How International School Operators Can Navigate Partnerships For Expansion In India

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International school brands are mushrooming across the world. ISC Research, a leading provider of K-12 data, records the number of English-medium international schools as 14,010 in January 2024. While Asia is home to 57% of these international schools, Africa and Latin America are also experiencing strong growth.

For international schools aiming to expand their geographical footprint, there are two main strategies: establishing a separate legal entity in the overseas jurisdiction which will be responsible for establishing the school or partnering with a local entity.

The latter is more common, where the local partner provides the capital, and the international school brand offers its expertise and branding. Under such arrangements, the international school brand is able to reduce some of the risks associated with overseas expansion by focusing on offering various services once the school is established, while the local partner manages permits and regulatory interaction, which it will be better placed to do. Some examples of international school brands partnering with a local entity in India and Southeast Asia include the Wellington, Harrow and Shrewsbury Schools.

Entering into a collaboration agreement is crucial to outline the roles, scope and responsibilities of both parties. In drawing up this agreement, parties must be cognizant of key economic drivers, structural pitfalls and contractual risk mitigation strategies.

Revenue sharing

The intellectual property (IP) and brand of the international school form the bedrock in such collaborations. Valuing this IP is complex, especially in light of asymmetric information about the value of this intangible asset. This often results in an arrangement wherein the local partner pays for the IP as its value is manifested – this is achieved by way of a royalty-based payment structure based on revenue earned by the local partner using such IP.

In essence, royalties are a percentage of revenue paid periodically by a licensee (local partner) to a licensor (international school) for the right to use intellectual property rights. Once the parties agree on such a structure, the collaboration agreement must also provide for when and how such payments are to be made, and what metrics they should be linked to.

Accordingly, characterising ‘revenue’ in such collaborations assumes great importance and must be documented clearly in the agreement. Key considerations include determining the basis for royalty calculation, such as planned capacity vs. actual enrolment at the school, and deductions from revenue for non-academic income; for example, revenue generated in connection with use of school premises for holiday camps and sports academies offered by the local partner.

Moral hazard

In business literature, 'moral hazard' occurs when one party's self-interest leads to actions that contradict the deal's intent, which the other party cannot fully observe or prove a violation of in court. In international school collaborations, since royalty payments can effectively act as a tax on the local partner's revenue, this may lead to undesirable behaviour; for instance, the local partner may seek to increase revenue net of royalty by prioritising a separate partnership or collaboration in which it pays no royalty, or perhaps lower royalty.

One method to mitigate this risk is to structure the deal with an upfront payment in addition to revenue-based royalties. Once this payment is made, it becomes a sunk cost, which no longer influences the local partner's efforts in connection with student enrolments. This also reduces revenue-based royalties, thereby incentivising the local partner to boost enrolments.

Another approach involves implementing verifiable contractual constraints – this often takes the form of exclusivity obligations preventing the local partner from entering into similar arrangements with other school brands. Given that these agreements are typically long-term, the local partner may seek limitations on this exclusivity. It is therefore crucial to clearly define its scope, which can be limited to specific jurisdictions, linked to one or multiple projects, or be made specific to a mode of pedagogy (conventional, online or supplemental).

Lastly, increasing visibility over the local partner's operations can reduce moral hazard. This can be achieved by securing rights to enter the school premises, audit the local partner's books of accounts and seek representation on school-level committees, subject to local law requirements.

Termination

Termination terms are vital for transaction design. Local partners need assurance that they can retain the value of their investment in setting up the school if the deal is terminated.

To balance opposing interests, parties often agree that while the school should stop using the international school's brand upon termination, it should be allowed to continue using IP developed or brought in by the local partner during the collaboration. This should be clearly stated in the agreement, along with an understanding on treatment of derivations of curriculum created by the local partner.

Lastly, a teach-out phase is often included to allow for the continued use of teaching materials and the international school's brand for a limited period if termination occurs during an academic year. This is in the best interest of the enrolled students, as it enables them to complete their course of study even after the agreement comes to an end.

Conclusion

For international schools looking at overseas expansion, partnering with local entities is a viable option, provided that the commercial understanding with respect to key terms, such as revenue sharing, exclusivity and termination, is carefully considered and legislated by way of contract. As this sector continues to grow, these strategies will be crucial in navigating international contracting and maintaining the high standards that parents and students expect from such school brands.

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