



EDUCATIONAL INSTITUTIONS

Rating Methodology

Educational institutions (EIs) fall into the service sector, and thus their rating is based upon their own peculiar parameters. Along with the quantitative factors, qualitative factors also play a deciding role in the overall rating of EIs. Apart from analyzing the overall educational sector, the institution's management and franchise value, its long-term strategies, its competitive situation/strength and its financial standing needs to be considered.

Demand for education is greatly dependent on the population, population growth rate and literacy rate of the country. Due to the high population growth rate in developing countries, there is almost always a deficit in the demand-supply situation in this sector.

Support of the government towards imparting quality education depends on its ability to allocate funds for this purpose. Where the government's efforts fall short, the private sector fills the vacuum. However, where the public sector education is strong, the private sector will have to show higher quality and a higher demand track record.

Government regulations also determine the barriers for entry particularly for the private sector. An active education policy pursued by the government generally ensures that EIs conform to the laid down standards leading to greater assurance of continuity. A government's relaxed stance towards private sector involvement may sometimes lead to substandard facilities. However, even small schools may play an important role in filling the gap between supply-demand for education in the country.

EIs may be organized under many different regulations such as laws governing companies, trusts, societies or partnerships. Each law adds varying risk with regards to continuity, growth and financial support in times of needs. The ability of the EI to handle and meet the various regulatory requirements is a factor considered while rating.

EIs can be sponsored by a large philanthropic group, community, trust, individuals, and limited liability companies or they may come under the public sector where the government exercises total/partial control over the gov-

ernance of the EI. Each of these means of sponsorships has varying degree of strengths which contribute to the overall credit rating of the institution.

Goals of each of these sponsors may differ. Objective of opening EIs by the government, community, trust is more towards imparting education in general. These sponsors normally subsidize education. Annual funds allocation over the years along with the funding of any extraordinary expenditure is analyzed to see how large expenses will be managed and provided for in the future.

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Ability of the management to deal with external threats and to capitalize on opportunities is important. While analyzing the strategies and plans of EI, it is also important to develop a view of the depth and experience of the EI's management team and the adequacy of the succession plan of the top management. It is very important that the vision and strategies of the top management is effectively passed down in the organizational hierarchy. Level of

faculty satisfaction is determined by their turnover rate. Motivation level of faculty is judged by their dedication and enthusiasm to convert the EI's goals and objectives into reality.

An important aspect to look at is the clarity, efficacy and efficiency of the rules, procedures and systems of governance in the EI. Well-documented systems and well-integrated IT systems will lead to efficient operations. Quality of internal audit is determined by the frequency and depth of audit reports within the institution. ISO 9001:2000 quality management system certification, if obtained by an EI will indicate well-managed systems and controls. Inspection of management practices is also a crucial quality control measure.

The curriculum holds prime importance. The internal system to research on, revise and modernize the curricula to be in line with changing needs of the society for future success of the institution is examined. Determining the adequacy and scope of the curricula and its effectiveness and proper

implementation is judged by the students' performance during exams and in practical life after they have completed education. Number of credit transfers to foreign EIs establish the recognition which an EI enjoys and reinforces the education standard of the EI. Teachers' recruitment process and their

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training programs also play a vital role in maintaining the quality of education. Quality of entrance tests and the whole process of students' induction in the EI determines the quality of students enrolled. The minimum academic performance (example GPA) expected from each student throughout the academic year is also a determinant of student quality maintenance.

Operating performance is measured against the institution's mission statement. Growth in terms of the number of students, teachers, branches, different courses/curriculums offered, etc is seen. Demand for admission will determine the franchise value that the EI has developed over the years and indicates its potential to attract enrollment in the future. The demand develops because of the academic achievements of students in the EI. Location holds significance

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in determining the amount of competition and

ascertaining the demand and expected demand growth in the area. Critical is the ability of the EI to develop a niche market for itself.

The influence of staff unions, student bodies and parent-teacher association on the management to meet its quality objectives along with its financial sustainability is ascertained. This may help determine the importance placed on the quality of education vs. its growth.

Historical financial performance is analyzed through time series trends and common-size statements. Budgets are compared to actual performance in order to highlight the accuracy of management's forecasts.

Growth in income will come from two areas - first, growth in the number of students and second, ability to increase fee in the future. Here, the management strategy and plans for expansion will play a role. Growth in fee rate must be analyzed by the ability of the target market to absorb the increase.

Emphasis on cost controls is important. A major running cost of an educational institution is the teaching and non-teaching staff salaries which increase with the student growth. Most of the other costs do not vary with capacity. The degree of control on these expenses is an important rating consideration.

Net cash from core operations and the cash flow cycle needs to be monitored carefully to ensure timely debt principal and interest payments. Adequate capitalization and level of investment are analyzed. A high debt leverage and cost of debt may greatly limit financial flexibility and may also dry out additional/new sources of funds.

EI's assets are mostly illiquid since it is much more difficult to close a school and sell the business in its running condition. As a result, if fixed assets of an EI are valued for purposes of mortgage, the fair value should have a high

discount be cause of the illiquidity factor.

By nature of their activity, EIs may have a large amount of security deposit liabilities which are taken from students at the time of admission. These are non-interest-based liabilities which have no fixed term of repayments. Gearing is a better ratio in comparative analysis of EIs.

Newly established institutions are more prone to competition than well-established public and private institutions. In case of a large branch network, initial losses and costs of opening new branches can be easily absorbed by the other profit-making branches. Profitable operations of large networks also confirm the management's ability to administer internal controls within its operations. Large profitable networks also, to some extent, confirm the quality maintenance of the institution and its franchise value. One way a stand-alone institution can compete with a large branch network, at least in obtaining a comparable rating, is its long-standing history of operating performance and a higher franchise value.

Important Rating Considerations

Management

- ◆ Legal Structure
- ◆ Quality and stability of management
- ◆ Long term vision and objectives for the institution
- ◆ Decision making process
- ◆ Policy planning and implementation procedures
- ◆ Succession planning
- ◆ Level of documentation (accounting and other procedures)
- ◆ Adequacy of internal audit
- ◆ Inspection of Teaching practices/management audits

Academic factors

- ◆ Adequacy of the curriculum and its frequency of revision
- ◆ Emphasis on extra-curricular activities
- ◆ Minimum qualifications of teachers and emphasis on teacher training
- ◆ Diversity of education provided by the institution
- ◆ Admission policy (age limitations, class enrolment limitations, courses limitations)
- ◆ Teacher-student ratio
- ◆ Franchise value as determined by the past growth and the future demand for enrolment in the institution
- ◆ Emphasis on information technology in the curriculum
- ◆ Degree of parents' involvement

Operating performance

- ◆ Sources of revenue and stability and quality of earnings
- ◆ Student and teacher growth over the past few years
- ◆ Fee structures; fee growth during the past and expected in the future
- ◆ Sources of future growth
- ◆ Ability to absorb losses
- ◆ Source of future growth in revenue
- ◆ Operating efficiency

Asset quality

- ◆ Growth in assets
- ◆ Capital expenditure requirements and expected payback periods
- ◆ Forced sale value/realisable value of assets

Capital structure

- ◆ Existing capital structure
- ◆ Major source of funding - present and future
- ◆ Contingent liabilities and operating leases
- ◆ Average borrowing cost

Liquidity

- ◆ Cash flow structure (frequency of fee receipts, level and growth)
- ◆ Debt coverage
- ◆ Matching of funds

Risks

- ◆ Level of competition
- ◆ Government regulations

External Support

- ◆ Financial strength and support from sponsors
 - ◆ Subsidies, grants, etc. available to the EI
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Faheem Ahmad has diverse experience with international consulting agencies in USA & Middle East. He has also held senior positions with local industrial and financial groups. In 1994, he established Vital Information Services (Pvt.) Limited, which is a leading capital market research house. VIS has the largest data bank of corporate Pakistan. His major research work includes copyrighted F&J financial strength rankings, Musharaka Variable Income Securities and stock market indices. VIS group includes JCR-VIS Credit Rating Company Limited and News-VIS Credit Information Services (Pvt.) Limited, the first private credit bureau of Pakistan. The majority of shareholders in group companies include the largest publication house in Pakistan and major financial institutions.

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Jamal Abbas Zaidi
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Jamal Abbas Zaidi has more than three decades of rich experience in finance and general management, at local and international level. Prior to joining JCR-VIS, he was CEO of a leasing modaraba and SEVP of the then largest leasing company having IFC and ADB equity. Internationally, he worked for World Bank at a multi-million dollar project in Nigeria. Mr. Zaidi has held key positions in the industrial and financial sector and has contributed many papers in international and local conferences and workshops. He is a member of rating committee of JCR-VIS.

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