FUNDING
for Independent Schools

The Independent School Awards 2012
Applications for this year open on March 1

STRATEGIC AND FINANCIAL BUSINESS INTELLIGENCE • FEBRUARY 2012

OPENING OVERSEAS
WHERE TO SET UP YOUR SCHOOL

PENNY PINCHING
HOW TO CUT YOUR COSTS

THE ISAs 2011 RESULTS
THE WINNERS CELEBRATE

www.fismagazine.co.uk • established 2006 • www.fisawards.co.uk

PAY SURVEY • INVESTMENT CLINIC • EMPLOYMENT • GIFT AID
ENTERPRISE • INTERVIEWS • PROPERTY CLINIC • SUMMER SCHOOLS

Foreign fields

There is an apparent rush to expand UK independent school brands overseas. But what are the real opportunities and pitfalls of opening campuses abroad? Karan Khemka, Alana Rush and Sarah Andries report on the trend

Growth in emerging markets has captured the imagination of Western brands. Evidence spans geographies and sectors: China is now the largest automotive industry market for General Motors after the United States; Asia is the fastest-growing market for luxury goods powerhouse Louis Vuitton Moet Hennessey (LVMH) globally. In Australia, education is the second largest "export" industry after tourism, driven by demand from Asia.

Growth in education is prevalent across emerging markets, where economic growth generates demand for high-quality English language schooling. By leveraging their legacy of quality, British independent schools can take advantage of the opportunity to expand abroad, reaping a windfall through increased earnings and brand expansion in these new markets. Indeed, some schools already have.

British independent schools abroad

The trend of British independent schools opening branch campuses is not new: over the last 13 years, British schools have opened branch campuses abroad to serve a growing expatriate population and affluent local students. Currently, there are 18 operational British branch campuses abroad, with a combined revenue of £175 million and 15 per cent pa growth. In most instances, schools opening in emerging markets are backed by a local investor providing the capital, land, licensing support and operating assistance. Alignment on the goals and performance of the school with the local investor is vital for success of the branch campus.

Examples of losses and damage to brand

Tension between the British school and local investor typically arises when the brand campus does not meet enrolment targets, lowering financial returns for the investor. In fact, of all British brand campuses that operate in the emerging markets today, only three (out of 18) have met their first-year enrolment target. Of the 15 branch campuses that have missed enrolment targets, eight have done so by over 30 per cent. Given the high cost of capital in emerging markets, missing enrolment targets in early years can significantly lower the return on capital, which affects the feasibility of the entire project.

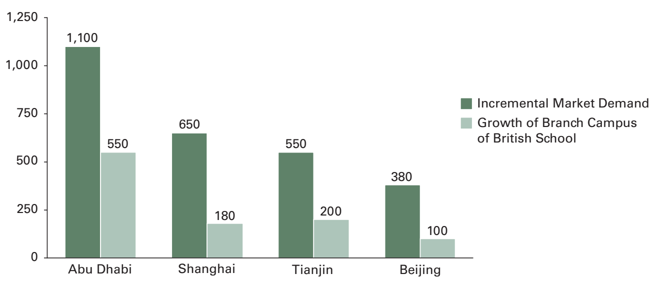
Local investors in these situations will press for lowering selectivity, decreasing teacher costs and associated pedagogical expenditures and other measures which impact quality and perception of the brand.

One of the keys to avoiding associated financial losses include having a strong, data-driven understanding of the local demand and the composition of the local market before deciding to open a campus in a particular area.

Mitigating risks of opening schools abroad

Given that in emerging markets expatriates and wealthy locals place a high value on a quality English education, why have around 80 per cent of British branch campuses abroad underperformed expectations? It is because (perhaps ironically) these schools do not do their homework to study the local market and competition to correctly estimate enrolment potential. Instead, strategies are built on faulty assumptions. The clear benefits for British schools opening abroad are accompanied by a range of risks and common pitfalls that can be mitigated if navigated with the correct set of data.

For British schools, doing your homework can be the key to avoiding common pitfalls.



Common pitfall number 1:

Unrealistic expectations about market share growth potential of a British brand: many British branch campuses and their investors assume the power of the British brand will enable them to attract a disproportionate share of market growth and take enrolments from existing schools. There is no precedent to support the assumption that British branch campuses can grow enrolments to the extent that competing local international schools decrease in net enrolment.

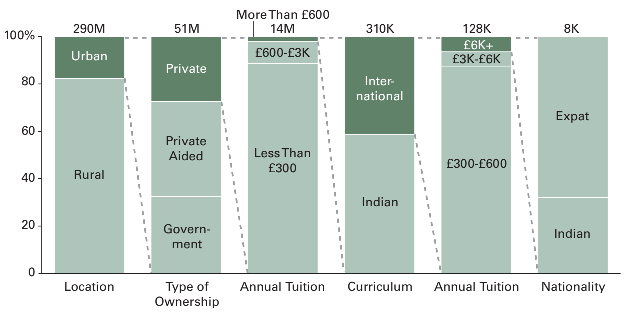
Most British schools opening abroad assume they will be able to take market share from existing competitors because local and expat parents will decide to move their children to their school based on reputation. The data doesn't disprove this: British brands abroad outperform local international schools, thus commanding a premium. However, their enrolment potential of one school is still defined by the size and growth of that school's local market: a high growth school in an underperforming market will not meet the high expectations broadly associated with emerging market growth potential.

Avoiding this pitfall: British schools should understand the local competitor set and quantify market growth potential before entering a market to correctly estimate enrolment potential. The strength of the local competitor set and value of a British education varies from country to country.

Common pitfall number 2:

Incomplete understanding of demand: actual demand is not as great as perceived demand. The perception of demand is often incommensurate with demonstrated levels. For example, many international school brands have prioritised India as a market. A simple description of the Indian market might suggest that there is adequate demand: India has scale, positive economic growth, and 290 million primary and secondary enrolments. However, a deeper look reveals that there are only around 8,000 students in India enrolled in schools charging over £6,000 pa. Half (4,000) of these students are the children of diplomatic staff attending local embassy schools who are exempt from paying fees. Additionally, most schools at this price point are running at low utilisation levels, resulting in a fiercely competitive environment with low returns. This reality is in sharp contrast with the perception of a 290-million-student market that attracts uninformed investors (see box below).

Avoiding this pitfall: a quantification of the true addressable market in the local catchment area at premium price points is required.



Common pitfall number 3:

Attempting to overcome local competition by adding a boarding component: once operational, some schools have attempted to mitigate the challenges of local competition and low demand by adding a boarding component. This tactic has not demonstrated success. A survey of all international curriculum boarding schools in the premium price point in the Middle East and Asia demonstrates limited enrolment potential (the highest having fewer than 150 enrolments) and either a flat or declining enrolment trend.

Avoiding this pitfall: build an enrolment model driven primarily by day students. If developing a boarding concept, be very conservative on underlying assumptions as the track record to date is one of missed targets.

Common pitfall number 4:

Poor understanding of local composition and regulatory environment: another variable for consideration is the composition of demand in each local market. For example, regulatory restrictions on Chinese nationals enrolling in schools targeting expatriates means the market for British branch campuses is composed of expatriates. However, the balance of expatriates in a market can pose its own challenges. A recently opened British branch campus in China had to turn down Korean applicants, despite missing enrolment targets, in order to maintain the international balance within the school. Another British branch campus has committed to opening in a fast-growing Asian city with an oversupply of IGCSE schools, even as Australian and US curriculum schools face supply shortages.

Avoiding this pitfall: schools exploring new regions should supplement their management team's knowledge with local expertise about the regulatory and operating environment.

British schools have the potential to exceed expectations for success in emerging markets. This success will be driven by a deep, thorough, data-driven understanding of their target markets. With a few weeks of data-driven due diligence, it is possible to ensure the feasibility of opening a branch campus in an emerging market. Validating the enrolment potential and competitive differentiation with an objective fact base can align a school and an investor to avoid common pitfalls, mitigate historic risks, and protect the brands that have been carefully built over time by British independent schools.

Karan Khemka is a partner and head of the Emerging Markets Education Practice at The Parthenon Group. Karan can be contacted at karank@parthenon.com. The company has released a report, British Independent Schools: International Growth Opportunities*, which is available for download from its website: www.parthenon.com/about/events.*