Access to Finance for Low Cost Private Schools in Pakistan
The LCPS Report has been completed in collaboration with:

Ilm Ideas is a three year DfID funded, DAI managed programme which awards grants nationwide for the purpose of improving education for children aged 5-16 across Pakistan. Ilm Ideas operates two funds; the Voice and Accountability (V&A) Fund & the Innovation Fund aimed at fostering public demand for increased accountability and transparency in the education sector, and supporting and scaling up education solutions that create value for people and communities.

Socio-Economic & Business Consultants Pvt Ltd (SEBCON) was established in 1987 and is engaged with cultivating an indigenous capacity for research on key development issues facing Pakistan today. SEBCON has extensive experience in community based development, impact assessments and evaluations, and social sector development.
ACCESS TO
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IN PAKISTAN
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The study on *Access to Finance For Low Cost Private Schools in Pakistan* was commissioned by Ilm Ideas with support from UK Department for International Development (DFID) in partnership with Socio-Economic Business & Consultants Pvt Ltd. (SEBCON).

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ACRONYMS AND ABBREVIATIONS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Definition</th>
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<tbody>
<tr>
<td>ASER</td>
<td>Annual Status of Education Report</td>
</tr>
<tr>
<td>CB</td>
<td>Commercial Bank</td>
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<tr>
<td>CIB</td>
<td>Credit Information Bureau</td>
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<tr>
<td>CNIC</td>
<td>Computerised National Identity Card</td>
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<td>DFI</td>
<td>Development Finance Institution</td>
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<td>DFID</td>
<td>Department for International Development</td>
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<td>eCIB</td>
<td>Electronic Credit Information Bureau</td>
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<td>EFA</td>
<td>Education Funding Agency</td>
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<td>EOBI</td>
<td>Employees’ Old-Age Benefits Institution</td>
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<td>FAS</td>
<td>Foundation Assisted Schools</td>
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<td>FIP</td>
<td>Financial Inclusion Programme</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GGGGR</td>
<td>Global Gender Gap Report</td>
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<td>GMR</td>
<td>Global Monitoring Report</td>
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<td>GoP</td>
<td>Government of Pakistan</td>
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<td>GPI</td>
<td>Gender Parity Index</td>
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<td>HS</td>
<td>Higher Secondary</td>
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<td>KP</td>
<td>Khyber Pakhtunkhwa</td>
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<tr>
<td>KVSI</td>
<td>Key Visible School Indicator</td>
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<tr>
<td>LCPS</td>
<td>Low Cost Private School</td>
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<td>LCPHSS</td>
<td>Low Cost Private Higher Secondary School</td>
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<td>MDGs</td>
<td>Millennium Development Goals</td>
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<td>MFB</td>
<td>Microfinance Bank</td>
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<td>MF-CIB</td>
<td>Micro-Finance Credit Information Bureau</td>
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<tr>
<td>MFI</td>
<td>Microfinance Institution</td>
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<tr>
<td>MSME</td>
<td>Micro Small Medium Enterprise</td>
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<tr>
<td>NADRA</td>
<td>National Database and Registration Authority</td>
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<td>NER</td>
<td>Net Enrolment Rate</td>
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<td>NGO</td>
<td>Non Governmental Organisation</td>
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<td>NP</td>
<td>Net Profit</td>
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<tr>
<td>OOS</td>
<td>Out Of School</td>
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<td>OOSC</td>
<td>Out of School Children</td>
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<tr>
<td>PEF</td>
<td>Punjab Education Foundation</td>
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<tr>
<td>PKR</td>
<td>Pakistani Rupee</td>
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<tr>
<td>P &amp; L</td>
<td>Profit and Loss</td>
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<td>SBP</td>
<td>State Bank of Pakistan</td>
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<td>SE</td>
<td>Small Enterprise</td>
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<td>SIF</td>
<td>School Improvement Finance</td>
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<td>SLEF</td>
<td>School Level Enhancement Finance</td>
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<tr>
<td>SME</td>
<td>Small and Medium Enterprises</td>
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<tr>
<td>STR</td>
<td>Student-Teacher Ratio</td>
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<td>UC</td>
<td>Union Council</td>
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Pakistan’s education industry provides a classic impact investment opportunity for private sector finance. Until now, the public sector has been playing a dominant role in the education industry. However, with increasing fiscal pressures, growing un-met demand for education, weak management of the public education system, and perceived poor quality of the public schools there is a structural gap on the supply side. Moreover, given the large number of out of school children and poor performance on international education indicators, there is a strong case for private sector intervention at the service delivery level either under a public-private partnership framework and/or on its own.

Identifying this profitable gap and weak competition from the public sector, micro and small enterprise (within the MSME space) entrepreneurs have, to a large extent, successfully executed an operating model for low cost private schools (LCPSs) that has positioned it at a competitive advantage over the public schools. The successful model has been replicated across the country growing at an exponential rate so that it accounts for 30% of the total school enrolment in 2012. Critical to their success LCPSs’ business strategy is aligned with parents’ preferences, maintains a flexible pricing structure, and boasts a lean cost structure. Thus far, LCPS sub-sector growth has been financed by LCPS owners’ personal savings and/or informal borrowings. Both of these sources have been used as owner equity for start-up investment and growth capital. Thus the LCPS sub-sector is under-leveraged and lacks large-scale private equity investment, professional management and a focus on improving learning outcomes. LPCS owners are, however, interested in and willing to explore external finance opportunities. Until now, they have been unaware of the limited education support services that do exist and/or lack the financial resources to access these services. Thus, the LCPS sector is a classic case for impact finance investors, targeting the base of the pyramid investment opportunities.

For the UK’s Department for International Development (DFID), addressing the “education emergency”1 in Pakistan is a key priority. DFID education programing has the ambition to increase the number of children in primary education by four million whilst eliminating the gender gap in schools. The public education system is central to this work, but given its recent growth rates, the LCPS sector is emerging as a key ancillary tool for improving enrolment rates and the quality of schooling in Pakistan.

DFID is also engaged in supporting the financial inclusion agenda in Pakistan. At present, DFID’s interventions focus primarily on extending commercial wholesale funding to microfinance providers and encouraging commercial banking lending to Micro-Small-Medium Enterprises (MSMEs).

As part of DFID’s strategy to achieve its education sector objectives of increasing enrolment rates and enhancing the quality of schooling in Pakistan, while increasing access to finance for the MSME segment, DFID commissioned this study as part of a wider commitment to access to finance that can develop a more sustainable business model for LCPSs. The study builds upon the DFID-funded and State Bank management Financial Inclusion Programme (FIP). FIP identified a lack of collateral as a major barrier to accessing finance for small businesses and has responded by introducing a credit guarantee that compensates the lender for a portion of the risk, should the borrower default. The study is expected to help inform the design of a long-term programme that seeks quality improvements in Pakistan’s private education system through the targeted use of credit linked to an expanded market in education support services.

There is little private sector development research that analyses the LCPS sector from a MSME entrepreneurship perspective in Pakistan. However, an International Finance Corporation (IFC) report on private schools in Pakistan2 asserts that 76% of private schools produce financial statements. While low fee schools are increasingly viewed as an attractive investment proposition for commercial investment purposes, it is essential to explore financing options for such schools to secure long-term financial viability.

The objective of this study is to determine how impact lending – bank credit from both microfinance and commercial banks – can be provided to the LCPS owners or education entrepreneurs, also referred to as “edupreneurs” for quality improvements and sustainable expansion.

Our survey data suggests that in order to reach informal LCPSs there is a need for an approach within the
microfinance sector. This report proposes a programme-based lending model, developed for microfinance institutions with indicative loan products designed to respond to the distinct needs of LCPSs.

The financial products suggested by this study are already being piloted with selected microfinance banks and institutions, and are based on an understanding of the pilot LCPS's cash flows (a 'non-collateralised lending model'), and determined by school enrolment and fee levels. A key assumption is that where a school has been in operation for more than two years, the model provides a fairly accurate assessment of any particular LCPS, because the standard operating model of schools across a variety of fee ranges and enrolment levels is reasonably predictable. Therefore pilot lenders can use the tools detailed in the study without acquiring the kind of detailed financial information and analysis on any particular schools that has previously been such a challenge for loan officers in the branch network.

We hope that this study and the pilot make a strong case that access to finance can be used as a key instrument to support growing enrolment and improved learning outcomes for children. For DFID and for all those working on access to finance for education in Pakistan, we need to build the evidence as to how best to support LCPSs to achieve these objectives. We encourage all interested parties to adopt and develop the tools, the methodology and to take our study findings and build upon them, so that we can better understand what edupreneurs most need and how to support them in achieving a sustainable and thriving industry that serves the children in Pakistan to the best of its ability.
This section provides the contextual background of education in Pakistan and recent growth in the private sector education system. It concludes with an overview of the DFID-commissioned study that analyses the low-cost private school (LCPS) financial model and the demand for external finance and provides a sector-based investment approach.

**Contextual Overview**

Located in South Asia, Pakistan is the sixth most populous country with 180.8 million people, 28.6% of which are children between five and fourteen years of age. Moreover, 43.6% are children under 18 years of age. With per capita nominal gross domestic product (GDP) of US$2,686 in 2012, a score of 0.515 on the Human Development Index in 2013 and the inequality adjusted index of 0.356, Pakistan ranks 146th out of 187 countries in human development. FIGURE 1 highlights some of Pakistan’s key educational statistics.

**FIGURE 1: Pakistan’s Key Education Statistics**

<table>
<thead>
<tr>
<th>Status - 2012</th>
<th>Target</th>
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<tbody>
<tr>
<td>Net primary enrolment ratio (%)</td>
<td>57</td>
</tr>
<tr>
<td>Completion/survival rate: Grade 1 to 5 (%)</td>
<td>58</td>
</tr>
<tr>
<td>Literacy Rate (%)</td>
<td>58</td>
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Within the South Asia region, Pakistan has one of the lowest literacy rates. In fact, almost half of Pakistan’s adult population is illiterate. Primary school retention rates are likewise low. In recent years, efforts to strengthen the provision of education improved literacy rates and the net enrolment rate (NER) by only 1% between 2009 and 2012. The NER for primary school (children ages 6-10), however, was reported to have improved from 56% in 2010 to 68% in 2012.

According to the 2010 UNESCO Education for All (EFA) Global Monitoring Report, a child’s gender, wealth and the location of his or her household have a strong influence on whether he or she is enrolled in school. However, as children get older, the gap between rich and poor tends to widen; children from disadvantaged backgrounds are called to contribute to the family income and subsequently are likely to withdraw from school. In fact, 50% of children between 7 and 16 years of age from the poorest households are considered out-of-school children (OOSC) in Pakistan. Furthermore, female literacy and girls’ school enrolment rates are particularly low in rural areas of Pakistan, at 33% and 48%, respectively. TABLE 1 summarizes Pakistan’s 2010 data on OOSC and dropout rates.

According to the latest Global Monitoring Report on EFA, the poorest girls in Pakistan are twice as likely to be out of school as the poorest girls in India, almost three times as likely as the poorest girls in Nepal and at least six times as likely as the poorest girls in Bangladesh. Thus, Pakistan is a long way’s away from reaching universal primary enrolment in comparison to its neighbors in South Asia.

Macroeconomic analyses show that the large number of OOSC in Pakistan and mean years of schooling (5.59 years in 2010) are linked to an estimated loss of per capita income. A study commissioned by Educate a Child conducted a microeconomic cost estimation and macroeconomic estimation to determine how much higher Pakistan’s GDP would be today if the prevalence of OOSC

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3 UNDP, 2013
4 World Bank Data, 2013
5 HDR 2013
6 Ibid, 2013
7 UNICEF, 2013
8 PSLM, 2011-2012
9 Ibid, 2012
10 The literacy rate increased from 57% in 2009 to 58% in 2012. The net enrolment rate (NER) increased from 56% to 57% in the same period.
11 PSLM, 2012 (pg., 23)
12 EFA Global Monitoring Report, 2011
13 Pildat, 2011
14 Burnett, N., & Guston-D, A., 2013
had been reduced. The study found that there is an estimated loss of per capita income of 5.2% of GDP as a result of the large number of OOSC in Pakistan. The percentage of OOSC aged 5-9 (10%) derives a direct cost of 0.8% of GDP and the probability-weighted GDP loss from a forgone secondary education is 0.5%.16

Although education is pivotal in the development of an informed citizenry and the economic growth of nations in the globalized world, the provision of education in Pakistan remains heavily reliant on historically low and static government budgets. FIGURE 2 highlights recent expenditures on education in Pakistan.

In this context, it is inevitable that other options and non-state players in education be considered and evaluated.

The use of neo-liberal frameworks has taken root in the development and planning policy discourse and has served to encourage private sector involvement in all aspects of education provision: financing, management, implementation, incentives, legal and institutional arrangements. This partnership has the potential to enhance the efficiency of the public sector, to reduce public expenditures, and to share both targets and risks.

Considering the poor public education delivery system, it is now crucial to devise strategies that remove constraints to growth and functioning of private sector educational institutions. Public-private-partnerships (PPPs) are becoming more common in the education sector and privately-owned and operated schools are expanding rapidly. Many argue that private sector involvement can increase accountability, quality and diversity in education systems.17

The private education sector in Pakistan has expanded dramatically in the last two decades. Such expansion is in part a response to an increasing demand for provision of education from a rapidly expanding school-age population, as well as the public sector’s inability to attract and provide education to all of these potential students. The number of private schools has multiplied almost three fold – at a much faster rate than the number of public sector schools. Most of this growth has been within low cost private schools (LCPS), which are mostly concentrated in urban and peri-urban areas and now account for 30% of total enrolment.18 LCPSs are those privately owned and operated schools charging low fees, often ranging between PKR 10 and PKR 2500. For many years now, the private education sector - especially at the primary level - has been recognised as one of the fastest growing sub-sectors of the education industry in the country. FIGURE 3 summarizes the education delivery system in Pakistan.

As has been demonstrated from the survey conducted for

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15 Burnett, N., & Guston-D, A., 2013
16 UNICEF, 2013
17 Robertson, et al., 2014
18 PSLM, 2012
this project, LCPSs, which resemble other typical informal enterprises, can be categorized as part of the Micro-Small-Medium Enterprise (MSME) segment. LCPSs converge two important areas for Pakistan’s development – education and access to finance for MSMEs.

For the UK’s Department for International Development (DFID), addressing the “education emergency”19 in Pakistan is a key priority. DFID education programing has the ambition to increase the number of children in primary education by four million whilst eliminating the gender gap in schools. The public education system is central to this work, but given its recent growth rates, the LCPS sector is emerging as a key ancillary tool for improving enrolment rates and the quality of schooling in Pakistan.

DFID is also engaged in supporting the financial inclusion agenda in Pakistan. At present, DFID’s interventions focus primarily on extending commercial wholesale funding to microfinance providers and encouraging commercial banking lending to Micro-Small-Medium Enterprises (MSMEs).

As part of DFID’s strategy to achieve its education sector objectives of increasing enrolment rates and enhancing the quality of schooling in Pakistan, while increasing access to finance for the MSME segment, DFID commissioned this study as part of a wider commitment to access to finance that seeks to develop a more sustainable business model for LCPSs. The study builds upon the DFID-funded and State Bank management Financial Inclusion Programme (FIP). FIP identified a lack of collateral as a major barrier to accessing finance for small businesses and has responded by introducing a credit guarantee that compensate the lender for a portion of the risk, should the borrower default. The study is expected to help inform the design of a long-term programme that seeks quality improvements in Pakistan’s private education system through the targeted use of credit linked to an expanded market in education support services.

The objective of this study is to determine how impact lending – bank credit from both microfinance and commercial banks – can be provided to the LCPS owners or education entrepreneurs, also referred to as “edupreneurs” for quality improvements and sustainable expansion.

There is little private sector development research that analyses the LCPS sector from a MSME entrepreneurship perspective in Pakistan. However, an International Finance Corporation (IFC) report on private schools in Pakistan20 asserts that 76% of private schools produce financial statements. Others have conducted valuable research on low cost private schooling in Nigeria and Kenya.21 Research from India22 indicates that low-fee schools are an investment opportunity for private capital. While low fee schools are increasingly viewed as an attractive investment proposition for commercial investment purposes, it is essential to explore financing options for such schools to secure long-term financial viability. There is a need for further research to establish that LCPSs can be sustainable enterprises.
The Study

This report does not directly address the issue of quality in private education in Pakistan. Rather, the report focuses on understanding the economic model of LCPSs in order to determine if LCPSs are credit constrained, need and want credit, can service credit, and can benefit from access to financing opportunities. It also aims to highlight the financial reality of LCPSs, their business model, their needs and the possibility of developing specific products, to be provided by mainstream financial institutions (micro-credit institutions in this case), catering to the needs of LCPS schools.

A purposive sample of 305 primary, middle and secondary private schools was selected from the Punjab, Sindh and Khyber Pakhtunkhwa. Fees across the surveyed schools ranged between PKR 300 per student per month to PKR 2,000. While this is not a statistically representative sample of schools across all of Pakistan, there is a wide variation across urban and per-urban areas, across the provinces that have the bulk of the private schools, and across the range of school fees charged. Surveys with owners, interviews with owners/Administrators, and focus group discussions with parents were conducted to collect relevant information about the schools.

The broader scope of this study, therefore lies in the challenge of identifying common objectives between seemingly disparate financial inclusion and education goals and between informal MSMEs and large financial institutions. If increasing enrolment and improved learning outcomes are to be achieved on the scale that is needed, then it is evident that new capital will be required, in a size that neither the donor community, nor the government, nor the family savings that currently finance low cost private schools are able to provide. Creating new and innovative financing sources for the private sector should be an immediate priority.23

There are three core components to this study: i) the operating model of LCPSs based on a survey of 305 LCPSs across Pakistan; ii) the design of a programme-based lending model and lending tools; iii) a lending pilot, linked with the provision of educational support services to raise quality.

The survey data shows that LCPSs are profitable business ventures and sustain their operations independently, at a low cost. Some LCPSs demonstrate the potential to meet creditors’ interest and terms. A sector-based programme lending model, similar to that outlined in this report offers an innovative approach to sector-based lending that can be adopted by financial institutions to help strengthen their credit appraisal process and unlock access to finance for well-managed, sustainable LCPSs.

The third component of the research is a pilot to be undertaken later, to develop linkages between access to finance and input markets (education support services), thereby linking credit with quality in the minds of stakeholders. Whilst an initial pilot, based on this research will primarily help facilitate lenders to use the programme-based lending model detailed in this report, education support services will also be central to the pilot and our long-term vision is the realisation of a commercially responsive and responsible education sector where LCPSs can not only access finance, but they can also access input providers – education support services - and that the relationship between credit and quality provision become as linked as the relationship between borrower and lender. That no functioning education market place (where education service providers recognise the commercial value of their services) currently exists is indicative of a market failure, and a key element of this failure in the inability of edupreneurs to access the capital needed to purchase inputs to raise quality. Most edupreneurs are unaware of the education services offered. Through the third component – an ongoing pilot – we are not only trying to link LCPS sector to the financial institution to address access to finance issues, but also to some extent create a market place where edupreneurs will have access to education services as well. There is a role for donors in tackling this situation: helping edupreneurs to identify and then access these services, and helping lenders to provide credit to facilitate a functioning market.

Some microfinance institutions, like Kashf Foundation, Khushali Bank and The First MicrofinanceBank are already engaged in studying the LCPS sector, and they are considering sector-based approaches to lending in partnership with established education stakeholders, such as the Education Fund for Sindh (EFS). The Pakistan Microfinance Network plans to issue a briefing paper on the topic, reflecting the wider interest of the microfinance industry in Pakistan. The State Bank of Pakistan, as the regulator of microfinance banks, is ensuring that regulations support microfinance

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23 IGC Pakistan, 2010
banks to develop enterprise lending models that will help microfinance banks develop small business lending models. A Centre for Economic Research Pakistan evaluation in Punjab, partnering with Aman Foundation and Tameer Microfinance Bank, is piloting education sector loans and grants and like Ilm ideas project, pioneering discussions around the concept of an education marketplace.

For its part, the wider education service sector is developing the tools to help schools improve the quality of teaching, curriculum and business management, an approach sometimes referred to as a “school in a box.” School franchise models have already demonstrated a successful model for school improvement and increased enrolment based on access to capital that a strong franchise can provide. The work of the Punjab Education Foundation is demonstrating that there is an important dynamic between public and private schooling that presents opportunities for collaborative service provision and economies of scale, mutual learning and partnership.

Can access to finance be used as a means of not only addressing access issues through growth in LCPS but education quality issues too? This important question requires more research and fieldwork and is detailed at the end of the report. The purpose of this report was limited to understanding the financial model of LCPSs and their profitability by assessing their credit constraints and developing products that would be suitable for addressing the credit needs of LCPS given all the relevant constraints they work under. The pilots that DFID has initiated, based on this report, will not only experiment with the products developed here but will also provide some opportunity to investigate the links between access to finance and the provision of quality education in Pakistan.

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CHAPTER 1: LCPS SECTOR ANALYSIS

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The Private Education Sector in Pakistan

Private sector education, especially at the primary level, has been one of the fastest growing sectors of Pakistan’s education industry over the last two decades. Recent estimates show that around 30% of enrolled children in Pakistan attend private schools. Private sector involvement is not a new phenomenon in Pakistan. In fact, the private sector had a share of almost 70% of service provision at post primary levels prior to nationalisation (1972) and has regained popularity progressively, in recent years, as a complementary mode of education provision in the country. As a result, for-profit schools grew exponentially since the 1990s, expanding in urban and increasingly in rural areas across the nation, especially in Punjab. It is estimated that between 1999 and 2009 the number of private schools (low-, middle- and high-income) multiplied almost three-fold, and over the same period, the private sector grew ten times faster than the public sector.

Approximately 31% of boys and 33% of girls ages (6-10 years) in Pakistan attend private primary schools. The corresponding percentage for older children ages 11–15 years attending private schools is 26% for boys and 30% for girls. Almost all the gains in school enrolment across the nation during the last decade, particularly at the primary level, can be attributed to private schooling. However, the spread of private education has been uneven: with a greater number of private schools in urban areas. In larger cities like Karachi and Lahore, private schools enrol more than 70% of the student population.

FIGURE 4 shows the primary school enrolment rate by income quintiles in Pakistan.

LCPS Sector Analysis

This section provides an overview of the LCPS sector dynamics and assesses the sector from the perspective of its contribution to the overall education industry and for private impact investment.

LCPS are mostly single proprietor-owned and run micro-, small- or at best medium-sized enterprises/operations, are largely proprietorships and are unsupported by external organisations. LCPSs are operational in either rented or self-owned residential buildings in local urban and rural communities.

In the absence of an effective public sector approach to addressing the “education emergency” in Pakistan, LCPSs have carved a niche as a local and customised solution, offering access to education for the middle, lower-middle and low-income segments of Pakistani society.

25 Tooley & Dixon, 2005
26 Pakistan Education Task Force, 2010
27 Tooley & Dixon, 2005
28 Pakistan Education Task Force, 2010
29 Tooley & Dixon, 2005
30 Pakistan Education Task Force, 2010
31 Tooley & Dixon, 2005
32 Pakistan Education Task Force, 2010
33 Pakistan Education Task Force, 2010
Private schools operate at different levels and offer services to all layers of socio-economic segments and areas in Pakistan. The sector features a highly varied range of fee structures and diverse operating models ranging from single elite schools and large networks of schools catering to the upper and middle-income segments of the population to LCPSs that cater to lower-middle and low-income households.

Primary enrolment into private schools by income quintiles shows that the share of private schooling mirrors the growth in income levels as illustrated in the figure above. Even for the first quintile, the enrolment in private schools is significant. Figure 5 highlights recent growth trends in the private education sector by province in Pakistan.

The LCPS sector in Pakistan accounts for about one-third (30%) of primary school enrolment. It serves 10.5 million students out of a total enrolment of 35.2 million, making it an integral part of Pakistan’s education system.

The average expenditure of a Pakistani family on a single primary school student is PKR 370 per month resulting in an average spending of PKR 4,423 per annum per child. However, urban households spend more than twice as much as rural households spend on each primary school student. At the same time, parents from urban households whose children attend private primary schools spend, on average, more than three times as much as those whose children attend government primary schools. Significantly, a majority of participants in focus group discussions reported that they paid for private tuition on top of school fees, as they expressed their inability to teach children at home. However, whilst we have no statistical evidence as to the extent of private tuition, this is an important observation, which has implications for the whole question of affordability.

34 It has been argued that LCPS are less successful in reaching the poorest of the poor (Harma, 2010) although such assertions would be challenged by others (Tooley, 2009). Despite these debates it is clear that in the medium term the state sector would not be able to absorb the number of children currently enrolled in the LCPS sector or vice versa, therefore any holistic support of education in Pakistan will need to take into account how to best support the LCPS sector.
35 PSLM, 2012
36 ASER Pakistan, 2012; The numbers differs across provinces a great deal, with substantial growth in the number of rural private schools in Punjab and KP, but very few private schools in rural Sindh and rural Balochistan – the major constraint being the availability of teachers locally.
37 Pakistan Education Statistics, 2011
38 Further research is needed into fee levels and family income of children attending private schools. The PEIP survey from 2000 found the median school fee for urban private schools was PKR 960, and for rural private schools it was PKR 751.
39 PSLM, 2012
Considering the affordability patterns of an average household to educate a child and the evident quality gap in public sector education, LCPSs are perceived as local and customised solutions that offer better learning opportunities to middle, lower-middle and poor segments of Pakistani society.

LOW COST PRIVATE SCHOOLS’ COMPETITIVE ADVANTAGE

Proximity has been shown to be a key determinant of primary school choice in the country.40 The LCPS sector has in many ways filled this gap. LCPSs usually operate in close proximity to the communities they serve, ensuring a safer commute to school for children.41 Long distances from schools, particularly at the middle and high school level, become the foremost reason for parents to keep girls at home. In addition, the population growth rate, and resultant increase in numbers of school-age children, has far exceeded the rate at which the state has been able to build schools. Therefore, LCPSs expand access to schooling for rural children and female students.

Conducive environment for female students: Focus group discussions with parents found that hiring female staff provides peace of mind and comfort to families when daughters attend school either as students or teachers.42 In its turn, improved access contributes to increased girls’ enrolment in schools. Evidence suggests that the LCPS sector is able to increase equity and access to education especially for female students due to its more tailored relationship with communities.

Client-focused business approach: The study also found that edupreneurs respond to parental demand, and during our research, they discussed the considerable pressure they feel from parents. Edupreneurs most certainly recognise that keeping parents satisfied leads to increased student retention and through reputation, serves to boost enrolment. This responsiveness to parental demand is a key difference between the public and private sector. However, it is difficult for parents to properly assess the quality offered by individual schools, and perceptions of quality can often be conflated with more observable proxies, such as the fee level and use of branded books and internationally-recognised syllabi. As rational economic actors, edupreneurs largely focus on these proxies in order to better market their schools, rather than focusing on ensuring improvements in purely learning-related factors.

Better student performance in LCPSs than in public schools, on average has been shown in recent studies43 on student performance on tests. Likewise, evidence has shown that by the time children in private schools are in class three, they are 1.5-2.5 years ahead of government school students.44

Parents’ preference for LCPSs: In recent years, there has been a noticeable increase in parental willingness to pay for better learning opportunities for their children. This is evident in the growth of private school enrolment even amongst lower socio-economic segments of society. Evidence in Pakistan suggests that when they have the choice, many parents prefer to send their children to low cost private schools instead of government schools.45

LCPS CONSTRAINTS

Nevertheless, edupreneurs are limited in their ability to expand their LCPSs, enhance access and improve the overall quality of educational opportunities. This section briefly highlights some of the key constraints in the LCPS sector.

Limited enterprise financial resources: There are limits to how far and how fast a LCPS can expand, given that school-fees are the main, if not the only source of revenue

40 Alderman, Orazem, Paterno, 2001
41 Careineiro, Das and Reis, 2010
42 Tahir, A., Jishnu, D., & Ijaz, K., 2008
43 ibid, 2008
44 LEAPS, ASER, 2007
45 Andrabi, 2007
46 Andrabi, Das, & Khwaja, 2006
for most edupreneurs. Thus, their ability to expand capacity is limited by the resources available to them. The survey undertaken as part of this study provides detailed evidence about these constraints.

**Lack of investment in quality factors:** Edupreneurs direct insufficient attention to (and inadequate investments in) substantial improvements in the quality of education provided in their institutions, mainly because they believe that these investments are more risky, require more capital and may have a delayed payback period. A strong case emerges for developing mechanisms that can address these concerns, and this study looks in particular at how access to finance can be a useful response.

**COMPETITIVE LANDSCAPE**

While the public sector has been the dominant education provider in Pakistan, its quality and capacity have not developed over time to meet the challenges of the country’s increasing population. **FIGURE 6** highlights the percentage of schools and enrolment in the public and private education sectors of Pakistan. **TABLE 2** provides the numbers for public and private sector enrolment.

**FIGURE 6:** Public and Private Education Enrolment

The public education system is characterized by poor oversight, non-transparent practices, insufficient and weak basic infrastructure across the sub-sectors of primary, middle and secondary levels, poor management, monitoring and teaching practices, and overall a poor quality of education. Over time, these factors have led to lower enrolments and even lower transition rates from one level of education to another. Heavily dominated by the public sector, Pakistan has some of the worst indicators in the world and is placed second only to Nigeria with respect to the highest number of out-of-school children at the primary level. **FIGURE 7** highlights the OOSC in low-income countries.

### TABLE 2: Enrolment by Sector (Public vs. Private)

<table>
<thead>
<tr>
<th>Province</th>
<th>Public Schools</th>
<th>Enrolled in Public Schools</th>
<th>Private Schools</th>
<th>Enrolled in Private Schools</th>
</tr>
</thead>
<tbody>
<tr>
<td>Punjab</td>
<td>57,410</td>
<td>10,539,517</td>
<td>41,972</td>
<td>7,907,535</td>
</tr>
<tr>
<td>Sindh</td>
<td>50,217</td>
<td>4,257,326</td>
<td>9,704</td>
<td>2,603,930</td>
</tr>
<tr>
<td>KP</td>
<td>27,153</td>
<td>4,110,123</td>
<td>6,321</td>
<td>1,432,565</td>
</tr>
<tr>
<td>Balochistan</td>
<td>12,346</td>
<td>1,072,256</td>
<td>874</td>
<td>213,396</td>
</tr>
</tbody>
</table>

**46** Pakistan Microfinance Network’s Policy Note was developed in parallel to this research study that highlights the prospect of a sector-led approach for financing of LCPS through microfinance. It looks at the role of various stakeholders, including microfinance providers (MFPs), low cost private schools, donors and policy makers in building a viable business case for microfinance interventions targeting the LCPS sector.

**47** Supported by a Constitution of Pakistan (Article 25-A) decreeing that education is a fundamental right and obligation of the state for children between 5-16 years.


**49** Ministry of Education, Pakistan Economic Survey, 2001

**50** EFA Global Monitoring Report, 2012
The demand for improvement creates a monumental challenge rooted in population growth patterns and the lopsided state of the education system in Pakistan. Higher transition rates would require building new schools and rehabilitating existing ones at each successive level of education. This implies higher expenditures, more time and resources as well as greater political will on the part of the government.

As a result of competing fiscal pressures, Pakistan allocates, on average, a mere 2% of its GDP to education, the lowest figure in South Asia. Of this allocation, more than 95% is earmarked for salaries, leaving a very small percentage for initiatives to improve quality in areas such as teacher training, curriculum, textbooks, assessment systems, research, infrastructure improvement, and equity for under-served groups in the poorest two quintiles. As such, there is a high demand for low cost private educational opportunities, now more than ever.

### MARKET POTENTIAL

One in every ten out-of-school primary-aged children (OOSC) in the world\(^51\) is Pakistani. In fact, 29% of all primary school-aged children in Pakistan are OOSC,\(^52\) equating to some 20 million school-age children. Between 5 and 6 million of these children are in the 5 to 9 years of age primary schooling bracket. Considering that there are on average 208 students at the primary level in the schools surveyed, Pakistan would require additional capacity, equivalent to 24,038 primary level schools to cater to the current OOSC. **TABLE 3** provides data on OOSC by province.

The current market potential for the LCPS sector could maintain exponential sector growth rates for the coming many years, depending on the rate of flow of private investment in this sector. However, there is a case for private sector intervention given the scale of market that exists. As will be discussed later in this report, even the LCPSs with the lowest fees generate a healthy net profit margin.

### TABLE 3: Out of School Children by Province in Pakistan\(^53\)

<table>
<thead>
<tr>
<th>Punjab</th>
<th>Sindh</th>
<th>KP</th>
<th>Baluchistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total OOSC</td>
<td>4,500,533</td>
<td>2,644,141</td>
<td>1,519,435</td>
</tr>
<tr>
<td>District (rural)</td>
<td>% of OOSC</td>
<td>District (rural)</td>
<td>% of OOSC</td>
</tr>
<tr>
<td>Rajanpur</td>
<td>40.3</td>
<td>Badin</td>
<td>46.1</td>
</tr>
<tr>
<td>DGK</td>
<td>29.8</td>
<td>Tando Allah Yar</td>
<td>41.4</td>
</tr>
<tr>
<td>RYK</td>
<td>27.2</td>
<td>Shikarpur</td>
<td>40.7</td>
</tr>
<tr>
<td>Chiniot</td>
<td>27.3</td>
<td>Thatta</td>
<td>39.2</td>
</tr>
<tr>
<td>Bahawalpur</td>
<td>23.8</td>
<td>Umrot</td>
<td>36.3</td>
</tr>
<tr>
<td>Lodhran</td>
<td>21.2</td>
<td>Mitiari</td>
<td>35.8</td>
</tr>
<tr>
<td>Multan</td>
<td>20.2</td>
<td>Ghotki</td>
<td>35.4</td>
</tr>
<tr>
<td>Bahawalnagar</td>
<td>19.8</td>
<td>Sanghar</td>
<td>33.2</td>
</tr>
<tr>
<td>Pakpattan</td>
<td>18.9</td>
<td>Daddu</td>
<td>31.3</td>
</tr>
<tr>
<td>Okara</td>
<td>18.4</td>
<td>Jamshoro</td>
<td>29.4</td>
</tr>
<tr>
<td>Vehari</td>
<td>18.3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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52 UNICEF, 2009
DEMAND FOR EXTERNAL FINANCE

The total estimated demand for external finance for the LCPS sector is PKR 77.1 Billion (GBP 440 million). To contextualise this scale, this requirement is 1.5 times the total gross loan portfolio of the entire microfinance sector amounting to PKR 50.8 billion as of September 2013, and 33% of the total SME outstanding loan portfolio of PKR 233.6 billion as of June 2013 (latest figure available).

The survey data provides the financing demand of LCPS for vertical and/or horizontal expansion (and renovation) and funding that can be made available from personal sources for the planned investment.

The total number of registered private schools in Pakistan was used to estimate the number of LCPSs by applying an assumption that 95% of those would be LCPSs. The annual growth rate of schools was estimated at 5% on the actual number of registered schools in 2012 to determine the total number of registered private schools in 2013. The total number of unregistered private schools in Pakistan was estimated by using the percentage of unregistered LCPSs in the survey. Using this information the total number of LCPSs operating across Pakistan are estimated in TABLE 4.

The cost of expansion has been provided by the surveyed LCPSs who expressed a desire to invest in the school operations/infrastructure. Survey data provided the percentage of the investment required that would be contributed through owner’s equity. This is almost one-third of the total financing needs. The remaining two-thirds requires funding through external finance sources.

At the primary level, survey data indicated a financial demand of PKR 1.6 million (US$16,000), of which PKR 1 million would be required in the form of external financing if all of the entrepreneur’s immediate requirements and expansion plans, were to be met. Similarly, the total cost of expansion of the 298 surveyed schools (excluding seven higher secondary schools), including the surveyed LCPSs that did not plan to expand, was PKR 482.47 million of which PKR 153.7 million would be provided as equity investment by the LCPS owners and the remaining PKR 328.7 million would be required from external sources. At the school level this translates into PKR 1.1 million of required average external demand for financing.

The required average external demand for financing for a LCPS was then multiplied by the estimated number of total LCPSs operating in Pakistan in 2013 to estimate the required total external financing required by the LCPS sector. TABLE 5 provides the estimated external financing.

### TABLE 4: Estimated Number of LCPSs

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Registered Private Schools - 2012:</td>
<td>58,871</td>
</tr>
<tr>
<td>Growth rate of Private Schools – 2013:</td>
<td>5%</td>
</tr>
<tr>
<td>Estimated Registered Private Schools – 2013:</td>
<td>61,814</td>
</tr>
<tr>
<td>Estimated percentage of Registered LCPS within Private Schools:</td>
<td>95%</td>
</tr>
<tr>
<td>Total Registered LCPS:</td>
<td>58,732</td>
</tr>
<tr>
<td>Percentage of unregistered schools (from survey):</td>
<td>16%</td>
</tr>
<tr>
<td>Total LCPS (registered and unregistered):</td>
<td>69,919</td>
</tr>
</tbody>
</table>

---

54 Microwatch September 2013 – Pakistan Microfinance Network
56 Pakistan Education Statistics, 2012
needed in the LCPS sector.

However, to enable the LCPS sector to develop into an effective education delivery system with a focus on continuous improvement in learning outcomes and the capacity to operate as long-term institutions, according to the survey results, the LCPS sector requires the following capacity enhancement services:

1. **Business development services:** As will be noted in **CHAPTER 2**, the LCPS management structure is limited and lacks documented financial records. Business planning and budgeting is also not undertaken in a structured manner. Therefore, there is a need for technical expertise to build LCPS owners’ capacity to improve documentation and business management practices.

2. **Professional school management services:** Survey data indicates that the LCPS sector is characterized by unsophisticated management structures. The edupreneur, typically a small micro-enterprise owner, is the main manager. Interviews with the owners also revealed that they own multiple businesses. Therefore, there is a lack of technical expertise for managing school operations.

3. **Teacher training:** Unless the school has access to donor-funded training programmes, there is no functioning market for commercial training for teachers. Also, better quality teacher training can be an expensive investment with no immediate pay-off. Combined, these factors have led to a chronic under-investment in training. In response to questions on their requirement for technical services, a high percentage of respondents showed interest in obtaining training manuals as opposed to technical services.

The above issues could potentially be addressed through either one or a combination of the following:

- a. Donor Interventions to support institution building and develop an education marketplace
- b. Private equity from school networks
- c. Franchise model
- d. Accessing bank credit

Thus, given the recent growth trends in the LCPS sector in Pakistan, as well as the increasing demand for local, private educational opportunities and the need to get OOSC into schools, it is undoubtedly necessary to expand LCPSs. The next two chapters provide a more specific analysis on how LCPSs operate in terms of management and finance.

---

**TABLE 5: Estimations of External Financing Needed for the LCPS Sector**

<table>
<thead>
<tr>
<th></th>
<th>Primary</th>
<th>Middle</th>
<th>Secondary</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Schools Surveyed</td>
<td>84</td>
<td>117</td>
<td>97</td>
<td>298 (7 schools were HS)</td>
</tr>
<tr>
<td>Total Cost of Expansion (PKR)</td>
<td>135,377,000</td>
<td>196,519,500</td>
<td>150,576,009</td>
<td>482,472,509</td>
</tr>
<tr>
<td>Demand for External Finance (PKR)</td>
<td>90,477,950</td>
<td>145,332,250</td>
<td>92,890,208</td>
<td>328,700,408</td>
</tr>
<tr>
<td>Total Cost of Expansion/School (PKR)</td>
<td>1,611,631</td>
<td>1,679,654</td>
<td>1,552,330</td>
<td>1,619,035</td>
</tr>
<tr>
<td>Demand for External Finance per school (PKR)</td>
<td>1,077,118</td>
<td>1,242,156</td>
<td>957,631</td>
<td>1,103,022</td>
</tr>
<tr>
<td>Estimated Number of LCPS</td>
<td></td>
<td></td>
<td></td>
<td>69,919</td>
</tr>
<tr>
<td>Total LCPS Sector Expansion Cost (PKR)</td>
<td></td>
<td></td>
<td></td>
<td>113,201,385,261</td>
</tr>
<tr>
<td>Total LCPS Sector Demand for External Finance (PKR)</td>
<td></td>
<td></td>
<td></td>
<td>77,122,247,743</td>
</tr>
</tbody>
</table>
CHAPTER 2: LCPS OPERATING MODEL

<table>
<thead>
<tr>
<th>Page</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>21</td>
<td>LCPS Market Survey</td>
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<tr>
<td>21</td>
<td>Ownership and Management Structures</td>
</tr>
<tr>
<td>23</td>
<td>LCPS Facilities</td>
</tr>
<tr>
<td>24</td>
<td>LCPS Branch Network</td>
</tr>
<tr>
<td>24</td>
<td>Maintenance of Records and Documentation</td>
</tr>
<tr>
<td>25</td>
<td>Operating Cycle</td>
</tr>
<tr>
<td>25</td>
<td>Business Operations Strategy</td>
</tr>
<tr>
<td>32</td>
<td>Financial Management</td>
</tr>
</tbody>
</table>
Access to Finance for Low Cost Private Schools

This section provides an overview of the low cost private school operation model in order to identify current challenges within the sector as well as to assess the potential impact that investments in LCPSs would have on the expansion of the sector and the quality of education. It further highlights the study’s survey and interview findings, which include feedback from both edupreneurs as well as parents.

**LCPS Market Survey**

Findings from the surveys and interviews with edupreneurs have helped refine the LCPS operating model, identify challenges that affect growth in the LCPS sector as a whole and form an assessment of the potential impact of investment on the expansion of the LCPS sector and its delivery of quality education. The main goal of the survey was to assess the inner workings of these schools, including the financial, managerial and educational aspects, their operational/capital cost structures, their profitability and their financing needs. This assessment was then used to develop the financial model, proposed sector-based lending methodology, and programme-lending product for microfinance and commercial banks- one of the possible private sector investment options.

In this section, we critically examine what the survey data tells us about the school ownership and management structure, premises, and operating cycle. We then look at what the survey data tells us about the operation strategy and financial management of LCPSs. Before we move on to the survey analysis, it is important to place the underlying assumptions of the survey data.

The survey sample data included 305 schools, of which seven were higher secondary schools, which were excluded because of the small number as it is not representative of the sample. From the remaining 298 schools, 56 schools that were in operation for less than two years were also excluded because they had not reached their maturity level. Lastly, for another 14 schools, important financial information was incomplete or validated and hence these schools were also excluded from the financial analysis section. The next several pages highlight how LCPSs in Pakistan are managed and operate.

**Ownership and Management Structures**

According to the survey, 63% of LCPSs are unregistered sole proprietorships, 23% are registered as NGOs and partnerships and 14% are registered companies or registered sole proprietorships.

For all types of LCPS in the survey the typical entity is the unregistered sole proprietorship. However, at the secondary school level there is a higher number of schools that are registered as legal entities, as these schools are approved by the provincial board of examinations. This is likely due to the larger scale of operations and higher investment levels. Figure 8 highlights the legal status of those LCPSs surveyed in this study.

### FIGURE 8: Legal Status of Surveyed LCPSs

- **Sole Proprietorship (unregistered)**: 63%
- **Trust, Society, NGO, Partnerships**: 23%
- **Company**: 14%

57 The legal status distribution of the LCPS, owner’s involvement in the day-to-day operations, and the unsophisticated management structure is representative of the typical smaller and informal enterprises (in emerging markets 90% of micro-small-medium enterprises (MSME) are micro or informal enterprises). Informal and smaller MSMEs would more easily be serviced by microfinance institutions rather than commercial banks, given that MFIs are structured and focused on servicing informal enterprises. The informal nature of the LCPS enterprise also implies that financial institutions should not expect financial statements and documentation to be available with the owners that are generally required by commercial banks for credit underwriting.
The majority of edupreneurs at all school levels manage their own schools. **FIGURE 9** summarizes the surveyed LCPSs management by school level. Owners’ day-to-day presence and direct involvement in school affairs suggests that owners’ salaries and equity returns are one and the same thing. Overall, 82% of the LCPSs surveyed were managed by their owners while only 13% reported having different managers. This structure indicates that in line with other micro, and small businesses, the principal-agent problem (common where ownership and management are separated) is not a major issue for most LCPSs, indicating a high level of accountability.

**FIGURE 9: Management of Surveyed LCPSs**

<table>
<thead>
<tr>
<th></th>
<th>Primary</th>
<th>Middle</th>
<th>Secondary</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>79%</td>
<td>82%</td>
<td>86%</td>
<td>82%</td>
</tr>
<tr>
<td>No</td>
<td>17%</td>
<td>10%</td>
<td>12%</td>
<td>13%</td>
</tr>
<tr>
<td>Partly</td>
<td>5%</td>
<td>8%</td>
<td>2%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Furthermore, the direct involvement of the owner ensures that the business strategy remains aligned with the owner’s understanding of the parents’ (clients) feedback through their regular interaction with parents and overseeing of teachers’ performance. The difference in the quality of management oversight has perhaps been a major contributing factor in increasing the attractiveness of the LCPS sector over government schools for parents. **FIGURE 10** summarizes the management structure of those surveyed LCPSs. The typical LCPS management structure comprises a principal and one shared resource for the positions of vice principal, administrator, and finance and administration. **FIGURE 11** highlights the gender of the owners of the surveyed LCPSs.

Male edupreneurs owned almost four out of five schools surveyed, a trend that is representative of the ownership of small businesses across Pakistan. The survey also shows a significant gender divide in ownership across provinces and school levels with the percentage of female edupreneurs higher in Punjab and Sindh and lower in KP. However, interviews with edupreneurs and focus groups with parents revealed that even where females managed schools, ownership normally resided with male family members who support LCPS operations behind the scenes. Ownership and management structures are likely nuanced by socio-cultural differences across provinces.

**FIGURE 10: Management Structure of Surveyed LCPSs**

- Owner/Sponsor (79% are male)
- Principal
- Vice Principal/Administrator/Finance & Administration
- Teachers
- 82% are managers
- 13% of the schools are NOT managed by the owner
- Multiple responsibilities for Administration

**FIGURE 11: Gender of Surveyed LCPSs Owners**

<table>
<thead>
<tr>
<th>Province</th>
<th>Female</th>
<th>Male</th>
</tr>
</thead>
<tbody>
<tr>
<td>Punjab</td>
<td>23%</td>
<td>77%</td>
</tr>
<tr>
<td>Sindh</td>
<td>19%</td>
<td>81%</td>
</tr>
<tr>
<td>KP</td>
<td>7%</td>
<td>93%</td>
</tr>
<tr>
<td>Total</td>
<td>20%</td>
<td>79%</td>
</tr>
</tbody>
</table>
**LCPS Facilities**

Unlike purpose-built government school buildings, LCPS classrooms, particularly in rented residential buildings are often shared by two classes. These classrooms are small, poorly lit and have little air circulation. Over 50% of the LCPSs surveyed operated from rented residential property as opposed to purpose-built school buildings. Middle schools represented the highest percentage of LCPSs using rented residential property, followed by primary schools. The survey showed a marginal preference among edupreneurs to use rented residential property at all levels of education, most likely because the required start-up capital is substantially lower than that needed to invest in purpose build facilities. **Figure 12** summarizes the type of facilities for the surveyed LCPSs.

Secondary and higher secondary LCPSs are typically in purpose-built buildings. Rented premises are less suitable for secondary and higher secondary schools because aside from the need for additional rooms to accommodate students graduating from lower levels to the higher secondary school level, there is need for more specialised facilities such as science and computer laboratories. Hence, the survey found more privately-owned, purpose-built LCPSs at higher levels of education.

Survey data also showed that the ownership status of the school premises had an impact on the revenue of the school. Revenue per student is higher for schools operating in rented buildings. Among the surveyed LCPSs operating from rented rather than self-owned premises across different school levels, the largest difference is at the primary school level. Primary LCPSs operating from rented premises charge, on average, 42% higher fees than those operating from self-owned buildings. Middle schools operating from rented buildings charged only slightly higher fees (3%), and secondary schools charged fees 9% higher fees than those operating from self-owned buildings. However, the average enrolment levels in schools operating from rented properties remain lower, perhaps due to space constraints while in self-owned properties that are mostly residential there is more flexibility to accommodate a larger student body. Table 6 highlights the status of the surveyed LCPSs’ facilities.

**Table 6: Status of Surveyed LCPS Building Ownership**

<table>
<thead>
<tr>
<th></th>
<th>Primary</th>
<th></th>
<th>Middle</th>
<th></th>
<th>Secondary</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Owned Property</td>
<td>Rented Property</td>
<td>Owned Property</td>
<td>Rented Property</td>
<td>Owned Property</td>
<td>Rented Property</td>
</tr>
<tr>
<td>Enrolment (#)</td>
<td>211</td>
<td>201</td>
<td>278</td>
<td>227</td>
<td>373</td>
<td>284</td>
</tr>
<tr>
<td>Revenue per child (PKR)</td>
<td>7,285</td>
<td>10,605</td>
<td>7,468</td>
<td>6,626</td>
<td>7,777</td>
<td>9,057</td>
</tr>
</tbody>
</table>
Low levels of financial literacy can prevent SMEs from adequately assessing and understanding different financing options, and from navigating complex loan application procedures. Similarly, the fact that SMEs owners’ accounting and financial statements are often not transparent makes them risky borrowers and thus less attractive to lenders.

Almost 14% (33) of the 228 LCPSs (45 of 305) surveyed reported having more than one branch. The graph below illustrates the percentages of schools with multiple branches in the same city, across educational levels. Half of all LCPSs at the higher secondary level have additional branches although this number is not as high as the corresponding figure found at lower levels of education. The prevalence of multiple branches and the extent of edupreneurs’ interest in multiplying their branches indicate the likelihood of high rates of return on LCPS operations and the requirement for additional investment. **FIGURE 13** provides the data on the surveyed LCPSs with multiple branches.

Edupreneurs’ lack of business and management skills have led to additional finance barriers for LCPSs. Typical of informal small- and micro-enterprises, the survey results showed a general absence of operational policies and procedures within surveyed LCPSs and a low prevalence of manuals and policies that are related to the quality of education, teacher performance, administration, and management.58

Systems for maintaining records, policies and procedures were found to be undeveloped in the surveyed schools. Although some basic rules exist, formal records of policies are not kept. However, just over half of surveyed LCPSs did maintain lesson plans, used to monitor learning, and attendance records, used to forewarn owners of parents’ intentions to withdraw their children from school without payment of dues. **FIGURE 14** provides the data on the surveyed LCPS’s policies and procedures.

---

**LCPS Branch Network**

Almost 14% (33) of the 228 LCPSs (45 of 305) surveyed reported having more than one branch. The graph below illustrates the percentages of schools with multiple branches in the same city, across educational levels. Half of all LCPSs at the higher secondary level have additional branches although this number is not as high as the corresponding figure found at lower levels of education. The prevalence of multiple branches and the extent of edupreneurs’ interest in multiplying their branches indicate the likelihood of high rates of return on LCPS operations and the requirement for additional investment. **FIGURE 13** provides the data on the surveyed LCPSs with multiple branches.

**MAINTENANCE OF RECORDS AND DOCUMENTATION**

Edupreneurs’ lack of business and management skills have led to additional finance barriers for LCPSs. Typical of informal small- and micro-enterprises, the survey results showed a general absence of operational policies and procedures within surveyed LCPSs and a low prevalence of manuals and policies that are related to the quality of education, teacher performance, administration, and management.58

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---

**FIGURE 13: Surveyed LCPSs with Multiple Branches**

<table>
<thead>
<tr>
<th>Level</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>85%</td>
<td>15%</td>
</tr>
<tr>
<td>Middle</td>
<td>89%</td>
<td>11%</td>
</tr>
<tr>
<td>Secondary</td>
<td>82%</td>
<td>18%</td>
</tr>
</tbody>
</table>

**FIGURE 14: Existing Policies and Procedures at LCPS**

<table>
<thead>
<tr>
<th>Policy/Plan</th>
<th>Primary</th>
<th>Middle</th>
<th>Secondary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational manual</td>
<td>55%</td>
<td>12%</td>
<td>22%</td>
</tr>
<tr>
<td>HR manual</td>
<td>36%</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>Finance manual</td>
<td>24%</td>
<td>38%</td>
<td>55%</td>
</tr>
<tr>
<td>Curriculum plan</td>
<td>11%</td>
<td>13%</td>
<td>12%</td>
</tr>
<tr>
<td>Prospective</td>
<td>11%</td>
<td>13%</td>
<td>12%</td>
</tr>
<tr>
<td>School investment plan</td>
<td>44%</td>
<td>41%</td>
<td>56%</td>
</tr>
<tr>
<td>School business plan</td>
<td>25%</td>
<td>42%</td>
<td>41%</td>
</tr>
<tr>
<td>Teacher training</td>
<td>12%</td>
<td>26%</td>
<td>26%</td>
</tr>
<tr>
<td>Yearly academic calendar</td>
<td>55%</td>
<td>55%</td>
<td>56%</td>
</tr>
<tr>
<td>Lesson plan</td>
<td>41%</td>
<td>42%</td>
<td>41%</td>
</tr>
<tr>
<td>Reading program</td>
<td>11%</td>
<td>13%</td>
<td>12%</td>
</tr>
<tr>
<td>Syllabus division</td>
<td>44%</td>
<td>41%</td>
<td>56%</td>
</tr>
<tr>
<td>Assessment record</td>
<td>25%</td>
<td>26%</td>
<td>26%</td>
</tr>
<tr>
<td>Attendance record</td>
<td>12%</td>
<td>13%</td>
<td>12%</td>
</tr>
<tr>
<td>Annual budget</td>
<td>44%</td>
<td>41%</td>
<td>56%</td>
</tr>
</tbody>
</table>

---

58 Low levels of financial literacy can prevent SMEs from adequately assessing and understanding different financing options, and from navigating complex loan application procedures. Similarly, the fact that SMEs’ owners’ accounting and financial statements are often not transparent makes them risky borrowers and thus less attractive to lenders.
OPERATING CYCLE

The operating cycle at each level of education begins in January, and is preceded by admission campaigns and school publicity. Classes commence in April, by which time the bulk of fee payments have been received. These payments include admission fees, uniform, books and stationery. Hence, the most cash-rich months for edupreneurs are from February to April. Over 96% of LCPSs did not receive any donations in the last three years, making school fees the only source of revenue and providing further insight into the owner’s motivation to operate LCPSs on a for-profit basis and the financially sustainable nature of the business. FIGURE 15 highlights the annual operating cycle for those surveyed LCPSs.

BUSINESS OPERATIONS STRATEGY

The critical success factors / strategic objectives for LCPS’s business operation strategy include: clients’ (parents’) perception of quality, a flexible pricing policy and a low-cost structure. Each strategy will be analyzed in detail in this section.

Strategic Objective 1: Client (Parents’) Perception of Quality

The concept of learning assessments for parents, particularly in the low-income areas is still underdeveloped. Based on the information gathered from focus group discussions, it is clear that many parents define attainment as a recall of information. Survey data indicate that academic results are a key constituent for quality perceptions amongst parents and that test scores are an important marketing tool for LCPSs. Focus group discussions with parents also suggest that academic achievements are of paramount importance in the choice of school, a factor confirmed in interviews with edupreneurs. Anecdotally, we understand from the Punjab Education Foundation experience that parents frequently switch their children between LCPSs in the neighbourhood. Edupreneurs, however, have devised strategies to disincentivise this practice. This implies that edupreneurs feel some pressure to deliver academic results, if not real learning outcomes.

Business Strategy Components

1. Student Acquisition and Retention: To develop a student body that can deliver top scores is the objective of the student acquisition strategy, which also supports long-term viability of the business. The survey results indicated that admission scores, and

FIGURE 15: Annual Operating Cycle for Surveyed LCPSs

Admissions open Classes beginning School fiscal year Admission fees
not ability to pay are the primary determining factor in the decision to offer a prospective student a place in a LCPS at the primary level. This observation is supported by the passing percentages in board examinations across all education levels (Grades 5, 8 and 10) found in the survey data. This finding is a strong indicator, that to some extent, selectivity is taking place in LCPS enrolments. Such selection may be described as merit-based, but may also reflect recognition that high-achieving students can be a useful marketing tool for subsequent enrolments, whilst at the same time mitigating the risk of dropout. **FIGURE 16** highlights the surveyed LCPSs’ admissions criteria.

**FIGURE 16: Surveyed LCPSs’ Admissions Criteria**

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Primary</th>
<th>Middle</th>
<th>Secondary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Admission test (written)</td>
<td>82%</td>
<td>56%</td>
<td>35%</td>
</tr>
<tr>
<td>Interview of student</td>
<td>91%</td>
<td>60%</td>
<td>29%</td>
</tr>
<tr>
<td>Interview of parents</td>
<td>92%</td>
<td>59%</td>
<td>32%</td>
</tr>
<tr>
<td>Others</td>
<td>7%</td>
<td>3%</td>
<td>2%</td>
</tr>
</tbody>
</table>

The student acquisition strategy varies with the level of education. This (superficially at least) non-financial, merit-based decision-making practice as to which students to admit is most prominent in primary schools and decreases as the levels of education progresses and the prospective fees increase. Data from interviews suggests that merit-based admissions are less important at higher levels of education as schools admit from a much narrower pool, and financial drivers become more important. For parents, the opportunity to transfer their child becomes similarly diminished given the education industry’s capacity at the higher levels of education.

Although the core of the acquisition model is to enrol the best students, edupreneurs stated that the overall extent to which admission criteria are followed was also determined by demand and capacity constraints for each particular year. Whilst survey data did not address the supply issue specifically, a shortage of school capacity at higher education levels could be one of the factors that hampers the transition from primary to post-primary levels of education, as could the ability of LCPSs to engage and motivate students to stay in school rather than engage in child labour.

Dropouts for any reason have a negative impact on the LCPS’s revenue stream and profitability, even though students are charged discounted fee rates. After a student drops out, the LCPS also incurs the cost of acquiring a new student. However, edupreneurs cited affordability and parents’ lack of interest in their child’s schooling as the key reasons for dropouts. **FIGURE 17** highlights the main reasons students drop out of the surveyed LCPSs.

**FIGURE 17: Reason for Dropouts in Surveyed LCPSs**

<table>
<thead>
<tr>
<th>Reason</th>
<th>Primary</th>
<th>Middle</th>
<th>Secondary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cant afford school fee</td>
<td>51%</td>
<td>58%</td>
<td>48%</td>
</tr>
<tr>
<td>Poor academic performance of student</td>
<td>24%</td>
<td>18%</td>
<td>21%</td>
</tr>
<tr>
<td>Lack of parents’ engagement</td>
<td>6%</td>
<td>3%</td>
<td>6%</td>
</tr>
<tr>
<td>Others</td>
<td>6%</td>
<td>4%</td>
<td>3%</td>
</tr>
</tbody>
</table>

2. **Marketing Plan:** As observed during field visits, LCPSs actively deploy marketing strategies such as advertising on cable television, placing banners in the streets that boast students’ high test scores and by displaying visible indicators of quality, such as well-designed uniforms, and clean and freshly painted classrooms, rather than in-classroom improvements in the quality of education. It was observed during field visits that newer schools are more likely to use these methods of marketing as the more reputable LCPSs have already
established their presence in the local community.

3. Monitoring Teaching Performance: Aiming to achieve marketable student test scores, edupreneurs focus on monitoring teacher performance to ensure appropriate classroom management and high test scores. Classroom management was identified as important for middle and secondary levels of education, whereas monitoring assessment scores had the highest priority at the primary level. **FIGURE 18** highlights the criteria included in teacher performance evaluations.

**FIGURE 18: Teacher’s Performance Evaluations at Surveyed LCPSs**

4. Extra Classes: Survey data indicates that LCPSs offer extra classes and some limited teacher training as strategies to drive improvements in learning outcomes / test scores at the primary school level. **FIGURE 19** highlights other strategies incorporated to improve learning outcomes. Whilst edupreneurs are less likely to recruit better-qualified teachers to replace existing ones, especially at the primary level of education, (because higher qualified teachers will command a wage premium and increase the costs), the sector does respond on some level to parental demand for quality improvements. This suggests that there is a complex feedback loop that is driven by exam results as an indicator of quality. Then parents are more likely to send children for private tuition and the owners to undertake some form of teacher training and extra classes to name just a few of the variables that determine demand for and retention of places in any particular LCPS.

5. Curriculum Planning: Survey data revealed that curriculum planning, for which LCPSs are not governed by any regulations, was placed as a high priority by edupreneurs at the primary level of education. This could be a visible marketable tool for school owners to increase enrolment and also improve in-classroom quality of education leading to better learning outcomes. In contrast, edupreneurs ranked lesson planning and a reading programmes as their lowest priorities across all levels of education.

6. Teachers’ Training: Teachers’ capacity, as countless studies show, is one of the main determinants of improved learning outcomes and better test scores.

**FIGURE 19: Strategies for Improving Learning Outcomes at Surveyed LCPSs**

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Primary</th>
<th>Middle</th>
<th>Secondary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offer extra classes</td>
<td>74</td>
<td>43</td>
<td>79</td>
</tr>
<tr>
<td>Advise parents to obtain services of private tutors</td>
<td>33</td>
<td>28</td>
<td>24</td>
</tr>
<tr>
<td>Offer need-based training to teachers</td>
<td>58</td>
<td>56</td>
<td>49</td>
</tr>
<tr>
<td>Change teaching method</td>
<td>47</td>
<td>54</td>
<td>43</td>
</tr>
<tr>
<td>Replace teachers to hire better qualified ones</td>
<td>31</td>
<td>34</td>
<td>32</td>
</tr>
<tr>
<td>Others</td>
<td>6</td>
<td>7</td>
<td>11</td>
</tr>
</tbody>
</table>
Obtaining teacher training manuals at the primary level and providing training at the middle and secondary levels were ranked higher than other services. This indicates that LCPSs value training; however, they prefer to conduct in-house training sessions by obtaining manuals in order to keep costs down. At the secondary level, LCPSs prefer to outsource training to improve learning strategies, followed by pedagogical skills training at the middle school level. The survey data shows that teacher training is a low factor in parental perceptions about quality and accordingly, is a low priority for the LCPSs owners. For employers, training (much more so than salaries) also carries the risk that once trained, teachers will leave for better employment opportunities – sometimes by securing government teaching posts, and therefore the investment returns to the enterprise are often low and mostly uncertain. FIGURE 20 summarizes the types of teacher training offered by the surveyed LCPSs.

7. English as a Medium of Instruction: Many edupreneurs recognised that English language instruction was a priority for many parents, so teachers who can teach in English are highly valued by parents. Likewise edupreneurs value English teachers as an important marketing tool. A large majority of LCPSs in Pakistan use English as a medium of instruction due to parental demand and this preference is evident at all levels of education and across all provinces. FIGURE 21 highlights the language of instruction at the surveyed LCPSs. Focus group discussions revealed that parents believed that English language skills would lead to better employment prospects for their children. The preference for English as a medium of instruction (substantiated by other studies such as ASER, 2013) was identified as a major recruiting tool.

FIGURE 21: Language of Instruction at Surveyed LCPSs

FIGURE 20: Teachers Training Offered by the Surveyed LCPSs

Tooley & Dixon, 2005
Strategic Objective 2: Flexible Pricing Policy and Parents’ Affordability

Survey data suggest that LCPSs are proficient at pricing. They are able to reduce fees for families they think cannot afford the full fee amount or if the parents enrol more than one child in the LCPS. The basis for any need-based reduction varies with the socio-economic profile of the individual families and since the marginal cost for an additional student in a class is low, the scope for fee negotiation is significant.60

Business Strategy Components

A significant number of surveyed LCPSs provide education for free or at reduced rates to underprivileged children. Figure 22 summarises the range of fees charged at the surveyed LCPSs. On average, between 20% and 30% of students receive scholarships in these schools. Furthermore, discounts of up to 25% were offered to 62%-67% of the students enrolled in the surveyed schools. To maintain enrolments, edupreneurs provide waivers and reduced fees for a majority of parents, who it can be assumed, consider fee negotiation as standard practice. In addition, delays in fee payments is common amongst LCPSs.

Strategic Objective 3: Low Cost Structure

Typical of the base of the pyramid business model, the financial strategy is to maintain costs below the low levels of revenue available from the market. Cost structures can be lowered by reducing the cost of the resources utilized per student (economies of scale), in this case mainly teacher salaries and no additional investment calls. The cost structure of a LCPS is comprised of mostly fixed costs (utilities and rent) with teacher salaries as a semi-variable cost, due to the supply-driven labour market for the profile of teachers hired by LCPSs. As mentioned above, the key indicator for economies of scale is the student-teacher ratio. The higher the ratio, the lower the cost per student.

Business Strategy Components

1. Profile of Teachers: Whilst responding to the choices of parents as consumers, the LCPS owners maintain costs at a level that will generate the desired profitability levels. This is evident from the profile of the teachers who are mostly young educated females often receiving below the government’s prescribed minimum wage with no other suitable and more

60 Research from India describes significant volatility of income cash flows as a constraint on LCPSs. Gray Matters Capital found that 71% of the schools that they surveyed in Hyderabad had 25-50% of their fee payments pending (Joshi, 2008).
lucrative employment options available within the local community. Survey results confirmed that salaries are well below equivalent salaries in the state school sector and below the minimum wage level of PKR 9,000 in Punjab.

Survey data indicates that the preference for hiring female teachers is a function of competitive advantage. By providing a conducive environment for girls to attend school, low cost structures, and a surplus of educated (matric, intermediate or graduate) females willing to work as teachers is a common strategy to increase LCPS marketability.

None of the edupreneurs articulated any great concern that low salaries had negative impacts on the business model, in terms of high staff turnover. In fact, at one school the edupreneur noted that neighbouring schools offered salaries as low as PKR 1,500. Poor labour relations do not therefore seem to be a significant factor in the LCPS model. And for many, it may be surmised that the alternative would be to leave the local community in search of work, or if opportunities for mobility are restricted for whatever reason, to remain within the home.

At the lower than minimum wage salary levels, LCPS are able to attract primarily F.A, B.A, and M.A qualified teachers, who combined, account for 79%, 82% and 76% of the number of teachers at primary, middle and secondary levels, respectively. The proportion of lower qualified teachers such as those who are only matriculation-qualified reduces at the middle and secondary levels of education as compared to the primary level. **FIGURE 23** summarizes teachers' qualifications at the surveyed LCPSs.

2. **Teacher Management:** To optimize the available resources, a LCPS teacher maintains an average workload of 24 periods/teaching classes a week. Teachers also typically act as class leaders with the added responsibility of maintaining class records (attendance, test results, compilation of annual examination results and preparing report cards). Thus, teachers fulfill many roles within their schools, reducing the need for additional staff.

The number of teachers increases with the addition of higher grades in the LCPS, reflecting the overall increase in the number of students and the requirement of subject-specific teachers at higher education levels.

Interviews revealed that primary schools employed one teacher per class, teaching all subjects. At the middle school level, the teacher rotates through classes depending on the subject, although subjects such as Urdu and Islamiat or English and Social Studies are often combined. Teachers with specific and relevant qualifications are hired for science and mathematics. Usually around eight teachers are deployed to teach at the middle school level, assuming that there is only one middle class section each in these schools.

3. **Teacher Turnover:** When better performing teachers leave the school, the LCPS incurs the cost of replacing the teacher with one with a similar reputation and performance to prevent any negative impact on the LCPS operations. The average tenure for a teacher at any particular LCPS is 1-3 years for middle and secondary schools. On average, teachers at the primary level work for a lesser number of months per school year as compared to those at the middle and secondary levels. The average length of service is also significantly lower at the primary level. **FIGURE 24** summarizes teachers' turnover rates in the surveyed LCPSs.

Teacher turnover is higher in the first year of service in

---

**FIGURE 23:** Teacher Qualifications in Surveyed LCPSs

- **Matriculation**
- **F.A.**
- **B.A.**
- **M.A.**
- **MSc.**
- **C.T.**
- **B.Ed.**
- **B.Ed. Hons.**
- **M.Ed.**

---

61 Teaching is a socially acceptable employment option for women across most of Pakistan.
Access to Finance for Low Cost Private Schools

A LCPS, at any level of education. The survey indicates that within primary schools, very few teachers leave in the first few months, but 19% leave within 6-10 months (approximately one academic year) whereas at the middle and secondary schools only 4% and 8% respectively leave in the same period. Approximately 42% of primary teachers stay for more than one year, whereas at the middle and secondary levels 67% teachers stay for more than one year, indicating lower teacher turnover at the higher levels of education. At the primary level with lower qualified teachers, it is observed and hypothesized that oftentimes, young women use teaching as a short-term job opportunity before returning to studies or getting married.

Focus group discussions with edupreneurs indicated that the reason for lower turnover at higher levels of education reflects the more vocational nature of employment at these levels. It is likely that because teachers employed in middle and secondary schools are better qualified and draw higher salaries, the opportunity cost of leaving employment is higher and demand for higher skills is lower. More attractive employment options and higher compensation are the most frequently cited reasons for teachers both leaving and arriving in the workforce. Focus group discussions and interviews with edupreneurs further indicated that though limited in application, some teacher training proxies as a non-financial compensation for teaching staff, (although as is noted later in the survey discussions on teacher salaries, teacher training appears to be largely confined to more experienced teachers, teaching at higher education levels).

4. **Student-Teacher Ratio (STR)** at a given fee level is an important indicator to measure the number of times a revenue driver covers the cost of a LCPS (cost coverage ratio). It compares a key revenue driver, i.e. enrolment and a key expense component, i.e. number of teacher. For the surveyed schools, the average student-teacher ratio (STR) was 19:1. Even though STR at the primary level is higher than that for middle and secondary levels, it is still below the global best practice of 25:1. This difference in STRs between the lower and higher levels is mainly due to the requirement of subject-specific teachers at the secondary level. The STR is also related to the school’s maturity and STRs were found to increase according to the number of years in operation. **TABLE 7** summarizes the STRs at the surveyed LCPSs.

**TABLE 7: Student-Teacher Ratios at the Surveyed LCPSs**

<table>
<thead>
<tr>
<th>Enrolment by Education level</th>
<th>Student</th>
<th>Teachers</th>
<th>STR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>46,665</td>
<td>2257</td>
<td>21</td>
</tr>
<tr>
<td>Middle</td>
<td>10,817</td>
<td>638</td>
<td>17</td>
</tr>
<tr>
<td>Secondary</td>
<td>3,359</td>
<td>294</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>60,841</td>
<td>3189</td>
<td>19</td>
</tr>
</tbody>
</table>

However, LCPSs could reduce their costs per student if the STR were to increase by increasing economies of scale. Interviews with edupreneurs suggested that LCPSs have lower overall STR not because of a conscious business decision based on smart education practices, but because not enough students are enrolled. One possible reason for persistently lower STRs than international benchmarks could be the unique infrastructure constraints faced by LCPSs, particularly where LCPSs are located in a few rooms of a small building in densely populated areas. Operating space could therefore be a significant premium for LCPSs, which indicates a notable constraint on expansion not faced by larger schools, both in the private and public sectors.
FINANCIAL MANAGEMENT

As expected of an informal enterprise, the survey data indicates that 90% of school fees for all levels of LCPS are collected in cash at the school premises. Typical of the service industry, cash flow is the principle LCPS asset, and remains outside the formal financial system. Whilst LCPSs are overwhelmingly cash businesses, almost one-third of the LCPSs surveyed and a similar proportion of edupreneurs owned bank accounts (including multiple responses). FIGURE 25 highlights the bank management of the surveyed LCPSs.

FIGURE 26: Method for Fee Collection

Approximately 31% of edupreneurs reported a bank account in the name of the LCPS and 37% in the name of the edupreneur. Those that responded with ‘not applicable’ are likely to comprise a combination of LCPSs who have chosen not to seek banks for their finances and edupreneurs that already have bank accounts. However, 28% of survey respondents indicated that they would be willing to open a bank account and deposit their revenues from their LCPSs.

At the primary, middle and secondary levels, only 7%, 3% and 6% of edupreneurs respectively explained that a high proportion or all of the parents paid the school fees into a LCPS bank account. In fact, 90% of the schools surveyed pay teachers in cash. The predominance of cash transactions for LCPSs indicates the low utilization and low access to formal financial services for the parents of the students, teachers and the largely informal nature of the LCPS business at all levels of education. FIGURES 26 and 27 summarise the methods for fee collection and staff payments at the surveyed LCPSs.

FIGURE 27: Method of Staff Salary Payments

The next chapter provides a more thorough analysis of the financial components of the low cost private school business model, including their cost structures and investment plans.
CHAPTER 3: LCPS FINANCIAL ANALYSIS

35 Revenue Analysis
37 Cost Structure
38 Teacher Salaries
39 Enterprise Profitability
40 Conclusion
41 Investments
42 Planned Investments
43 Improvements in Physical Infrastructure
This section examines the ‘financial drivers’ (the key cost, revenue and profitability elements of the LCPS business model), highlighting survey findings relevant to private investors. A review of the existing financial structure of the LCPS is followed by an examination of principle revenue (fees and enrolment) and cost drivers (salaries, level of education and STRs). Survey data findings on the edupreneurs’ likely investments in the school, financing options and exposure to formal borrowing through financial institutions are also explored.

REVENUE ANALYSIS

Survey data indicated that student fees account for 97% of total revenue. Other income sources, including donations, commission on books and uniforms, and earnings on sales of snacks, admission, and examination fees accounted for the remaining 3% of total school revenue. The survey data did not fully capture these marginal revenue streams. FIGURE 28 summarizes the surveyed LCPS’ revenue streams.

The principle revenue drivers of a LCPS are enrolment level and student fees. For the surveyed schools, the average revenue per student is PKR 7,797/PKR 653 per month with an average enrolment of 262 per school.

School Level Impact on Revenue: In the survey data there is an unexplained dip in the revenue for middle level schools. One possible reason is that the middle level schools selected in our survey generally had lower weighted average fees as compared to other school levels in the survey. TABLE 8 summarizes the enrolment and revenue per child in the surveyed LCPSs.

Age of School: Revenue per student for more mature LCPSs are lower than those that have been initiated more recently. One possible explanation could be the lower fee levels of the schools operating for 5 years and more. TABLE 9 summarizes the revenue per child by surveyed LCPSs’ years of operation.

Student Fees

Growth in fees: Survey data indicates that student fees for all levels of schools increased over the last 3 years with higher compounded annual growth rate (CAGR) of fees for primary and middle schools. Furthermore, survey data showed no negative correlation between fee growth and enrolment levels for LCPS indicating low or no elasticity of demand at the fee levels of surveyed schools. This is important to note since enrolment is also a revenue driver and a negative correlation would have lowered revenue growth even though there was growth in fees. However, there is a need for additional research on the pricing.
power of LCPSs and the relationship with quality and affordability for low-income parents. FIGURE 29 summarizes recent growth in fees and enrolment at the surveyed LCPSs.

FIGURE 29: Growth in Fees & Enrolment in Surveyed LCPSs

Influencing factors for fee levels: Aside from the affordability (socio-economic profile) of parents to determine the fee level for students at a particular school, the following different aspects of schools were analysed to determine their relationship with fee levels:

1. Education levels
2. Age of School

Education levels: survey findings made clear the relationship between the level of education and the fees charged. As the level of education increases the fee level also rises.

For LCPSs offering multiple levels of education, such as primary schools offering pre-primary and primary, middle schools offering pre-primary, primary and middle and secondary schools offering pre-primary, primary, middle and secondary; the school fees for each successive level of education rises. For higher levels of education the fee levels change by a greater percentage. For example for a secondary school, the increase of fee level from pre-primary to primary is 15%, from primary to middle the increase in fees is 20% and from middle to secondary the increase in fee level is 25%. This can perhaps be explained by the lower average number of students per class grade for secondary (21) and middle levels (20) than that for primary schools (34). Likewise, there is a higher cost structure for middle and secondary schools, driven by higher teacher wages and availability of science laboratory and library. TABLE 10 summarizes the fee structure by school level in the surveyed LCPSs.

Age of School: The survey provided a snapshot of LCPSs at different fee levels operating at different levels of school maturity stage. The data indicates only a weak relationship between fee levels and the LCPSs’ years in operation. For lenders this does mean that higher fee levels are not necessarily indicative of greater business maturity.

Student Enrolment

Student enrolment is concentrated at the primary level for surveyed schools. This could be interpreted as capacity limitations, as those applicable in the public sector, for transition from primary to higher education levels. Moreover, there may be a lower demand for higher education levels. One additional explanation may be that LCPSs do not have access to formal finance markets to build institutional capacity for higher education levels.

### TABLE 10: Fee Structure by School Level in Surveyed LCPSs

<table>
<thead>
<tr>
<th>School Type</th>
<th>Pre-Primary - PKR</th>
<th>Primary Fee - PKR (% increase)</th>
<th>Middle Fee - PKR (% increase)</th>
<th>Secondary Fee - PKR (% increase)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>633</td>
<td>17.9% (738)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle</td>
<td>512</td>
<td>16% (603)</td>
<td>18% (682)</td>
<td></td>
</tr>
<tr>
<td>Secondary</td>
<td>499</td>
<td>15% (616)</td>
<td>20% (734)</td>
<td>25% (928)</td>
</tr>
</tbody>
</table>
Growth in enrolment: On a cumulative basis, the survey indicates that for all school levels there was growth in enrolment over the period 2011-13. This increase is net dropouts, (dropout rate is 2% per annum) and the gross enrolment rate is therefore higher than shown in Figure 31 summarizes growth in enrolment in LCPSs.

Age of School: For those surveyed LCPSs that survived the start-up phase of the first two years, enrolment levels start to rise beyond the initial start-up enrolment level. Figure 32 summarizes the surveyed LCPSs’ enrolment based on its years in operation.

COST STRUCTURE

The overall costs per student at the primary and middle levels are almost the same as PKR 3,695 and PKR 3,603 per month. However, at the secondary level the cost per child increases to PKR 4,679 (compare this with an average revenue of PKR 7,798 across all schools). Figure 33 summarizes the cost structure of the surveyed LCPSs.

The bulk of LCPS expenditures comprise salaries, followed by rent and utilities. The major advantage of LCPS schools, in terms of being able to provide education at a low cost, is the low salaries paid to teachers. Total operating costs among the surveyed LCPSs increased for higher level of schools primarily due to change in the qualification mix of teachers, increasing the salary expense. Figure 34 summarizes the operating costs per child at the surveyed LCPSs.
TEACHER SALARIES

Teacher salaries are the main expense item for the surveyed LCPSs, comprising 71% of the total expenses (total operating expenses including salaries, and general and administrative expenses) and equating to 52% of total revenues.

Regardless of whether the school caters to primary, middle or secondary students, salary levels across the sector are closely correlated with teaching qualifications. For all qualifications except M.Ed., salaries increase only marginally from primary to secondary with a slight drop for the middle level, perhaps due to the lower fee levels for middle schools in the survey. Average teacher salaries are between PKR 3,000 and PKR 4,000 for F.A, PKR 4,500 and PKR 6,300 for B.A and PKR 6,300 and PKR 9,200 for M.A. The salary levels are lower than the minimum wage set by the government. However, it is noted that some of these teachers choose to supplement their income by providing home tuition.

In turn, the qualification mix is a function of the level of education offered by the school, and the number of teachers employed at a LCPS is a function of the number of classes offered by the school. The total salary expense for a LCPS is determined by the following:

1. Number of teachers;
2. Qualification mix for each level;
3. Salary scale for each teacher qualification.

Qualification Mix and Salary Scales: Not surprisingly, the highest teaching salaries are designated for those with twenty or more years of experience, and these teachers are also more likely to specialise in science or work at secondary and higher secondary school levels. Teachers with sixteen or more years of education, though fewer in number, usually teach at secondary levels. The proportion of MSc and B.Ed 1-year qualified teachers increases at the secondary level to cater to the subject-specific requirements. A small percentage of teachers at those levels received formal teacher training. Survey data show that differentials in teachers’ salaries reflect both the relatively low educational qualifications and the low fee levels charged by LCPSs. Keeping qualifications constant, the salaries of teachers fluctuate with fee levels, indicating that as parental perceptions of quality rise and schools are able to charge higher fees, teacher salaries can also increase. FIGURE 35 summarizes teachers’ salaries by qualification and school level in the surveyed LCPSs.

Increase in Salaries: 68% of surveyed LCPS owners provided teacher salary increments between 5%-15% at all levels of education across the provinces surveyed, while

FIGURE 35: Teachers Salaries in Surveyed LCPSs
9% provided no increase and 8% provided between 15-25% increases in salaries. An annual rise in consumer prices slowed to 7.9% in January compared with 9.2% in December 2013, suggesting that some teaching salaries are actually falling in real terms. Further research is needed to ascertain whether survey findings are consistent with wage growth across other sectors. FIGURE 36 summarizes the salary increases in the surveyed LCPSs.

FIGURE 36: Salary Increases in Surveyed LCPSs

However, when analysing the operating costs for the different segments of LCPSs according to the status of the premises, there appears to be significant differences. The cost structure of schools operating from rented premises is 40% higher than that for LCPSs operating from self-owned premises. This higher cost is due to the addition of rent expenses, 11% higher staff costs, and marginally higher utility costs. However, repair and maintenance costs are lower for LCPS operating from rented premises, which is most likely explained by the landlord having responsibility for these costs.

A NP margin of 54% at the primary level is higher compared to that of the middle level at 43% and secondary at 43%. NP margins for schools in the lowest fee bands are close to 30% and peak at around 60% for some primary schools. TABLE 11 presents the per child profit and loss of LCPSs at the primary, middle, and secondary levels, together with an average Profit & Loss Statement for the surveyed schools.
CONCLUSION

Some of the larger and better-managed schools can make substantial profits, evidenced by the enthusiasm articulated by some edupreneurs for multiple branches. If this is the case, then multiple low cost branches indicate that profits are retained in the enterprise to finance minor investments- less to achieve quality improvements or even vertical expansion, but in a horizontal expansion of the existing franchise of low cost primary schools positioned to be at best marginally better than public schools in the same catchment area.

Horizontal growth is the strategy of a rationale economic actor. There are likely to be multiple reasons why it is easier for edupreneurs to repeat a tried and tested model than it is to acquire the business skills, educational support services, the infrastructure and of course access to finance needed to make this more ambitious business.
model a reality. Nevertheless, given the prevalence of lower STRs amongst LCPSs as compared with government schools and international benchmarks, and assuming that physical space of the schools can accommodate growth in enrolment without additional fixed investments, there is inherent potential for LCPSs on average to increase profitability given the historic enrolment and fee growth rates. Survey data indicated that where school enrolment was lower for any given floor space, profitability was not surprisingly also lower.

The survey data did indicate that the compounded annual growth rate of student fees is lower than Pakistan’s current headline inflation rate. This could imply that in an expanding market LCPS pricing power is weak, or that LCPS costs are growing at a rate below inflation – and that particularly wages are not subject to inflation pressure to the same extent as other inputs. In the short run, profitability remains robust but there is a risk that this situation could be eroded if inflation continues to run at historically high levels in Pakistan. Below inflation fee increases also suggest that teacher’s salaries are declining in real terms, an issue remarked upon in earlier sections. More work needs to be undertaken to understand the relationship between headline inflation, pricing power (fees) and input costs (wages) for the LCPS sector.

**INVESTMENTS**

**Start-Up Investment**

According to the survey, most LCPS are self-financing, with edupreneurs investing their own funds and/or borrowing from family and/or friends and other informal sources in order to start their schools (83% from personal savings and 11% borrowing from friends and family). **FIGURE 38** summarizes the sources of initial investment in the surveyed LCPSs.

**FIGURE 38: Sources of Initial Investment in Surveyed LCPSs**

<table>
<thead>
<tr>
<th>Source of Initial Investment</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal savings</td>
<td>83%</td>
</tr>
<tr>
<td>Loan from informal sources</td>
<td>1%</td>
</tr>
<tr>
<td>Loan from friends/family</td>
<td>11%</td>
</tr>
<tr>
<td>Commercial Bank loan</td>
<td>1%</td>
</tr>
<tr>
<td>Others</td>
<td>1%</td>
</tr>
<tr>
<td>Not answered</td>
<td>1%</td>
</tr>
</tbody>
</table>

Only 3% of the surveyed schools were established with the help of donations and other sources (details of which were mostly undisclosed). Only 1% of respondents reported borrowing from banks for business or personal purposes, confirming the low prevalence of bank finance as a means of starting or growing a LCPS. **FIGURE 39** summarizes the value of initial investments.

For the majority of surveyed edupreneurs, start-up capital was less than PKR 300,000. The average initial capital investment was below PKR 500,000 for 70% of surveyed
For the majority of surveyed edupreneurs, start-up capital was less than PKR 300,000. The average initial capital investment was below PKR 500,000 for 70% of surveyed schools, with 56% of the sample investing less than PKR 300,000. Edupreneurs explained that once a primary school is operational, further capital for vertical expansion to introduce middle schooling is almost always lower but the exact size of investment depended on the size of the building and number of students expected to transition from primary school to middle school. Moreover, LCPSs typically manage upgrades as each class graduates to the next level, meaning that the investment is paced and gradual.

**PLANNED INVESTMENTS**

Survey data shown below suggest that edupreneurs are interested in investing to build permanent and better physical structures for the schools. This is an indication of the edupreneur’s confidence in the market potential and long-term viability of the operating model. From the perspective of the type of financial resource it also indicates the demand for longer-term financing – equity and debt. The range of the amount of the planned investments demonstrates that LCPS sector is a potential client segment for both microfinance and commercial banks. **FIGURE 40** highlights the surveyed LCPS’s planned investments.

**FIGURE 39: Value of Initial Investment**

![Bar chart showing the distribution of initial investment values](chart)

**FIGURE 40: Surveyed LCPS’s Average Planned Investments**

![Bar chart showing the distribution of planned investment values by category and level](chart)
Improvements in Physical Infrastructure

A large number of survey respondents revealed that they need to improve the physical facilities of their schools across all education levels. Computer laboratories, furniture and fixtures were prominent areas identified for further investment and the majority of primary and middle schools described plans to upgrade existing facilities using internal financing as the main resource. LCPSs at the secondary level identified land purchases and construction of new school buildings as additional priorities. This finding is in line with survey results on parental perceptions of quality that placed physical infrastructure high on the list of quality indicators. A desire to make infrastructure improvements also demonstrates edupreneurs’ recognition of parental perception, but may also reflect a realization that physical space is a key obstacle in raising STRs and expanding enrollment. **FIGURE 41** highlights surveyed LCPSs’ physical infrastructure requirements.

Survey data shows that edupreneurs were able to identify investment opportunities across all levels of education. The most urgent need identified was to borrow funds to acquire computers and furniture.

**Finances required to make improvements:** Survey respondents provided estimated minimum and maximum investment amounts needed for each school improvement item amongst a list of 15 items. **FIGURE 42** summarizes the estimated amount of funds required to update the physical facilities.

**Improvements in Learning Outcomes**

Significantly and in contrast to infrastructure, edupreneurs only consider making improvements that benefit learning outcomes if external financing became available. Survey data indicates an average monthly salary for a primary school teacher is PKR 4,527. At the middle school level, survey data indicates an average salary of PKR 10,791. With an average primary school employing five teachers, this would imply an average monthly wage bill of PKR 22,650. At the middle school level, the average number of teachers increased, and assuming eight teaching staff, this would imply an average monthly wage bill of PKR 22,650. At the middle school level, the average number of teachers increased, and assuming eight teaching staff, this would imply a wage bill of PKR 86,330, an almost four-fold increase in the school’s primary cost driver.

**FIGURE 41:** Required Physical Infrastructure Facilities at Surveyed LCPSs

<table>
<thead>
<tr>
<th>Facility</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer laboratory</td>
<td>64</td>
</tr>
<tr>
<td>Chairs / benches for pupils</td>
<td>58</td>
</tr>
<tr>
<td>Chairs / tables for teachers</td>
<td>41</td>
</tr>
<tr>
<td>Science laboratory</td>
<td>30</td>
</tr>
<tr>
<td>Classrooms</td>
<td>36</td>
</tr>
<tr>
<td>Library</td>
<td>32</td>
</tr>
<tr>
<td>Blackboards / whiteboards</td>
<td>26</td>
</tr>
<tr>
<td>Drinking water</td>
<td>24</td>
</tr>
<tr>
<td>Functional Toilets / latrines</td>
<td>15</td>
</tr>
<tr>
<td>Playground</td>
<td>11</td>
</tr>
<tr>
<td>Staffroom</td>
<td>8</td>
</tr>
<tr>
<td>Electricity</td>
<td>5</td>
</tr>
<tr>
<td>Kitchen</td>
<td>4</td>
</tr>
<tr>
<td>Support staff</td>
<td>2</td>
</tr>
</tbody>
</table>
Assuming the school maintains its primary school function, upgrading from primary to primary and middle would imply a rise in the wage bills from PKR 22,650 to PKR 108,980, an increase in five times. As salaries constitute almost 71% of the operational costs of LCPSs and for an operating model largely driven by the wage bill, the challenge of embarking upon a vertical expansion is significant, particularly when financed from solely internal resources.

Despite these challenges, edupreneurs are aware of opportunity. Edupreneurs described how they were conscious of losing students after the primary level and many wanted to upgrade the school to ensure the transition of primary level pupils to higher levels of education in the same school if external finance could be secured.

According to the research, the majority of owners recognise that different types of investment have different impacts on parental perception, and that generally investment in any form improves the reputation and market standing of their school in the area. Over half of the surveyed edupreneurs believed further investment in schools would have a positive impact on student learning outcomes, though as we have seen, edupreneurs do not often have a sophisticated understanding of the kind of education services that make the greatest impact on learning outcomes, and some that do fail to prioritise these kind of investments because they conflict with commercial drivers rooted in sometimes misplaced parental perceptions around quality. Figure 43 summarises the impact of investments in LCPSs.

Analysis of province-wise data showed that almost all edupreneurs in Sindh believe further investment would improve the image of their schools while telling nearly half identified better test scores as a mark of increased investment. Similar conclusions emerged from data obtained in KP. However only 75% of edupreneurs in Punjab demonstrated a conviction that further investment would enhance the general outlook and reputation of their school and less than half of the population thought it would have a positive impact on students’ performance.

Thus, as survey results show, there is a significant demand for external finance. Edupreneurs have expressed great interest in investing in their schools and expanding access to more children. The next chapter highlights the study findings that indicate an increasing demand for external finance.
CHAPTER 4: DEMAND FOR EXTERNAL FINANCE AND IMPLICATIONS

47 LCPS Owners’ Current Financing Strategies
47 Access to Formal Bank Loans
48 Potential Impact Indicators and Rationale
49 Gender Equity
49 Job Creation
49 Improvement of Learning Outcomes
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DEMAND FOR EXTERNAL FINANCE AND IMPLICATIONS

This section highlights LCPS owners’ current intentions for investment, demonstrating their interest in and demand for external finance opportunities. Furthermore, if external finance options are made available, this will undoubtedly have a positive impact on the LCPS sector in Pakistan.

LCPS OWNERS’ CURRENT FINANCING STRATEGIES

To finance their business strategies, LCPSs plan to rely mainly on additional equity injections from personal savings and borrowing from friends and family. A significant number of LCPS owners plan to invest up to 50% of the cost of school improvement and expansion through equity while the remainder is expected to be borrowed mostly from informal sources. Only a few edupreneurs expect to borrow from commercial or microfinance banks. The low percentage of LCPSs expressing confidence in their ability to secure finance from banks is likely to be explained by multiple and varied factors as described by the survey data. These factors include the absence of a tailor-made financial product, the absence of pro-active marketing by formal financial institutions, and a perception that bank credit is un-Islamic. Hence, profitable LCPS business models continue to rely on informal sources of finance. FIGURE 44 summarises the surveyed LCPSs’ planned sources of funding.

FIGURE 44: Surveyed LCPSs’ Planned Sources of Funding

The current common practice of seeking financing from friends and family, and using personal savings could be replaced by formal financing for the stable and profitable LCPSs, given that there is a significant requirement for financing as expressed by edupreneurs.

Financing from personal savings and borrowing from informal sources (family or informal lenders) for investment in LCPSs is considered a personal debt and equity investment by the edupreneur and (technically) is not recorded as debt on the enterprise balance sheet. This equity investment could be leveraged with debt from banks since a majority of the respondents were interested in taking bank loans if banks provided products that were suited to their needs and business profile.

ACCESS TO FORMAL BANK LOANS

Approximately 52% of survey respondents were willing to access credit from banks for expansion despite banks’ current lack of a structured approach. A total of 156 schools were interested in seeking formal finance, including 32 primary, 71 middle and 61 secondary schools. Yet in contrast to these findings, only 1% (3 in number) of all schools had applied for bank loans reflecting the need for a targeted approach from the formal financial institutions to market and supply credit. FIGURE 45 highlights LCPS owners’ interest in bank loans.

FIGURE 45: LCPS Owners’ Interest in Bank Loans

Access to Finance for Low Cost Private Schools
Key reasons for not applying for bank loans: The most common reason for not applying for a loan as identified by 32% of edupreneurs was the high interest cost of credit. There was also a range of different reasons identified by between 3-18% of respondents, including a lack of awareness about loan options and the number of requirements necessary to access loans. Hence, edupreneurs do not appear overly negative about their abilities to avail of credit. Rather, the absence of a lending product/methodology that fits with the profile of the targeted clients may well be the major obstacle on the demand side. FIGURE 46 highlights LCPS owners’ reasons for not previously applying for loans.

FIGURE 46: Reasons LCPS Owners Have Not Applied for Loans

On the supply-side – from the perspective of the lender – most lending in Pakistan is fully collateralised, albeit often of a symbolic nature given the difficulty of realising security in Pakistan. Nevertheless, in the absence of collateral or the promise to invest in assets that may be taken as collateral or future collateral, financial institutions have been reluctant to consider the LCPS sector as a lending opportunity.

There is a casual link between investment – in assets – and borrowing, with one facilitating the other, and in turn improving educational outcomes as well as expanding access to education. Survey data does suggest that edupreneurs are focused on expanding access – increasing student numbers. As a strategy, this may be laudable, but focusing on enrolment does not push the school into investment in assets, which in turn does nothing to support a schools’ ability to borrow. The edupreneurs need to be supported to understand how their LCPSs can develop and how developing a balance sheet can support future financing.

Informal MSMEs are far less likely than formal businesses to have existing deposit relationships with financial institutions, and are also far more difficult to serve, especially for commercial banks. Therefore, short of comprehensive approaches to move LCPS enterprises into the formal sector, survey data suggest that reaching informal LCPSs will have to build on microfinance approaches, including up-scaling existing microfinance institutions to serve small businesses. The State Bank of Pakistan takes this policy direction in the form of enterprise financing.

Such an approach needs to be combined with enhancements to the enabling environment for MSME lending. Significant initiatives to improve the financial infrastructure of credit reporting and collateral registries are in progress. There is also recognition across the financial services industry that lending driven by fully collateralised and undifferentiated products and service levels are insufficient if enterprise lending objectives are to be achieved.

There is opportunity with respect to LCPSs to develop non-collateralised lending models, and the next chapter articulates a practical and implementable programme-based lending approach based upon free cash flows as opposed to securitised lending.

POTENTIAL IMPACT INDICATORS AND RATIONALE

With access to external finance opportunities, the LCPS sector can make major contributions to education in Pakistan. Notably, gender equity can be enhanced, there will be more job opportunities for aspiring teachers and more opportunities to invest in improving the quality of learning.
GENDER EQUITY

A summary of the 2012 EFA Global Monitoring Report reveals that Pakistan has some of the worst indicators in the education sector, with the second highest number of OOSC in the world (over 5 million) and the second highest number of girls out of school (63% of the total OOSC in the country).

Based on survey results, private growth capital for LCPSs would lead to improved gender equity, given that more female students attend LCPSs (53% boys: 47% girls) when compared with the overall gender ratio in the education system as a whole (58% boys: 42% girls). These findings support secondary research that shows that the share of female enrolment is 3-5% higher in private schools than in government schools. It is highly likely that accessibility is a contributory factor in the prevalence of female enrolment in LCPSs.

Teachers: Also, at the teacher level, LCPSs engage more women than men. The typical profile of a LCPS teacher is a young unmarried female living locally. Out of a total of 4,175 teachers surveyed, 83% or 3,470 were found to be females. The proportion of female teachers is much higher than the national education system average of 55%. Thus, the LCPS sector can increase workforce opportunities for young women.

JOB CREATION

The labour force participation rate for women in Pakistan is low, and outside the major cities there are few opportunities for productive employment for females. Focus group discussions also touched on parental concerns about children who have graduated but lacked suitable employment opportunities. However, SMEs in Pakistan contribute 70% of the labour force in manufacturing, trade and services.

LCPS could be a market-based source of employment opportunities. The surveyed primary LCPS owners employ on average 10 teachers, middle LCPSs employ 13 teachers and secondary LCPSs employ 18 teachers. Using these average numbers and the actual number of private schools for 2011-12, it is estimated that private sector schools employ 835,358 teachers. Channeling private investment from the formal financial sector to meet the un-met demand only at the primary school level would potentially generate 240,380 new jobs (from 24,038 primary schools). Enhancing the physical infrastructure to address the imbalance in capacity at the middle and secondary levels would create more jobs given the higher number of teachers required at those levels of education.

IMPROVEMENT OF LEARNING OUTCOMES

The LCPS sector performs only moderately against quality measures and global benchmarks. LCPSs tend to de-prioritize teaching quality - the integral factor in education that affects quality and translates into improved learning outcomes. Teacher training is too often seen as a poor investment and one not valued sufficiently by the clients (parents) or by edupreneurs and is regularly substituted with informal and poorly structured teacher facilitation by the school.

Investing in the LCPS sector, which brings with it teacher training and other learning outcome enhancing expertise and tools will create a positive impact on the quality of education, improving it to achieve global standards. Currently, the limited resources LCPS owners have to invest, they use to update or maintain physical facilities. With additional external finance opportunities, they will have more money to invest in other aspects of their institutions, including teacher training, and learning resources.

Thus, as the study reveals, edupreneurs are both greatly interested in and willing to explore external finance opportunities. With such options available, edupreneurs can invest in their institutions, expand enrolment and access to out-of-school children and eventually improve the quality of education. The next chapter provides a unique sector-based investment approach.

64 Andrabi, Das, & Khwaja, 2006
65 IFC, 2011
66 Bari & Muzaffar, 2010
CHAPTER 5: SECTOR-BASED INVESTMENT APPROACH

53 Programme-based Lending Model - Rationale
54 Financial Products
SECTOR-BASED INVESTMENT APPROACH

The LCPS sector assessment and financial analysis sections demonstrated growth in the LCPS sector in the recent past and the requirement of additional capacity to meet the current and future demands, and the profitability of the LCPS sector with almost no available source of external finance. From these analyses, the LCPS sector is well positioned for private sector investment, the only appropriate investment to provide the enormous amount of capital required to meet the industry demand. It is envisaged that private sector investment channeled to the LCPS sector would be an impact investment as it would be driven by two key objectives, increasing enrolment and improving learning outcomes, and market-based risk adjusted returns for the investors.

At present, there are two main sources of private sector investment in Pakistan: bank debt from microfinance and commercial banks and private equity investment from private school networks. Equity investment in a LCPS is much lower than the usual normal thresholds for private equity firms. However, private equity could be routed through private school networks considering expansion in the lower-income segments (down-market).

Under this project, the focus was on developing a link between bank credit to LCPSs and introducing sector-based impact lending. Therefore, two financial products were tailor-made for the microfinance and commercial banks to lend to the LCPS sector. However, a new lending methodology was also designed since neither commercial banks nor microfinance banks in Pakistan undertake cash-flow based enterprise lending to the MSME sector. This section introduces a sector-based programme lending methodology and the suite of financial products subject to the current pilot with participating microfinance providers.

PROGRAMME-BASED LENDING MODEL - RATIONALE

The overall approach adopted for the programme-based lending methodology and products has been summarised below.

The research objective was to develop financial products that would cater to the profile of LCPS enterprises, which are characterised by a lack of formal registration, the absence of tangible collateral and the unavailability of documented financial information on the enterprise. Moreover, based on survey data, there is a recognition that enterprise-focused lending is a shift for microfinance providers from a predominant reliance on the character of the individual to the cash-flow generation capacity of the enterprise.

As key elements of a sector-based lending methodology, a financial model and LCPS-sector specific product suite were designed to supplement the prevalent borrower due diligence by the lending institution. The methodology responds to the lack of enterprise and sector knowledge of the branch officers that would enable them to undertake a reasonably accurate cash flow analysis of the enterprise. A programme- lending approach for a particular sector addresses this limitation. The financial model developed in Excel has been informed by survey data from 280 schools. This provides the average sector values and circumvents the risk of lending to a sector outlier if the free cash flows were to be determined by the loan officer / branch staff on its own.

Under this methodology, a matrix sheet - a laminated sheet of A4 paper – developed from using different values for enrolment and fee in the financial model can be used by the loan officers at the branch level. Using this sheet and identifying the actual value of two verifiable variables
At the time of writing, MFPs offer two main loan products: i) an equal monthly installment loan for trading activities and ii) a seasonal loan mainly for farm-based economic activities such as crops and livestock. Both loan products are generic as opposed to tailored to a sector specific understanding of the firm’s business model, with credit decision-making undertaken to a large extent by the branch staff of the MFB or MFI.

The matrix can be prepared by the management of the MFP or CB and shared with the branch staff for implementation. Use of the model and matrix are expected to strengthen rather than supplant normal lending appraisal procedures, affording an additional level of portfolio and risk management comfort for the financial institution.

The following are the core elements of the methodology and product design:

1. Enterprise financial model and repayment capacity assessment is based on a survey of 305 schools that normalizes to an extent the risk of lending to outliers in the sector.

2. Standardized enterprise repayment capacity assessment across all branches of the lending institution that allows for:
   a. A more efficient process for cash flow evaluation of the enterprise
   b. Improved assessment of the risk exposure of the loan portfolio of lending institutions
   c. Addressing limitations of branch officer skills and knowledge of the sector

3. Cash flows are routed through the account of the enterprise held with the lending institution or its correspondent bank that allows for:
   a. Verifying actual cash flow information of the enterprise
   b. A more efficient follow up process for loan repayments
   c. Float income for the bank with the enterprise account

The product architecture is summarized in FIGURE 47.

With access to external finance opportunities, the LCPS sector can make major contributions to education in Pakistan. Notably, gender equity can be enhanced, there will be more job opportunities for aspiring teachers and more opportunities to invest in improving the quality of learning.

**Product Outline**

**Purpose:** The purpose of the proposed loan products is i) to finance physical infrastructure improvements and ii) to acquire quality-enhancement services/products, which include building classrooms, science laboratory, computer laboratory and the purchase of furniture and fixtures for the new rooms.

**Product Flexibility:** The financial model provides the free cash flow of the enterprise and the maximum loan amount eligibility based on the school’s enrolment and fee level. However, for each institution (MFB/MFI/CB) the model allows the financial institution to tailor the credit management process based on its specific risk policy and the interest rate and loan tenure can be adjusted. **TABLE 12** summarises the Enterprise Strategy-Product Matrix.

**Matrix of Key Visible School Indicators (KVSI) Matrices (TABLE 12):** The maximum loan amounts for the different

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67 At the time of writing, MFPs offer two main loan products: i) an equal monthly installment loan for trading activities and ii) a seasonal loan mainly for farm-based economic activities such as crops and livestock. Both loan products are generic as opposed to tailored to a sector specific understanding of the firm’s business model, with credit decision-making undertaken to a large extent by the branch staff of the MFB or MFI.
The loan officer in the branch would use the matrices provided to determine the maximum loan amount eligibility of the LCPS based on the loan tenure. After determining the loan amount from the matrix, the loan

**TABLE 13: KVS Matrices**

<table>
<thead>
<tr>
<th>Enrolment Number</th>
<th>Fee Level (PKR)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>350</td>
</tr>
<tr>
<td>100</td>
<td>Free Cash Flow from the financial model</td>
</tr>
<tr>
<td>125</td>
<td>Free Cash Flow from the financial model</td>
</tr>
<tr>
<td>150</td>
<td>Free Cash Flow from the financial model</td>
</tr>
</tbody>
</table>

**TABLE 15: Fee and Enrolment Factor**

<table>
<thead>
<tr>
<th></th>
<th>Primary/Middle</th>
<th>Primary/Secondary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee factor-Middle</td>
<td>116%</td>
<td>119%</td>
</tr>
<tr>
<td>Fee factor-Secondary</td>
<td></td>
<td>151%</td>
</tr>
<tr>
<td>Enrolment factor-Middle</td>
<td>28%</td>
<td>30%</td>
</tr>
<tr>
<td>Enrolment factor-Secondary</td>
<td></td>
<td>21%</td>
</tr>
</tbody>
</table>

**TABLE 12: Enterprise Strategy-Product Matrix**

<table>
<thead>
<tr>
<th>Strategy: Hold or Maintain or horizontal growth</th>
<th>Primary</th>
<th>Middle</th>
<th>Secondary</th>
<th>Financial Product</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy: Horizontal or Vertical Growth</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**TABLE 14** (Page 54)

A snap shot of the actual matrix used by loan officers is shown in **TABLE 14** (Page 54).

In the case of middle and secondary schools, the matrices have been developed based on the actual number of enrolled students and the average fee charged at primary level only. The financial model uses factors calculated from the survey data that are applied on the actual primary enrolment and fees to estimate the enrolment and fees for the middle and secondary levels. The factors used to estimate middle and secondary fees and enrolment are shown in **TABLE 15**.
### PRODUCT ONE – SCHOOL IMPROVEMENT FINANCE (SIF)

#### Key Product Features

1. **Purpose of Loan**: Improve school infrastructure / acquisition of quality enhancing products and services

2. **Amount of Loan**: as determined by the KVS1 matrix

3. **Tenure**: 12/ 24/ 36 months depending on the policy of each lender

4. **Proposed service charges**: 27% - 30% depending on the pricing policy of each lender

5. **Repayment Structure**: Equal monthly installments to be deducted from the LCPS account held with the lending institution / MFI’s correspondent bank

6. **Primary source of repayment**: Monthly school fees from current operations (secondary source of repayment: other income and/or equity of the borrower).

---

### TABLE 14: Snapshot of the actual matrix used by loan officers

<table>
<thead>
<tr>
<th>Enrolment</th>
<th>Fee 350</th>
<th>Fee 400</th>
<th>Fee 450</th>
<th>Fee 500</th>
<th>Fee 550</th>
<th>Fee 600</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>11,218</td>
<td>37,255</td>
<td>63,292</td>
<td>89,328</td>
<td>115,365</td>
<td>141,402</td>
</tr>
<tr>
<td>150</td>
<td>17,056</td>
<td>56,112</td>
<td>95,167</td>
<td>134,223</td>
<td>173,278</td>
<td>212,334</td>
</tr>
<tr>
<td>200</td>
<td>22,665</td>
<td>74,739</td>
<td>126,813</td>
<td>178,887</td>
<td>230,961</td>
<td>283,035</td>
</tr>
<tr>
<td>250</td>
<td>28,274</td>
<td>93,366</td>
<td>158,459</td>
<td>223,551</td>
<td>288,643</td>
<td>353,736</td>
</tr>
<tr>
<td>300</td>
<td>33,883</td>
<td>111,994</td>
<td>190,104</td>
<td>268,215</td>
<td>346,326</td>
<td>424,437</td>
</tr>
<tr>
<td>350</td>
<td>39,492</td>
<td>130,621</td>
<td>221,750</td>
<td>312,880</td>
<td>404,009</td>
<td>495,138</td>
</tr>
<tr>
<td>400</td>
<td>45,330</td>
<td>149,478</td>
<td>253,626</td>
<td>357,774</td>
<td>461,922</td>
<td>566,069</td>
</tr>
<tr>
<td>450</td>
<td>50,939</td>
<td>168,105</td>
<td>285,272</td>
<td>402,438</td>
<td>519,605</td>
<td>636,770</td>
</tr>
<tr>
<td>500</td>
<td>56,548</td>
<td>186,732</td>
<td>316,918</td>
<td>447,102</td>
<td>577,287</td>
<td>707,471</td>
</tr>
<tr>
<td>550</td>
<td>62,157</td>
<td>205,360</td>
<td>348,563</td>
<td>491,766</td>
<td>634,970</td>
<td>778,172</td>
</tr>
<tr>
<td>600</td>
<td>67,766</td>
<td>223,987</td>
<td>380,209</td>
<td>536,431</td>
<td>692,653</td>
<td>848,873</td>
</tr>
</tbody>
</table>

An officer will assess the basic profile of the LCPS, including number of girls studying in the school and the total number of teachers (to determine the impact on Gender Parity Index and employment). The branch staff will open an account in the name of the LCPS where the monthly school fees would be deposited by the parents of the students of the school.
Collateral

1. LCPS cash flow to bank account: total school fees routed into the LCPS bank account. LCPS will provide standing instructions to debit the LCPS bank account for the amount of monthly installment. Lender provides specially designed deposit slips with pre-printed LCPS bank account number for parents of the students to deposit the school fees in the LCPS account.

2. Edupreneur’s personal guarantee for the total loan amount

Due Diligence by banks:

1. Target market segment: LCPS should comply with the following conditions:
   - Minimum two years in operation
   - Minimum enrolment of 100 students
   - Minimum fees PKR 350 per month per student

2. Role of the Bank Branch Staff: Matrix of Key Visible School Indicators (KVSI) will be used by the lending institution’s branch staff. Based on the student enrolment number and fee per student for primary level, the KVSI matrix will provide the maximum loan amount for three tenures – 1 year, 2 years or 3 years.

3. Marketing: Loan officers will market the product to edupreneurs and complete the application form for interested LCPSs. Loan officers will also check the market reputation of the school and edupreneur (willingness to repay) with the student’s parents and businesses in the nearby vicinity/ verify residential address of the edupreneur

4. Loan amount and tenure: The Credit department will review the application form and determine the maximum amount of loan and the appropriate tenure based on the KVSI matrix and the requested loan amount. In the case the fee level or enrolment number is not available on the matrix, the amount for the lower combination of fee and enrolment will be used

5. Risk department review: existence of the LCPS/ meeting with the edupreneur/ average fee level/

6. Documents required for loan approval: Main documents required from LCPS for approval of the loan are:
   a. Signed confirmation from the edupreneur to route monthly school fees to the bank account
   b. Standing instruction from edupreneur to have the monthly installment deducted from the LCPS bank account
   c. Debit authority to deduct the entire loan amount
   d. LCPS utility bills for the last three months
   e. Lease agreement copy in case of rented premises
   f. CNIC verification from NADRA
   g. CIB report from MF-CIB and eCIB for the edupreneur and LCPS

7. Pre-disbursement: Once the loan is approved, the edupreneur will be required to open an account for the LCPS with the lending bank and sign the promissory note and mark-up agreement

8. Disbursement: Subject to opening of the LCPS bank account with the lending institution.

Credit Enhancement

Credit enhancement may be accessed through the Credit Guarantee Scheme under Financial Inclusion Programme at the State Bank of Pakistan. The credit guarantee would be 40% of the loan amount covering first loss on the LCPS loan portfolio.
Product Two - School Level Enhancement Finance (SLEF)

Key Product Features

1. **Approved Amount of Loan:** 75% of the borrower’s requirement or 75% of the amount in the matrix, whichever is lower for construction of maximum of three (primary to middle) or two (middle to secondary) classrooms.

2. **Disbursement:** To be disbursed in three tranches:
   a. First tranche of one-third of the approved amount at the time of approval of the loan in December / January.
   b. Second tranche of one-third of the approved loan amount upon complying fully with the conditions for disbursement of the tranche in December / January.
   c. Third tranche of one-third of the approved loan amount upon complying fully with the conditions for disbursement of the tranche in preferred Disbursement Period: December / January.

Proposed conditions for disbursement of second and third tranches:
   a. Completion of construction of additional new rooms / purchase of planned infrastructure.
   b. Achievement of assumed number of enrolment in the first grade of the new level (grade VI and grade IX for middle and secondary respectively).
   c. Receipt (realization) of planned fees for the grade in the new level.
   d. For second and third tranches: Timely and full payment of the monthly installments of the first / second tranche.
   e. Continuation of receipt of school fees into the bank account of the school held with the lending bank / correspondent bank in case of MFI.

3. **Tenure:** 3 years for each tranche including grace period for the total loan amount.

4. **Repayment Structure:** Loan to be repaid in monthly installments that would increase with the disbursement of each tranche of the loan. For example, repayment of the first tranche would be in 33 monthly installments; however, the monthly installment amount will increase after disbursement of each subsequent tranche (second and third tranches).

5. **Grace period:** monthly payment of interest only/ loan repayment in 33 monthly installments. Grace period of 3 months or up to April of the following year, whichever is earlier to be available for the first tranche only.

6. **Proposed service charges:** 27% - 30% p.a. effective depending on the pricing policy of each Bank / MFI.

7. **Sources of repayment:**
   - **Primary source of repayment:** Monthly school fees from the current level of education (primary/middle).
   - **Secondary source of repayment:** Monthly school fees from the new level of education (middle for primary and secondary for middle).

Collateral

1. LCPS cash flow to bank account: School fees routed into the LCPS bank account at all school levels. LCPS will provide standing instructions to debit the LCPS bank account for the amount of monthly installment. Lender will provide specially designed deposit slips with pre-printed LCPS bank account number for parents of the students to deposit the school fees in the LCPS account.

2. Edupreneur’s personal guarantee for the total loan amount.

Due Diligence by banks:

1. **Target market segment:** LCPS should comply with the following conditions:
   a. Minimum two years in operation.
   b. Minimum enrolment of 100 students.
2. **Marketing:** Loan officers will market the product to LCPS and complete the application form for the interested LCPS. The loan officer will check the market reputation of the school and edupreneur (willingness to repay) with the student’s parents and businesses in the nearby vicinity/verify residential address of the edupreneur.

3. **Loan amount and tenure:** Credit department will review the application form and determine the maximum amount of loan and the appropriate tenure based on the KVSI matrix and the requested loan amount. In the case the fee level or enrolment number is not available on the matrix, the amount for the lower combination of fee and enrolment will be used.

4. **Risk department review:** existence of the LCPS/meeting with the edupreneur/average fee level/enrolment number/years of operation and compliance with all requirements of the product programme.

5. **Documents required for loan approval:** Main documents required from LCPS for approval of the loan are:
   a. Signed confirmation from edupreneur to route monthly school fees to the bank account
   b. Standing instruction from edupreneur to have the monthly installment deducted from the LCPS bank account
   c. Debit authority to deduct the entire loan amount
   d. LCPS utility bills for the last three months
   e. Lease agreement copy in case of rented premises
   f. CNIC verification from NADRA
   g. CIB report from MF-CIB and eCIB for the edupreneur and LCPS
   h. Loan application form confirming the number of un-utilized rooms in the LCPS premises (this would provide the additional rooms required).

6. **Loan approval:** The loan would be approved for the entire amount required for construction of rooms for expanding the LCPS into the next level of education. The calculation of the required number of rooms would be made after taking into account the number of available un-utilized rooms at the premises.

7. **Pre-disbursement:** Once the loan is approved, the edupreneur will be required to open an account for the LCPS with the lending bank and sign the promissory note and mark-up agreement.

8. **Disbursement:** Subject to opening of LCPS bank account with the lending institution.

9. **Role of the Bank Branch Staff:** Matrix of KVSI will be used by the lender’s branch staff. Based on the enrolment number and fee for primary classes, the KVSI matrix will provide the maximum loan amount for the three tenures – 1 year, 2 years or 3 years.

**Credit Enhancement**

Credit enhancement may be accessed through the Credit Guarantee Scheme under Financial Inclusion Programme at the State Bank of Pakistan. The credit guarantee would be 40% of the loan amount covering first loss on the LCPS loan portfolio.
CONCLUSION
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Pakistan must educate more than twenty million out of school children with its limited resources and an under-performing public education sector. This challenge is compounded by the urgency of ensuring that demographic changes contribute positively to the economic development of the country. This monumental task requires innovative, alternative solutions and service providers that cater to lower socio-economic segments. In response to these issues, LCPSs have shown merit and potential in Pakistan as they have in other contexts.

The survey shows just how flexible the LCPS model is, allowing schools to operate and remain profitable across different socio-economic segments, different levels of schooling and with a range of fee bands. A locally designed model emerges from the study of LCPSs, responding to the needs of the local community, driven by parental preference and offering education at a lower cost. However, the research also indicates how constrained the LCPS business model is, and how in particular, edupreneurs experience significant obstacles in financing growth. One of the major barriers to growth in the LCPS sector (and the focus of this study) is the lack of access to finance.

That the survey clearly shows that credit is absent from the LCPS business model is indicative of market failure. The normal role of lenders – as financial intermediaries – is to supply credit to those enterprises that can deploy these resources productively. Yet in the case of the LCPS sector this vital role of intermediation is not working. This means that edupreneurs who want to invest and grow their businesses and who are good credit risks currently go unserved. This is a market failure that has enormous social consequences for Pakistan. We hope that this research makes some small contribution to unblocking this market failure, as we are sure that our partners in this study and in the pilot are making their contribution.

Solving these challenges is difficult and complex, because market failure is underpinned by multiple obstacles and blockages. Our research has touched on some but not all of these factors. Some factors, such as the constricted supply of credit to the MSME sector as a whole, or employment opportunities for school leavers, are related to the economic management and performance of Pakistan itself. Other factors relate specifically to the LCPS sector, such as the legal and regulatory frameworks that need to be strengthened, the capacity and skills of edupreneurs to act as responsible borrowers, or the absence of commercially minded education service providers who can market a product to the edupreneur at an affordable price. Additional factors, such as the capacity of loan officers in the branch network, or the absence of collateral registries or a secured transaction regime that would enable lenders to lend to smaller enterprises, relate to the work that still needs to be done to develop a more supportive financial infrastructure.

To address these market failures and specifically those related to access to finance, the engagement of all stakeholders, working together to address specific blockages is essential if scalable and sustainable solutions are to be achieved. We hope that by positioning education and financial services as equal partners in our research that a clear case has been made for seemingly disparate industries to work together in partnership. The overwhelming response to this work from both education and financial service contributors has been one of support and enthusiastic participation, but that this response has not been universal highlights the difficult task of getting two industries to work together for mutual benefit.

With respect to lending, the study has proposed a programme based lending model, designed to overcome the difficulties faced by lending institutions in developing a sector approach that facilitates good lending decisions that are based on an informed understanding of the school's business model. In piloting the model and loan products it is expected that the tools can be refined. By improving the tools and sharing the experiences of those lenders engaged in the pilot, it is hoped that more financial institutions will begin to view lending to LCPSs as a key portfolio.

Certainly, a scenario in which financial institutions adopt a programme based lending approach and begin to develop a LCPS sector portfolio without outside support is to be welcomed. This would represent a milestone in overcoming market failure and the beginnings of a functioning financial intermediation role for lenders in the service of LCPS as small businesses. This is at heart the only scalable and sustainable lending model for the sector.

In the short term, the donor can play a role and should focus efforts on working with the financial sector to develop mechanisms that unblock the barriers to financial intermediation, whilst still ensuring that credit risk remains largely – or wholly - with the lender. This approach ensures that the financial institution’s own
to harness access to finance for education as a key tool in ending the poverty of learning experienced by many millions of students already in LCPSs and creating the opportunity of access for the millions more out of school children in Pakistan.

With respect to education support services, this research touches upon (but does not explore in detail) the opportunity to link credit with quality in the form of an education services marketplace. The only long term, scalable and sustainable model is one where the edupreneur is aware of and can access cost effective education services that help the business grow, and where lenders are willing to finance the purchase of these inputs. Such a model envisages education support service providers working together with financial institutions, and where donors make targeted investments in building the business development capacity of the edupreneur and the LCPS in areas such as school audits, business planning and financial literacy. In the short term therefore, there is an important role for donors in helping create the conditions whereby edupreneurs have access input markets that enable schools to deploy new capital to improve marketability and at the same time ensuring improved learning outcomes.

The donor could consider subsidising the cost of these inputs whilst also helping to develop a more commercially minded education service sector that is in the longer term less dependent on donor funding and has the ambition and the governance structures to achieve systemic change in the LCPS sector.

Hence, in piloting the programme-based lending model, our research has specifically linked credit provision with a proportional investment in education services for each borrowing school – initially a school audit - to raise awareness amongst edupreneurs as to how education support services can support growth based upon quality. By engaging education support service providers in the pilot, relationships between the financial institution and education support service providers are being nurtured, mutual incomprehension reduced, and the link between credit and quality established in the minds of stakeholders. Working together, these stakeholders have the potential


MicroWatch. Pakistan Microfinance Network


Tahir Andrabi, J. D. (2007). Pakistan Learning and Educational Achievement in Punjab Schools (LEAPS) Insights to inform the education policy debate.


Stein, Gloand, Schiff. IFC and McKinsey, Two Trillion and Counting


## Annexures

### Annex 1: Enterprise and Sector Risk Analysis

<table>
<thead>
<tr>
<th>Risks</th>
<th>Mitigants</th>
</tr>
</thead>
</table>
| **Industry Risks**                                                  | • Meeting MDG targets – Pakistan is off-track on its MDG target of 100% primary enrolment. Therefore, the GoP will need to maintain an enabling environment for LCPSs to remain profitable and encourage growth in enrolment.  
• Private schools account for 38% of Pakistan’s total enrolment with LCPSs accounting for a major portion. There would be political pressure on the GoP to introduce a proportionate regulatory framework, allowing for continuation of growth enabling environment |
| Introduction of regulations: Regulatory cost could have an adverse impact on the profitability of LCPSs | • 63% of the LCPSs surveyed are informal enterprises and are not registered as legal entities. Labour laws may not apply to these entities  
• Low levels of institutionalization and lack of evidence of full time employment contracts for the LCPS staff  
• Some LCPS teaching staff are paid at or above the minimum wage level, particularly teachers with higher qualifications and those working in secondary schools |
| Implementation of national labour laws: Most surveyed LCPSs do not comply with labour laws for minimum wage and EOBI | • PEF supported schools to have a maximum limit on the number of students per school  
• Large number of children are out of school estimated at 5.1 MM at the primary level and 25 MM at all levels  
• PEF FAS supported schools are only 3,200 (7.6%) out of the 41,972 registered private schools and Sindh Education Foundation’s PPRS supports 390 (4%) of the 9,704 registered private schools in Sindh |
| **Business Risks**                                                  | • Survey results demonstrate an increase in the number of teachers in the surveyed schools  
• Average STR for the schools is below the international benchmarks |
| Market distortion by donor programmes may cause loss of enrolment from schools operating a sustainable revenue model | • The number of OOSC is large and growing therefore there is a large untapped market available for new LCPSs  
• Increased competition within the LCPS sector would argue well for the quality of education as enhanced service level differentiation would be required to compete successfully |
| High turnover of teachers at the primary level                      | • There is a large and growing number of OOSC in Pakistan at all levels  
• The public school system would also have capacity constraints in accommodating the growing number of OOSC |
| Low barriers to entry                                               | • Credit life insurance available from insurance companies would cover the exposure of lending financial institutions |
| Improvement in perception of quality of public schools              |                                                                                                                                           |
| Management Risk                                                     |                                                                                                                                           |
| Weak succession planning and institutionalization                   |                                                                                                                                           |
ANNEX 2: REVIEW OF REGULATORY FRAMEWORK

Review of State Bank of Pakistan (SBP) regulatory framework for Small Enterprise and Enterprise Finance

The SBP is mandated to provide an enabling environment through its regulatory frameworks for microfinance banks and for SME lending by commercial banks. The Prudential Regulations for microfinance banks and SME lending for commercial banks provide a proportionate regulatory environment with guidance on developing the approach by banks to provide financial services to the largely untapped SME market in Pakistan.

Key Features of Prudential Regulations for Enterprise Lending by Microfinance Banks (updated March 2012)

- Microenterprises shall mean projects or businesses in trading /manufacturing / services / agriculture that lead to livelihood improvement and income generation. Moreover, these projects/businesses are undertaken by micro-entrepreneurs who are either self-employed or employ few individuals not exceeding 10 (excluding seasonal labor).
- In Pakistan, microenterprises operate in numerous forms including carpenters, electricians, food stalls, farmers, live-stocks, lathe machines, mechanics etc. and these have traditionally lacked access to formal financial services
- Maximum enterprise loan size of PKR 500,000
- Counter-party for the loans will be the micro-entrepreneur

Key Features of Prudential Regulations for Small Enterprise Lending by Commercial Banks (updated May 2013)

- Small enterprises are those that meet both the following criteria:
  - Number of employees of the enterprise up to 20 (including contractual) and
  - Turnover up to PKR 75 MM
- Maximum clean exposure from Banks and DFIs not to exceed PKR 5 MM
- Total maximum borrowing by small enterprises up to PKR 15 MM
- Borrower Assessment: Normally, Small Enterprises do not maintain proper financial accounts for the satisfaction of the banks/DFIs. Their record generally contains sale/purchase books and cash received/paid records in a rudimentary form. Banks/DFIs shall use relevant/practical cash flow estimation techniques and other proxies to assess repayment capacity of SE borrower. To supplement, banks/DFIs are encouraged to use the available sector/cluster-specific financial models that can capture cost structure, revenue streams and margins in the sectors. For programme-based lending, banks/DFIs, as a substitute, may also use Income Estimation Models to assess repayment capacity of the borrowers (Regulation SE R-4: Repayment Capacity of the Borrower and Cash Flow Based Lending
- Banks and DFIs are not required to obtain a copy of borrower’s audited accounts
ANNEX 3: ANALYSIS OF LIMITATIONS, RISKS AND OPPORTUNITIES

Limitations

The private sector mirrors the public sector in terms of trends in transition from primary to post-primary levels of education:

Enrolment in primary schools is higher in the private sector. The transition trends are similar to those encountered in public schools: numbers of students fall at the middle and secondary school levels and are the lowest at higher secondary levels.

Change in cost structures at different levels of schools:

The growth of LCPSs is bound by costs, when a vertical expansion is the target: upgrading primary schools to the middle level and middle schools to high school level remains problematic. Changes or escalations in cost structures are due to the profile of required teachers (better qualified teachers) and also reflect the costs attached to the number of classrooms and other essential facilities. The market demand for highly qualified teachers is higher. Accordingly, employing and supporting such teachers would raise expenditure dramatically. Increasing the tuition fee is an option these schools tend to avoid in fear of losing enrolments among the socio-economic segment they serve.

Private Equity:

LCPSs tend to use private equity and avoid credit, which has restricted their potential expansion and any improvements designed to increase quality in the sector. Due to the lack of access to formal financing avenues specific to LCPSs, the owners borrow from informal sources (family, friends, etc.). Although the schools are profitable, owners expressed interest in exploring sources of finance but also shared some serious concerns:

- Survey results list the main reasons that discourage owners from borrowing from formal financial sources: cumbersome procedures, high costs of leasing and credit and the requirement for collateral in order to obtain credit.
- LCPSs are small businesses but the owners have very little connection to, and access to banks as sources of credit. As the survey data shows, many schools do not have a bank account to route the small amounts collected as fees.
- Declaring assets and income was another concern as most owners named corruption as an issue; as a result they were reluctant to declare their assets and income and approach the formal financial sector.

Low Fee:

The strength of LCPSs is rooted in their low fee structures, and is positively correlated with enrolments. The LCPS sector is the third layer in the system that provides education to poverty stricken children. Although LCPSs may reach the lower socio-economic segments of society, it is likely that children who belong to the poorest families (unable to pay PKR 50 per month) would still opt for public schools education or stay out of school.

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69 The first tier is the elite private schools, the medium tier schools such as the Educators, Allied schools and similar and the third is the LCPS sector. The public sector with all its limitations remains a channel for educating the lowest socio-economic segment of society.

Opportunities

Out of School Children:
The sector can benefit from significant opportunities such as the large pool of out of school children (OOSC) in their respective catchment areas and in the country at large.

Competition:
The main competitors of LCPSs tend to be public schools and other LCPSs. The underperformance of government/public schools is largely an opportunity for the LCPS sector and one of the main reasons of its existence and proliferation. Competition between LCPS is noticeable; however there is still an opportunity for establishing schools due to the immense demand and room for growth. Parental preference for private schools and the number of OOSC are two factors favoring low cost private schools.

Easy Entry in the Sector:
It is relatively easy for an entrepreneur to start a school because the cost of entry in the market is relatively low. Investment levels vary depending on the kind of school an entrepreneur aspires to establish. In addition, expenses are incurred gradually, distributed over three or four years, for example primary schools can start with a pre-primary class and build on it as each class graduates.

Parental Trust:
LCPSs enjoy parents’ trust since most operate in local communities. Parents find it safer to send their children there due to the reduced commute for both children and local teachers.

Risks

Negative Regulatory Framework:
Several potential risks threaten this sector. For example, the introduction of taxes, labour laws and an unfavorable regulatory framework for private sector education institutions may disturb the current status quo.

Phenomenal Improvement in Public Sector Schools:
It is highly likely that improvement in public schools and other donor-funded projects supporting public schools can impact the private education sector negatively.

Unionisation:
Unionisation has not yet reached the LCPS sector. Experience from developed countries shows that private-school teachers were not still unionized even when the private sector was moderately mature. However, over time the concept became as strong as it is in the public sector in Pakistan.

Employment Opportunities offered by GoP:
GoP employment is an attractive alternative for LCPS teachers. Improving the skill set of LCPS teachers is likely to increase their marketability and attractiveness to the state sector.
### Annex 4: Actual Sample Covered in the Survey

#### PRIMARY

<table>
<thead>
<tr>
<th>Tuition Fee Band</th>
<th>Punjab</th>
<th>Sindh</th>
<th>KP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 350 - Rs.800</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rs. 801 - Rs.1200</td>
<td>12</td>
<td>11</td>
<td>1</td>
</tr>
<tr>
<td>Rs. 1201 - Rs.2000</td>
<td>4</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Others</td>
<td>50</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>67</td>
<td>12</td>
<td>6</td>
</tr>
</tbody>
</table>

#### MIDDLE

<table>
<thead>
<tr>
<th>Tuition Fee Band</th>
<th>Punjab</th>
<th>Sindh</th>
<th>KP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 350 - Rs.800</td>
<td></td>
<td></td>
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#### TOTAL

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<th>KP</th>
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<tr>
<td>Rs. 801 - Rs.1200</td>
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<td>Rs. 1201 - Rs.2000</td>
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<tr>
<td>Others</td>
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<td>Fee</td>
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<td>400</td>
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<tr>
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<td>37,255</td>
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<td>134,240</td>
<td>204,720</td>
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<td>400</td>
<td>7,944</td>
<td>158,720</td>
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<td>18,744</td>
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**ANNEX 5: KVSI MATRIX**

LCPS-Financing Product MATRIX-Primary Level (1 Year)
<table>
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<tr>
<th>800</th>
<th>850</th>
<th>900</th>
<th>950</th>
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<th>1,050</th>
<th>1,100</th>
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<td>3,946,136</td>
<td>4,219,522</td>
<td>4,492,912</td>
<td>4,766,299</td>
<td>5,039,689</td>
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<tr>
<td>7,492,046</td>
<td>8,286,158</td>
<td>9,080,292</td>
<td>9,874,426</td>
<td>10,668,549</td>
<td>11,462,672</td>
<td>12,256,794</td>
<td>13,050,928</td>
<td>13,845,051</td>
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</tr>
<tr>
<td>5,158,397</td>
<td>5,705,164</td>
<td>6,251,944</td>
<td>6,798,724</td>
<td>7,345,498</td>
<td>7,892,271</td>
<td>8,439,044</td>
<td>8,985,825</td>
<td>9,532,598</td>
<td>10,079,378</td>
</tr>
<tr>
<td>5,281,403</td>
<td>5,841,187</td>
<td>6,400,986</td>
<td>6,960,785</td>
<td>7,520,577</td>
<td>8,080,368</td>
<td>8,640,160</td>
<td>9,199,959</td>
<td>9,759,751</td>
<td>10,319,550</td>
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<tr>
<td>2,947,754</td>
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<td>3,572,638</td>
<td>3,885,084</td>
<td>4,197,526</td>
<td>4,509,968</td>
<td>4,822,410</td>
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<tr>
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<td>3,870,262</td>
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<td>4,885,703</td>
<td>5,224,181</td>
<td>5,562,664</td>
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<td>6,239,626</td>
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<tr>
<td>1,350,986</td>
<td>1,494,188</td>
<td>1,637,392</td>
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<td>1,923,799</td>
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<td>2,210,204</td>
<td>2,353,408</td>
<td>2,496,611</td>
<td>2,639,815</td>
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<tr>
<td>1,247,31</td>
<td>1,395,202</td>
<td>1,543,095</td>
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<td>1,986,774</td>
<td>2,134,668</td>
<td>2,282,561</td>
<td>2,430,454</td>
<td>2,578,347</td>
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<tr>
<td>5,158,397</td>
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<td>8,439,044</td>
<td>8,985,825</td>
<td>9,532,598</td>
<td>10,079,378</td>
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<tr>
<td>5,281,403</td>
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<td>6,960,785</td>
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<td>8,640,160</td>
<td>9,199,959</td>
<td>9,759,751</td>
<td>10,319,550</td>
</tr>
</tbody>
</table>

Access to Finance for Low Cost Private Schools

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# ANNEX 6: PRODUCT TERM SHEET

## School Improvement Finance

| **Target market** | Minimum two years in operation  
Minimum enrolment of 100 students  
Minimum fees PKR 350 |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purpose of loan</strong></td>
<td>Improve school infrastructure / acquisition of quality enhancing products and services</td>
</tr>
<tr>
<td><strong>Loan Amount</strong></td>
<td>Depending on the fee / enrolment matrix</td>
</tr>
<tr>
<td><strong>Loan tenor</strong></td>
<td>12 / 24 / 36 months</td>
</tr>
<tr>
<td><strong>Repayment structure</strong></td>
<td>Equal monthly instalments</td>
</tr>
<tr>
<td><strong>Source of repayment</strong></td>
<td>Monthly fees (cash flow from operations)</td>
</tr>
<tr>
<td><strong>Collateral</strong></td>
<td>Monthly fees collection in the lending bank’s account and personal guarantee of the owner / DPN</td>
</tr>
<tr>
<td><strong>Credit enhancement</strong></td>
<td>Proposed 40% through the Credit Guarantee Scheme under Financial Inclusion Programme at SBP</td>
</tr>
<tr>
<td><strong>Proposed service charge rate</strong></td>
<td>27-30% p.a. effective</td>
</tr>
</tbody>
</table>

## School Level Enhancement Finance

| **Target market** | Minimum two years in operation  
Minimum enrolment of 100 students  
Minimum fees PKR 350 |
<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Purpose of loan</strong></td>
<td>Build infrastructure for upgrading the school from Primary to Middle and Middle to Secondary</td>
</tr>
<tr>
<td><strong>Loan Amount</strong></td>
<td>Depending on the fee / enrolment matrix</td>
</tr>
<tr>
<td><strong>Loan Disbursement</strong></td>
<td>In three tranches for construction of Middle and two tranches for construction of Secondary</td>
</tr>
<tr>
<td><strong>Loan tranche disbursement period</strong></td>
<td>December / January</td>
</tr>
<tr>
<td><strong>Loan tenor</strong></td>
<td>36 months</td>
</tr>
</tbody>
</table>
| **Tranche disbursement conditions** | Completion of construction of additional new rooms  
Achievement of assumed number of enrolment in the first grade of the new level (grade VI and grade IX)  
Receipt of planned fees for the grade in the new level  
Timely and full payment of the monthly instalments of the first tranche  
Continuation of receipt of school fees into the bank account of the school held with the lending bank / correspondent bank in case of MFI |
| **Grace Period** | 3 months or up to April of the following year whichever is earlier |
| **Repayment structure** | Grace Period: monthly payment of interest only  
Equal monthly instalments  
After grace period: 33 equal monthly instalments |
| **Source of repayment** | Primary: Monthly fees (cash flow from operations) from the current level of education (primary / middle)  
Secondary: Monthly school fees from the new level of education (middle for primary and secondary for middle) |
| **Collateral** | Monthly fees collection in the lending bank’s account and personal guarantee of the owner / DPN |
| **Credit enhancement** | Proposed 40% through the Credit Guarantee Scheme under Financial Inclusion Programme at SBP |
| **Proposed service charge rate** | 27-30% p.a. effective |
ANNEX 7: LIST OF ORGANIZATIONS MET DURING THE RESEARCH PHASE

1. Acumen Fund
2. Aman Foundation
3. Bank Al-falah
4. Cyan Limited
5. Damen
6. Education Fund for Sindh
7. Faysal Bank
8. First MicroFinanceBank Limited
9. Habib Bank Limited
10. ITA - Center of Education and Consciousness
11. Kashf Foundation
12. Khushhali Bank Limited
13. McKinsey, Roadmap Team for Punjab Education Foundation
14. Nasra Trust
15. Pakistan Education Foundation
16. Pakistan Microfinance Network
17. Pak Oman Microfinance Bank
18. SIMORGH
19. Society for Advancement of Education (SAHE)
20. Socio Engineering Consultants
21. State Bank of Pakistan
22. Tameer Microfinance Bank
23. World Bank, Islamabad
Rozeena Kindergarten School - Multan

“I love to serve my country and do it by running a private school. I couldn’t find any other way. I tried to get a job in Pakistan but I couldn’t.”

Atta Mohammad took his degree at Punjab University and migrated to the UK at the age of 28. He attended a Diploma Electrical technical course (Higher National Diploma) and worked as an electrician for 35 years. He returned to Pakistan in 1998 and tried tirelessly to find suitable employment in Lahore.

As a result, he decided to open an English language, co-education school in his own house in Multan. ‘Rozeena Kindergarten School’ was established as a business venture with an initial self-investment of PKR 25,000. Atta had no difficulty registering the new school with the Education Board, and advertised it by putting up banners and distributing pamphlets. The fees were low – PKR 250 in the first year – and by 2013, he had 95 students at the ‘Rozeena’ School.

It wasn’t always easy. Atta faced competition from similar schools, parents negotiating fees, and fee payment delays. As a strategy, he hired teachers who had completed their matriculation exams, FAs and BAs for the pre-primary, primary and middle levels, providing an average salary of PKR 2,686 per month. To compensate for the low wages he allows his teaching staff to provide private tutoring to existing students.

“Even though the teachers are highly qualified they are very hard-working and provide private tuition to the students of the school if they are willing to pay.”

Now Atta wants to upgrade the school to middle level because he feels it would bring about an increase in enrolment. For that, he will have to build classrooms and repair the building. Even though he is enthusiastic about the future of the school, he needs financial support to make his dreams and plans become reality.
Mohammad Altaf Ahmed started the first English language primary school in Shujaabad in 1998. Named City Computer Institute, the school was set up in a three-room rented building, a former boys’ hostel. The school had two teachers, one of whom was Altaf’s own wife. Just 20 young children attended the pre-primary class in the first year.

The school grew over the years. By 2011 it had 65 pre-primary students, 52 of whom graduated to primary the following year. In 2012, the Institute upgraded to a middle-level school. School fees also increased gradually from the initial PKR 100 to PKR 600 in 2013, for pre-primary students.

Altaf employed qualified teachers and paid them an average salary of PKR 6-7,000. To accommodate more students, he built four additional classrooms and an office with construction materials and money borrowed from friends.

Altaf knows that the expansion of his school is the way forward, to meet the high demand for English medium education in the area. His challenge has never been enrolling more children but creating space for them. With the right kind of terms and conditions, Altaf would consider taking a bank loan for his school expansion.

“I have four brothers. One works for an NGO, another works in a bank, the eldest is in Kuwait but I’m the happiest. My school is doing good!”

“I’m working with passion to improve and expand this school.”
Bushra was born in a family that forbade girls’ education and lived in a small village in Gujranwala. However, Bushra’s father, an enlightened teacher in a local government boys’ school, believed in female education and home-schooled his daughter until she reached class 3. Then Bushra’s father established a girl’s school on family-owned land in the neighborhood, in an attempt to promote female education. Years later, Bushra returned to teach in this school.

When her husband discouraged her from working, Bushra had to suppress her dreams and turn down a position as School Principal of a public school. She dedicated herself to raising her family instead.

Then, in 1993, a relative offered Bushra a fifty percent partnership in a school, the role of Managing Partner and School Principal, and his three-room double-storey ancestral residential property - an offer she could not refuse. Bushra invested PKR 50,000 and established Kids’ County Junior School, an English language primary school in Tariq Colony, Sodhiwal, Lahore.

The school, started with only 30 students, currently has 156 students. Over the years, Bushra built three additional classrooms to accommodate new students. Bushra feels the lack of financing has restricted her ability to expand the school.

“I wanted to go to school just like my brothers. I was fortunate that my father supported me. It is now my wish to help others.”
Jabbar is a car mechanic by profession. He worked in Kuwait all his life. His first business venture, while still in Kuwait, was to open a computer college in partnership with a friend. It didn’t go well: he was cheated and lost his hard earned money.

When Jabbar returned to Pakistan ten years ago, he established a mechanic workshop. Two of his sons dropped out of high school and helped him manage it. When the business was stable Jabbar decided to invest in a catering business and managed it with the help of his own sons. The success of his businesses encouraged Jabbar to open a primary school in his father’s house in the narrow streets of Qazipur, Sheikhupura. Jabbar repaired and furnished the three poorly-lit small rooms and two bathrooms of the property a few months before he opened the school. He named it The Royal Cambridge School.

The Royal Cambridge, an English medium school, became operational in 2011 and admitted 30 children, with fees set at PKR 500. The school currently enrolls 52 children in pre-primary and primary classes.

Jabbar hired a trained local head teacher and four highly qualified teachers. The school provides good facilities such as computers, a generator, a small mobile canteen, teaching aids and a clean environment for the students. He offers scholarships and fee concessions to five deserving students and considers it a duty to give back to the community although the school is not yet making a profit.

Jabbar uses different ways to market the school: hiring local teachers, distributing pamphlets, airing expensive advertisements on cable TV during the months before the admission process starts in March of every year. He has not yet registered the school with the Education Board but he plans to do so once the number of children in class five increases further.

Jabbar plans to rent or buy a new larger building in a better location and with a playground; he intends to hire highly qualified subject-specialist teachers to teach in the Royal Cambridge Secondary School. He aims to charge a minimum fee of PKR 1,000 like other private schools. The required investment is considerable – an estimated 100,000,000 – but Jabbar believes in a bright future for his school.

“I am determined to make The Royal Cambridge School better than all private schools in the area.”