Room for improvement

A new report indicates that there's still plenty of potential in China's test prep, tutoring and enrichment market, but those looking to make a play must remember that space doesn't guarantee success, writes **Josh O'Neill**

Room for one more?

There is in China's education market, which has ample headroom for another test prep, tutoring and enrichment (TTE) behemoth, similar to the likes of publicly-listed players TAL and New Oriental, according to a recently published report from global consultancy L.E.K.

"The [TTE] market tends to be fragmented at the city level, presenting a consolidation opportunity for investors who could look to build the next big TTE platform, following in the footsteps of TAL or New Oriental," the report states.

China is "the largest, most attractive TTE market in the world," the report continues, and since 2015 has grown 14% annually to reach a revenue scale of ¥500 billion (£57 billion). Robust gains are underpinned by three key factors, according to the report. First, despite a rising number of undergraduate seats available in China, demand for higher education still outstrips supply. Second, the country's all-important, high-stakes Gaokao and Zhongkao exams taken by school students require a staggering amount of preparation. And finally, there are gaps in public school provision in certain subjects, such as English. As a result of an undying appetite for extra-curricular tuition, China's TTE market is forecasted to be worth ¥1,500 billion by 2023, the report says, "driven by favourable growth of the relevant age cohort, a growing middle class and intense competition".

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Specifically, there is "demand for non-academic enrichment activities such as music and sports, as well as STEM [science, technology, engineering and mathematics] and coding education," states the report, which was co-authored by L.E.K. partners, Anip Sharma, Maryanna Abdo and Kaushik Mohan.

Meanwhile, the online tuition sector is growing nearly three-times faster than the traditional brick-and-mortar market at 38% year-on-year, compared with 14% for the latter. It's worth noting, though, that online tuition currently accounts for just 8% of China's TTE market. However, this share is set to surge, according to the report, which indicates that 23% of China's test prep market will be online by 2023, "representing an estimated ¥350 billion opportunity".

Capital gains

Tuition titans TAL and New Oriental, which are both listed on the New York Stock Exchange, have capitalised on an ethos among Chinese parents that there's always room for improvement when it comes to their children's academic performance. TAL, the world's largest listed education firm, has a market cap of £13.5 billion, while its rival New Oriental in second place is worth around £8.6 billion. Over the past five years, TAL's market value has soared nearly 1,000%.

Emulating the success of either of these businesses would be no mean feat, though. China's regulatory regime is as complex as they come, and listed education companies with operations on the mainland are acutely vulnerable to policy changes. A string of recent regulatory overhauls across numerous sub-sectors, reported extensively by *EducationInvestor Global* in past issues, sent shockwaves through the market to trigger a landslide in listed firms' share prices. L.E.K.'s report acknowledges this: "The impact of regulatory headwinds is evident in the stock market performance of listed education companies, many of which are trading at historic lows and, in some cases, below the IPO price.

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Balancing risk and reward

Still, without risk there would be no reward. And in China, if you can stomach the turbulence, the payout can be plentiful. Taking TAL as a prime example, the group last year chalked up gross profits of $833 million, up from $521 million logged just a year prior.

According to L.E.K.'s report, in China's English-language training (ELT) market, which is currently worth $18 billion, 70% of revenues are derived from junior-focused tuition. "Parents aspire for their children to be English-proficient, and that aspiration is driving the market," the report states. Enrolment rates evidence this: in Tier 1 cities, where a premium offering is preferred, registration rates for offline, skills-based junior ELT have leapt 25% year-on-year, the report shows. Both premium and mid-priced offerings have prospered, the report continues, growing 20% and 30%, respectively. L.E.K. describes online provision as a "key trend" – even though it represents a "small segment" of the junior ELT market at roughly 10%, "given consumer perspectives on online education… supporting traditional centre-based ELT companies in moving online will be a key opportunity for investors," the report says. "One emerging business model observed in China is business-to-business providers who are assisting ELT providers with their move online."

> Expanding product offerings – potentially into edutainment, while positioning online products as effective and delivered safely at home – could bring more of these consumers online, with a potential for $1 billion to $3 billion in revenues

Upskilling an unequipped market

Historically, higher education and vocational training markets in China have been "highly fragmented, presenting an opportunity for investors," the report states. However, they must tread carefully, as "there is the possibility that new regulations under consideration could require the conversion of acquisition targets to for-profit entities prior to transactions, which will generate a larger regulatory burden and raise costs," the report warns. Nonetheless, China's private vocational education market has witnessed "the strongest growth since 2013," according to the report, which notes that "China's higher education system is highly skewed toward academic-oriented programmes and the demand for practical and employability-related vocational education is not fully satisfied.

"As China pivots toward a service-based economy, there is a need for the workforce to be trained to meet these new demands. Investors focusing on these segments are likely to see less regulatory intervention and faster growth than other segments.

"Reflecting this, there is strong growth of nearly 12% in employability-oriented, non-degree conferring private vocational education, now a market of nearly ¥350 billion. This segment, unlike degree-conferring programmes, has no restriction on the share equity of foreign investors."

Online economics

Accessing education online is now the norm in China. According to the report, the country now has 250 million children who collectively consume nearly 280 million hours of screen time daily, of which 45% – or 120 million hours – is educational. And the value proposition for online education in China is distinctive, as more than 85% of consumers are willing to spend more on online education, the report finds. This is, perhaps, unsurprising, given that Chinese parents, on average, spend $18,000 a year on extra-curricular tutoring, according to the Chinese Society of Education, which finds that some families shell out as much as $43,000 annually to give their children an edge.

What may come as a surprise, however, is that 75% of the total school-age population – equivalent to 180 million children – do not access formal, organised after-school tutoring, according to L.E.K.'s report. They are largely from lower-income households, are younger, or live in lower-tier cities, it notes, and while they may access tutoring of some form, it is "mainly informal". Herein lies a gap in the market for ed techs to fill, the report argues. "Expanding product offerings – potentially into edutainment, while positioning online products as effective and delivered safely at home – could bring more of these consumers online, with a potential for $1 billion to $3 billion in revenues," the report states.

It should be noted, however, that since L.E.K. published its report in February, China's education minister Chen Baosheng has announced that the education ministry will publish new guidelines that aim to rein in the country's unsupervised online after-school tuition market, as part of a broader effort to curtail students' titanic workloads. According to reports, Chen didn't elaborate on how or when the ministry would regulate online tuition providers, but a crack-down last year on brick-and-mortar tuition centres requiring all classes to end no later than 8:30pm offers an indication of its generally protective stance.

Nevertheless, there's still more money to be made, it seems, in the mainland's $300 billion education market – albeit a market that is rife with regulatory risk and so should be navigated carefully. Ask anyone for advice about doing business in China as a foreigner, and nine times out of 10 they'll tell you to find a solid, trustworthy partner before even thinking about setting up shop, whether it's a legal requirement to do so or not.

Jack Ma, co-founder of Chinese conglomerate Alibaba, once said: "The more I come to know about the outside world's perception of China, the more I feel there are all sorts of misunderstandings." And while the report concludes that "there is headroom for growth", investors and operators would be wise to remember that adequate space does not, unfortunately, guarantee success. ■