

HOW COVID-19 IS TRANSFORMING CHINESE EDUCATION



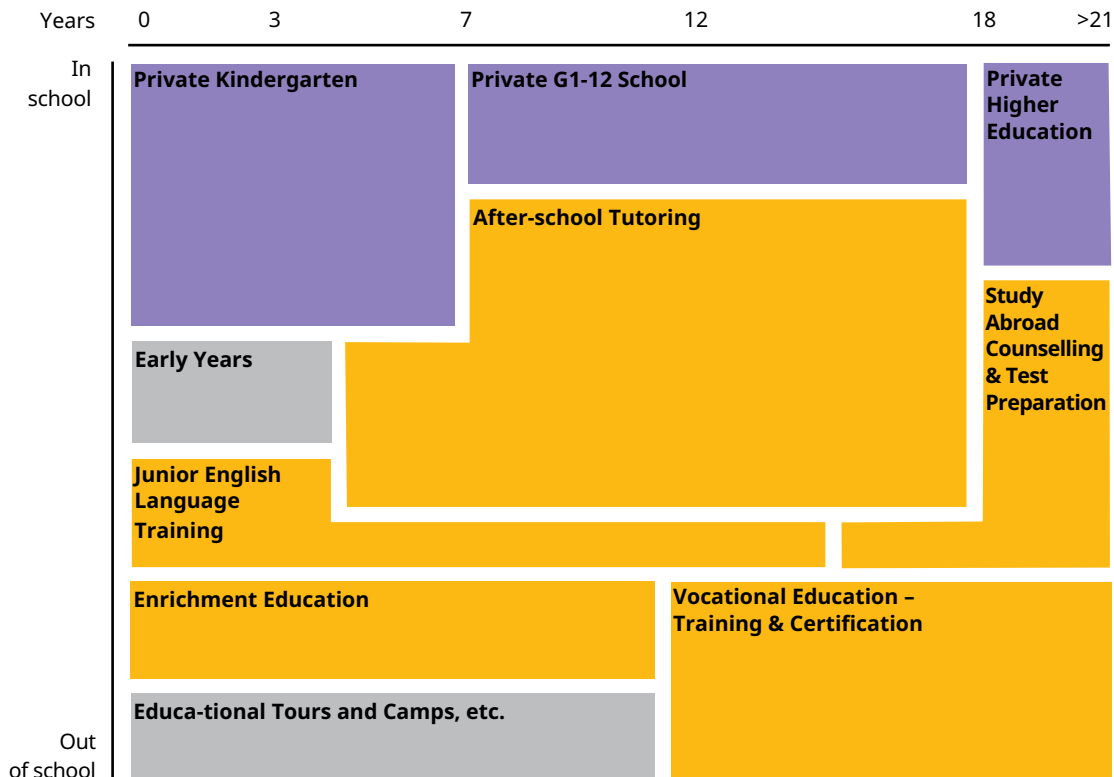
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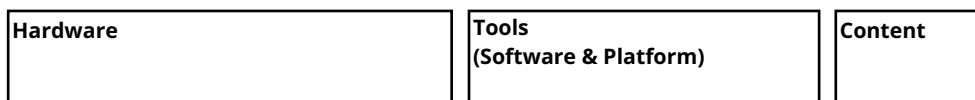
China's education industry is an important component of its tertiary sector. The industry has been adversely affected by the COVID-19 outbreak, arousing extensive societal attention and discussion. Complaints during this period have primarily been about the poor quality of some online classes, the low ratings garnered by some learning apps, the cancellation of major exams, and the stress over searching for and finding suitable jobs. Given the outbreak's tremendous and profound impact on the market's landscape and dynamics, Oliver Wyman here summarizes the implications to the industry's different sub-segments and the potential changes to customer behavior, so as to highlight key market trends and identify segmental opportunities during this critical time.

CHINA EDUCATION INDUSTRY SEGMENTATION

OFFERINGS TO CUSTOMERS



OFFERINGS TO BUSINESSES



■ School Businesses
 ■ Training Businesses
 ■ Experience-based education

The segmentation is based on the core nature of the different sub-sectors.
 The education industry refers to the private segment only. The public segment is not covered.

We estimate that China's education industry will witness negative growth in 2020. While school businesses will remain stable due to resilient demand, training businesses will suffer a serious economic blow, with the exception of a few sub-segments, such as businesses that focus on test preparation for admission into higher-learning institutes. Separately, the adoption of online education will accelerate, but the respective increase in terms of the number of paid users will still be limited. Meanwhile, online competition will be home to the Matthew Effect, while the gap between the leading and lagging offline players will widen (呈现头尾分化), and many mid to small-sized training businesses will be eliminated due to a lack of cash flow. Consolidation will take place in the experience-based education segment, where demand has shrunk drastically due to the heavy reliance on commuting to various teaching venues. The big winners are players that focus on providing offerings to businesses, as the demand for these offerings has grown exponentially since the beginning of the outbreak.

FIVE POLITICAL, ECONOMIC AND MACRO-ENVIRONMENTAL INFLUENCES

Institutions, from kindergartens up to universities, are required to delay the recommencement of the Spring semester. The Ministry of Education has launched an initiative to 'ensure learning is undisrupted when classes are disrupted (停课不停学) to encourage all schools to leverage online platforms to continue teaching.

Based on the current information available, most provinces will gradually resume traditional offline teaching from May, with schools in Qinghai, Guizhou and some other provinces planning to open this month. In order to make up for lost time, schools in some provinces such as Shandong and Guangdong, will either adopt a six-school-day a week schedule or shorten the summer break.

THE MINISTRY OF EDUCATION HAS CALLED FOR THE SUSPENSION OF ALL OFFLINE TRAINING PROGRAMS AND GATHERINGS BY TRAINING PROVIDERS.

According to the notice issued in February, training providers cannot restart their offline operations until schools officially reopen, so most of them will need to wait until May. Moreover, with schools needing to make up for lost time, these providers' course hours are likely to be further squeezed. Additionally, online training is under strict supervision. Any violation, such as super-syllabus teaching, test-oriented teaching, false advertising, or exam ranking, will be investigated and punished accordingly.

ENTRANCE EXAMINATIONS AND STANDARDIZED TESTS HAVE BEEN POSTPONED OR CANCELLED.

The Ministry of Education has postponed the following: self-taught higher education examinations, the registration of graduate admission tests for candidates of equivalent learning capabilities, and primary and secondary school teacher qualification and teacher certification examinations. New

schedules will be announced at a later date. Meanwhile, some standardized tests, such as the SAT, GMAT, GRE, TOEFL, and IELTS, have been cancelled in February and March. Students also cannot sit for these tests in other regions due to the current travel bans in place.

CUSTOMERS' WILLINGNESS TO PAY MAY BE LOWER IF ECONOMIC GROWTH FURTHER SLOWS.

According to Oliver Wyman, China's gross domestic product (GDP) growth may still range from 5.8% to 6% in 2020 with strong government stimulus. Without government intervention though, it could slump to between 5% and 5.5%. Slowing economic growth and decreasing disposable income during the coronavirus outbreak may weaken customers' affordability with regard to spending on education. On the other hand, the government is taking measures to help offset the weakening demand in the job market, such as creating more job opportunities by creating more entry-level positions in the public sector and encouraging students to join the army. It is also offering more tertiary-education seats, with 190,000 more seats in master and doctorate programs, and 320,000 more seats in bachelor programs.

THE SITUATION CAUSED BY THE OUTBREAK REMAINS GRIM.

Since late February, the surge in COVID-19 cases in some countries and regions has deepened the complexity and uncertainty of the economy in the short term. A number of international flights have been cancelled, and visas for several countries and regions have been suspended.

IN LIGHT OF THE ABOVE, OLIVER WYMAN EXPECTS THE FOLLOWING IN TERMS OF CUSTOMER BEHAVIOR:

- **Affordability will be suppressed.** Parents will be more prudent about spending on supplementary education for their children. Moreover, as price sensitivity will increase, spending on premium education offerings may be impacted.
- **Fewer students will pursue short-term study abroad programs.** The cancellation of standardized tests, travel bans, and the general increasing complexity of going to certain destination countries will all exert a negative impact. As such, some students may end up postponing or cancelling their plans to study abroad. Some short-term transnational education programs, such as outbound educational tours and summer schools, will also be postponed or cancelled.
- **Growing anxiety with regard to job placement.** The difficulty in finding jobs may urge students or workforce newbies to attend more training programs. As such, preparing for graduate admission tests, financial certification qualifications, and other higher-learning programs will gain momentum unless the outbreak impact is long term (when the prospects of finding a higher paying job are less clear).
- **Increasing adoption of online education.** Having online classes has been the main solution for schools and training providers amid the COVID-19 outbreak. Some online training providers have leveraged this opportunity to attract students by offering free or low-cost classes, leading to a surge in online education user numbers and adoption rates.

KEY MARKET SEGMENT DYNAMICS AND TRENDS

Based on the expected changes mentioned above, we expect the dynamics and trends to take place in the following key market segments:

SCHOOL BUSINESSES TO REMAIN STABLE DUE TO RESILIENT DEMAND

School education is mandatory for most grade levels. The coronavirus outbreak may change the teaching venue in the short term, but its impact on tuition and student enrolment is negligible. Except for the kindergarten segment (which may see a decrease in demand by ~20%), we expect to see continued resilient demand for the primary to tertiary-level segments.

In terms of cost, moving to an online teaching environment during the outbreak has increased the operational cost for a lot of schools. However, it is also a great opportunity for them to optimize their overall operations and transform their capabilities in terms of information technology.

TRAINING BUSINESSES: STRONG NEGATIVE IMPACT, WIDENING COMPETITION GAP (头尾分化), AND IRRESISTIBLE ONLINE-EDUCATION TREND

Training businesses consist of various sub-segments, but most have primarily adopted offline delivery models. During the COVID-19 outbreak, these offline players have tried online delivery to offset the effects of both the outbreak and its associated regulatory impacts. On the other hand, existing online players have leveraged free or low-cost classes in order to attract trial customers.

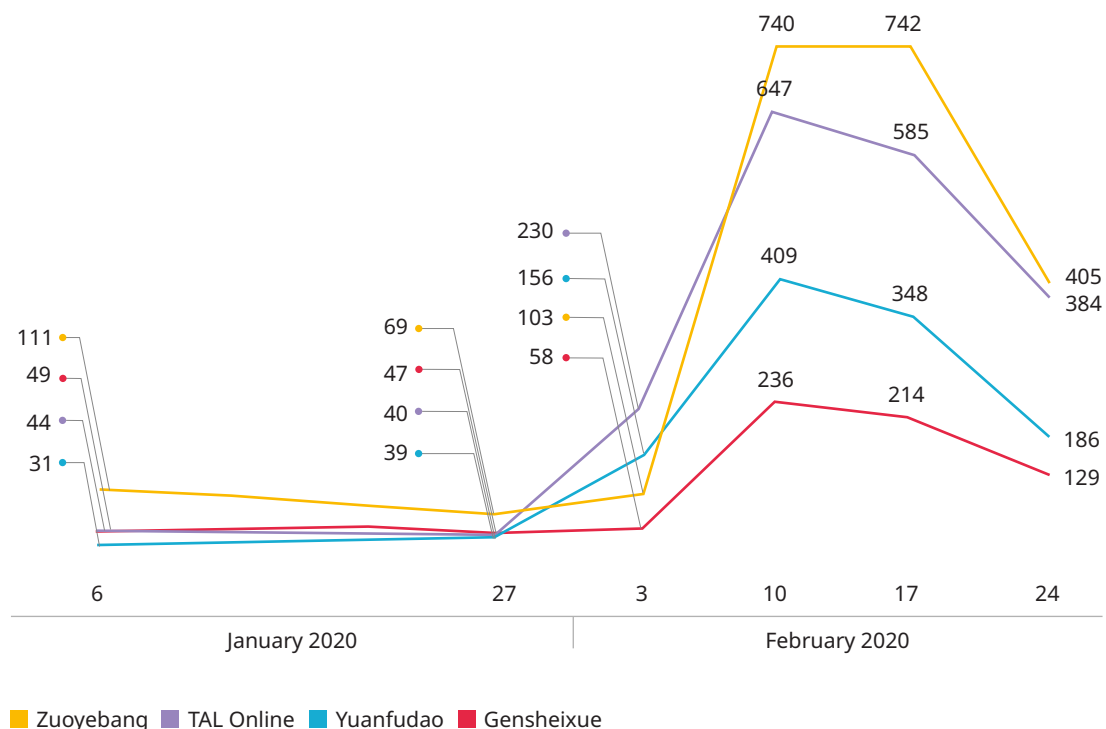
The market for training businesses will see negative growth this year. The three key reasons include the following: losses and/or refunds (of up to 20% of all business) for students who originally enrolled for the winter holiday and spring semester; course fee discounts, ranging from 20% to 100%, due to offline classes moving online; and the overall reduced intake of new students. As such, most providers will suffer from the spring semester to the summer break or even the fall semester, especially ones that rely heavily on offline customer acquisition channels.

However, there are some exceptions. For example, the graduate admission test preparation segment may suffer from fee discounts and lower student enrolment in Q1 2020, but with graduate seat numbers increasing and the labor market worsening, we expect this segment to regain momentum from Q2 2020.

Online training providers, such as TAL Online, Zuoyebang, and Yuanfudao, have all reported more than 20 million new users during the past six weeks. However, with a lot of customer overlap among competitors and low attendance rates, the quality of the trail users is relatively low. Thus, the conversion rate to full-fee paying users likely will not be as encouraging as expected. Nevertheless, online education is an irresistible trend, and customer acquisition costs should fall drastically in the short term.

There will be a widening competition gap between the leading and lagging offline providers during the COVID-19 outbreak. We believe the leading players with their online product capabilities and agile long-tail operations, will survive during this period. For medium to small-sized offline operators that will only likely return to operation in mid-to-late May, however, we believe that over 70% of them will face a severe cashflow shortage, and nearly half of them may have to close down. The circumstances should create a great opportunity for the leading players to conduct M&As and industry consolidation.

Exhibit 1. ACTIVE USERS OF THE APPS OF LEADING AFTER-SCHOOL TUTORING PROVIDERS 2020/01-2020/02, '0000



Source: QuestMobile, Oliver Wyman

Exhibit 2. The New Customer Marketing Cost Per Head for Online After-school Tutoring Providers

Free classes during the COVID-19 outbreak have attracted millions of new students, leading to a huge decrease in customer marketing cost; the winter 2020 new customer marketing cost per head is less than 5% the cost for summer 2019.



Source: Oliver Wyman analysis

In terms of online competition, the Matthew effect will take place, resulting in the leading players gaining further domination in the market. Large online classes are the mainstream product right now, and they also offer the best economic model at present in terms of scalability and profitability. Interestingly, the current competition landscape still only focuses on the respective players' customer acquisition, conversion and retention capabilities. Product differentiation is not a priority at this stage. In the after-school tutoring segment, TAL Online, Yuanfudao, Genshuixue, and Zuoyebang, are the clear market leaders. We believe that it will be very difficult for any late-comers to gain a significant market share.

After the coronavirus outbreak subsides, we believe that the leading offline providers, as well as some of the medium to small-sized ones, will keep offering online courses as a supplement or tool to attract new customers. We also expect that OMO delivery will emerge as one of the key delivery models in the long run.

EXPERIENCE-BASED EDUCATION: SHRINKING DEMAND DUE TO ITS RELIANCE ON COMMUTING AND TEACHING VENUES; MARKET RESHUFFLE IS INEVITABLE

Experience-based education, such as educational tours and camps, relies on interaction and travelling. With the COVID-19 outbreak restricting offline teaching and travel, the impact on the segment is huge. Moreover, the demand for experienced-based education is less resilient than the demand for the former two segments. Hence, experience-based education is easily the most adversely affected segment in the education industry.

MIND EDUCATION

Mind education was established in 2002. It is China's largest educational tour provider and has over 200 products, including domestic and international education tours, theme camps, family camps, and teacher-training forums.

Performance during SARS

Mind Education recorded no revenue and doubled the debt on its books during SARS in 2003.

Key outbound educational tour destination countries, demand and program type	Visa restrictions and impact
US Background enhancement, cultural visit, in-class study, etc.	Travel ban on Chinese citizens from 2020/02/02, so students from mainland are impacted.
UK Background enhancement, camp, in-class study, cultural visit, etc.	No travel ban announced as of 2020/03/06, but schools may cancel / postpone the programs.
Australia Cultural visit, camp, etc.	Travel ban on Chinese citizens from 2020/02/01, with weekly updates on travel-restriction extensions.
Canada Background enhancement, cultural visit, etc.	No travel ban announced as of 2020/03/06, but schools may cancel / postpone the programs.
Singapore Background enhancement, cultural visit, etc.	Travel ban on Chinese citizens from 2020/02/02, so students from mainland are impacted.

Many providers have tried to move online with little success. Generally speaking, their product and operational capabilities are not ready for such a move. Moreover, since they are experience-based in nature, it is difficult for them to rely on online product offerings alone to attract student traffic.

In such circumstances, we believe that leading players will suffer from high operational costs. Moreover, since some of these players may not be able to survive many months of industry shutdown, consolidation will likely take place. Vice versa, smaller players with light operation models may be able to survive and come back after the coronavirus outbreak subsides.

We think the key for experience-based education operators is to pay attention to their cash flow management. They need to avoid large-scale refunds, actively lobby for policy support, control operational costs, plan for student admissions after the COVID-19 outbreak subsides, and attract more investors if necessary.

B2B BUSINESS: DEMAND HAS SURGED WITH EXPONENTIAL GROWTH

B2B businesses are the biggest winners of the COVID-19 outbreak. The surge in demand within this low-key segment has been mainly driven by the need of schools and traditional offline training providers to move their product delivery online.

Educational tool providers benefitted the most. These market participants include not only internet giants such as Alibaba's DingTalk and Tencent's WeChat Work, but also educational sector specialists such as EEO's ClassIn and Xiaoe-tech. With their large customer base and online traffic advantage, the internet giants already enjoy a 50% market share and plan to build their own educational ecosystems. Vertical specialists such as EEO's ClassIn have leveraged their strong track record in the education industry, as well as their comprehensive understanding of customer demands, to also enjoy a 50% market share. Their customers include educational giants such as New Oriental.

CLASSIN

ClassIn is EEO's online teaching solution. Customers can use the platform for the live broadcast of 1-on-1, group class, and large class teaching.

Performance during COVID-19

ClassIn's daily user number is 10 times higher versus the same period in 2019.

ZHIBOYUN

Customers can leverage TAL's online live broadcast platform to deliver 1-on-1, small class and large class teaching.

Performance during COVID-19

Zhiboyun's customer numbers have increased 8-10 times year-over-year.

BAIJIAYUN

Baijiayun is a one-stop video solution provider that offers live broadcasting for education and business, video on demand, online schooling, corporate e-learning, and other settings.

Performance during COVID-19

Baijiayun's daily precise customer leads have increased by a factor of 15-20 times during the COVID-19 outbreak.

For content providers segment, Aixuexi and TAL Mofaxiao have advanced side-by-side and acquired many new customers. These customers are mostly medium to small-sized training providers with relatively weaker teaching and operational capabilities. As such, they need support in terms of not only technology and tools, but content as well.

We expect that the active user ratio for both schools and training providers will decrease after the COVID-19 outbreak subsides and the delivery model shifts back to offline. The lingering question then for B2B businesses is how best to add more modules and other content online to increase customer stickiness.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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