VIS

Credit Rating Company Limited.

# EDUCATIONAL INSTITUTIONS RATING METHODOLOGY

## Table of Contents

# SCOPE OF CRITERIA

The criteria titled 'Rating Methodology-Educational Institutions' primarily applies to the evaluation of entities defined and regulated as educational institutions, including universities, colleges, schools, vocational training centers, and other specialized educational organizations. These institutions fall into the service sector and their rating is determined based on a unique set of parameters. Along with the quantitative factors, qualitative factors also play a deciding role in the overall rating of Educational Institutions (EIs). "Quality Education," is also one of the 17 Sustainable Development Goals established by the United Nations in 2015 as part of the 2030 Agenda for Sustainable Development. The main aim of SDG Goal 4 is to ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.

# SUMMARY OF CRITERIA CHANGES

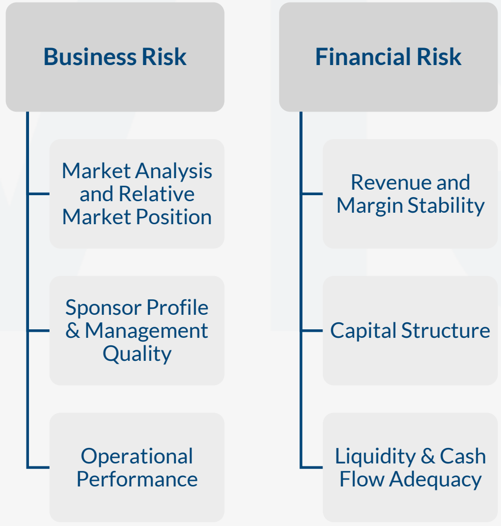
The fundamental framework set forth in 'Rating Methodology - Educational Institutions,' initially dated June 2002, largely remains the same. However, the criteria has undergone certain refinements to enhance clarity and comprehensiveness. The updated methodology includes a well-defined mechanism within the framework and consolidates key benchmarks. Additionally, Environmental, Social, and Governance (ESG) considerations have been integrated to align with current assessment standards.

# AN OVERVIEW OF RATINGS FRAMEWORK

VIS employs two principal analytical frameworks: (A) Business Risk Profile, and (B)Financial Risk Profile for rating educational institutions.

Within the Business Risk Profile, a methodical assessment is conducted that encompasses multiple facets such as market size, demand dynamics, competitive environment, and regulatory framework together with market positioning, legal structure, sponsor profile, mission and quality of management and teaching staff. Furthermore, quality of education is analyzed vs-a-vis student achievements, operational performance is evaluated by giving due consideration at historical stability and quality of earnings, student strength and growth trends, fee structures and operating efficiencies.

Financial Risk Profile encompasses a review of revenue stability, the capital structure and liquidity and cash flow analysis.



# RATING METHODOLOGY

Our assessment model is based on some key factors, qualitative and quantitative, which may further be broken down into sub-factors to comprehensively capture the rating drivers.

## A. BUSINESS RISK PROFILE

Business risk profile constitutes a critical component in the educational institution rating methodology employed by VIS. The evaluation encompasses a holistic understanding of both internal and external factors that influence the institution's operational and financial stability.

### A. (i) Market analysis and relative positioning

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. Consequently, VIS considers the education industry to evidence low cyclicality.

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.

Educational Institutions may operate under various legal frameworks, such as corporate laws, trusts, societies, or partnerships. Each legal structure and regulatory requirement introduces distinct risks related to institutional continuity, growth prospects, and financial resilience during emergencies. An institution's aptitude for navigating and complying with these multifaceted regulatory requirements is a crucial factor considered in the rating process.

The legal structure of the entity and the nature of the institute's sponsorship are considered pivotal factors in the rating process for EIs. They can be sponsored through a diverse range of entities, including philanthropic organizations, community groups, trusts, individual benefactors, limited liability companies, or public sector bodies where the government wields total or partial governance control. Each form of sponsorship comes with its unique set of strengths and/or weaknesses that contribute to the institution's overall credit rating. The objectives behind the establishment of EIs by various sponsors can differ significantly. For example, governments, community groups, and trusts often aim to provide education more broadly and are inclined to subsidize educational costs. 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. An analysis of the corporate structure is conducted to ascertain the degree to which the EI is dependent on its sponsors. It is highly probable that an institution's rating may be influenced by the financial standing and credibility of its sponsoring entity unless the institution operates with a considerable level of independence from its sponsor. Therefore, the symbiotic relationship between the institution and its sponsor(s) is a critical factor considered during the rating process.

An institution's market positioning is appraised based on a multi-faceted approach. The operating history of an EI is examined to gauge the stability and reliability it has demonstrated over time. Moreover, the quality of the infrastructure is assessed, taking into consideration facilities, and not limited to, such as classrooms, laboratories, and libraries, among others. Student preference is another metric that is critically evaluated. Factors such as enrollment rates, student retention, and demand for courses are studied to understand how an institution is perceived within the education market. The strength and quality of alumni also holds weight in this assessment. Alumni achievements, their positions in various fields, and their continued engagement with the institution are assessed to comprehend the long-term value an institution provides to its students, which is reflective in the franchise value of the EI developed over time.

## A. (ii) Management

Evaluating the rating of an entity within the education sector necessitates a comprehensive understanding of the management's objectives, guiding philosophies, and strategic initiatives that influence both the operational and financial performance of the institution.

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.

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 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 (e.g. GPA) expected from each student through-out the academic year is also a determinant of student quality maintenance.

The integration of ESG metrics into the rating methodology for EIs serves as a multifaceted lens through which long-term sustainability and ethical governance can be assessed. Environmentally, an institution's efforts in energy efficiency and waste management together with governance aspects of accountability, compliance and data privacy as well as social metrics such as diversity and inclusion and community engagement are evaluated under VIS" ESG RATING METHODOLOGY" available at our website on the following link, https://docs.vis.com.pk/docs/ESGRatingMethodology.pdf.

An EI that scores well on ESG metrics is likely better equipped to navigate future challenges and maintain stakeholder trust, thereby providing a more holistic view of its creditworthiness. Building and upgrading education facilities that are child, disability, and gender-sensitive and provide safe, non-violent, inclusive, and effective learning environments for all are also important part of the ESG assessment.

### A. (iii) Operational Performance

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 evaluated. 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. Sources of revenue and stability and quality of earnings are assessed together with future sources of growth and diversification. Student and teacher growth over the past few years along with fee growth in the past and expected in the future is analyzed. Maintenance of operational efficiencies remains an important element in credit ratings of EIs.

## B. FINANCIAL RISK PROFILE

Financial risk analysis encompasses analyzing the entity's accounting quality, any qualifications made, method of revenue recognition and any material off-balance sheet items, which may require recasting of financial statements to reflect the true financial position of the entity. This is essential for an accurate assessment of its financial performance vis-à-vis peers.

### B. (i) Revenues & Margin Stability

Historical financial performance is methodically analyzed through time-series trends and common-size financial statements. Budget-to-actual performance variances are reviewed to ascertain the reliability of management's forecasting abilities. Unlike entities in manufacturing/service sector which have cash inflow spread over the year, cash inflows of most of the educational institutions are relatively skewed as the tuition fee is collected annually/semi-annually/quarterly/monthly. At the same time, cash outflow towards capital expenditure and operating expenditure is spread over the entire year. Given this, the management of cash flow assumes greater significance in educational institutions.

Revenue growth is projected to emanate from two key areas: firstly, the expansion in student numbers, and secondly, the potential to increase tuition and other fees. In this context, management's strategic plans for institutional expansion are considered pivotal. Well established institutes with good track record of enrolment and entities with relatively diversified courses are better placed as they offer stability in revenue.

Revenue diversity, which encompasses multiple income streams, such as tuition, hostel, transport, and cafeteria fees. The evaluation also considers the diversification of courses and campuses that are offered in different geographical locations and/or franchises.

These factors collectively inform an understanding of the institution's market positioning and its ability to leverage that positioning to generate sustained enrollment and revenue growth. Revenue visibility is assessed by considering proposed fee structures across diverse courses and by weighing expected occupancy rates against available operating seats and historical enrollment data.

Cost control mechanisms, particularly given that staff salaries both teaching and non-teaching are a significant operational cost and are likely to rise commensurate with student growth. The variability of other costs in relation to capacity is also assessed, and the institution's capacity to manage these expenses becomes a vital consideration in the rating process.

The trend in profitability margins vis-à-vis capital deployed is an important factor impacting the debt servicing ability of the institutes. With majority of the cost of an educational institution being of fixed nature, stability in margins is important.

### B. (ii) Capital Structure

The adequacy of capitalization and the level of investment are assessed in parallel. Elevated debt leverage and cost of debt can significantly constrain financial flexibility and potentially exhaust new avenues for funding. Furthermore, EIs often hold substantial amounts of security deposits, acquired from students upon admission. These liabilities, which neither accrue interest nor have a fixed repayment term, are a distinctive financial characteristic of EIs. Thus, the gearing ratio becomes a more effective metric for comparative financial analysis among EIs.

Due to the inherently illiquid nature of the assets belonging to EIs, a unique set of challenges emerges when valuing these assets for mortgage purposes. In addition, entities involved in offering education services generally need to carry out continuous capex for expanding capacity and improving existing infrastructure in order to ensure growth in revenue. While fulfilling the above obligation, effective planning of financing based on the existing and future cash flows is key to maintain/improve its financial position.

### B. (iii) Liquidity & Cash flow Adequacy

Net cash from core operations and the cash flow cycle are subjects of monitoring to ensure the timely fulfillment of obligations related to debt principal and interest payments.

The ability to manage cash flows, particularly timing mismatches between fee collection and debt servicing, is a key rating driver. While working capital is generally not a requirement in EIs, availability of funding lines or cash reserves provides comfort against any mismatch of cash flow that may arise. Timely realization of receivables remains a key rating driver.

## RATING SCALE & DEFINITIONS

Rating scale and Definitions may be accessed at (https://docs.vis.com.pk/docs/VISRatingScales.pdf)

## Faheem Ahmad

President & CEO, VIS Credit Rating Company Limited
Founder, VIS Group Chairman,
Vice-Chairman, Association of Credit Rating Agencies in Asia

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters Degrees in Engineering and Business Administration from USA.

## Sara Ahmed

Director - Ratings

Sara Ahmed possesses 17+ years of experience in financial risk assessment and credit structuring. She has worked in Corporate Banking & Risk Management functions locally as well as internationally. Sara has been involved in the entity ratings of numerous corporate organizations as well as financial institutions besides being part of the Methodology and Criteria Development team. She holds a Master's degree in Business Administration from the Institute of Business Administration, Karachi (2001).

## Saed Muhammad Jafri

Senior Assistant Manager

Saeb Muhammad Jafri joined VIS Credit Rating Company Limited in 2023, as an Assistant Manager and Analyst within the ratings team. His responsibilities encompass the execution of rating assignments for a diverse range of corporate entities, spanning multiple sectors. With three years of professional experience under his belt in the financial sector, Saeb has considerable understanding of financial analysis. His educational credentials include a Master's degree in Business Analytics from Karachi School of Business & Leadership and is currently pursuing the CFA program, with Level 1 cleared.


Jahangir Kothari Parade (Lady LLoyd Pier) Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose genrosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

**Dome:** A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

**Origins**: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.

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**VIS Credit Rating Company Limited** is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, VIS is positioned to aim for an international mark. In this regard, the global experience of our international affiliates and partners have been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors. The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, VIS continues its endeavour to remain an emblem of trust.

## INTERNATIONAL

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### Collaborations

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