Executive Insights

Impact Investing in Education: The Opportunity to Make a Difference

Although access to education is improving around the world, 260 million children, or one-fifth of the global school-age population, are still out of school. More than 80% of these children are in low-income countries, where access to education has stagnated for nearly eight years; even those able to secure access are grappling with poor learning outcomes and weak educational infrastructure (see Figure 1).

Massive development capital needed in education

Expenditure on education in low-income and lower-middle-income countries will have to more than double to $3 trillion by 2030 from $1.2 trillion currently[1] in order to reach the United Nations' Sustainable Development Goal of providing universal access to education. Despite the requirement of public spending to double and "Official Development Assitance (ODA)" to quadruple, there will remain a sizable funding gap, and private social and developmental capital will have a large role to play.

Moreover, the recent spread of the coronavirus pandemic has impacted about 1.5 billion learners globally, according to UNESCO. Given that low-income countries often have poor infrastructure and lack readiness for online and technology-enabled learning, the pandemic has further exacerbated the divide among low income countries, and the middle and high income countries. This calls for more funding from a social financing perspective, solidifying a massive opportunity set for social and impact investors.

A leading social financing model underutilized in education

Social financing can take a variety of forms, chief among them are two models: grants and repayable finance (see Figure 2).

Grants are more traditional and can potentially support a wider cost base, as they can be open-ended. However, this can result in a trade-off with accountability, which has been an area of concern for several years now. Consequently, modern-day grant making is shifting toward "venture philanthropy," which is a more results-based approach. The Qatar Foundation, the Bill and Melinda Gates Foundation and Impetus Private Equity Foundation are some large grant providers.

Repayable finance, another category of social finance is a kind of private investing focused on both social and economic returns. Repayable financing provides access to private capital at a low cost while improving accountability, with the use of "leverage" creating a multiplier effect in the case of lending. Further, it allows social organizations to access the business toolkit, which improves capital utilization.

Impact Investing in Education: The Opportunity to Make a Difference was written by **Sudeep Laad,** Partner, **Ashwin Assomull,** Partner and Aakash Budhiraja, Consultant with analytical support from Amiya Maitreya, Associate and Avleen Kaur, Associate.

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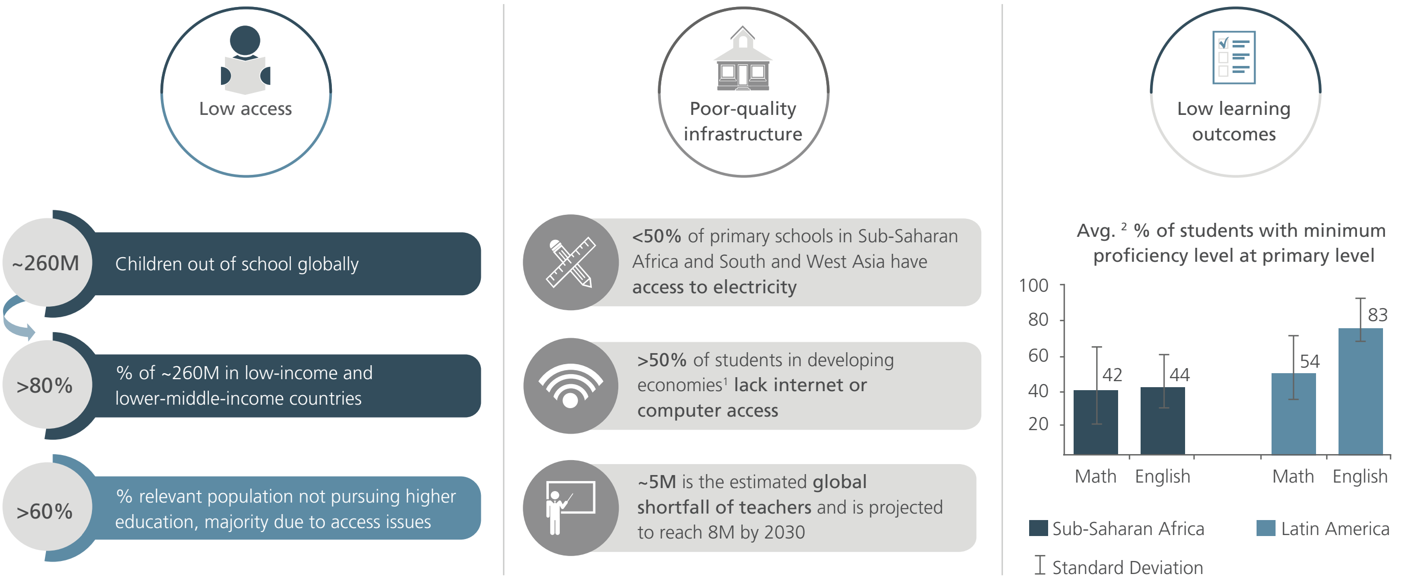
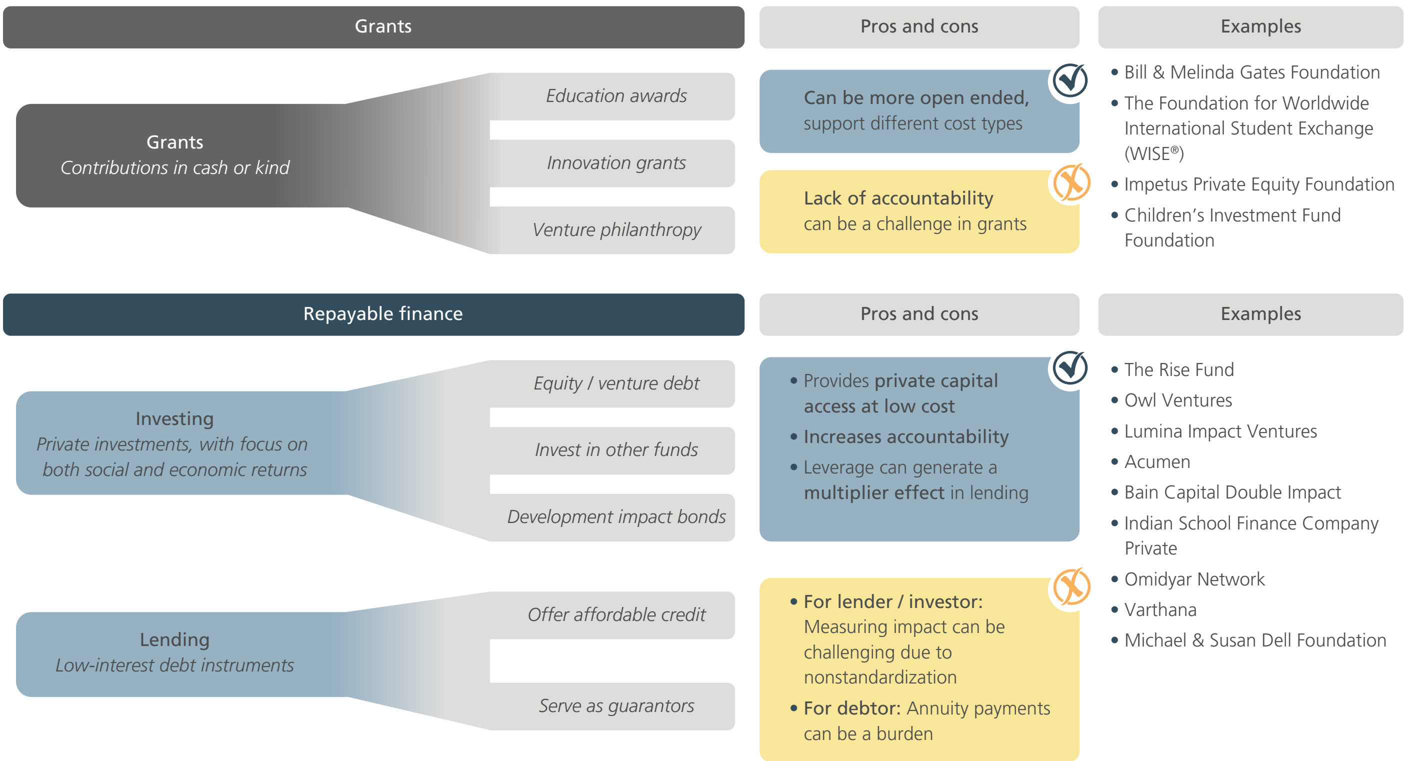
L.E.K.

Figure 1
Education sector needs social and impact finance



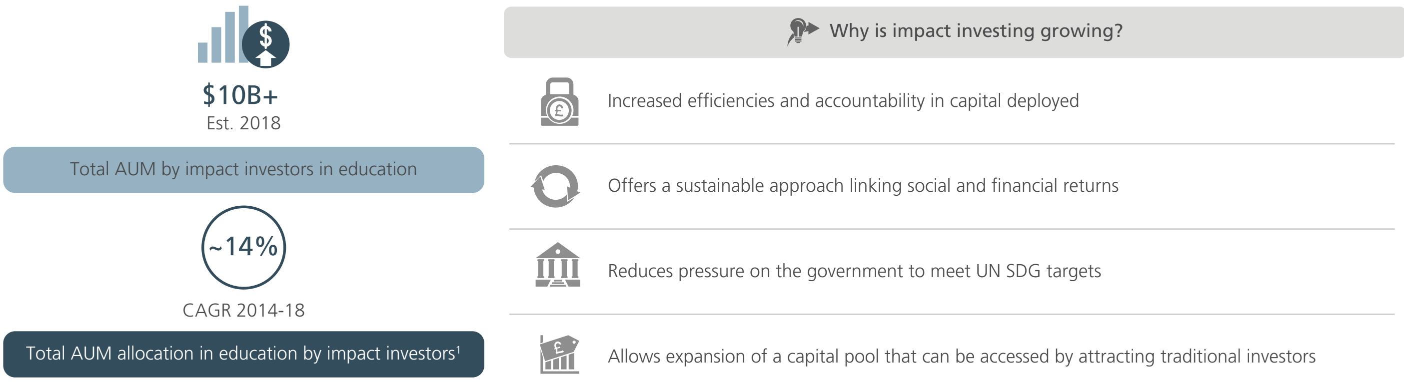
Note: [1]Developing economies indicate Sub-Saharan Africa, Latin American and South and West Asia; [2]Average across relevant regional countries with standard deviation shown in chart
Source: UIS Statistics

Figure 2
Types of social financing and their features



Source: L.E.K. research and analysis
Select names only; The selection of these examples in no way represents scale / efficiency and omission of few other examples may purely be co-incidental

Figure 3
Impact investing: a growing type of social finance in education



Note: [1]Sample N=80 from GIIN 2018 survey respondents; [2]Values based on GIIN 2018 survey respondents N=259, excluding two outliers
Source: GIIN 2018 Annual Impact Investor Survey, L.E.K. research and analysis

Within repayable finance, impact investing has emerged as a growing class of social financing (see Figure 3). As per Global Impact Investing Network (GIIN) estimates, impact investing in education is small but growing, at ~15% annually, and there is room for growth since education makes up only about 4% of total assets under management (AUM) for impact investing.[2]

There are a number of reasons for the steady rise in investments. First, impact investing increases efficiencies and brings about more accountability to the capital deployed. Second, it offers a sustainable approach, linking social and financial returns while reducing pressure on governments. And last, it allows for the expansion of the accessible capital pool by attracting traditional investors.

Impact investing in education at play: opportunities across sectors and geographies

Impact investing in education finds its place in both developed and developing markets. From a sectoral perspective, investments in education have focused on both the school-going age group (K-12) and young adults (tertiary education).

In developed markets such as the U.S., charter schools have taken center stage in the K-12 space.[3] The Walton Foundation is an active investor in this space, setting up the Building Equity Initiative to provide financing support for charter schools to grow.

In higher education and technical and vocational education and training (TVET), the focus in developed countries is on improving access, reducing dropout rates and boosting employability for students from low-income families. To this effect, the Bill and Melinda Gates Foundation invested ~$2 million in Uversity, a mobile app and data solutions company that partners with colleges and universities to improve student enrollment and retention. Bain Capital's Double Impact Fund has also invested in this space, backing Penn Foster, a vocational training organization.

In emerging economies, investments have aimed at bridging the access gap that is due to insufficient government spending. Acumen's investment of over $2 million in Nasra Public School, a network of schools in Pakistan, and Omidyar's investment in the Indian School Finance Co. and Varthana, which are education-focused nonbanking financial companies, are examples of how impact capital is helping students from low-income families gain access to quality K-12 education.

Lastly, EdTech is an emerging area globally and has seen significant investments. The Rise Fund's investment in Dreambox, which is focused on improving math skills in K-8 learners in the U.S., and investments in Bridge International Academies by investors such as Learn Capital, the International Finance Corp., the CDC Group and the Chan Zuckerberg Initiative illustrate the traction this segment has seen.

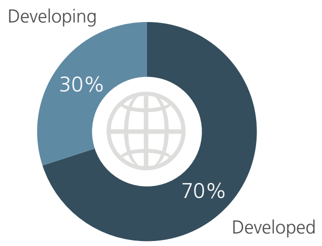
Innovative impact investing models in results-based finance

There are various innovative models emerging in impact investing. One such model is development impact bonds, which is a three-way partnership between a payee, an investor and a service provider in order to achieve a defined outcome. Instead of directly remunerating a service provider, the payee brings in a financial intermediary to make the upfront investment. The investor gets paid the base investment as well as a fixed return if the provider achieves the stated outcome. The system helps the payee decrease upfront risk while helping build projects that make quality education more accessible.

The first development impact bond in education was initiated in India in 2014, with the Children's Investment Fund Foundation acting as the outcome payer, UBS Optimus the financial intermediary and Educate Girls the service provider. The goal was to improve female participation and learning outcomes in schools

Figure 4
Impact investing in education: key themes

Geographical distribution of impact investing assets



- Developed economies
- Emerging economies

Key sectors of deployment

ECE*	E	Focus is more on bridging the access gap due to insufficient government spend, **e.g., Hippocampus (India)**
K-12	D	**Developed:** Focus is on improving learning outcomes, especially in low-income families, **e.g., charter schools**
	E	**Emerging:** Focus is on bridging the access gap due to insufficient government spend, **e.g., SEED, Bridges**
HE**, TVET	D	Focus is on improving access to HE, reducing dropout rates and boosting employability for students from low-income families, **e.g., Penn Foster**
School financing	E	Focus is on providing financial support to low-income families for access and to schools for infrastructure support, improving learning outcomes, **e.g., Varthana**
EdTech	D, E	An emergent theme across **both** types of economies, enabling technological advancements to innovate solutions, **e.g., Dreambox (U.S.), Zaya Labs (India)**

D Developed E Emerging

* ECE — Early Childhood Education; **HE — Higher Education
Source: L.E.K. research and analysis

Figure 5
Innovations to in social financing

	Governments and Multi Lateral Agencies	Private Institutional Investors / Philanthropists		Private Individuals
Lending / GrantS	**Multilateral Hybrid Funding** Global institutions leveraging various financial instruments	**Income Share Agreement** Students pledge part of future earnings to secure loans	Blair	**Peer to Peer lending** Crowd funding platforms
Lending / GrantS	The International Finance Facility for Education (IFFFEd)	**Variable rate loans** Lower than market rate lending	Varthana	
Lending / GrantS	**Advanced market commitments** Financial intermediaries create market for good to boost production			
Lending / GrantS	**Debt buy downs and debt swaps** A financial stronger entity agrees to pay a loan / waive off the loan of financially weaker entity, in return of the financially weak entity making social investments (typically at governmental level)			
Investing	**Green bonds** Similar to green bonds, energy bonds. Have been proposed, not demonstrated.	**Off-shoot funds of PE houses** Focused expertise in impact investing	The Rise Fund	
Investing	**Social impact bond** 3 way partnership involving government, an investor and a service provider	**Development impact bond** 3 way partnership involving an outcome payer, an investor and a service provider	Educate Girls	

Exists in education sector (grey)
Not demonstrated in education yet (yellow)

Source: Industry reports; L.E.K. research and analysis

in Rajasthan and India. UBS invested $270,000[4] in the project and earned an internal rate of return of 15%, as the project was highly successful and met all its targets.

Other models are also being explored in the social financing space, with several models increasingly finding applications in the education sector. Among them is a mix of equity and debt financing tools used to provide capital against measurable outcomes as well as other models such as income share agreements, peer-to-peer lending, education bonds and debt swaps (see Figure 5).

Traditional private equity houses turn to impact investing

Regardless of the model used and despite being a nascent sector, impact investing has delivered desirable returns. For example, Unitus Capital, a financial advisor, has facilitated three exits in Indian education companies, at a median investment return upwards of 25%-30% for a five-year holding period.

Realizing the fundamental value of an impact and social investment, as well as the commercial potential, a number of private-equity (PE) houses have set up specialized impact investment arms. The Rise Fund by TPG, Bain Capital's Double Impact Fund and the Partners' Group's PG Impact Investments are some notable examples.

Due diligence and critical success factors in impact investing

Besides the traditional metrics that investors consider before making for-profit investments, impact investments in education require additional due diligence.

First, the nature and scale of the challenge have to be assessed. Investors should look to invest in organizations focused on wider challenges — as opposed to those focused on niche problems — to expand the opportunity set and improve returns.

Second, high-quality assets will need to be identified. The focus should be on identifying organizations that have a clear path to achieving their social objectives, high scalability and replicability, and low reliance on external factors. Nearly 80% of spending in the education sector is driven by governments, as opposed to 60% in healthcare, meaning the number of investable assets is lower. Moreover, most social enterprises are innovative, raising difficulties in identifying the solutions that will work or the benchmarks they can be measured against. Plus, solutions in education are context-driven and there are few hard, measurable targets.

Third, there are multiple impact drivers. Learning outcomes are governed by the quality of content and availability of teachers and infrastructure, among other things. Investors should focus on solutions, where the impact of external variables are assessed appropriately and can be controlled. However, this does not mean operators that work on the entire education value chain should be favored, since they may face additional challenges in delivering outcomes.

Last, the impact of the investment will have to be measured, with investors working to ensure the impact is quantifiable by employing external assessment resources, developing assessment frameworks and embedding impact measurements within program configurations.

Investors and those receiving funding need to be aligned on outcomes, the methodology of assessing the outcomes and the timeline for delivering the desired results. Since the outcomes are mostly social and vary by problems and solutions, they will have to be separately identified. Furthermore, investors need to be aware that the gestation period for social outcomes can vary significantly across solutions, and this needs to be factored in when setting expectations for returns from an investment.

Conclusion

While impact investing in education is relatively new, the potential opportunity set is massive, and with a number of innovative investing tools still being explored, returns from these investments can be on par with, or even in excess of, the broader market.

A number of philanthropies are already at play and PE houses are setting up dedicated arms, but there's scope for several players to partake in the market, especially with the United Nations' goal of achieving universal education only a decade away.

Endnotes

[1] Annual spend estimates, based on the report "Learning Generation" by the International Commission on Financing Global Education Opportunity.

[2] Based on the annual impact investor surveys conducted by GIIN.

[3] Charter schools are public schools in the U.S. that are managed by nongovernment operators and can be either for-profit or not-for-profit entities.

[4] Total cost of the project, including administration and management, was $1 million.

About the Authors

Sudeep Laad is a Partner at L.E.K. Consulting and a founding member of the firm's Global Education practice. He has particular expertise serving a wide range of clients on strategic decisions, investment opportunities and value creation. Sudeep brings in-depth experience in education segments covering K-12, tertiary education, transnational education, after school supplementary education, language learning and education technology. In addition to serving private operators and investors in education, Sudeep leads the practice's work with governments, foundations and impact investors in their education initiatives across Americas, Asia Pacific, Africa-Middle East and Europe.

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Research Lead and Key Contributor

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