

by Rohin Dharmakumar

# IN A CLASS OF HIS OWN

After making his millions selling educational content across India, Educomp's Shantanu Prakash now wants to set up his own schools

For reasons that remain shrouded in mystery, in July 2005 the Carlyle Group, a global private equity firm, sold its 16 percent stake in the education services company, Educomp, back to founder Shantanu Prakash. Incredibly, Carlyle made the sale at a loss of roughly 94 percent on the \$2.1 million (Rs. 1,087 lakh) it had paid to acquire the shares in June 2000.

While 94 percent is a really bad "haircut" — an investing term describing the reduction in the value of a security — it paled in contrast to what Carlyle had given up in the future. Less than six months after Carlyle's exit, Prakash took Educomp through an IPO. The shares Carlyle sold back to him in 2005 for Rs. 60 lakh are today worth roughly Rs. 300 crore. Prakash's total shareholding in Educomp is valued at over Rs. 700 crore.

Educomp's services (multimedia content, computer labs, teacher training) reach 23,000 schools and 12 million students and teachers. The company has grown at a compounded rate of over 100 percent over the last five years, making 20 paise of every rupee earned as pure profit. With a market capitalisation of over Rs. 7,000 crore, Educomp is easily the most

valuable company in the Indian education sector. (Network 18, the parent of *Forbes India*, is a partner with Educomp in Graycells18 Media, a company offering interactive educational services on television.)

Yet, in many ways Educomp is just getting started. Because the overall market for private education in India is estimated

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*Shantanu Prakash*

at \$40 billion by brokerage firm CLSA. And Educomp has annual revenues of just Rs. 637 crore (about \$140 million).

When Prakash established Educomp in 1994, his goal was to set up and run computer labs for schools. Prakash knew there was potential in the education sector but wasn't clear what kind of business model would work. The biggest obstacle was the fact that Kindergarten-to-class 12 (K12) school education (valued at \$20 billion, half the size of the entire education mar-

ket) was deemed "non-profit" by regulators and governments. That's why most private schools are governed by non-profit "trusts". As a result, investors were wary of putting money into any K12-focused entrepreneur, even as a majority of schools were struggling to provide world-class education.

"Indian classrooms were highly dysfunctional with large number of students per classroom, underpaid teachers, growing curriculum and competitor peer pressure. Would 80 percent of students take private tutoring if classrooms were working?" says Prakash. "We had to intervene to get results from classrooms."

Prakash hit upon both the root of the problem with Indian education, as well as its most lucrative segment. He focussed on improving the quality of education using existing infrastructure: School classrooms. That was more efficient than setting up his own, which is what his older competitors (NIIT, Aptech) were doing.

His solution, Smart Class, introduced in 2003, was a canny combination of computer and audio-visual hardware and multimedia content. Smart Class' interactive content was "enthusiastically adopted by underpaid and unrecognised

teachers who desperately needed help," says Prakash.

Prakash, 44, decided to become an entrepreneur at a time when his father, a manager with SAIL, couldn't even afford to buy a flat in Delhi. He got his first taste of business by organising music concerts while studying at Delhi's Sriram College of Commerce, which he later expanded into broader event management. He continued with this business on the side even as he was studying at IIM Ahmedabad (batch of 1988). Prakash is an Art of Living follower. He is a frugal man; no executive travels business class in Educomp.

Entrepreneurs before Prakash who had tried to sell digital content to schools had run into a chicken-and-egg wall. Most schools didn't have the hardware (computer servers, networks, flat screen televisions) to play content, nor did they want to invest in setting it up first without having quality content at hand.

Prakash smartly decided to sell the chicken and the egg together. Educomp would offer hardware along with bundled content to schools, which were charged a per child, per month fee of Rs. 75 to Rs. 150. Educomp in most cases recovered the value of its investments in just the second year, leaving pure profits ahead. Today Educomp's pre-tax profit margins on Smart Class revenues are 59 percent.

"Bundling software and hardware together felt radical to many others, but we felt it could become like the Bloomberg of education. We saw a billion dollar product in Smart Class," says Gopal Jain, a partner with private equity firm Gaja Capital Partners which invested in Educomp just after Carlyle's exit. Jain is also on the board of Educomp. Bloomberg gives users customised hardware to access the financial information it provides.

But as his competitors try to replicate his Bloomberg model, Prakash is now upping the ante. Not content with merely helping schools, he now wants to create them too.

Prakash realised that there were still many untapped revenue opportunities



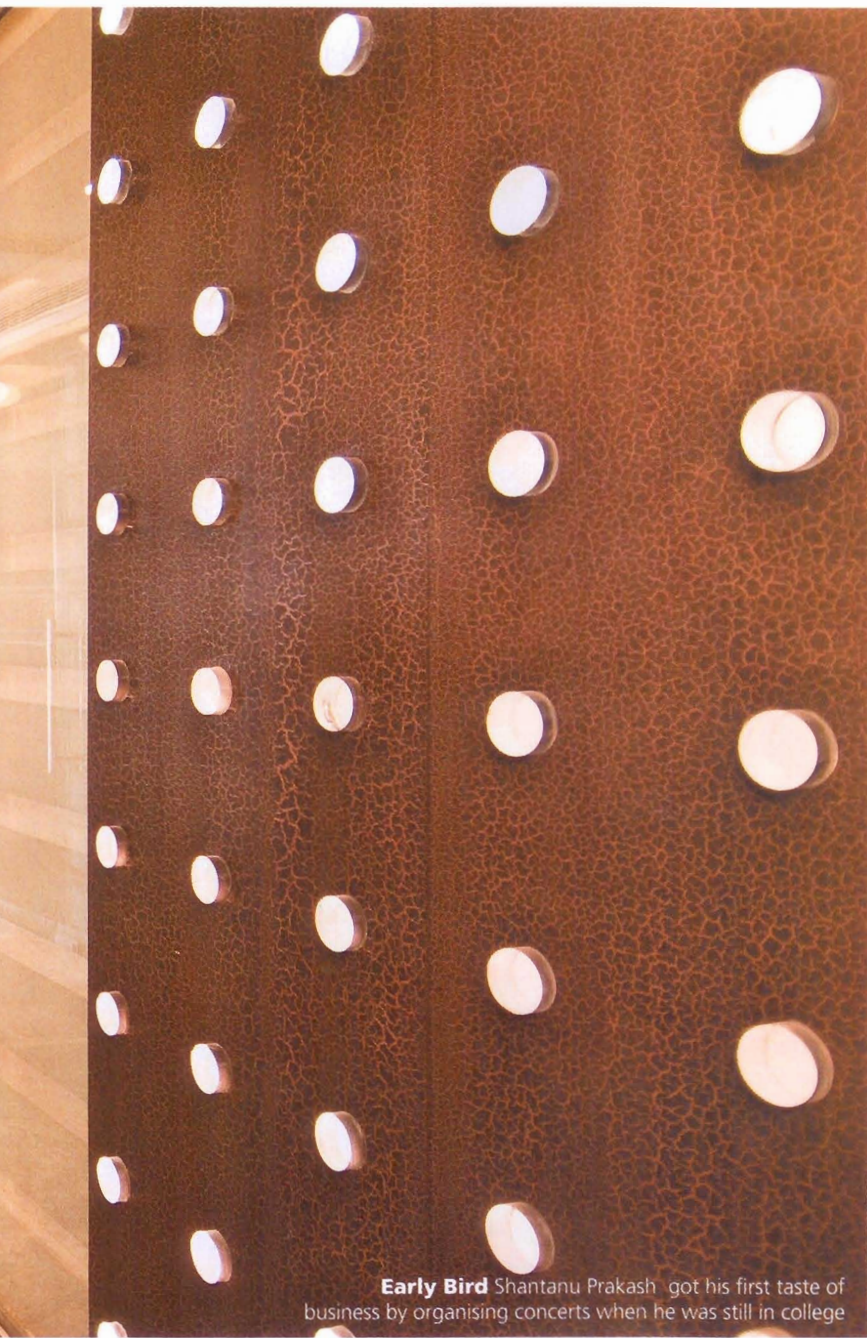
in schools. There are more than 15,000 schools that charge more than Rs. 1,250 per month from a student as fees, according to CLSA. And Prakash was getting a measly Rs. 75-150 of that.

Therefore, for many analysts, Educomp's 2008 announcement about starting its own K12 schools across India was a logical next step.

Today it has 23 schools, and a similar number are in varying stages of construction. "It is undoubtedly the future of Educomp and has a potential to be its Number One business," says Jain.

In most of these schools Educomp sets up a school trust that transfers all profits to a consolidated supplier, Educomp Infrastructure & School Management Ser-

Amit Verma



**Early Bird** Shantanu Prakash got his first taste of business by organising concerts when he was still in college

vices (EISMS), thereby conforming to the “no-profit” rule. EISMS in turn provides literally everything that makes up the school — land, buildings, teachers and other staff, and IT infrastructure. CLSA estimated that each such school could generate a “surplus” of 60 paise for every rupee earned, to be duly transferred to “suppliers” who are allowed profits.

Lucrative as this new model may be, it is also capital intensive with payback periods nearing a decade.

Each school is expected to cost Educomp Rs. 14 crore to set up — and it wants to set up 150 over the next three years. So, as his new child grows hungrier for capital, Prakash is now trying to wean off his grown up ones.

To free up capital from his flagship Smart Class business, which contributes close to half of Educomp’s revenues, Prakash now wants to transfer ownership and management of all new Smart Class contracts to a new company, Edu Smart. Under the new model, when a new Smart Class deal is signed with a school, usually for a period of five years, Edu Smart will offer the five years’ fee receivables as collateral to a bank in return for a discounted loan with interest. It will then pay Educomp roughly 75 percent of the five-year value of the contract up front. For the next five years Edu Smart will collect the monthly fees from the school, using the bulk of it to pay off its bank loan, and the rest for its operational needs.

According to CLSA, Edu Smart will operate at zero profit, though it will be responsible for both service delivery to the school and loan repayment to the bank.

It’s a radical albeit inexplicable model. Why should Edu Smart, an independent company not owned by Educomp, take on this dual burden for zero profit? How will schools react to Educomp palming them off to a new company? How will Educomp monitor or guarantee service levels?

While most analysts were positive about this new model, CLSA strongly questioned if more complexity was being added to Educomp’s business model, and if this was just about transferring financing liabilities off its balance sheet (Educomp offers guarantee to the banks for Edu Smart’s loans.) It is probably to assuage such concerns that Educomp is now planning a major pan-India advertising initiative, its first ever, to position the company favourably to Indian teachers, students, parents, investors and regulators.

“We want to be like the HDFC of education,” says Prakash, possibly implying the same recall or breadth of operations for Educomp in the education sector that HDFC has in the financial sector. Whether he is promising HDFC-like stability and risk-averseness, is another matter altogether ■

*Additional reporting by  
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