INCLUSIVE INNOVATIONS

Making Tertiary Education Possible for Low-Income Students

HIGHLIGHTS

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

Development Challenge

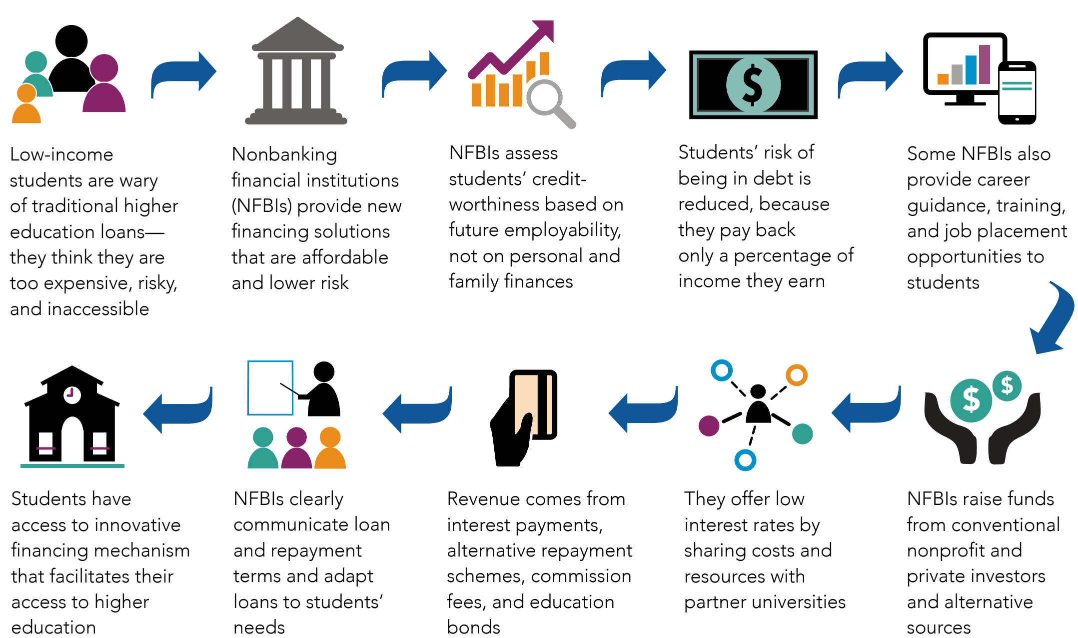
Millions of low-income students would like to receive higher education but are unable to do so because they cannot afford it. Many public lending schemes suffer from high default rates and administrative costs. Moreover, most students from low-income households do not qualify for such loans—and among 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

Nonbank 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.

Models generate revenue from loan repayment and other sources. Many charge interest rates. Others (such as Fundación Ventanas, Lumni, and UpSkill) 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.

Features of the Student Finance Business Model



Implementation: Delivering Value to the Poor

Awareness

Most models leverage their partners' customer bases and infrastructure to market their products. Eduloan has representatives and offices on the campuses of partnering universities. FINAE outsources marketing to partners; potential borrowers can consult company representatives through their mobile. 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 text.

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

Accessibility

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 student accommodation providers. It accepts repayments through a mobile payment system.

Affordability

Nonbank financial institutions offer lower interest rates than traditional lenders. Eduloan charges just one percent more than the prime rate. Ideal Invest offers a zero-interest scheme. 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.

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.

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 balance 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.

Results and Effectiveness

Many models conduct impact evaluations, based on the number of beneficiaries, number of disbursed loans, enrollment, 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.

Non-profit organizations support some lenders by providing nonfinancial support, such as legal advice on contract design or marketing assistance. Some enterprises partner with private sector companies that interview graduates for jobs.

Initial results seem to be positive. An external study on Eduloan suggests that the number of academic credits completed by its borrowers increased by about 40 percent. About 30 percent of FINAE students drop out of university, fewer than the Mexican average of 38 percent. In 2011, 95 percent of Fundación Ventanas students graduated, compared with the Colombian average of 45 percent. FINAE estimates that it generates a social return on investment of approximately $3 for every dollar invested. Lumni claims that the projected annual income of participating students increases by 50–300 percent.

Nonbank 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.

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