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BEST IN CLASS: THE INVESTMENT FUNDAMENTALS OF THE EDUCATION SECTOR

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Citius, altius, fortius—faster, higher, stronger—may be the Olympic motto, but it also reflects a basic human desire to improve on what we have already achieved. This is precisely the case with education, where parents—be they millionaires or daily wage earners—instinctively want their children to transcend the achievements of previous generations. This desire is particularly evident in emerging markets.

Fortunately, education is no longer the preserve of the privileged few and is accepted as a fundamental right, with children in nearly all parts of the world *required* rather than *expected* to attend school. Viewed in investment terms, education is a nondiscretionary service, or to be more precise, the education industry is *emotionally* nondiscretionary. This is particularly true in countries where the gap between the demand for education and its supply is significant. Typically, these are economies where the median age of the population is young and the public education system is inadequate. Parents in these countries, therefore, strive to give their children at least a secondary, if not a tertiary, education.

What does this mean in terms of sector analysis? First, we need to separate education into two groups: 1) taxpayer-funded public institutions, and 2) private, fee-paying establishments run by local or multinational institutes. We examine these latter, investible entities in this paper.

This framework is not a definitive guide to the sector, but is intended as a starting point that invites and encourages you to study the sector's investment factors in greater depth.

THE LOCAL MARKET AND ECONOMY

Let's begin by examining employment conditions in a company's domestic market and how those conditions affect the demand for education.

- First, assess the level of importance employers and students place on educational qualifications. As an economy becomes more knowledge oriented, it will require more specialised skills; the demand for more sophisticated and higher levels of education is, therefore, likely to rise.
- Second, gauge the effect of unemployment rates on student enrolments. Demand for basic education could be noncyclical while demand for higher education could actually be countercyclical: contracting economies will

often lead to a rise in the number of student opting for higher studies, as job vacancies are limited and determined parents will somehow find the money to pay for college fees. Of course, you should also attempt to predict how these trends will evolve.

- Third, note the broad economic mix in the company's markets. How is the economy split between the agriculture, manufacturing, and services sector, and which of these areas employs the most people? Activity in the services sector—an excellent barometer of the health of an economy—and the growth prospects for knowledge-based industries are increasingly vital determinants of employability and the nature of courses that the education systems need to offer.

DO THE COURSES WORK?

Having established an outline of the economic conditions in the target company's domestic market, appraise the portfolio of services offered by the company. Are the services relevant to the company's customer base and is its revenue model scalable?

Services can cover everything from grammar schools, colleges, and universities, to private tuition, vocational training, and test preparation. Build a picture of how these services are broken down (e.g., undergraduate, postgraduate, doctorate) and look at the types of courses on offer. In developing countries with tourist appeal, you should see more institutions offering hospitality studies. Conversely, advanced markets will focus on business, arts, science, and engineering.

Because education is a service industry, how well the company delivers its services is another crucial factor. Screen the number of outlets or centres the company operates and see how many students are enrolled. At the same time, size up the revenue and operating profit per student in each of these facilities. Does the company offer its full range of courses across all outlets? This will help you to judge the strength of the business, as broad exposure doesn't always translate into deep market penetration.

We would be remiss if we provided a framework for analysing this sector without mentioning how technology is disrupting the education space. The distance learning market is booming, particularly in Asia

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where, among other things, a shortage of qualified teachers in various fields is forcing students to seek online solutions. Find out if a company's key markets have easy access to inexpensive, high-speed internet connectivity. Determine the company's mix of student enrolments and revenue between on-campus and virtual delivery and how that ratio compares with that of the company's competitors.

From a revenue perspective, try to determine how the company makes its money. Is it from components such as tuition fees, books, or fees? Follow up by observing how quickly the company expects these segments to grow in the next three to five years. Does the firm intend to expand its operations and offer courses in any new fields of study? These determinations can also apply geographically, so inspect any plans by the company to open institutions elsewhere.

PUBLIC VERSUS PRIVATE

The education sector faces competition not only from firms offering similar products but also from public institutions. Attitudes toward private education differ from country to country, with some viewing it as an essential service that helps to compensate for a weak public system while others class it as a luxury item. Either way, you must understand the strength of the state-run school system in the company's markets. Examine the infrastructure and share of enrolments within the different segments and understand why students may prefer a public institution over the equivalent private operation. What do employers think? For example, do they treat privately educated students more favourably?

COMPARE AND CONTRAST

Having obtained a general understanding of both company-specific and environmental factors, carry out some comparison work on costs. We encourage you to set the per-capita income levels in the company's key markets against average annual tuition fees to see how they measure up. Furthermore, learn about the impact that scholarships and financing have on

enrolment rates and check out the proportion of students who fund their studies through these means.

Another factor to be aware of is the proportion of overseas students using the company's facilities. From a financial perspective, these students provide an additional income stream—in some cases, foreign student fees are higher—and give an institution the distinction of being an "international centre of learning."

SCHOOL RULES

Take a moment to explore the regulatory side of the education sector, paying attention to education policies in the company's markets and the prevailing attitudes toward private providers. This could include the licensing system in each market. Moreover, learn about the challenges that education companies may face—could any legislation in the pipeline affect their operations, either favourably or unfavourably?

ESG INTELLIGENCE

Whether you work in finance or are an investor, awareness of environmental, social, and governance (ESG) issues has become a necessity in the investment world. During your investigations, assess whether the company you are analysing understands and is responding to ESG-related risks. For example, is the firm aware of how its fee structure is viewed and that a negative opinion will result in reputational damage? Similarly, does it support people from disadvantaged communities or contribute to charitable causes by leveraging the expertise and research efforts of its teachers and students?

On that note, the school bell has just sounded. Today's lesson gives you a sense of how education companies operate and whether the business model of each is sustainable—we urge you to do your homework, as there are many more granular questions that you should ask.

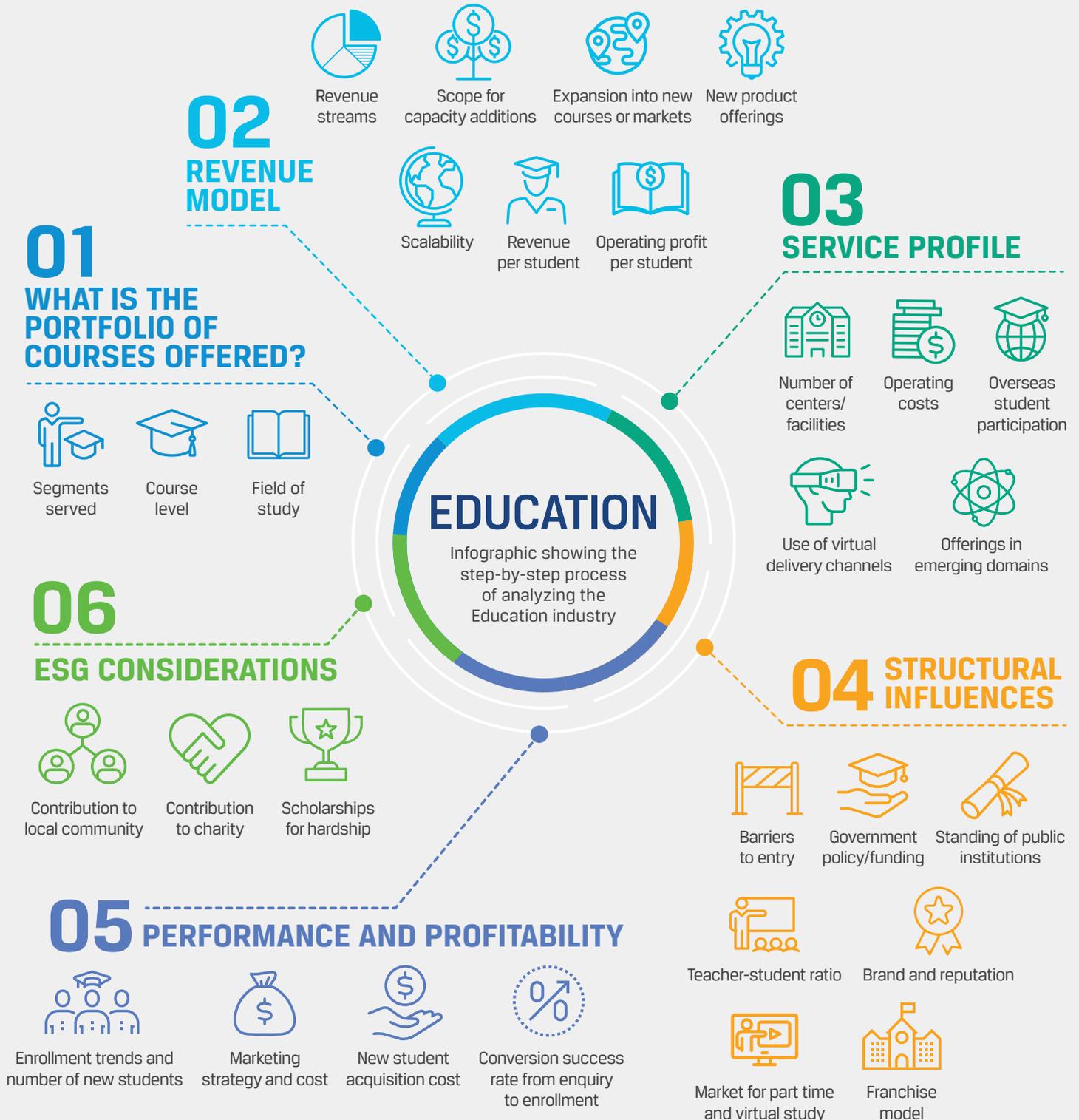
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Common to the Sector

1. How do employment conditions impact demand for education in the company's key markets?

- How much importance do employers place on educational qualifications as a criterion for employment?
- How useful do students and employees perceive educational qualifications to be in the employment market?
- How are these trends evolving and how are they expected to change in future?
- How much impact do unemployment rates have on student enrollments into higher education?

2. Portfolio of courses offered.

- What are different segments (test preparation, grammar schools, private tuitions, regular schools, vocational training, colleges, universities) does the company offer? What is the breakdown of all institutions in each segment?
- At what different levels (non-formal, school, college, university, undergraduate, post-graduate, doctorate) are study courses offered?
- In which fields of study (Arts, Business, Hospitality, Humanities, Life Sciences, Science, Technology, Engineering & Management) does the company offer courses?

3. What is the company's revenue model and how scalable is it?

- What is the company's revenue mix from components, such as tuition fees, books, study materials and testing fees?
- How does the company envisage each of these segments growing in the coming years? Are any changes to the revenue mix anticipated in the next 3-5 years?
- How does the company intend to expand its operations?
- Does the company plan to offer courses in any new segments, levels or fields of study?
- Are there any plans to expand capacity in courses currently offered?
- Are there any plans to offer courses in new cities, or to add centers in cities where the company already has a presence?
- Does the company plan to expand into new countries?
- What efficiencies of scale or scope are envisaged from introducing new courses or new locations? Are these efficiencies likely to be easy to come by, or where are challenges anticipated?

4. The company's delivery network.

- How many outlets or centers does the company operated? In how many cities are these facilities based?

- What is the enrolment capacity across the outlets?
- On average, how many students are enrolled across these outlets?
- What is the revenue and operating profit per student across the different outlets?
- Are all courses offered across all outlets? If not, how does the company plan expand its offerings across different outlets?

5. Are the company's courses available through virtual-delivery channels?

- Do the company's key markets have easy access to cheap, high-speed internet connectivity? How is the availability of these services evolving?
- What proportion of courses are offered through virtual delivery channels?
- Does the company expect to see increasing demand for specific courses online?
- What is the mix of student enrolments and revenue between in-person and virtual delivery channels? How is the company placed relative to competitors?
- How do course completion rates differ between the two channels?
- Are margins more attractive in one channel rather than the other?
- How is the mix between in-person and virtual delivery channels expected to evolve in the future?

6. What is the demand impact of changes in economic conditions?

- Is education demand counter-cyclical or non-cyclical in key markets?
- How does this vary for different segments, levels and fields of study?
- What fields of study are particularly popular currently?
- How does the company's current course portfolio compare with this cyclicity and demand profile?

7. How do education fees and affordability compare with income levels in key markets?

- What are per-capita income levels in the company's key markets?
- What is the average annual tuition fee charged? How does this compare with income levels?
- How much impact does the availability of scholarships and financing have on enrolment rates?
- What proportion of students fund their study out of their own pocket versus through financing?

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8. What proportion of prospective students are from overseas?

- How significant is the participation of international students in campuses in key markets?
- What percentage of the company's current student population is from overseas?
- From which countries do these students typically originate?
- How friendly are immigration and visa regimes in countries where campuses are located?
- How is the availability of higher education services expected to evolve in the home countries of international students? Is the number/quality of facilities in those countries expected to increase or decline? How are these trends expected to affect future enrolment of international students?

9. What demographic and macroeconomic factors impact demand?

- What proportion of the population is in the age group 15-25 in key markets?
- How is this forecasted to change in future? What could be the impact of immigration on this forecast?
- What are the urbanization trends in key markets?
- What percentage of GDP is spent on education in key markets?
- What is the per capita spending on education in key markets?
- What is the gross enrolment ratio at different stages of education? How is this expected to evolve?

10. What is the sectoral mix of the economy (agriculture, manufacturing, services) in the company's key markets?

- Which industries employ the most manpower?
- Which fields of study are in high demand in these employment markets?
- How rapidly is the services sector growing and expected to increase in the future?
- What are the prospects of a transition to a knowledge-based economy in key markets?

11. What are the evolving new fields of study?

- How does the company identify new fields of study that might interest students?
- How does the company develop curriculum, acquire faculties and offer courses in new fields of study?
- How often is the current course portfolio reviewed in light of market trends?

12. What are the entry barriers for new players?

- Is there space for new players to enter in key markets?
- Are there specific segments and fields of study where demand requirements outnumber current supply? If so, what are the company's current and proposed offerings in these segments and fields?
- Is there adequate availability of qualified teaching staff across different segments, levels and fields of study?
- Is it easier for new entrants to break into particular segments, levels and fields of study, or are barriers to entry consistent across all of these?
- Are courses currently offered in any areas with relatively low barriers to entry? If so, what are the unique characteristics of the company's courses in these areas?

13. What are the education policies in the company's key markets?

- What are the government policies with respect to the role of the private sector in education?
- What is the regulatory structure pertaining to different segments and levels of education?
- What regulatory hurdles are faced by private education providers?
- How easy is it to obtain required approvals?

14. What is the extent of financial assistance available?

- Does the company or its students receive subsidies, scholarships, concessions or other forms of financial/non-financial assistance from the government or other sources?
- How accessible are education loans for prospective students?
- Does the company have partnerships in place to facilitate loans to prospective students?

15. Considering expansion plans, what challenges are expected to be faced relating to government policies and regulations?

- What kind of approvals must be obtained to implement expansion plans?
- What legal and regulatory challenges is the company likely to face in scaling up its revenue model?
- Are there any caps on tuition fee or other components?
- In overseas markets that the company is planning to enter, are there any restrictions on investment and participation by foreign entities in the education sector?
- Are there restrictions/regulations on any other aspects of the company's operations?

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16. What is the educational infrastructure in the public sector of the company's key markets.

- How strong are public institutions? What is their share of enrolments within different segments, levels and fields of study?
- What is the preference of the student community between public and private institutions?
- What is the perception of the market, employers, students and faculty about private institutions?

17. What is the demand-supply balance in key markets and fields of study?

- Is there a mismatch in demand and supply across different segments, levels and fields of study?
- How do the company's offerings compare with courses that are in demand and which are offered by competitors?
- How quickly can the company tailor its offerings according to changes in demand?
- How are student preferences evolving with respect to study duration? Do students typically prefer longer or shorter courses?

18. Where does the company stand regarding brand value and reputation in key markets?

- How many of the company's campuses and colleges participate in national and/or international rankings of higher education institutions?
- How do participating campuses and colleges fare in such rankings?
- Does the company intend to increase participation and improve its standing in these ranking programs?
- What are the various accreditations required and obtained by the company's various campuses and their associated courses of study?

19. Collaborations and partnerships with industry and other institutions.

- Does the company collaborate with the respective industries for various courses of study?
- How effectively is the company able to facilitate internships for students?
- Does the company have any twinning programs with reputable domestic and overseas institutions?

20. How easy is it to attract qualified and quality teaching staff in key markets?

- What is the average cost of the company's faculties?
- How do faculty salaries compare with what non-academic employers offer to similarly qualified staff?
- How difficult is it to retain qualified staff? How does the firm manage attrition among faculty members?
- What is the teacher to student ratio and how does it compare with private sector peers and public institutions?
- How does the company ensure faculty members are kept up to date with developments in their subject areas, market developments and teaching methodologies?
- Do the company's faculties actively perform and participate in research and publishing?

21. How is the market for part-time and virtual modes of study evolving?

- How big is the market for these channels relative to full-time courses and how fast is it growing?
- What is the acceptance level of these modes among employers and students?
- Which fields of study have particularly high acceptance levels?
- What is the company's strategy to leverage on these channels for expansion and growth?

22. Does the company employ a franchise model?

- What proportion of operations is run directly by the firm versus through franchisees?
- If a franchisee model is employed, how is it structured?
- Which elements are managed by the firm and which aspects by franchisee?
- What proportion of investments are made by franchisees?
- What is the basis and proportion of revenue, cost and profit sharing?

23. What are the current enrolment trends and new-student starts?

- What is the average duration of study for the courses that students enroll in?
- How is this evolving? Is student preference turning towards shorter or longer duration courses?
- What is the impact of course duration on the company's cost structure and margins?
- How does the profitability of shorter duration courses compare with that of longer duration courses?

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24. Please explain the company's marketing and outreach strategy.

- What is the company's marketing spend and how is it apportioned?
- How does the company connect with potential students?
- Which channels are used and which are the most effective and efficient?
- What is the average cost of new student acquisitions? How does this differ by segment, level and field of study?

25. What are the company's operating expenses, costs and margins? How do these compare with peers?

- What is the firm's cost structure?
- What is the ratio of teaching to non-teaching staff? How does the ratio compare to peers?
- What are the company's overheads per student? How do these compare to peers?
- How efficiently is the company able to leverage its classroom space? Is a day / evening / weekend course model employed to optimize the infrastructure?
- What is the company's operating margin? How does this compare with local and global peers?

26. How are relationships with government and regulatory authorities managed?

- How many different government departments and agencies are dealt with in the company's operations?
- How does the company ensure dealings with these agencies is fair and in accordance with applicable statutory, regulatory and governance requirements?
- Do any promoters, major investors, affiliates, or executives have any family or business relationships with key politicians or government officials?
- Has the company ever been investigated or alleged to have acted in an illegal or inappropriate manner while dealing with government and regulatory authorities?
- Has the company faced accusations of bribery or paying 'kickbacks' to any politicians or government officials?
- Does the firm donate to political parties? If so, please provide details.

Environmental, Society and Governance

27. What are the company's ESG principles, practices and track record?

- Does the company support students from disadvantaged communities?
- Does the firm have programs to increase awareness of ESG and sustainability issues among students?
- What is the company's understanding of the public perception about transparency and fairness in determining fees charged?
- What steps are taken to ensure the environment for students and faculty in the company's campuses remains safe?
- Does the company contribute to social, community and charitable causes by leveraging the expertise, skills and research efforts of faculties and students?