JOINING THE TWO CONVERSATIONS

The international conversation about quality assurance and accreditation that tends to focus on the strengths of US accreditation can benefit from at least some additional attention to the national conversation of concerns and criticisms in the United States. Awareness of US concerns can assist quality assurance leaders in other countries in assessing the value of their own ongoing initiatives. Understanding these concerns can provide an early alert to developing countries that are in the preliminary stages of establishing their own quality assurance organization and structure. At the same time, the US national conversation can benefit from awareness of the international conversation—a reminder of accreditation’s strengths and usefulness, a view that is lost in the current national dialogue.

The Private Financing of Higher Education

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In recent years, cost sharing has been on the rise. Tuition has been introduced in countries such as Australia, China, Germany, and the United Kingdom. Likewise, where charging tuition was already the norm (e.g., Canada, Japan, and the United States) students have faced a substantial rise in tuition. While the growth of cost sharing has been swift, the financial mechanisms to facilitate this cost sharing have not developed as quickly. In a handful of countries, the growth of mechanisms such as bond issuances, private equity, and philanthropy have marked an increased role for private finance in higher education, but these mechanisms have not been widely adopted. Both students and institutions continue to face credit constraints on worthwhile educational investments. If greater cost sharing is to achieve what its proponents claim it can—namely, greater efficiency, equity, and access—private finance will have to play a greater role in overcoming these credit constraints.

BOND ISSUANCE AND SECURITIZATION

One way that higher education can tap private capital markets is through the issuance of bonds. A university can issue bonds on a public exchange, and over time investors are repaid the original capital plus some interest rate. This interest rate reflects the risk that the institution will fail to meet its obligations—in other words, that it will default. The likelihood of default, in turn, is determined by the financial health of the institution, rather than by the specific project for which money was borrowed. For example, a university may want to raise funds to build a new business school, but it will have to issue bonds that carry a high interest rate if many of the university’s other operations are struggling.

In 2001, the Hungarian Ministry of Finance established the Student Loan Centre (SLC), a nonprofit company that by August 2007 had issued loans to 234,000 students amounting to 142.8 billion Hungarian forints (about US$780 million). To fund the scheme, the SLC issues bonds backed by a state guarantee. The scheme appears to have helped boost enrollments. According to data from the UNESCO Institute for Statistics, enrollment at the tertiary level increased between 2000 and 2005 by 42 percent. This compares favorably to other eastern central European countries. In the same period, Slovakia and the Czech Republic both saw an increase of 33 percent, and Poland saw an increase of 34 percent. However, it is still difficult to judge if the SLC will be financially sustainable in the long run since default rates on the student loans have not been established.

In a very different part of the world, universities, rather than the state, are taking steps to draw on private finance. A handful of Mexican universities have received credit ratings, including Universidad de las Americas de Puebla, Universidad Autonoma de Nuevo Leon, Universidad Autonoma del Camen, and Benemerita Universidad Autonoma de Puebla. Credit ratings are necessary for these universities to issue bonds because they help investors judge the likelihood of default. This trend is not limited to Mexico. In August 2007 Moody's, one of the major credit-rating agencies, issued a report on its methodology for rating public universities outside the United States. Moody's has already issued ratings for universities in Canada and the United Kingdom and expects that public universities in France, Germany, Italy, and elsewhere are likely to seek ratings in the future.

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Securitization, a more recent financial innovation, can help deal with risk more effectively in some situations than the types of bond issuances described earlier. In particular, securitization has helped finance the growth of government-guaranteed and private loans in the United States over the last 10 years. During a securitization, student loans—issued by a commercial bank, nonprofit organization, or any other institution—are bundled together and placed in a legally independent trust.
Risk is no longer assessed based on the overall financial health of the bank or nonprofit organization but solely on the likelihood of default of the student loans. While the United States has the most experience with this process, it is not entirely alone. The British government has securitized student loans three times, in 1998 and again in 1999, and most recently in 2007 by the former chancellor and current prime minister, Gordon Brown. The off-loading of these assets onto the private market has helped free up public funds for other pressing needs, including additional student loans.

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Private Equity
Private equity has recently taken an interest in investing in higher education. In contrast to bonds, private-equity finance is not raised through a public exchange like the New York Stock Exchange or the São Paolo Stock Exchange. Instead, a private-equity firm provides funds to a company in exchange for a direct stake in its future profits. Companies that utilize private equity are often small and have a high potential for growth.

In 2005, Banco Pátria, a major Brazilian private-equity firm, formed a private-equity fund called the Fundo de Educação para o Brasil (FEBR). FEBR served as an investment vehicle in Anhanguera Educacional S.A. (AES), a private, for-profit education company that required additional capital to expand its operations. AES wanted to build new campuses in small and midsize cities in southeastern Brazil. The company offers a low-cost education—average tuition stood at reais $503 in mid-2007 (approximately US$261)—for underserved, lower-income students in fields like engineering and business. In addition, AES spends 10 percent of its annual gross revenue on scholarships, taking advantage of government tax incentives to promote access. The strategy has proven highly successful, with enrollment nearly doubling, from 23,366 students in mid-2006 to 46,001 students by mid-2007. AES was successfully floated on the Brazilian stock market in March 2007.

Philanthropy
While the term private finance is usually associated with the profit motive, philanthropy also falls under this term. Philanthropy has a long history with higher education. Nevertheless, the growing demands of higher education have spurred a search for greater efficiency and accountability in higher education philanthropy. One of the most interesting recent developments is the combination of philanthropy with profit-driven finance. Philanthropists with this approach hope that their money can achieve greater efficiency in the pursuit of the same goals as more traditional philanthropy.

While it is too early to say whether this approach is viable, an example from Indonesia illustrates the possibilities. The Sampoerna Foundation worked with the International Finance Corporation (IFC) and the Bank Internasional Indonesia to establish a risk-sharing facility that provides loans on subsidized terms to Indonesian students and parents. The Sampoerna Foundation provided an initial cash reserve covering potential first losses, while Bank Internasional Indonesia provides the loans and the IFC provides additional risk sharing on any losses in excess of the initial cash reserve. As of September 2007, 12 Indonesian institutions of higher education have agreed to participate in the loan program. If the scheme succeeds, it will serve as a valuable demonstration to banks in Indonesia and elsewhere that student loans can be profitable.

The Future of Private Finance
Given that cost sharing has become a permanent feature of the terrain of higher education, private finance in its many forms will need to become a regular partner of higher education. Yet private finance presents its own risks, most recently demonstrated by the student loan scandal in the United States that involved commercial lenders. What steps can be taken to create a successful partnership between private finance and higher education? While the answer is complex, two elements are crucial. First, there must be wider sharing of information across institutional and geographic lines. Private investors need reliable information about profitable investments, and higher education administrators must become more familiar with the intricacies of private finance. The second factor is legislative reform, to promote and regulate private finance. Many countries will have to address the tax treatment of philanthropy, the regulation of securitization, and the governance of public-private partnerships. When these issues have been addressed, private finance will be able to play a key role in ensuring that greater cost sharing promotes, rather than undermines, equity and access in higher education.

Author’s note: This article summarizes The Global State of Higher Education and the Rise of Private Finance: www.ihep.org/Pubs/PDF/Global_State_of_Higher_Education.pdf.