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## **Golden Age of China's Education Industry** Seize the Momentum

Technology, Media & Telecommunications Industry, Deloitte China  
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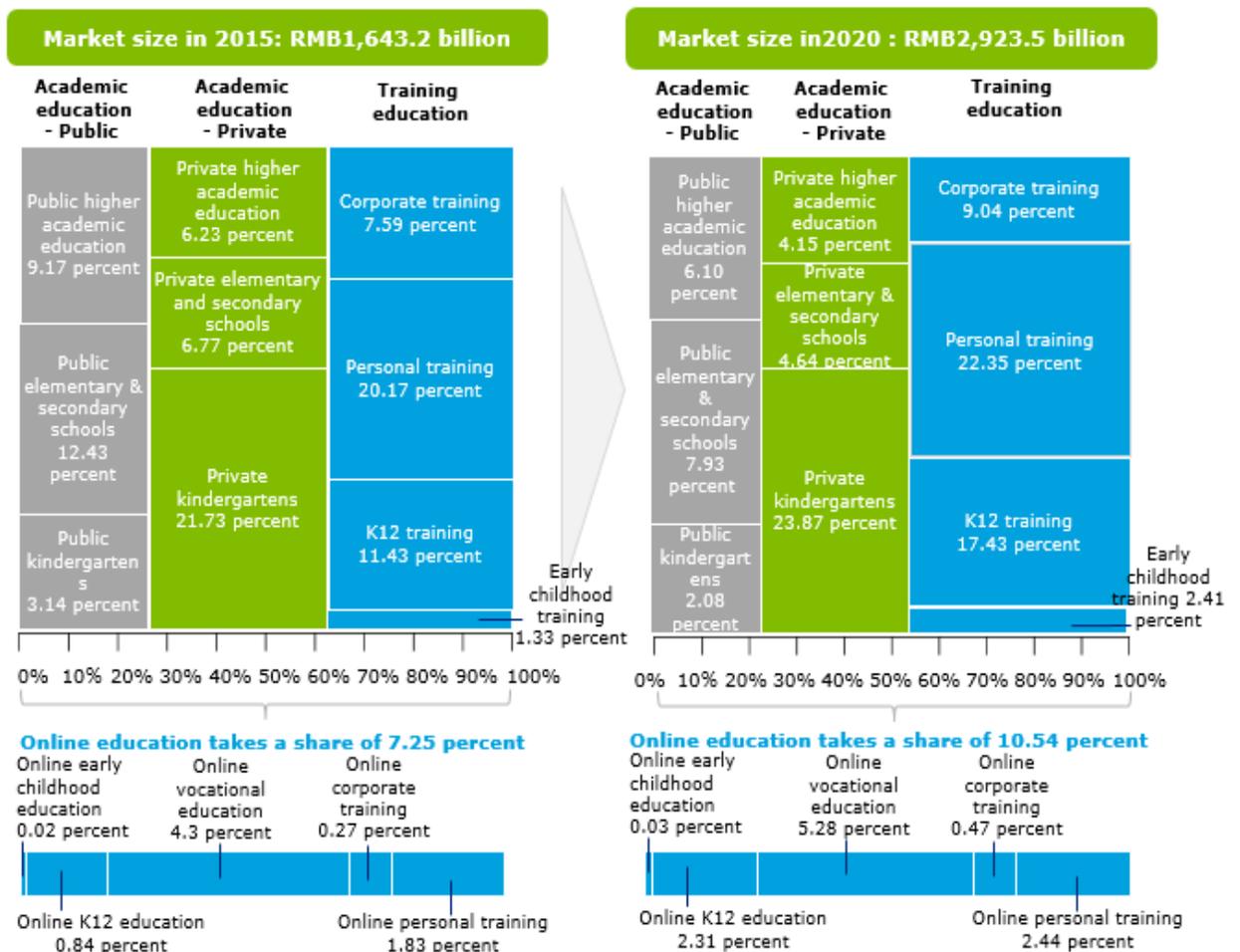
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# Preface

China's education industry is ushering into its "golden age" with expansion in terms of both industry size and market activity. In 2015, the overall size of China's education industry was RMB1.6 trillion. This figure is expected to grow to nearly RMB3 trillion in 2020 with a Compound Annual Growth Rate (CAGR) of 12.7 percent. Educational training in particular including early childhood education, K12 training, and vocational training will become the major growth point in the future. Early childhood education is driven by the implementation of two-child policy which brings sufficient demand and the government's policies to encourage preschool education; the growth of K12 extra-curricular training is attributed to the demand increase resulted from the pick-up of the school age population. Meanwhile, desire for further education and international education also drives the demand for K12 examination-oriented education and language education; personal training grows because of better economic capability and higher willingness to improve competitiveness.

**Figure 1: Market size of China's education industry**



Source: Deloitte Analysis

In general, four factors contribute to the "golden age" of China's education industry:

- 1. Favorable policies:** with the increase of investment from the government in education industry and accelerated amendment of private education related laws and supporting policies, it is expected to see industrialization development of education. In terms of different education stages, relevant policies have outlined the future trends of each sector: preschool education will see positive development under the guidance of policies including the proposals for China's 13th Five-Year Plan which proposes the target to realize inclusive preschool education in 2020; key points of K12 educational informationization are accelerating informationization, and admission policies at the compulsory education stage have created a favorable condition for fair distribution of high-quality resources; higher academic education is focusing on "boosting employment" and "standardizing independent colleges"; vocational education, benefited from the relevant development planning and the Belt and Road Initiative will see development trends of "running school by means of collectivization", "investment of private capital in education", and "going global" in the future.
- 2. Capital inflow:** there has been a rapid increase of social capital flowing into the education industry both in terms of total amount and frequency. In 2015 the total amount of investment into the education industry was over twice of that in 2014; the total amount of mergers and acquisitions (M&As) increased by 165 percent year on year; IPOs increased by 76 percent from a year earlier. More capital is expected to flow into the industry under easy policies.
- 3. Frequent cross-sector business:** education industry is seeing involvement of enterprises from other industries, which has become a common phenomenon and resulted in intense competition. Players include Internet companies represented by BAT, large real estate companies, and non-educational listed companies in need of transformation. They are motivated by diverse factors to invest in education: Internet companies are searching for segments of in-depth development to improve their ecological layout; real estate companies take a share of educational real estate for overall profit growth via synergy between businesses; investment in education by enterprises from other industries is also driven by the pursuit of new growth points.
- 4. Technological innovation:** explosion of Internet and mobile Internet has brought increasing influence of online education. The concept of online education is more popular than traditional education. In addition to integrating with traditional education, online education will use technologies to realize segmentation and customization, create more application scenarios, and diversify feasible business models.

**Driven by the four factors above, China's education market is experiencing six changes:**

**Trend 1: capital inflow promotes education industry development:** investment, M&As, and listing will serve as the "Troika" to continuously drive the rapid development of education industry. Investment invigorates the development of the industry led by K12, vertical platforms, early childhood education, and vocational education; M&As promote the transformation of education industry ecosystem. Horizontal M&As and cross-sector M&As are developing in parallel connecting all parts of the value chain of the industry, forming industrial chain closed loop and seeking new business models and transformation opportunities; listing accelerates the development of the industry. With increasingly open policies and industry integration, New Third Board market will also continue to maintain growth.

**Trend 2: individuation and differentiation are the keys to online education:** after several years' development, online education companies realize that it is far from enough to provide intermediary platforms or certain online products deriving from the integration of education resources, and the core of value chain is to fully understand users' need and provide corresponding contents and mature products and services. In terms of profitability models, online education will employ different charging patterns including online value-added services, platform commission, online advertising, and monthly payment for software, and achieve precise positioning to provide differentiated products and services, thereby to improve competitiveness.

**Trend 3: O2O needs to "return to reason" following capital influx:** generally, domestic education enterprises are still in the primary exploring stage of their internet-oriented transformation. Though O2O tutoring platforms and test bank products have stood out in the process of the internet-oriented transformation and their online products and design concepts are recognized by the market, they still need to dig deeper. The development of education O2O needs to be professional, contextualized, and ecological.

**Trend 4: policy reforms will drive for an industrialized and diversified education:** "classified management" reform has implemented differentiated supportive policies regarding finance, land, tax, fee, and enrollment based on clear definitions of non-profit education and for-profit education, attracting various capital represented by enterprise capital and charity fund to flow into education industry and leading to management model reform within the industry and more international cooperation. Early childhood education, vocational education, and international schools are more profit-oriented and can realize diversified development based on flexible corporate strategies and the market-oriented approach to attracting capital.

**Trend 5: multi-models help foreign investment penetrate into China's education market:** foreign educational institutions are carrying out active distribution in preschool education, language training, international schools, and online higher education market. In vocational education, Chinese-foreign cooperation will also increase. With the development of China's education industry, there will be more opportunities for foreign capital to flow into the education market of China.

**Trend 6: China's education industry needs to explore "going global" in the future:** the balance between imported and exported educational resources is fairly uneven. "Import" is at a mature stage, while "export" still needs exploration: preschool education in China is homogenous in content and is under fierce competition, thus "going global" may be a way out for China's online early childhood education companies; at the K12 education stage, large K12 extra-curricular tutoring organizations are taking "going global" as the key development strategy, and are likely to conduct more distribution; currently, there is no vocational education related export due to different educational standards. But with the incentive of the Belt and Road Initiative, vocational education is likely to embrace opportunities to go global.

# Trend 1:

## Capital inflow promotes education industry development

2015 saw an explosion of social capital flowing into education industry directly or indirectly in the form of investment, M&A, and listing, which serves as the new driver of the industry's growth. Two factors have motivated the growth: companies in and out of the industry can obtain benefit from the capital: companies in the industry (traditional educational institutions) can integrate businesses of the peers to increase market share, or link the upstream and downstream of the industrial chain; companies out of the industry (traditional and Internet companies) can invest in education industry to identify new profit growth points or to diversify their businesses to mitigate operational risks. Moreover, amendment of laws and preparation of supportive policies regarding private education are accelerating, and hot topics such as classified management are on the agenda. Under this background, the industry is expected to embrace a favorable prospect.

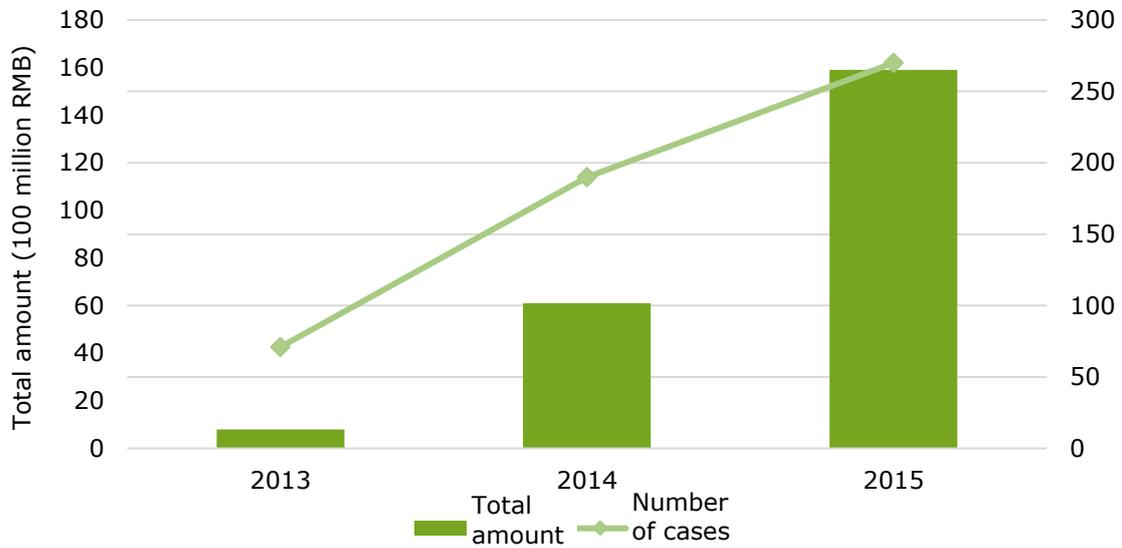
### 1.1 Investment: growing by leaps and bounds and led by four sectors

#### 1.1.1 Increase in investment cases and deal size

In recent three years, investment cases and individual deal size have been growing by leaps and bounds. In 2015, there were 270 investment cases increasing by 42 percent from 190 of 2014; and the total investment amount reached RMB15.9 billion, more than twice of RMB6.1 billion of 2014. Meanwhile, education industry in 2015 embodied three characteristics: "large amount", "fast speed", and "high frequency". "Large amount" means that during the peak time, companies had access to financing every day, which led to the situation where capital competed to win educational projects; "fast speed" means that the period from interest to financing was very short; "high frequency" means that there were continuous financing opportunities.

In terms of organizations, in 2015, venture capital claimed 77 percent of the investment cases with 23 percent from non-venture capital. Non-venture capital consisted of Internet companies and education companies including Internet giants such as Iqiyi, Tencent, and Alibaba and educational tycoons such as New Oriental, Tomorrow Advancing Life, and Xueda Education Group.

**Figure 1-1 : Amount and number of investment in education industry (2013-2015)**

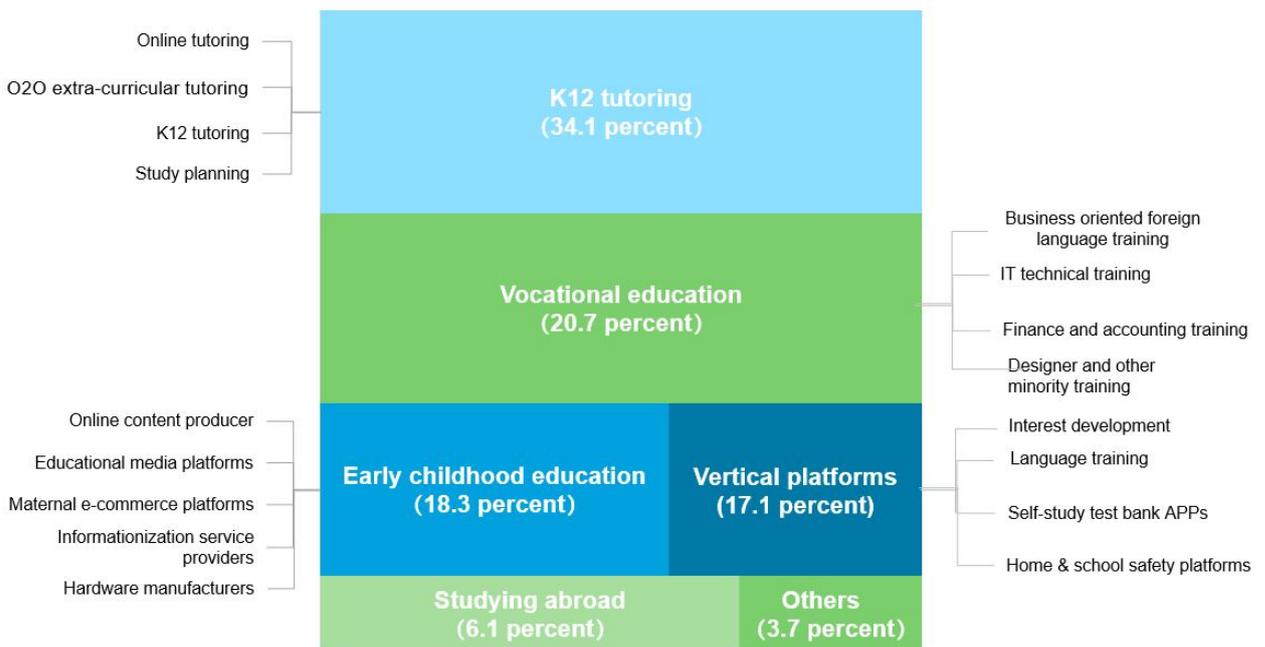


Source: Zero2IPO, IT Juzi, Deloitte Analysis

**1.1.2 K12 tutoring, vertical platforms, early childhood education, and vocational education are the popular sectors**

Popular educational investment sectors include: K12 tutoring, vertical platforms (language and interest), early childhood education, and vocational education:

**Figure: 1-2: Investment sectors in education industry (2015)**



Source: Zero2IPO, IT Juzi, Deloitte Analysis

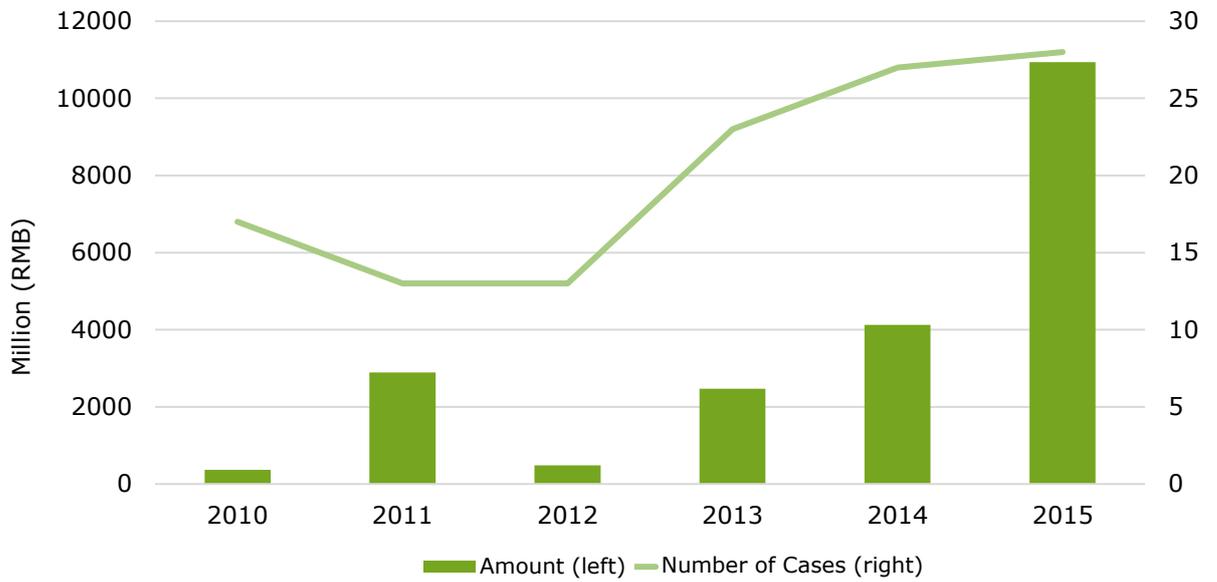
- **K12 tutoring - rapid expansion online:** two factors are driving the investment in K12 tutoring: first of all, under the existing educational system, test-oriented education is still the mainstream, thus K12 tutoring, oriented to tests is undoubtedly indispensable. Secondly, by the end of 2014, among about 283 million people receiving K12 tutoring services in China, only 18 percent ever had access to online education, and will have more opportunities to receive online education in the future. Therefore, K12 tutoring will be a continuous popular investment field. Investment size of the first half of 2015 surpassed that of the whole year of 2014 with more than half (57 percent) of the investment exceeding 10 million and one-to-one tutoring projects as the most popular investment targets. In this context, K12 tutoring will continue to be a popular investment target in the future.
- **Vertical platforms - language training tops the list:** in spite of serious homogeneity problem in online education, vertical platforms which have distinctive features and specialize in different market segments can target the customers effectively and have more opportunities for growth, thus they are favored by the investors. In 2015, over 50 online vertical education platforms obtained successful financing and specialized in significantly different fields. Among the language training platforms which attracted most capital, 29 obtained financing in 2015, accounting for more than half of vertical platforms. Under the current international background, foreign language skills are increasingly required as the "basic skills" in work or study. Thus there is great demand for foreign language training. It explains why language training platforms attract capital.
- **Early childhood education – enormous market potential:** China's early childhood education companies are in a good momentum both online and offline. Offline early childhood education industry will see digital transformation of physical content and more diverse marketing channels. Capital will enhance industrial integration of offline channels such as kindergartens and early childhood institutions: the mid- to high-end quality brands will develop positively while the small brands will be challenged by more hardships. Online early childhood education, encouraged by capital will comprehensively develop more new products related to content providers' digital content and APPs designed for children in vertical segments, and it will become a popular investment target in the future.
- **Vocational education - boutique companies prevail:** interest in vocational education is still high. Investment in IT technical training accounts for 27.5 percent of the total investment cases. At the same time, vocational education is seeing a large amount of newly-established boutique companies. Due to limited teachers and traffic as well as the need to cultivate professional vocational technical talents, boutique startups are obviously inclined to go deep into certain fields.

## 1.2 M&A: horizontal M&As and cross-sector M&As are developing in parallel

### 1.2.1 Explosion of M&A amount increase

The total M&A amount in China's education industry realized 60 percent CAGR over the past four years recording over RMB10.9 billion in 2015, more than twice of that in 2014. Moreover, the average size of single investment increased significantly. In 2015, the average deal amount of single M&A in education industry was RMB355 million, compared to RMB120 million in 2014. In January 2016, Longwen Education was acquired by Kingsun Optoelectronic (LED lighting) with RMB2 billion, which was the biggest M&A case related to education industry at the beginning of the year.

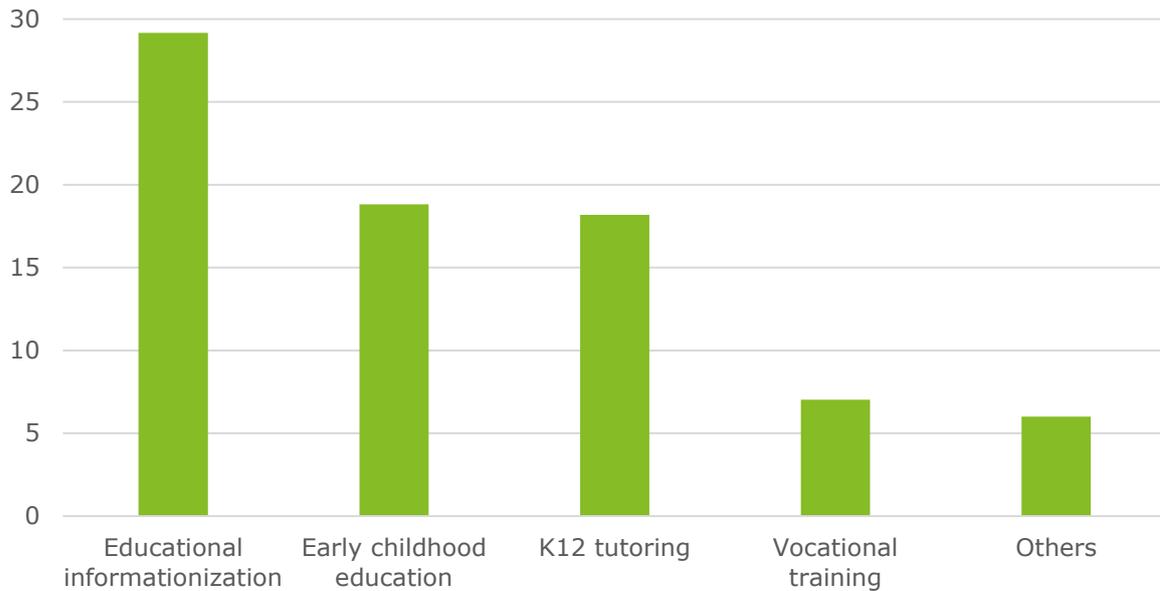
**Figure 1-3: Number and total amount of M&A in education industry over the years**



Source: Zero2IPO, IT Juzi, Deloitte Analysis

In terms of segments, in 2015, M&A fever changed in different fields: penetration of high technology such as Internet triggered more demand for "technology graft" and M&A fever in this traditional industry. Early childhood education and K12 tutoring related M&As happened more frequently than the previous year.

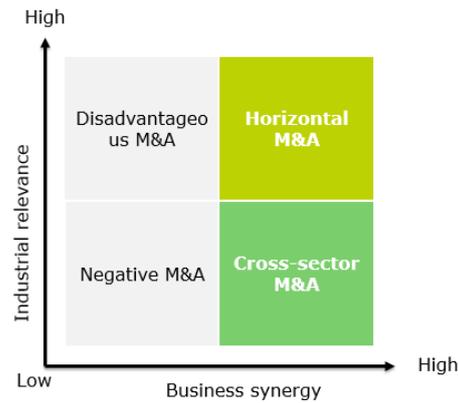
**Figure 1-4: M&A amount in China's education industry (2015, RMB100 million)**



Source: Zero2IPO, IT Juzi, Deloitte Analysis

### 1.2.2 Cross-sector M&As and horizontal M&As are the mainstream

M&A is an important way for enterprises to realize capital expansion, and it requires consideration of both industrial relevance and business synergy. "Horizontal M&As" happen when business synergy is high and the target company and the acquirer are in the same industry ; "cross-sector M&As" happen when the industrial relevance is low. The two models are the M&A mainstream in education industry. On the contrary, M&As of low industrial relevance or business synergy are "disadvantageous M&As" and "negative M&As".



**Figure 1-5: Choice of M&A models**

Source: Deloitte Analysis

#### Horizontal M&As: K12 tutoring and educational informationization are the highlights

Horizontal M&As happen frequently because the current education industry has not realized a linkage between different parts of the value chain, thus giants in the industry are trying to adopt M&A to connect resources of the upstream and downstream with the middle platform, and control resource distribution channels to bridge different parts of value chain. In this way, integrators can not only achieve industrial chain closed loop, but also optimize resource distribution, obtain bigger market share, improve monopoly power, and create scale effect. K12 tutoring and educational informationization are the highlights of M&As in the education industry:

- ❑ **K12 tutoring:** M&As increased from two in 2014 to eight in 2015. The industry concentration ratio of this sector is low at present with many homogeneous brands coexisting. Horizontal M&As can increase the market share of the industry's giants and create coupling effects. "Tomorrow Advancing Life" for example, acquired First Leap which provides curriculum covering all subjects in English for children from 2 to 15 years old in September 2015 based on many English educational institutions it has obtained to integrate the industry and support its building of diversified English education system. The newly acquired First Leap can realize advantage complementation with its original brands to achieve effective integration.
- ❑ **Educational informationization:** industry characteristics also contribute to frequent M&As. In 2014, a great deal of capital flowing into educational informationization motivated entrepreneurs to invest in this field blindly, resulting in bogus boom. After that, educational informationization underwent integration and realignment, as evidenced by frequent M&As in 2015. Talkweb, provider of O2O ecological platforms of Internet-based education for 0-18 year olds, for instance acquired three educational informationization companies at minimum including Shannxi Chengzhang Information Consulting and Sea Sky Land in succession in 2015.

#### Cross-sector M&As: two types of players have respective emphasis

Compared with horizontal M&As, "cross-sector M&As" are mainly used by companies to pursue new business models and transformation opportunities. Players mainly include two types of companies from other industries: Internet companies (33 percent) and non-educational listed companies (67 percent).

- ❑ **Internet companies:** for Internet companies, acquiring educational companies is an important way to enrich business types and improve ecological distribution: educational products are engaged in intense competition and have serious homogeneity problem. Acquirers are more attracted by vertical platforms which have distinctive features and specialize in different market segments. Apart from K12 training which has been the focus of attention, language investment and financing still draw much interest. In early 2015, Baidu fully acquired Chuanke.com, an online education platform which provides live interaction services via online course launch websites and live interaction classrooms, based on its advantage of enormous educational traffic and quality educational resources. In addition, including online education in the company's business distribution can

supplement current distribution, expand business channels, and help to establish closed service platforms.

- **Non-educational listed companies:** when challenged by obstacles in increasing revenue, non-educational listed companies may take it as a feasible choice to seek new profit growth points in other industries. These companies focus on segments of significant potential such as early childhood education, K12 training or online education with the purpose of increasing revenue via transformation. For example, VTRON which mainly provides HD large-screen video wall systems and interactive digital boards started to seek new development approach since its dramatic performance decline of main businesses in 2014, and identified profit opportunities in preschool education market. It then took over two leading companies in early childhood education, Hoing Education and Golden Cradle to explore how to combine early childhood education and information technology to enter education industry and operate diversified businesses, thereby to wrest a living with a cross-sector approach.

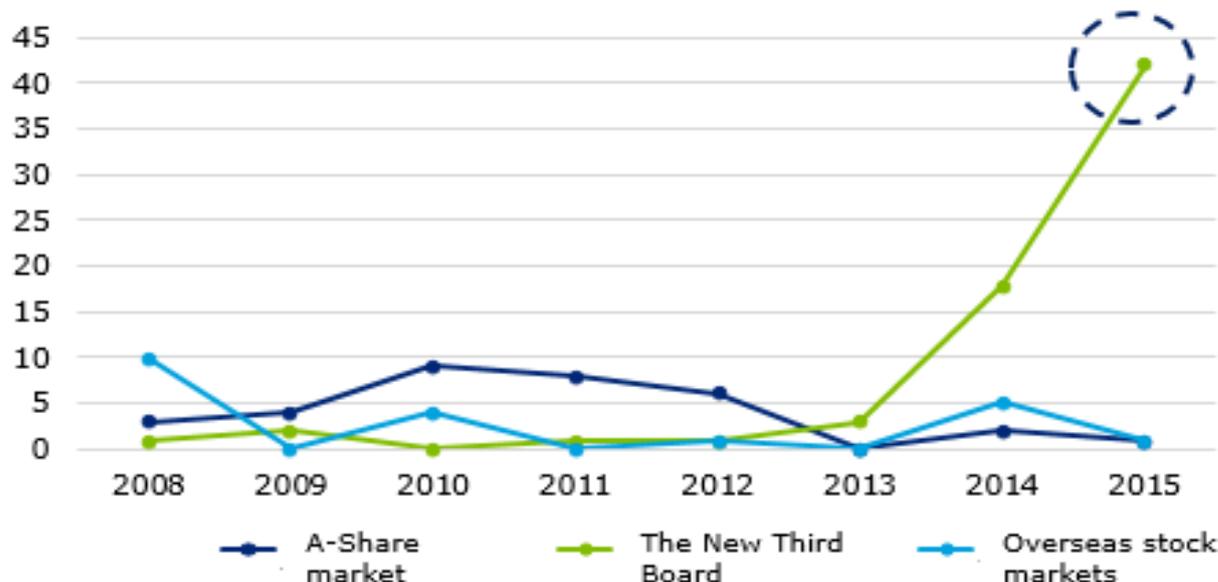
### 1.3 Listing injects dynamics to industry development

Expansion of financing channels, embodiment of value and improvement of brand effects are three major drivers for enterprises to be listed. In terms of the role of financing, IPO is in itself a financing activity, and an enterprise may expand its refinancing channels after listed, such as issuance of bonds, and financing from banks with the market value of stocks traded in the secondary market as mortgages. With regards to value, as the capital market often plays the role of revaluation, assets may be securitized after listing, thereby providing shareholders fullest value of their shares via trading price in the secondary market. As for brand effects, after listing, a company may attract the attention of media, investors and so on, thus increasing its market position and eminence. In addition, it would be easier for a listed company to gain trust from upstream suppliers and downstream customers, which plays a quite positive role to the construction of a company's brand.

#### 1.3.1 Overall recovery of listing market for education enterprises

The listing market for education enterprises is recovering, as shown in the following two aspects. Firstly, the number of listed enterprises has increased sharply from 25 in 2014 to 44 in 2015. The rapid increase is resulted from the wave of listing on the New Third Board.

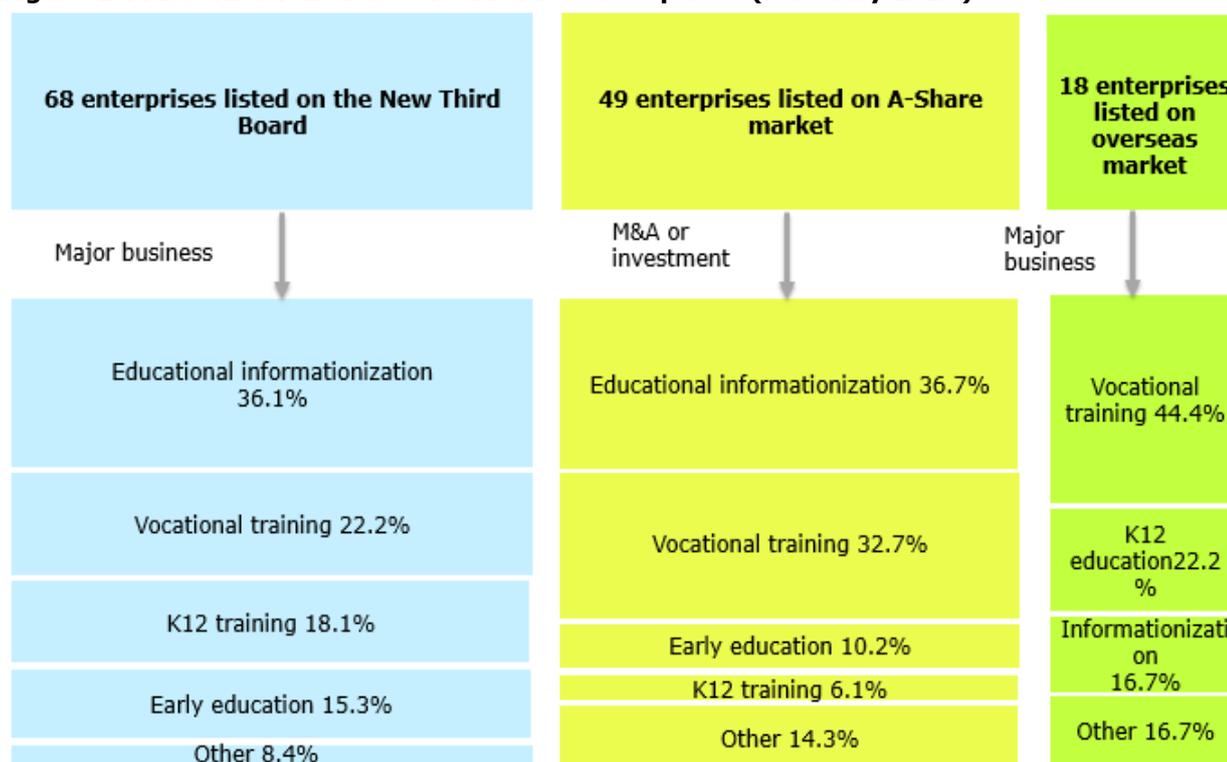
**Figure1-6: Number of listed education enterprises (2008-2015)**



Source: Deloitte Analysis

Additionally, the business performance of listed education enterprises has also shown rapid growth. From the perspective of financial data, the revenue of education enterprises listed on the New Third Board in 2015 has totaled more than RMB2.2 billion yuan, six of which have achieved revenue of more than RMB100 million yuan; nearly seventy percent of enterprises have gained profits, with eight of them realizing net profit of over RMB10 million yuan. The good financial conditions of the New Third Board will also increasingly attract more capital. The three major channels for listing include the New Third Board, A-Share market and overseas stock markets, which have shown different characteristics:

**Figure 1-7: Distribution of listed education enterprises (February 2016)**



Source: Deloitte Analysis

### 1.3.2 The rise of the New Third Board supported by three sectors

Compared with A-Share market, the New Third Board is less demanding on qualifications of listed enterprises while providing financing platform, improving corporate governance and promoting brand effects to a certain degree as well. Therefore, many small and medium sized education enterprises still choose to list on the New Third Board, although it is featured by such weaknesses as low financing limit and poor liquidity. The number of education enterprises listed on the New Third Board has shown a y-o-y increase, growing rapidly from 3 in 2013 to 25 in 2014 and then to 44 in 2015. Currently, there are 68 education enterprises listed on the New Third Board, mainly in three market segments:

- ❑ **Education informationization - benefited from the penetration of information technology in education industry:** as Internet plus has increasingly changed the education industry, many small and medium sized enterprises are intended to complete their business upgrading by leveraging internet plus, thus showing rigid demand for technologies. Therefore, demand for capital has promoted the sharp increase in the number of enterprises listed on the New Third Board. Everbright Education listed on the New Third Board in September 2015 is a technology-based enterprise with application development and computer system integration as the major business.

- ❑ **Vocational training – customer-oriented training has shown a sharp increase:** listed companies generally focus on market segments, mainly in such areas as finance, tax and IT training, which are in compliance with hotspots of social development. A case in point is Boode Education listed on the New Third Board in September 2015. It mainly provides professional personnel training services to financial institutions such as banks, securities firms and insurance companies, apart from financial advisory training, and community bank training, etc.
- ❑ **K12 extra-curricular tutorials – benefited from positive industry growth:** the launch of two-child policy has objectively increased the number of K12 students, thus promoting the industry demand for capital; and listed companies have excellent brand eminence and core products with copyright in certain fields. Jiayi Education listed on the New Third Board in October 2015 is an education institution which focuses on K12 extra-curricular tutorials.

### 1.3.3 A-Share companies constantly gain education assets

Compared with listing on the New Third Board, listing on main board will enable enterprises to gain higher valuations, higher liquidity, as well as more exposure, but it has also put forward stricter requirements for enterprises' financial qualifications. Therefore, it is more difficult for small and medium sized enterprises to be listed on main board than on the New Third Board. Currently, 49 enterprises related to education industry have listed on A-Share market, with education only part of their major business, mostly as an extension or complement to their existing business. These enterprises gain education assets mainly by merger and acquisition, shareholding or investment in subsidiaries. Therefore, the listing of Anly Education through buying shell of Xin Nanyang Co., Ltd. in 2014 is extremely meaningful. For the enterprise itself, listing has created opportunities for its expansion as a regional brand, and provided advantages in M&A and integration. And for the industry, the successful listing of Anly Education through buying shell has made it the first education enterprise listed on A-Share market in real sense. It should be noted that there may be two possibilities in the main board market:

**1). Enterprises listed on overseas stock markets may come back to A-Share market:** currently there are 18 education enterprises listed on overseas stock market, representing the smallest number. High valuation of A-Share market was in striking contrast to the downturn of overseas stock markets. In the future, some education enterprises listed on overseas stock market may come back to the main board. In fact, some enterprises have, due to stock price drop, sought to delist from the U.S. stock market while preparing for listing on domestic A-Share market.

**2). Academic education enterprises may seek main board listing:** before the completion of industrial reform, education enterprises, if fail to gain profits, will not be recognized by investors, and if they gain profit, will break education laws. Therefore, so far, only two academic education enterprises have listed on overseas stock markets. However, after approved by *Private Education Promotion Law*, profitable education institutions may be recognized by domestic capital market via legitimate registration. Therefore, main board market may expect the emergence of profitable academic education enterprises.

## Trend 2:

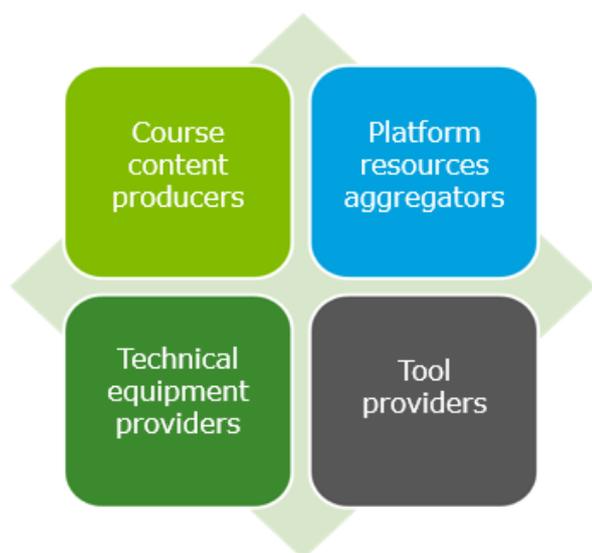
# Individuation and differentiation are the keys to online education

Disrupted by the wave of global innovation and affected by the reform of education system, there are tremendous potentials for China's great number of traditional and offline education institutions to evolve. Currently, China's online education is showing continuous growth, with many traditional offline training institutions going online. The swarm of online education startups is accompanied by the entering of BAT - the three Internet giant comprised of Baidu, Alibaba and Tencent - into the education industry, thus bringing dynamics to the entire industry. In the future, the great demand of different age groups for online education will inevitably promote the development of the entire education industry.

### 2.1 Differentiation in profitability and models of online education enterprises

Education and training institutions have made various forms of attempts during the process of integrating with the Internet. Currently, service modes of online education may develop via four approaches, which include course content producers, platform resources aggregators, technical equipment providers, and tool providers.

**Figure 2-1 Four approaches for the development of online education**



Source: Deloitte Analysis

Course content producers mainly include traditional online schools, distance schools, documents and ubiquitous learning contents; technical equipment provides aim at improving and elevating education quality; platform resources aggregators, comprised of four modules including education resources database, online classes, examination systems and discussion groups, win out by attracting internet traffic; tools vary in terms of forms, including tools for memorizing words, question banks, note-taking tools, products for early childhood education, as well as tools for testing and consulting.

In spite of the striking diversity of online education, performance of online education still calls for improvement with different segments progressing at different rates. In terms of market segments, pre-school education, featured by a high degree of homogenization and unclear business models, is still in the exploration phase, with a large number of manufacturers and investment flooding into it; while K12 education is in the setup phase with increasing market size and highly standardized products, the output is not proportional to the input, making it difficult to gain satisfying profits based on existing customer resources; higher education is in the setup phase with just a small market share, and users still have not formed the habit of learning online, which may be attributed to the ineffectiveness of certificates and insufficient coverage of course credits; vocational education is in the development phase, and it has made relatively significant progress compared with other market segments and already achieved profits by charging for content. With regard to the size of enterprises, relatively developed education enterprises have taken a new look via high finance and their layout. For example, YesHJ.com, NetEase Cloud Class (study.163.com) and Baidu Chuanke(chuanke.com) have experienced rapid growth supported by sufficient capital and Internet giants; some startups, however, are experiencing a difficult time due to unclear profit models, such as tizi.com, laoshilaile.com, and cedu.cn which have gradually disappeared from the public eye due to capital chain rupture and development in the wrong direction.

Currently, there is a variety of profit models for China's online education industry. With the technological development in mobile Internet, Big Data, and cloud computing, it is estimated that the profit opportunities of online education industry continue to lie in using Internet to provide users with truly personalized and irreplaceable services to ensure that the paid services are valued-based.

## **2.2 Online education continues to face various challenges with quality contents and services at the core of value chain**

It can be seen that online education is quite attractive to capital with many enterprises entering into it. However, rapid industry development is always accompanied by some realistic problems. Since most emerging online education enterprises have basically adopted the same business models to expand market, and tended to use highly homogeneous courses and similar profit models, there is an increasing number of problems such as overlapping of corporate positioning. Online education enterprises have realized that in the early period of development, quality course contents (extend to educators such as faculties) are at the core of value chain and constitute the most guaranteed way to attract and retain users.

It is believed by Deloitte that online education, which has vast potential, is characterized by:

1). Increasing degree of mobility: mobile learning enables users to make fullest use of fragmented time, thereby providing good customer experience. With the increasing popularity of mobile ends, especially smart phones, expanding coverage of wireless network, and faster connectivity, the coverage of mobile learning will be further increased. In the coming several years, there will be an increasing trend of learning via mobile devices. When investors become fed up with online foreign teachers, question banks and snapping a photo of problems for answers, new technological forms will surface, such as one to one online education, virtual reality, robot education, 3D printing, electronic pens, and assessment of subjective tests, which may give rise to a new round of financing for online education projects.

2). Continuous optimization and upgrading of products: as online education used to focus more on systematic resources, education products of various versions covering various grades and disciplines have been developed. However, the quality of course contents calls for improvement. In addition, the

demands of users have also changed, requiring further upgrading of online education products, such as adding more interactions during online courses, increasing the proportion of personalized learning and providing smart diagnosis reports. In general, future online education products will get rid of single model and become more diversified to meet users' demands.

3). Indispensable Big Data technologies: online education enterprises have already made enough attempts and explorations in terms of models, and have accumulated sufficient course contents. Upon the completion of accumulating contents at an early stage, online education will continue to rely on efficient operation and accurate data mining in the future to constantly understand and meet users' demands.

4). Integration of online and offline education: while online education may promote the development of China's education and change existing education models, it mainly relies on training, thus unable to fully replace face-to-face education, especially in terms of personality, intelligence and social skills. In the future, online and offline education will be further integrated and develop in coordination with distinct focuses. While online education provides resources and tools, offline education focuses on the growth of personality. Therefore, it is necessary to connect the two platforms to achieve "blending learning". From the micro perspective of corporate development, the development of online education products depends on the integration of offline traditional course contents, since technological support and interaction on various platforms are meaningful only when the quality of course contents is ensured; however, for traditional offline education to transform towards Internet enabled education, it is also necessary to shake off the shackles regarding platform promotion and technologies. In addition, due to the scarcity of education resources, unavailability of well-noted teachers in the third- and fourth-tier cities proves to be a pain point. As a result, parents and students in these cities turn to online education. A direct solution to this pain point is sharing quality education resources of the first- and second-tier cities with the third- and fourth-tier cities via online education courses, which will yield twice the result with half the effort.

In short, online education in the future will incorporate various profit models including online value-added services, platform commissions, online ads, and monthly software subscription package. With the application of new technologies, online education is expected to be quite profitable if it may provide a diversity of contents with accurate positioning and improved charging model.

# Trend 3:

## O2O needs to "return to reason" following capital influx

With consumers at the core, O2O model enhances the integration of Internet with education, which is sought after by most online education enterprises. This model may well solve the problems regarding the time and place of learning, and enable the maximum combination of online education with traditional education. With transparent platforms, parents may find teachers online to teach their children offline, thus breaking the barriers between teachers and parents in the traditional training structure while improving the efficiency of learning.

### 3.1 Education O2O experienced a capital inflow frenzy in 2015

K12 online education is the key development area for O2O model in 2015, with 50 million dollars of financing for genshuixue.com earlier this year refreshing the records of A round financing. However, in September 2015, the O2O tutoring platform laoshilaile.com, which was among the first to receive financing, has announced to terminate operation due to failure in round B of financing. As a result, various parties began to reevaluate education O2O which has experienced capital inflow frenzy. Although this platform has revolutionized the tutoring industry by employing the business model of taobao.com, it just focuses on facilitating the procedure of matching tutors with students, instead of highlighting the value of tutors, students and parents during the teaching process. By contrast, changingedu.com, which has landed its US\$100 million funding for C round, dugged into the value of tutoring during the process of teaching service. A well-organized tutoring loop through in-depth exploration featured by three elements of standardized, systematic and intelligent tutoring, may not only help gain access to quality teachers but also provide good user experience.

Apart from K12 education, online education O2O projects regarding early childhood education and art education have also shown positive development. The O2O platform, xiaohaitun365.com, has begun to apply the new door-to-door model to early childhood education, and in May 2015, it has acquired strategic investment of millions yuan from Xingkong Piano Store. Currently, early childhood education is mainly featured by in-store model, with door-to-door model still in the early stage of development and not well-understood by the market. However, with parents paying more attention to early childhood education, the launch of two-child policy, and the emergence of post-85s and post-90s parents, the market size of early childhood education will show rapid increase. There is great potential for the market of early childhood education O2O after the year 2016, and one to one personalized door-to-door early childhood education will also be widely accepted.

**Figure 3-1 Online education O2O projects in 2015: early childhood education, K12 education and art education**

	Date	Enterprise	Round	Funds	Investors
<b>Early childhood education</b>	22/07/2015	Xiaohaitun365.com	Seed	Millions of renminbi	Dadaozhijian Capital
	26/11/2015	Zaojiaodaojia.com	Pre-A	RMB10 million	Undisclosed
<b>K12 education (primary and secondary education)</b>	29/03/2015	Laoshilaile.com	A	US\$2 million	Undisclosed
	30/03/2015	Genshuixue.com	A	US\$50 million	Banyan Capital/QF Capital
	26/06/2015	Changingedu.com	C	US\$100 million	Sequoia Capital/IDG/ Tomorrow Advancing Life
	22/07/2015	Entstudy.com	B+	US\$24 million	Share Capital/ Kunling Capital
	24/07/2015	Qingtajiao.com	A+	RMB86 million	Ginkgo Investment/Plum Ventures/ Newsion Venture Capital
	19/08/2015	5teacher.com	A	Undisclosed	58.com
	30/04/2015	Xueyinyue.com	A	RMB30 million	Hu Haiquan
<b>Art education</b>	11/06/2015	Xingkong Piano Store	C	US\$20 million	Vision Knight Capital/Shunwei Capital / BlueRun Ventures
	16/06/2015	Skwy.com	Angel	Tens of millions of renminbi	Undisclosed
	14/12/2015	Singerdream.com	Pre-A	Tens of millions of renminbi	Blue Capital

Source: Open websites, Deloitte Analysis

### 3.2 There are still many problems in education O2O

Generally, domestic education enterprises are still in the primary exploring stage of their internet-oriented transformation. Though O2O tutoring platforms and test bank products have stood out in the process of the internet-oriented transformation and their online products and design concepts are recognized by the market, they still need to dig deeper.

For service itself, education is an irreversible process, with problems of teaching quality and trust crisis demanding urgent solutions. Currently most education O2O organizations are making utmost efforts to 'round up famous teachers' without thinking about fostering mechanisms and capabilities to develop top-class faculty in a systemic and standardized manner. Such shortsightedness undermines the improvement of the teaching quality across the platform, and will end up with losing users in the long term, which would not be good for the long term development of online education.

As to profitability, it is also at its exploring stage despite of various attempts in the market, with no signs of benchmarks. Relentless money burning, scalping, false data and other problems are often seen in the education O2O sector. Unlike taxi-hailing, takeout ordering and other life services markets with high frequency (frequently used), the demand for education faces difficulties with lower frequency, individualization, and geographically fixed locations. It will not help students find the right teacher nor form a closed transaction loop by simply displaying information. A platform without any screening mechanism is unable to play any diversion role. It will be very difficult to get to the sore point of consumers by entering the education market simply through a deal making approach. As capital of the

education sector rationalizes in 2016, the models for education O2O will be deeper explored. A sort-out process is inevitable.

### 3.3 The development of education O2O needs to be professional, contextualized, and ecological

Online education O2O can bring the accumulation of teaching research and teaching capability and experience into active use, and collaborate with organizations to address the issue of offline coaching; at the same time improve the current situation of traditional offline organizations to expand the market, fulfilling the purpose of reshaping education with internet thinking. Though challenging, such development model is worthy of attention.

**Professional:** Increasing professional capability, enhancing quality, and establishing brand means to guarantee teaching faculty while capture and monitor key points of each service, so as to ensure consistency of service quality. Education O2O programs need to deliberately manage service reputation, as recognition of the product will be maximized quickly through the social properties of vertical groups; reputation, however, are built on the basis of service quality higher than that of industrial level, and spread vertically through different groups of people. For example, changingedu.com fully standardized its customer experience process by: step 1, matching; step 2, prepayment (recharges by parents); step 3, teaching; step 4, payment; step 5, evaluation. Through a standardized process, changingedu.com assists teachers in completing the whole tutoring closed loop, which will help acquire the finest teachers while create quality customer experiences.

**Contextualized:** Although most education O2O models reduce intermediary costs charged by traditional educational organizations for parents and increase teachers' income per hour of lesson, they overlook the extra cost of time that teachers have to spend. From the prospective of students and parents, with the same rates per lesson they are unable to have the same learning atmosphere and teaching environment at their homes as at the educational organizations. Therefore, education O2O programs urgently need to bring up more education-contextualized experience by cooperating with offline educational organizations and focusing more on providing models for educational scene experience, so as to enhance users' trust in online educational organizations. For example, Xing Kong Piano, who mainly provides piano coaching O2O services, is different from ordinary O2O models. It sets up offline experience stores, which are the primary scene for lesson confirmation and changes, and also where users make pre-payments once lessons are confirmed. The stores also serve as sites for adult piano lessons and occasionally venues for concerts and lectures on music, extended as social platforms. Currently, Xing Kong Piano mainly cooperates with real estate developers including Wanda, CapitalLand, Longfor, and Vanke, and has opened nearly 40 stores covering more than 30,000 users in 16 cities across China. It is expected to have 60 stores in 20 cities in China by the end of 2015.

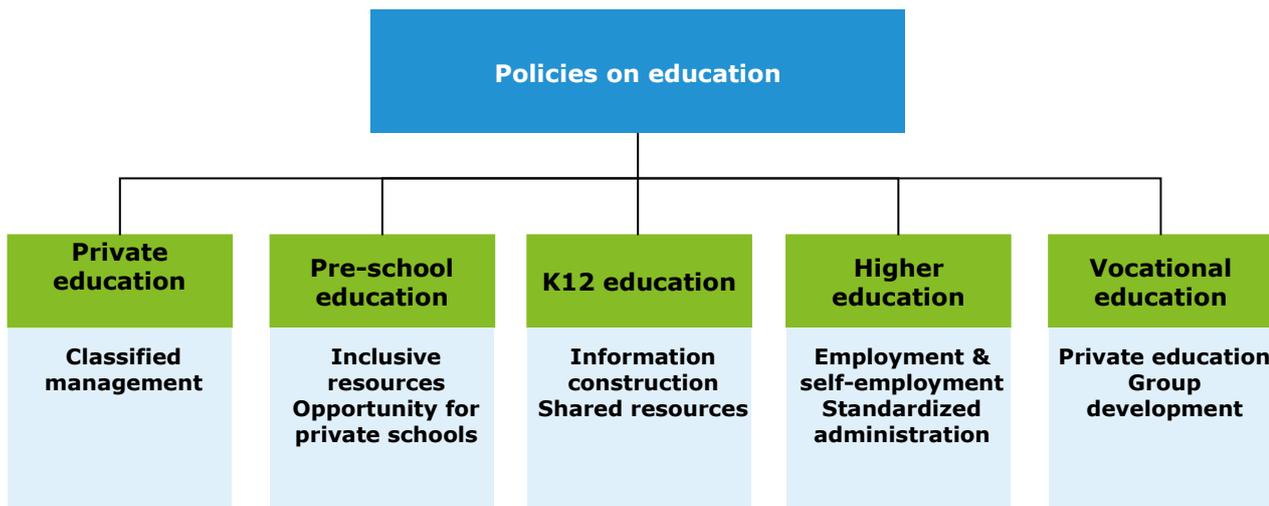
**Ecological:** Education O2O is not just a tool for the search of teachers, but should be a synthesis that brings "pre-transaction experience + post-transaction process control + service system integration" together, that is to provide customers with an all-round service. Take K12, the sector with the greatest potentials at present, as an example, the ideal scene is to connect users (students), decision makers (parents), and service providers (teachers) and concatenate them with high efficiency. Users obtain information about the teachers and choose service method online, and receive educational services offline, then complete payment, evaluation, and other processes online. Therefore, O2O platforms that have true possibility to make profits should focus on organization-oriented B2C, which will absorb not only the advantages of the brands of traditional educational organizations, teaching research, services and others, but also the advantages in the internet online technology and products. For example, Xueda Education launched an individualized intelligent tutoring system, "eXueda", to establish its O2O education foothold. "eXueda" comprises of online and offline sections, with ASPG being the online platform and individualized tutoring system for students as the offline section. When students login to "eXueda", the system will record and analyze their learning activities, and send the results to their teachers. Teachers will organize offline learning contents in accordance with the precise positioning by the system for the individual students. Thus the offline process as a whole becomes more specialized and individualized.

# Trend 4:

## Policy reform will drive for an industrialized and diversified education

The development pattern and industry structure of the education sector as a whole are profoundly impacted by national policies on education. At the same time, the introduction of various policies and regulations also offer new opportunities for the development of different areas of education.

**Figure 4-1: Overall structure of policies on education**

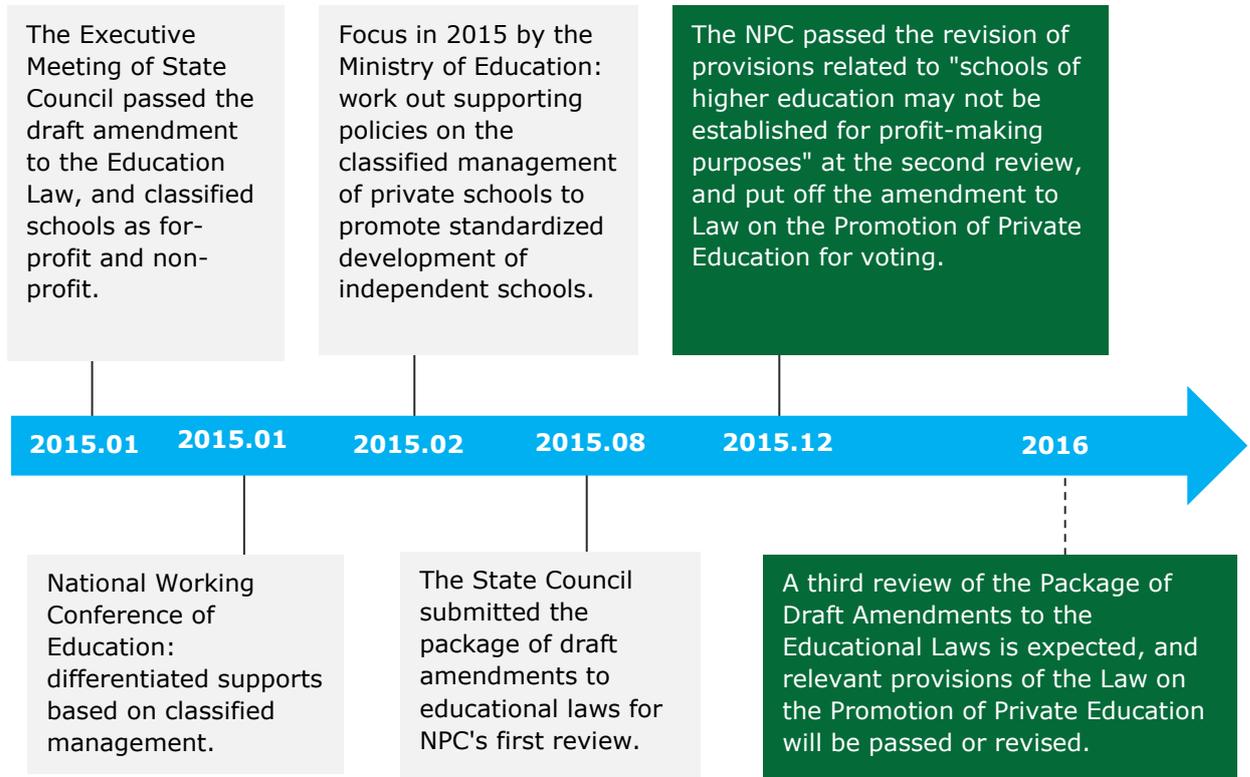


Source: Deloitte Analysis

### 4.1 Reform of private education accelerates

In 2016, the most important reform in the education sector is the amendment to the Law on the Promotion of Private Education, which was submitted to the State Council together with the Education Law and Higher Education Law as a package of draft amendments to educational laws. After two rounds of reviews and discussions by the National People's Congress (NPC), the review process is expected to complete by 2016. The reform, setting out classified management for private education and allowing the establishment of for-profit schools, is critical to the vast practitioners in the private education sector, and directly determining the legal basis for private schools in the capital market.

**Figure 4-2: Progress of the reform of classified management**



Source: Deloitte Analysis

**4.1.1 Non-profit private education will gradually move towards public education, while for-profit private education will have higher level of autonomy**

Prior to the implementation of classified management, there were no clear boundaries within the private education sector, and its poor management made it unable to compete with public education in finance, tax, land and other aspects. Through classified management, profit models of private education can be defined clearly, and corresponding supporting measures can be further developed specifically according to the features of each model, in order to promote standardized and diversified development of private education.

**Table 4-1: Public education and private education before and after the classification reform**

		Finance	Tax	Land	Charges	Admissions	
<b>Public education</b>	<b>Before and after the reform</b>	Depends on government finance investments as its stable source of funds	Enjoys preferential tax policies	Enjoys more preferential policies on land use	Charges under items set out by government policies	Admissions generally in accordance with national standards	
<b>Private education</b>	Before the reform	Support may be granted by local government, with relatively less fiscal subsidies	Some preferential policies have not been implemented	preferential policies on land use have not been specified	Academic education must be reported to the department concerned for approval, and other education for filing	Has a certain degree of autonomy on admissions	
	<b>After the reform</b>	<b>Non-profit private education</b>	Increase fiscal subsidies, moving gradually towards public education	Increase tax cuts to reduce capital burden	Enjoys more preferential policies on land use	Determined by local governments of province, autonomous regions or municipalities	Being administered to a certain extent, autonomy on admissions reduced
		<b>For-profit private education</b>	Relies on other sources of funding, as application for fiscal subsidies not possible	Less tax cuts with loaded tax burdens	Basically has no preferential policies on land use	Market-oriented, determined by the school at its discretion	Has full autonomy on admissions

Source: Open websites, Deloitte Analysis

From the perspective of finance, fiscal policies on non-profit private education will gradually move towards public education and more fiscal subsidies will be granted; for-profit private education, though enjoys no such fiscal subsidies, is entitled to other preferential policies and can make use of its market-oriented advantages to raise funds.

From the perspective of tax, through classified management, non-profit private education will fulfill its "non-profit" nature, and gradually enjoy the same tax preferential policies as public education; for-profit private education, however, may further receive less tax preferences due to its "for-profit" nature.

From the perspective of land use, preferential land policies for non-profit private education will gradually be implemented, and the sector will enjoy the same land tax cuts as public education; for-profit private education may enjoy less preferential policies and need to make use of own advantages to acquire land by market-oriented means.

From the perspective of charges, non-profit private education will have less autonomy in charges after the reform of classified management rolls out, and charges will be determined by local government of province, autonomous region or municipality; for-profit private education, however, will have full autonomy on their own charges, which will be decided by schools at their own discretion based on the market.

From the perspective of admissions, the state will enforce stricter instruction, administration and supervision over admissions by non-profit private education, while restrictions on for-profit private education will be further loosened, granting this sector full autonomy on admissions.

In conclusion, by implementing classified management in the private education sector, it will change to an extent its disadvantages against public education. Non-profit private education will be aligned with public education in terms of policies, enjoying more preferential policies in finance, tax, land, and other aspects, while for-profit private education will have more autonomy in management and can make full use of its market-oriented advantages to recruit talents and raise funds for a diversified development.

#### **4.1.2 A restructured capital pool will help bring in social capital**

**Capital:** Previously, investors would receive "reasonable return" from the account balance of school operation, raising doubts from various social capital on where the money have been spent in the private education sector. As a result, there has been little social investment for private education, which in effect leads to very limited sources of funds for the private education sector, with fiscal subsidies from the government being the main source of funds. However, when the above differentiated supportive policies are implemented, it will help various social capitals flood in by clearly defining the profit modes of private education, and restructure the capital pool of this sector. Sources of funds are different for non-profit and for-profit private education. Non-profit private education is funded mainly by fiscal subsidies, while for-profit private education uses its market-oriented advantages to raise funds extensively from the society.

For non-profit private education, firstly it can enjoy larger amount of fiscal subsidies and more preferential land tax policies, which to a great extent increases its sources of funds; meanwhile, in confirming its "non-profit" nature, it will receive confidence from the society in its capital spending. Additionally, more restrictions, administration and supervision from the state will make this sector more compliant with relevant state rules on admission and charges, increasing social recognition. As a result, more donors and foundations will prefer to invest in non-profit private education organizations to help them develop.

As to for-profit private education, though difficult to get social charitable donations, it can make full use of own advantages in capital returns to raise funds extensively from the society. It will have, after the reform, more flexible systems in charges and admissions, and will adopt more flexible development and capital policies similar to enterprises to bring certain benefits and returns to investors. At the same time, it also enjoys certain preferential policies due to its nature of public welfare in education. As a result, it will, by its relatively good profit prospects, attract substantial social capitals.

**Management Mode:** In addition, the implementation of classified management facilitates the standardization and segmentation of the management modes of private education. Non-profit private education will adopt a more standardized management mode that are aligned with the traditional mode of public education, and its management will rely more on relevant state policies and standards. For-profit private education, however, will have more flexibility in its management with less restrictions on the development of traditional schools, and introduce a management mechanism similar to that of enterprise development, so as to improve the efficiency and quality of management, bring new life to education.

**External cooperation:** As capital increases and the management mode changes, private education will work to conduct more extensive external cooperation. Non-profit private education will get more resources from the state and government and more opportunities to communicate with public schools, while for-profit private education can communicate and cooperate with enterprises through fundraising and other channels to provide students with more social resources.

#### 4.1.3 Different directions of development for each segment

After the policy of classified management is implemented, each segment of education including K12 basic education, higher education, and vocational education will choose their own future directions of development based on own features of education and policy impacts of classified management on non-profit and for-profit education.

**Table 4-2: Possibilities for the development of each segment after the classification reform**

	Early education	K12 basic education	Higher education	Vocational education	International schools
Non-profit private education	Few	Many	Even	Few	Few
For-profit private education	Many	Few	Even	Many	Many

Source: Deloitte Analysis

Early education will mainly adopt a profit management mode in view of its relatively lower professional requirements and more flexible settings. The development of kindergartens will be more diversified in order to meet different demands within different regions and cultural groups.

K12 basic education will see more policy restrictions in realizing profitable development due to its nature of academic education. And it makes less sense for K12 basic education to pursue profitable development since it has in itself limited margins. As a result, K12 basic education will mainly develop as non-profit private education.

As for higher education, non-profit education can enjoy more state preferential policies, bring in more government resources, and make better cooperation with public schools; and for-profit education can have deeper communications with enterprises to increase students' employability. Both non-profit and for-profit education have good prospects for development, and an even situation will get into shape in the higher education sector.

For international schools, for-profit education will gradually take the lead, as it is more appealing in competition because of its high-level flexibility in introducing international courses, international faculty, advanced facilities, and funds from enterprises to establish modern corporate management systems.

Vocational education will gradually become market-oriented and develop into for-profit education, which provides professional and vocational training to students by absorbing funds from enterprises and promoting cooperation between schools and enterprises, making educates more tailored to enterprises' demand and resolve the issue of their employment.

#### 4.2 Private pre-school education sees opportunities as inclusive resources extend

Currently the 2<sup>nd</sup> Division of Basic Education Department of the Ministry of Education is the main authority responsible for the overall planning and management of pre-school education. However, pre-school education does not fall within the scope of compulsory education, thus the government is not obliged to and it is difficult for the government to make large-scale investments in this sector. As a result, public kindergartens account for only 33 percent of all kindergartens in total, and are unable to satisfy people's demand for public inclusive pre-school education for children. Meanwhile, gross enrollment rate for 3-year pre-school education was around 70 percent in 2014, and the Ministry of Education plans to increase the number to 75 percent by 2020. Furthermore, the second action plan for 3-year pre-school education will continue to implement preferential policies in land use, tax and other aspects, draw in strengths from society to establish kindergartens, and on such basis further step up supports for inclusive private kindergartens. Therefore, it is predictable that private education will be taking the lead for a long time to come.

As a consequence, supported and attracted by government policies, more capital will be put into private preschool kindergartens. For example, more enterprises and public institutions will establish their own kindergartens through capital or physical investments to meet the learning demands of their own employees' children. And more social organizations and charity funds will also invest in the construction of kindergartens. At grass-root levels, residents and villagers committees of all communities will build local kindergartens with the gradually opening policies to serve their residents. In short, under the support and guide of policies, preschool kindergartens will receive more capital for construction in addition to government expenditures.

#### 4.3 K12 education - speed up information building and share quality resources

"Speed up information building" and "share quality educational resources" are the policy priorities of K12 sector in 2016. Academic education and educational institutions are adopted in parallel to accelerate information building. Academic education uses wider Internet platforms to enable the interaction and communication among students and teachers and share quality teaching resources. For educational institutions, different kinds of teaching applications and platforms will be launched to satisfy the needs of various types of students in all phases so as to promote the diversified development of K12 education.

In terms of quality educational resource sharing, facilitate the implementation of the *Educational Development Initiative in Central and Western China (2016-2020)* and the Phase II of Basic Capability Development of Universities in Central and Western China. According to *the State Council's Opinions on Deepening the Balanced Development of Compulsory Education*, 95 percent of counties (cities, districts) will achieve a basically balanced development of compulsory education by 2020. Quality teaching resources will be penetrated into the rural, remote and minority areas for fair educational development.

#### 4.4 Higher education - promote employment and entrepreneurship, and implement standardized management

The main efforts for developing higher education will focus on "employment" and "standard" in 2016. At the education work conference, "eligible ordinary undergraduate colleges and universities are encouraged to transform to be more practical", achieve integration with social industries while realizing knowledge teaching and promote better employment of college graduates by enabling them to fit the market and enterprises better through adjusting the cultivation modes and teaching approaches of higher education. Specific measures include driving the establishment of innovative undertaking service platforms, pioneering parks for college students, and setting up educational innovation and startup bases in Universities. Later, the development of higher education will focus more on developing students' flexibility and practicality apart from building top disciplines and universities. It is likely to conduct an

extensive cooperation among universities and enterprises for joint development and training of students.

As for standards, the release of *Setup and Management Measures for Independent Colleges* (Document No. 26) with its work statement indicates that China will rectify and regulate the current complex situation of higher education, which will help the country cultivate more professional and skillful talents. Meanwhile, our country encourages wholly-owned independent colleges of existing universities to be run together with social powers while gradually closing those universities without social powers, aiming to optimize and integrate the entire industry.

#### **4.5 Vocational education - advance private education and realize grouping development**

Vocational education will further towards privatization and grouping. It has gained attention due to its high marketization and flexibility among various educations. In 2015, the release of Made in China 2025 brought policy supports for vocational education.

In recent years, the privatization of China's vocational education has gradually deepened. Private vocational colleges have unfolded more and more advantages due to their marketization and professionalism. Later, more private capital will participate building vocational schools with further supports and incentives from related national policies to cultivate more professionals for all industries.

Moreover, the announcement of the *Opinions of Ministry of Education on Deepening Vocational Education School Operation by Groups* offers a historic opportunity for the grouping development of vocational education concerning school running size, attribute, and policy. With the grouping development of vocational education, the integration of industry and education and cooperation between colleges and enterprises will be implemented better to reinvigorate the vocational education. In the meanwhile, grouping development and management effectively enable vocational education to draw on its scale advantage, improve management system and achieve efficient operation to enhance its competitiveness. As stated in the *Innovation and Development Initiative of Higher Vocational Education* (2015-2018), policies will continue to promote the grouping development of vocational education, taking enterprises as the main role in school running, and encouraging vocational education groups to work with MNCs and overseas educational institutions.

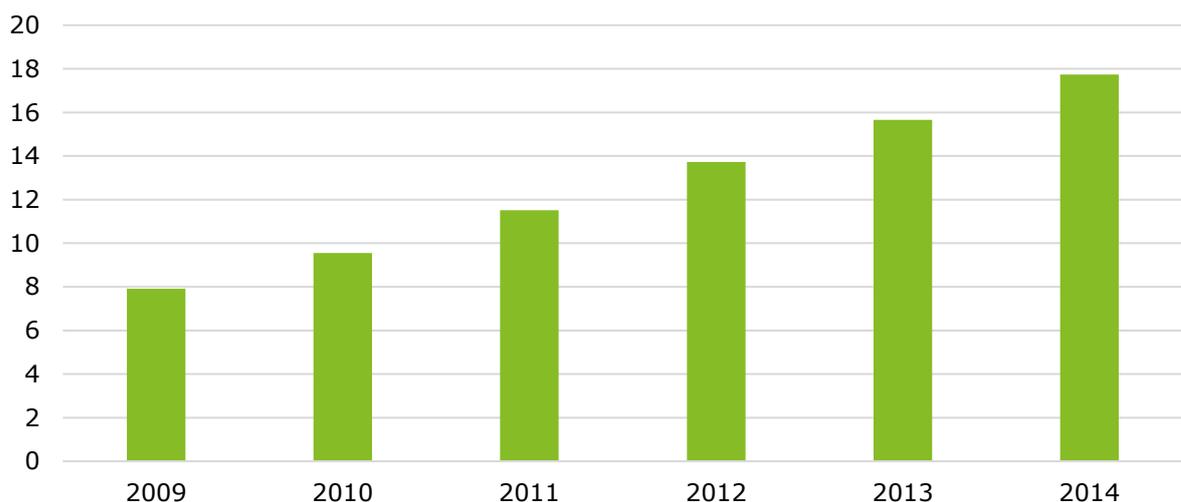
## Trend 5:

# Multi-models help foreign investment penetrate into China's education market

### 5.1 The increasing penetration of foreign investment into China's education market

As of 2015, foreign investment occupied 18 percent among 13,000 agencies for early childhood education in China according to China industry information research. In K12 education, 597 international schools as NSI stated in *2015 China international school development report*, make China a country with the largest number of international schools, and since 2009, the total number of students in those schools and the market size both have been on the rise. In higher education, the amount of Chinese-foreign jointly-run schools and programs approved by Ministry of Education has also been growing over the years. Currently, 86 percent of ordinary undergraduate colleges and universities have set up international committees or leading groups, 75 percent with foreign teaching resources, and over 70 percent of key universities conducting international educational programs. In vocational education, the number of Chinese-foreign cooperative programs is also increasing.

**Figure 5-1: Total number of students in international schools (ten thousand person)**



Source: NSI 2015 China international school development report, Frost&Sullivan, Deloitte Analysis

The following three drivers facilitate China's education industry to be attractive for foreign capital: politically, with policies' further opening, educational concepts and teaching approaches are allowed to enter China and activate China's education; economically, the economic improvement enables more and

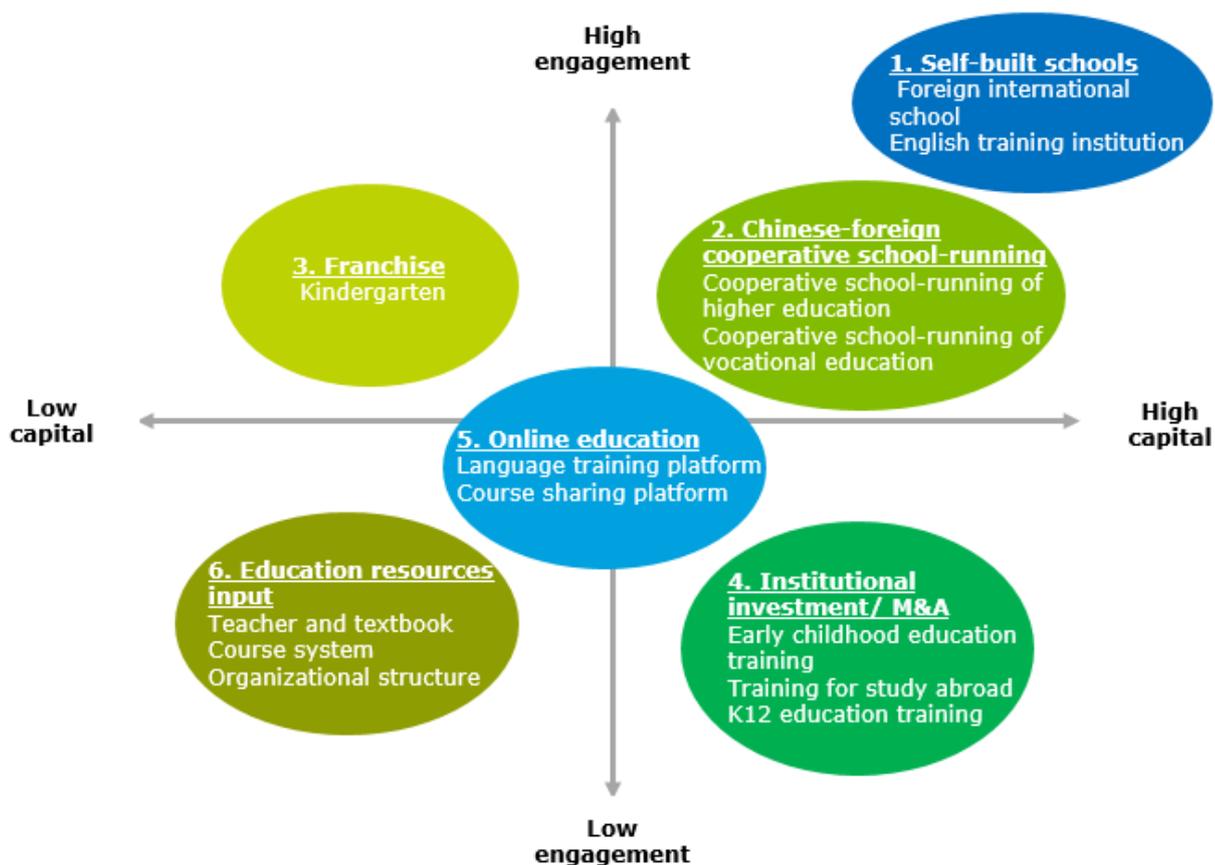
more parents to afford higher cost of foreign-invested education; culturally, the international culture communication increases the acceptance of parents and students about foreign-invested education. As a result, foreign-invested education has developed rapidly and various capital, teachers and systems have penetrated into China's education industry in recent years.

This penetration provides foreign-invested education opportunities to develop in China, and also makes a big difference for improving China's education industry landscape. As for content, it offers China education fresh teaching resources; for systems, it makes up for the deficiencies of China's education system. In terms of development, the integration of foreign-invested and traditional education helps promote the further innovation of China's education industry.

### 5.2 Multi-models of foreign capital into China education market

As capital input and engagement vary, the foreign capital entering China's education market can be classified six models: self-built school, Chinese-foreign cooperative education, franchise, investment and M&A, online education and educational resource input.

**Figure 5-3: Various models for foreign capital to enter China**



Source: Deloitte Analysis

### 5.2.1 Self-built school

Self-built schools refer to schools established in the form of self-operation and self-built of foreign capital, with independent school siting, design, construction and execution of the subsequent management, also a kind of heavy asset expansion model of tangible output. This model requires higher inputs as foreign-invested educational institutions need to fund most facilities. But the direct supervision and administration of foreign capital ensures the professional and improved supporting facilities for the school internationalization and features. Currently, self-built foreign-invested schools are focused on foreign international schools in K12 education and professional English training institutions.

- For foreign international schools, the keys for their success are policy support and abundant resources. Especially in resources, they have higher requirements for capital, management, teacher, and hardware facility as most of them are completely self-running and self-built. Later, the entire market of international schools will continue to grow with the influences from the improving economic development and higher internationalization. Furthermore, favorable policies enable private international schools to compete with these foreign counterparts. With these two factors, foreign international schools will develop at a relatively steady pace.
- For English training institutions, more and more foreign-invested English training institutions come to China as a result of increased internationalization and demands for English learning in China. To guarantee the features and quality of training institutions, self-built schools and self-management gain interests from some foreign-invested educational institutions. For example, Wall Street English, one subsidiary of Pearson Group, has over 60 learning institutes in China and all of them adopt company-operated management approach.

### 5.2.2 Chinese-foreign cooperative education

“Chinese-foreign cooperative education” is mainly classified by its depth into Chinese-foreign jointly-run schools, Chinese-foreign jointly-run departments and institutes, and Chinese-foreign cooperative programs. In the horizontal fields, influenced by relevant national policies (*The Ordinance of Chinese-Foreign Cooperative Education* shows that the country urges Chinese-foreign cooperative education in higher education and vocational education), Chinese-foreign cooperative education mainly covers higher and vocational education.

Judging from the current situation, Chinese-foreign cooperative education is relatively mature in higher education, penetrating into all the three aspects. In terms of Chinese-foreign jointly-run schools, for example, New York University Shanghai, jointly established by New York University and East China Normal University, is officially approved by Ministry of Education to be an independent legal entity with the right of degree-conferring. It is also an important part of New York University’s global education system. In terms of Chinese-foreign jointly-run departments and institutions, take CDHK of Tongji University as an example, which was initiated by the Chinese and German governments. It integrates excellent educational resources of both countries and becomes a significant platform for cultural communication between China and Germany. In terms of Chinese-foreign cooperative programs, varied collaborative programs are widely penetrated into our key universities, such as an education program for master’s degree in law jointly held by Tsinghua University and Temple University. In comparison, the cooperative school-running in vocational education is in its early stage with little substantial communication and collaboration. Statistics show that among 374 major cooperative programs of vocational education in the first decade of 21st century, 12 percent of them signed cooperation agreements, 42 percent for cooperative school-running and programs, and 46 percent for general communications and visits.

Chinese-foreign cooperative education can effectively aggregate and share quality teaching resources of both countries, but there also exist certain management integration risks concerning the differences of cultures and education concepts. Chinese-foreign cooperative education will make Chinese-foreign teaching resources shared, so complementary advantages and efficient integration will be its key success factors. During cooperation, the fact that whether the education essence of both countries can be fully digested and integrated greatly determines the quality of Chinese-foreign cooperative school-running and the appeal to the educatees, consequently, it is of great significance for Chinese-foreign

jointly-run schools, Chinese-foreign jointly-run departments and institutes, and Chinese-foreign cooperative programs.

### 5.2.3 Franchise

For foreign-invested educational institutions, this model focuses on early childhood education and English training. For foreign capital, franchise avoids fund raising and school self-building to reduce largely the cost required for education enterprises' expansion. While connecting loosely with franchisees, enterprises also have difficulties in guiding and controlling them, which brings challenges for enterprises' centralized management and regulated control.

Some foreign early childhood institutions developing better in China like My Gym and Romp n'Roll operate mainly by franchise. They have certain agent investment companies for early childhood education in China to link their head offices and franchisees, such as My Gym's Meizhimei Education and Technology (Beijing) Co. Ltd., which is responsible for issues relevant to franchisees in China. The franchising requirements and charges of all early childhood institutions are not the same. Take Romp n'Roll with successful localization as an example, it expands the market by franchise to increase franchising willingness through quality joint cost and buy-back of franchise center and attract those franchisees with capital strengths and willingness to accept training.

**Table 5-1: Major foreign early childhood institutions in China**

Institution name	Home country	Key client	How to enter China market
<b>Gymboree</b>	U.S.	0-5 years	Set up directly-operated offline locations, then expand to fringe markets like toys and learning aids
<b>KindyRoo</b>	Australia	0-8 years	Set up directly-operated branches in early stages, and then adopt franchise
<b>FasTracKids</b>	U.S.	3-6 years	Set up directly-operated branches in early stages, and then adopt franchise
<b>My Gym</b>	U.S.	0-8 years	Set up directly-operated branches in early stages, and then adopt franchise
<b>I Love Gym</b>	U.S.	0-6 years	Set up directly-operated branches in early stages, and then adopt franchise

Source: Institutions' official websites, Deloitte Analysis

In terms of English training, some international English training institutions begin selecting franchise as their operation approach based on capital input and localized management. EF Education First, for example, entered into China in 1993, has transformed its direct operation into the combination of direct operation and franchise. It uses direct operation in first-tier cities while franchise in second and third-tier cities. Franchised locations occupy over half of all its schools in Chinese mainland. Such franchise partly speeds up the expansion of foreign education in China and reduces capital input. However, it also brings about some objective issues such as loose management and poor service.

**Table 5-2: Major foreign-invested English training institutions in China**

Institution name	Current locations in China
Shane English School	51/ 26 cities
Wall Street English	69/ 11 cities
Longman Schools	70/ 7 cities
EF Education First	70/ 56 cities

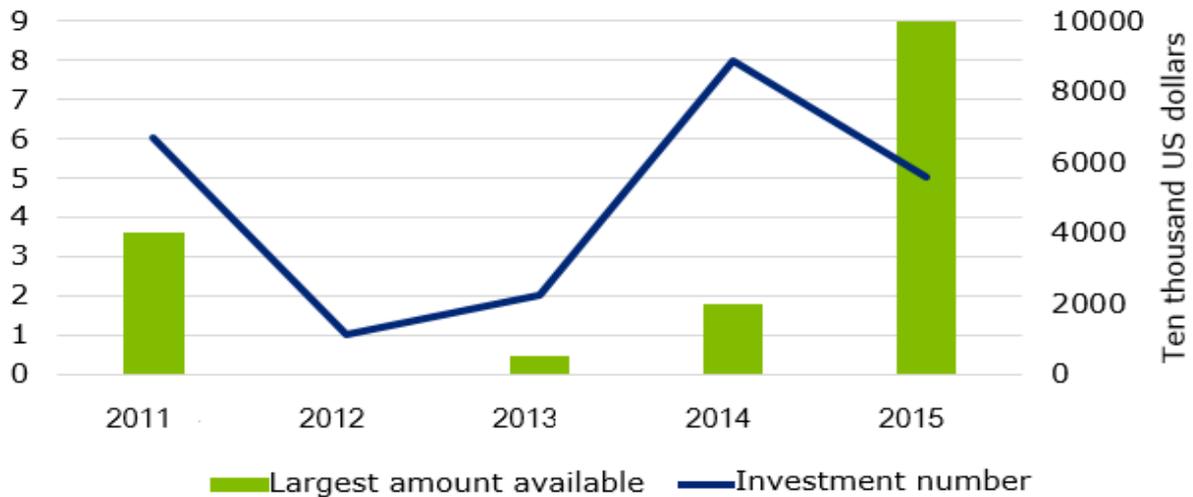
Source: Open websites, Deloitte Research

Foreign characteristics and localized development are the key for franchise to success. As globalization accelerates, more and more Chinese parents hope to build their children’s international thinking and awareness. Compared to local educational institutions, foreign characteristics are the largest advantage and appeal of foreign-invested education. Additionally, franchised institutions also need localized development to increase their expansion speed and enter China market quickly by effectively attracting local franchisees.

**5.2.4 Institutional investment/ M&A**

In recent years, foreign investments have increased and the volume of PE/VC investments and the value of single investment have also on the rise. The investment numbers of foreign PE/VC were 6, 1, 2, 8, 5 respectively between 2011 and 2015. As for the largest amount of a single investment, the figure gradually surged to 100 million US dollars in 2015 from 20 million US dollars in 2014 and 5 million US dollars in 2013, indicating a growing single investment. IDG Capital and DCM (American venture capital institutions), two typical examples, both have invested 3 Chinese educational companies over the past five years. On the whole, institutional investment is more flexible and capital is easy to allocate and manage. Yet, this model is highly risky due to its low engagement into the development of educational enterprises and difficulties in controlling over the operation and management of the invested educational enterprises.

**Figure 5-3: Investment number of foreign capital PE/VC into China’s education industry and the largest investment amount from 2011 to 2015**



Note: Only one investment in 2012 without available amount

Source: CVSsource, Deloitte Analysis



**Table 5-3 : Overseas enterprises' M&A over domestic counterparts from 2011-2015**

Target	Announcement	Transaction Type	Dealing price(US\$100 million)	Buyer
Noah	2013.12.25	Privatization	1.07	Morgan Stanley
New Oriental	2012.10.1	Stock acquisition	/	Morgan Stanley
GEDU	2011.11.21	Privatization	2.94	Pearson

Source: Open websites, Deloitte Research

### 5.2.5 Online education

In the sector of online education, content production, content sharing and related derivatives are the main development patterns. The profit point of content production lies in original teaching content. For example, language training platforms, which attract consumers by creating unique teaching content, to make profits. While the profit point of content sharing is the diversity and completeness of resources. For instance, course sharing platforms make profits by expanding its consumer groups via the integration and sharing of various teaching resources. As for related derivatives, the key for making profits is connecting online and offline channels. There are mainly two ways for overseas education institutions to enter into Chinese online education market:

- Offer online courses through companies registered in China**  
 Some companies would choose to establish related business companies in China to provide online education, considering convenient use and the need of connecting online and offline channels. For example, Education First provides online courses via its operating company in China. This model can better promote their online education websites in China and improve objective conditions such as the network speed.
- Provide online education directly via overseas companies**  
 In addition to establishing related business companies in China, some foreign online education websites can also directly operate in China. For example, all the online education platforms in the table below can offer online courses in Chinese Mainland. It is a kind of asset-light export, reducing operation costs, but is inferior in product promotion and network speed, and can be limited by some relevant Chinese Internet regulations.

**Table 5-4 Cases of foreign online education enterprises**

Name	Country	Area	Main Content
<b>zero to three</b>	U.S.	Early childhood education	Help parents to implement early childhood education. Parents can subscribe introductions on babies' physiological and psychological development and recommendations on parent-child activities
<b>K12 International Education</b>	U.S.	K12	Offer various online education courses during K12 phase
<b>Coursera</b>	U.S.	Higher education	Collaborate with top universities and institutions, and provide free online courses
<b>PluralSight</b>	U.S.	Vocational education	Education platforms of software development, including iOS, Java and other teaching courses

Source: CVSource, Deloitte Analysis

### 5.2.6 Import of educational resources

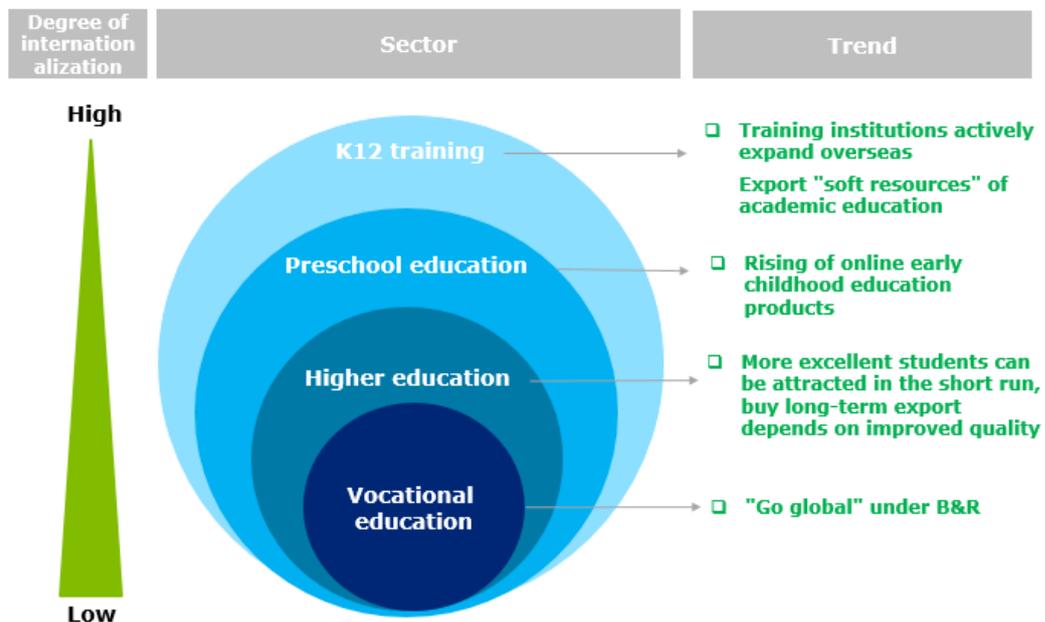
The import of educational resources mainly has three layers: replenishing teachers and teaching books, modifying the curriculum system and improving management structure. Among various kinds of foreign capital import, it is the most common in China. For example, RYB educational institution introduced TMC's authentic music classes in February 2016, which is a typical model of importing foreign educational resources. It is easy to use and convenient to implement. However, as too little substantial content has been introduced into China's education industry, the profitability is limited. And since it is easy to import educational resources, quality educational resources would be imported firstly. Meanwhile, only resources fully fitting local development can significantly help improve the educated. Therefore, quality resources and localization are the key elements for successful educational resource import.

# Trend 6: China's education industry needs to explore "going global" in the future

Currently, the internationalization of Chinese education faces extremely unbalanced import and export. Restricted by weak educational resources of domestic education institutions, although the "export" of international education is highly potential, it is still in the beginning stage.

Enterprises' overseas presence and policy support will drive the export of Chinese education industry in the future. For enterprises, overseas presence not only helps them build their international images and prove the quality of their education content, to get more recognition domestically, but helps expand overseas markets in advance and identify new profit growth point. In addition, national policies also actively encourage local education to "go global". For example, B&R initiative proposed by the central government will "increase the number of overseas students studying in China and Chinese students studying in countries along B&R, and cooperate in running schools", to provide opportunities for education export. However, different to "import", currently the degree of internationalized "export" in various education sectors are different, form high to low are K12 training, preschool education, higher education and vocational education.

**Figure 6-1 : Internationalization degree of Chinese education (export)**



Source: Deloitte Analysis

## 6.1 K12 education

### 6.1.1 Training institutions actively expand overseas

Based on a wealth of experience and strong commercial operation capability, many K12 training institutions consider internationalization as one of their future development directions, and begin set foot in international export. Jiayi Education and New Oriental are two typical examples. They build presence in overseas markets through investment or M&A, and then popularize their own core solutions. In 2015, Jiayi Education registered a wholly-owned subsidiary in the UK. The subsidiary in London invests in UK's biggest online mathematics education platform, EZ Education (accounting for a share of 10 percent) to advance its strategic vision of internationalization. Besides, it also enters into a strategic cooperation agreement with a county government's education department, aiming to introduce its core courses of "dynamic teaching approach" in English to the county's primary and secondary schools, to popularize Chinese K12 mathematics tutorship.

### 6.1.2 Export "soft resources" of academic education

For academic education, resources during K12 phase are mainly exported via overseas teaching and overseas publishing of tutorial books. Most of them are for primary students, and are some individual attempts in the early stage. But these attempts may be the first step of Chinese education industry "going global", so the significance cannot be underestimated.

The first export approach is Chinese teachers' overseas teaching. When European and American countries are considering whether to introduce Chinese education model during K12 phase, they often carry out contrast experiments by introducing Chinese teachers. But currently public opinions differ on whether to introduce "Chinese school model" during K12 phase: governments are actively advancing contrast experiments, while teachers and parents still doubt about it. Therefore, "experimental" overseas teaching may continue in the short run, but large scale export won't happen for now.

The second export approach is publishing tutorial books overseas. But we have just seen several cases, which has not yet formed a stable business model, and for now most are mathematics tutorial books for lower grades. For example, in 2015, thanks to the trend of Sino-UK primary education exchange, East China Normal University Press entered an agreement with Harper Collins Publishers, a famous UK press, to publish "British version" of YikeYilian (mathematics) in series, by rearranging content in accordance with British curriculum, but keeping the original layout and knowledge points. This was an important attempt for exporting Chinese tutorial books, and will help Chinese elementary education especially mathematics education gain more recognition from the international community.

Whether the export of K12 academic education is successful depends on whether its content has core competitiveness in the international community. Based on the current situation, though not innovative and unique enough, China's elementary education has remarkable advantages in enhancing basic knowledge. Therefore, to advance the export of China's K12 elementary education, we still need to fully dig out our competitiveness and show our advantages in basic subjects such as mathematics.

## 6.2 Preschool education

### 6.2.1 Rising of online early childhood education products

Before the rising of online education, there was nearly no international export of preschool education. After the appearance of online preschool education, due to fierce competition on domestic online early childhood education and Chinese users' weak awareness of paying for Internet content, most domestic online preschool education enterprises are struggling to survive. By contrast, overseas industrial environment is much more orderly, and users have developed good payment habit. Therefore, several early childhood education applications begin to expand overseas, and have made good profits. For example, a mobile early childhood education application, Baby Bus, has gone global to energetically expand new markets, winning over tens of millions of independent users. This education software

product is designed for preschool children, most revenues of it derive from overseas markets, and which are on the rise. Even though, online early childhood education enterprises also face difficulties brought by further business model exploration. Except payment and advertisement, the most common profit-making way is selling peripheral products, such as toys, children's clothing, and dolls and so on.

## 6.3 Higher education

### 6.3.1 More excellent students can be attracted in the short run, but long-term export depends on improved quality

There are two ways to export Chinese higher education:

- 1) **Enroll overseas students:** from the perspective of number, foreign students studying in China increases slowly every year, however, compared to the growth of Chinese students studying overseas, the former is still much slower. From the perspective of quality, it is still very difficult for Chinese universities to attract excellent students: in 2015, as Shanghai Jiao Tong University Graduate School of Education stated, the average proportion of overseas students to the number of total students in Chinese key universities was 3.7 percent, which is far lower than the proportion of 20 percent to 30 percent in European and American universities. In the future, China will invest more in overseas student scholarships and the internalization of Chinese universities in accordance with Higher Education Promotion Law and other laws, which may attract more students in the short run. But in the long run, quality English teaching resources, standardized evaluation systems and the international recognition will be the key for Chinese universities to attract more excellent students.
- 2) **Establish overseas branches:** in addition to enrolling overseas students, in the future Chinese top higher educational institutions can start to go global by directly establishing overseas branches and exporting curriculum systems, when they are capable of doing that. For example, Xiamen University has established its overseas branch in Malaysia. It held the opening ceremony for the first batch of students in February 2016, marking the first Chinese university's overseas school-running. Although this branch is set in a Chinese state, it's already an important breakthrough and attempt of Chinese higher education's overseas export and penetration.

## 6.4 Vocational education

### 6.4.1 "Go global" under B&R

There is barely no international export of Chinese vocational education. When considering the internationalization degree of Chinese vocational education, we would find that though with various international activities and clear goals, we import more foreign experience and achievements than export in the process of internationalization, meaning that most of our exchanges are one-direction. China recognizes more advanced international development experience and achievements in vocational education sector, while that being known or recognized by other countries are far less. It means that Chinese vocational education is not versatile enough. China's new international cooperation and exchange programs in vocational education sector are increasing every year, but universities engaged in such programs are not enough, indicating that Chinese vocational education is not open enough. However, in the future, with opportunities brought by B&R, different players can enhance international export of vocational education from the following two directions:

### 6.4.2 For vocational education institutions/ groups

1). Improve the international recognition of vocational education, and build a bridge with enterprises offering services overseas:

The recognition of vocational education is mainly embodied in qualifications, courses and the experience of vocational education. There are two ways to improve the international recognition of vocational

education: first, domestically, sort out and construct a knowledge framework and rules of Chinese vocational education system, then spread them to the international community systemically and professionally, to build a professional international image and gain recognition; second, build the bridge of going global with the help of enterprises offering services overseas. Matching the standards of vocational education qualification and course standards with the requirements of enterprises in regions or countries along B&R, while developing the model of Chinese vocational education.

2). Foster a team of vocational education experts, and build professional platforms of vocational education:

Since social and economic development and social systems vary widely in different countries, so it is necessary to set up special programs for fostering a team of vocational education experts. Besides, we should collect data in respect of vocational education in different countries, build databases, and track the situation of social and economic development and the development of vocational education in the long run, to lay a solid foundation for building up professional platforms of vocational education consulting.

#### **6.4.3 For vocational institutions:**

With the support of policies, more vocational institutions should launch joint school-running and exchange activities, including joint school-running, student-teacher sessions and collaborative research with regions and countries along B&R, to make vocational education more open. Domestic provinces and cities along B&R should use opportunities provided by China Scholarship Council, Asian Infrastructure Investment Bank and the Export-Import Bank of China more adequately, carry out cooperation of substantial significance with regions and countries along B&R. Specific implementing measures mainly include two aspects:

- 1) **Actively encourage Chinese vocational-technical schools to run schools overseas.** In the early stage of vocational-technical schools' overseas development, government support and the integration of industry and finance play a very important role. In May 2012, Wuxi Vocational Institute of Commerce signed an agreement of co-building a training center with Sihanoukville Special Economic Zone (SSEZ) of Cambodia. And later in June, SSEZ started to provide training courses including Chinese, English, enterprise management and other related courses. By the end of 2015, Wuxi Vocational Institute of Commerce had trained over 22,000 Cambodian employees via 18 training classes. All of these started from 2009, when Lake Taihu (Jiangsu) - Cambodia International Economic Cooperation Zone Investment Co., Ltd. (held by HODO) won the bid of co-building SSEZ, which brings huge demands of Chinese and Chinese professional training to Cambodia. Therefore, in the future growing international economic cooperation will further increase overseas demand of Chinese professional training, meanwhile, under the instruction of B&R, vocational education export will have broader space for development.
- 2) **Domestic vocational institutions accelerate to open to overseas students.** While running schools overseas, vocational institutions should also accelerate to open to foreign students. In August 2014, Shandong Lanxiang Senior Technical School enrolled an overseas student from Ghana. Except professional skills, teachers also teach this student Chinese and design Chinese examinations. At present, overseas students studying in vocational institutions are less than that in higher education institutions, for they would confront greater language and cultural challenges in vocational institutions. Thus, in the future the key for vocational institutions to attract overseas students will include improving professional skills, creating international environment and offering Chinese courses.

Besides, establishing international training centers and cultivating talents based on the development needs of enterprises are also good ways for advancing B&R strategy. For example, Benin International Training center established by Ningbo Polytechnic has not only cultivated employees that Chinese enterprises are in need, but also driven the economic development of Benin. We should learn from and promote such valuable experience.

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