THE INDIA EDUFINANCE SUCCESS STORY

LESSONS FOR OTHER EMERGING NATIONS



VERSION 1.0

PREFACE

The critical role being played by affordable non-state learning providers (ALPs) in emerging countries has been well documented. These entities have brought entrepreneurship and non-state capital to the education sector, thereby creating choice and hope for hundreds of millions of families belonging to the lower- and lower-middle-income strata. Providing credit facilities to ALPs is an exciting opportunity to create a significant impact while generating sustainable financial returns. In this context, the Indian non-banking financial companies have many valuable lessons to offer due to their head start. This report is an attempt to capture and share the key ones.

It would not have been possible to prepare this report without the contributions from Varthana, ISFC, Michael and Susan Dell Foundation and Gray Matters India. We sincerely thank them for their support.

In the context of the ongoing Covid-19 pandemic, it is worth highlighting that the affordable non-state sector has been one of the worst affected sectors in education. The livelihood of the customers of ALPs faces unprecedented perils and this has understandably led them to not paying fees on time. Very few ALPs will be able to absorb this financial shock and a vast majority of them will find it untenable to continue paying salaries to their teachers. As many as 75-80 percent ALPs have availed the moratorium on loan repayment provided by lenders to all their borrowers as part of the relief package designed by the Reserve Bank of India. The need to support the ALPs financially, through suitable credit facilities, for example, is now more dire than ever before. It is of paramount importance that the affordable non-state sector is salvaged so that it continues to work in tandem with the state for the achievement of United Nation's Sustainable Development Goal 4 (SDG-4) - "ensure inclusive and equitable quality education and promote lifelong learning opportunities for all."

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EDUCATION: THE MOST EFFECTIVE YET UNDER-UTILIZED CHANGE LEVER



1

The critical role of education as an enabler of sustainable and holistic development of individuals and societies is widely acknowledged.

According to the UN SDG charter, "Obtaining a quality education is the foundation to creating sustainable development. Education is the key that will allow many other Sustainable Development Goals (SDGs) to be achieved."

There is also a near-unanimous acceptance of the fact that without the support of private, or non-state, resources it would not be possible to address, what the World Bank has recently labeled as, the global learning poverty. Currently, 53 percent of children in low- and middle-income countries cannot read or understand a simple story by the end of primary school. In poor countries, the level is as high as 80 percent. Progress in reducing learning poverty is far too slow to meet global SDG aspirations.

At the current rate of improvement, it is estimated that by 2030 about 43 percent of children will still be learning-poor. Even if countries reduce their learning poverty at the fastest rates that we have seen so far in this century, the goal of ending it will not be attained by 2030[1].

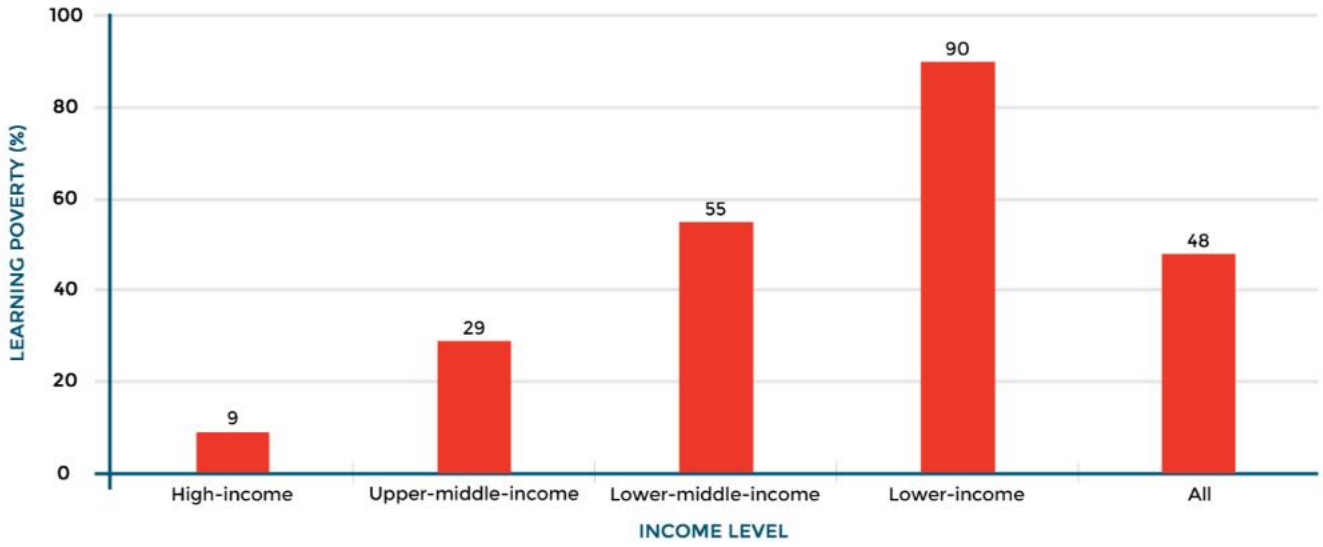


Figure 1: Global Learning Poverty by Country income level

There is an annual financing gap of US$39 billion over 2015-2030 for reaching universal pre-primary, primary and secondary education of good quality in low and lower-middle-income countries[2].

1 World Bank. 2019. Ending Learning Poverty: What Will It Take?. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/32553 License: CC BY 3.0 IGO.
2 UNESCO. 2015. Education for All Global Monitoring Report. Policy Paper 18. https://unesdoc.unesco.org/ark:/48223/pf0000232197/PDF/232197eng.pdf.multi

AFFORDABLE NON-STATE EDUCATION: GLOBAL, GROWING & IMPACTFUL



2

In an ideal world, all education should be high-quality, free and accessible to all. Significant public resource constraints, however, will not allow this goal to be realized in the foreseeable future. Even where governments have succeeded in making free primary education accessible, high-quality education remains a distant dream.

Generations of students will be deprived of growth opportunities if the world were to wait for the provision of free and high-quality education through public systems. On the other hand, macroeconomic factors are leading to ever-growing demand for good quality education amongst families across all income strata and geographies.

Over the past few decades, a silver lining in the form of affordable non-state education has emerged and holds the promise to make a significant positive difference to the education of hundreds of millions of underserved students around the world. It is powered by the entrepreneurial zeal and education passion of hundreds of thousands of small and medium-sized entrepreneurs, hereinafter referred to as **"Affordable Learning Providers (ALPs)"**, who have committed their wealth and boundless energy to create affordable learning opportunities for students across the entire socioeconomic pyramid.

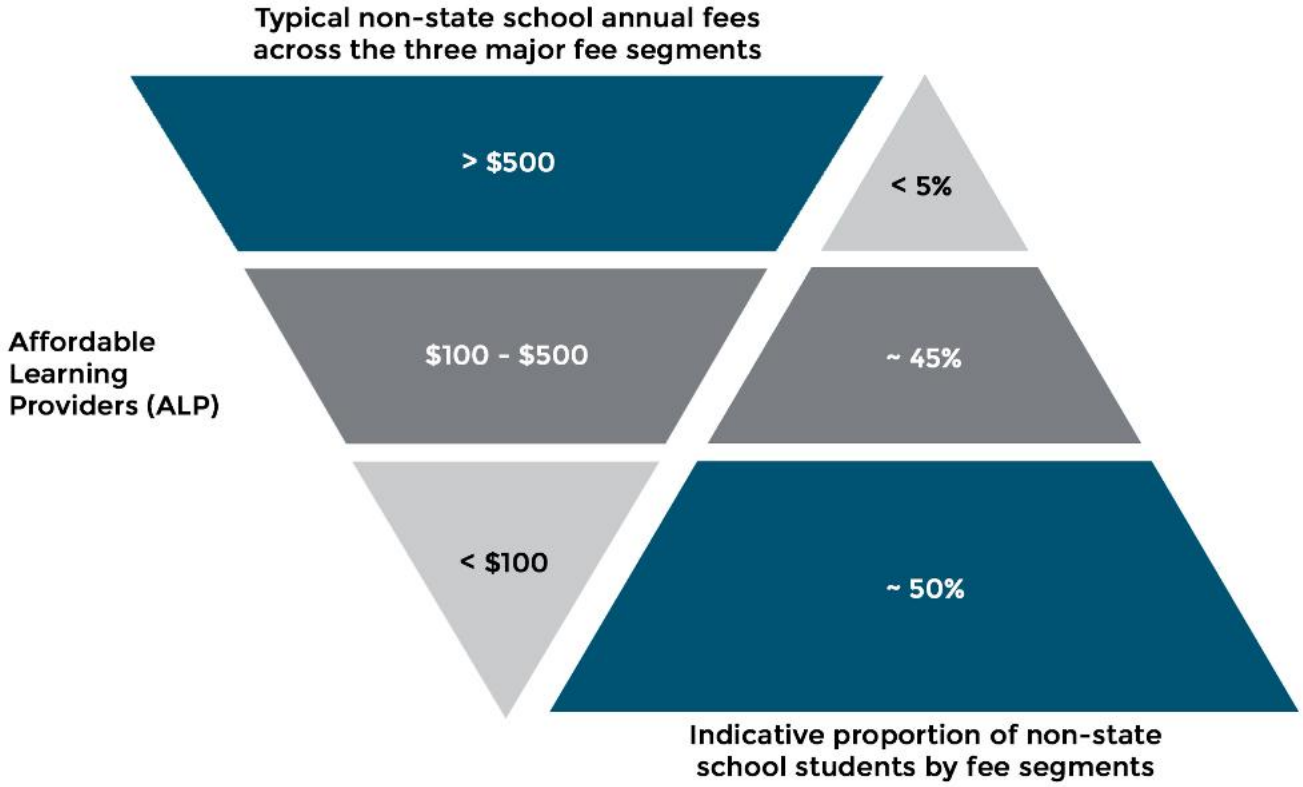


Figure 2: indicative student distribution across the Affordable Learning Provider (ALP) fee segments[3]

3 IZA Institute of Labour Economics. 2017. The Private Schooling Phenomenon in India: A Review. http://ftp.iza.org/dp10612.pdf | Kaizenvest analysis

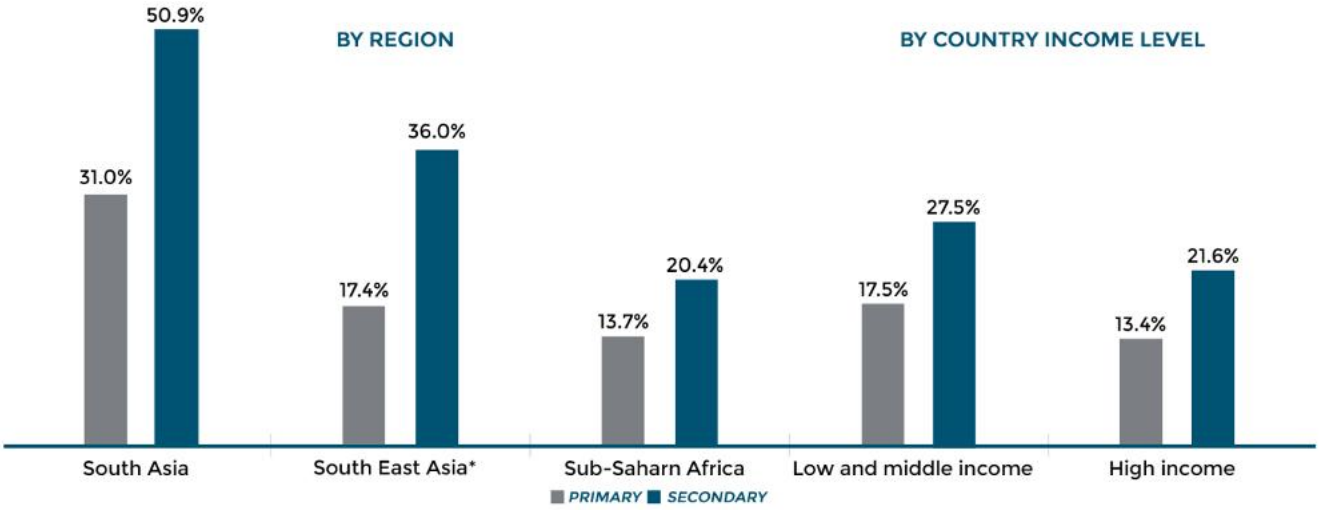
Parents, particularly in emerging nations, are increasingly choosing ALPs over state provided free education due to the following reasons:

Despite lower salaries compared to their peers in public institutions, teachers in non-state institutions seem more committed and hardworking.

Parents from the lower socioeconomic strata feel that they have relatively more social equity and are therefore more comfortable in dealing with non-state institutions.

The use of English as the medium of instruction by non-state institutions increases the future employment prospects of students.

Education is regarded as the most probable path to prosperity for their children by parents in developing countries. As ALPs become more affordable, there is a growing number of parents willing to spend on their children's education, **with some families spending as much as 10-15 percent of their household income** even when public education is available for free. An indicator of the prominence that affordable non-state learning has gained is that roughly a fourth of all primary school students in low- and middle-income countries already attend non-state schools. This translates to approximately 300 million students attending one of the 1.5 million non-state schools, the vast majority of which are affordable.



(Note: * Indonesia and Philippines have been used as a proxy for South East Asia)

Figure 3: Non-state school enrolment as a percentage of total enrolment[4]

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Going forward, it is estimated that non-state education will continue to grow with **an additional 48 million children** enrolling in non-state schools by 2023[5].

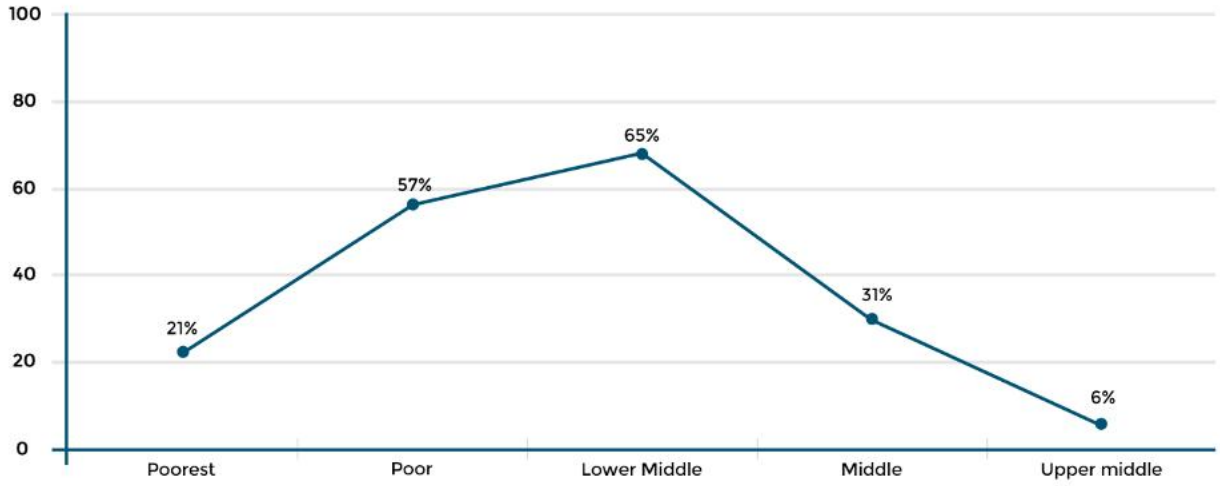


Figure 4: Indicative ALP students' distribution across family economic status

ALPs are highly impactful in improving education for the underprivileged. A study in Africa found that 78 percent of ALP students are from the poorest or poor families. Another salient aspect of ALPs is that they promote gender inclusion.

More than 40 percent ALPs are **owned and run by women** entrepreneurs, majority of the teachers are women and half of the students are girls[6].

5 Opportunity International. 2018. The $24 billion opportunity: A case for increasing private school's access to finance in low- and middle-income countries. https://edufinance.org/latest/publications/research-and-learning/the-24-billion-opportunity/

6 emii.capplus.org

THE ALP CONUNDRUM: BANKABLE YET CREDIT-CONSTRAINED



Most of the ALPs are profitable despite operating at low fee levels. A study of the Indian ALPs found that several can generate upwards of 30 percent profit margin even when operating at less than $15 per month fee.

REVENUES		COSTS	
ALL NUMBERS IN INR UNLESS OTHERWISE STATED		*ALL NUMBERS IN INR UNLESS OTHERWISE STATED*	
AVERAGE FEE PER CHILD PER MONTH	860	TEACHER SALARY PER MONTH	126,000
NUMBER OF CHILDREN IN SCHOOL	390	*(18 TEACHERS X 7,000 AVERAGE SALARY)*	
GROSS MONTHLY FEE REVENUE	335,400	STAFF SALARY PER MONTH	42,500
LOSS DUE TO FEE DELINQUENCY PER MONTH	(16,770)	NUMBER OF STAFF	12
(5% DELINQUENCY RATE)		AVERAGE SALARY PER STAFF MEMBER	3,542
NET MONTHLY FEE REVENUE	318,630	POWER AND UTILITY COSTS	20,000
NET ANNUAL FEE REVENUE	3,823,560	COST OF LEARNING AIDS	10,000
TOTAL COMMISSIONS FROM BOOKS & UNIFORMS	307,125	COST OF MAINTENANCE	10,000
AVERAGE ANNUAL COST OF BOOKS PER CHILD	1500	EXPENSES ON MARKETING	10,000
AVERAGE ANNUAL COST OF UNIFORMS PER CHILD	750	SUNDRY COSTS	10,000
MARGIN OFFERED TO OWNER	35%	TOTAL MONTHLY COSTS	228,500
NET ANNUAL REVENUES	4,130,685	NET ANNUAL COSTS	2,742,000
NET ANNUAL REVENUES (USD)	63,549	NET ANNUAL COSTS (USD)	42,185
NET ANNUAL PROFIT INR 1,388,685 (USD 21,364)			

Figure 5: Illustrative Income Statement of an ALP[7]

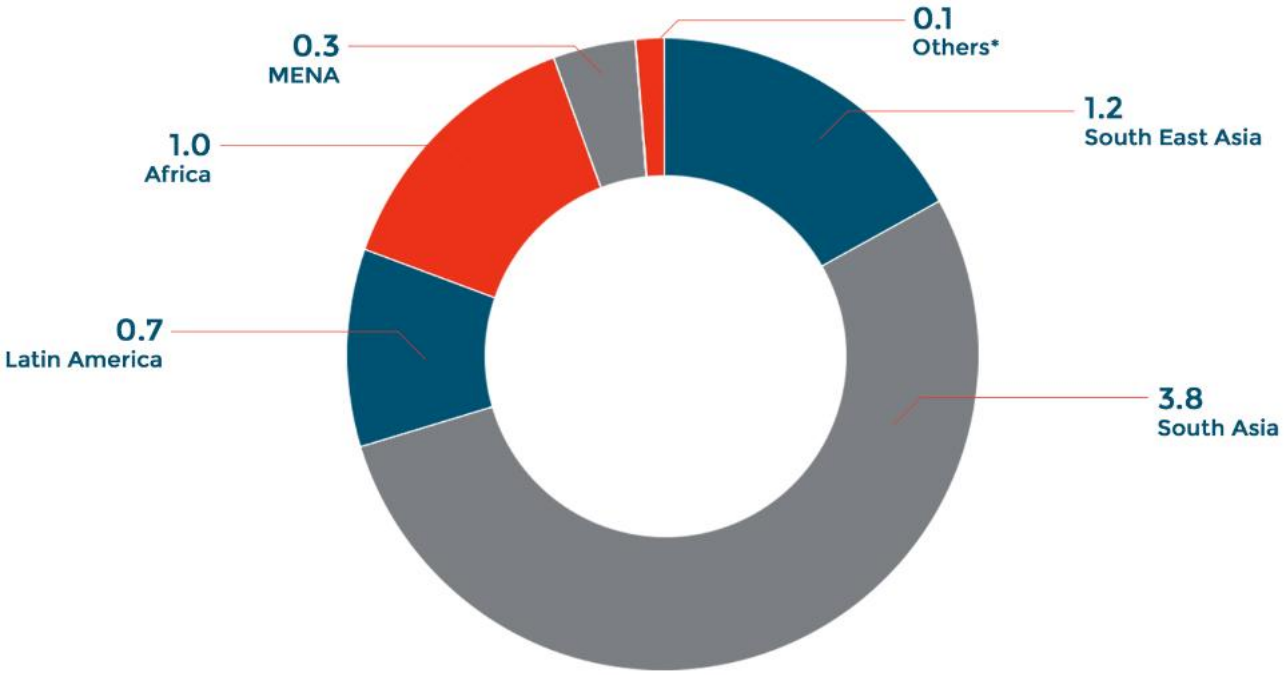
Another study of 988 ALPs across five Sub-Saharan African cities found that 69 to 93 percent of them, depending upon the city, were profitable[8]. DFID's five-year "Developing Effective Private Education Nigeria" program established that ALPs are a viable and potentially bankable segment[9]. Once their operations stabilize, ALPs, as other education institutions, have predictable cashflows and are therefore able to service loans.

Despite the above, ALPs are credit-constrained due to factors of both demand and supply. Most of the ALPs are established by educators turned edupreneurs who have a limited amount of starting capital. They rely on support from friends and family and, in some cases, borrowing from local moneylenders who charge exorbitant interest rates. Most ALPs usually begin their operations in rented premises to minimize the upfront investment and only consider investing in owned facilities once enrollments have reached a breakeven threshold. Further, banks and other SME lenders are usually wary of lending without collaterals. Even when ALPs have collaterals to offer, which are usually in the form of their land and building, financial institutions are hesitant to accept them

7 FSG. 2017. Understanding the Affordable Private School Market in India. https://www.fsg.org/sites/default/files/Understanding%20the%20Affordable%20Private%20School%20Market%20in%20India.pdf
8 CapitalPlus Exchange. 2017. Banking on Education. http://capplus.org/files/2017/04/CapPlus_BankingonEducation_5Cities_final-05.01.pdf
9 DFID. 2019. Project Completion Review – Developing Effective Private Education Nigeria (DEEPEN) Programme. https://devtracker.dfid.gov.uk/projects/GB-1-202678/documents

due to the reputational risk and possible community backlash associated with seizure, and resultant closure, of school facilities. In several countries, regulations mandate that ALPs set themselves up as not-for-profit, a structure that financial institutions usually do not have the domain expertise to deal with.

The gap between the amount of credit required by the ALPs and what is currently available to them has created a multi-billion global financial inclusion opportunity. One study estimates the size of this opportunity to be around $7 billion.



* Others includes Europe, Central Asia and Pacific countries
Figure 6: Global EduFinance Market Size ($ billion) [10]

While **South and South East Asia** are the largest markets For EduFinance, **Africa** is the fastest growing.

10 Opportunity International. 2018. The $24 billion opportunity: A case for increasing private school's access to finance in low- and middle-income countries. https://edufinance.org/latest/publications/research-and-learning/the-24-billion-opportunity/

THE INDIA EDUFINANCE SUCCESS STORY



4

At 620 million, India has the world's largest population under 25 years of age, and the highest number of individuals enrolled in an education institution. Just within the K-12 bracket, there are nearly 260 million students, of which approximately 43 percent attend non-state schools, the highest number for any country. The country has nearly 1.5 million schools, 25 percent of which are non-state. A majority of these schools' fees are lower than the per-pupil expenditure in government schools.[11] Between the 2010-11 and 2015-16 school years, student enrolment in government schools across 20 Indian states fell by 13 million, while non-state schools acquired 17.5 million new students.[12] While there is no conclusive evidence to suggest that learning outcomes at non-state schools are better than those at government schools, teacher presence, activity, and adoption of approaches linked to better learning outcomes tend to be higher in the former..

The challenges faced by non-state ALPs in India for securing credit are not very different from their counterparts in other developing countries. However, the situation has dramatically improved since the establishment of the first ALP-focused NBFC (ANBFC), Indian School Finance Company (ISFC), in 2008.

ISFC was incorporated in 1994, as a public limited company, under the name Corporate Deposits Investments Limited. Drawing inspiration from a study by James Tooley and Pauline Dixon on low-fee private schools in Hyderabad, Gray Ghost Ventures (GGV) acquired the NBFC in 2008, committed an equity infusion of $5MM, and started focusing on lending to the ALP segment. It took the company a few years to stabilize its leadership team, product offering and processes. But eventually, things started to fall in place. What started as an excel-based template for credit-rating the ALPs has eventually morphed into a full-fledged and home-grown IT system that tracks the entire customer lifecycle from origination to closure. This system is still in use at ISFC and has become valuable IP of the company. Banks were unwilling to lend to ISFC in the early days. IFMR Trust (now Northern Arc) was the first to give a loan to the company and soon others followed. Expansion to other Indian cities was undertaken to expand sales. The company now operates in 15 out of the 29 Indian states and provides loans to affordable schools, colleges, coaching centers, vocational colleges and playschools. It also

11 Centre for Civil Society. 2018. Faces of Budget Private Schools in India. https://ccs.in/sites/default/files/research/bps-report-2018.pdf

12 IZA Institute of Labour Economics. 2017. The Private Schooling Phenomenon in India: A Review. http://ftp.iza.org/dp10612.pdf

provides loans to teachers and students, as well as SMEs that work with ALPs as suppliers.

After ISFC, Thirumeni Finance Private Limited, which operates under the name **"Varthana"**, was set up in 2013 and became India's second ALP-focused EduFinance provider. **Varthana focuses primarily on ALP loans and has recently started providing loans to students for higher education.** Varthana was able to successfully raise equity as well as debt capital from globally renowned investors and rapidly grew to become the largest ALP-focused EduFinance company in India, and likely globally.

India's third ALP-focused EduFinance provider, Shiksha Financial Services India Pvt. Ltd. (Shiksha), was set up in 2014 and currently operates in 5 states, primarily in South India. The company also provides loans to middle and lower-income families so that they can finance the school fees of their children.

ISFC, Varthana and Shiksha have grown rapidly. Collectively, they provide EduFinance to over 10,000 ALPs in India and have a loan book of over $200 million.

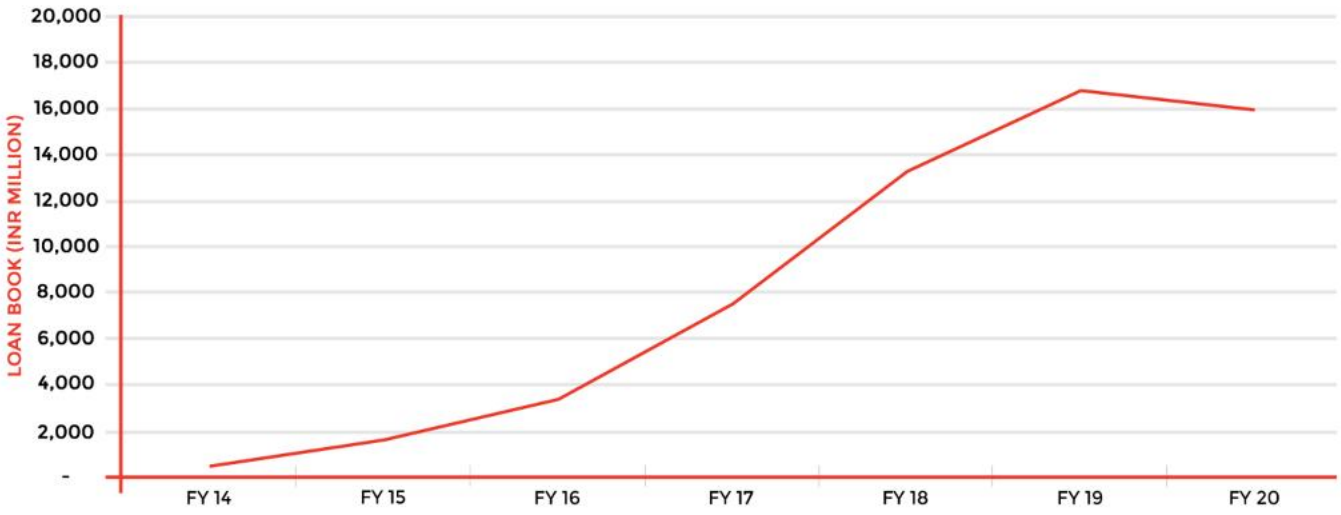


Figure 7: Loan Book Growth of India's Top 3 ANBFCs[13]

Between the period FY14 to FY19, the collective loan book of India's top 3 ANBFCs grew at an astounding CAGR of more than 80%. Like the NBFC sector at large, ANBFCs also faced a slowdown in FY20 as a result of the unexpected and sudden downfall of one of India's leading NBFC in September 2018.

These ANBFCs have demonstrated that it is possible to grow rapidly and profitably, while maintaining impressive operational and financial KPIs.

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Globally renowned investors have invested in these entities through equity and debt. An indicator of the ANBFCs' maturity is the fact that they now have a well-diversified debt portfolio comprising loans from local banks, wholesale non-banking financial intermediaries and even offshore lenders. Despite the broad-based credit slowdown in India since September 2018, ANBFCs have successfully continued to raise debt capital, albeit at a slower pace than the previous years, while maintaining a healthy capital adequacy ratio in most cases. Their rapid growth and moderate credit costs have prompted banks as well as diversified NBFCs in India to also focus on the ALP segment. This increased competition is benefitting the ALPs who now have multiple cost-effective providers of credit, each trying to outdo the other.

Tremendous progress has been achieved over the past decade and many lessons have been learnt. The most important one is that it takes ALP-focused financial intermediaries for the ALP credit asset class to blossom. Key functions of a financial intermediary, such as deal sourcing, credit policy, credit assessment and collections, must be tailored for it to effectively address the ALP segment. Lessons learnt in India are very useful for other developing countries since the underlying dynamics related to the ALP sector are similar.

India is the most advanced market in the world when it comes to credit availability for the **ALPs.**

LESSONS LEARNT



The practices that have worked for ANBFCs in India, and are worth emulating outside India, span across the entire customer lifecycle. The key learnings are summarized below and grouped under different stages of the ALP's EduFinance journey. The list is not exhaustive, and the applicability of the practices listed is contextual. There is no doubt though that it is a good starting point for any financial intermediary interested in establishing a successful presence in the EduFinance sector.

5.1 Deal Sourcing

A large majority of the ALPs are stand-alone and fragmented. As a result, it is difficult to reach out to them. Most edupreneurs are unlikely to proactively reach out to financial intermediaries for credit due to the perceived, and at times past experienced, difficulty of dealing with one.

In the early days, the prevalent channels for selling financial products did not exhibit much interest in ALP financing due to low ticket size and long sales cycle. Due to that and considering the importance of maintaining a long-term direct relationship with the ALPs, ANBFCs chose to build an in-house sales team comprising primarily Relationship Managers (RMs). This approach, with some minor enhancements, has stood the test of time. Even now, when channel partners are much more interested in school financing, they usually work with diversified NBFCs and are focused primarily on the refinancing of loans.

EduFinance is now a well-understood concept by ALPs in India, particularly the ones in urban and semi-urban areas. When that was not the case, ANBFCs tactically used small-value unsecured loans to break the ice with the ALPs. These early customers then subsequently availed larger secured loans from the same ANBFC and became the latter's reference point for other ALPs. Offices were set up at key locations to provide confidence to the ALPs, although this had to be done carefully to keep the overhead costs under control.

Varthana uses a hub and spoke model so that it can increase its sales reach without having to incur large fixed costs associated with starting and operating offices. Hubs are typically present in large cities and house functions such as sales, marketing, credit and collections, and support spokes that cover semi-urban and rural areas. Spokes allow decentralization of operations and factoring in the local dynamics in, say, credit assessment. Location of hubs and spokes, as well as the distance between them, is carefully planned.

Deal sourcing through RMs has allowed the ABNFCs to rapidly expand their ALP coverage in a relatively short period of time. Just the top 3 ABNFCs employ several hundred RMs. Few important lessons have been learnt along the way.

To maximize the productivity of the sales organization, a considerable amount of planning is required for hiring the right individuals, their training, territory allocation, target setting, performance monitoring and retention. The difference in the productivity of a good salesperson and not so good one is multifold. Solutions such as geo-tagging to track daily activities can be effective but could face resistance from the sales team. The salesperson must have the right balance of “hunting” and “farming” skills to be able to maximize the life-time value of the ALP for the ANBFC. As many as a third of the new loans of Indian ANBFCs are sourced from their existing customers.

One area that requires attention is the design of sales incentives. As is the case with all lending businesses, the sales team should be incentivized not only based on the number of loans that are disbursed but also on the credit quality of customers and collections. In the case of ANBFCs, this requirement becomes even more critical due to the unorganized nature of the ALPs. As elaborated in subsequent sections, informal inputs picked up in and around the ALP premises are an invaluable source of credit assessment. In many situations, the salesperson is the only one who can collect these inputs since the ALPs are geographically spread out. If that person, intentionally or otherwise, fails to report all the data collected from the field then that can lead to an increase in the bad debts.

Schools usually pay their dues but not always on time, and collection is another area that depends significantly on the ground support from the sales team. RMs usually do not like to irk their customers by following up for collections, but they can effectively assist the collections team because of the relationship they share with the ALPs. ANBFCs prefer to keep the sales and collections function separate.

Historically, the sales function has suffered from a higher churn compared to the other functions. Depending solely upon the RM to manage customer relationships can, therefore, expose an ANBFC to the possibility of customer churn every time a high performing RM quits to join competitors. ANBFCs are therefore increasingly using technology-based solutions to maintain contact and regular communication with the ALPs.

5.2
Credit Policy

Credit policy of an ANBFC, on one hand, acts as a guardrail for the RMs to target the right set of ALPs and on the other hand ensures that portfolio growth and safety are appropriately balanced. Therefore, the policy must be simple yet robust.

A good credit policy covers three important dimensions: (i) financial ability of the ALP to service the loan, (ii) willingness or intention of the ALP to service the loan, and (iii) suitability of the loan for the ANBFC from an overall portfolio perspective.

Determining the ability of the ALP to service the loan is relatively straightforward once some key data points are available. The student fee is the primary source of income for an ALP. The number of students enrolled, average fees and the timing of the fee, therefore, provide a good understanding of the ALP's cash inflow. On the other hand, teacher and staff salaries are the largest contributor to an ALP's expenses. Loan eligibility is determined such that the repayment installments are a certain percentage of the free cashflows.

For financing infrastructure, loan disbursal is usually linked to the stage of construction and at times the payment is made directly to the vendor to prevent diversion of loans. Infrastructure loans typically make up 80 percent of an ANBFC's portfolio - the rest are working capital loans. ANBFCs also typically have policies regarding the minimum duration that must have elapsed before an ALP becomes eligible for a top-up loan, and the amount of top-up loan, as a percentage of the original loan, that can be provided.

An ALP's willingness to pay is ascertained by studying the ALP's and promoter's credit history. It is also important to know if the promoter is involved in any other business. Chances of a credit relationship succeeding are the highest when running the ALP is the promoter's only occupation. In case of multiple businesses, financial stress in any of them could adversely affect the promoter's ability to service the ANBFC's loan.

To expand the market, **ABNFCs in India also experimented with giving loans to Early Childhood Learning (ECL) and tuition centers.** However, the high NPA in these segments proved to be deterrents. ECL and tuition centers are unregulated in India and therefore the entry and exit barriers for their promoters are low as, unlike in the case of K-12 schools and colleges, these centers do not have to go through registration formalities which can be quite cumbersome.

More than 90 percent of ANBFC loans are now collateralized. Collaterals could either belong to the ALP or to the promoter. At times, the collateral is owned jointly by the promoter with other family members, in which case all the collateral owners are made a signatory to the loan application. Pricing, as reflected in the interest rate being charged, is usually a function of, amongst other things, the marketability and liquidity of the collateral.

Several criteria, besides the ALP cashflows, such as years of operation, qualifications of the promoters and student success are also used for credit underwriting. ANBFCs have refined their policies over the years based on experience and therefore are able to keep NPAs under check.

Based on years of experience, ISFC has developed a proprietary algorithm that evaluates over 35 parameters to arrive at each ALP's risk score. In the company's experience, no single parameter on its own is a reliable predictor of an ALP's credit behavior, however, the 35 parameters collectively provide a very good assessment of an ALP's creditworthiness. between them, is carefully planned.

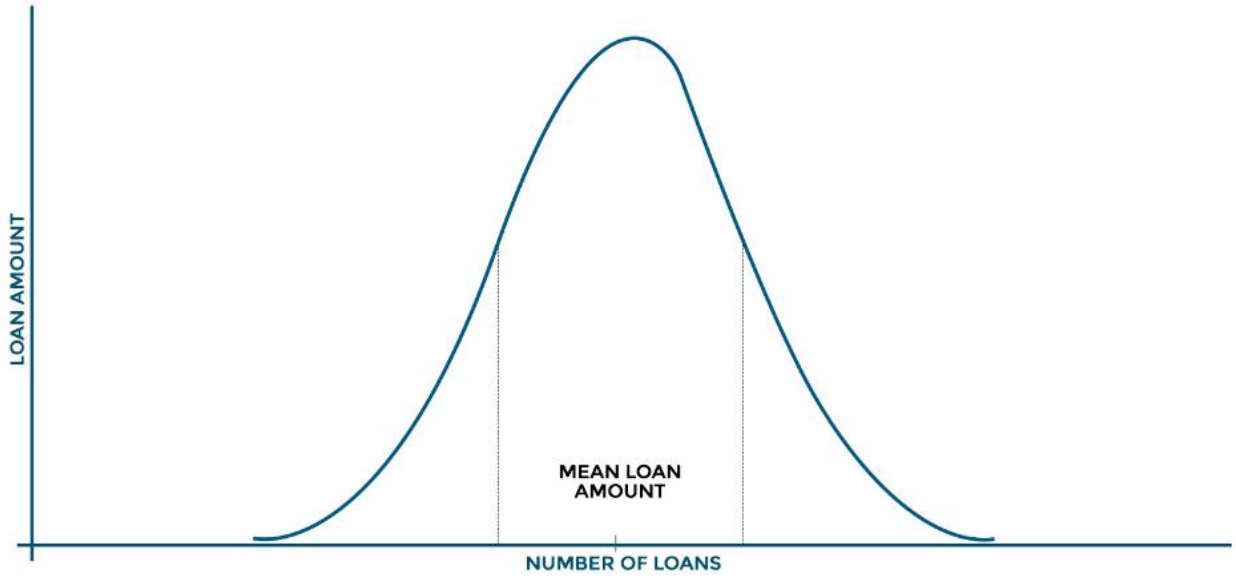


Figure 7: Loan Book Growth of India's Top 3 ANBFCs[13]

A good indicator of a loan's suitability for the ANBFC from the portfolio perspective is how close the loan value is to the mean value of all its loans. If the loan is too small then it becomes difficult to recover the cost incurred in acquiring and servicing the ALP effectively. On the other hand, if the loan given to an ALP is too high then any NPA problem with that ALP can drag down the performance of the entire portfolio. The sweet-spot for the ANBFCs thus far has been small- to mid-sized ALPs with a stable cashflow but without well-organized accounting systems and collaterals that the other financial institutions would insist on.

The other aspect to be considered is the duration of the ALP loan. Most large loans are also longer duration ones, sometimes even more than 5 years long. This can lead to asset-liability mismatch for the ABNFCs since the tenure of their borrowing is typically no longer than 3 to 4 years. In this context, the recent availability of overseas impact capital with longer repayment tenure is a positive development for the ANBFCs.[14]

14 https://www.dfc.gov/media/press-releases/dfc-provides-15-million-loan-varthana-expand-access-quality-education-india#:~:text=DFC%20Provides%20%2415%20Million%20Loan%20to%20Varthana%20to,to%20Quality%20Education%20in%20India&text=%E2%80%9CDFC%20is%20proud%20to%20support,Chief%20Executive%20Officer%20Adam%20Boehler.

5.3
Credit Assessment

Considering the unorganized nature of the ALP sector, credit assessment is a function that calls for the most amount of pragmatism and localization. It is quite likely that the ALP may not have audited financial statements in the format specified by the ANBFC's credit underwriting policy. Even if they are available, there is no substitute for checking other documents such as the attendance register and cash register, or walking through the school on a school day, to get an accurate understanding of the ALP's financial health. Cross-checking data such as student strength with government records is equally important. ALP's income comprises recurring and non-recurring academic fees, as well as non-academic fees such as uniform and transportation fees. The lack of precise records and income breakup, therefore, makes credit assessment a non-trivial exercise.



Figure 9: Sample ALP Attendance and Fee Register

Informal inputs from the community can be a very useful source of data. Edupreneurs often belong to the same community and therefore much can be known about them by enquiring around. It is very useful to obtain a better understanding of, for example, whether the teachers and school suppliers are paid on time, and how the local parents rate the school vis-à-vis other options that are available to them. Parents of ALP students are not hesitant to shift their children to a better option, even if it is relatively new, and therefore ALP's vintage is not a good standalone indicator of its financial health.

ANBFCs typically engage local evaluators and lawyers for finalizing the loan agreement so that nuances specific to the ALP's geographical area of operation, if any, are appropriately addressed. This is particularly applicable for better understanding of the marketability and liquidity of the collateral involved.

NBFCs use innovative methods for credit assessment of ALPs. Shiksha, for example, uses psychometric assessments during the loan approval process to understand the risk profile of its customers.

5.4 Collections

As can be inferred from figure 10[15], the experience of ANBFCs in India suggests that **ALP lending is relatively safe**. However, it is important to state that ALP-lending is a relatively new asset class and therefore has limited historical data. Market information suggests that ANBFC delinquencies have been rising since the broad-based slowdown in India's NBFC sector post September 2018 and have further gone up recently due to the devastating impact of Covid-19 on the ALP sector.

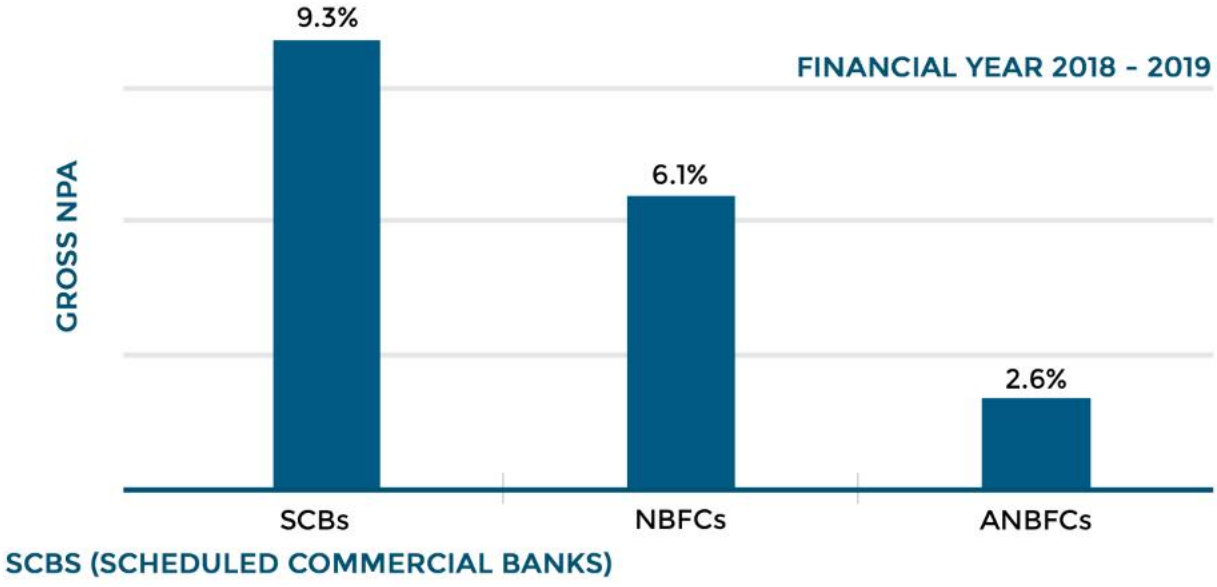


Figure 10: Comparison of NPAs of SCBs, NBFCs and ANBFCs

Suitable checks and balances are required across the full customer lifecycle, from sourcing to collections, for minimizing the NPAs without stifling credit growth.

15 Reserve Bank Of India/Kaizenvest analysis

Since points related to deal sourcing, credit policy and credit assessment have already been covered, this section will focus on salient collection practices that have proved effective over time.

It is most important to understand that ALP-focused lending is a high-touch business. There is no substitute for building a strong relationship with the ALP promoter through regular and in-person interactions. ALPs assign a significant premium when they see the ANBFC not just as a lender but as a partner genuinely interested in the ALP's success. This not only translates into repeat loans and cross-sell opportunities, but also timely collections. One approach that has been tried by ISFC and Varthana to demonstrate their commitment to the ALP's success is offering an outcome-linked rewards program to the ALPs in partnership with the Michael and Susan Dell Foundation. The program has been covered in the next section.

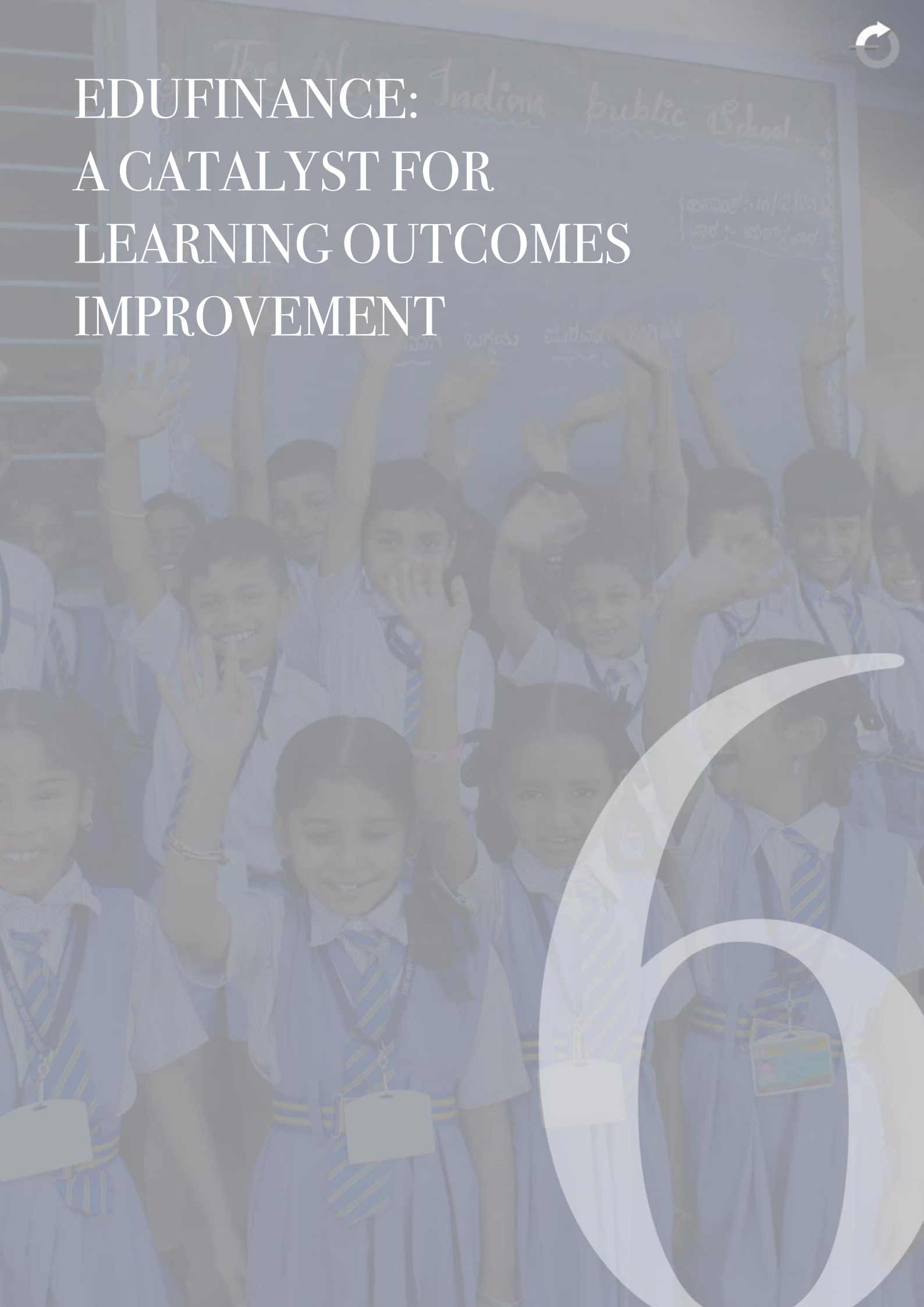
The ongoing Covid-19 pandemic has forced all the education institutions in India, including the ALPs, to remain shut. To assist its customers during these highly challenging times, Varthana has created a digital platform comprising live online classroom infrastructure, recorded lectures that can be distributed via whatsapp, and digital lessons plans, in partnership with leading ed-tech service providers such as Google, Toppr and Pratham. This platform is initially being provided free of charge by Varthana to all its customers.

Besides having a dedicated in-house collections team, ANBFCs use technology for maintaining regular communication with the ALPs, as mentioned previously. Once the first disbursal is made, key terms of the loan agreement are once again explained to the ALP promoter via phone, email and SMS. Before every deduction of loan repayment installment from the bank account of the ALP, a reminder is sent sufficiently in advance so that the required balance can be maintained in the account.

ALPs typically have surplus cash when they receive fees from parents. And most of them make it mandatory for parents to pay fees before their children can appear for final exams. Liabilities that are top-of-the-mind at that time usually get prioritized. Visits and other relationship-building initiatives can be timed by the ANBFCs around the fee collection period to reinforce their mindshare.

Finally, it is important to have a systematic dunning process that defines the steps to be taken and their timing. Once the payment due date is crossed, steps taken in a phase-wise manner include tele-calling reminders, visits, follow-up letters, loan recall notice, demand notice and arbitration. Some of these steps are outsourced to specialized agencies. In extreme cases, the collections department of the ANBFCs also assist the ALP promoters in finding a new owner for the ALP. Setting up a new ALP and getting it registered is usually a complex and time-consuming process. Often, successful ALP promoters find it is easier to expand their operations by taking ownership of another existing ALP.

EDUFINANCE: A CATALYST FOR LEARNING OUTCOMES IMPROVEMENT



While there is enough evidence to prove that ALPs operate at a significantly lower cost than their counterparts in the state-funded system, there is no conclusive evidence to establish that they deliver better learning outcomes as well. This is somewhat intuitive. Return on investment in quality improvement is back ended since it takes time, sometimes years, before efforts and inputs translate into better outcomes. ALPs have scarce access to long-term patient capital. Any spare capital is first diverted towards infrastructure enhancement since, in the absence of any other data, infrastructure is used by parents as a surrogate for quality. In this context, projects undertaken by the Michael & Susan Dell Foundation along with ISFC and Varthana are worth mentioning.

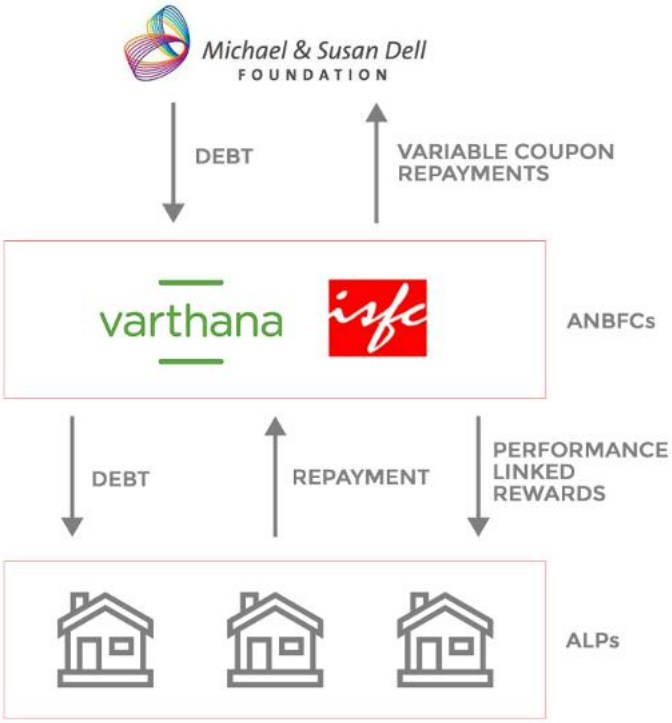


Figure 11: MSDF Social Success Note

In partnership with and leveraging their last-mile presence, the Dell Foundation launched a 3-year program in 2016 in partnership with ISFC and Varthana under which financial incentives were given to those ALP customers of the ANBFCs who achieved certain targeted improvement in learning outcomes of their students. These targets were based on ALP research undertaken by Dell Foundation. An independent outcomes measurement firm, Gray Matters India (GMI), evaluated the schools' performance by conducting baseline (2016-17), mid-line (2017-18) and end-line (2018-19) assessments.

While the programs rolled out via both ISFC and Varthana were similar, Varthana had an additional component of "School Transformation Program (STP)",[16] through which the company offered quality improvement support and third-party products to its customers, to create better traction for the Dell Foundation's program.

16 "Varthana" is the Sanskrit word for transformation. The name reflects the founders' philosophy that EduFinance is a powerful tool to empower communities to create local solutions for their transformation.

As a result, **31 percent of Varthana's customers that enrolled in the program successfully cleared the end-line assessment** by achieving the targeted improvement in learning outcomes.

The corresponding figure for ISFC was 12 percent. Interestingly, an analysis undertaken by GMI comparing the learning outcome achievement of three different programs aimed at improving quality at ALPs indicates that while a combination of financial rewards and educational interventions is the most effective, stand-alone financial rewards are more effective than stand-alone educational interventions.

Lastly, based on an extensive experiment covering 855 ALPs across 266 villages in Pakistan, research by the World Bank Group demonstrates that financial saturation (i.e. wider capital availability) crowds-in quality investment and leads to higher social surplus.[17]



17 "The World Bank Group. 2018. Upping the Ante: The Equilibrium Effects of Unconditional Grants to Private Schools. http://documents.worldbank.org/curated/en/489361534875600698/Upping-the-ante-the-equilibrium-effects-of-unconditional-grants-to-private-schools

THE WAY FORWARD



There are over 400,000 non-state K-12 schools in India, of which around 80 percent would qualify as ALPs. Half of these ALPs are registered, and therefore targets for the ANBFCs. To date, all the ANBFCs together have addressed less than 10 percent of this market and therefore there is significant headroom for growth.

ALPs so far have usually targeted K-12 ALPs that offer both primary and secondary education and are located in urban and semi-urban areas. With the entry of diversified NBFCs and therefore increased competition, ANBFCs are now focusing on K-12 ALPs in rural areas that most of the time offer only primary education. New ALPs are being set up every year which also presents an opportunity. At present, there is little focus on greenfield projects due to their being riskier.

ANBFCs are also experimenting in adjacent spaces such as student financing, teacher financing and supply chain financing, although these are yet to scale. Valuable lessons are being learned and new capabilities developed in the process.

ANBFCs have only selectively lent to higher education institutions thus far and that presents another opportunity in the form of either lending to the institutes or their students for fee payment.

While the opportunity in India itself is large and growing, successful ANBFCs can also look at expanding to other emerging countries once they have acquired scale. EduFinance initiatives are already underway in other South Asian countries, South East Asia and Africa through the provision of capital and expertise either by the ABNFCs or their promoters. There are well over a million ALPs in emerging countries other than India.

There is a tremendous opportunity for the world to study and understand the ALP lending model that has been successfully developed and scaled by the Indian ANBFCs. It applies not only to other emerging countries but also to other developmental sectors that are looking to catalyze greater access and quality using market-based mechanisms.



"It was a concept when we started this, it became a product now. In our initial days lenders were apprehensive about the model, its sustainability, scalability and profitability. All of these apprehensions are answered by the mere fact that the big banks and NBFCs have changed their thinking and viewpoint on education financing and all of them are eying the pie in the industry."

- Neeraj Sharma,
Education Finance Specialist
(Ex CEO – Indian School Finance Company)

"India's edufinance sector is an extremely dynamic one. Enrolment in private schools is dramatically increasing, new schools are entering the market each year and a growing number of entities are providing financial and educational support to the schools. We expect these trends to hold for many years to come as income levels increase and India's middle class continues to emerge."

- Steve Hardgrave,
CEO and Co-founder - Varthana





"In the absence of standardized assessments in primary grades in India, parents use several proxies for determining the quality of a school, such as English medium education, digital learning, enforcement of discipline, infrastructure etc. School owners understand this market dynamics well and cater to it by investing in infrastructure over outcomes. If student outcomes can be reliably measured and communicated to parents in a way that they start demanding quality outcomes, it could lead to behaviour change in school owners."

- Prachi Jain Windlass, Director India, Michael & Susan Dell Foundation

"As a 3rd party assessor evaluating school quality metrics and learning outcomes, GMI has assessed 1000s of ALPs across India. Based on our data, it is evident that provided with access to an ecosystem of quality financial and educational products, ALPs are able to achieve outcomes that are on par with some of their high-fee counterparts in the country."

- Sowmya Velayudham, CEO - Gray Matters India

