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Impact Investing in Education: An Overview of the Current Landscape

D. Capital Partners

2013 No. 59

WORKING PAPER

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EDUCATION SUPPORT PROGRAM

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About the Author

D. CAPITAL PARTNERS, a Dalberg Group company, is a mission driven investment advisor and asset manager facilitating capital flows to underserved countries, sectors and beneficiaries. D. Capital acts as an intermediary across a range of investment types and between different investors groups to ensure efficient capital deployment and to enhance liquidity and transparency in the impact investment market. We use the incentives and instruments of disciplined finance and investing to provide more transparent and efficient capital solutions to development issues. To this end, we work with a wide spectrum of clients: public and private actors, investors and asset managers, sector catalysts and entrepreneurs, all of whom share a common goal of using capital to boost private sector development while achieving financial, social, and environmental impact.

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Abbreviations and Acronyms

ARK	Absolute Return for Kids
BoP	Base of the income pyramid
CIFF	Children's Investment Fund Foundation
EGF	Equity Group Foundation
GCN	Girl Child Network
GDP	Gross Domestic Product
IFC	International Finance Corporation
IRC	International Rescue Committee
J-PAL	Abdul Latif Jameel Poverty Action Lab
MIT	Massachusetts Institute of Technology
PEAS	Promoting Equality in African Schools
PRI	Program-Related Investments
TCF	The Citizen's Foundation
UNESCO	United Nations Educational, Scientific and Cultural Organization
VSLA	Village Savings and Loan Associations

Executive Summary

While governments maintain the responsibility to provide education opportunities to citizens and the global development community has pledged to provide funding to support them in their efforts, many low-income countries still lack the resources and capacity to provide universal basic education of quality. While access to education has dramatically increased over the past decade, 57 million children do not currently have access to education, and many of those who do receive limited, low-quality services. A recent estimate has shown that the stagnation of aid and inflation has meant that the funding gap needed to provide basic education for all children, youth, and adults has increased to US$26 billion. In this context, impacting investing, which uses the tools of commercial capital deployment for social good, has emerged as a potential tool to support education access, equity, and quality. Education impact investing could mobilize new funding, enable private sector engagement in both public and private education service delivery, and introduce and scale approaches or tools to improve efficiency of service delivery, promote innovation in teaching and learning methods, and monitor outcomes and systemic effectiveness.

This study maps the emerging landscape of education impact investing, with a view to identify potential areas for intervention by impact investors. It describes the characteristics of impact investment, including sources of capital, investor profiles and preferences, and areas of investment. Its focus is on investments that broaden access to quality education, especially for the most vulnerable populations.

Impact investing has advanced in many areas but remains nascent in the education sector. Most deals remain small, and investments in schools currently dominate deal-making, with more innovative technology and management models just beginning to emerge. As yet, few business models deliver strong immediate financial return while reaching the most vulnerable beneficiaries. As a result, private financiers of education are of two main types: donors focused on reaching the lowest income populations without expectation of any financial return, and finance-first investors who target middle and upper class populations.

Between these two poles, investors look at the risk and return of an investment and also consider the positive and social impact it has. This enables investors to look at different possibilities or preferences. These preferences guide them toward particular matrices of investment types, stages, sizes, and vehicles. Many impact investors are still seeking to strike the optimal balance in terms of the parameters most important to them. As the sector develops, a broader range of local education funders could offer additional capital and more sustainable partnerships with the public education sector.

Because of the perceived lack of innovation in education, the persistent magnitude of the global need, and the still limited capacity of the public sector to fulfill that need, there are a variety of important roles for private impact capital to serve. Where government is absent, private capital can fill a gap through funding direct service provision. Where government is present but has low capacity, private capital can spur innovations that increase equitable access, enhance quality, and ensure retention. Ultimately, in a mature system where the public sector is the provider of choice for being free, effective, and accessible to all, the private sector can offer alternative and premium education services.

Impact capital differs from ***commercial private capital*** in that it seeks to reach the most vulnerable beneficiaries; it differs from ***private philanthropic capital*** in that it seeks to apply market-based innovations to ensure financial sustainability, if not financial profit. When private capital is being used within public systems to target the most vulnerable or to build the public sector's ability to reach them, ***patient or concessionary capital*** will most likely be required. It is unrealistic to expect that models seeking the most impact in reaching the most vulnerable will be immediately commercially attractive because end-beneficiaries lack a fundamental ability to pay for services. However, not being commercially attractive does not mean that only grants can be used. Targeting financial sustainability can achieve important results such as returning and recycling capital, leveraging other sources of funding, and incentivizing improved public sector delivery.

The challenge for impact investors is to catalyze models and approaches that target high impact and financial sustainability simultaneously. Models that show promise either involve an underlying intervention that brings a new, more effective solution to equitable access, or a new funding methodology for the underlying intervention that results in a more effective and efficient use of capital. Commercial investors are constrained by ***risk aversion*** and ***return expectations***. Public systems are often best suited for standardizing and scaling models, rather than developing new models quickly. What remains are impact investors who have the patience and risk tolerance to experiment, but also bring the market discipline to find the most efficient use of capital.

Recommendations for Funders Looking at Education

Maintain realistic expectations. The education sector is still relatively nascent for investors because of the difficulties in privatizing short-term gains from an essentially public good where benefits are realized over the long-term, and where the government can provide free access for all in an ideal world. As such, finding "gems" where high impact and high financial returns can be realized in the short-term remains a challenge.

Establish philosophical clarity upfront. Given some inherent tradeoffs between social impact and financial return in the education sector, funders need to be clear upfront about their priorities and their timeline. This requires looking at the risk and return of an investment and then also considering the positive social and environmental impact it has. Defining expectations before will ensure a clearer strategy for sourcing and executing transactions and measuring results.

Look to interventions in the broader educational ecosystem. Most education funders have focused on building school infrastructure and providing services. Such efforts are intuitive and can reach vulnerable populations effectively; however, to avoid overlooking vast opportunities for social returns funders should look at the broader education ecosystem. From low-cost tablets that could revolutionize the textbook industry to back-office management systems that reduce teacher absenteeism, ecosystem investments can make a large-scale impact in improving quality, access, and equity.

Consider channeling capital through funds and intermediaries to deploy larger amounts more efficiently. The education impact investing landscape is fragmented, with a multitude of small deals that generate little to no profit. Some funds and intermediaries are beginning to develop dedicated expertise in education with proven models that can enable investors to overcome this fragmentation, so that they can diversify risk and invest larger sums.

Adopt a more flexible definition of success. Funders that have been impactful in the education space tend to be more flexible and realistic. Success for them can mean a small grant that catalyzes larger funders into the space or it can mean supporting a model that raises the bar for quality education, pushing the public sector to meet that bar. As they focus on reaching the most vulnerable, targeting financial sustainability rather than maximizing financial profit is a meaningful way for successful impact investors to distinguish themselves from both commercial investors and philanthropic donors.

Focus on innovation. Impact investors may be uniquely positioned to innovate because commercial investors are more risk-averse to experimentation and the public sector is often better suited to standardizing and scaling existing models than developing new ones. Yet all models that show promise for having high impact as well as being financially sustainable require some element of innovation. Many effective impact investors demonstrate a learning orientation and seek innovation through collaborative processes that draw on diverse expertise and experience.

Measure and evaluate impact on education quality and access. Many models are hampered by a lack of evidence on their effectiveness. Stakeholders should invest in monitoring and evaluation, particularly for models and transactions that target the most vulnerable populations, where impact is as important—if not more important—than financial returns.

1. Introduction

The role of education in promoting economic growth and social justice has long been recognized, and its benefits amply documented across a range of sectors, from health to livelihoods. For instance, one year of primary schooling boosts wages by five to 15 percent, while each year of secondary school increases wages by up to 25 percent.[1] Education also confers less quantifiable benefits, including critical thinking, skills, and training necessary to engage in open societies.

Over the last decade, low-income countries have increased their education spending from an average of 2.9 percent of GDP to 3.8 percent.[2] Yet many governments in the developing world cannot meet the enormity of their citizens' education needs, and significant gaps in funding, quality, and access remain. In 2010 estimates showed that an additional US$16 billion per year would be needed to provide basic education for all children, youth, and adults by 2015. However, a more recent estimate found that the stagnation of aid coupled with inflation has meant that the funding gap has increased to US$26 billion.[3] As a result, 57 million children are out of school and of those 57 million, 31 million are girls.[4] Moreover, of the approximately 650 million children of primary school age globally, as many as 250 million either do not reach Grade 4 or, if they do, fail to attain minimum learning standards.[5] It is believed that there are 130 million children in school who are not even learning the basics.[6]

One of the main messages emerging from the thematic consultations on education and the post-2015 development framework is that of identifying innovative financing strategies in order to realize an expanded vision of equitable educational access and quality. There is recognition that the private sector can—and is—playing an important role in providing financial and strategic support to governments and schools by providing, for example, material or technical assistance. However, in order for the post-2015 education agenda to achieve its vision there is a call to develop more dynamic and collaborative means for private sector engagement in education, beyond direct provisioning. The broad education community is therefore working to develop ways to extend the private sector's role in areas such as promoting innovation, expanding access to marginalized groups, and improving the quality, effectiveness, and efficiency of national education systems.

Official development aid and private philanthropy have long helped expand access to quality education in the developing world. Impact investing has emerged in recent years as a potentially promising tool to mobilize additional capital toward the goal of broad-

1. Open Society Institute. 2010. "Innovative Financing for Education," (ESP Working Paper No. 5). London: Open Society Institute.
2. World Bank. "World Bank Data Indicators." http://data.worldbank.org/indicator.
3. UNESCO. 2013a. *EFA Global Monitoring Report: Education for All is Affordable – by 2015 and Beyond*, (Policy Paper 6). Paris: United Nations Educational, Scientific and Cultural Organization.
4. UNESCO. 2013b. EFA Global Monitoring Report: *Schooling for Millions of Children Jeopardized by Reductions in Aid*, (Policy Paper 9). Paris: United Nations Educational, Scientific and Cultural Organization.
5. UNESCO. 2012. EFA Global Monitoring Report: Youth and Skills – Putting Education to Work. Paris: United Nations Educational, Scientific and Cultural Organization.
6. Save the Children. 2013. *Ending the Hidden Exclusion: Learning and Equity in Education Post-2015*. London: Save the Children.

ening access to quality education. It developed as a response to problems that neither the government nor commercial capital and market forces could address on their own. Today, impact investing includes a range of funding activities in various sectors that combine financial return with social and environmental good. Unlike pure aid or philanthropy, impact investors use market incentives and tools to achieve social and environmental impact.

> *"Education is a key sector for emerging economies. Parents put education first in most countries and are willing to put a good chunk of their disposable income into education."* – AfricInvest

The primary objectives of this report are to:

- Describe the landscape of impact investing in education, including types of investments being made and key actors active in the sector.
- Serve as a starting point for impact investors to engage in the education sector, as well as create a dialogue between the public sector, philanthropy, and impact investors in education.

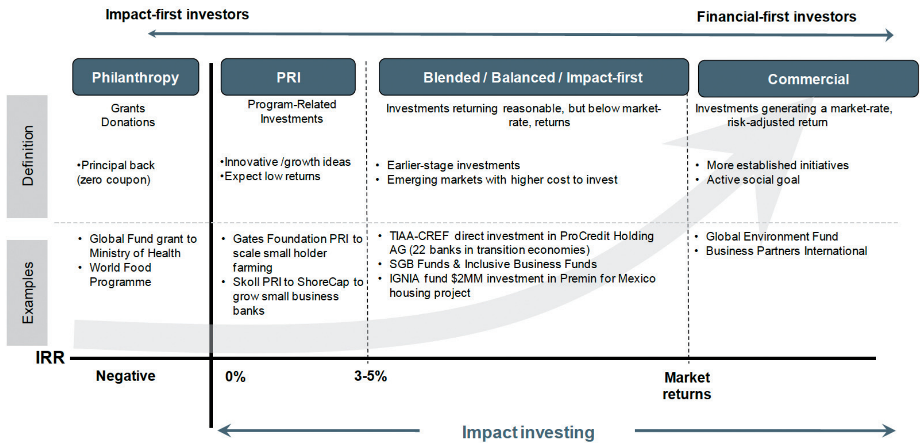
In order for this report to reach a broad audience, explanations of key financial terms are described in Annex 1. The findings of this report rely on interviews with a wide range of investors, companies, educational institutions, and education experts and entrepreneurs with interests in the developing world. A full list of experts consulted is provided in Annex 2.

This report is organized as follows: Chapter 2 lays out the spectrum of impact investing, from impact-first to finance-first motivations. Chapter 3 examines the types of transactions that currently characterize education impact investing. Chapter 4 locates impact investing within the larger education funding landscape and analyzes types of impact investors. Chapter 5 considers the role that private financing can play in public education systems. The summary findings in Chapter 6 highlight key learnings and steps that impact investors can take to play a role in supporting education in developing economies.

2. The Spectrum of Impact Investing

Impact Investing is an investment approach that uses the incentives and tools of ***commercial capital deployment*** to actively improve social and environmental well-being. Impact Investing covers a wide spectrum. On one end of the spectrum is philanthropic funding, such as Program-Related Investments (PRI). Sometimes called "patient" or "soft" capital, philanthropic capital does not seek immediate financial return, often focusing on the eventual self-sufficiency of the organization: not-for-profit, but not-for-loss. On the other end of the spectrum are finance-first impact investors. They seek to make investments with social return, but their priorities revolve around their financial requirements.

Figure 1. *Impact investing spectrum*[7]



Whatever their risk-impact profiles, impact investors can serve a variety of purposes along the impact value chain. Impact capital can help to:

- **Experiment—"Prove the Concept"**

  These impact investors provide capital on concessionary terms to entrepreneurs and start-ups. The projects they fund are often geared toward proving the viability of a new business model. Accordingly, these investments display a wide variance in risk and return. In addition, they tend to be small and bear high transaction costs. Impact investors at the experimental phase play a valuable role in proving whether a concept works; if it does, their funding paves the way for other investors and greater impact. The Children's Investment Fund Foundation (CIFF), for instance, funds experimental, non-commercial programs such as education for HIV-infected and affected children.

7. Rockefeller Philanthropy Advisors, 2009, *Solutions for Impact Investors: Strategy to Implementation*; Bridges Ventures/Parthenon Group/GIIN report, March 2010, *Investing for Impact: Case Studies Across Asset Classes*; Dalberg/D. Capital analysis.

- **Catalyze—"Grow and Refine"**

  At a later stage, impact investors serve an important role by funding models that have demonstrated early results but require growth capital or further transformation to be truly scalable. Investors here might support the aggregation of small-scale models into larger investment vehicles or innovative financing structures that enable more capital to enter the space. An example of a catalyzing impact investor in the education sector is the Acumen Fund, which makes investments in profitable small private schools and school franchises that commercial investors consider too risky. With ***patient capital***, these investments can become more viable commercial prospects down the road.

- **Scale—"Deploy large-scale Capital"**

  Impact investors that deploy larger pools of institutional or commercial capital can help scale up proven concepts. Since returns at this stage are more stable, and risks and transaction costs are lower, these impact investors are able to commit larger amounts of capital on more commercial terms. An investor in this category in education is the International Finance Corporation (IFC), the private sector investment arm of the World Bank. IFC investments include loan facilities for banks that lend to schools, which tend to be larger investments that garner commercial rates of return while increasing schools' access to credit.

For each of these roles, the investor faces a different set of risk-versus-impact trade-offs, and this is as true in education as it is in other sectors. Models that target lower-income populations or seek to build the broader education ecosystem tend to face limited potential for ***near-term financial return***. Models that target higher-income populations with greater spending power present more investment opportunities and can offer attractive or even commercially competitive returns. However, the social impact of serving families who already have resources and options in their education pursuits is arguably more limited.

3. The Education Investment Landscape

Impact investors have a range of choices in terms of where to invest, what to invest in, how to deploy their capital, and whom their investments should target. In the education sector, investments in schools dominate over investments in services or tools. Some investors are choosing to invest through intermediaries, which may allow them to deploy larger amounts of capital. Deal sizes remain small, particularly for those that target lower-income beneficiaries.

3.1 Types of Investments

Education delivery includes a range of inputs, including infrastructure, human capital, tools, technologies, and supporting services.

School **infrastructure** investments are the most prevalent, perhaps because building and upgrading schools seems intuitive and results are easily measurable. This category is characterized by a multitude of small deals and a few larger programs supported by large multilateral organizations.

Investments in **people** include student loan programs, vocational training, and teacher training. Those models or organizations that present an investment opportunity tend to be newer in developing countries, but as the market develops, deal opportunities should follow.

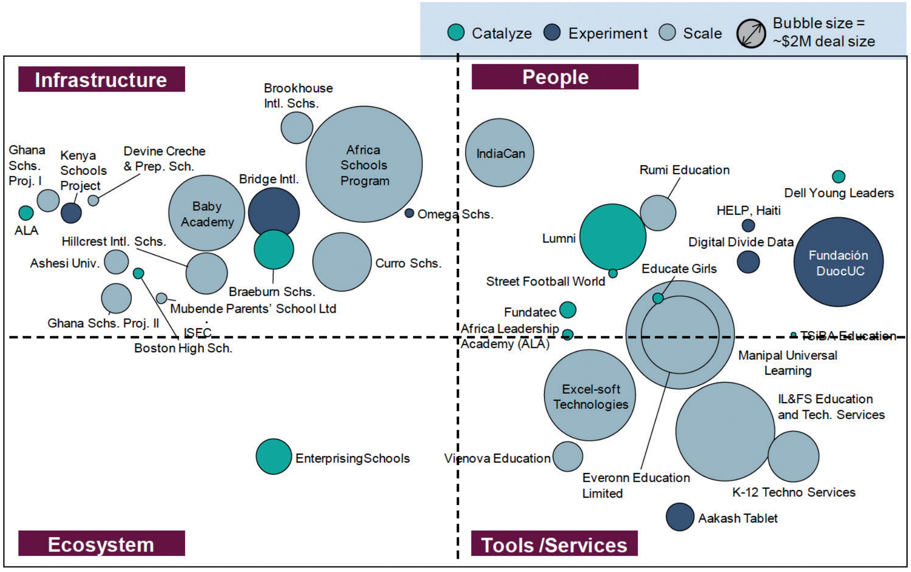
Investments in **technology** and **services models** include education software development, distance learning programs, and integrated management or back-office support for school chains. This subsector has generated innovations that could reduce costs and improve quality across a variety of public and private applications. Technology may present a particularly promising arena for impact investors to seed innovations that have crosscutting commercial potential, especially if they can be deployed in large-volume markets. Current deal flow is limited, though, and deals can be very small and high risk.

Funding to build the educational **ecosystem** is providing support to activities or models that shore up capacity in the education system as a whole and help to build a more robust education marketplace. Examples include school ratings programs that charge schools to be rated and funding research that demonstrates the efficacy of certain interventions. Due to their limited potential for return of capital, most ecosystem-building efforts are good candidates for grant making.

For impact investors, there is also a need-based opportunity to support broader ecosystem building efforts that will help support stronger public sector education capacity and facilitate a more vibrant education marketplace down the road.

Taken together, these present a diverse basket of opportunities to deploy capital. Figure 2. illustrates examples of the deal activity to date in the aforementioned types of education investing.

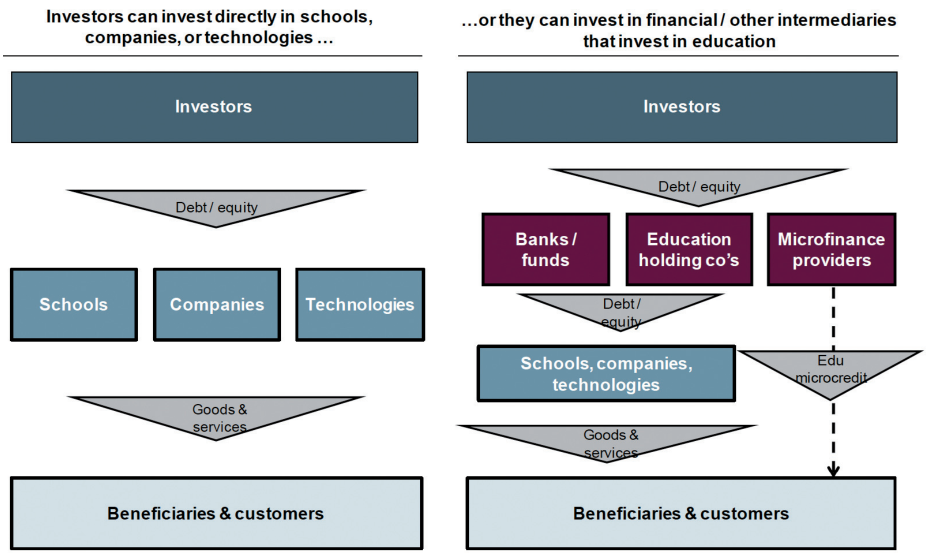
Figure 2. *Examples of transactions in education impact investing*[8]



3.2 Channels of Education Investments

Impact investors utilize two primary modes or channels for their investments. They invest directly into schools, businesses, or technologies that deliver education; or they invest through intermediaries that serve education providers. The choice of whether to invest directly or through an intermediary depends primarily on the investor's risk-versus-impact goals.

Figure 3. *Channels for investing in education*



8. IFC Health & Education Facts; "Learning Pays Dividends," *AfricInvest Magazine* (March 2011); Venture Intelligence Report, *Private Equity Pulse on Education*; investor/fund websites; CLSA Indian Education Sector Outlook 2008; Dalberg/D. Capital research, interviews, and analysis.

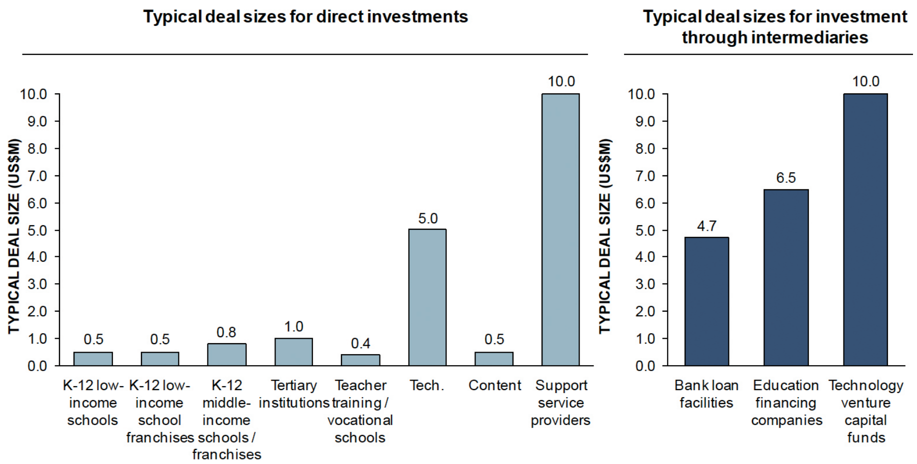
As shown in Figure 3. intermediaries can take the form of:

- Loan facilities, or risk guarantees for loan facilities, that enable banks to do more lending to schools.
- Fund-of-funds models whereby fund managers are education investment experts.
- Education holding companies that operate networks of schools and try to realize efficiencies of scale and management through aggregation.
- Microfinance institutions that offer credit to low-income families to send their children to school.

The investment channel chosen by an investor depends on how much capital it seeks to deploy and how much risk it wants to take. Investing directly may enable investors to fund specific innovative models and entrepreneurs. However, it has drawbacks: deal sizes are small, transaction costs are high, and there is greater risk. By investing through intermediaries, investors can deploy more capital, enabling them to take on larger-scale projects or spread risk across a range of models with relatively lower transaction costs. Currently, very few impact investment intermediaries are dedicated to education.

Overall, deal sizes remain small, particularly for investments that target lower-income beneficiaries. Figure 4. compares the size of deals between direct investments and investments through intermediaries.

Figure 4. *Typical deal sizes in education impact investing*[9]



3.3 The Geographical Focus of Education Impact Investing

Education impact investors have so far focused their capital on a few high-potential regions: Latin America and the Caribbean, Sub-Saharan Africa, and South Asia. These regions are considered high potential for several reasons: they have large, vulnerable populations; public education in these regions is often insufficient in scope and quality; their lower and middle classes aspire to greater economic achievement and, because

9. Typical deal size estimates are indicative only, based only on available data for completed transactions.

they consider schooling a means of social mobility, are willing to invest in it; and these regions also have an active entrepreneurial base.

In Sub-Saharan Africa, several countries have seen significant investments in low-cost private schools and school franchises. In India and Southeast Asia, local entrepreneurs have been very active in starting low-cost private schools, creating robust markets for impact investment activity. In Latin America, the availability of impact investing opportunities varies based on the state of each country's education system. Some countries, such as Chile, have strong public education systems, and are thus not targeted for education impact investment. Mexico and Brazil are large markets that have seen a great deal of investment activity in areas such as the student loan market and private and vocational education. Multilateral investors such as the Inter-American Development Bank cite Central America as a region that is ripe for greater social investment.

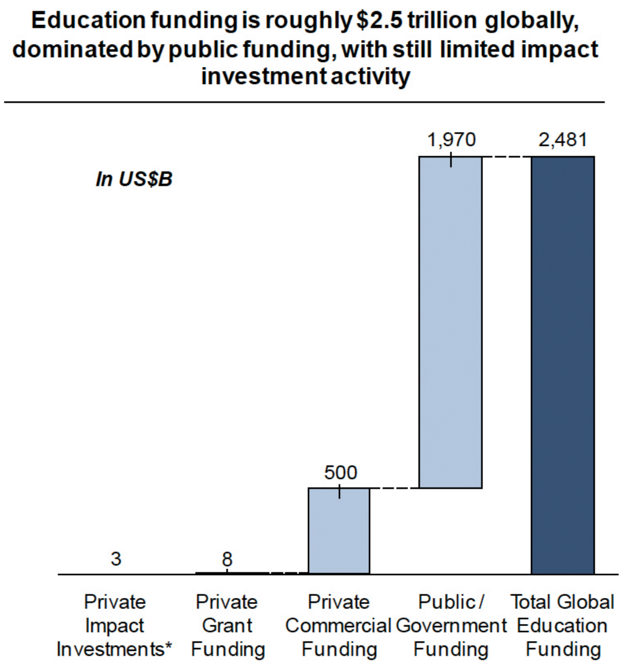
4. Education Funding and Investor Landscape

Impact investing accounts for a tiny share of overall education funding. The sector is still in its infancy, meaning that large international players still dominate the landscape and most investors are taking a gradual, opportunistic approach to building their education portfolios. The lack of innovations restricts ***deal flow*** and limited examples of success heightens perceptions of risk, so funders have clustered around either proven, for-profit models targeting those who can already afford to pay, or grant-like models to reach more vulnerable beneficiaries.

4.1 The Size of the Education Impact Investment Pool

Impact investing currently accounts for a very small share of overall global education funding, which is dominated by the public sector. Approximately US$2.5 trillion is spent annually on education, excluding private household spending on education. The vast majority of it—almost US$2 trillion—comes from public or government funding. Private commercial funding accounts for an estimated US$500 billion. In comparison, funding from private grants and private impact investments is very slight, an estimated US$10 billion, based on industry research of executed deals. Impact investing comprises about US$3 billion of that subset. Household financing of education, while harder to quantify, represents an important source of education funding; innovating on how to better leverage this cash flow it remains a challenge for impact investors.

Figure 5. *Global education funding*[10]



10. This does not include household education expenditures. The private impact investments figure is a Dalberg estimate based on industry research of executed deals. Sources: *Global Campaign for Education Report 2010*; UNESCO Education for All 2011—Facts and Figures; World Bank Population Projections 2010; Ron Perkinson, IFC estimates 2006; *Global Campaign for Education Report 2010*; UNESCO Institute for Statistics "Global Education Digest 2007"; Foundation Center Database online; International Higher Education; Dalberg/D. Capital research and analysis.

The comparatively small footprint of impact investing underscores its newness in the education sector. Impact investing has gained popularity in sectors such as agriculture and finance, where social and environmental benefits are more easily privatized. In sectors considered public goods, including health and education, impact investing faces challenges—especially in reaching the base of the income pyramid (BoP). Because impact investing is a recent addition to the education funding toolkit, trends and patterns are just beginning to emerge.

4.2 The Emergence of Local Investors

International organizations are the source of most education philanthropy and impact investment activity. Local sources of philanthropy are undeveloped, and local impact investing—where capital from local sources is deployed toward local education activities—is rare. However, some corporations in larger developing economies have recently begun setting up foundations and developing Corporate Social Responsibility programs, some of which focus on education. In Kenya, Safaricom, a major telecom company, and Equity Bank, a major national bank, have both developed corporate foundations whose activities include a strong education component.

Examples of local investing in Kenya: The Equity Group Foundation (EGF) and the Safaricom Foundation

EGF Wings To Fly is a scholarship program aimed at increasing access to secondary schooling and student success by providing comprehensive scholarships, mentoring, and leadership development training to promising yet poor students for the duration of their secondary school tenure. Scholarships cover tuition, room and board, books, transportation, uniforms, health insurance, and incidental expenses. Wings To Fly is currently working to provide 10,000 secondary school scholarships by 2015. Since 2010 when it was founded, EGF has supported 6,396 Wings To Fly scholars to access over 600 secondary schools nationwide, including 3,340 female students, thanks in large part to the support of its founding partner, the MasterCard Foundation, as well as DFID, USAID, Kiwi, and numerous individual scholarship sponsors. 99 percent of scholars have met school requirements for annual retention and transition, and over 60 percent of scholars maintain a B grade average or better. The first class of scholars is due to graduate in December 2013.

Equity African Leaders Program: Started in 1998 by Equity Bank and now managed by EGF, the Equity African Leaders Program (EALP) is a rigorous internship and leadership development program that works to create a community of talented leaders who are capable of solving the world's most pressing challenges. EALP targets top-achieving male and female students from across Kenya based on national secondary school examination results, and offers several concurrent and complementary initiatives aimed at increasing access to tertiary education and ultimately academic, professional, and personal success. These include paid internship opportunities and a college savings scheme to help scholars finance their studies, a college counseling initiative, a virtual academy, an online literary journal, a secondary school mentoring program, a business innovation and incubation working group, and a global summer internship program. Since its inception, EALP has benefited more than 1,550 scholars: 32 percent of scholars study or have graduated with degrees in Engineering and Computer Science; 25 percent with degrees in Medicine and Dentistry; and 23 percent with degrees in Business and Economics.

The Safaricom Foundation supports the achievement of education for all through a variety of projects and initiatives, including infrastructure development, income generating activities, learning materials, and health and hygiene. Between 2012-2013, Safaricom Foundation spent KSh 114,596,746 in over 70 projects spread across Kenya. Eleven projects were carried out in marginalized areas while nine were in schools with special needs learners. The Foundation also works in partnership to support schools in regions that are poverty-stricken. The **Know and Grow Education Programme Partnership** brings together the Safaricom Foundation, the Tinga Tinga Tales Foundation, Coca Cola (Central, East, and West Africa), and Kenya Literature Bureau to improve the education opportunities in disadvantaged regions of Kenya. Using the National Poverty Index of 2009, the partnership identified 27 primary schools countrywide; some were recipients of a model classroom, water and sanitation systems, greenhouses, and schoolbooks.

Wealthy individuals and families are another important source for local education funding, and they can form a strong donor base for established local, education-focused NGOs. Less commonly, wealthy individuals selectively invest in commercial education ventures. Two self-made technology millionaires, for example, have invested heavily in Hillcrest International Schools, a chain of premium private schools in Kenya that service ECD through to secondary levels.[11] Direct ownership of large national corporations by a country's prominent families intimately links corporate and family giving.

From the perspective of the recipient organization, local funding has certain benefits. The recipient organization may consider local funders as more committed to long-term partnership, particularly with a cause like supporting education in their own community. Risk-taking startups may decline international institutional funding, which is sometimes accompanied by conditions, in favor of more flexible local funding. Depending on local capital markets and regulatory environments, organizations may find foreign capital more expensive or fraught with administrative hurdles.

Sources of local education funding are quite limited, though, in comparison with international education funding, because private foundations, trusts, and family offices are a new phenomenon in many developing countries. Organizations committed to working

11. AllAFrica.com, "IT Millionaires Buy Matiba Schools," August 2, 2011; Dalberg interviews.

with local funders must have strong fundraising abilities to raise several sets of smaller grants or funds. Doing so can prove burdensome, especially in comparison to accepting capital from one large international organization.

Emerging models of local intermediation have the potential to promote more vibrant local funding markets. Dasra is a strategic philanthropy foundation in India that serves as an intermediary grant maker. It channels funds from local and international philanthropists to high-impact Indian NGOs and social enterprises. Dasra mobilizes funders through "giving circles" comprised of small funding groups focused on particular themes, such as gender equality or livelihood improvement. A giving circle is made up of 10 donors who pool their funds (approximately US$27,000 each) over a period of three years. This group then collectively selects one non-profit to receive this pool of funding. Post-selection, Dasra provides the chosen organization up to 250 days of hands-on assistance over the funding period. An international giving circle member's funds are matched by Indian donors who commit not only their money but also their time to help scale the selected organization. To date, Dasra has successfully closed five circles so far, with two circles that have focused specifically on education. Circle 1—"Girl Power" has enabled Educate Girls to works with girls to enroll and stay in government schools and improve the quality of their education. This giving circle has enabled a 565 percent growth in staff, and will enable a 10x growth in outreach, working with over 500,000 girls in the next two years. Circle 2— "Making the Grade" has enabled Muktangan to train community women to become government school teachers, improving the quality of education and learning outcomes. This giving circle has enabled a 30 percent growth in staff and a 15x growth in outreach with a view to training 10,000 teachers in the next 2-3 years.

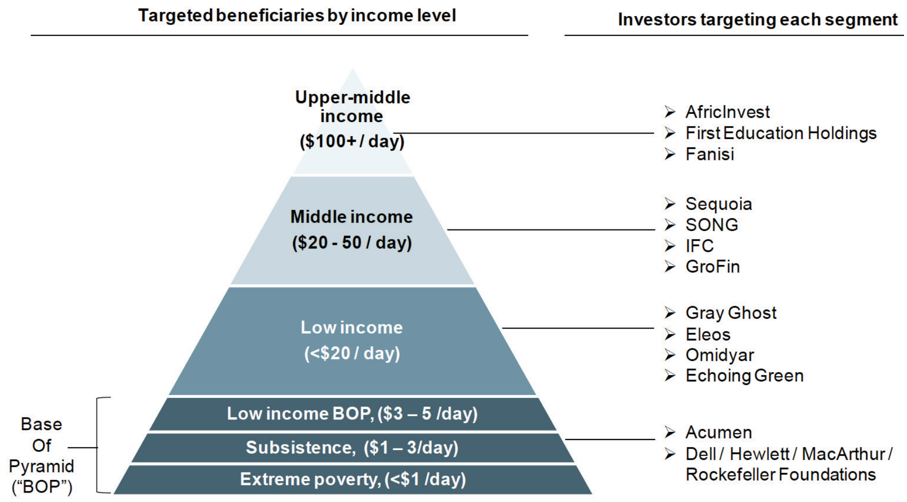
Ultimately, many local education challenges will be best addressed by local knowledge, ingenuity, and resources. As local economies develop and local funders focus more on supporting education, they are poised to bring locally appropriate innovations to education funding.

4.3 Current Trends in Investor Activity

Education impact investors may target different types of beneficiaries when it comes to income levels. At the base of the income pyramid is a wide swath of families who subsist on less than US$3-5 a day. In between are those who are lower to middle income, with more discretionary income available for education spending. Most finance-first oriented impact investors have targeted middle to upper-middle income customers who have meaningful ability to pay for various for-profit education models.

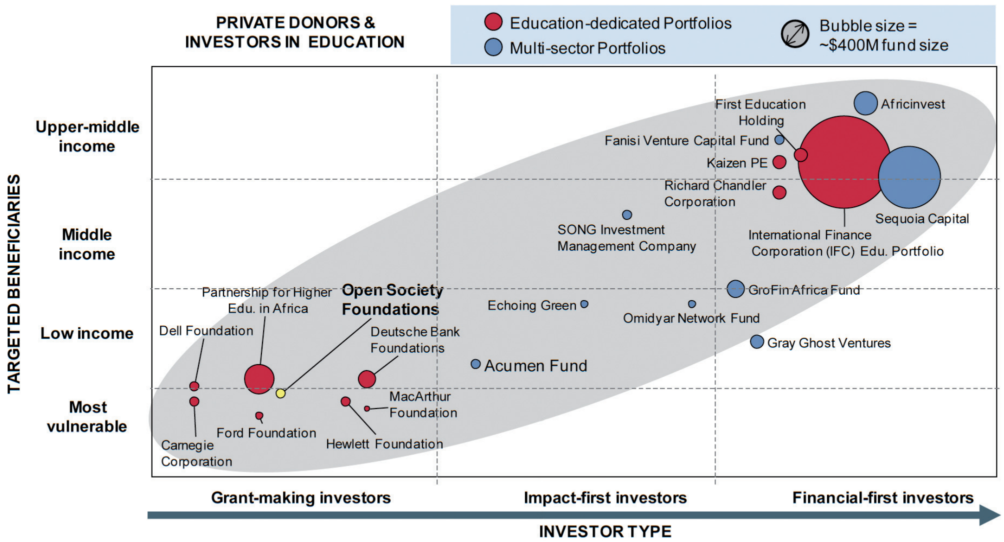
In some cases, these education deals have proven to also be commercially attractive. Meanwhile, impact-first oriented investors have focused on reaching the most vulnerable populations at the BoP. Their activities have not targeted generating much, if any, financial return. Mapping out the current landscape of impact investors in education, as Figure 7. Illustrates, shows a cluster of activity around two poles—those targeting the BoP, with limited return expectations, and more commercially oriented dealmaking targeting populations with the ability to pay.

Figure 6. *Targeted beneficiaries by income level*[12]



> *"Development impact is the reason for our existence, but the deals need to make business sense as well."* – International Finance Corporation

Figure 7. *Landscape of education impact investors*[13]



12. "Segmenting the Base of the Pyramid," *Harvard Business Review*, June 2011; investor interviews; Dalberg analysis.

13. Only funds disbursed to non-government actors in developing countries are included in this analysis. Analysis presented is meant to offer representative sample of grantors and impact investors, not to present a comprehensive view of all education impact investment activity. Many multi-sector portfolios include only one or two education deals. Foundation education portfolios for 2009 include both U.S. and international grants. Sources: Foundation Center, "Top Education Grants 2009"; fund/investor websites; investor interviews; Dalberg analysis.

> *"Impact investors will be learning in low-cost education for many years to come. We are excited by school services and vocational training while we wait for regulatory clarity in the K-12 space, but are opportunistic and are eager to learn by investing in promising opportunities that work to serve the poor."* – Acumen Fund

The tradeoff between impact and financial return stems partly from investors' risk-return-impact perceptions thus far. Larger funds and institutional investors tend to seek investments with low transaction costs, lower perceived risk, and greater potential for returns to capital. Foundations and other grant-making institutions have more freedom to direct their funds toward projects supporting low-income populations, but have conceded the difficulty of attaining financial sustainability in doing so. Both segments have been limited by 1) a lack of innovative education models and innovative financing structures that restricts deal flow, 2) a lack of a track record of successful interventions that increases the perception of risk among all funders, and 3) a constrained definition of success that is informed by traditional/commercial investing principles.

The first limitation in terms of deal flow is a result of the relative nascence of innovative finance in education, an arena traditionally dominated by government, household, or grant funding. The second limitation in terms of track record is a natural outcome of limited deal flow and ***dealmaking*** to date. The third limitation has some impact investors focusing on financial return as the only way to distinguish themselves from charities. As a result, investors seeking returns have avoided anything other than middle- to upper-income beneficiaries and proven business models due to too much perceived risk, and funders seeking to reach the BoP have operated more like traditional philanthropists. All these limitations have perpetuated the prevailing perspective that the impact-return tradeoff in education investing is a steep and intractable one. So, few impact investors to date have focused solely on education or have clearly defined strategies on ***deal sourcing*** and execution. Instead, their investment portfolios tend to include education deals as one part of a multi-sector portfolio and they tend to source and execute on an opportunistic basis.

However, as the following chapter discusses, the role impact investors may be able to play is to catalyze innovations in education models, as well as financing approaches in order to overcome these limitations and ultimately expand the system-wide capacity to deliver quality access.

5. The Role for Private Capital in Education

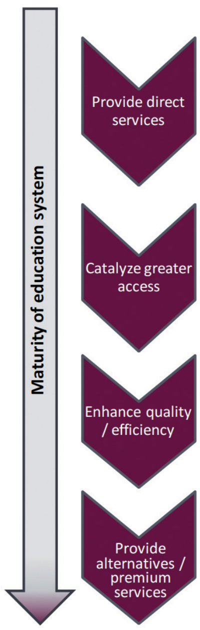
Because of the need and opportunity for scalable innovation in education, the persistent magnitude of the global need, and the still limited capacity of the public sector to fulfill that need, there are a variety of important roles that private impact investors can play. While building up the public sector's capacity to deliver education offers the most sustainable option for ensuring equitable access to quality education opportunities, private capital is best-positioned to innovate. As such, impact investors can have a catalytic effect on public and private education delivery to enlarge system-wide capacity.

The range of roles for private impact capital as it builds up the education sector can be thought of as a continuum, paralleling the maturing of a national education system. Where government is absent, the private sector can fill a gap through direct service provision. Where government is present but has low capacity, private capital can spur innovations that increase utilization and enhance quality to ensure retention and access to under-served populations. Ultimately, in an ideal world where the public sector is the provider of choice for being free, effective, and accessible to all, the private sector can offer alternative and premium education services.

Under this construct, impact capital differs from commercial private capital in that it seeks to reach the most vulnerable beneficiaries; it differs from private philanthropic capital in that it seeks to apply market-based innovations to ensure financial sustainability, if not financial profit. The challenge for the impact investor is to catalyze models and approaches that accomplish both. Successfully meeting this challenge will lead to innovations that ultimately expand public and private delivery capacity, closing the gap collaboratively.

Figure 8. presents a categorization of the various interventions that are subsequently cited in this report.

Figure 8. *Categorization of interventions cited*



Example intervention	Description	BoP reach	Financial sustainability
• CARE Pakistan	• Adoption of government schools	• High	• Leverages gov't resources, relies on grants
• TCF (Pakistan)	• Low-cost private schools	• High	• Grant-reliant
• Naandi (India)	• Early childhood, remedial, supplemental services	• High	• Grant-reliant
• YMCA Limuru Agricultural Youth Center (Kenya)	• Vocational training	• High	• Grant-reliant
• WERK (Kenya)	• Mobile schools for nomad communities	• High	• Transfer to gov't ownership
• IRC Save for School (Cote d'Ivoire)	• Microsavings program for edu	• High	• Admin is grant-funded; economic activities drive savings
• Kiva (Kenya)	• Microloans for college	• Medium	• Low interest rates
• Higher Education Loans Board (Kenya)	• Low-interest college loans	• Medium	• Low-interest rates
• Educate Girls (India)	• Community mobilization for girls edu	• High	• Grant-reliant
• Girl Child Network (Kenya)	• Enrolling marginalized girls	• High	• Grant-reliant
• Enterprising Schools	• School ratings tool	• Medium	• Very subsidized pricing scheme
• Worldreader (Global)	• Tablets and ebooks	• High	• Grant-funded, potential to generate revenue
• PEAS / ARK (Uganda)	• Financially sustainable schools run on behalf of gov't	• High	• Cross-subidies and income generating activities
• Private schools	• Private schools that charge tuition	• Medium to low	• Revenue-generating [2]

> *"We need to sufficiently diversify the marketplace to allow public and private forms of education to co-exist in order to deliver quality access for all."* – Absolute Return for Kids

5.1 Filling a Gap Through Direct Service Provision

With as many as 57 million out-of-school children around the world, there is a clear need for more direct service provision. With limited budgets and a whole host of other near-term concerns, governments often lack the will and/or capability to deliver basic education services, particularly when it comes to harder-to-reach low-income, minority, or other vulnerable populations. Where government is entirely absent, impact capital can help fill a basic gap that the state cannot. Where the government provides basic services, there is also ample room to supplement public services through congruent education for at-risk children, vocational training, or adult literacy services.

Most institutions that provide direct education services targeting the most vulnerable rely on grants, donations, or patient capital to do so because of the beneficiaries' inherently limited ability to pay. A few have ventured into innovative financing models, such as cross-subsidizing affordable schools with profits from private schools charging higher tuition. Some organizations have built in sustainability of their programs by turning them over to the government when they have reached a certain level of community participation and support.

Two approaches to education provision in Pakistan

Pakistan is home to about 10 percent of the world's population of out-of-school children—approximately seven million children. The government operates only about 200,000 schools. With the population growing almost four percent per year, the burden on public education will grow. In contrasting ways, CARE Pakistan (CARE) and The Citizen's Foundation (TCF) are both working to fill the education gap at the base of the pyramid. One of CARE's approaches is to "adopt" government schools, aiming to increase their quality and capacity over the long run. CARE programs are rooted in the belief that the government must be the foundation of equitable, sustainable access, according to founder Seema Aziz. CARE began its adoption program in 1988 with 10 schools, and has now adopted some 214 schools, mostly across the Punjab and Sindh provinces. Their model has proven successful enough that other organizations, such as the Progressive Education Network, are attempting similar models.

In contrast, TCF builds and operates schools across all four provinces of Pakistan, as well as Azad Jammu and Kashmir, largely independently of the gov ernment, though the 910 schools in its network are government certified and use the national curriculum. Both CARE and TCF depend on private sources of funding. At TCF schools, parents contribute on a sliding scale (capped at 5 percent of household income) that is based on an assessment of household income and the number of children in a family. However the average monthly contribution, US$1 per pupil, represents a small percentage of the US$11 monthly cost faced by TCF. Corporate and philanthropic donations pick up the rest, with over 50 percent of funds raised within Pakistan and the remainder from all over the globe. CARE's schools are free for parents, but CARE's costs amount to US$6 per pupil per month beyond the existing government infrastructure they are able to leverage. As such, CARE's funding comes from private donations.

TCF produces a high-quality outcome with 99 percent of students passing the board Matric exams, which are equivalent to the British General Certificate of Secondary Education, and 53 percent doing so with an A*- A grade. In 2011 TCF began to witness the wider benefits of its education program; 72 percent of TCF students pursued post-secondary education, compared to the government school average of 40 percent. Furthermore, in 2011 over 200 female students returned to TCF as teachers; the overwhelming majority of them were motivated by the desire to give back to society—a sure sign that TCF affects social change. Encouragingly, 460 TCF alumni have also been enrolled into tertiary education.

CARE has begun to experiment with a cross-subsidy funding model, partnering with Allied Schools, a Pakistani private school franchise that charges students up to US$20 per month. Under the plan, CARE would assume operations of an Allied School and use profits to subsidize their adopted schools and other programs that target the base of the pyramid (BoP). The pilot project with Allied Schools broke even in April 2013, two years after the project was started. Based on the success of this pilot, CARE is now working to start more schools in 2014 that will generate profits and help sustain CARE's activities in the rural areas and urban slums of Pakistan.

Even when governments succeed in providing basic education services, they may lack the means to address the needs of certain populations. Private actors can fill these gaps by providing supplemental education services, such as vocational training, remedial education, and early childhood education. They can also address the needs of marginalized populations.

In India, most children enroll in primary school, but government schools are often of low quality and an estimated 43 percent of all children drop out before Grade 5. To improve retention in government primary schools, the non-governmental organization Naandi offers a variety of free services through its education centers: early childhood education, remedial education, and social support to girls, who often face gender barriers to education. Naandi works very closely with the government, signing a memorandum of understanding with each government school.

In addition, Naandi works at the grassroots level to make public education more responsive to citizen needs. It educates and mobilizes rural communities to become a constituency for quality, equitable education. This safeguards the viability of the program after funding ends. After four years, Naandi begins phasing out of its programs; by the seventh year, the community has taken full charge of the program.[14]

For Kenyan students who fail to pass university admission requirements, the Limuru Agricultural Youth Center provides continuing education in agricultural technology. The Center, owned by the YMCA of Kenya, serves more than 200 students per year and uses a combination of live training programs in bee keeping and biogas demonstrations, as well as tablet-based learning.[15]

In addition to providing supplemental services like vocational training, private actors can provide access to education for structurally marginalized populations, such as linguistic and other minorities. Over generations, lack of access to quality education ensures that such groups remain politically marginalized. To stop this vicious cycle, some non-governmental organizations work to build up physical and social infrastructure for public education in those communities, with the intention of turning over the schools to the government for longer-term management.

5.2 Building Capacity and the Broader Education Ecosystem

> *"The 'gems' in education impact investing have historically been about specific entrepreneurs and models. We don't want to just look for 'gems,' we want to think about education investing for systemic, long-term impact."* – ELMA

In many cases, the state offers basic education services, but their efficacy is constrained by poor quality, poor utilization, and/or poor retention. There is rich potential for impact investors to intervene and innovate, particularly through creative public-private partnerships in this arena.

Increasing utilization of education services

For poor and lower-income families, school fees and tuition can pose a barrier that seems insurmountable. The International Rescue Committee's Save for School Project is one innovative, holistic project that uses microcredit to boost assets and channels family savings to enroll out-of-school children, as described in the text box highlighting the project.

14. Dalberg analysis.

15. Dalberg analysis.

At post-secondary levels, low-interest student loans have become more prevalent; in parts of Central and South America, the post-secondary loan market is sophisticated, with some securitization of student loans.

Low interest student loans: KIVA and Strathmore University

Web-based micro lender Kiva recently partnered with Strathmore University in Nairobi to offer student loans that enable low-income Kenyan students who have high academic scores the opportunity to access and excel at higher education. Kiva lenders receive 0 percent interest and thus have no financial incentive.

There are three types of loans offered to approved students:

1. Full-Tuition Loans are 11-year long-term loans with a grace period of up to five years. During this time the borrower is not required to make any payments and s/he is charged an interest rate of 0 percent. At the end of this grace period, repayments are due on a monthly basis and during this period the borrower pays 4 percent for the remainder of the loan term.

2. Partial-Tuition Loans are shorter loans that are available to enrolled students (second year and above) who face cash-flow constraints. Repayments are due monthly, and the borrower is charged 6 percent per annum. The borrower makes repayments immediately and understands repercussions if unable to do so. There is no grace period for these loans but there is an extended repayment period. Two-thirds of the repayment is required before the student is allowed to graduate.

3. Laptop Loans are given to purchase laptops with a 12, 18, or 24-month loan term at an interest rate of 6 percent and open to students studying an undergraduate program. For these loans there is no grace period.

Since the inception of KIVA loans at Strathmore in January 2012, US$508,679 has been received for 65 loans (full-tuition, partial-tuition, and laptop), with 34 of these loans being full-tuition loans. Within four years the university forecasts having 100 full-tuition loans at any given time. To date, 24 students have benefited from laptop loans. The university aims to give another 20 loans in November 2013 and then grow the number to 100 by November 2014.

The university has already collected US$23,585 from 12 loans that have been fully paid. In addition, every month Strathmore remits an average of US$3,000 for repayments made by students for the short-term loans. The delinquency rate is 0.46 percent. Strathmore has an MOU with Metropol Corporation Limited (credit reference and collection) to assist in collection of loans that have huge risks and list problematic defaulters. So far, the university has only registered one loan with the huge risk of not being paid back fully; the loanee has already paid 95 percent of the agreed amount.

In the future, Strathmore would like to offer a loan-scholarship option; the scholarship would be pegged to performance. A loanee who earns a First class (an average of 80 percent after four years) would apply for a rebate of 50 percent of the total loan amount if s/he repays the loan within the agreed repayment period.

While subsidies, loans, or other mechanisms for financing education are often effective, there may be less expensive ways to stimulate demand over the long term, especially at the primary level. For instance, the Abdul Latif Jameel Poverty Action Lab (J-PAL) at the Massachusetts Institute of Technology (MIT) found two particularly cost-effective ways of promoting school attendance:

1. **Providing families with information about the higher lifetime wages earned by those who finish school.** Interestingly, it should be noted that this intervention was tested in both Madagascar and in the Dominican Republic and is only likely to have the observed impacts in contexts where students and/or parents systematically (or on average) perceive the benefits of education to be lower than they actually are.
2. **Addressing health problems such as intestinal worms and chronic anemia.** A randomized evaluation in Kenya found that treating worms, which make children tired, anemic, and unable to go to school, led to an additional 12.5 years of education for every US$100 spent. Also, evidence from Miguel and Kramer's (2011) deworming study has helped inform the debate and has contributed to the scale-up of school-based deworming across four countries where over 26 million children have been dewormed.[16]

Several programs aim to promote the attendance of girls at school. In developing countries, girls face social barriers to education such as early marriage and pregnancy, female genital mutilation, and general antipathy towards female education. As a result, female attrition rates can be double those of males. In Kenya, the Girl Child Network (GCN) plans to improve girls' school attendance and retention rates by identifying girls who are out of school and working with their parents and communities to create awareness of the barriers to girls' access to schooling and their needs. GCN conducts parent sensitization programs through community meetings, parent forums, and training with school boards and teachers.

16. See: Jensen, R. "Impact of Information on the Returns to Education on the Demand for Schooling in the Dominican Republic." J-PAL, 2010. http://www.povertyactionlab.org/evaluation/impact-information-returns-education-demand-schooling-dominican-republic. See also: Baird, Hicks, Kremer, and Miguel. "Worms at Work: Long-run Impacts of Child Health Gains." Poverty Action Lab, October 2011. http://www.povertyactionlab.org/publication/worms-work-long-run-impacts-child-health-gains.

A similar program in Rajasthan, India, Educate Girls, mobilizes the community to enroll out-of-school girls and take ownership of government schools to improve retention and school quality. Educate Girls draws on the existing school and community infrastructure and leverages a combination of public and private funding to train community volunteers and build capacity so that the community can then sustain the program with minimal external support. It addresses the entire scope of issues that impact girls' education, from teacher training and pedagogy to school infrastructure and administration. In 2012, Educate Girls operated in approximately 4,500 schools in two districts of Rajasthan. Today, the organization has expanded to three districts in Rajasthan and approximately 5,700 schools, bringing over 52,000 girls back to school. In 2014 Educate Girls hopes to reach an additional three districts in Rajasthan and by 2018 aspires to be in 15 districts across India, with the aim of reaching 4.4 million children. To measure the impact of its activities, Educate Girls, in collaboration with the University of Michigan, is conducting an impact evaluation in four blocks of Jalore district. Interim results, based on data from the first two academic years of this ongoing evaluation project, have shown that the program in terms of girls' enrolment is effective but work needs to be done to increase overall attendance.

Community-based loans to catalyze access: IRC, Cote d'Ivoire

Families in Cote d'Ivoire cite lack of financial means as the number one barrier to education. Even before conflict broke out in western Cote d'Ivoire in 2011, the region had a net enrollment rate of less than 50 percent, with school enrollment of girls at only 37.9 percent. The conflict and associated insecurity and instability further reduced economic opportunity and damaged the schools themselves. While addressing supply-side issues by rehabilitating 24 schools in the conflict zone, the International Rescue Committee (IRC) also helps families to afford to send their children to school. Their Save for School program, which is being funded by Educate A Child, uses an innovative community-based savings and loan program. In this program, groups of 25 families with out-of-school children form Village Savings and Loan Associations (VSLAs) to pool their capital and, guided by a community-based facilitator, make loans to members for economic activities. At the end of a 14-month term, participants recover their capital, along with interest and any fines. IRC estimates that participants can earn an average 11 percent and up to 30-40 percent return.

At present, 2,838 families with 3,995 out-of-school children form 112 VSLAs. VSLA members are being encouraged to use the cash-out (planned for December 2013) to pay for school expenses. Simultaneously, during the term of the loan, group discussions on how to overcome financial and other barriers to education and maintain out-of-school children in school are happening, with 10 out of the 13 modules already given to VSLA members.

A total of 44 public schools and 12 community schools have been identified as currently having space for out-of-school children; all of them are located in areas with high concentrations of out-of-school children. Of these 56 schools, 13 have at least one class filled to maximum capacity. The IRC is currently meeting with the targeted communities to identify solutions to this lack of space and is in regular contact with all of the school directors and teachers to ensure that they accept out-of-school children from the VSLA groups. An exchange platform has been set up with local education authorities to facilitate the process of accepting the out-of-school children into these schools.

It has been noted so far that the identification of out-of school children has taken longer than planned for a variety of reasons: (i) a large proportion of out-of-school children had become too old to attend primary school; (ii) families were often ashamed of declaring that a child was not attending school; and (iii) because fewer out-of-school children than expected could be found in the villages, the area of intervention had to be expanded. In order to achieve the project goals, the IRC has more than doubled the number of VSLAs (from 50 initially planned VSLAs to the current total of 112) and the number of targeted communities (from 24 to 58 sites identified for a total of 56 schools).

Enhancing education quality and efficiency

Enhancing quality and efficiency of education services is another important role that the private sector can play. Many of these involve innovations that reduce costs, improve teachers' effectiveness, or streamline school management for enhanced learning outcomes. Schools ratings programs, like the Enterprise Schools pilot program in India funded by Gray Matters Capital, can promote accountability even among public schools. Management programs and practices can track teacher performance and absenteeism, increase the efficiency of operations, and promote a host of streamlined back-office practices.

Technology can also be used to make tremendous strides in curriculum and materials development, especially at the secondary and post-secondary levels. Aside from school fees and tuition, one of the major costs of education in the developing world is textbooks. In one analysis of developing countries, annual textbook costs averaged US$250 to US$300 for high school students—putting them out of range for many students. Moreover, much of their content was outdated or inconsistent, and textbook distribution channels were grossly inefficient.[17]

New technologies, such as low-cost tablets, could revolutionize the textbook industry in the developing world, reducing costs and providing higher quality curricula. At the same time, mobile telecom operators and data providers are eager to engage customers more creatively and provide interactive learning solutions through technological applications. Already, there are a number of low-cost tablet models targeted to students in the developing world.

17. Dalberg analysis.

One of the more established models is Worldreader, started by a former Amazon.com executive. As of September 2013, the NGO has distributed more than 721,129 digital books into the hands of 12,381 children in nine African countries, and aims to reach one million children by 2015.[18] Worldreader has negotiated with international publishers to distribute ebooks, sometimes at no charge.[19] So far, Worldreader relies on grant funding. Eventually, a more commercially viable tablet model would offer a low-cost product that lower-income students could afford, and it would be linked to high-quality, locally-appropriate content and curricula. It must be noted, however, that provision of technology or materials alone is not sufficient and will not have the intended impact on quality and learning without equal attention to the needs of the teachers responsible for facilitating learning and utilization of technology.

> *"It's becoming easier and easier for vendors to reach the education sector; we will eventually start to see neat things happening with deal flow."*
> – Steve Hardgrave, Varthana Finance

5.3 Strategies for Complementing the Public Sector

Based on these examples, private capital can play a variety of roles in public systems, from filling in gaps to building capacity. When private capital is being used within public systems to target the most vulnerable or to build the public sector's ability to reach them, patient or concessionary capital will most likely be required. It is unrealistic to expect that models seeking the most impact in reaching the BoP will be immediately commercially attractive because the beneficiaries lack a fundamental ability to pay for services. However, not being commercially attractive does not mean that only grants can be used. There is significant opportunity and indeed need for providers of impact capital to innovate on models that target high impact and financial sustainability simultaneously. Financial sustainability may mean simply return of capital, avoiding losses but without any additional upside, so that the capital can be recycled into other new projects. Models that allow the funder to leverage other sources of capital and eventually exit include those that:

- Transition gradually from grants to investments (e.g. catalyzing new innovative technologies that have the potential to eventually generate returns once they have proven the concept and built up the market demand).
- Transition gradually from private funding to government funding (including those where the government may eventually reimburse the funder, such as government-issued education bonds).
- Take an already proven business model and extend its reach to more vulnerable populations (like tablets for delivery of curriculum).

18. "An E-Reader Revolution for Africa?" www.worldreader.org and *Wall Street Journal*, June 15, 2012.
19. www.worldreader.org.

- Employ cross-subsidy models using for-profit business lines to subsidize non-profit activities focused on lower-income beneficiaries.

A common theme across all these models is that they require innovation. Either the underlying intervention itself needs to bring a new, more effective solution to equitable access, or the way in which the intervention is funded needs to apply a new, more effective and efficient use of capital. And innovation may be best pursued by impact investors. More commercial investors are constrained by risk aversion and return expectations. Public systems are often best suited for standardizing and scaling models, rather than developing new models quickly. What remains are impact investors who have the patience and risk tolerance to experiment, but also bring the market discipline to find the most efficient use of capital.

For many impact investors, the ultimate goal of sustainability is demonstrated not through financial profit, as is the case with commercial investing, but rather through community buy-in and government responsibility. Successful exit for the impact investor may simply mean preserving capital until community or the government has the capacity to take over operations and funding. In this way, impact investors are uniquely positioned to use private delivery models to promote higher quality and a more diversified marketplace of private and public services.

Partnerships for public education: Absolute Return for Kids, Uganda

Despite great strides towards universal primary education, many countries in Africa have underinvested in secondary education, with too many children leaving school with only very basic knowledge. In Uganda, 72 percent of secondary school-aged children are not in school. Working with the social enterprise Promoting Equality in African Schools (PEAS), the UK funder Absolute Return for Kids (ARK) is developing and scaling an innovative new project in Uganda to operate within the government's pioneering public-private partnership policy over the next five years. The policy encourages collaboration between non-state organizations and the government to deliver universal secondary education.

The PEAS model is to run low-cost private schools on behalf of the government. ARK pays for the capital cost of the school. The government pays for just under 50 percent of the operating costs. Families pay a fee for school lunches, but do not pay tuition. The schools also take on boarding students whose boarding fees help to cross-subsidize other school costs. Lastly, students can participate in income-generating learning activities such as farming for an agricultural course, which also contributes to the school's bottom line. By involving the government, ARK is not only leveraging its own capital, but also demonstrating how to offer higher-quality, self-sustaining education services while building up government capacity to do so.

In March 2012, the first two secondary schools were opened; over 400 pupils are now enrolled. One in three of the students are the only children in their family to go to school; their average reading age is nine years, compared to an average actual age of 16. Government funding has been secured for pupils' fees immediately, rather than having to wait the usual two-year probation period, helping to accelerate the ARK-PEAS schools' financial sustainability. Eight more schools will be opened by the end of 2014. To address low levels of numeracy and literacy, teachers will be trained to run intensive catch-up courses for all students. By 2014, combining PEAS' local expertise with ARK's focus on measurement and quality, the program aims to show that public-private partnerships can deliver academic achievement greater than the national average, at a lower cost to the government.

6. Implications for Impact Investors

Education impact investing has exciting potential to mobilize new sources of funding and develop innovative approaches to education. In the long run, it could become a valuable tool in the effort to broaden access to quality education for all.

These are still early days, with much groundwork to be laid before impact investing can truly play a catalytic role in the education landscape. Whether finance-first investors or non-profit foundations, private funders of education currently operate under a steep tradeoff between financial return and impact. This requires funders to establish philosophical clarity upfront on what their goals are. Models that reach the vulnerable populations at the base of the pyramid generally do not generate financial returns. The models that do generate financial returns are usually targeted toward middle and high-income populations.

While this tradeoff makes education a sector where it is more difficult for impact investors to source deals that have near-term financial returns as well as the ability to reach more vulnerable populations, there is still significant opportunity and need for providers of impact capital to innovate.

Instead of focusing on doing discrete, small deals one-by-one, funders may choose to channel their investments through innovative intermediaries who are able to deploy larger amounts of capital more efficiently. Instead of looking for obvious investments in brick-and-mortar schools, investors can seek to catalyze innovative tools and service providers who are enhancing quality while reducing costs. Instead of focusing on near-term social and financial returns, investors can find funding opportunities to support the broader education ecosystem so that a healthier marketplace of private and public models can co-exist in the future. And instead of defining success narrowly in terms of traditional risk-return-impact parameters, investors can be more creative about catalyzing longer-term benefits with their funding interventions and designing ***concessionary finance mechanisms*** that can build in a strong tie with the public sector over time.

Annex 1: Glossary of Terms

Term	Definition
Commercial capital deployment	Allocating money invested from business.
Commercial private capital	This is capital or funding that was raised not from stock markets but from organizations, companies, or individuals with cash to invest in another organization.
Concessionary finance mechanisms	A way of loaning money at no interest or at a rate below the market value.
Deal flow	A term used by finance professionals to refer to the rate at which they receive business proposals or investment offers. The term is also used not as a measure of rate, but simply to refer to the stream of offers or opportunities as a collective whole.
Deal making	The process of making a commercial agreement through the negotiation of terms, drawing up a contract, and arranging how to finance or fund it.
Deal sourcing	For one organization to see a part or a whole of another organization that they could add value to, therefore justifying a commercial agreement that could work between both parties.
Near-term financial return	The return on an investment over a short period of time, for example in less than one year, on money invested.
Patient capital (or long term capital)	The investor is willing to make a financial investment in a business with no expectation of turning a quick profit. Instead, the investor is willing to forgo an immediate return in anticipation of a more substantial return later on.
Private philanthropic capital	Money used by philanthropists to buy what they need to make their products or provide their services, in an attempt to solve social problems.
Return expectations	What an investor hopes to get back on an investment.
Risk-return-impact	Investors consider the risk and return of an investment and also consider the positive social and environmental impact it has.
Risk aversion	The reluctance of a person to accept a bargain with an uncertain payoff rather than another bargain with a more certain, but possibly lower, expected payoff.

Annex 2: Experts Consulted

Charles Abani, Managing Director, Absolute Return Kids

Samuel Akyianu, Operations Officer, International Finance Corporation

Seema Aziz, Founder, CARE Pakistan

Saleha Parvez, Marketing Manager, CARE, Pakistan

Ross Baird, Program Director, Village Capital, ex-Gray Ghost Ventures

Conor Bohan, Founder/Executive Director, HELP, Haiti

Cesar Buenadicha Sanchez, Officer, Multilateral Investment Fund/IADB

Helen Cho, Director, Education Program Investments, ELMA Philanthropies Services

Kenneth Donkoh , CEO/Co-Founder, Omega Schools, Ghana

Nina Gene, Investment Manager, Jasmine Social Investments

Laura K. Goldman, ex-Fanisi Capital

Steve Hardgrave, Founding Partner, Triumph Finance

Susannah Hares, Director, Absolute Return for Kids

Jeremy Hockenstein, CEO/Co-founder, Digital Divide Data

Paul Mbugua Kamau, ex-Partnership Manager, Girl Child Network, Kenya

Dennis Mutifo, Partnership Manager, Girl Child Network, Kenya

Riaz Kamlani, ex-Vice President, The Citizen's Foundation, Pakistan

Jay Kimmelman, CEO/Co-Founder, Bridge International Academies

Joyce Kinyanjui, Program Manager, Women Educational Researchers of Kenya

Skander Oueslati, Principal Investment Officer, AfricInvest

Udo E. Schulz, Sr. Business Development Advisor, SABIS Educational Systems, Inc.

Ankur Shah, Education Portfolio & Business Development, Acumen Fund

Fred Swaniker , CEO/Co-founder, Africa Leadership Academy

Aleesha Taylor, Director of Special Projects, Open Society Foundations, Education Support Program

James Tooley, Professor of Education Policy and Co-Founder of Omega Schools, Newcastle University, England

Ivy Mwai, General Manager of Education and Leadership, Equity Group Foundation, Kenya

Amina Salahuddin, Director of Fundraising, The Citizen's Foundation, Pakistan

Lilian Njeri Munene, Special Projects Manager of Financial Aid, Strathmore University, Nairobi

Nooreen Dossa, Communications Manager, Educate Girls, India

Alexander Mette, Fundraising Strategist, Educate Girls India

Anna Demetra Yalouris, Policy Associate, Abdul Latif Jameel Poverty Action Lab

Meghan Mahoney, Policy Associate, Abdul Latif Jameel Poverty Action Lab

Amir Qureshi, Manager Resource Development, Progressive Education Network, Pakistan

Gayatri Divecha, Business Development and Partnerships Manager, Dasra India

Bill Steve Ayieko, Monitoring and Evaluation Officer, Safaricom

OPEN SOCIETY FOUNDATIONS

EDUCATION SUPPORT PROGRAM

Budapest Office
Október 6. u. 12
H–1051 Budapest, Hungary
Tel: +36 1 882 3100

London Office
7th Floor Millbank Tower, 21–24 Millbank
London SW1P 4QP, United Kingdom
Tel: +44(0)20 7031 0200

New York Office
224 West 57th Street
New York, New York 10019 USA
Tel: +1 212 548 0600