Why US education is ready for investment

As education transforms, the traditional and highly limited openings for private companies are growing wider. Investors should take note.

Jake Bryant and Jimmy Sarakatsannis

US education is a $1.5 trillion industry and growing at 5 percent annually. On the face of it, those figures warrant attention from investors. But most of that spending is hard for investors to access: education is everywhere seen as a public good, entrusted to government and nonprofit institutions, and most spending is on personnel. For-profit companies have historically achieved scale by stepping in to provide education where society has left gaps—by acting as school operators in K–12 and higher education or by providing ancillary services such as tutoring, day care, and test preparation. Private companies have also found niches in corporate training and textbook publishing, though the latter is a heavily consolidated industry.

This decades-old picture is now changing in several ways. The pressure on schools to deliver a higher-quality product is intensifying as the labor market demands better-skilled workers and students and families enjoy greater transparency into schools' performance. Moreover, students are coming to education with greater needs. Most US public-school students in the primary grades now come from low-income households, and about half of post-secondary students need remedial-level instruction when entering college. Finally, technology is disrupting education, as it has so much of modern life and business; more than a third of today's college students have taken at least one course online.

These forces are causing traditional providers to rethink how they serve their students—and providing a moment for investors to reconsider the sector. The number of annual private-equity deals has more than doubled, from 30 in 2007–10 to about 70 in 2012–14. Venture-capital investment hit a record high in 2014 of $1.87 billion, up 55 percent from 2013.

These deals have mostly been dedicated to the traditional investment theses—school operators, large publishers, tutoring and test-preparation services in traditional education settings—as well as corporate training. In the future, investors will likely pursue more fine-grained opportunities as the paths to growth and scale in the space become more diverse. We have identified nine investment themes in education, all driven by the broad forces upending the sector. Here we focus on three of the most prominent—one each in pre-K–12 education, postsecondary education, and corporate training.

Digital resources for K–12 schools. Primary and secondary schools are adopting digital curricula at unprecedented rates, yet teachers report they have trouble finding digital products that meet their needs. We surveyed teachers and found that 60 percent lack the digital instructional resources they need. The gap is the worst in science and language arts in the early grades, where more than 70 percent of teachers can't find what they need. New companies are sprouting up to answer these needs. These companies are benefiting from the widespread adoption of the Common Core State Standards, which makes investments in product development relevant to a significant base of potential customers. Many of them are subscale and not yet on investors' radar but could be ripe for roll-up.

Completion services for postsecondary institutions. The focus has shifted from a race to enroll new students to a realization that sustainable growth will only come from helping more students who start a college education actually complete it. Enrollment growth is slowing. And both public attention and government regulations are pressuring colleges and universities to help more of their students graduate and find jobs. Schools are therefore looking to get help from three types of companies: marketing and recruiting services that specialize in finding the kind of student who is likely to succeed, remedial-curricular companies that can help at-risk students catch up to their peers quickly, and companies whose risk analytics can flag students who need intervention throughout their time in college. These companies are worth a look from investors. Many are already at scale, and others are teaming up to provide powerful end-to-end "completion" offerings.

Digital innovation in corporate training. Employers increasingly say that university graduates are not ready for the workplace. Only 40 percent of US employers believe their new employees have the skills they need to succeed. Many are therefore investing more seriously in training their employees themselves, aided by a new generation of online companies whose sophisticated and comprehensive offerings make returns on such investments more certain. The game in corporate education is changing quickly. Recent deals have focused on new types of players (such as informal-learning players and skills-oriented "boot camps") and are integrating the once-distinct offerings of HR services providers, learning-management systems, and training providers. Investors will want to look closely and move quickly. ■

Jake Bryant (Jake_Bryant@McKinsey.com) is a consultant and **Jimmy Sarakatsannis** (Jimmy_Sarakatsannis@McKinsey.com) is an associate principal in McKinsey's Washington, DC, office.