SCHOOL'S IN

CapPlus
CapitalPlus Exchange

# The Banker's View On Delivering Profitable Services To Private Schools

The percentage of children enrolled in private schools worldwide is rising in all levels of education, according to UNESCO, and CapPlus advisor James Tooley reports that as many as 70 percent of low-income school-aged children in some developing economies are educated in private schools.

Like all small businesses, these schools need capital to build infrastructure, run their operations, and improve education quality. This paper summarizes CapPlus' conversations with managers at fourteen financial institutions in nine countries, of which twelve are already providing financial services to private schools. The bottom line:

**Schools are a market opportunity larger than first-mover financial institutions have captured.**

## THE BANKERS' VIEW: SCHOOLS MAKE GOOD CUSTOMERS

All but one of the bank managers say that schools are no riskier than the average small business, and some see schools as less risky. Their reasons?

- **Education is a growth sector:** Many countries enjoy rapid growth in both the number of private schools and the percentage of school-aged children enrolled in private institutions. This expansion creates commensurate demand for school finance, likely a long-term trend as population increases drive up demand for education.
- **Demand goes deep:** Families at all income levels send their children to private schools in the belief that they offer a superior education. Even poor parents find a way to pay for private schooling.
- **School finances are stable:** The bankers say their school customers have stable cash flows enabled by the long-term relationships schools have with local families, and by the tuition payment cycle, which often requires families to pay school fees in full at the beginning of each term.
- **Opportunities to cross-sell:** Some financial institutions require schools to keep a deposit account for fee collection. Others cross-sell insurance products to the school, or offer loans to school staff. While not an active product for any of the interviewees, they mentioned the possibility of tuition loans for families.

School lending is not without risk, however. The financial institution managers most frequently mentioned:

- **Inadequate collateral:** Managers universally said it would be difficult to foreclose on a school that failed to meet its debt obligations—the reputational hit would be too high, or the courts would prevent it. School buildings and physical assets like buses likewise could not be seized to defray debt.
- **School cash flow is dependent upon school quality:** Satisfied parents keep their children at the same school for years, but the converse is also true—if kids are failing to meet grade-level standards, parents will take their tuition dollars elsewhere. Thus school quality determines enrollment and cash flow, yet the managers acknowledge that their staff do not have the skills to assess that quality.

To compensate for these risks, financial institutions have modified their practices for schools as follows:

- **They lend only to schools registered with the national government education ministry.** The institutions use registration status as a de facto risk assessment tool, since the registration process involves vetting by education regulators.

- **They lend only to larger, more established schools.** The financial institutions use cash flows to assess schools' capacity to repay. Schools that have been accepting students for three years or more have a longer cash flow history and higher enrollment, since schools often launch with one or two primary grades and then add class years as students progress.
- **They require personal collateral as a condition of finance.** Most managers say their banks will not lend to any small businesses without collateral. Since school buildings or buses are not acceptable, banks rely on other collateral owned by school proprietors.

## EXPANDING FINANCE FOR BETTER SCHOOLS

These interviews and CapPlus' quantitative research demonstrate that there is far greater demand for finance from affordable private schools than financial institutions currently serve. Furthermore, the financial institution managers broadly acknowledge that their institutions serve schools reactively, and do not have school-specific processes or evaluation mechanisms in place.

There is a clear opportunity here. In CapPlus' view, **financial institutions can sustainably serve more low-cost schools and facilitate better quality education with an integrated set of services and in-house tools tailored for the private school segment**. Financial institutions are not pursuing these goals alone. They desire and need partners to help them mitigate the risks they see in serving private schools and to address quality improvements. This could happen by:

### 1. Enabling financial services to the underserved

CapPlus' on-the-ground market research on low-cost private schools in five African cities found **cumulative demand for $1.3 billion** in finance over three years from both registered and unregistered schools. **Unregistered schools represent between 29 percent and 77 percent of the total affordable private school market, depending on the city**. In Abuja, Dar es Salaam, Kampala, and Lusaka, 32 percent of the 530 unregistered schools CapPlus interviewed have been in business more than five years, and many enjoy reputable standing and tacit government support. Yet few financial institutions will serve these unregistered schools. One solution could be deploying an independent system of assessing ("grading") schools over time to monitor risk.

Capital assistance in the form of credit guarantees, patient capital and/or lower-cost capital could allow financial institutions to offset the risks they perceive and lend to more schools serving low-income families. Without such assistance, the bank managers say their institutions are likely to continue lending opportunistically, a practice which limits debt finance to a small percentage of the schools that need it, and in turn limits children's access to education.

### 2. Providing services tailored for low-cost schools

Many financial institutions do not lend to SMEs of any kind that don't have collateral, credit histories or financial statements. Those that are lending to affordable schools have figured out that cash flow-based lending works best. They determine a school's credit worthiness based on cash flows and offer generic SME products to school clients. Schools' needs can sometimes be quite different however, presenting opportunities for financial institutions to offer a school-specific portfolio of products such as daily digital collection of school fees, longer-term loans for building improvements, or repayment schedules that reflect tuition payment schedules.

The interviewees acknowledge that their staff members don't have sufficient knowledge about school operations to propose credit structures or product designs optimized for schools or their clientele, however. Nor do they have the internal metrics to assess the profitability of the entire school-institution relationship.

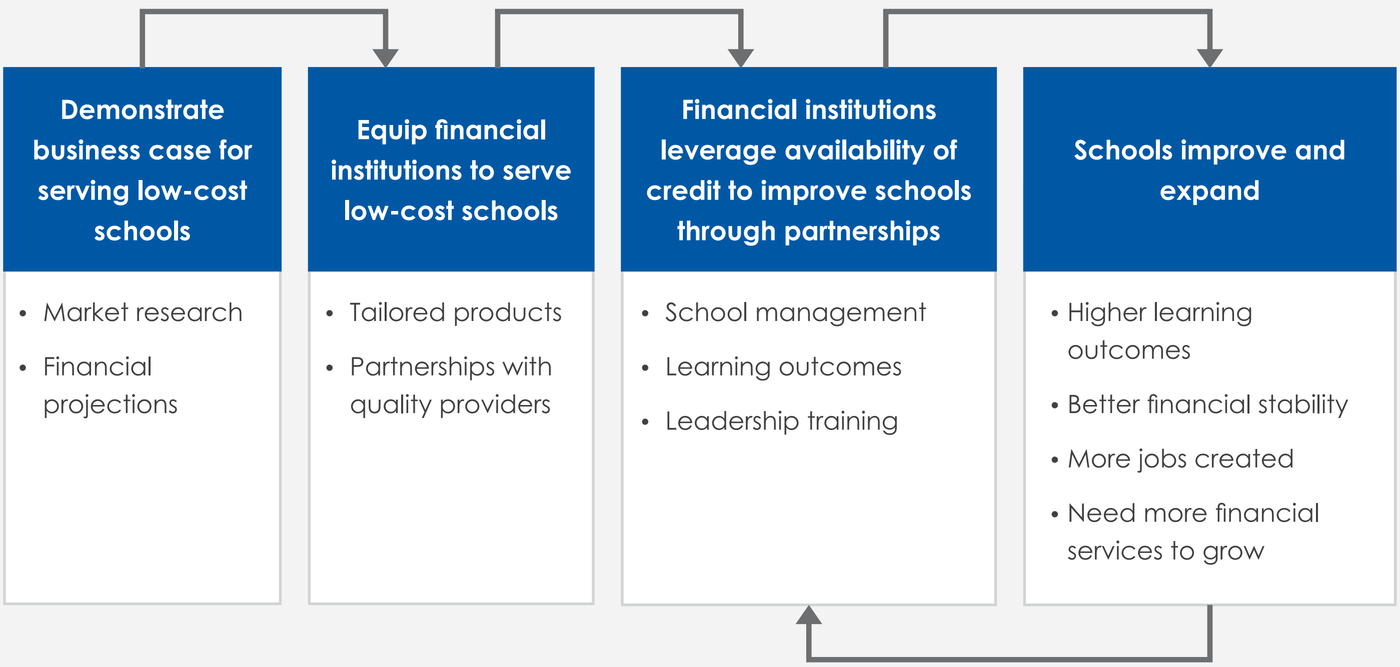
### 3. Leveraging access to credit to improve education quality and business practices

Many schools suffer from poor fiscal and managerial discipline, or difficulty collecting fees. Ensuring the stability of a school's finances and consistency in attendance (households' financial vulnerability often causes drop-outs) is a precondition for education quality.

Financial institutions can leverage their credit commitments to promote improvements in school management and learning outcomes. Delivering such education-focused enhancements is clearly outside the traditional scope of financial institutions, but the interviewed bank managers believe their institutions could benefit from establishing partnerships with organizations that have expertise in these areas.

Technical assistance partners can improve schools' sustainability, allowing proprietors to focus more on educational outcomes rather than worrying about operational challenges, such as covering the cost of student lunches. Likewise, leadership training, teacher education or curriculum enhancement can allow a school to improve learning outcomes, which in turn stabilizes enrollment. Such improvements reduce the financial institutions' risk while providing significant social benefits.

**Expanding Access to Quality Education Through Financial Services**



## CONCLUSIONS

Growing demand for quality education has unleashed expansive demand for school finance. Some financial institutions already meet some of that demand, but only a small part and only through generic products and approaches.

CapPlus sees a different way. Financial institutions can serve low-cost schools and contribute to education improvements on a long-term sustainable basis if they receive the capital and consulting support needed to address low-cost schools as a coherent market. Such support will entail partnerships with organizations in the fields of education, development finance, and small business training.

One interviewee told a story that provides a useful analogy. Years ago, financial institutions in his country would not lend to agricultural businesses because the institutions viewed agricultural cash flows as too unpredictable given the vulnerability to weather. Government-sponsored risk mitigation changed that. Temporarily, financial institutions lending to agricultural producers received a credit guarantee. That nudge allowed the financiers to experiment and learn about a previously unknown client base. Today, agricultural lending is considered a common element in that country's bank portfolios.

Similar investments in private school finance would help the schoolchildren of today, catalyze organic growth for the financial sector, and support quality schools that are educating engaged students—the citizens, entrepreneurs, and financiers of the future.

To learn more about partnering with CapPlus, contact Lynn Pikholz at lynn@capplus.org.

### Tailored Strategies Required

Although commonalities exist, the context for lending to private schools is inherently local, such as:

- Whether the government – especially the education regulators – perceives private schools as complementary to or competing with public schools
- The baseline quality and access provided by national and state public school systems
- School registration requirements and teacher qualification standards, and how consistently they are enforced
- Financial system regulations, especially collateral requirements
- Legal and court systems, including laws governing land ownership and rulings relating to seizing school properties
- School cash flows – the interviewed bankers all believe that schools have reliable cash flows, but CapPlus interviews with schools in five African cities reveal that many schools see the collection of outstanding school fees as a challenge