

## Financial Problems Faced by Private Unaided Educational Institutions and Scope for Private Equity Participation



### Management

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### ABSTRACT

*Indian education sector has witnessed a series of changes in the last few years, which resulted in a significant increase in market size of the education industry. With economic growth and enhanced technology it has become necessary to develop the Indian education sector. Funds are a major concern in the market to meet this demand. Education in India is financed through 3 primary sources – Government, Charity and Private Funding. Over the last two decades or so, participation of private sector in higher and technical education has increased tremendously. In fact major share in the total colleges is of the private unaided segment. The way these colleges and institutions arrange for their finances has implications on the fees paid by the students studying in these colleges. Private equity is emerging as a new funding avenue for these institutions. This paper gives emphasis on private equity participation can help for funding educational institutions in India.*

### Introduction:

Education is a necessary ingredient for social and economic progress in India. The government has taken many initiatives for the development of education infrastructure which needs to be supplemented led by private players. The government has also opened the doors for foreign universities by passing Foreign Educational Institution (Regulation of Entry and Operation) Bill, 2010, which will help in shaping the education industry structure specially pertaining of higher education in India.

The country's minister of human resources development, Mr Kapil Sibal recently said that he hoped to attract some of the leading education institutions of the West to India. The idea of providing better education to those seeking to improve their quality of life and business skills has caught on. Originally based on the British system of education, the education sector in India has evolved over the last few decades into a large, fragmented and multi-faceted industry. The Indian Education Industry has seen a phenomenal growth in the past couple of decades. The market size in terms of the population belonging to the age group between 6-24 years of age group is estimated to be around 500 million or about 40% of the country's population<sup>1</sup>.

### Need for Study:

The need for this study is felt in the backdrop of the Government adopting a liberal policy by allowing Foreign Universities to participate in this sector. In a recent announcement the government has assured the NRIs that it would remove regulatory constraints to encourage their participation in the education sector as skill development was necessary to achieve 10% economic growth in the 12th Five-Year Plan (2012-17)<sup>2</sup>. This move and other such steps are expected to change the dynamics of the Indian Education System. Sooner or later, we are going to see corporate players actively participating in this sector that has so far been controlled by the Government and Organizations that are run as "not-for-profit" Institutions. It would be interesting to understand the financing models adopted by these private unaided colleges because these models have implications on the cost that is ultimately passed on to the students.

### Funding Pattern of Private unaided Educational Institutions :

In India most of the private un-aided institutions operate as Charitable Trusts. These institutions are not-for-profit type organizations. The revenue expenditure is generally met through the fees paid by the students. Government does funding of students who belong to various categories like scheduled caste, scheduled tribe, other backward class etc. The fees are usually divided into two parts – a. Tuition Fees, b. Development Fees. These fees are decided by the Fee Fixation Committees operat-

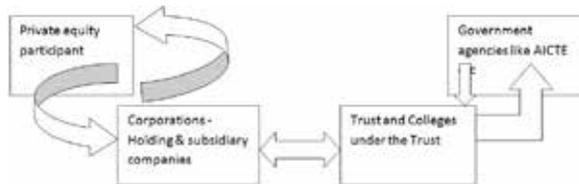
ing under the control of the State Governments. While the tuition fees are towards the operating expenditure of the colleges including expenses towards salaries, development fees are towards capital expenditure to be incurred for development in infrastructure, equipments, computers etc.

In Maharashtra, these fees are 7% of the tuition fees<sup>3</sup>. However, one would understand that this amount of development fees is reasonable enough only for nominal routine developments like up-gradation and maintenance of the facilities in general. These cannot take care of major expansion activities. Such initiatives are to be financed through long-term funds. There are 3 primary sources of long-term funds for these types of organization – a. Donations / Financial support from outside agencies, b. Donations by the Trustees themselves and c. Loans. Interestingly enough, the Fee Fixation Committees have specified that, students cannot be burdened with the cost of borrowed funds, that is, interest. This stand has been taken on the premise that a college has to set-up the infrastructure first from the Trust Funds and it is the responsibility of the Trustees to arrange for the infrastructure. Hence, in a way, Colleges are discouraged from borrowing any funds because the interest cost paid on such loans is not allowed to be recovered from the students. So what remains is the Trust Fund or the Corpus of the Trust that has to take care of the long-term funding requirements of the colleges. This in essence is the equity of the Trust. How much equity can be raised through outside donations and from the sources of the Trustees? And can it be raised whenever there is an opportunity for expansion or diversification? These are very difficult questions to answer. It is ok if one is thinking in terms of a small stand-alone school or even a stand-alone MBA College with an investment of around say Rs.5 crores. But if somebody is thinking of a Medical College, or a state-of-the-art Engineering College or a full-fledged campus consisting of number of schools and colleges, then it is difficult to raise the long-term funds for such organizations. In the present set-up and with the conventional sources, it is not possible to finance aggressive growth initiatives. Taking into account the tremendous potential that exist in the education sector, it has been estimated that around \$150 billion worth investment would be needed in the education sector in the next 10 years or so<sup>4</sup>. So from where this money is going to come?

### The way of Private Equity:

A solution that is emerging to the problem discussed above is the private equity route. By this, we mean private equity funds including those from abroad would invest by way of equity in companies that would take over the responsibility of management of these educational institutions. At present the Government does not recognize the Corporate form of ownership and

management in the education structure. It is strictly against any kind of profiteering by organizations that are running these institutions. At the same time the general quality level of education that is imparted by both the Government institutions (except for a few coveted ones like the IIT's, IIM's etc.) and the "not-for-profit" organizations being operated by the Trusts is far from satisfactory. Thus, there is a strong case for active inclusion of the corporate sector in the education industry. Yet the legal and regulatory framework constituted by the Government prevents direct participation of the corporate sector. In such a situation an obvious solution that emerges is to retain the existing "Trust" structure on the face of interaction with the Government and also bring in a Corporate structure in existence so as to facilitate private equity participation. Thus, the structure that would emerge would be something as under --



On one hand there would be the Company whose responsibility would be to manage the Trust and the Colleges under the Trust. Basically, the Company would be undertaking all the responsibilities and the activities that are undertaken by the Trust's Head Office under the present set-up. Various financial aspects related to the Company are discussed below -

**I. Revenue** - The Company would undertake the responsibility for managing the operations of the colleges that may even include teaching. In other words, colleges would be outsourcing their activities from the Company against a consideration payable to the Company. This would be the revenue for the Company. There can be multiple companies specialized in dealing with various aspects like - supply of stationery and consumables, infrastructure, housekeeping and maintenance services etc.

**II. Assets** - These companies can actually own the infrastructure and lease it out to the colleges. The fee fixation committees do allow rent paid on buildings by the colleges as an alternative to depreciation. The companies can borrow against these assets, if required, and even recover the interest cost by way of a suitable charge to the college.

**III. Capital** - The Capital of the Company would be contributed by private equity players. Over a period of time, after establishing itself, it can even tap the IPO markets. Shareholders would get rewarded by way of both dividends and capital appreciation of their investments.

This kind of set-up should not be a problem for the Government because, it would continue to deal with the Trust and not with the Company. Moreover, the interest of the students can continue to be protected because the colleges will still be required to submit their accounts to the Fee Fixation Committee for approval of their fees. Thus, there is no case of dilution of any control of the Government over the colleges. But at the same time, the colleges can have more funds to facilitate their expansion and diversification activities. The merits in the concept of private equity are discussed below -

#### Merits of Private Equity Route:

- Educational institutions would be relieved of the headache of fund management as this activity would be taken care of by the Company. It can concentrate on academics and other more value adding activities like research.
- A corporate set-up for fund management is always desirable as compared to the Trust set-up. The former can ensure more professionalism in fund management, both, long-term and short-term.

- As of now because of the policies of the Fee fixation committees of disallowing interest on loans, colleges are discouraged to borrow. Companies on the other hand will not face this problem. They on the other hand can borrow up to reasonable levels and enjoy benefits of financial leverage.
- A corporate culture is also desirable from the academics point of view. As stated earlier, general quality level of education that is imparted by both the Government institutions (except for a few coveted ones like the IIT's, IIM's etc.) and the "not-for-profit" organizations being operated by the Trusts is far from satisfactory. A corporate culture with a clear objective of profit can actually ensure high quality standards.
- The students at large would also benefit in terms of cost. In other words, they might actually pay lesser fees than what they are paying now. When the telecom sector was opened to private players, we have seen how the costs have dramatically come down to some paise per second. This is very much possible in the education sector as well if the corporate players are at the helm of the management. The cost of large inefficiencies in the education sector would get eliminated when the private sector with a clear profit objective takes over the management of the colleges.
- Once these companies get listed on the stock markets, their true valuation would be known. Lucrative valuations of such companies will attract more investment in this sector.
- With the kind of investment required in the education sector in India over the next decade (\$150 bn), it is important to promote a larger role for private players. Corporate sector so far has not launched itself in the education sector because of the highly regulated environment. However, the Government cannot afford to keep the private sector out of this sector for a long time. While the demand for education is increasing rapidly on one hand, the quality levels are depleting on the other. Funding is one of the key aspects for any activity. Government should encourage private equity participation so that we can attract good investments in this sector including those from the foreign equity players. It can still continue to exercise reasonable controls through agencies like AICTE, Fee fixation committees etc. The benefits of the Corporate culture in the education sector are too big to be ignored. Hence it is expected that the Government will take a liberal stand on this issue.

#### Conclusion:

With the kind of investment required in the education sector in India over the next decade (\$150 bn), it is important to promote a larger role for private players. The biggest regulatory stumbling block perceived by the investors is the legal requirement that schools should be run only by non-profit entities or trusts. "While some states, Haryana and Maharashtra for instance, allow for-profit schools, both the state and central school educational boards, to which almost all schools are affiliated, specify that they will only approve schools owned by non-profit bodies," Like most regulatory hurdles, many Indian companies get over the issue by forming a trust and getting most of the work 'outsourced' to the actual company. Many foreign PE firms are reluctant to invest in policy-ambiguous sectors, forcing even early-stage education companies such as Educomp and Everonn to tap the public market. Education is the last major sector which is yet to be liberalised...

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