Prodigy Finance: Pioneering Community-Based Student Finance

"Lehman Brothers, the 4th largest US investment bank, has filed for bankruptcy protection, dealing a blow to the fragile global financial system." It was 16th September 2008. As the words scrolled across the TV screen on the BBC channel, Cameron Stevens saw everything he had worked for starting to slip away. A year prior, he had founded Prodigy Finance (Prodigy) with Miha Zerko and Ryan Steele, aiming to provide student loans exclusively to international postgraduate students attending the world's top-ranked business schools and universities, who have difficulty accessing loans from traditional lenders. The company had spent a year, and considerable funds, developing the risk assessment algorithm and legal enforceability model to offer borderless loans at a competitive interest rate. With the collapse of the banking system, the main source of investment money was in jeopardy.

Cameron had been in talks with Barclays in London to provide the initial loan base. The bank was so enthused at the pitch Prodigy offered, it had convened a weekend-long meeting over 14th-15th September to iron out the terms of their investment. As events turned out, by the next week's end, the team that was working with Prodigy no longer existed.

As the founding team reconvened, it was obvious that the already innovative model was going to have to go one step further; the company needed to find people willing to invest money for international student loans, using a pioneering and proprietary algorithm, while the global financial system was crumbling around them. It was time to get to work.

THE BIRTH OF A COMPANY

Prodigy Finance was born at Brussels' Bar one sunny August afternoon in Fontainebleau, France. It was 2005, and Cameron and Miha were lamenting over a beer about the challenge they and their classmates had financing business school at INSEAD. Credit ratings are used by most lending bodies to assess individuals' credit worthiness, and to evaluate their ability to pay back the debt and the potential risk of default on a loan. Lenders also use credit scores to determine credit limits, interest rates, and shortlist individuals that qualify for a loan. As regulations vary from country to country regarding credit reporting and usage of information, the system works well for people inside their home country, where they can build up a credit history that will indicate to lenders the risk that an individual will fail to repay. However, for those who move internationally for school, work, or other reasons, their credit history does not and cannot follow them. Expats who, in their home countries, are low risk for lenders are typically unable to access credit after moving abroad.

To make matters worse, institutional lenders' risk models look only at past repayment – via the credit report – and other factors such as current salary, family situation, residence status, etc., to determine the risk profile of borrowers. This makes borrowing particularly burdensome for international students, as they have neither a credit history in the country in which they are relocating to advance their studies nor a current salary. The dual challenge of being students and being abroad lead to a dearth of finance options, and those that do exist often have prohibitively high interest rates. Every year, brilliant and qualified students are unable to attend top-tier schools to which they are admitted only because no one will lend them the money they need to pay for tuition and living expenses.

Research Associate Adam Storck prepared this case under the supervision of the Skoll Centre for Social Entrepreneurship at the University of Oxford, Said Business School. This case was developed from published sources and interviews, solely for the basis of discussion at the 2016 Skoll Social Innovation Case Competition. Case is not intended to serve as endorsement, source of primary data, or illustration of effective or ineffective management.

This problem is further exacerbated for students from emerging markets, who have assets and earnings in soft currencies, yet need to budget for tuition and living expenses in hard currencies. This is a particular problem at INSEAD, where close to 70 percent of the 1000 students in each class come from outside North Western Europe and North America, with 78 different nationalities represented. These students only had three options: self-fund from family, friends, and personal savings, sell or dispose any existent assets, or borrow at usurious rates from banks in their home countries and eat the costs of foreign exchange rates and fees. For many students these options were not enough.

Cameron and Miha knew there had to be a better way. Their classmates were ideal candidates for low interest loans. They were successful prior to acceptance at INSEAD, and most had exceptional credit track-record in their home countries. They were brilliant and motivated. They were among the best in the world within their respective fields. And they were likely to double their previous salary – or more – after they finished their MBA. From the standpoint of a lender, they were the safest category of student, and were safer than many other borrowers based on future earning potential alone. The problem lay only in the assessment metrics and process used by traditional lenders. The solution was to transform the way financial institutions assess risk.

A COMPANY DEVELOPS

From the outset, Cameron saw Prodigy as a social impact company. Going to a top university was life-changing, and Cameron believed to his core that experience should be open to all, regardless of financial ability. By lending primarily to the future leaders of economic, political, social, and cultural institutions in both developed and emerging countries, Prodigy could contribute to growth and development around the world. That ethos is still imbued in the company's fibre, with 82 percent of student borrowers saying they had no alternative funding options, with more than 75 percent of loans going to students from emerging markets - 66 percent of whom return home after graduation - and with 34 percent of student borrowers coming from BRIC countries.

These students, who otherwise would not have access to finance, are able to dramatically improve their skills, knowledge, and networks, and take those back home to aid their countries of origin. Even those who don't return home immediately after graduation typically end up having higher wages, and thus can infuse more cash back in to their home economies through remittances and investment. And many do eventually return home, but now with several years' work experience at some of the world's top banks, consulting agencies, and companies. The fact that there was impact was clear to the founders. What specifically it was, or should be, was less clear.

Beyond social impact, two far more practical elements dominated the early model development: risk identification and legal enforceability. The risk algorithm had to be borderless, essentially able to tap in to the home credit history that an applicant had amassed no matter which country he or she had applied from. It also had to take into account future earning potential post-MBA, which required careers data inputs from each university incorporated into the platform. Last, and most difficult, the application had to be online, and be able to offer a loan conditional offer within five days. Ryan, initially constructed the algorithm. Miha, as the IT expert on the team, then worked closely with an outsourced development team developing and rewriting the algorithm to ensure its proper function. In 2007, many of the required systems that the platform needed to function effectively were not widespread. The team had to develop capacity to authenticate digital messages and documents to speed the approval period, and backup documentation from the applicant needed to be digitally identified, sorted, and stored in a highly secured systems. Everything had to run, and run correctly, every time without any intervention. A tall order was made even more challenging, as since the requirements were shifting rapidly as the company grew and developed. It took months of hard work, but the site was finally ready for a pilot with the INSEAD class of 2008.

Legal enforceability was the keystone to reducing risk. This was a major factor in traditional lenders' reticence to expand to international student loans: if a borrower refused to pay the loan back, what recourse did the lenders have? If anything constituted the biggest existential threat to the young company, this was it. Cameron worked closely for months with a legal team, and eventually developed a model that allowed Prodigy to enforce repayment and collections of loans in 150 countries around the world. The company had a risk assessment model and it had legal enforceability. Now it only needed investors.

Despite the progress the founders had made, in September, 2008, the prospects looked bleak. The Barclays team that Cameron had worked with so diligently had folded. The global financial markets were in crisis. The founding team was spread thin, trying to make a living at the same time they were trying to start a company. It looked like the end. But the team would not let Prodigy die without a fight. So they met at a pub, to the place where Prodigy was born, in a desperate attempt to revive it. The model had to change – or at least the investment source did; they needed people with available money who understood the funding plight MBA students faced. Suddenly inspiration struck: alumni.

In 2008, crowdfunding platforms were virtually non-existent. Kickstarter, a US-based global crowdfunding platform, wouldn't launch for another year. And yet, here was an upstart financial firm talking seriously about crowdfunding large-scale investment to provide student loans in the middle of a financial crisis. Surely they were crazy. Reflecting on it later, Cameron would say "it was not rational; it was definitely not intelligent. I'm not sure that even now I would advise someone else to keep going at that point." But keep going they did.

A NEW MODEL EMERGES

Prodigy needed access to INSEAD alumni who might be willing to invest in loans. The school's development office was reticent – a trend that would manifest each time the company expanded to a new school. Key help came from Michael Ullmann, an INSEAD Professor who was an advisor to the founders in the early development stages and who stayed on as Chairman.

Michael had been a serial entrepreneur for 20 years, supporting more than 40 different entrepreneurial businesses, by the time he came across Prodigy at a business plan competition in which Prodigy earned a well respected 2nd place. The company intrigued him. A few years before, while a fellow at St. Catherine's college at University of Oxford, Michael had been approached by a business development team from First Marblehead, a US provider of private student loan solutions for lenders, credit unions, and schools, which was looking to expand to the UK undergraduate student lending market. This experience showed him the size of the market. He believed that with the right model, there was a great opportunity to tap in the sector, and especially so with MBAs since their maturity and likelihood of doubling their salary after graduation made them a far less risky class.

Prodigy's model might be the breakthrough to upend the global education lending credit system, and Michael wanted to help the company do just that. He also had access to alumni. For many years, with a group of other alumni, Michael had invested in companies led by INSEAD MBAs, including Active Hotels, Green & Blacks, The Paris Real Ale Company, and i2o. Now was time to tap in to that network once again. Cameron had already secured a commitment from the first investor, Michael Butt, another alumnus of INSEAD and a long time supporter of the school. With the momentum of the first two underway, six additional wealthy alumni invested collectively €750,000, giving the company enough firepower to lend to 30 students, and inadvertently creating a core element that has set Prodigy apart as a lender: the community *(see Exhibit A)*.

Traditional lending and investment is relatively faceless. Borrowers apply for loans from institutions; investors buy financial instruments. Borrowers rarely, if ever, know whose money they are using. Prodigy would be different. Investors invest in education bonds that are tied to a specific class at a specific school – the 2015-2016 University of Oxford, Said Business School bond, for example – and as part of their investor package they are able to see the students receiving a Prodigy loan, as well as their repayment status. The transparency and community enforcement has a dual purpose. First, it makes the process more personal, both for the investors who can see the tremendous social impact their investment has for borrowers and for borrowers who know the money for their loans are from people previously in their shoes. Second, it creates an additional incentive for borrowers to repay in full and on time as it is no longer just about repaying their debt, but also about maintaining relationships with influential alumni. Layered on top of this, Prodigy works with schools to restrict access to alumni benefits – i.e. careers services, alumni events, etc. – for borrowers who are delinquent in their repayments.

The human aspect and community feel is integrated in to borrowers' relationship with Prodigy as well. The company has an interest in helping students repay, and on a case by case basis, has revised repayment terms for borrowers facing challenges finding employment after their studies. As part of the company's commitment to impact, it may consider flexible repayment terms for borrowers who work for non-profits or social enterprises, and is attempting to start a loan forgiveness programme specifically aimed at borrowers from low-income countries who return home to start businesses or work in the social or public sector. This community focussed lending dynamic has helped Prodigy attain repayment rates well above those projected by traditional lenders and historic industry standards. Prodigy currently has a 99 percent performing loan book over its nine-year lending history; less than 1 percent cumulative default rate.

A SPECIAL RELATIONSHIP WITH INSEAD

Prodigy's model was a potential winner, but without support, and the ability to overcome the myriad hurdles that the company encountered along the way, it would have failed. INSEAD, in many ways, was the perfect breeding grounds for a company like Prodigy.

Perennially among the top European business schools in the rankings, it attracted the calibre of people who could go to transform their home countries for the better. It also was one of the first truly multi-cultural business schools. The curriculum, which allows to split time between campuses in France and Singapore, attracted an incredibly diverse class profile, and its success with international recruitment influenced other European schools to expand theirs. The numbers speak for themselves: more than 78 nationalities represented in each class, and less than 25 percent of the class coming from any individual region. This was a school where the majority of the class would struggle to find traditional lenders to fund their education, and by a wide margin. The administration knew they were missing out on talent every year because of the funding barrier, so when Prodigy emerged, it was quickly receptive to the idea.

Receptive did not mean cavalier. Cameron credits the school's due diligence process for Prodigy's future success. INSEAD hired Aon to critically assess Prodigy's risk screening and management model, putting it through the highest quality stress tests on offer. It also was deliberate about validating the legal enforceability and helping test the flow of funds. "They put us through the ringer" says Cameron, but once INSEAD signed on officially, the company knew it had a model that would be accepted by any top-tier university in the world.

The challenge then lay in accessing alumni networks to find investors. INSEAD's development office closely held alumni contact information, but it refused to allow Prodigy access. In the mind of the development team, Prodigy's ask to alumni for investment in INSEAD students would cannibalise donors, who would then prefer to invest money and receive a return, rather than giving with no financial return. Prodigy's stance was that it was not competing with the donation pool, but with other investments alumni were making across their financial options, such as in mutual funds, stocks, and corporate bonds. However, without support from the development office, Prodigy was once again forced to overcome a hurdle.

Through those initial connections, Prodigy was able to access enough alumni investment to get started, and based on early successes, eventually attracted larger investments from more alumni. Over time Prodigy has shown that contrary to the fears of the development office, alumni donation among investors has actually increased. For example, one early Prodigy investor had at one time said he would never donate to INSEAD; he gave €5,000 in 2015. The company credits the community-focussed nature of the investment scheme with producing this positive impact, as it develops an additional relationship with the school, and investors have an added interest in upholding the quality of education at their alma mater.

GROWTH

Expansion was always part of the plan for Prodigy. As the model became settled at INSEAD, the founding team began exploring the next target schools. It knew it wanted to focus on the Financial Times top 100 schools to have the greatest impact, and to ensure the highest likelihood of repayment. The first expansion happened almost organically. A buzz from success at INSEAD started to spread, Vlerick Business School in Ghent, Belgium approached Prodigy to develop a relationship. The school, ranked by the Financial Times at 97 in 2008, just fit in the category Prodigy wanted to serve. And it was willing to co-finance the investment with University-own funds, making it an easy expansion option, and Vlerick was brought on that year. Meanwhile, the company had bigger plans.

The UK schools were among the most alluring targets. The big three – Said Business School at University of Oxford, Judge Business School at Cambridge University, and London Business School – had strong alumni bases and a large international presence. As Prodigy was registered and licensed in the UK, both international and British nationals were eligible to apply for a loan with Prodigy Finance.

University of Oxford's Said Business School was particularly intrigued by the opportunity that Prodigy presented. The relationship building was slow at first, but when Peter Tufano took over as Dean of the school, the process accelerated. Dean Tufano had previously been a finance professor at Harvard Business School, and had an interest in financial innovation that opened up inclusion in the financial markets to the underserved. The company's stated focus on social impact through providing access to education also fit well with the social impact ethos that ran through the fibre of the school.

The process of on boarding new schools varied in difficulty. Some already had schemes in place to help fund international students. For instance, London Business School had negotiated with HSBC to make available £100 million in debt for student loans. Other schools took on the role of guarantor for international students' loans, transferring the risk of default from the bank to the institution. Others simply went without providing any form of assistance for student borrowers. In all cases, Prodigy offered an improved option that de-risked the loan process, ensured top talent could still afford to attend while maintaining a thorough credit check, and increased the diversity and competitiveness for schools.

In 2012, four business schools signed up to offer loans with Prodigy to incoming students, including University of Oxford's Said Business School and London Business School. The first American schools, Columbia Business School and the University of Michigan's Ross School of Business, would agree to partner in 2013. Prodigy was seeing steady and encouraging growth, bringing on three to four schools per year between 2012 and 2014. However, another barrier to the company's ultimate goal - to be the lender of choice for students at the Financial Times top-100 business schools - was rearing up: lack of growth capital to expand.

THE FUTURE

Prodigy needed a large infusion of cash to dramatically expand the number of schools it served. Unfortunately, its model of investment by alumni created a barrier – investor acquisition was a time consuming process and had to be developed from the bottom-up and re-engaged with each new school. Prodigy did not have connections to a large pool of high net worth investors to which it could appeal directly. The only way to access one was to tap into a new network.

By 2014, as it engaged the search for a partner investor, Prodigy had amassed a history of excellent operations. Its performing loan book was more than 99 percent. With no early repayment penalties, the average weighted life of a loan was 4.4 years meaning borrowers were paying back loans early, which indicated that borrowers were more than able to repay in full. And it had successfully prosecuted a case to enforce repayment from a delinquent borrower in India, proving the global enforceability of its loans. The best option the company had for a partner emerged in the form of the impact investment team at Credit Suisse. But to solidify the deal, Prodigy had to figure out how to tell the story of its social impact.

THE POTENTIAL FOR SOCIAL IMPACT

The founding team was comfortable with an unstructured impact in the beginning. Cameron saw boxing certain metrics up front as an artificial constraint that could hinder the company's ability to grow and scale. He wanted to make sure the company could scale first, since a company's impact is limited to the scale at which it operates, and so deliberately did not establish key impact targets or performance indicators. He felt it was better to wait until the company had scaled effectively, and only then assess its actual impact. If a company had impact, creating a truly global win-win opportunity to enhance access to world-class education, and establishing a virtuous cycle at its core, then it would scale into a company that still had positive social impact.

Prodigy knew that it was providing finance to people who had limited alternative funding options: 82 percent of loan recipients fell into that category. It also knew that more than 75 percent of the students it served were from emerging economies. These were all qualified individuals who received world class business educations that they could then deploy for good in the world *(see Exhibit B)*. Similarly, Prodigy bonds were perceived as smart and ethical investments.

Unfortunately, the extent of the impact to borrowers is difficult to know. Some measures, like the percentage of borrowers who returned to their home country, were reasonable quantifications, but didn't tell the whole story; those that worked for a few years elsewhere provided avenues to access capital and remittance money, and many later returned home with a broader knowledge base. Other measures, like the economic impact that an MBA returning home had on her community, were almost impossible to reasonably assess.

Yet, Prodigy certainly had an impact, and the talks with Credit Suisse pushed forward the issue of communicating that impact to the fore. Prodigy had to be able to prove enough to qualify as a social impact firm in the eyes of the bank. The data was thin, but Prodigy had plenty of stories. Stories from borrowers like the Zimbabwean in the first class of recipients, who had fought through several hurdles just to get accepted to INSEAD, and wouldn't have been able to attend but for a loan from Prodigy. She brought a strong vision for what she wanted to do to help Zimbabwe develop, and her place in making it happen. After the MBA, she went back home and put her education to use. Abundant qualitative stories like this prevailed, except the growing social impact industry prioritised quantitative measurement and key performance indicators (KPIs), and Prodigy was short on those. The team was confronted by a series of questions it had to answer as it looked to impact investors to help fund the company's growth aspirations.

FRAMING QUESTIONS

- The for-profit social impact industry has several different definitions, and a spectrum exists from full-fledged social enterprise (impact-led) to businesses that create impact as a consequence of making money (profit-led). Where on the spectrum does Prodigy fall and how does that affect the way it should approach impact definition and measurement?
- What social impact key performance indicators should Prodigy be measuring and tracking?
- What measures should Prodigy implement to accurately reflect social impact across the ***whole*** value chain (from capital raising to loan repayment)?
- What actions should Prodigy take to measure the impact of lending to talented students who otherwise would not have access to finance their postgraduate studies?
- How do you measure the impact that globally-exposed talented minds have on their communities?
- Can providing only student loans to postgraduate students be financially viable in the long-run, and actually make the firm truly scalable? If not, how could Prodigy grow into a $10B company?
- As Prodigy expands beyond Europe and into the US, what are the key challenges and opportunities the company will face? How should this new market entry be managed? How and what type of capital should attract?
- How do you balance expanding into adjacencies with even more impact (e.g. low income students in domestic emerging markets) with the need to remain focused on the core model? What is the best model to expand into them?

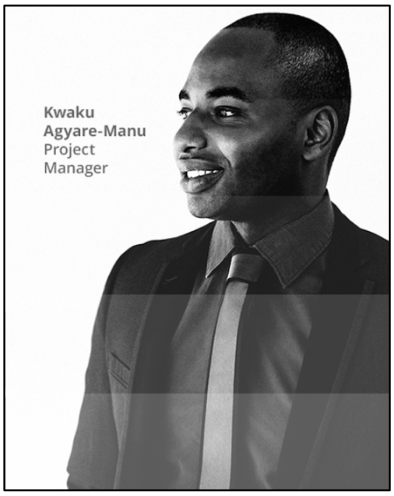
EXHIBITS

Exhibit A: Prodigy community includes alumni that invest in a listed bond that funds a class of students.

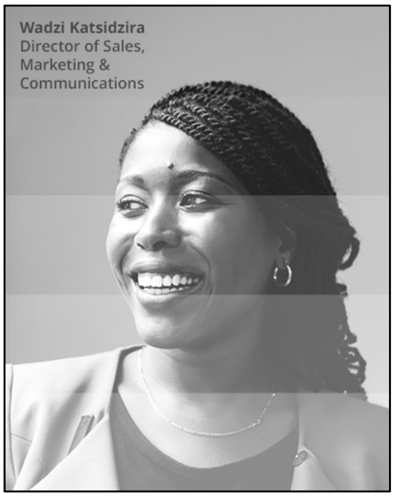
Source: Prodigy Finance

Exhibit B: Prodigy's borrowers are future leaders from diverse countries.

Name: Emma Buckland,
School: Cranfield School of Management
Course: MBA 2013
Nationality: United Kingdom
Post-MBA Job: Operations Director, FICO



Name: Kwaku Agyare-Manu
School: UCT Graduate School of Business
Course: MBA 2015
Nationality (Dual): Ghana & South Africa
Post-MBA Job: Project Manager focused on infrastructure, mining and water projects.



Name: Wadzi Katsidzira
School: INSEAD
Course: MBA 2012D
Nationality (Dual): Zimbabwe & Australia
Post-MBA Job: Director of Sales, Marketing & Communication, African Leadership Academy

Source: Prodigy Finance