



Rating Criteria for Education Sector

Executive Summary

One of the most important foundations of a country and its economy is education. Furthermore, it is crucial for a country's inclusive and long-term economic success. In addition to increasing a person's productivity and earning potential, it instills the knowledge and abilities necessary to empower them and enhance their quality of life. Formal and informal education are the two basic categories into which the Indian educational system can be divided. While informal education is unregulated and includes pre-schools, training facilities, and coaching centers, formal education is heavily regulated at both the state and federal levels and includes schools (kindergarten through the 12th grade), colleges, and universities (graduate and post-graduation).

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 following sub-sectors comprise the formal Indian education system:

- Primary education serves as the cornerstone for lifetime learning;
- Secondary education serves as a foundation for reading, numeracy, and other essential skills;
- Higher education, which satisfies the demand for managerial and professional abilities.

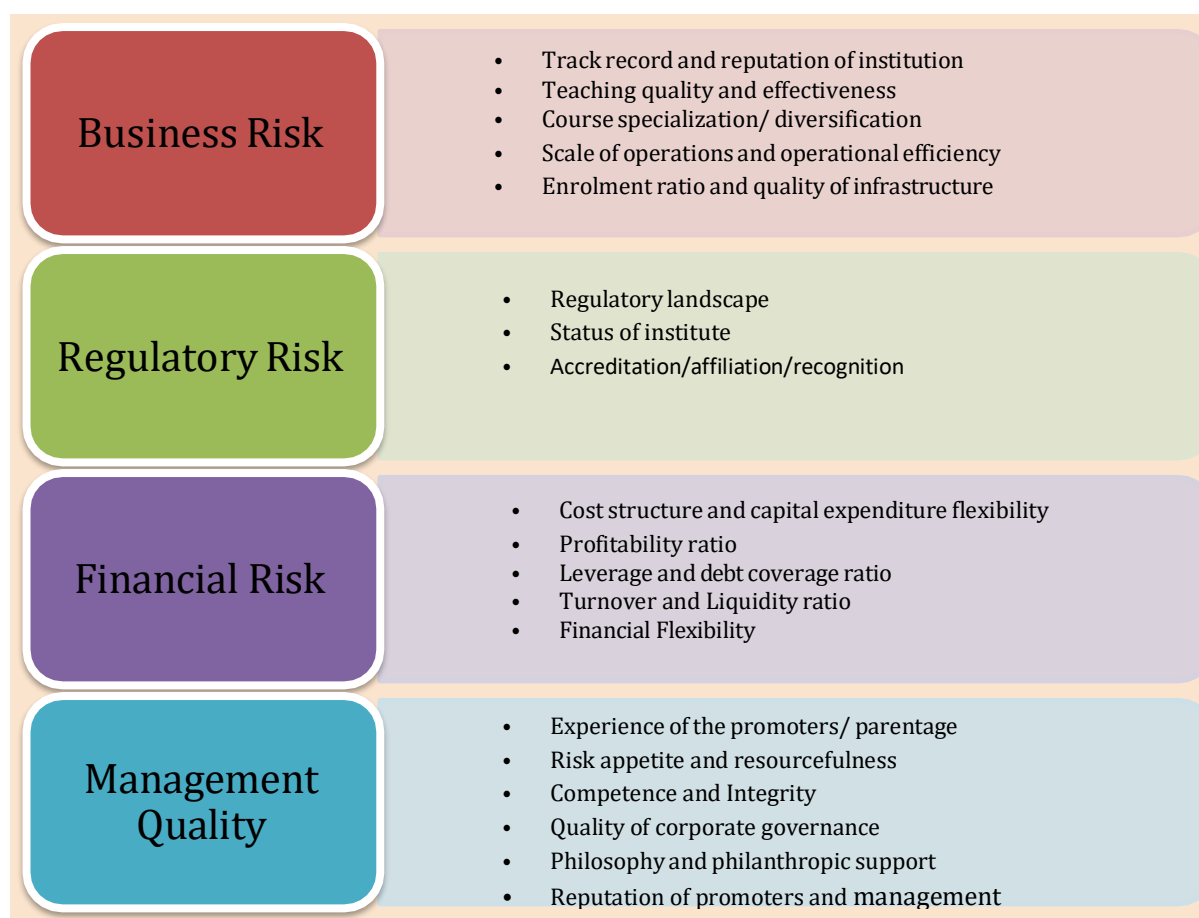
Expanding the 5+3+3+4 structure to integrate all educational stages across school boards and guarantee a holistic learning approach is one of the main goals for 2025 and beyond, as stated in the National Education Policy (NEP) 2020. The AICTE, NCTE, and UGC will be governed more efficiently by a unified higher education regulator. By bringing pedagogy into line with NEP objectives, the NISHTHA (National Initiative for School Head's and Teacher's Holistic Advancement) program will improve teacher preparation. Additionally, initiatives will concentrate on bridging the digital divide, guaranteeing fair access to resources and technology. Achieving an inclusive, equitable, and future-ready educational system also depends on resolving implementation issues and disparities.

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

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**

An institution's long-term viability and position in the education industry are determined by a combination of its reputation and business risk history. An organization's ability to withstand economic or regulatory obstacles is demonstrated by its good business risk track record, which also shows its operational effectiveness, financial stability, and effective risk management. However, low entry barriers in the educational sector present an additional risk, as they make it easier for new institutions to emerge and increase competition. This intensifies the pressure on established institutions to maintain their reputation and competitive edge. The university's strong reputation built on academic achievement, alumni success, industrial contacts, and a favorable public image, helps to draw students, teachers, and partners. But with the rise of new competitors, the institution must continuously innovate and offer unique value to retain its position in the market. When combined, these factors reduce risks and enhance the institution's reputation, making it a trustworthy and respectable option in the highly competitive educational market.

- **Teaching quality and effectiveness:** The Unique Selling Proposition (USP) of any educational institute lies in the quality of its faculty and the effectiveness of its teaching. The learning environment is greatly influenced by important elements such the student-teacher ratio, alumni

network, and faculty experience. Outstanding teachers, a strong institutional reputation, and a track record of successful placements give students more confidence and raise the institute's profile among rivals.

- **Course Specialisation/Diversification:** 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 providing 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.
- **Scale of operations & Operational Efficiency:** An educational institution's capacity to provide specialized courses, research opportunities, and support services is influenced by its infrastructure, student body, and diversity of academic programs. Because of economies of scale, larger universities are able to draw in more faculty, funding, and industrial relationships. A large operational scale boosts competitiveness, student and alumni networks, and brand awareness, all of which increase the caliber of instruction and the standing of the institution.
- **Enrolment ratio and Quality of Infrastructure:** The percentage of students enrolled in an educational institution in relation to its entire capacity or the desired student population is known as the enrollment ratio. It shows how well-liked and in-demand the school is by attracting and keeping students. A high enrollment ratio indicates a solid reputation, successful marketing, and the capacity of the school to provide programs that satisfy the demands of its students. Because a balanced enrollment ratio contributes to the maintenance of ideal class sizes, sufficient resources, and a supportive learning environment, it can also indicate sound institutional management. Furthermore, these elements are greatly supported by the quality of the infrastructure. Well-equipped classrooms, cutting-edge technology, easily accessible amenities, and secure surroundings are examples of high-quality infrastructure that improves the educational process and increases student retention and satisfaction. A positive feedback loop that promotes long-term success can be created when high-quality infrastructure is combined with a favorable enrollment ratio to enhance the institution's reputation and draw in more potential students.

Both the infrastructural quality and the enrollment rates are strongly impacted by geographic location. A single-campus institution is more susceptible to changes in the local economy and population, which might affect investments in infrastructure and enrollment. Geographic diversification, on the other hand, helps multi-campus institutions maintain stable enrollment and consistent infrastructure quality that is suited to local demands.

Regulatory Risk

- **Regulatory landscape**

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 sector is regulated by highly regulatory bodies, such as:

- a) University Grants Commission (UGC)
- b) All India Council for Technical Education (AICTE)
- c) Distance Education Council (DCE)

- d) Medical Council of India (MCI)
- e) Bar Council of India (BCI)
- f) National Council for Teacher Education (NCTE)

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.

- **Status of institute**

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.

- **Accreditation /Affiliation/Recognition**

Since accreditation attests to an educational institution's compliance with legal and academic norms, it is a crucial component of regulatory risk. Retaining or gaining accreditation is crucial for finance, student recruitment, and maintaining the institution's credibility. For institutions to maintain compliance with regulatory standards, including accrediting criteria, licenses must be approved and renewed on time. An institution's reputation and long-term profitability can be severely impacted by noncompliance with accrediting standards or license renewals, which may make it more difficult for the institution to draw in students and obtain funding.

Financial Risk

- **Cost structure and capital expenditure flexibility**

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. The asset turnover ratio is particularly significant since it shows how well assets are being used to produce income, which is necessary to pay expenses and

maintain expansion. Additionally, because delays or decreases in government reimbursements can raise financial risk, institutions that rely on these funds should be aware of their timing and stability. Diversifying funding sources, including grants, donations, and other revenue streams, is essential for maintaining financial security and reducing this.

The competitiveness and fee structure of an institution affect its financial flexibility. Schools that have flexible, competitive pricing plans that meet consumer demand can draw in more students while keeping a healthy cash flow. Maintaining enrollment and lowering financial risk require striking a balance between affordability and profitability.

- **Profitability Ratio**

When assessing an educational institution's capacity to manage costs, produce steady profits, and effectively use capital in the face of financial risk, profitability ratios are crucial. The institution's general financial health, ability to fulfill commitments, reinvest in expansion, and ability to continue operations are all reflected in these measures.

The detailed computation of these profitability metrics is shown in the table

Operating Margin	$\frac{\text{Operating Income}}{\text{Revenue}}$
PAT Margin	$\frac{\text{Profit After Tax}}{\text{Revenue}}$
ROCE	$\frac{\text{EBIT}}{\text{Average capital Employed}}$

- **Leverage & Debt Coverage Ratio**

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, often requiring a higher dependence on debt financing. In this situation, equity is usually represented in the net assets of the organization, such as endowment funds, reserves, and accumulated surpluses, which offer stability and enable the organization to manage debt commitments and reinvest in its educational infrastructure.

The detailed computation of the ratios considered are shown in the table

Debt to Equity Ratio	$\frac{\text{Total Debt}}{\text{Total Equity}}$
Interest Coverage ratio	$\frac{\text{EBITDA}}{\text{Interest \& Finance charges}}$
Debt Service Coverage Ratio	$\frac{\text{PAT} + \text{Dep.} + \text{Int.}}{\text{Int.} + \text{Principal Repayment}}$

- **Turnover & Liquidity Ratio**

In order to evaluate an educational institution's financial stability and capacity to handle short-term obligations—two important aspects of the grading process—turnover and liquidity ratios are essential. The institution's cash flow efficiency, liquidity situation, and dependence on external debt are all shown by ratios such as payable days, receivable days, current ratio, cash to current liabilities, and total outside liabilities to tangible net worth. A strong ability to fulfill financial obligations, maintain operations, and reduce financial risk is shown by a balanced management of these ratios. Good performance on all of these measures indicates less financial risk and improves the institution's resilience to changes in the economy.

The detailed computation of the ratios considered is shown in the table:

Receivable Days	$\frac{\text{Trade Receivables}}{\text{Net Sales}} * 365$
Payable Days	$\frac{\text{Trade Payable}}{\text{Cost of goods sold}} * 365$
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Cash to Current Liabilities Ratio	$\frac{\text{Cash \& Cash Equivalent}}{\text{Current Liabilities}}$
Total Outside Liabilities to Tangible Net Worth	$\frac{\text{Total outside liabilities}}{\text{Tangible Networth}}$

- **Financial flexibility**

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. Adequate cash flow is essential in this context, as institutions with unpredictable cash flow may struggle to meet their obligations, while those with consistent cash flow may do so without concern. A poor debt service tracking record can make it more difficult for institutions to secure financing, whereas a strong debt servicing history enables them to access favorable future borrowings. Contingent and off-balance sheet liabilities introduce unanticipated risks that can reduce financial flexibility. Additionally, contract termination and insurance clauses act as safeguards, offering protection against financial shocks. Accounting quality also plays a vital role, as it ensures accurate forecasting of financial flows and efficient resource management.

However, financial flexibility can be severely impacted by excessive debt, delayed government reimbursements, or poor fundraising efforts, which forces institutions to seek alternative sources of income to maintain operations. Projecting the cash budget becomes crucial in these circumstances to preserve liquidity and guarantee that the organization can fulfill its immediate commitments. Institutions can anticipate periods of cash shortages and make plans for alternate financing sources by projecting cash inflows and outflows. Cash budget predictions give the organization the insight it needs to make wise cash management decisions and maintain its financial stability.

BWR analyses the funding mix and debt servicing ability of these institutions, noting that an aggressive financial policy leading to heavy reliance on debt is viewed negatively.

Another risk that could affect financial flexibility is the delayed reimbursement of tuition and hostel fees for certain categories of students, such as SC, ST, and OBC, by government authorities. Since the institution depends on these reimbursements to meet large operating costs, these late payments may cause cash flow issues. The institute's overall financial flexibility may be impacted by these delays since they may put a pressure on liquidity and force it to look for other sources of funding or credit facilities in order to maintain operations. Furthermore, endowments and fundraising are

important components of financial flexibility. Strong endowments and fruitful fundraising initiatives provide financial stability by lowering dependency on debt and repayments.

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. Additional crucial elements are the parentage/promoters' experience, competence and integrity, quality of corporate governance, philosophy and philanthropic support, management's reputation, and experience of the promoters. Collectively, these components demonstrate the institution's capacity to uphold stability, overcome obstacles, and guarantee sustained success.

A good regulatory compliance record, with audit and compensation decisions being taken by an independent director is seen positively by BWR.

In addition to the mentioned risks above, BWR also believes Environmental, Social and Corporate governance (ESG) risks and opportunities can increasingly have an impact on the operations and sustainability of business of an issuer. Hence, BWR while assessing the credit profile also assesses the ESG profile of the issuer based on data availability. It may be noted that the impact of the ESG profile of the issuer, both in terms of its strengths and weaknesses, are incorporated in the various management risk related parameters while assessing the credit risk associated with the issuer entity.

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.

The previous version of this document can be found at this link

https://www.brickworkratings.com/download/CriteriaEducationSector_Sep2021.pdf

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