Education Sector Rating Methodology

Executive Summary

Education is one of the most fundamental pillars of a Nation and its economy. Further, it is highly essential for inclusive and sustainable economic growth of a Nation. It inculcates the skills and knowledge needed to empower an individual and improve their quality of life, besides boosting their productivity and income earning potential. The Indian education system can be broadly classified into the formal and informal education sectors. Formal education is highly regulated at both, the state and central levels and comprises schools (kindergarten to 12th standard), colleges and universities (graduation and post-graduation), whereas informal education is unregulated and comprises pre-schools, training institutes and coaching centres. Mostly, education institutions in India are not-for-profit organisations that operate under trusts or charitable societies. Additionally, there are some for-profit organisations that own and have established education infrastructure and are always on the lookout for new courses to add to be able to scale-up their operations.

Given these positive externalities, the Government of India has introduced various schemes and initiatives to increase the Gross Enrolment Ratio (GER) and improve the quality of education delivered in schools and universities. The funding support for government schools, colleges and universities is provided through budgetary allocations from the central and state governments.

The formal Indian education system has the following sub-sectors:

- Primary education, which acts as a bedrock for lifelong learning,
- Secondary education, which acts as a founding base in literacy, numeracy and other vital skills
- Higher education, which fills the need for skills required at the professional and managerial levels.

The Indian education sector has gone through a technological revolution over the last one and a half year due to the pandemic, adopting innovative approaches in digitized learning to keep up the pace of education and provide a better learning experience to students. The year also saw efforts being taken on the part of teachers, who shunned technically backward modes of teaching and stepped-up their game by keeping students engaged through project-based learning, interactive sessions and assignments.

The recently introduced National Education Policy (NEP) 2020 is expected to further aid the education sector. As part of the National Education Policy, 15000 schools are expected to be developed where the NEP will be implemented, and these can act as models for other schools. The aim is to increase the GER in higher education to 50% by 2035 from 26.3% recorded in 2018. In the area of skill development, the realignment of the National Apprenticeship Training scheme for providing post-education apprenticeship, training of graduate and diploma holders in Engineering, as well as partnerships with various countries to enable knowledge transfer are expected to facilitate the creation of a qualified workforce.

Scope of the Criteria

The document provides a brief analysis of the attributes considered by Brickwork Ratings (BWR) while arriving at the rating of educational institutions. The scope of this document is to capture the important aspects of various risks associated with the creditworthiness of the entity, while arriving at the rating of private schools, higher education institutions and universities. A summary of the effect of these attributes on the overall credit rating of education institutions is highlighted, which helps ascertain the debt servicing capability as against the cash flow generation and ability of these institutions to undertake expansion projects.

Risk Assessment and Rating Methodology

BWR factors in various quantitative and qualitative risks pertaining to the business and financial risk profile, management quality, funding, staffing, stakeholder management such as regulatory compliance, and investors and other market participants, among others, along with other considerations for arriving at the rating of educational institutions. These risks can be broadly classified as under:

Business Risk	Track record and reputation of institution Teaching quality and effectiveness Course specialisation/ diversification Scale of operations and operational efficiency Enrolment ratio and quality of infrastructure
Regulatory Risk	Status of institute Regulatory landscape
Financial Risk	Cost structure and capital expenditure flexibility Turnover and profitability ratio Liquidity ratio Leverage and coverage ratio
Management Quality	Experience of the promoters/ parentage Risk appetite and resourcefulness Competence and Integrity Quality of corporate governance Philosophy and philanthropic support

Business Risk

The business risk of an educational institution can be assessed based on its operational track record and reputation, teaching staff and effectiveness of teaching on students, courses offered and diversification, scale of operations and student enrolment, competitive fee structure and amenities such as laboratories and libraries etc. The USP of any educational institute is the quality of faculty and effectiveness of teaching, teachers experience and student-teacher ratio, along with its alumni base/network. Exceptional faculty, along with the placement track record and institute reputation, further deepens confidence among students, enhancing the institute's ranking among competitors. Moreover, the specialisation and expertise of the faculty, which can be assessed in terms of the number of years of experience, availability of adequate research funding, research papers published, educational background and so on, gives the institute an unparalleled edge over competitors. All these factors help increase an institute's enrolment ratio (the ratio of actual intake to sanctioned ratio), an important factor contributing to its cash flow and revenue visibility. Demand for an institute also depends on factors such as the demographics of the areas it operates in, courses offered, specialisation in a particular course, trend of overall student strength with a good placement track record, overall macroeconomic conditions and the perceived mindset of students and parents about the institute, besides its competitiveness. Apart from the above, demand for educational institutes also depends on how they attract or retain students by offering courses at competitive prices or provide education through practical examples or live projects. Furthermore, the creation of tech-infrastructure or digital content by the institutes, to cope with increasing demand from online classes will be analysed.

Regulatory Risk

Education is highly recognised as necessary for accomplishing the Millennium Development Goals (MDGs), and thus, invites attention from the government and other regulatory bodies that frame the codes of conduct, norms and procedures to be followed for educational institutions. The Indian education sector is socially important as it is associated with positive externalities and is thereby a highly regulated sector by the government. University Grants Commission (UGC), All India Council for Technical Education (AICTE), Distance Education Council (DCE), Medical Council of India (MCI), Bar Council of India (BCI), National Council for Teacher Education (NCTE), among others, are some of the regulatory bodies governing the sector. These authorities further help establish the minimum education norms and infrastructure requirements to be followed in terms of learning content standards, teacher and education personnel standards, education management standards, infrastructure standards, cost and finance standards, and so on. The number of regulatory bodies that an institute is affiliated to is an indicator of the financial and operational flexibility it enjoys. The more the number of regulatory bodies an institute is governed by, the lesser will be its power and independence in terms of regulating the seat allocation/enrolment and fee structure. The subsidies provided by the government towards quotas for the underprivileged are also regulated, affecting the financial performance of these institutions. The autonomous status institutes such as deemed universities and private universities, therefore, makes them more flexible in terms of deciding the fee structure, course offered/ curriculum, student intake, examination pattern and so on. Education plays a vital role in the development of any nation. Therefore, there is a premium on both the quantity (increased access) and quality (relevance and excellence of academic programs offered) of higher education. The National Assessment & Accreditation Council (NAAC) has been set-up to facilitate volunteering institutions to assess their performance vis-a-vis set parameters through introspection and a process that provides space for the participation of the institution. It helps educational institutes know their strengths, weaknesses, and opportunities through an informed review process. This also helps funding agencies to look for objective data for performance funding; this kind of assessment also helps institutions to initiate innovative and modern methods of pedagogy, among others.

Financial Risk

The main revenue source for an educational institution is the tuition fee it collects at the beginning of each semester/year. The revenue stream from tuition fee collection, usually on a bi-annual or annual basis, is highly skewed, unlike revenue streams in other industries or sectors. Therefore, the diversity of the revenue stream is critical, wherein revenues from the various courses, hostel fees, mess fee and transportation fees ensure stable cash flows and are seen positively. Additionally, to avail tax benefits, these institutes need to use 85% of their revenues towards the goals and objectives of the trust they are associated with. This continuous need for capital expenditure hampers their liquidity and financial flexibility as the amount incurred for capex could have been used to improve their liquidity position. BWR also analyses the trend in operating performance, scale of operations and profitability margins of these institutions to assess their debt servicing ability and liquidity position and ability to absorb shocks during a downturn. Furthermore, their ability to meet short-term cash obligations, internal sources of fund flow, unencumbered cash and cash equivalents on the balance sheet, unutilised working capital facilities, and prospective cash flow from asset monetisation identifies the institutes' liquidity position. Due to the obligation of complying with infrastructure standards, it is imperative to invest in fixed capital assets. This requires a higher dependence on debt financing to cover for investment in fixed assets. Furthermore, an institute's ability to raise funds at a short notice or attract investors, fresh borrowings, debt servicing capability and refinancing provides it strong financial flexibility. However, BWR analyses the funding mix and debt servicing ability of these institutes. An aggressive financial policy of an institute causing heavy reliance on debt is seen negatively.

Management Risk

Experienced management with a demonstrated track record, commitment and reputation among various institutes in the industry is an important indicator of the educational quality delivered by an institute. Apart from experience, BWR captures the management's ability to adapt to changes in the external environment with respect to technological advancements, risk appetite, resourcefulness and ability to support the institution financially, and risk mitigation plans, policies on leveraging, student demands, capital expenditure and infrastructure improvement plans, among others. A good regulatory compliance record, with audit and compensation decisions being taken by an independent director is seen positively by BWR.

Conclusion

BWR analyses these regulatory, financial, management and business risks specific to educational institutions and quantifies them to arrive at the rating of these educational institutions. Due to the heavily skewed nature of cash flows in the sector, importance is given to the assessment of the institute's liquidity position. Additionally, due to the requirement of continuous capital expenditure and investment in fixed assets, the sound financial position and ability of an institute to make sizable profits after accounting for debt servicing, promoters' financial flexibility, philosophy and philanthropic support, and capex plans are of utmost importance while assessing the credit quality.

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