages, especially that of academic excellence and a well-earned reputation for discipline and emphasis on ethical values, give the School a lead over other private schools.
- ii. Given that the School presently runs a single stream and the pupil strength is less than 400, the additional capacity will be easily filled, given the School's reputation, moderate fees and also the growing demand for quality basic education in Lima.
- iii. The commercial viability of the investment program is established.
- iv. The implementation risks are being addressed by engaging the services of reputed consultants/ architects and engineers.
- v. The expansion is being planned on existing land belonging to the School and the present value of its premises would be very high as compared to the book value.
- vi. The financial plan is compiled on conservative basis and the assumptions on school fees and rise in school fees are realistic.
- vii. The financial plan does not assume any revenues from the levy of any developmental charges from the pupils in addition to the school fees, though this is the general practice.
- viii. The coverage ratios indicate that the project will generate adequate cash to service the loan.
- ix. From an investment point, the expansion program is attractive. At a discount rate of 30%, and assuming a life of 10 years for the project and a constant cash accrual from Year 5, the NPV of the total cash flows (existing + additional) works out to XXX

Appendix II

Some educational measures of success

- | | |
|--|--|
| (i) Enrollments | <ul style="list-style-type: none">• Since school or college enrollments drive the revenues, they are a key measure of success.• Enrollments may be limited by physical infrastructure like building capacity and also by applicable municipal or Ministry regulations.• Enrollment demand can be gauged from the current enrollment levels and the overall trend. There may be a waiting list especially at the beginning of a school year. Higher demand can drive decisions for a larger facility, while excess capacity may be the result of newly acquired facilities or an unsuccessful program with shrinking demand.• Programs where demand is falling should be stopped as they may be uneconomic to deliver. |
| (ii) Teacher qualifications and rates of turnover | <ul style="list-style-type: none">• Academic performance will be influenced by teacher turnover and teacher qualifications.• A school which is not able to retain good teachers or where majority of the teachers are not well qualified, may fall in the esteem of the parents and students.• If the school or college invests in staff development and training (or secondments) it is an indicator of a commitment to quality. |
| (iii) Student attendance and satisfaction | <ul style="list-style-type: none">• Average student attendance levels are an indicator of the school's success and demand for enrollment as well as an indicator of internal discipline.• High student satisfaction is crucial to retention; if there is a high retention rate (with a low wastage rate) the school or college is performing successfully. |
| (iv) School classification and academic performance | <ul style="list-style-type: none">• Where the Ministry of Education operates a school grading system, the classification or grade allotted is an indicator of the school's standing.• In higher education if the findings of an external quality agency review are published, they can influence the reputation and affect student enrollments.• Improvement in the academic performance of the students is one possible measure of school effectiveness, where comparative examination results are known and published.• Improvement in the academic performance of the students could be measured through the improvement in their success rate achieved in public examinations and also by assessing (if possible) how successful the school's students are in securing admission for higher education or direct entry to their chosen career.• In higher education another measure of effectiveness is the percentage of graduates who obtain jobs within a year of graduation, since most private institutions seek to make their graduates employable.• Number of students having to repeat/re-sit examinations is a negative indicator.• Employer satisfaction is an important measure of whether a college is giving its graduates the key skills needed in the world of work. Very often public universities and colleges are failing in this respect and parents pay for private higher education precisely to secure jobs for their children. |
| (v) Discipline, administration and governance | <ul style="list-style-type: none">• School discipline and administration are important factors and parents choose schools or colleges which are able to enforce a strong sense of discipline and where there is no rioting or political disturbance..• A strong administration is essential to control expenses and collect revenues when due.• Governance practices vary from school to school and many private schools are owner managed, which has advantages and disadvantages.• An institution needs strong foundations for proper governance so that the school can function well in the owner's or Head's absence. |

Appendix III

An indicative checklist of questions to ask when appraising a school or college

Income:

1. Are any discounts on fees offered? To siblings or parents in special categories? To children of staff?
2. What scholarships, if any, are given (from any local charities or trusts)?
3. Overall, what is the percentage of discounts and scholarships? It should not really exceed 6 or 7%.
4. If it is TVET or HE, what proportion of students are getting grants or loans from the government, or privately from a bank?
5. In TVET what proportion of fees are paid by employers?
6. How are the tuition fees paid? Termly, monthly? What proportion of fees is *not* paid in advance each term?
7. How much is received as pupil deposits or entry fees paid in advance? How are these treated in the accounts?
8. Is there any delay in the government or bank paying these grants? Does this affect the cash flow?
9. What is the bad debt percentage? How much has been written off regularly in the accounts?
10. What proportion of income comes from sources other than tuition—eg: enrolment fees, library fines, charges for trips and excursions, examination fees, study visits?

Expenditure – salaries

11. What percentage is paid on salaries and payroll costs? Has this been constant and how does it compare with known benchmarks in the country?
12. What proportion of staff are part time? Has this been changing?
13. How are salaries fixed—by a national or local scale, according to market demand?
14. How do the salary and benefits levels compare with competitors?
15. Do teachers get any benefits (eg: discounted fees for their children)?
16. Do professional staff get any additional employee benefits?
17. What is the level of staff turnover? Is it reasonable?
18. In HE/TVET are there any foreign academic staff and how is their pay level decided? Do they get any special benefits (eg: fares home) not available to local staff?
19. What proportion of the payroll costs are for support and non-academic staff?
20. What is the ratio of teachers to non teaching staff? Has this changed over time?
21. What is the ratio of students to teachers? How does this compare with other similar organizations in the same market? Has it changed over time?
22. What is the expenditure on staff training and development?

Expenditure – other costs

23. What share of the budget is spent on the premises annually? Has this been constant?
24. Is it enough to maintain (and upgrade as necessary) the fabric of the buildings?
25. If the building is leased, does the landlord maintain it adequately?
26. How much of the budget is spent on teaching resources (textbooks, other books, materials, science consumables)? Has this proportion changed over time?
27. What are the costs of ICT facilities and networks? What is the average age of computers in the school/college?

28. In TVET/HE what is the ratio of students to PCs? Does the school have facilities for wireless or hard wired networks?
29. In HE/TVET what proportion of costs is devoted to educational software or subscriptions to resources and databases?
30. How much of the budget goes on bank interest charges? What have bank borrowings been used for?

Marketing

31. What is the competitive position against other similar independent schools in proximity, their differences, their student and curriculum profiles, comparative fees charged and any comments on the future competitive position; and waiting lists at comparable schools?
32. What are the demographics of the school-age population in the same city—and details of the socio-economic groups where most of the students come from?
33. Is the balance of demand versus supply in the catchment area favorable?
34. What is the ratio of applications to places available?
35. Are there any possible changes ahead in the education sector (regulation; competition etc.)?
36. What is the marketing strategy? And how does it use alternative media?

Educational issues

37. Is there an internal policy and procedures for monitoring the quality of teaching? Does this involve any external review?
38. Is there any system of feedback from students on their satisfaction with the quality of teaching and support? If there is a system, what messages does it give?
39. What proportion of students drop out during their program and do not complete? What is the trend and how does it compare with peer institutions?
40. What is the retention rate? Are there any policies to improve it?
41. How is teaching staff performance assessed—if at all? Is there any reward for good teaching?
42. How does the school/college ensure that its programs and offerings are providing what its local market and employers want?
43. In HE/TVET is there any mechanism for getting feedback from industry and the community about the relevance of the curriculum?
44. In HE/TVET are there any international partnerships that strengthen the academic content and the ability to deliver what the local market wants?
45. Do international staff visit as lecturers or researchers?
46. Does the college have any data about the employment record of its graduates? For example, what proportion are unemployed one year after leaving?
47. Does the college cater well for part time students? Can they study in the evenings and at weekends?
48. Does the range of courses on offer change as a consequence of feedback from employers or declining demand?

Management

49. Are there any external members on the Board? If so, which interest groups do they represent?
50. How often does the Board meet?

51. In TVET/HE are its responsibilities clearly defined as regards academic matters and the Academic Board (eg: is the Board ultimately responsible)?
52. Apart from reviewing the budget, how does the Board monitor the performance of the school or college? Does it use any Key Performance Indicators? If so, what are they?
53. What drawings or dividends does the proprietor take from the enterprise?
54. Are any members of his/her family working in the business?
55. What proportion of annual surpluses has the proprietor re-invested in the business?
56. Is the performance of the Principal/Vice Chancellor reviewed by the Board?
57. If the client is a large company, does it follow the IFC's guidelines on Corporate Governance?²

² See <http://www.ifc.org/ifcext/corporategovernance.nsf/Content/Approach> for a description of the IFC's approach to Corporate Governance.

Appendix IV

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Contact Information

Health and Education Department

2121 Pennsylvania Avenue, NW

Washington, DC 20433 USA

www.ifc.org



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