

INCLUSIVE INNOVATIONS

Making Tertiary Education Possible for Low-Income Students

Innovative finance mechanisms by non-bank financial institutions are opening the doors of institutions of higher learning

HIGHLIGHTS

- Non-banking financial institutions assess risk based on their assessment of potential borrowers' employability and future incomes rather than their households' assets or incomes.
- Students pay back a percentage of the income they earn, reducing the risk of taking on debt as they do not need to repay the loan if they fail to find work.
- To enhance students' employability, some models provide career guidance, training, and job placement opportunities.



Summary

Millions of low-income students are unable to attend universities and vocational training institutes after finishing high school because they cannot afford the tuition. Innovation financing programs from non-banking financial institutions—including schemes in which borrowers repay the loans with a share of their future income—are making higher education possible for some of these students.

Development Challenge

Millions of low-income students would like to receive higher education but are unable to do so because they cannot afford it. Many public lending schemes suffer from high default rates and administrative costs (Salmi 2003). Moreover, most students from low-income households do not qualify for such loans—and among those who do, many decide not to borrow, because interest rates are too high and they fear falling deep into debt if their future income is insufficient to repay the loans. The challenge is to develop a better way to finance higher education for low-income students.

Business Model

Non-bank financial institutions are providing new financing solutions that are designed to be accessible, affordable, and low risk for low-income students. These lenders raise funds from conventional investors, such as investment funds or development agencies, supplementing them with capital from alternative sources, including crowd-sourcing. They keep interest rates low by minimizing operational costs and partnering with universities. To reduce the risk of default, they provide career guidance, training, and job placement opportunities to students.

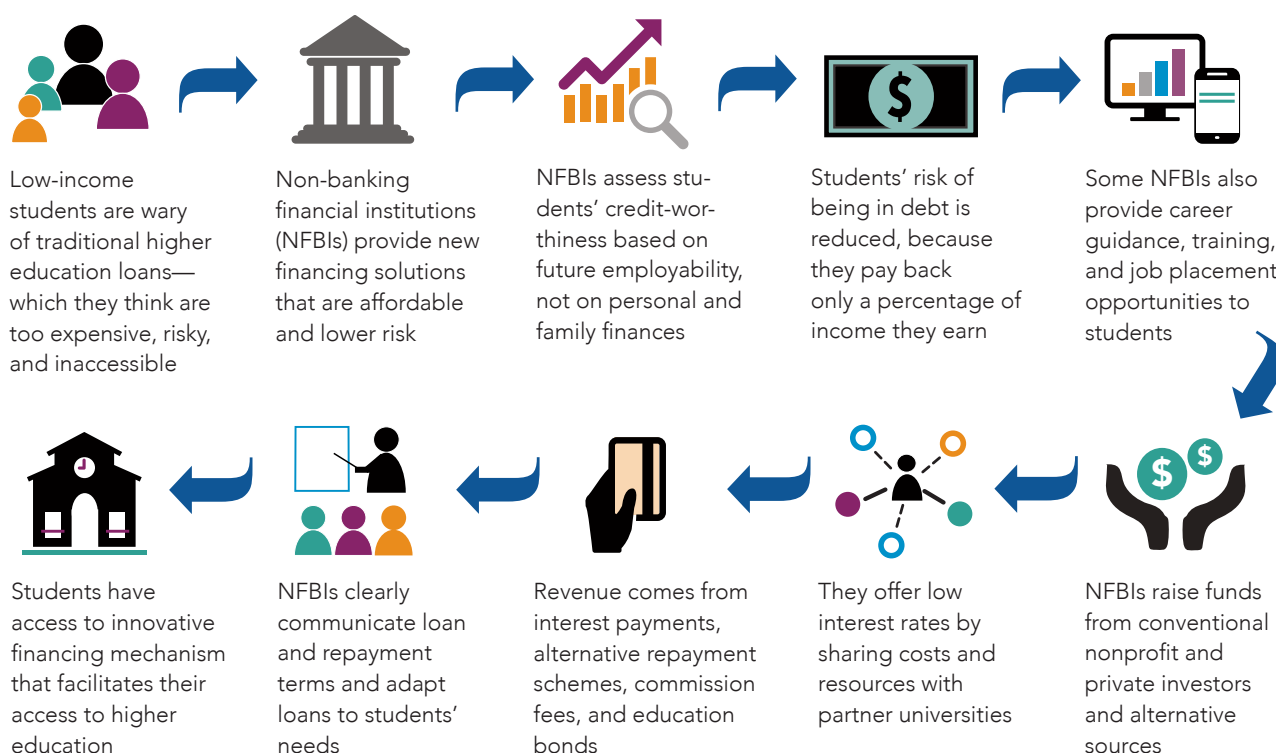


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This series on Inclusive Innovations explores business models that improve the lives of those living in poverty. Editors are Elaine Tinsley and Natalia Agapitova. Researched and

Components of the Model

Figure 1. Features of the student financing model



Cost Factors

The key cost factor is the establishment of a fund to generate the loans, and this will normally require attracting impact investor capital. Online platforms and mobile money apps are another investment needed to reduce costs and facilitate loan applications, control student loan expenditures, and facilitate payment. Another key cost is the setting up of partnership agreements with higher education institutions, which can help facilitate intake of applicants.

Revenue Streams

Models generate revenue from loan repayment and other sources (see Table 1). Many charge interest rates. Others (such as Fundación Ventanas, Lumni, and UpSkill Capital) charge a fixed percentage of students' future income instead of interest. Many models generate additional revenue from fund administration and performance-based fees charged to investors or commission fees to partnering universities. Eduloan, FINAE, and Ideal Invest issue education bonds on capital markets, generating revenues from the loans before they fall due.

Table 1. Revenue sources and financial models of selected non-traditional educational lenders

Enterprise/Country	Sources of revenue	Revenue model
Eduloan (South Africa)	<ul style="list-style-type: none"> Interest payments Percentage of tuition Bonds sold on capital market 	Students pay fixed interest rates of 1 percentage point above national prime rate, with monthly repayments over a period of 6–24 months. Educational bonds are sold at market rates to socially responsible investors to generate additional capital.
FINAE (Mexico)	<ul style="list-style-type: none"> Interest payments Bonds sold on capital market 	Students pay annual interest of 15–17 percent, through monthly payments over a period of three times the duration of studies. Education bonds are sold on the Mexican capital market to generate additional capital.

Ideal Invest (Brazil)	<ul style="list-style-type: none"> • Interest payments • Bonds sold on capital market • Performance fee • Commission 	Partnering universities pay a commission equivalent to a percentage of the loans issued to their students and (partly or fully) cover the students' interest payments. Students avoid paying a large upfront tuition fee, but instead pay a more affordable monthly fee at no interest.
Lumni (Latin America and United States)	<ul style="list-style-type: none"> • Fund management fee • Bonus fee 	Investors pay Lumni an individually agreed upon management fee, which is a percentage of the invested assets (typically about 2.5 percent). Lumni also charges investors a bonus fee if the real financial return is higher than the promised return. Students payback a fixed percent of their paycheck for a set period of time.
Fundación Ventanas (Colombia)	<ul style="list-style-type: none"> • Share of students' income 	Students pay 10–15 percent of their future income after graduation over a period of time negotiated with each borrow.
UpSkill Capital (India)	<ul style="list-style-type: none"> • Share of students' income • Placement fee 	After students graduate, UpSkill places them with employers, who pay a placement fee. During their six-month paid internships with these employers, students pay an average of 22.5 percent of their income to UpSkill to repay tuition costs.
Trustco Finance (Namibia)	<ul style="list-style-type: none"> • Interest payments 	Students pay interest rates of about twice the national prime lending rate. Repayment is over a period of 12–60 months (average is 29 months).

Note: Table includes revenues generated from business activities only. Some enterprises also receive donations, grants, and subsidies.

Financial Viability

Results are sparse, but some suggest that models can break even and even earn profits. FINAE reached breakeven in 2012, six years after its inception. Lumni's subsidiary in Colombia broke even in 2013, seven years after it was established. Lumni's investors have returns on investment of about 9 percent. In 2008, 12 years after its foundation, Eduloan offered its stakeholders a 30 percent return on invested capital (IFC 2008).

Partnerships

Partnerships are key to the success of non-banking financial institutions in the student finance sector. Private investors, microfinance institutions, investment funds, and development agencies provide funding to establish the funds and increase broaden loan/investment portfolios. Development banks and agencies can support the lenders by providing credit guarantees, as the Agence Française de Développement does for Eduloan.

Educational institutions help lenders keep operating expenses low, by providing infrastructure and personnel. Some of them cover some interest payments. Others reduce tuition slightly. FINAE's university partners are required to establish first-loss collateral funds that compensate for borrowers' repayment defaults. Some institutions provide access to contacts within target communities. Trustco Finance, for example, piggybacks on its partners' mobile offices to promote its loan schemes. Other institutions support lenders by designing and conducting impact assessments.

Unlike traditional financing schemes, some models focus on private universities, not just nonprofit or public institutions. Graduating from a private university may increase employability, which increases graduates' ability to repay their loans.

Not-for-profit organizations support some lenders by providing nonfinancial support, such as legal advice on contract design or marketing assistance. Some, like Fundación Ventanas and Lumni partner with private sector companies, which interview graduates for jobs, while others such as UpSkill, matches internships with private companies.

Implementation: Delivering Value to the Poor

Awareness

Most models leverage their partners' customer bases and infrastructure to market their products. Eduloan, for example, has representatives and offices on the campuses of partnering universities; FINAE outsources marketing to partnering institutions. The company also conducts school visits to promote the schemes to high school students. Ideal Invest runs a call center that contacts interested borrowers upon request via SMS.

Acceptance

Clear and simple communication of loan and repayment terms ensures that they are easily understood. Loans are adapted to low-income students' needs, in some cases through individualized repayment terms. The repayment period and the share of income repaid in Lumni's income share agreements are tailored to each student and investor. Basing repayments on actual future income reduces the risk of default or prolonged indebtedness as result of low wages or unemployment.

Availability

Quick procedures make enrolment easy. Trustco Finance reaches out to remote students through door-to-door visits by salespeople using handheld devices that can immediately assess their creditworthiness and preapprove loans.

Models offer consultations and borrower support through partner institutions, representatives, and mobile offices. Students often access services and apply for financing through lenders' websites, online forms, or online crowd-funding platforms, such as Milaap. Financing is disbursed either to the student (via bank or mobile money transfer) or directly to the universities. Eduloan issues borrowers electronic cards that they can use only at selected places, such as bookstores and specific student accommodation providers. It accepts repayments through a mobile payment system.

Affordability

Non-bank financial institutions offer lower interest rates than traditional lenders. Eduloan charges just 1 percent more than the prime rate. Ideal Invest offers short-term loans with a zero-interest scheme for students, with the education facility absorbing the interest payments. FINAE's partner universities establish first-loss collateral funds. Income share agreement models, such as Fundación Ventanas, Lumni, and UpSkill, increase affordability by allowing borrowers to pay a percentage of their income after graduation rather than a fixed interest rate.

Results and Cost-Effectiveness

Scale and Reach

Ideal Invest has reached more than 80,000 students since 2001, Trustco Finance disbursed more than 55,000 loans between 2005 and 2011, and Eduloan provides loans to 50,000–80,000 students a year.

Models reach out to students from diverse income groups but focus on students from low-income households and/or rural areas. At Lumni's Colombian fund, 88 percent of students are the first in their families to attend university. About 78 percent of Trustco Finance's loans are to students from rural areas. In contrast, 47 percent of FINAE's borrowers are from middle-income families (19 percent are from low-income backgrounds).

Improving Outcomes

Many models conduct impact evaluations, based on the number of beneficiaries, the number of disbursed loans, enrolment, and retention rates. Most evaluations are internal. Some models, such as FINAE and Lumni, use auditing firms, universities, or research institutes to evaluate their results.

Initial results seem to be positive. An external study on Eduloan in South Africa found that between 2004 and 2007, access to an education loan increased the probability of enrollment by 23 percentage points, and the number of academic credits completed by its borrowers increased by about 40 percent (Gurgand,

Lorenceai, and Mélonio 2011). About 30 percent of FINAE students drop out of university, fewer than the Mexican average of 38 percent (IDB 2013). In 2011, 95 percent of Fundación Ventanas students graduated, compared with the Colombian average of 45 percent (World Bank and OECD 2012). FINAE estimates that it generates a social return on investment of about USD 3 for every dollar invested. Lumni claims that the projected annual income of participating students increases by 50–300 percent.

Cost-Effectiveness

Non-bank financial institutions achieve cost-effectiveness by lowering administrative overhead, reducing default rates, and leveraging partnerships to keep costs low. Models that schedule repayments as a percentage of income rather than fixed monthly fees reduce defaults. Negotiating slightly discounted tuition with universities lowers costs for students.

Scaling Up

Challenges

Establishing education financing funds requires substantial initial and ongoing funding: Student loans are a long-term investment that takes years before generating a substantial stream of income, particularly in low-income settings, where schemes need to be designed as long-term small repayments to be affordable for students. Institutions whose revenues depend mainly on low interest rates need to have large portfolios to be able to cover their operating costs.

Demand for higher education and investor interest are growing. In 2012, 32 percent of secondary school graduates were enrolled in tertiary education, up from 20 percent in 2001 (World Development Indicators n.d.). Over the same period, the ratio increased 81 percent in East Asia and the Pacific and 78 percent in Latin America. In 2013, social impact investments in education totaled USD 3 billion (D. Capital Partners 2013).

Three factors determine the ability to reach scale:

- *Establishing cost-efficient mechanisms for disbursement and collection of payments:* Some enterprises pay tuition directly to students' universities. Eduloan gives students debit cards that can be used for various types of expenses and allows students to repay their loans using mobile phones. Lumni works with employers to automatically deduct repayments from borrowers' paychecks.
- *Forging close partnerships with higher education institutions:* Successful models turn partner universities into their main promoters. Universities are often the first point for potential students to learn about financing options.
- *Reducing risk for lenders and investors:* Institutions share risks with partners. Eduloan and FINAE have their loans guaranteed by third parties. IDEAL Invest "outsources" the risks by setting up special purpose vehicles that purchase the assets and issue them on capital markets.

Role of Government and Public Policy

Government involvement in these models has been limited. The South African government promotes Eduloan among its agencies and schools, and it enables direct payroll deduction of loans provided to civil servants. The South African Micro Finance Regulatory Council supports the development of lending regulations and the microfinancing industry in general.

Table 2. Non-bank financial institutions providing student loans

Enterprise	Countries	Description
Eduloan	South Africa	Provides education loans targeted primarily at civil servants who wish to upgrade their qualifications and increase their salaries. Loans cover tuition, educational materials, accommodation, and food. They are repaid through automated monthly payroll deductions. Eduloan generates additional capital through an educational debenture bond sold in the capital market.

FINAE	Mexico	Finances full tuition costs, at rate of 15–17 percent interest a year. Students repay loans with fixed monthly payments over a period equivalent to two to three times the duration of their studies. Universities establish first-loss collateral funds. Company generates revenue from selling educational bonds on the Mexican capital market.
Fundación Ventanas	Colombia	Social investment fund provides academically promising students with interest-free financing and comprehensive mentorship program. Program based on profit and loss-sharing relationship between borrowers and investors in which students pay investors a set percentage of their future income for a given number of years.
Ideal Invest	Brazil	Finances educations through successive small loans. Once a student is approved to borrow, Ideal issues initial loan covering part of first semester. Each subsequent loan covers another semester's tuition. All loans are repayable in 12 months. Repayment is coordinated and staggered, so that only one installment is due each month.
Kiva	Global	Online crowdfunding platform connects lenders with borrowers from a variety of sectors, including (since 2010) higher education. Lenders select borrowers based on their online profile and disburse the loan capital (of USD 25 or more) to Kiva. Kiva passes the full amount on to borrowers through its network of field partners, microfinance institutions, and nonprofit organizations, who identify borrowers and manage the loans.
Lumni	Chile, Colombia, Mexico, Peru, United States	Promising students receive financing in return for an agreed percentage of their future income for a given number of years. Company creates and administers funds for investors (companies, universities, individuals) and manages student tracking, payment collection, and follow-up.
Milaap	India	Online crowd-sourcing platform enables individuals to lend to low-income Indians to provide them with access to education, clean water, energy, and other services. Loans go to prequalified individuals and small businesses through network of community partners that specialize in providing and managing microloans. Job-linked training for youth provides rural people in the informal sector with skills. Loans also help meet infrastructure needs of schools serving poor families.
Trustco Finance	Namibia	Part of Trustco Holding Group, which owns the Institute for Open Learning, which provides higher education through distance learning. Provides educational loans to students enrolled at the institutes, predominantly teachers, who live in rural areas and take classes online.
UpSkill Capital	India	Finances technical and vocational training. Students repay a portion of their salary when they enter paid six-month internships after completing their training.

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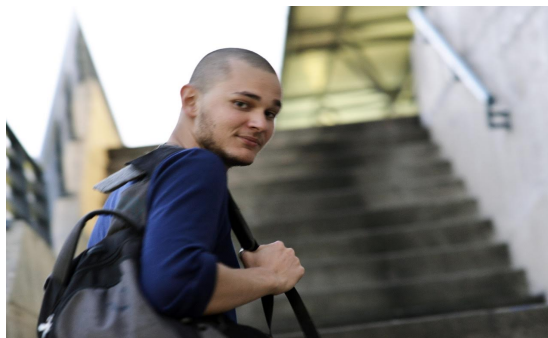
PROFILE: Lumni

Providing funding and career support to promising students in Latin America and the United States who agree to pay back a percentage of their future income



Challenge

Low-income students are underrepresented in tertiary education. A major obstacle is lack of financing for tuition and related costs. Government lending programs are inadequate—and even where such loans are available the terms are usually unattractive, because low-income students are classified as high-risk borrowers.



Innovation

For-profit Lumni (www.lumni.net) has developed model based on “income share agreements.” Promising students receive financing from Lumni in return for an agreed percentage of their future income. Various types of investors provide the funds in expectation of earning profits. The approach has three key features:

- 1) **Shared risk:** Investors share the students’ risks, losses, and profits. Because they lose if graduates are unemployed or poorly paid, investors want to ensure that students find well-paid employment.
- 2) **Non-financial support:** To enhance the success of students and investors, Lumni provides seminars, an online learning platform, career coaching, and job placement throughout students’ contracts.
- 3) **Fund management:** Lumni manages the relationship between investors and students. It designs and runs social investment funds for corporations, private investors, and nonprofit organizations. Each contract is tailored to a specific student’s case. The percentage of income to be shared ranges from 10–18 percent, and the payment period is typically 2–2.5 years per year financed.

Investors earn income from students’ payments. Lumni generates revenue from two types of fees it charges investors: a management fee, typically about 2.5 percent of assets under management, and a bonus fee, which it earns if the actual financial return is higher than the expected return committed to investors.

Impact

The company served nearly 1,000 students in 2009, about 5,000 in 2014, and more than 7,000 in 2015. Students come from a range of economic backgrounds, cities, and family backgrounds. In Colombia, virtually all students funded belong to the bottom three income groups, and 88 percent are the first generation in their families to attend university. Drop-out rates are just 2 percent.

Scaling Up

Lumni has subsidiaries in five countries (Mexico, Chile, Colombia, Peru, and the United States), where it manages 33 funds (11 investment funds and 22 corporate funds). Large investments from donors and investors have enabled Lumni to grow its portfolio quickly. Its assets under management more than tripled between 2012 and 2014, to about USD 35 million. Reaching large scale has been key to generating sufficient revenue to break even. In 2014, the company broke even in Colombia, after reaching about 4,300 students. It expects to break even in all countries in 2016. To date annual returns have averaged more than 9 percent. The payment default rate is extremely low, at about 0.9 percent (Lorin 2014).

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PROFILE: FINAE

Enabling low- and middle-income Mexican students to attend private universities through affordable payment plans



Challenge

Tertiary enrollment in Mexico soared between 2002 and 2012. Public universities can accommodate only a fraction of applicants, forcing most students to attend private institutions. The USD 1,500–15,000 annual tuition these universities charge puts them out of reach of the 70 percent of applicants who come from families earning less than USD 3,000 a year. The challenge is to make tertiary education affordable for them.



Innovation

For-profit company FINAE (<http://www.finae.com/>) lends students money for tuition, which they repay in fixed monthly payments over a period equivalent to two to three times the duration of the studies. The payments include implicit interest payments of about 15–17 percent. The company works with a dozen high-quality private universities at which the ratio between tuition and expected income after graduation is high, thereby increasing the likelihood that its students will pay back their loans. As a result, its default rate is about 8 percent, according to the company.

FINAE's model is based on key strategies:

- **Fixed payments, whether or not tuition goes up:** FINAE fixes payment rates at the beginning of the contract. To compensate for fluctuations, it takes them into account in drafting the payment plans.
- **Risk and cost sharing with universities:** FINAE partners with universities to share costs and risks associated with financing loans. Universities absorb the marketing and infrastructure costs necessary to promote the program and fund a First Loss Collateral Fund in case a student defaults on his or her loan. Low operating costs, and risk-sharing with university partners permits FINAE to remain sustainable and profitable while providing students affordable interest rates (approximately 15 to 17 percent).
- **Additional revenue:** To generate revenue before the payment plans reach maturity, FINAE creates education bonds, which it sells on the Mexican capital market.

Impact

Since its launch in 2006, FINAE has served more than 7,200 students, including 19 percent from low-income families and 47 percent from middle-income families. About 70 percent of students are the first in their families to pursue higher education. FINAE increased lending from USD 2.2 million in 2010 to USD 25 million in 2015. It fully covers its operating costs of approximately USD 4 million a year. In 2013, HR Ratings rated FINAE's education bonds AAA. According to a social return on investment analysis conducted by the Dutch consulting firm SHAERPA, FINAE generates a social return of USD 3.16 per USD 1 invested.

Scaling Up

FINAE currently partners with 10 universities in 24 states, totaling 87 campuses and more than 20 percent of total private enrolment in Mexico. The demand for private tertiary education is expected to remain strong, boding well for prospects for expansion. However, FINAE's growth may be constrained by skepticism in Mexico toward borrowing and the moderately high dropout rate (approximately 30 percent). To address the latter problem, the company is trying to identify at-risk students early enough to orient them toward appropriate careers to keep them enrolled.