

## **A CHAIN OF LOW-COST PRIVATE SCHOOLS FOR THE UK: A DEMONSTRATION MODEL OF THE VIABILITY AND EFFICACY OF FREE MARKETS IN EDUCATION**

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### **Summary**

*Educational standards are too low, especially for the poorest tertile. The IEA proposed free-market solutions, endorsed by the Thatcher government. Yet they floundered, thwarted by vested interests. In part, defenders could offer no evidence of how genuine educational markets work.*

*The proposal here is to get that evidence, to allow governments to revisit educational finance. We create a UK demonstration model of a chain of low-cost private schools, inspired by the ubiquity of private education for the poor in developing countries and success of emerging chains of low-cost schools. These demonstrate attractiveness to investors and educational efficacy to poor parents.*

*Our chain of low-cost schools will charge fees of £2,600 per annum (£50 per week). Household discretionary income data show that this is just about affordable to those at the top of the bottom income tertile. With the simultaneous creation of a scholarship fund, the model becomes affordable to all. Our chain will be attractive to investors and will raise educational outcomes, and hence prosperity, for the poorest tertile. Because it will inspire educational competition and innovation, it will also raise prosperity for the population as a whole.*

### **The problem stated**

Schooling is not good enough for the bottom third in the United Kingdom.<sup>1</sup> Low educational attainment is linked to poverty, so the poorest families are deprived of opportunities that would enhance their prosperity. International tests show poorer students are 'less likely to succeed than their more advantaged peers'. After years of compulsory state schooling, 16 per cent of adults in England are functionally illiterate, predominantly from the lowest tertile. The poor are more likely to attend 'inadequate' schools, reports government inspectorate Ofsted.<sup>2</sup> Something dramatic is needed to solve these problems.

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<sup>1</sup> Different schooling systems apply to the constituent parts of the UK; sometimes we refer to evidence from England only.

<sup>2</sup> PISA (2016), Country Note: UK, Results From PISA 2015, <https://www.oecd.org/pisa/PISA-2015-United-Kingdom.pdf>; Literacy data from [http://www.literacytrust.org.uk/adult\\_literacy/illiterate\\_adults\\_in\\_england](http://www.literacytrust.org.uk/adult_literacy/illiterate_adults_in_england) accessed 07/01/17; Ofsted data from <http://www.telegraph.co.uk/education/2016/08/02/parents-pick-schools-based-on-social-class-depriving-children-of/> (all accessed 7 January 2017).

## Free markets thwarted

These problems are not recent. The IEA's 'impressive academic studies'<sup>3</sup> convinced Rhodes Boyson, who was to become education minister in Thatcher's government, of the need for 'an extension of fee-paying private education'. This required '*either a cutback in taxation and generous scholarships for poorer families, or a state-sponsored voucher system for all*'. While Boyson preferred the first approach, the universal voucher was more politically feasible. In any case, it would be a 'stepping stone' to private education for all.

With the Conservatives in power from 1979, Secretary of State for Education, Sir Keith Joseph, wrote that he was 'intellectually attracted'<sup>4</sup> to educational vouchers. A national petition demanding vouchers strengthened the case. Yet, at the 1983 Party Conference, Sir Keith announced the voucher was 'dead'.

State education's vested interests – the Department of Education, local education authorities and teacher unions – saw only risk. Moreover, they had little understanding of how educational markets work: they argued that the 'ebb-and-flow of pupils' would 'create difficult management and organisational problems for schools', ignoring that this 'ebb-and-flow' of customers is the reality for businesses every day. They could not envisage how private school supply could expand, given that starting new schools 'is a slow, expensive and risky business'.<sup>5</sup>

The IEA brought together a group of academics to respond to the objections. But crucially, they could offer no evidence of the functioning of real markets in education. So the market solution to education floundered in the UK.

The idea faced similar problems in America. Milton Friedman expressed how he had been 'repeatedly frustrated' over 50 years of advocating vouchers, by the 'adamant and effective opposition of trade union leaders and educational administrators to change that would reduce their control of the educational system'.<sup>6</sup> Progress towards Friedman's universal educational voucher has been almost non-existent<sup>7</sup> – nationally less than 1 per cent of American school children use vouchers.

The problem remains to this day. When Michael Gove was Secretary of State for Education, we spoke to him about market-based solutions for educational

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<sup>3</sup> Quotes in this paragraph from: 'Appraisal', Beales, A.C.F., Blaug, M., Veale, D. and West, E.G. ([1967] 1970) in *Education: A Framework for Choice. Papers on Historical, Economic and Administrative Aspects of Choice in Education and its Finance*, London: Institute of Economic Affairs, p. xiv- xv.

<sup>4</sup> Citations in this paragraph from Seldon, A. (1986) *Capitalism*, Cambridge, Mass., p. 14, p. 36, p. 14, p. 15.

<sup>5</sup> Citations in this paragraph from Seldon, A. (1986), p. 39, p. 38.

<sup>6</sup> Friedman, M. (2006a) 'Prologue: A personal retrospective', in Enlow, R. C. and Ealy L. T. (eds), *Liberty and Learning: Milton Friedman's Voucher Idea at Fifty*, Washington DC: Cato Institute, p. ix.

<sup>7</sup> Some examples (not what Friedman would fully endorse) of universal voucher programmes have been implemented in two countries – Chile and Sweden – but both of these came about because of very particular political circumstances (General Pinochet in Chile, and a peculiar conflation of social democrat forces in Sweden), which are unlikely to be repeated anywhere else.

improvement. He raised the same objection: without demonstration models of markets in education, he could not contemplate political reform.

Education thus remains an area where the economic free-market revolution has had zero impact.

## **Just do it**

The proposed solution will change that. We will ignore the political roadblocks and create a chain of low-cost private schools to demonstrate what a free market in education can do.

By creating a chain of low-cost, high quality private schools, within reach of those in the bottom third of family income in the UK, we will do three things. First, we will provide a demonstration model to show how the poorest wish to access private schools and that shows the private sector able and willing to respond to demand.

Second, we will provide data showing how the private school chain raises educational outcomes compared to the state sector. (Both of these are needed to push government to revisit its educational financing model).

Third, the private school chain itself will inspire competitors to enter the market, which in itself will bring down costs, so making educational opportunities even more affordable. Private educational opportunities can therefore expand of their own accord and bring innovation and competition into the education sector, for the benefit of all.

## **The inspiration**

In a competition ten years ago, the prize-winning essay revealed the extraordinary revolution of low-cost private schools in developing countries.<sup>8</sup> Poor parents do not acquiesce in the mediocrity of government schools, where research shows teachers teach only 50 per cent of the time. In urban areas of Africa and South Asia, 70 per cent or more of children use private education, including in the poorest slums. In poor rural areas, the figure is 30 per cent. Testing random samples of children, controlling for background variables, research shows how children in low-cost private schools significantly outperform those in government schools. Moreover, private schools are affordable to those on the poverty line.<sup>9</sup>

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<sup>8</sup> Gold Prize winner, 2006 IFC/*Financial Times* private sector development prize competition, published as Tooley, J. (2007) 'Educating Amarech: private schools for the poor and the new frontier for investors', *Economic Affairs*, 27(2): 37-43.

<sup>9</sup> See Tooley, J. (2009) *The Beautiful Tree: A personal journey into how the world's poorest people are educating themselves*, Washington DC: Cato Institute; Tooley, J. (2016) 'Extending access to low-cost private schools through vouchers: an alternative interpretation of a two-stage "School Choice" experiment in India', *Oxford Review of Education*, DOI: 10.1080/03054985.2016.1217689; Tooley, J. and Longfield, D. (2016) 'Affordability of Private Schools: Exploration of a conundrum and towards a definition of "Low-cost"', *Oxford Review of Education*, 42(4): 444-459.

The prize-winning essay introduced the idea of *chains* of low-cost private schools. An American entrepreneur, duly inspired, co-founded Bridge International Academies.<sup>10</sup> This opened its first schools in 2009 and is now the largest chain of schools in the world, with 200,000 children in schools across Kenya, Uganda, Nigeria, Liberia and India. Investors include Bill Gates and Mark Zuckerberg. A more modest chain, Omega Schools, backed by Pearson, was founded at the same time, now with 60 schools in Ghana and Liberia. These chains have proven the free-market model for bringing higher standards to the poor at an affordable price. They've also inspired competition: there is frequently news of some entrepreneur setting up similar chains in Africa, Asia or Latin America.

Within a decade of the first introduction of the idea, it has become a proven concept. International agencies, governments and philanthropists, inspired by what they see, are revisiting the role of government in education: for instance, students in schools run by Bridge and Omega in Liberia are funded through an innovative voucher-like mechanism. Crucially, governments and international agencies did not have to be persuaded first; they were convinced by what they saw working. The same can happen in the UK.

Readers may be impatient: it's all very well to think of low-cost private schools in the slums of India or Africa, because there all costs are low. But obviously we can't do the same here: everything would be far too expensive.

Actually, we can.

## **Low-cost in the UK**

UK private school fees average £15,500 per annum,<sup>11</sup> obviously out of reach for low-income families.

However, a rule of thumb in private primary education – interestingly applicable to low-cost private schools in Africa *and* high-fee schools in the UK – is as follows: Take the annual teacher cost to the employer and multiply by three. Divide by the number of pupils in the class. This gives the likely annual fee for that class.<sup>12</sup> So in a UK independent school, the teacher cost to an employer might be £45,000. Multiplying by three (£135,000), then dividing by 9 (the average class size in posh independent schools<sup>13</sup>) gives fees of £15,000 per annum, a typical figure.

But we don't need to follow that model. In our low-cost school, we would employ fresh, new and so lower-paid teachers. We would have larger class sizes, beneficial

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<sup>10</sup> <http://www.bridgeinternationalacademies.com/> (accessed 7 January 2017).

<sup>11</sup> <http://www.independent.co.uk/news/uk/home-news/the-charts-that-shows-how-private-school-fees-have-exploded-a7023056.html> (accessed 7 January 2017).

<sup>12</sup> This works because the teacher cost for each class comes to one third of the total income for that class. The other two-thirds go on overheads (including the headteacher and bursar), scholarships and surplus. In a well-functioning, mature school, it might be expected that one third goes on overheads and the other third on surplus.

<sup>13</sup> <http://www.hmc.org.uk/about-hmc/why-choose-a-hmc-school/smaller-class-sizes/> (accessed 7 January 2017).

in our 'blended learning' model – where a judicious mix of teachers, technology and peer learning ensures high academic quality. (Class size has been shown to be an educational fad in any case, not related to academic achievement until some large maximum is reached).<sup>14</sup>

An average annual teacher cost to the employer could be around £26,000. Multiplying by three (£78,000) and dividing by 30 gives a school fee of £2,600 per annum, exactly £50 per week spread over the full year.

We've developed a business model for this fee-level school and tested assumptions with some UK private school providers. It's viable. A school with 120 children and 4 classes, could return a surplus when full (after 4-5 years) of around £78,000 per annum.<sup>15</sup> Some of this surplus could be returned as scholarships for the poorest.

The investment required would be a maximum of £150,000: because we envisage renting buildings, this money is for furniture and fittings, learning technology, books, refurbishment to quality school standards, and working capital to fund losses until break even.

As a stand-alone school it's an attractive enough investment proposition. It is very attractive indeed if you think of a chain of, say, 50 of these schools. This would require an efficient head office, for teacher recruitment, training and mentoring, quality control and curriculum development, as well as strategic development. Our model shows that such a chain would require an investment of around £8 million, and return around £3.2 million per annum once at capacity.<sup>16</sup> This essay is not primarily aimed at investors, so we won't go into further detail here: the point is that the business is financially interesting even with school fees of only £2,600 per annum.

Why are existing private school fees so much higher? Many private schools offer scholarships, so high fees can be a form of cross-subsidy. But prices are also driven up by expensive-to-maintain ancient buildings, Olympic-standard swimming pools, planetariums and other fripperies, not forgetting non-profit directors' expenses.

But let me emphasise: low-cost does not mean low quality. Our private schools charging £2,600 per annum will be 'low frills', but they will be of high educational quality. We'll cut costs by renting buildings and sports facilities. We'll employ good, less expensive, new teachers and supplement their abilities with a powerful educational model and supportive team. We'll teach English using phonics, to ensure that all children learn to read. We'll teach mathematics to mastery, using software

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<sup>14</sup> See Greene, J. P. (2005) *Education Myths: What special-interest groups want you to believe about our schools – and why it isn't so*, Oxford: Rowman and Littlefield; Hoxby, C. M. (2000) 'The effects of class size on student achievement: new evidence from population variation', *Quarterly Journal of Economics*, 115(4): 1239-1285.

<sup>15</sup> The financial model shows fee income of £312,000 per annum. Four teachers cost £104,000 per annum. Additional costs are £130,000 per annum, leaving a surplus of £78,000 per annum, i.e. 25 per cent of income.

<sup>16</sup> Head office salaries and overheads require around £700,000 per annum, the surplus from 9 schools. In a chain of 50 schools operating at capacity, the remaining 41 provide the chain's surplus. At around £78,000 per school, this brings around £3.2 million. The investment for the schools requires 50 times £150,000, plus around £500,000 for head office investment, a total of £8 million.

where appropriate to ensure all children advance. And we'll emphasise good discipline, as requested by poor parents.

## **Better outcomes**

Given that there are no data on low-cost private school performance in developed countries, we need to look to evidence elsewhere. We believe that the educational and social impact of the chain of schools will be the same as that found in developing countries. There, children in low-cost private schools dramatically outperform children from the same socio-economic groups in government schools, in key subjects such as mathematics and English. As children perform better, so they are able to access further education or employment more readily or better create business opportunities themselves. Low-cost private education in developing countries leads to improved prosperity for those in the bottom quintile.<sup>17</sup>

We can assume that the impact will be similar here. What causes the improvements overseas is that all incentives are properly aligned; the same will be true here. Parents will be paying fees (in full or in part), so will have skin in the game, demanding the best for their children. Teachers will know that their jobs depend upon delivering high quality outcomes and they will not be able to hide behind excuses; parents will not tolerate low ambitions/aspirations. The company too will know that it can only flourish if its children succeed, retaining parents and attracting more. With all incentives in the right direction, there is every reason to assume educational outcomes will also be better than in government schools, just as in the developing world.

## **Affordability**

Alongside the creation of the chain of low-cost private schools, we'll also be raising philanthropic funds for scholarships, in full or in part, as part of a voucher demonstration model, so it is hoped there will be a significant sliding subsidy for students, carefully administered to minimise moral hazard. But, pushing the model to the limit, could those in the bottom third of the population afford the required £50 per week on private education?

Usefully, there is data on UK family *discretionary* income,<sup>18</sup> the amount families have left after paying for all necessities. The necessities include food, clothing, housing, utilities, transport, communication, health, *as well as costs for children's schooling* such as uniform, books and transport to school. (So when we consider discretionary income available for school fees, we know that families are also able to afford schooling's additional costs).

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<sup>17</sup> See references in footnote 9.

<sup>18</sup> Not to be confused with family *disposable* income, which takes gross family income and subtracts (or adds) taxes (or tax credits).

Using figures provided by the Centre for Economics and Business Research,<sup>19</sup> we see that an average family at the cut-off point of the bottom third of income, with an average number of children, is likely to have up to £72 per child per week available to them as discretionary income.<sup>20</sup>

So, if we were unable to raise *any* philanthropic funds to subsidise school fees, then a family at the top end of the bottom third of income – still some of the poorest people in the UK – would just about be able to afford the required £50 per week per child.

Of course for such families, this will mean cutting back on things such as ‘holidays, cinema, eating out, toys, sports’, and ‘national lottery and other gambling’ (but not alcohol, as this is included in necessities). In developing countries, it is reported how families scrimp and save to afford private education, and many don’t see this kind of self-help as undesirable. If families in the UK so favour private education that they are willing to apportion their income in the way proposed, then we don’t believe judgement should be passed on their choices. The degree to which these fees can be made more affordable to those in the lowest third will depend on how much can be raised in the scholarship fund. To demonstrate the model properly, we need investment and philanthropic funds alongside.

## **A modest proposal**

We can create a low-cost private school in the UK for £2,600 per annum, or £50 per week. This is (just about) affordable to families at the top of the bottom third, and can be made affordable to the poorest of the poor with a scholarship fund.

We will start with one pilot school, probably in the north-east of England, marketed to target communities. There is no suggestion that this will be easy – parents in England, unlike those in sub-Saharan Africa and South Asia, take it for granted that state education should be provided free. But we are heartened by high dissatisfaction we’ve found in small-scale studies amongst disadvantaged populations in the North-East, where 80 per cent said they would prefer private school if they could afford it and 20 per cent of parents said that they might be able to afford £50 per week.

We need only a few parents to get started, as operational losses for the first two years are built into the model. A few parents reporting back to their communities the success of the new schools, and further intensive marketing, will lead to slow growth of the first school. Marketing will become easier, although never easy.

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<sup>19</sup> Centre for Economics and Business Research (2016), Asda Income Tracker (report: December 2015, released: January 2016), London: CEBR.

<sup>20</sup> For the latest year (2015) the average family had £194 per week discretionary income. The average number of children per family is 1.8 – for simplicity we assume that this is also the average number of school-aged children. Then the average available per child is £194/1.8, or £108. We can estimate that families at the bottom third of income cut off point will be at two-thirds of £108, that is, £72 per child per week. Even if there are errors in our assumptions, there is still enough margin of error to make our schools affordable.

Meanwhile, we finalise our business plan to raise the significant investment for the chain of schools, and simultaneously raise the scholarship fund. After one year, we open a second school, and after two years, another five schools. In three years, if all goes to plan, we could expand to 20 schools, and in five years to 50 schools. This is how the African chains of schools expanded, and there seems no reason why we can't emulate that here.

Early on, we'll go after significant publicity. With *The Sun* or the *Daily Mail* onside, we'll convey the miracle of low-cost private schools, operating at less than half the cost of state education, better serving low-income communities than the government alternative. Through such publicity, government can be encouraged to revisit the issue of financing education. Why not allow vouchers to parents, so that they can make the educational choices they prefer?

Inspired by the publicity and our success, other entrepreneurs will enter this market, just as is happening in developing countries. Competition will lead to further innovation and some chain will no doubt bring fees lower than £50 per week. Soon, a competitive market in low-cost private education will emerge. Notice how a further advantage of our model now emerges, extending the benefits not only to the lower tertile: because of education's important role in the economy, an improved education system – improved because of innovation and competition from the private sector – can lead to economic improvements to the economy as a whole.

### **Towards free-market education**

For those who believe in free markets, it's an anomaly that education – so important for societies to function and for individuals to flourish – is firmly under state control, finance and provision. Creating a chain of low-cost, high-quality private schools, affordable to those in the lowest third, that will stimulate competition in the sector, and which will encourage government to revisit educational financing, is a compelling route to improve the lot of the poorest in this country.

State education systems are harmful, delivering poor quality and low expectations. But the proposed solution does not require any political change at first. Politicians, constrained as they are by the tyranny of the thinkable, do not have to be persuaded of any arguments here. When there is a critical mass of people ready for change, then politicians can act in complete safety.

Let politicians huff and puff about their essential role in education; they'll be huffing and puffing to catch up with us when they realise the world has moved on to its private future.