Development Trends of Training Service Market in China

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China's reform and opening has had a tremendous impact on economic, social and cultural development. On one hand, with increased incomes, people not only spend more on food, clothes and housing, but also on education, which has a huge market demand due to the large population base. On the other hand, as China's traditional, government-provided education was developed before China's reform and opening and lags behind the market demand growth. As a result a training service market has emerged that is met primarily by private education and training agencies. The paper describes the development of a training service market in China distinct from the degree education system, namely the development of private training service market. It further put forward that although after 20 years of development the private training service market still has problems such as inconsistent and untimely information disclosure and incomplete corporate governance, but some positive trends such as branding, internationalization and capitalization have appeared and the market is of great investment value.

INTRODUCTION

The development of China's training service market refers to the non-degree education market, namely the development of the private training service market. China's education system is comprised of the non-market degree education and market-oriented non-degree education, i.e. training services.

Two major players in China's training service market include, first, the government-owned and government-operated agencies, such as the training colleges of the public universities and training centers run by government ministries. Second, the privately owned and operated agencies, such as New Oriental Education & Technology Group, Global Education & Technology Co., Ltd, and other listed companies.

The first group of players is confined by the system they belong to and cannot become a major force of change to push forward China's non-degree training education market. Therefore, the market development of China's non-degree training education has to rely on the development of China's private training service providers. In this paper, the discussion over China's training service market mainly focuses on that provided by the private agencies.

In China, the emergence of private agencies providing non-degree training services started in the 1990s and such businesses began to flourish in 2004, after the central government issued the "Private Education Promotion Law Implementation Regulations". Its total market value has maintained an average double-digit growth over the past years. International Data Group (China) estimates that China's private spending on education totaled RMB 560.8 billion in 2008. China's education and training industry reports show that education and training market value exceeded RMB 680 billion in 2009 and that it could reach RMB960 billion in 2012. Driven by strong market demand, China's private training institutions have mushroomed across China. Currently, China has nearly 120,000 such organizations, of which 13 have successfully listed in overseas capital markets. Among these 13 listed companies, 85% of them are listed in the United States and they include New Oriental Education & Technology Group, TAL Education Group, Xueda Education Group, Global Education & Technology Co., Ambow Education Holding Ltd., China Distance Education Holdings Limited, ATA, ChinaCast Education, ChinaEdu Corporation, Noah Education Holding, and China Education Alliance Inc.

Although China’s private training service market is still in its primary stage, with characteristics such as "big market, small players”, lack of supervision, and disorderly competition, we have observed some positive and valuable trends and characteristics in their booming business, especially those led by the 13 listed industry leaders. These deserve our attention: their lessons could be applied to guide the rational and regulated development of China’s private education market, and they could help international and domestic investors make well-informed investment decisions. This paper on private training service development in China presents the three major trends demonstrated by this market in recent years, i.e. branding, internationalization, and capitalization, as well as some major existing problems.

BRANDING

The first trend presented in the development of the Chinese private training service market is branding. During the past two decades, the early players in this market, especially those that offer high-quality services and experienced rapid growth and those that are already listed or seeking IPO, have evolved from small workshops, to intermediary agencies, and now to a brand names. These players have led the entire industry into a new era that highlights the importance of brand names and branding.

The connotation of the brand development of Chinese private training service institutions is first differentiation, second, quality improvement, and finally developing chain or franchise stores. The development of the 13 overseas-listed industry leaders is not exceptional. Based on customers’ age group, we could classify China’s private training service industry into four sub-segments, i.e. early childhood education, primary and secondary school tutoring, training for overseas studies and vocational education. In addition, based on the ways that the training services are delivered to the customers, we could also classify it as face-to-face training and long-distance training, i.e. offline and online training.

The Beginning of Differentiation

Each of China’s listed training agencies is the leader in a sub-segment of the market. Take the private training service giant New Oriental as an example. It led the early childhood education sub-segment with its POP Kids program, it lead the high-end primary and secondary school tutoring with Neolink Secondary Education and MaxEn Education and it excelled in overseas study training programs on GRE and TOEFL. TAL specializes in classroom teaching and Xueda specializes in one-on-one teaching, and both are competitive in primary and secondary school tutoring. Global Education has been focusing on IELTS training over the past decade. Ambow focuses on building a lifelong education platform for further studies and on-the-job training.

China Distance Education Holdings worked hard to build the remote training platform, especially the China Accounting Web, and has recently extended its remote training courses to 15 subjects, such as law, medicine, postgraduate qualification exam and higher-education self-study exam. ATA aims to become the world’s biggest exam training provider that focuses on government, industry, company and personal exam businesses. ChinaCast focuses in the acquisition and operation of some of the independent colleges of the universities in recent years. Beida Jade Bird is a flagship IT professional training organization. Wan Guo is a leading brand name in China’s judicial examination training.

In addition, a number of private training institutions are beginning to explore the blue ocean market of China’s training service market, such as specialized international schools, private schools and home schools. This reflects the demand for internationalized, traditional, and personalized training programs in the contemporary education market. The revenue generated by the specialized education business is very impressive.

According to the annual financial reports of listed companies, revenues of the primary and secondary education segment of Xueda, TAL, New Oriental and Ambow all exceeded USD 100mn in 2010. In 2011, revenue of New Oriental's POP Kids program achieved a 49% year-over-year increase to USD 77 million, and the number of students increased 29% year-over-year; the contribution of the POP Kids program to New Oriental's total revenue increased from 12.7% in 2010 to 13.4% in 2011. Gross profit margins of Kid's English and POP Kids program reached 53% and 55%, respectively.

As the indisputable market leader, New Oriental registered a total revenue of USD 835 million in 2012, the same as the total of the rest of the top five players, i.e. Xueda, Ambow, TAL and ATA. Each of Xueda, Ambow and TAL achieved USD 200 million in revenue in 2012, and their revenues are USD 281 million, USD 265 million, and USD 210 million respectively.

Quality Improvement

A training service institution which offers characteristic services may not become a brand name organization, which requires years of experience to sufficiently improve quality. In the meantime, the company founders must first develop a sense of mission and responsibility and internalize it and reflect it in corporate strategy and culture. Secondly, the company founders use the management team and corporate culture as the core to establish cohesion and the backbone of the business. Thirdly, the company focuses on product R&D and relies on their core team and corporate culture to ensure its ability to grow sustainably. These are the common characteristics and experiences of all leading Chinese private training service companies.

Branding

Companies provide tailored products and services in order to survive, improve product and service quality to grow into the fittest companies, and establish a good brand name to ensure expansion. The sign of successful branding is acquiring other industry players and setting up chain or franchise stores to replicate successful business model to become the industry leader.

Chinese private training service enterprises started to adopt the franchising business model in 2000, with pioneers like the IT training provider Beida Jade Bird, English training providers such as EF and Wall Street English. Now they have adopted the chain store and direct selling business model, which have been adopted industry-wide now. Take the primary and secondary school tutoring market as an example, Xueda first introduced the business model in 2004 and its application reached a peak in 2008.

In the first half of 2008 only, Xueda has established 80 branches all over China, and now its service is available in 256 branches in 61 cities. Even for the low-profile Pyramid Education, the number of its branches has recently reached more than 300. Ambow caught up with the early movers by aggressively acquiring and merging the regional brand names, which offer competitive services and products. In recent years, New Oriental is expanding aggressively by adding 100 new training schools to their portfolio every year. In the fourth quarter of 2012 only, it added 238 training schools (Zhu, 2013). At present, a few brand name institutions, such as TAL, Xueda, Ambow, Juren and Elite Education, mainly serve the primary and secondary school tutoring market in China's three major cities i.e. Beijing, Shanghai and Guangzhou.

During the process of scale-up and post-M&A restructuring, the private training institutions with brand names did not give up the features and quality of products and services (Ma1, 2011). In the third quarter of 2012, New Oriental closed its bar exam and Certified Public Accountant (CPA) examination training program, neither of which were relevant to its core English training business. Previously it had also divested the businesses to train students to retake the college entrance exams and to train software development professionals, as these non-core businesses all offer deteriorating profit margins.

In 2012, a few listed companies, such as New Oriental, TAL and Xueda, slowed down from expansion to promote internal control and improve efficiency, so that the companies can grow at a healthy and sustainable pace. In addition, non-listed companies such as Longwen Education, which set up 1,000 schools in China within the first two years of business, made an announcement in 2012 to adjust its expansion strategy, which now only allows expansion at a slow pace, but also pays more attention to internal management.

In 2012, after China's private training institutions developed their brand names, they started to focus more on the second and third tier cities in their expansion. As at August 31, 2012, TAL had entered 15 cities, now mainly focusing on opening new schools in cities other than Beijing and Shanghai. In the first quarter of 2012, it entered Shenyang; in the second quarter, it focused on opening new schools in Wuhan, Shenzhen, Xi'an, etc. In the most recent quarter, New Oriental's revenue growth in Beijing and Shanghai was only 12%, while that of other regions reached 35%. In addition, New Oriental highlighted in its acquisition strategy that in the future it only adds new schools in second and third-tier cities.

INTERNATIONALIZATION

The second trend presented by the current development of private training services in China is internationalization. International development of China's private training service is demonstrated in the following three aspects, first, the business, second, private placement, and third, public offering.

Internationalization of the Business

The internationalization of China's private training service is reflected in three aspects. Firstly, internationalization of the high quality products; secondly, scale-up of international business of the industry; thirdly, investment in overseas education. To leverage its expertise in overseas study training and foreign language teaching business and the current market trend of younger students going to study abroad, New Oriental announced in November 2011 that it would set up the joint venture MaxEn Education with McGraw-Hill Education, the largest listed education company in the US, to provide high-end education and training for Chinese teenagers aged between 4 to 17.

In October 2010, TAL set up the joint venture "Mobby" with McGraw-Hill Education. Shenzhen Pengyuan Credit Service Co., Ltd. and BPP, one of the world's largest financial services training company, signed a cooperation agreement to bring in two international financial training and education certifications, i.e. International Certificate in Financial Advice (ICFA) and Chinese Certified Accounting Technician (CCAT), both of which aim to provide employment assistance to job seekers. Similar cases are abundant.

The size of China's overseas study training market has continued to expand in recent years. According to a 2012 Survey Report on the Overseas Study Market in China, the number of people who went to study overseas grew from 179,800 in 2009 to 229,300 in 2010 and to 354,700 in 2011. As a result, revenue from the training programs that help Chinese students to study abroad and in international schools grew at a remarkable speed of 30% every year. Also, according to the Open Doors Report released by the US Education Association in late 2012, the number of students who went to US universities for undergraduate degrees increased by 31% year-over-year in 2012, marking the first time in 12 years that the number of students going to the US for undergraduate degrees exceeding those going for postgraduate degrees.

According to the 2012 Overseas Study Report published by China Education Online, the number of Chinese students who study in the US high schools increased by 10 times compared to 2005 (Wan, 2012). Now in some first tier cities, such as Beijing, Shanghai and Guangzhou, there is a strong demand for "study tours" where training institutions take students to undertake short study tours in foreign countries during a summer or winter vacation for one or two weeks or one month. If students find a good opportunity to study abroad during their tour, the training organization will help them become full-time students. EF is a market leader in this market.

High-quality private training service institutions in China have been experimenting to set up schools overseas. New Route International Education Group Limited opened branches in Japan, Canada and the US, while New Oriental has opened branches in Canada and other countries. China's investment in overseas education markets is mainly focused on Singapore, South Korea and Hong Kong in Southeast Asia, as well as the US in North America. 80% of the projects and 100% of the investments are concentrated in Southeast Asia. It is reported that in 2011, Mr. Ding Furu acquired a 50% stake in the Singapore-based Value Vantage with USD 37 million.

Private Equity Going International

Of the 10 private financed projects with China's top-quality private training service institutions from 2007 to 2010, overseas financing accounted for 70%, and the average deal size grew from USD 24 million in 2008-2009 to USD 35.6 million in 2010-2011. In 2011, the UK-based Pearson PLC, USD invested 289.6 million to acquire a 100% stake in Global IELTS. So far, private equity investors in the US, Europe and Southeast Asia, such as Baring Asia, ARC Capital, the Carlyle Group and Actis Capital have shown particular interests in China's private training service sector. In 2012, a few more US and UK-based private equity funds started to focus on private training service schools in China, especially those in foreign language teaching business.

International IPO

All of the 13 Chinese private training service institutions are listed in overseas stock markets. Oriental Century Limited is the first such company seeking public offering and it was listed in Singapore on June 1, 2006. Modern Education launched the most recent IPO and it was listed in the Hong Kong Stock Exchange on July 4, 2011. The remaining 11 are listed in the US.

The constraint of China's domestic capital market is part of the reason why China's private training service institutions were seeking IPO in overseas markets. If a company is seeking IPO in China's capital market, then the listing applicant has to be a legal entity. However, the provisions of Article 3 of the "Private Education Promotion Laws" defines private education as "public service" and therefore most of the Chinese private training service institutions registered with the Civil Affairs Department as non-corporate legal entities.

The natural attributes of the private training service institutions as nonprofit and non-corporate legal entities become the barrier that makes it difficult for them to get listed in China's stock market. In addition, China's Education Act also prohibits any organizations or individuals from setting up for-profit schools and educational institutions. As a result, the earnings of China's private educational institutions can only be reinvested in the business and cannot be used to pay dividends to the investors. In addition, property rights of private schools belong to legal entity, not the investors. Therefore, it is not possible for China's private training service institutions to seek IPO in China, especially on China's main board, such as the Shanghai Stock Exchange and Shenzhen Stock Exchange.

Going international is the right path that China's private training service institutions picked in order to become global players. It helps them to reduce the cost of innovation, to expand market, to narrow the gap between emerging markets and developed economies and to put them at the forefront of the industry.

CAPITALIZATION

The third trend presented by the development of private training service in China is capitalization. For companies, the capital markets not only provide them with capital but also provide a platform to improve management and to advertise brand names. Therefore, capitalization is a major theme and a natural choice to be undertaken by the Chinese private training service institutions. Of course, the favor and attention from the investors and the capital markets would bring them exposure to advertise their brand names.

The capitalization process of China's private training service institutions was initiated by venture capitalists and it further reached a peak when companies sought IPOs. The final destination is M&A and post-M&A integration. Among the 120,000 private training service institutions in China, 13 companies have gone through the three stages and they are the true forces that are pushing forward the capitalization process of the entire industry.

Introducing in Venture Capital

Based on public information, we made the following timeline that captured this trend:

In the period 2000-2003, online education and IT training brought VC and PE into China's education and training industry. During this period, three such cases were disclosed, with total financing totaling to USD 6.5 million.

In 2004, in addition to Noah Education Holdings, traditional education and training provider New Oriental and postgraduate degree application training provider Wanxue also got investment from venture capitalists. Total financing of the three companies reached USD 66.5 million.

In 2005, four companies, including China Training Network, Feloon Training Network, WebEdu and Saybot, received venture capital totaling USD 24.15 million.

The public listing of New Oriental in 2006 is by far the most successful investment case in China’s education industry and it has greatly stimulated the interests of the overseas VC in China's private education industry. The 13 investment cases in this industry in 2006 helped to raise a total of USD 92.12 million. Eight companies received Series A financing and five received Series B financing.

2007 was another boom year. From January to October 2007, 13 venture investment cases brought in a total of USD 166.7 million. Seven companies received Series A financing, four received Series B financing and two received Series C and D financing.

In 2006 and 2007, venture capitalists mainly focused on China's private education companies that were in the expansion stage and that serve several sub-segment markets. In 2006, seven companies under the expansion stage received venture investment, accounting for 53.8% of the total number of cases in that year. In 2007, nine companies in the expansion stage received venture investment, accounting for 69.2% of the total number of cases in that year. These companies offered not only online training for high school and primary school students and foreign language learners, but also offline foreign language instruction, primary and secondary school tutoring, IT professional training, and corporate management training.

In 2011, 24 projects in China's private education industry received venture investment, totaling USD 528 million.

After receiving venture investment, private education companies can rapidly expand their business and benefit from the first mover advantage. Yin Xiong, president of Giant Education Group, revealed that after the company received venture investment, it quickly increased the number of branches from 100 in 2007 to 500-1000 in 2010, before it was listed.

Most overseas venture capitalists were richly rewarded by investing in China’s private education industry. The average price-to-earnings ratio of education companies is as high as 22, while it was only 16.3 for other industries (Jiang, 2012; Ji, 2011; Ma2, 2011).

Public Offering

Below we provide a list the Chinese private training service companies that were listed in overseas market in chronological order (Yu, 2012; Wang & Zhang, 2005; Anonymous, 2012):

In 2006, Oriental Century and New Oriental became the two pioneers to get listed; in 2007, Noah Education Holding, ChinaCast Education, and ChinaEdu became the immediate followers. In 2008, despite the financial crisis, ATA and China Distance Education Holdings went public. In 2009, only China Education Alliance made an IPO. In 2010, with the recovery of the economy and capital market, four companies went public; Ambow, Global Education Group, TAL and Xueda. In 2011, Modern Education got listed.

From 2006 to the end of 2011, 13 private education companies in China got listed in overseas stock markets. Among them, only ChinaCast Education and China Education Alliance resorted to backdoor listing, and the other eleven made an IPO. At present, 10 of them are operating successfully. Oriental Century got delisted in 2009 due to financial issues, China Education Alliance was delisted in 2011 because their stock price was too low and Global Education was delisted in the second year after it was acquired by the UK-based Pearson.

Recently, the private education company Beihai Education was listed in the Tianjin Equity Exchange in April 2011. This shows that Chinese private training service institutions can raise funds not only in overseas capital markets, but also in some primary domestic capital markets.

Mergers and Acquisitions

The ultimate goal for Chinese private education company to seek external funding is to improve and grow their business, and therefore mergers and acquisitions are the ultimate destination.

In September 2006, Global IELTS received RMB 200 million of investment from SAIF. It used the money to set up Global Education & Technology Group and in 2007 it invested RMB 100 million in business expansion and consolidation.

After a series of successful public offerings, M&A activities of China's private training service institutions peaked in the period from 2007 to 2009. Ambow, Global IELTS and Giant Education Group all achieved large-scale expansion through mergers and acquisitions. For example, after Ambow received USD 54 million of financing in September 2007, it used the capital to expand its core business and to consolidate China's quality vocational schools and training centers through M&A.

During 2007 to 2010, ChinaCast Education made two investments, USD 64.97 million and USD 66.18 million, to acquire certain businesses of Chongqing Normal University and Hubei University of Technology.

In 2011, M&A-related investment in China's private training service sector reached a record high: a total of 24 M&A deals with total investment of up to USD 528 million. The trading volume increased 4% year-over-year, while the transaction value increased by an alarming 29% (Chuanguowuhen, 2013; Nan & Luo, 2006; Ren, 2011,Tian & Zhou, 2012; Tian & Dai, 2012).

INVESTMENT RISKS

China's private training service market has experienced significant growth in the past two decades, but it is still in the early stages of development and has a lot of problems. The most important issue is that investors are exposed to risks. I will elaborate on this in the following chapter (Philip L., 2010).

Stockholders Equity Protection

For foreign investors who invested in China's private training service market, in some cases, their investments cannot be effectively protected. Below we will use ChinaCast Education as an example to make an analysis.

Management of ChinaCast Education and the US investors have been battling for control from the end of 2011. They fought for that during the shareholders' meeting in January 2012. After Ned Sherwood and his referee were elected to join the Board of Directors, they replaced a large proportion of management team in the following three months. Chan Tze Ngon, Chairman and CEO, resigned in March 2012 saying he could not get along with Ned Sherwood and other directors who controlled the Board.

On April 2, 2011, ChinaCast Education failed to file its Form 20F for 2011 on time and was suspended for trading on NASDAQ. On May 9, 2011, ChinaCast received a notification from the NASDAQ saying it has made a determination to delist the company's securities in view of its significant losses, the inability to control bank account because of the disappearance of official chop, and the inability to provide audited financial reports of the previous fiscal year on time. On June 21, 2011, after further consideration and taking into account its ongoing investigations into various matters involving former management and its continuing delay in reporting its financial results, the company withdrew its request to appeal this delisting determination. After being delisted from NASDAQ, ChinaCast commenced trading on OTC Markets on June 25, 2011, with the company's shares plunged to USD0.82/share on the first day of being traded on the pink sheet market.

The then CFO of ChinaCast Education Group revealed in March 2012 that former chairman Chan Tze Ngon pilfered the company's coffers of RMB 510 million from July 1 to December 28, 2012 through 12 transactions and that the money was mostly from the two most profitable subsidiaries of the company. After his resignation, he took with him the business licenses of the two subsidiaries, the official chop and financial books. In addition, Chan Tze Ngon had transferred the core assets of ChinaCast Education Group to several natural persons.

The Application of Professional Manager System

Some failed investment cases in China's private training service sector revealed the problem that the professional manager system is not well received in China. Xueda offers a good example.

After CDH Venture Investment invested in Xueda, it assigned its employee Wang Jun as the director of Xueda. Wang Jun was actively involved in Xueda's strategy development, team building and operations management and made positive contribution to Xueda's development. In 2010, Xueda hired Wang Jun as its president and at the same time hired a large number of professional managers.

On January 12, 2012, Xueda announced that Wang Jun resigned from the positions as company president and board director for personal reasons. CIO Yang Hai, who also resigned for personal reasons, followed Wang's resignation. After that, Xueda dismissed more than 200 employees, including a Vice President, 15 directors, five senior managers and 35 managers.

This marks Xueda's failure in attempting to introduce the professional managers into the company. It also shows that it is not easy for some private training service institutions to accept professional management systems.

Policy Risk

Government policies have played an important role in the development of China's private training service market. TAL offers a good example.

On August 18, 2012, China Central Television news channel reported on the "Mathematical Olympiads training" phenomenon in China. On August 20, the Beijing Education Commission issued a notice to prohibit secondary and high schools to use Mathematical Olympiads scores as a benchmark to select applicants. On August 26, CCTV news exposed TAL's Mathematical Olympiads training courses. On August 27, a number of agencies were notified to stop providing Mathematical Olympiads training courses, and the Education Commissions of Beijing Fengtai District and Haidian District both introduced guidelines to regulate this market. On August 28, China's Ministry of Education released 30 supervision orders that ban middle schools from selecting students based on their performance in math competitions and other academic competitions, as well as talent competitions. Primary schools are also banned from setting up classes for the top students.

Mathematical Olympiads training is TAL's core business and Beijing is its most important source of its income. The crackdown on Math Olympiads training in Beijing had negative impact on TAL's business. As a result, TAL adjusted its fiscal income target for 2013 from USD 230.8-239.7 million down to USD 227.2 -232.6 million. On August 29, 2012, TAL's shares tumbled by 13% to USD 7.3 per share, with a record intraday low of USD 6.97 per share.

In addition, China's private training service institutions have other problems such as inconsistent and untimely information disclosure and incomplete corporate governance structures. However, China's private training service industry is set on the right track to pursuit branding, internationalization and capitalization. This comes naturally, as the industry develops and the external world develops. The companies, the education industry, and China, as well as the rest of the world could all benefit from this trend. It is almost certain that the three trends are irreversible and will continue to evolve in China, although the process may be difficult and painful.

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