# Harnessing non-state education providers through innovative financing

*If properly harnessed, the non-state education sector has the potential to improve access to quality education services for the poor. Significant gaps remain among governments and donors in developing and capitalizing on promising non-state models. Creative new financing mechanisms targeted at the non-state sector are required to help seed robust, potentially scalable models that enhance the quality and affordability of education and ultimately benefit the poor.*

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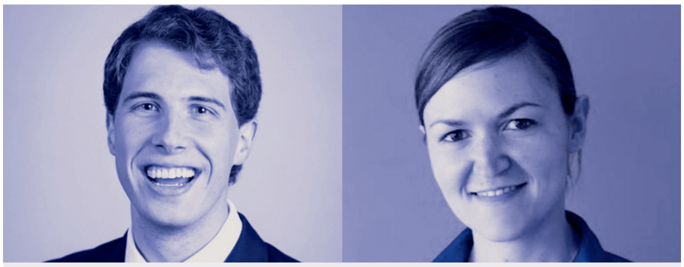
The United Nations estimates that, for basic and lower secondary education in low- and middle-income countries (LMICs), an annual USD 38 billion external financing gap exists between what governments can reasonably be expected to fund and what international aid donors are likely to support. Despite a rise in the share of government spending on education in low-income countries – from 2.9% of gross domestic product (GDP) in 1999 to 3.8% in 2011 – a major shortfall in financing for education persists (UNESCO, 2011). Traditional aid, which can amount to as much as one-fifth of education budgets in low-income countries, is in decline – falling from USD 14.4 billion in 2010 to USD 13.4 billion in 2011.



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On its side, the private sector has been slow to intercede and expand its role in financing for education in LMICs, a role it has successfully assumed in such arenas as health. Corporations invest 16 times more in global health than in global education. This may be explained by the complexities of education systems such as regulatory uncertainty, a lack of enforced standards and an extended time horizon for investment as well as the fact that, historically education, especially for the poor, has been regarded as a public good governed and financed by the public sector. In that context, the financing gap seems unlikely to be addressed, and indeed may even widen, unless new actors intervene and new financing mechanisms are put in place to advance the status of education.

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## The constraints and financial needs of non-state providers

Beyond the essential challenge of generating additional resources for public education in LMICs, a greater degree of attention should be focused on developing and testing creative financing mechanisms that respond to the financial needs and constraints that hinder the enhancement and effective harnessing of non-state providers. Given the current challenges of education, the non-state sector, while controversial, is increasingly viewed as a viable source of education for the poor.[1] 113 million children in LMICs are enrolled in non-state schools, representing approximately 11% of primary students and 24% of secondary students. Nevertheless, the tremendous variance in quality – especially among low-cost ▸▸▸

[1] *Non-state providers represent a diverse constellation of models, including for-profit and non-profits entities, social enterprises, religiously-affiliated or community-based providers, and organizations which work closely with the public system.*

Unlocking the potential of the private sector to improve education

▸▸▸private schools – has raised some concerns. Many lack the resources required to attract qualified human resources, improve both quality and cost-effectiveness, and ultimately scale services. Education financing for non-state providers currently comes largely either in the form of grants from state, philanthropic or faith-based organisations to traditional non-profits; through capital investment and loans to a minority of well-known providers delivering standardised, low-cost education or to institutions that target upper-income families. The independent, small-scale private schools, where a significant percentage of low-income students in LMICs actually learn, however, rarely have access to government or donor finance. These small-scale providers – who often inhabit a grey area between formal and informal sector – also tend to be too small to qualify for debt or attract traditional financing. As a result, many of these schools remain heavily dependent on fees. Though an exceptional few may achieve economies of scale through vast expansion of enrollment, dependency on fees precludes most providers from sufficient investment in key services such as teacher training, curriculum enhancement and infrastructure. Recognizing this gap in financing options, a number of new public and private financing mechanisms have emerged that demonstrate significant potential to enhance both access and quality of education solutions among non-state providers.

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### Harnessing public financing

India's 2009 Right to Education Act established mandatory standards for school infrastructure, teacher-pupil ratios, school days and teacher qualifications, as well as a quota for private schools who must now reserve 25% of their places for underprivileged students. Yet, many private unaided schools lack the resources to comply with these stringent norms and are forced to shut down. Despite the intention of enhancing access to quality education, this act could actually prove to be the death knell of low-cost private schools which provide education to a large population of low-income students (Dixon, 2010). This tumultuous experience is not unique to India. Indeed similar challenges in Nigeria, South Africa and Ghana, show that in addition to quality-improvement legislation, there is urgent need for meaningful private sector engagement to strengthen policy frameworks and streamline registration, paired with strong financing mechanisms that enable non-state entities to serve low-income students.

A range of public-private mechanisms can be mobilized to finance non-state providers while ensuring efficient delivery of quality education for the poor. Voucher schemes, under which the government or another entity pays either full or partial school fees directly to a provider for each low-income student enrolled, can create options for students in contexts where the public system is overstretched or unable to reach low-income students. To foster enhanced commitment to quality continuing financing for participating institutions can be made conditional on student learning outcomes. In Colombia, for example, voucher students are less likely to have to repeat years of study and have improved educational achievement. Cash transfer programs – that distribute funds directly to households, with payments either conditional on school attendance or targeted to encourage attendance – can also have a positive impact on providing revenues to non-state providers while subsidizing the continued enrollment of low-income students. More structured Public Private Partnerships (PPPs) can offer a contractual mechanism to finance non-state providers for the delivery of quality education to the poor. For instance, the Foundation-Assisted Schools programme, launched by Punjab Education Foundation, enables 1.2 million students from poor households in Punjab, Pakistan to attend selected non-state primary schools. Subject to publically advertising the abolition of fees for all students, participating institutions receive a per-student enrolment-subsidy and the school with the highest test performance in each district is rewarded annually through a competitive school bonus scheme (Malik, 2010). Social impact bonds (SIBs) are now emerging as a permutation of PPPs that leverages results-based financing for educational outcomes. SIBs are a form of an outcomes-based contract between the government, independent investors – including banks, foundations, and individuals – and service providers. Typically investors provide up-front funding to support a non-state education provider. The investment generates a financial return only after projects demonstrate they have achieved targeted outcomes. If the results are not achieved, the government does not pay. This mechanism offers governments a means of pursuing innovative education programs and scaling promising interventions with reduced risk.

## FOCUS

**Results for Development Institute (R4D)** is a non-profit organisation whose mission is to unlock solutions to tough development challenges that prevent people in low- and middle-income countries from realising their full potential. Using multiple approaches in multiple sectors including, global Education, global Health, governance and market dynamics, R4D supports the discovery and implementation of new ideas for reducing poverty and improving lives around the world.

### Impact Investing, an alternative source of capital

Estimated at USD 3 billion to date, impact investing has thus far constituted a very small proportion of education financing (Fillip, Lerer, 2013). Yet a growing cohort of impact investors is now exploring the establishment of education portfolios. To realise their aims, they will have to overcome significant hurdles in identifying investments with the potential for both social impact and financial returns. The handful of current deals are restricted to several large-scale chains of low-cost non-state schools or training programmes, with promising small-scale operators deemed to be at too early a stage of their development for investment. To surmount this pioneer gap, some impact investors, such as Edupreneurs, a joint initiative of the Pearson Affordable Learning Fund and Village capital, are using accelerator or incubator programmes to prime promising models to ultimately receive investment. Other investment vehicles are emerging that blend patient capital with grants to test new models and prepare them for scale – ultimately selecting the most promising models for a second impact-focused investment round. There is also a clear role for impact investors to better support and coordinate with intermediaries that provide financial services and training for early-stage education entrepreneurs.

### Unlocking Local Capital

New financing for private providers may actually be drawn from existing financial assets within LMIC countries themselves. Corporate social responsibility (CSR) funds within middle-income countries could provide an important source of financing for education. In South Africa, for example, companies must direct 1% of net profits after tax to corporate social investment activities. These investments have doubled between 2001 and 2013 to reach a level of more than USD 700 million (Trialogue, 2013) – more than 40% of this has been spent on education. India is following suit, by requiring companies with a net worth greater than INR 5 billion, or net profits of INR 50 million over any of the past three years to commit 2% of average net profits to CSR activities (Kordant Philanthropy Advisors, 2014) – which could generate as much as USD 2 billion. Thus far, CSR has been deployed inefficiently, and often in a short-sighted manner that fails to make a lasting impact (Fleet, 2012). CSR funds could restructure their approach to ensure resources are directed towards undervalued areas. Collaboration between CSR funds and policy makers could also be enhanced. This might include establishing pooled CSR funds to invest in public goods such as the expansion of promising education models, or contributing to PPPs or SIBs. Lastly, the substantial pool of public and private pension funds accruing in the developing world – an estimated USD 1 trillion – could be unlocked through an array of bond and guarantee schemes to support education projects.

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Greater attention needs to be given to developing and testing creative financial mechanisms that respond to the needs of non-state education providers in LMICs (Box). Financing is of course just one aspect of the overarching ecosystem, but it plays a critical role in raising standards, encouraging innovation, and helping to seed robust models with the potential to scale. Thus improved financing is a necessary, if not sufficient, requirement to harness the non-state sector more effectively for the benefit of the poor. •

### BOX: MOBILIZING DONOR FUNDS

Development finance institutions have begun to use challenge funds as a means of identifying promising non-state education models. These tend to pool multiple sources of financing (donor, impact investor, crowd-funding, etc.) to spur innovation – the UK's Department for International Development's (DFID) Girls Education Challenge, for example, has committed almost USD 500 million to support new and effective non-state mechanisms to expand education opportunities to marginalized girls. However, due to the logistical difficulties associated with publicising and managing a global selection process combined with the tendency to invest in proven interventions, many competitions tend to favor a select group of established programmes. To nurture innovation, challenge funds should embrace their role as a source of risk-tolerant philanthropic capital that can be leveraged to identify, test, and refine promising solutions. They could notably seek to seed partnerships between promising small-scale providers and technical assistance and support organizations that prepare them for scale. The DFID Girls Education Challenge will offer a test of this premise through its inclusion of an innovation window directed towards pilot projects.

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