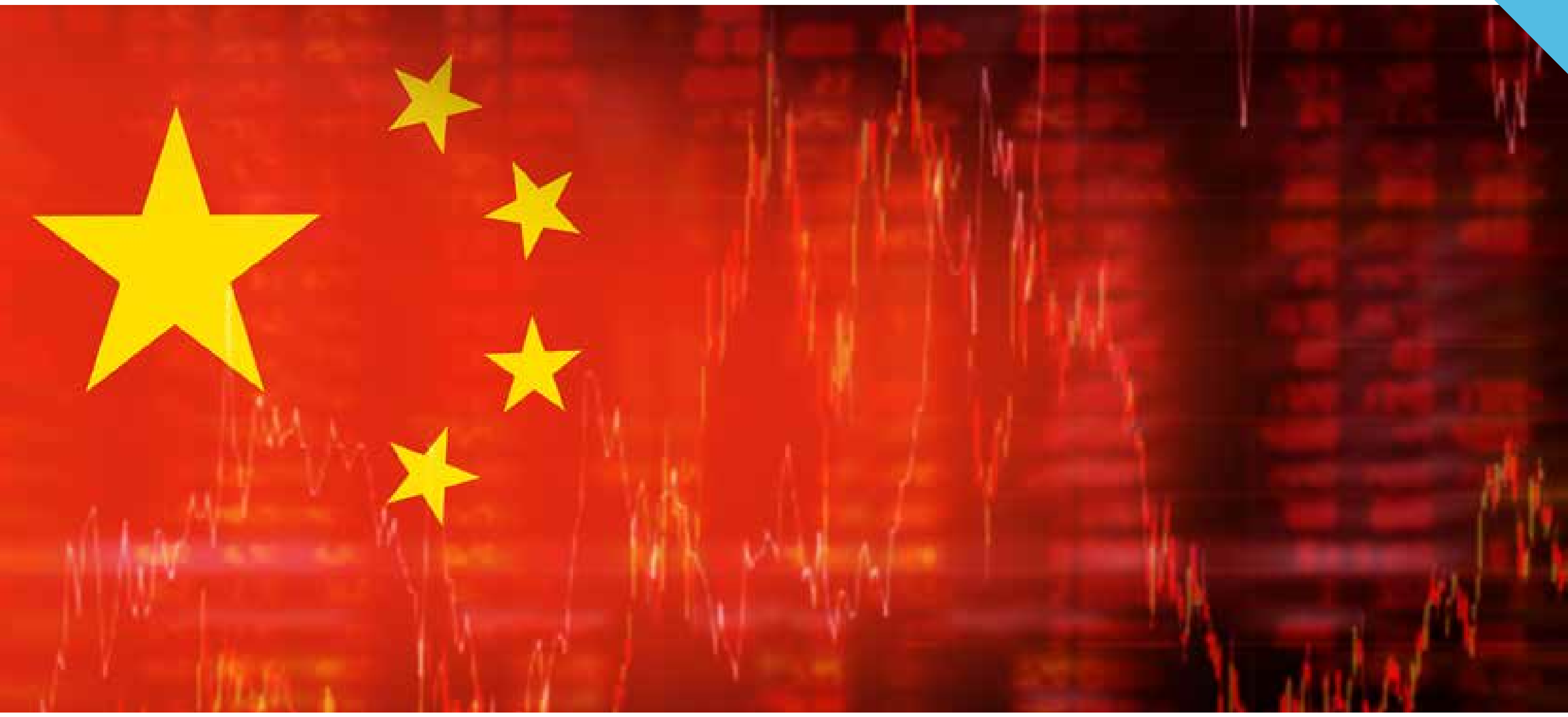
EducationInvestor Global
May 2018



The ultimate consumer good: education trends in China

The availability and quality of Chinese private education is improving, driven by an increasingly affluent, urban, and cosmopolitan population. Choosy Chinese education consumers are advantage seeking, premium preferring and internationally minded. So how should investors and operators respond? L.E.K. Consulting's global education practice partner **Anip Sharma** and senior manager **Maryanna Abdo** investigate

An education investment 'frenzy'

China's private education market is large and growing quickly, at RMB1.6 trillion (£177.8 billion) and set to grow at 9% year-on-year until 2020. It is also underpenetrated in comparison to other markets; if it had the same relative size as the US, it would be at least RMB3 trillion.

Moreover, China's education landscape has rapidly consolidated and matured within the past five to 10 years, spurring what *EducationInvestor Global* called a 'frenzy' of investment activity. There are more than forty deals projected for 2018, valued at a total of £2.5 billion.

Core segments of education continue to dominate deal flow, and there are three principal trends observed in recent investment activity:

- Continued growth in education investments as China-listed companies increase their exposure to the sector.
- A flurry of activity in higher education acquisitions, as newly publicly-listed providers seek rapid growth.
- Ed tech emerging as a key investment theme: 30-40% of investments across subsectors are in ed tech, and in segments like English language training (ELT) they were among the top two largest deals.

A period of capital deployment in high-growth companies eight to 10 years ago helped them to gain scale and is now resulting in a boom in initial public offerings. The world's two largest listed education companies, TAL and New Oriental, are Chinese, and eight of the world's 15 largest listed education companies are now Chinese. Five years ago, only two Chinese companies were among this group.

The ultimate consumer good

Across the world, education has moved from a niche to a mainstream investment theme, but in China, with its brand-conscious, aspirational consumers, education is the ultimate consumer good.

Nearly 9% of Chinese household spending is on education, compared to approximately 4% for other emerging markets – despite the fact that Chinese have one or two fewer children and public education is free. Affluent Chinese parents may spend as much as RMB2.5-3.8 million (£280,000 to £420,000) on a child's education from early years to university.

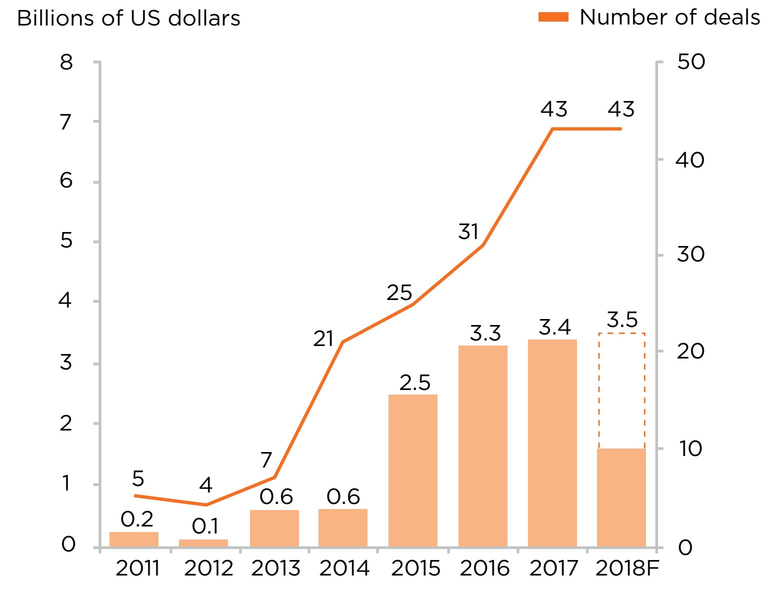
There are three distinctive demand characteristics for Chinese consumers of education:

1. **Advantage seeking:** The Chinese education sector is highly competitive, with 9.4 million sitting each year for the gaokao (the national higher education entrance examination) and C9 League universities selecting as few as one in 50,000. Parents will spend to get an edge, generating hyper-competition from pre-primary school. Education subsectors that particularly benefit are: tutoring, test prep, K12 schools, and ELT.

2. **Internationally minded:** The Chinese are the largest cohort of international students, with 500,000 initiating international study each year. The hunger for transnational education (TNE) continues to grow, at around 5% a year. These international ambitions require significant preparation and spend, from test prep and tutoring, to enrichment and ELT.

3. **Premium preferring:** Chinese consumers have a strong preference for premium branded goods. While this is well-established in the global premium luxury segment, a preference for premium also permeates wider consumer behaviour, with approximately 50% of consumers reporting that they always buy the most expensive product across categories. This affects a range of education subsectors with premium options.

FIGURE 1: TOTAL VALUE OF EDUCATION DEALS IN CHINA (2011-18F)



These factors are driving the emergence of a hyper-consumerisation of education in China, where what has traditionally been seen only as a social good is now also a consumer good.

Trends and disruptions in Chinese education

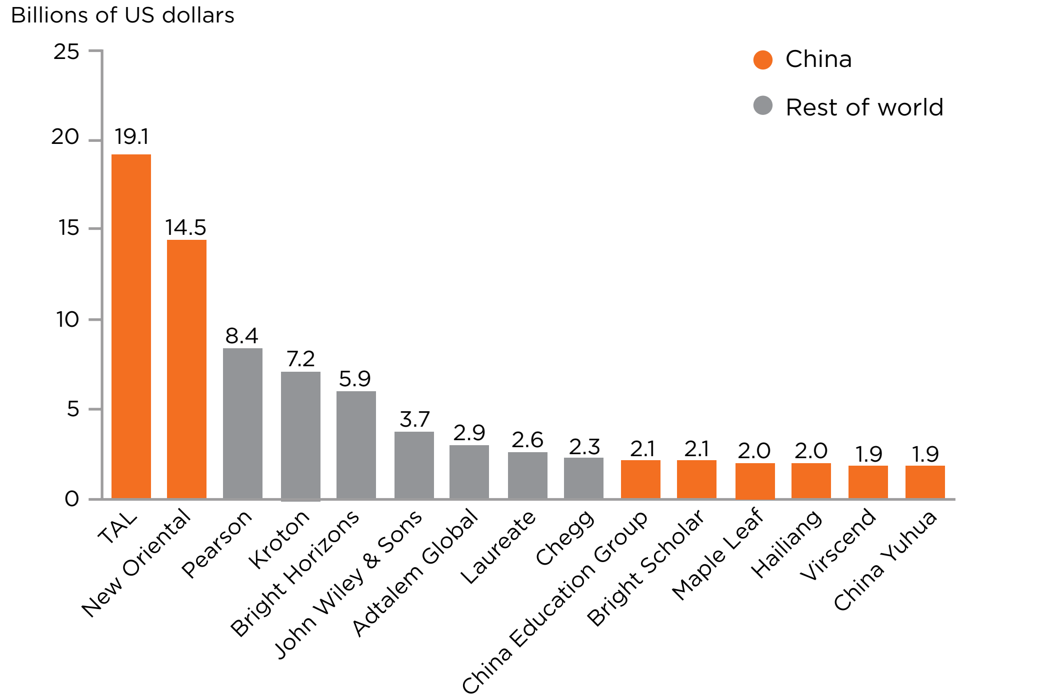
Against this backdrop, investors and operators keen to expand in China should be aware of three key trends.

Trend 1 – Brands do battle

Because education is not a 'try-before-you-buy' service, parents and students across markets look to education providers' reputations in the selection process. In China, as elsewhere, about 75% of parents choose education based on brand-related factors.

Typically, in education, it can take decades to build a premium brand. What differentiates the Chinese education landscape is how providers have established brands without the advantage of time. Chinese education companies trade on prestige and legacy to drive customer perception by 'borrowing' brands. Legacy brands, particularly where ▶

FIGURE 2: MARKET CAPITALISATION OF THE 15 LARGEST LISTED EDUCATION COMPANIES (2018)



they use established foreign names, have an advantage. For example, in premium K12, foreign brands typically grow twice as fast as local brands.

For local companies to compete without the benefit of legacy, they need to become known for either:

- Solving local problems in an innovative way, for example in segments such as after-school tutoring. Companies like Gaosi have traded on the credentials of 'star' teachers to differentiate their offering and signal quality.
- Gaining market share quickly in subsectors with less legacy and international competition (such as online junior ELT, where all five of the largest companies are home-grown). In this subsegment most of the key players have also built their reputations in five years.

Investors must therefore align themselves with premium and international brands in order to secure a foothold, or pick segments where offerings are distinctive or unique to China and leverage home-grown brands.

Trend 2 – The niche goes mainstream

Beyond focusing on building brand, education companies are taking advantage of new opportunities. As the education ecosystem rapidly matures, what were once niche groups of consumers are now viable segments for core business strategy.

For example, ELT is already a well-established, approximately £8 billion sector in China growing at 15% annually. Where the sector was once limited to in-person tutoring and classes, there is now a profusion of offerings catering to a variety of learner types. Overseas students, for example, now account for an estimated £1.5-2 billion in revenues. This segment can therefore support targeted, scale business offerings.

ELT providers now offer specialised content to advanced students who want top-tier business and academic English, with immersive subject learning. It is likely that other niches will themselves become viable segments, for example, in further diversification of TNE, differentiated K12 offerings, and after-school enrichment.

Trend 3 – Online cracks open China

Tier 1 and Tier 2 cities pull in talent and money, but 1.1 billion Chinese live outside these cities, presenting an addressable market of 165 million affluent, middle class consumers. They have aspirations for top-tier university places, international education, and English proficiency, but limited access to private offerings.

Education technology is driving access, with these regions growing faster than Tier 1 and Tier 2 cities. This is particularly relevant for mass market products with a relatively lower price point, such as online ELT and tutoring.

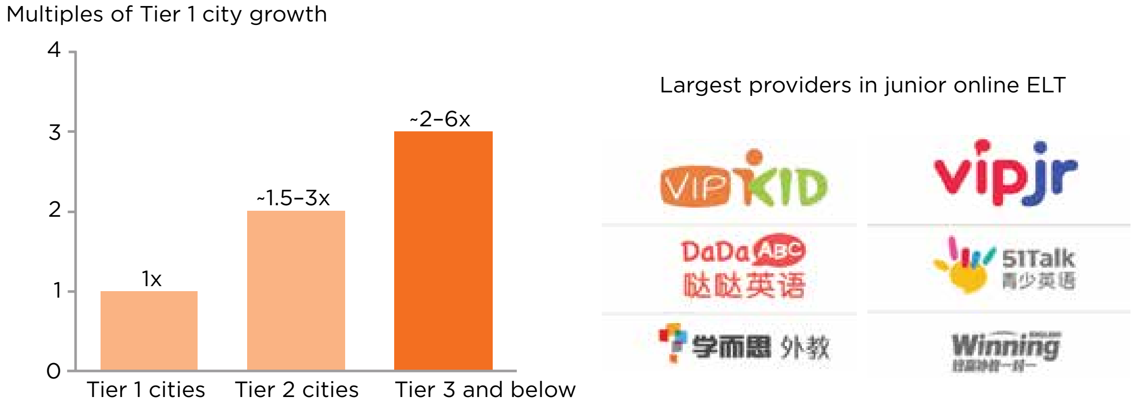
There is the potential that in China, as in other emerging markets, online education can help to level the playing field. Six hundred million Chinese live outside cities, and education quality, access, and relevance are all lower in rural than in urban areas.

For education companies with mass market products, a pan-China and online strategy is essential for rapidly gaining scale beyond big cities.

Looking ahead

Alongside these three key trends, there are other emerging

FIGURE 3: ENROLMENT GROWTH OF ONLINE ENGLISH LANGUAGE TRAINING BY CITY TIER



themes for investors and operators to watch in the months and years ahead:

- **Ed tech is only getting started:** As online provision becomes the norm across China, the urgent questions are: "What's next, and when?" Artificial intelligence is already shaking up personalised language learning, for example on apps like Liulishuo. The personalisation and flexibility promised by ed tech could transform other segments.
- **Public higher education will become a major consumer of private services:** The number of gaokao takers is declining, and reskilling is on the national agenda. This context will put pressure on Chinese universities to serve non-traditional students. In light of similar challenges, US universities have looked to online programme management. Chinese universities are likely to adopt this know-how in their quest to be competitive, reduce costs, and drive relevance for new student groups.
- **China goes global:** Chinese companies and foreign operators in China are developing unique operating capabilities. Key opportunities are likely to be in segments where China has a distinct scale or capability advantage. For example, some premium K12 brands are pioneering fully bilingual schools in China catering to Chinese parents – a model with potential applications abroad. Home-grown companies (for example, in ELT) are also likely to begin to expand operations in the region.
- **Universities abroad adapt:** Chinese students are becoming an ever more common sight on university campuses from Melbourne to Manchester. And while this has been positive for university bottom lines and student experience across destination markets, university leaders must develop support services and manage student experience to ensure that both Chinese and domestic students are satisfied with campus life. Key segments likely to grow will include pathway providers alongside 'micro' TNE provision which meets student demand for international experiences, while anchoring students at universities in China itself.

The technology sector in China is said to have a 9-9-6 working culture: 9:00am to 9:00pm, 6 days a week – a notion that captures the dynamism and growth potential of the market. Given the opportunity in China's education sector, its operators and investors may wish to adopt a similar approach. ■

This article is adapted from a new report, 'The Ultimate Consumer Good', available at lek.com. Report authors include Anip Sharma, Maryanna Abdo, Julius Chen, and Vinit Hase.

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