

Japan education: School run

PE and VC investors are increasingly active across the breadth of Japan's education sector, armed with an evolving set of targeting criteria and growth strategies intended to exploit sweeping social changes

IN THE PAST FEW MONTHS, THE GROWTH

of Japanese cram school operator BC Ings has distilled a number of warming trends in Japan's JPY2.5 trillion (\$22 billion) education sector. However, investors drawn to this increasingly attractive space will still need to do their homework.

Since December last year, BC Ings has made two specialized bolt-on acquisitions: pre-school operator Tokyo Gakushusha and medical training-focused high school Akasaka Gakuin. The company was acquired by CLSA Capital Partners (CLSA CP) last year in what was said to be the first-ever private equity investment in a school of its kind. This spark appears to have opened the floodgates into an industry considered traditional and standoffish, even by Japanese standards.

"Before our investment last year, private equity was not common in Japan's education industry

demographics during an aging crisis as well as a distinct preference for specialized, extracurricular services.

It is possible to summarize these various targeting philosophies, however, as a reaction to public uncertainty about future job markets in a smaller, increasingly wired world. Understanding this driver will be the key to navigating new competition dynamics as investors embrace a more open and hence more crowded playing field.

Looming deadline

The most pressing horizon in Japan's education landscape is 2020, when a number of government policy changes are due to come into effect. Most importantly, the country will shift toward a more US-style approach to university entrance examinations that will

raised a \$5.4 million venture round in 2014, citing investor confidence in its monetization model and subscription numbers.

The company is backed by a number of VCs, including Infinity Venture Partners, Mitsubishi UFJ Capital, Fuji Startup Ventures and CyberAgent Ventures, one of the sector's more active players. CyberAgent has also invested learning platform Manabo alongside Mitsubishi UFJ, as well as teacher-student matching website Street Academy and Rarejob, an English tutoring specialist looking to expand a suite of blended online-offline programs and one-on-one services.

"The big trend imported from the US is active learning," says Naohiko Hatae, a vice president at CyberAgent. "Teachers need to change teaching to coaching and support learning."

Rarejob claims to be the biggest online English tutorial company in the country, with a business model that connects Filipino teachers with Japanese students online while providing face-to-face support sessions with Japanese teachers. The company plans to expand across consumer, enterprise and school markets and now counts about 150 schools as clients across the country.

Private equity interest in the company, which also includes support from Global Brain, has also been tied to the 2020 policy shift. As a result of the new rules, schools will be required to expand their English programs beyond the written word.

"Ten or twenty years ago, high school English was taught in Japanese and mainly focused on reading and grammar, but now more schools are teaching English in English and have to teach speaking skills," explains Gaku Nakamura, founder and CEO of Rarejob. "That's a big change, and it's why lots of schools are starting to consider online tutorials like us."

English, however, remains a relatively limited investment opportunity in Japan. The domestic industry is said to be worth around JPY300 billion a year, but regionally, it remains a distant second to the Chinese market which is estimated to be some 20 times larger. CyberAgent says its Chinese portfolio company in this space, iTutor, has already raised \$300 million, while Rarejob's valuation remains around \$30 million.

The most effective Japan strategies may therefore employ a more generalist approach.

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– Takashi Fukumoto

as a solution for business growth. People thought PE was just about restructurings," says Keisuke Shitomi, a vice president at CLSA CP. "That's why the deal was meaningful, as BC Ings is a famous, stably growing school with a healthy balance sheet. It helped to improve the reputation of financial sponsors in the industry."

Subsequent activity has included investments in one-on-one tutoring businesses Alpha Corporation and Shonan Seminar by J-Star and Yukon Capital Partners, respectively. In June, Advantage Partners acquired Yaruki Switch, a diversified education group that emphasizes early English training.

A handful of strategic themes have emerged from this eruption, including the potential for consolidating a fragmented market, negotiations colored by company owner succession issues, and the education sector's dual nature as a state security concern and a consumer-style services play. Private equity interest is also largely shaped by a counterintuitive gravitation toward younger

prioritize critical thinking and interviewing skills over more traditional, linear test-taking. Other changes will include mandatory IT programing and lesson plans based on technology such as tablets.

"We are not only teaching small kids how to use IT as a tool but also guide them to practice skills needed to succeed in work, life and citizenship in their future," says Shoko Sakai, director of business development at children's learning app provider Smart Education. "Traditionally in Japan, mastering the fundamental skills in each subject was education's main focus, but it is now changing to face the reality of a serious decrease in population, a much higher elderly population ratio, and the development of AI."

Smart Education focuses purely on developing software and online materials for children, and expects to leverage government mandates for more technology use in elementary school classrooms nationwide after 2020. It

"As internet speeds have got faster, real-time online communication models such as RareJob and Manabo have become successful," adds CyberAgent's Hatae. "Against this technology trend, the importance of offline experience also increased, and that is where and why we invested in Street Academy."

Future-proof?

Street Academy, which is also backed by Mobile Internet Capital, Genuine Startups and a clutch of strategic players, has raised about \$4 million to date. The company operates an online marketplace that helps organize adult education classes in physical locations of the teacher's choice, typically a group workshop or seminar hall. The service spans a range of hobbies such as yoga, but is predominantly geared toward business skills, especially IT and English.

As such, Street Academy offers one of the more transparent glimpses at the fundamental social drivers behind much of Japan's education investment momentum. Takashi Fukumoto, the company's founder and CEO, cites a groundswell of local apprehension related to Japan's looming demographic problems, as well as the notion that new technologies will utterly transform the job market within the lifetime of the current workforce. While most of the subject matter

focuses on improving tech skills, the offline classes provide a familiar networking forum for a generation anxious to adapt.

"Japanese people are worried that just getting the education that has been institutionalized over the past 50 years is not going to cut it for the next 20 years, but there's no immediate solution, no one school that says they'll prepare you for life," says Fukumoto. "That's why people are more frequently looking to the internet for more immediate and light solutions where they can at least get to know the possibilities and what's available."

Online-offline strategies do have operational challenges, however, that investors can find hard to swallow. In the case of Street Academy, this includes a tendency for an online education marketplace to attract charlatans hawking get-rich-quick lessons. As a result, the company curates its marketplace conservatively, and does not typically allow financial services classes.

The approach reflects a long-term view that the cleanness and reputation of the business should be prioritized over maximizing immediate customer volumes. In theory, this view would be attractive to VC investors, but a number of groups weren't convinced and rejected the company based on this strategy.

Paradoxically, the challenges around

establishing legitimacy in a field of entrenched educational institutions may represent the best value-add opportunities for PE and VC investors. This work often involves hooking up unknown start-ups with mainstream media and credentialed corporations.

Other business improvements will involve marketing assistance to attract new students and technology upgrades such as speech recognition systems for streamlining language lessons. In the case of established schools such as BC Ings, a tendency for administration to be handled by people trained as teachers means that management professionalization is the key play, as well as mitigating reputational issues related to transitioning a traditional institution into a changing world.

"In the cram school industry, we've rarely seen best practices in other industries being introduced. For example, cram schools have always faced labor shortages, due to long-hour working environments, as is the case with many Japanese companies in other industries," says CLSA CP's Shitomi. "By leveraging recruiting networks and problem solving expertise gained from other portfolio companies, financial sponsors can help cram schools not only to solve labor issues but also to seize more business opportunities." ▀