MERGERS & ACQUISITIONS

Why impact investors love the education sector

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Up to now, the education sector has made up a relatively small part of the impact investing pie. The Global Impact Investing Network estimates that only 4 percent of the half a trillion dollars in total impact investments is devoted to education, far behind financial services and energy.

That small share, perhaps, has to do with the perceived complexities of the education sector, the traditional dominance of government in this area, and the difficulty of measuring outcomes precisely.

But there are signs that the market is changing as some big impact investment players warm to the education sector. Several recent developments and deals have highlighted this trend, suggesting it has the potential to become a theme for mid-market funds as well as the bigger players.

Bain Capital's $390 million Double Impact fund last year led a group of investors that purchased online education provider Penn Foster. Penn Foster, which focuses on providing post high-school skills training, then went on to acquire online institution Ashworth College this February.

U.S. private equity firm TPG Capital's $2 billion RISE fund announced last year it was investing $130 million to take a majority stake in DreamBox, a K-8 educational technology company used by nearly 3 million students in the United States, Canada, and Mexico.

KKR announced last year it was jumping on the impact investing bandwagon. With its new fund aiming for deals around the $50-$75 million range and with investment themes tied to the United Nations' Sustainable Development goals, the education sector can be expected to benefit.

Largely the prior realm of large foundations, non-profits and governments, these recent transactions show that big funds are starting to wake up to the unlocked potential in the education sector, both in the United States and globally. They are now willing to consider putting hundreds of millions of dollars to work in the sector, rather than the tens of millions previously.

Much room for growth

Several factors are driving this trend, which should make the education sector an attractive target for impact investors and mid-market PE firms in the coming years.

First, there is a sense that education is not working around the world, creating a clear need for private-sector dollars to make up for a global shortfall in education investment. Even as global demand for access to quality education has grown, governments have failed to keep pace with the necessary investment in schools and colleges.

Education systems in many rich countries have struggled due to public spending cuts and soaring prices for higher education. Total spending on education will need to go from $1.2 trillion per year in 2016 to $3 trillion by 2030 across all low- and middle-income countries in order to meet the U.N. Sustainable Development goals for education, according to the International Commission for Financing Global Education.

Second, technological advances have revolutionized the way in which education can be designed and delivered. Rather than building and running bricks-and-mortar schools, modern education firms are more likely to be focused on improving students' access to learning through software platforms, online classes, and support.

This has reduced some of the old complexity and costs of education investing, making it a more attractive proposition. One successful example of this is Bridge International Academies, which has rolled out its "academy in a box" program to cover nearly 100,000 students in several African countries. It has attracted funding from venture capital investors like LearnCapital and Rethink Education as well as impact investors Omidyar Network and CDC.

Lastly, there is the supply side of the equation. U.S. private equity is sitting on about $2 trillion in dry-powder funds, according to Bain Capital and facing a diminishing range of things to do with it. With so much money chasing relatively few opportunities, investors are taking a closer look at alternative investments and are willing to accept more modest returns.

Returns are not everything

These days, an IRR of 15-20 percent is seen as acceptable, which brings many education investment opportunities into range over a seven-year time frame. For PE firms, buying impact assets in education and other sectors has also become an attractive way to boost their image, differentiate themselves, and attract investors who are increasingly interested in being benevolent as well as generate investment returns.

All levels of education are set to benefit from this trend, but perhaps the most promising in the medium term is the field of corporate training and professional development.

This is where a lot of U.S. ed tech investment has been focused recently in an effort to address a growing skills gap in the workforce between high school, college, and the workplace. Bain's purchase of Penn Foster and its subsequent acquisition of Ashworth College are among those that are squarely focused on this theme.