Banking ON Education

The Demand for Finance from Low-Cost Private Schools

Private schools in five sub-Saharan African cities educate approximately 1.8 million low-income school children, including 84% of Kampala's children and 60% of Nairobi's. They want to borrow $1.3 billion over the next three years. They also conduct most of their transactions in cash, representing an additional $1.5 billion opportunity for financial services providers over three years.

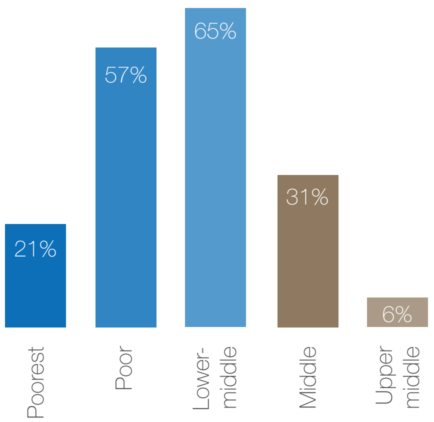
These are top-line findings from CapitalPlus Exchange's market research conducted in 2016 with 998 low-cost private schools in Abuja, Dar es Salaam, Kampala, Lusaka, and Nairobi. In four of the five cities, private schools educate more than 40% of enrolled students.

The low-cost private school market is growing, profitable, and serving the poor

In all five cities, private schools represent a growing small business sector, with annual increases of between 6% and 20% in the number of schools. Almost 30% of low-cost private schools have been in business for more than ten years, and 51% have been in business for more than five years. Most are sole proprietorships, and between 40% and 52% of the proprietors are women. Only 15% are part of a chain, most of which have two or three schools.

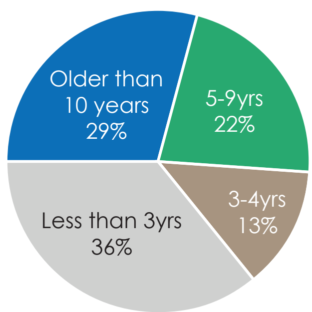
The data indicate that most low-cost private schools are profitable. In four out of five cities, the average school is profitable even if parents

PRIVATE SCHOOLS SERVE LOW-INCOME STUDENTS



NOTE: Data from Dar es Salaam, Kampala, and Lusaka

51% OF SCHOOLS HAVE BEEN IN BUSINESS 5 YEARS OR LONGER



QUALITY AND CREDIT

Education quality for children is key to schools' success, since better schools attract more students. However, most low-cost private schools are at the growth stage where they are focusing on business fundamentals, such as increasing enrollment. Credit is often a pre-condition for achieving better learning outcomes: it accelerates schools' ability to meet their basic needs, after which they can focus on improving literacy and numeracy in students. CapPlus is also testing ways to structure credit as an incentive for delivering better learning outcomes.

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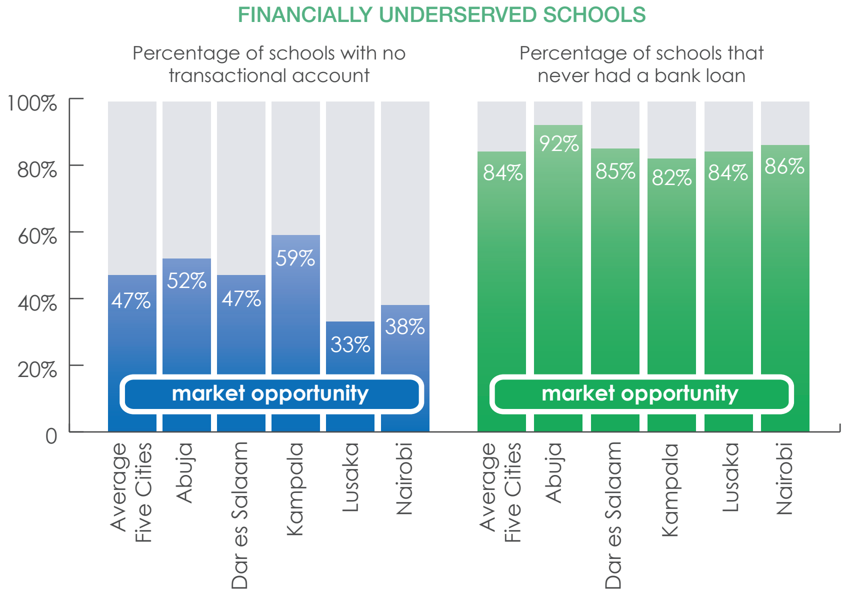
make only 70% of promised tuition payments. When we estimate actual school cash flows, we find that 69% to 93% of schools are profitable, depending on the city.

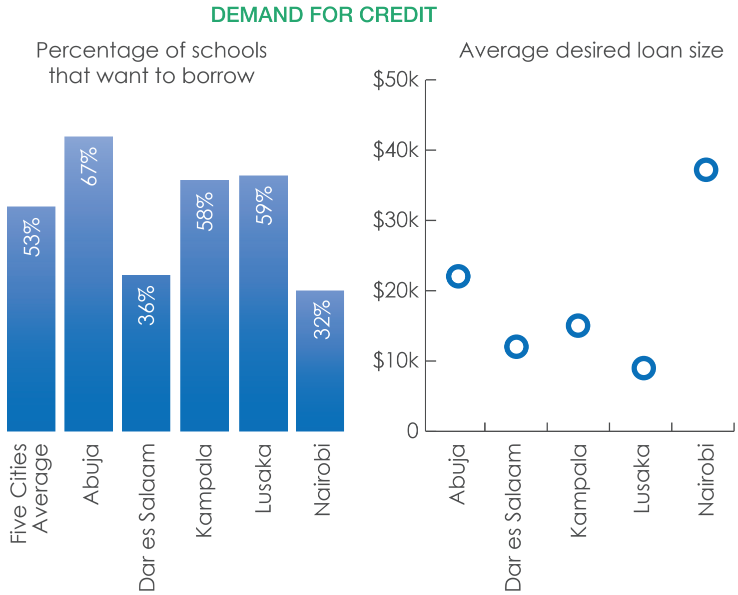
These private schools serve poor and lower income families even though public education is often free. Parents believe private schools provide a higher-quality education, according to research conducted by CapPlus advisor James Tooley and confirmed by our findings.

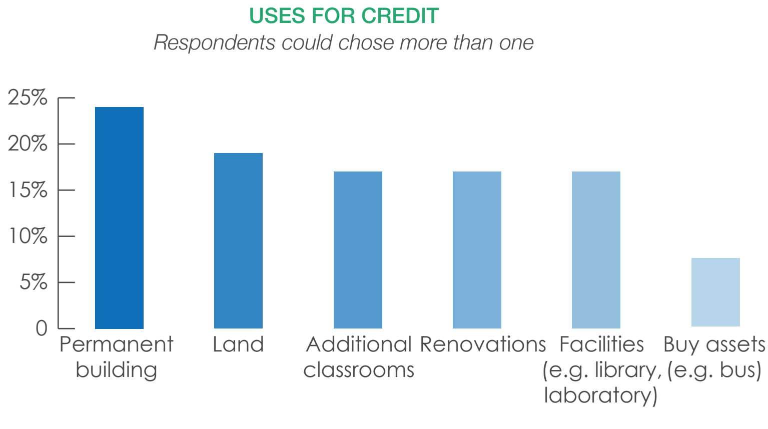
Low cost private schools are financially underserved, but want to borrow

Fifty-three percent of schools in the sample have a dedicated bank account, and only 16% have ever had a loan from a financial institution.

School proprietors say a lack of credit is one of their biggest challenges and many want to borrow to expand their businesses. Credit is critical for growth because tuition and fees are the sole source of cash for 90% or more of these schools, and proprietors say many parents pay in increments over the year. The resulting ups and downs in cash flow make it hard to amass the lump sums necessary to pay for school improvements or to meet government registration requirements.





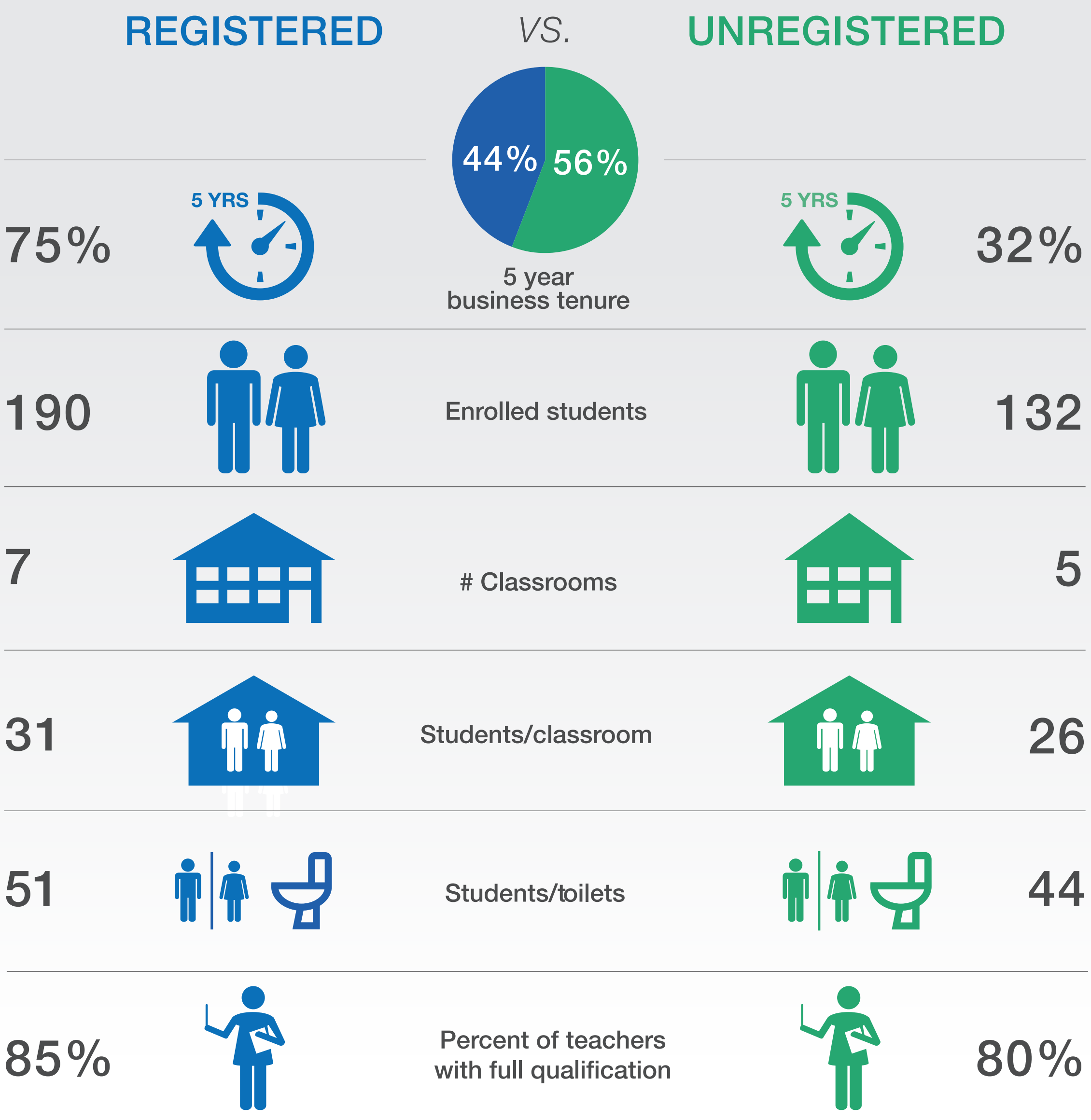


Most prospective borrowers want credit so they can build a permanent structure, expand or improve existing school buildings, or buy land. Over half of those wanting to borrow to buy land are in Abuja.

Registered schools are an immediate opportunity for financial institutions

Schools registered with the national education ministry in each of the five cities had higher average enrollment, which directly links to profitability. Higher enrollment levels may be related to the fact that registered schools tend to be older: 75% have been in business for five years or more, in contrast to 32% of unregistered schools.

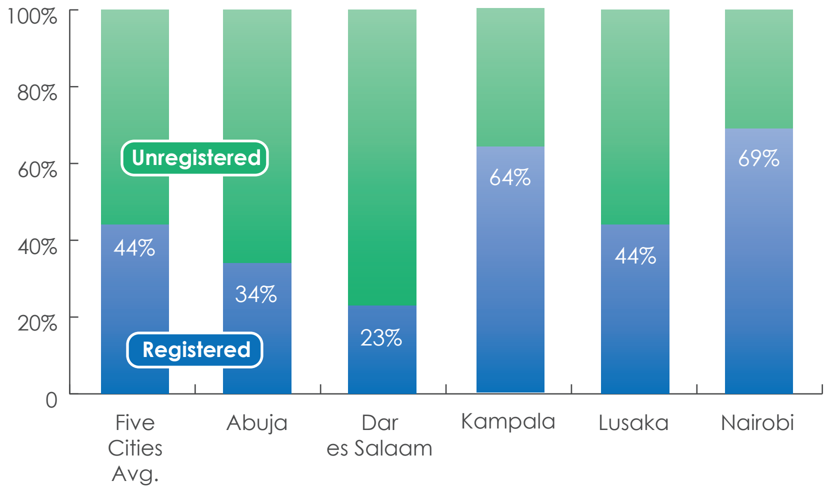
Registered schools have more students per classroom, and the teachers are more likely to be fully qualified. Likewise, registered schools are more likely to employ traditional accounting methods, have a bank account, and maintain separate accounts for business and personal use.



NOTE: This image uses averages or medians for each category. Numbers vary by city. Numbers for the age of schools, classrooms, toilets, and number of students do not include Nairobi.

Unregistered schools are profitable and there are more of them

POPULATION OF REGISTERED VS. UNREGISTERED SCHOOLS



Registration status is an imprecise measure of business stability. Though 56% of schools in our sample are unregistered, the majority are profitable, 32% have been in business for more than five years and 64% for at least three years. Unregistered schools play a long-term and substantial role in educating children, but are even more financially underserved than registered schools. They have a similar desire to borrow and invest in their businesses as their registered peers. A financial institution meeting their needs would benefit from significant customer loyalty.

The fast-growing local private school market creates an opportunity for banks

This research illuminates a growing, competitive segment of established and profitable schools eager to increase the number of students they educate. On the demand side, parents at all socioeconomic levels are not only willing to pay for school, but also move their children to the best school they can afford. Population growth on the African continent indicates increased demand for affordable, quality schools.

To stay competitive, schools need to invest in providing higher-quality service to their communities. Those investments require finance—fee income is not enough. Given that, we provide the following conclusions:

- *Schools grow proportionate to their physical infrastructure*

In all five cities, our data reveal a profitability threshold for low-cost schools at around 50 students. Schools with fewer than 50 students struggle to meet expenses; above that, profitability increases as enrollment grows. Simply put, higher enrollment brings higher profit and greater ability to borrow.

Higher enrollment requires space, however. Proprietors with growth ambitions emphasize land and physical facilities as their top priority for finance. Expanding facilities can also improve quality by allowing teachers to separate kids by learning level or otherwise create a more conducive learning environment.

Financial institutions can meet this need by designing products and structuring repayment schedules to match schools' cash flow patterns. For example, schools need longer-term loans at affordable interest rates to finance construction or renovation, perhaps with a delayed start for principle repayment given that facilities need to be finished before schools can fill them with fee-paying students.

■ *Schools that focus on quality will stay competitive*

Individual schools experience ups and down in enrollment, and school proprietors report high competition as one of their main challenges. Together, these facts indicate that parents are demanding clients. They can see when a school has improved classrooms and equipment, and they hear from other parents when students excel or fail interim exams; they will move their kids if they think their school isn't doing a good job.

Sufficient physical infrastructure may be a first step to attracting students, but keeping them demands quality education. Schools must invest in leadership and teacher training, as well as in new curriculum, in resources, and in teaching methods that inspire children and meet global standards for academic achievement. Financial institutions can encourage such quality investments as a way of managing their credit, regulatory, and reputational risk.

■ *Strong business management helps grow profit margins*

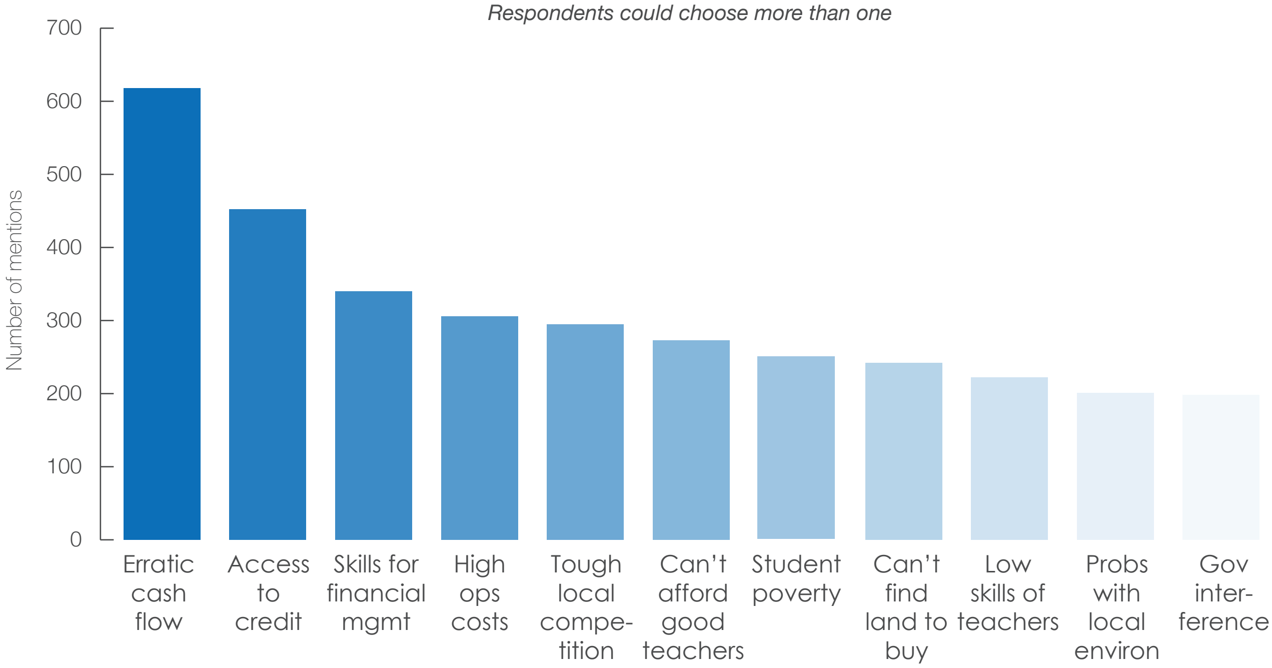
The most common challenges reported by school proprietors are erratic cash flow, access to credit, and financial management, with cash flow and access to credit also ranked as most severe. Financial institutions can help school customers with these issues and thereby reduce their credit risk.

For instance, financial institutions can bundle deposit accounts with loan products. Doing so will increase financial access for private schools and provide greater security for their earnings, allowing them to focus more on quality. Financial institutions can also calculate loan size based on actual fee collection rates to prevent school over-indebtedness.

For improved cash flow and financial management, financial institutions can partner with third parties to give school customers access to nonfinancial services. Business workshops can provide private school customers with training in financial management, and lenders can require attendance as a condition for credit. CapPlus partner IDP Foundation successfully provided such services in its Rising

CHALLENGES SCHOOLS SAY THEY FACE

Respondents could choose more than one



Schools Program pilot launched with Sinapi Aba Savings and Loan in Ghana. Financial institutions can also partner with fintech providers offering cloud-based accounting systems for schools and other small businesses, or they can offer their own technology solutions such as credit-scoring tools, mobile fee payments, or daily school fee collection services.

Solutions like these address proprietors' key constraints and can be marketed as such. They also give lenders more insight into the cash flow status of their clients. Over time, institutions can adjust product design and repayment plans based on their experience. These investments will pay off especially given that many of the proprietors are women, and research shows that women-owned businesses make particularly loyal customers, creating long-term cross-selling potential.

Financial institutions have willing partners

FINANCIAL SERVICE PROVIDERS have an opportunity to serve a growing small business sector while making quality education accessible to more children, but they don't have to do it alone. Other organizations are already active, including CapPlus, local education quality providers, international NGOs, fintech firms, and education technology companies.

Access to finance is key. Local financial institutions, as permanent self-sustaining entities with large distribution networks, are ideal intermediaries to reach thousands of privately-owned schools. By providing the capital schools need to grow, financial institutions can create inflection points, incenting schools to improve learning outcomes and connecting them with the resources to do so.

We know with certainty that financial institutions need patient, affordable capital and technical assistance to move into this nascent market. Therefore, the most powerful and sustainable solutions will combine patient capital with capacity building in both schools and financial institutions.

IMPACT INVESTORS AND VENTURE PHILANTHROPISTS can play a pivotal role given education's importance in overcoming poverty, improving health, and creating opportunities for successive generations. Long-term investors that value impact over market-rate returns can provide patient capital. They can test new approaches, be it public-private partnerships, ed-tech solutions or strengthening the ecosystem so local school entrepreneurs can grow their own school chains to provide quality education to the poor.

With low-cost schools educating 40-80% of primary school children in African cities, their importance is simply too large to ignore if we are serious about meeting the United Nation's sustainable development goals. With the right combination of credit and technical assistance, low-cost private schools can be key partners in expanding the availability of quality education to girls and boys across the continent, including the 34 million children currently not in school, preparing a competitive workforce for Africa's future.

For more information, please contact CapPlus CEO Lynn Pikholz at **lynn@capplus.org**
or Peter Hinton, Co-Lead Affordable Education Finance at **peter@capplus.org**.

Visit our website at **www.capplus.org**

METHODOLOGY

In 2016, under the leadership of Dr. Joanna Härmä and Peter Hinton, CapPlus researchers in Nairobi, Kenya; Abuja, Nigeria; Dar es Salaam, Tanzania; Kampala, Uganda; and Lusaka, Zambia visited low-income communities. They conducted a census to identify all the private schools in the selected neighborhoods and identified 1,893. In each city they randomly selected schools to survey. Overall, our researchers surveyed 998 low-cost private schools. The sample size exceeded 200 schools in four cities, with 96 in the fifth.

School proprietors answered the survey questions in person. Surveyors likewise documented observable school characteristics such as facility size and quality, and the number and availability of toilets, libraries, laboratories, and computers. Researchers supplemented these surveys with qualitative interviews with representatives of education ministries and leaders of local private school associations. Profitability estimates include the assumption that schools in existence for three years or more are covering their costs, hence are profitable. Results from each of the five cities can be found in our supplementary city documents.

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CapPlus equips financial institutions in emerging economies to deliver finance profitably for social impact. By providing strategic and operational capacity building that increases financial services to small businesses, CapPlus creates sustainable solutions that accelerate job creation, societal benefit and equity.